**ERIE TOBACCO ASSET SECURITIZATION CORPORATION**
Edward A. Rath County Office Building
95 Franklin Street
Buffalo, New York 14202

March 26, 2015

Honorable Members
Erie County Legislature
92 Franklin Street, Fourth Floor
Buffalo, New York 14202

**Re: Erie Tobacco Asset Securitization Corporation – 2014 Audited Financial Statements**

Dear Honorable Legislators:

Please find attached the 2014 audited financial statements of the Erie Tobacco Asset Securitization Corporation.

Sincerely yours,

Timothy C. Callan
Treasurer

**Drescher & Malecki LLP**
*3083 William Street, Suite 5*
*Cheektowaga, New York 14227*
*Telephone: 716.565.2299*
*Fax: 716.565.2201*

*Certified Public Accountants*

March 11, 2015

Board of Directors
Erie Tobacco Asset Securitization Corporation
Erie County Office Building
95 Franklin Street Room 1600
Buffalo, New York 14202

Board of Directors:

We have audited the financial statements of the Erie Tobacco Asset Securitization Corporation ("ETASC"), a component unit of County of Erie, New York, as of and for the year ended December 31, 2014, and have issued our report thereon dated March 11, 2015. Professional standards require that we advise you of the following matters relating to our audit.

**Our Responsibility Under Generally Accepted Auditing Standards**

As communicated in our engagement letter dated December 17, 2014, our responsibility, as described by professional standards, is to form and express an opinion about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements 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 entity's internal control over financial reporting. Accordingly, as part of our audit, we considered the internal control of ETASC solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

**Planned Scope and Timing of the Audit**

We conducted our audit consistent with the planned scope and timing we previously communicated to you.

**Compliance with All Ethics Requirements Regarding Independence**

The engagement team, and others in our firm, have complied with all relevant ethical requirements regarding independence.

**Qualitative Aspects of the Entity's Significant Accounting Practices**

*Significant Accounting Policies*

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by ETASC is included in Note 1 to the financial statements. There have been no initial selection of accounting policies and no changes in significant accounting policies or their application during the year ended December 31, 2014. No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

During the year ended December 31, 2014, ETASC implemented GASB Statements No. 67, *Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25*, No. 69, *Government Combinations and Disposals of Government Operations,* and No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees.* The objective of GASB Statement No. 67 is to improve financial reporting by state and local governmental pension plans. This Statement replaces GASB Statement No. 25 and Statement No. 50. The objective of GASB Statement No. 69 is to establish accounting and financial reporting standards related to government combinations and disposals of government operations. The objective of GASB Statement No. 70 is to improve financial reporting by state and local governments that extend and receive nonexchange financial guarantees. GASB Statements Nos. 67, 69, and 70 did not have a material impact on ETASC's financial position or results from operations.

*Significant Accounting Estimates*

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments.

The most sensitive estimates affecting the financial statements were the recognition of tobacco settlement revenues as a receivable within governmental activities; the swap agreement valuation; and, the subordinate Turbo CAB's outstanding and related interest.

Management's estimate of recognition of tobacco settlement revenues is based on knowledge and experience about past and current events and on assumptions about future events. Management's estimate of the swap agreement valuation is performed by a professional third party. We have independently confirmed the amount with the third party. The subordinate Turbo CAB's outstanding and related interest have been estimated by ETASC management, while we have determined the estimates to be reasonable based on the assumptions presented, we recommend that ETASC obtains a professional third party valuation to calculate future estimates.

**Significant Difficulties Encountered during the Audit**

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

**Uncorrected and Corrected Misstatements**

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole and each applicable opinion unit. Management has corrected all identified misstatements.

In addition, professional standards require us to communicate to you all material, corrected misstatements that were brought to the attention of management as a result of our audit procedures. No misstatements were identified by us as a result of our audit procedures that were considered material, either individually or in the aggregate, to the financial statements taken as a whole.

**Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to ETASC's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

**Representations Requested from Management**

We have requested certain written representations from management, which are included in the attached letter dated March 11, 2015.

**Management's Consultations with Other Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

**Other Significant Matters, Findings, or Issues**

In the normal course of our professional association with ETASC, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, operating and regulatory conditions affecting the entity, and operational plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as ETASC's auditors.

* * * * *

This report is intended solely for the information and use of the ETASC Board and management of the ETASC and is not intended to be and should not be used by anyone other than these specified parties.

Drucker & Maleski LLP

March 11, 2015

**ERIE TOBACCO ASSET SECURITIZATION CORPORATION**
Edward A. Rath County Office Building
95 Franklin Street
Buffalo, New York 14202

March 11, 2015

Drescher & Malecki LLP
3083 William Street, Suite 5
Cheektowaga, New York 14227

This representation letter is provided in connection with your audit of the basic financial statements of the Erie Tobacco Asset Securitization Corporation (the "ETASC"), a component unit of the County of Erie, New York, as of and for the year ended December 31, 2014, and the related notes to the financial statements, for the purpose of expressing an opinion as to whether the basic financial statements present fairly, in all material respects, the financial position and results of operations or changes in fund balances of the organization in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm that, to the best of our knowledge and belief, having made such inquiries as we consider necessary for the purpose of appropriately informing ourselves as of March 11, 2015:

**Financial Statements**

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated December 17, 2014, for the preparation and fair presentation of the financial statements referred to above in accordance with U.S. GAAP.

- We acknowledge our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

- We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.

- We acknowledge our responsibility for the fair presentation of the required supplementary information, including Management's Discussion and Analysis.

- We acknowledge our responsibility for compliance with the laws, regulations, and provisions of contracts and grant agreements.

- We have reviewed, approved, and taken responsibility for the financial statements and related notes.

- We have a process to track the status of audit findings and recommendations.

- We have identified and communicated to you all previous audits, attestation engagements, and other studies related to the audit objectives and whether related recommendations have been implemented.

- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.

- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of U.S. GAAP.

- All events subsequent to the date of the financial statements and for which U.S. GAAP requires adjustment or disclosure have been adjusted or disclosed.

- There are no identified material uncorrected misstatements.

- The effects of all known actual or possible litigation and claims have been accounted for and disclosed in accordance with U.S. GAAP.

- All funds and activities are properly classified.

- All funds that meet the quantitative criteria in GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus* as amended, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, for presentation as major are identified and presented as such and all other funds that are presented as major are considered important to financial statement users.

- All components of net position, nonspendable fund balance, and restricted, committed, assigned, and unassigned fund balance are properly classified and, if applicable, approved.

- Our policy regarding whether to first apply restricted or unrestricted resources when an expense/expenditure is incurred for purposes for which both restricted and unrestricted net position/fund balance are available is appropriately disclosed and net position/fund balance is properly recognized under the policy.

- All revenues within the statement of activities have been properly classified as program revenues, general revenues, contributions to term or permanent endowments, or contributions to permanent fund principal.

- All expenses have been properly classified in or allocated to functions and programs in the statement of activities, and allocations, if any, have been made on a reasonable basis.

- All interfund and intra-entity transactions and balances have been properly classified and reported.

- Special items and extraordinary items have been properly classified and reported.
- Deposit and investment risks have been properly and fully disclosed.
- All required supplementary information is measured and presented within the prescribed guidelines.
- Recently issued GASB pronouncements and the effects have been properly recorded and/or disclosed in the financial statements.
- With regard to investments and other instruments reported at fair value:
  - The underlying assumptions are reasonable and they appropriately reflect management's intent and ability to carry out its stated courses of action.
  - The measurement methods and related assumptions used in determining fair value are appropriate in the circumstances and have been consistently applied.
  - The disclosures related to fair values are complete, adequate, and in conformity with U.S. GAAP
  - There are no subsequent events that require adjustments to the fair value measurements and disclosures included in the financial statements.

**Information Provided**

- We have provided you with:
  - Access to all information, of which we are aware that is relevant to the preparation and fair presentation of the financial statements of the various opinion units referred to above, such as records, documentation, meeting minutes, and other matters;
  - Additional information that you have requested from us for the purpose of the audit; and
  - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We have no knowledge of any fraud or suspected fraud that affects the entity and involves:
  - Management;
  - Employees who have significant roles in internal control; or

- Others where the fraud could have a material effect on the financial statements.

- We have no knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, vendors, regulators, or others.

- We are not aware of any pending or threatened litigation and claims whose effects should be considered when preparing the financial statements.

- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.

- There have been no communications from regulatory agencies concerning noncompliance with or deficiencies in accounting, internal control, or financial reporting practices.

- ETASC has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.

- We have disclosed to you all guarantees, whether written or oral, under which ETASC is contingently liable.

- We have disclosed to you all significant estimates and material concentrations known to management that are required to be disclosed in accordance with GASB Statement No. 62 ("GASB-62"), *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. Significant estimates are estimates at the balance sheet date that could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year.

- We have identified and disclosed to you the laws, regulations, and provisions of contracts and grant agreements that could have a direct and material effect on financial statement amounts, including legal and contractual provisions for reporting specific activities in separate funds.

- There has been no:

  - Violations or possible violations of laws or regulations, or provisions of contracts or grant agreements whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency, including applicable budget laws and regulations.

  - Unasserted claims or assessments that our lawyer has advised are probable of assertion and must be disclosed in accordance with GASB-62.

  - Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by GASB-62

- ETASC has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets, nor has any asset been pledged as collateral.

- We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

**Other Specific Representations**

- In preparing the financial statements in conformity with accounting principles generally accepted in the United States of America, management uses estimates. We are responsible for making the accounting estimates. ETASC has disclosed in the financial statements all estimates where it is reasonably possible that the estimate will change in the near term and the effect of the change could be material to the financial statements.

- ETASC maintains procedures and provisions to fully secure the entity's financial interest in investments. ETASC has entered into written contracts pursuant to which investments are made within the guidelines established by authoritative bodies.

- In addition to the audit services, Drescher & Malecki LLP has assisted ETASC in compiling ETASC's financial statements for the year ended December 31, 2014. In conjunction with the compilation of the financial statements, ETASC has performed the following functions:

  - Made all management decisions and performed all management functions.

  - Designated Sara Dayton, Partner, Lumsden & McCormick, LLP, whom we believe has suitable skill, knowledge, and/or experience who has overseen this service.

  - Evaluate the adequacy and results of the services performed.

  - Accepted responsibility for the results of these services.

- ETASC management understands the Drescher & Malecki LLP has not performed any management functions or made management decisions on behalf of ETASC. Any nonattest services were performed in accordance with the applicable professional standards issued by the American Institute of Certified Public Accountants.

Robert W. Keating, President

Timothy C. Callan, Treasurer

# ERIE TOBACCO ASSET SECURITIZATION CORPORATION

*(A Component Unit of the County of Erie, New York)*
*Basic Financial Statements and Required Supplementary Information for the Year Ended December 31, 2014 and Independent Auditors' Reports*

# ERIE TOBACCO ASSET SECURITIZATION CORPORATION
## (A COMPONENT UNIT OF THE COUNTY OF ERIE, NEW YORK)
## Table of Contents
## Year Ended December 31, 2014


Page

Independent Auditors' Report ..... 1

Management's Discussion and Analysis ..... 3

**Basic Financial Statements:**

Government-wide Financial Statements:

Statement of Net Position ..... 9

Statement of Activities ..... 10

Fund Financial Statements:

Balance Sheet—Governmental Funds ..... 11

Reconciliation of the Balance Sheet—Governmental Funds to the Government-wide Statement of Net Position ..... 12

Statement of Revenues, Expenditures and Changes in Fund Balances—Governmental Funds ..... 13

Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances—Governmental Funds to the Government-wide Statement of Activities ..... 14

Notes to the Financial Statements ..... 15

Independent Auditor's 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* ..... 30

**Drescher & Malecki LLP**
*3083 William Street, Suite 5*
*Cheektowaga, New York 14227*
*Telephone: 716.565.2299*
*Fax: 716.565.2201*

Drescher & Malecki

*Certified Public Accountants*

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Erie Tobacco Asset Securitization Corporation:

### Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and each major fund of the Erie Tobacco Asset Securitization Corporation (the "ETASC"), a component unit of the County of Erie, New York, as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise the ETASC's basic financial statements as listed in the table of contents.

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

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

### *Auditor's Responsibility*

Our responsibility is to express opinions 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

***Opinions***

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 ETASC, as of December 31, 2014, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Other Matters***

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated March 11, 2015 on our consideration of ETASC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ETASC's internal control over financial reporting and compliance.

Drescher & Malecki LLP

March 11, 2015

As management of the Erie Tobacco Asset Securitization Corporation ("ETASC"), a blended component unit of the County of Erie (the "County"), we offer readers of ETASC's financial statements this narrative overview and analysis of the financial activities of ETASC for the fiscal year ended December 31, 2014. This document should be read in conjunction with additional information that we have furnished in ETASC's financial statements, which follow this narrative.

**Financial Highlights**

- Total government-wide liabilities and deferred inflows of resources of ETASC exceeded government-wide assets and deferred outflows of resources by $284,648,094 at December 31, 2014. This compares to total government-wide liabilities and deferred inflows of resources of ETASC exceeding government-wide assets and deferred outflows of resources by $284,312,930 at December 31, 2013.

- ETASC's net position decreased by $335,164 for the year ended December 31, 2014.

- At the close of the current year, ETASC's governmental funds reported combined fund balances of $20,654,489, a decrease of $275,730 in comparison with the prior year. Approximately 0.08% of this amount, $16,877, is available for spending at ETASC's discretion (unassigned fund balance).

- At the end of the current fiscal year, *unassigned fund balance* for the General Fund was $16,877, or approximately 11.7 percent of General Fund expenditures. This total amount is *available for spending* at ETASC's discretion and constitutes approximately 32.4 percent of the General Fund's total fund balance of $52,077 at December 31, 2014.

- ETASC's total bonded indebtedness decreased by $4,855,000 as a result of principal payments made during the year.

**Overview of the Financial Statements**

This discussion and analysis are intended to serve as an introduction to ETASC's basic financial statements. ETASC's basic financial statements comprise of three components: 1) government-wide financial statements, 2) fund financial statements and 3) notes to the financial statements.

**Government-wide financial statements**—The *government-wide financial statements* are designed to provide readers with a broad overview of ETASC's finances, in a manner similar to a private-sector business.

The *statement of net position* presents information on all of ETASC's assets, liabilities, and deferred inflows/outflows of resources with the difference reported as *net position*. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of ETASC is improving or deteriorating.

The *statement of activities* presents information showing how the government's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

The government-wide financial statements can be found on pages 9-10 of this report.

**Fund financial statements**—A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. ETASC, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Both of ETASC's funds are classified as governmental funds.

> ***Governmental funds***—*Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources*, available at the end of the fiscal year. Such information may be useful in assessing a government's near-term financing requirements.
>
> Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.
>
> ETASC maintains two individual governmental funds, the General Fund and the Debt Service Fund. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balance for both funds.
>
> The basic governmental fund financial statements can be found on pages 11-14 of this report.

**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 on pages 15-29 of this report.

**Government-wide Overall Financial Analysis**

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. In the case of ETASC, liabilities and deferred inflows of resources exceeded assets and deferred outflows of resources by $284,648,094 at December 31, 2014, as compared to $284,312,930, at December 31, 2013. Table 1, shown on the following page, presents the condensed statements of net position for ETASC at December 31, 2014 and December 31, 2013.

**Table 1—Condensed statements of net position**

| | December 31, | |
|---|---|---|
| | 2014 | 2013 |
| Current assets | $ 37,619,865 | $ 35,986,501 |
| Deferred outflows | 27,035,325 | 21,367,555 |
| Total assets and deferred outflows | 64,655,190 | 57,354,056 |
| Current liabilities | 1,129,150 | 1,146,316 |
| Noncurrent liabilities | 348,174,134 | 340,520,670 |
| Total liabilities | 349,303,284 | 341,666,986 |
| Net position | $ (284,648,094) | $ (284,312,930) |

A portion of ETASC's net position, $20,602,412, represents resources that are subject to external restrictions on how they may be used. Therefore, the unrestricted deficit totals $305,250,506 and $304,905,729 at December 31, 2014 and 2013, respectively.

Total assets and deferred outflows of resources as of December 31, 2014, were $64.7 million, representing an increase of $7.3 million from the prior year. The major components of total assets and deferred outflows of resources at December 31, 2014 and 2013 consisted of the following: (1) cash and cash equivalents of $627,052 and $188,834, respectively; (2) investments of $20.0 million (30.8%) and $20.7 million (36.2%), respectively; (3) amounts receivable from New York State of $16.9 million (26.6%) and $15.0 million (26.2%), respectively; (4) prepaid items of $35,200 and $17,340; and (5) deferred outflow on forward purchase agreement swap of $8.2 million (12.7%) and $1.8 million (3.1%), respectively; (6) deferred outflow of amortized loss on defeasance of $18.8 million (28.9%) and $19.6 million (34.1%) respectively.

Total liabilities at December 31, 2014, were $349.3 million, compared to $341.7 million at December 31, 2013. The liabilities at December 31, 2014 and 2013 consisted of the following: (1) long-term liabilities of $348.2 million (99.7%) and $338.7 million (99.6%), respectively; (2) accounts payable of $18,150 and $10,316, respectively; (3) $1.11 million and $1.14 million, respectively, in accrued interest payable; and (4) a derivative instrument valued at $8.2 million and $1.8 million, respectively.

**Governmental Activities**—During the current year, net position for governmental activities decreased $335,164 from the prior fiscal year for an ending net position deficit of $(284,648,094). The statement of activities presents revenues received and expenses paid by ETASC. Presented as Table 2 on the following page, is the condensed statement of activities for the years ended December 31, 2014 and 2013.

**Table 2—Condensed statements of activities**

| | Year Ended December 31, | |
|---|---|---|
| | 2014 | 2013 |
| General revenues | $ 19,322,233 | $ 15,110,582 |
| Expenses—governmental activities | (19,657,397) | (19,478,749) |
| Change in net position | (335,164) | (4,368,167) |
| Net position—beginning | (284,312,930) | (279,944,763) |
| Net position—ending | $ (284,648,094) | $ (284,312,930) |

Total revenues for the years ended December 31, 2014 and 2013 were $19.3 million and $15.1 million, respectively. The net increase in revenues of $4.2 million is primarily due to the increase in tobacco settlement revenues in 2014. Revenues for the years ended December 31, 2014 and 2013 consisted of $19.3 million (99.9%) and $15.0 million (99.8%), respectively, of tobacco settlement revenues, $11,424 and $36,264, respectively, of realized gains, and $1,018 and $923, respectively, of interest and other income.

During the fiscal year ended December 31, 2014, ETASC received increased tobacco settlement revenues as a result of the settlement of a lawsuit disputing MSA payments in sales years 2003 through 2012. The lawsuit was brought about by Participating Manufactures (tobacco companies) on the basis that certain settling states, including New York State, did not diligently enforce their respective Qualifying Statues in each of those years. The Arbitration Panel determined that New York State diligently enforced its Qualifying Statues during sales year 2003 and therefore is not subject to the NPM Adjustment for 2003 pursuant to the MSA.

A summary of sources of revenues for the years ended December 31, 2014 and December 31, 2013 is presented below in Table 3.

**Table 3—Sources of revenues**

| | Year Ended December 31, | | Increase/(Decrease) | |
|---|---|---|---|---|
| | 2014 | 2013 | Dollars | Percent (%) |
| Tobacco settlement revenues | $ 19,309,791 | $ 15,073,395 | $ 4,236,396 | 28.11 |
| Interest and net earnings from investments | 12,442 | 37,187 | (24,745) | (66.54) |
| Total revenues | $ 19,322,233 | $ 15,110,582 | $ 4,211,651 | 27.87 |

Total expenses for the years ended December 31, 2014 and 2013 were $19.7 million and $19.5 million, respectively. The increase in expenses of $0.2 million is primarily due to the increase in CAB interest accretion in 2014. Expenses for the years ended December 31, 2014 and 2013 primarily consisted of $19.5 million (99.3%) and $19.3 million (99.3%), respectively, of bond interest expense, and $144,800 and $140,616 respectively, of general government support expenses incurred in connection with the operations of the ETASC.

A summary of operating expenses for the years ended December 31, 2014 and December 31, 2013 is presented below in Table 4.

**Table 4—Operating expenses**

| | Year Ended December 31, | | Increase/(Decrease) | |
|---|---|---|---|---|
| | 2014 | 2013 | Dollars | Percent (%) |
| General government support | $ 144,800 | $ 140,616 | $ 4,184 | 3.0 |
| Interest and fiscal charges | 19,512,597 | 19,338,133 | 174,464 | 0.9 |
| Total operating expenses | $ 19,657,397 | $ 19,478,749 | $ 178,648 | 0.9 |

**Financial Analysis of Governmental Funds**

As noted earlier, ETASC uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

***Governmental Funds***—The focus of ETASC's governmental funds is to provide information on near-term infows, outflows, and balances of spendable resources. Such information is useful in assessing ETASC's financing requirements. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for discretionary use as they represent the portion of fund balance which has not yet been limited to use for a particular purpose by either an external party, ETASC itself, or a group or individual that has been delegated authority to assign resources for use for particular purposes by ETASC's Board.

At December 31, 2014, ETASC's governmental funds reported combined fund balances of $20,654,489, a decrease of $275,730 in comparison with the prior year. Approximately 0.08% of this amount, $16,877, constitutes unassigned fund balance, which is available for spending at ETASC's discretion. The remainder of the fund balance is either nonspendable or restricted to indicate that it is not in spendable form, $35,200, or restricted for a particular purpose, $20,602,412.

The General Fund is the chief operating fund of ETASC. During the year ended December 31, 2014, the General Fund decreased $143,827 due to operational expenditures. At the end of the current fiscal year, total fund balance of the General Fund included unassigned fund balance in the amount of $16,877. As a measure of the General Fund's liquidity, it may be useful to compare both unassigned fund balance and total fund balance to total General Fund expenditures. Unassigned fund balance represents approximately 11.7% of total General Fund expenditures.

The Debt Service Fund, the remaining major governmental fund, had a decrease in fund balance during the current year of $131,949 to bring the year end fund balance to $20,602,412. The decrease essentially results from principal and interest expenditures during the current year. First, principal and interest in the amount of $17,551,903 was paid. Second, investment fees of $973 were paid. The total decrease in fund balance from these two amounts is $17,552,876. These expenditures were offset by revenues totaling $17,420,927.

**Debt Administration/Economic Factors**

**Long-Term Debt**—As of December 31, 2014, ETASC had $258,340,000 of tobacco settlement asset-backed bonds outstanding, which are reported in the statement of net position net of unamortized discount on the sale of bonds of $9,567,764. Additionally, as of December 31, 2014, ETASC had accreted subordinate capital appreciation bonds ("CABs") of $92,666,743, which are reported in the statement of

net position net of unamortized discount on the sale of bonds of $1,501,234. At December 31, 2014, ETASC's net tobacco settlement asset-backed bonds outstanding and net subordinate CABs were $248,772,236 and $91,165,509, respectively, while at December 31, 2013, ETASC's net tobacco settlement asset-backed bonds outstanding and net subordinate CABs were $253,556,461 and $85,158,790, respectively.

Principal payments of $4.9 million and $1.8 million were made during 2014 and 2013, respectively. Additional information on ETASC's long-term debt can be found in Note 5 to the financial statements.

**Contacting The Corporation's Financial Management**

This financial report is designed to provide a general overview of ETASC's finances for all those with an interest in ETASC's finances. Questions concerning any of the information provided in this report, or requests for additional financial information, should be addressed to the Erie Tobacco Asset Securitization Corporation, President, 95 Franklin Street, Room 1600, Buffalo, NY 14202.

# BASIC FINANCIAL STATEMENTS

** THIS PAGE INTENTIONALLY LEFT BLANK **

## ERIE TOBACCO ASSET SECURITIZATION CORPORATION
**(A Component Unit of the County of Erie, New York)**
**Statement of Net Position**
**December 31, 2014**

| | Primary Government |
|---|---|
| | Governmental Activities |
| **ASSETS** | |
| Current assets: | |
| Cash and cash equivalents | $ 627,052 |
| Investments | 20,010,387 |
| Due from New York State | 16,946,189 |
| Interest receivable | 1,037 |
| Prepaids | 35,200 |
| Total assets | 37,619,865 |
| **DEFERRED OUTFLOWS OF RESOURCES** | |
| Deferred outflow on forward purchase agreement swap | 8,236,389 |
| Deferred outflow on loss on defeasance | 18,798,936 |
| Total deferred outflows of resources | 27,035,325 |
| **LIABILITIES** | |
| Current liabilities: | |
| Accounts payable | 18,150 |
| Accrued interest payable | 1,111,000 |
| Noncurrent liabilities: | |
| Due in more than one year—bonds, net | 248,772,236 |
| Derivative instruments | 8,236,389 |
| Subordinate Turbo CABs payable, net | 91,165,509 |
| Total liabilities | 349,303,284 |
| **NET POSITION** | |
| Restricted for debt service | 20,602,412 |
| Unrestricted | (305,250,506) |
| Total net position | $ (284,648,094) |

The notes to the financial statements are an integral part of this statement.

## ERIE TOBACCO ASSET SECURITIZATION CORPORATION
**(A Component Unit of the County of Erie, New York)**
**Statement of Activities**
**Year Ended December 31, 2014**

| Functions/Programs | Expenses | Program Revenues | Net (Expenses) and Changes in Net Position — Primary Government — Governmental Activities |
|---|---|---|---|
| **Primary government:** | | | |
| Governmental activities: | | | |
| General government support | $ 144,800 | - | $ 144,800 |
| Interest and fiscal charges | 19,512,597 | - | 19,512,597 |
| Total primary government | $ 19,657,397 | $ - | 19,657,397 |
| General revenues: | | | |
| Tobacco settlement revenue | | | 19,309,791 |
| Interest earnings | | | 1,018 |
| Net earnings on investments | | | 11,424 |
| Total general revenues | | | 19,322,233 |
| Change in net position | | | (335,164) |
| Net position—beginning | | | (284,312,930) |
| Net position—ending | | | $ (284,648,094) |

The notes to the financial statements are an integral part of this statement.

## ERIE TOBACCO ASSET SECURITIZATION CORPORATION
**(A Component Unit of the County of Erie, New York)**
**Balance Sheet—Governmental Funds**
**December 31, 2014**

| | General | Debt Service | Total |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and cash equivalents | $ 35,027 | $ 592,025 | $ 627,052 |
| Investments | - | 20,010,387 | 20,010,387 |
| Interest receivable | - | 1,037 | 1,037 |
| Prepaid items | 35,200 | - | 35,200 |
| Total assets | $ 70,227 | $ 20,603,449 | $ 20,673,676 |
| **LIABILITIES AND FUND BALANCES** | | | |
| Accounts payable | $ 18,150 | $ - | $ 18,150 |
| Unearned revenue | - | 1,037 | 1,037 |
| Total liabilities | 18,150 | 1,037 | 19,187 |
| **FUND BALANCES** | | | |
| Nonspendable | 35,200 | - | 35,200 |
| Restricted for debt service | - | 20,602,412 | 20,602,412 |
| Unassigned | 16,877 | - | 16,877 |
| Total fund balances | 52,077 | 20,602,412 | 20,654,489 |
| Total liabilities and fund balances | $ 70,227 | $ 20,603,449 | $ 20,673,676 |

The notes to the financial statements are an integral part of this statement.

## ERIE TOBACCO ASSET SECURITIZATION CORPORATION
**(A Component Unit of the County of Erie, New York)**
**Reconciliation of the Balance Sheet—Governmental Funds**
**to the Government-wide Statement of Net Position**
**December 31, 2014**

Amounts reported for governmental activities in the statement of net position (page 9) are different because:

| | |
|---|---|
| Total fund balance—governmental funds (page 11) | $ 20,654,489 |
| Other long-term assets, including due from New York State, $17,290,966, and interest receivable, $1,037, are not available to pay for current period expenditures and, therefore, are reported as unavailable revenue in the funds. | 16,947,226 |
| Long-term liabilities, including bonds payable and derivative instruments, are not due and payable in the current period and, therefore, are not reported in the funds. | (322,249,809) |
| Net position of governmental activities | $ (284,648,094) |

The notes to the financial statements are an integral part of this statement.

## ERIE TOBACCO ASSET SECURITIZATION CORPORATION
**(A Component Unit of the County of Erie, New York)**
**Statement of Revenues, Expenditures, and Changes in Fund Balances—Governmental Funds**
**Year Ended December 31, 2014**

| | General | Debt Service | Total |
|---|---|---|---|
| **REVENUES** | | | |
| Tobacco settlement revenue | $ - | $17,408,531 | $ 17,408,531 |
| Interest earnings | 46 | 972 | 1,018 |
| Realized gains | - | 11,424 | 11,424 |
| Total revenues | 46 | 17,420,927 | 17,420,973 |
| **EXPENDITURES** | | | |
| Current: | | | |
| General government | 143,827 | 973 | 144,800 |
| Debt service: | | | |
| Principal | - | 4,855,000 | 4,855,000 |
| Interest | - | 12,696,903 | 12,696,903 |
| Total expenditures | 143,827 | 17,552,876 | 17,696,703 |
| Net change in fund balances | (143,781) | (131,949) | (275,730) |
| Fund balances—beginning | 195,858 | 20,734,361 | 20,930,219 |
| Fund balances—ending | $ 52,077 | $20,602,412 | $ 20,654,489 |

The notes to the financial statements are an integral part of this statement.

## ERIE TOBACCO ASSET SECURITIZATION CORPORATION
**(A Component Unit of the County of Erie, New York)**
**Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balance—Governmental Funds to the Government-wide Statement of Activities**
**Year Ended December 31, 2014**

Amounts reported for governmental activities in the statement of activities (page 10) are different because:

| | |
|---|---|
| Net change in fund balances—total governmental funds (page 13) | $ (275,730) |
| Revenues providing current financial resources exceed the revenues reported in the statement of activities. | 1,901,260 |
| The issuance of long-term debt (e.g., bonds) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net position. Also, governmental funds report the effect of premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities. This amount is the net effect of these differences in the treatment of long-term debt and related items. | (1,960,694) |
| Change in net position of governmental activities | $ (335,164) |

The notes to the financial statements are an integral part of this statement.

** THIS PAGE INTENTIONALLY LEFT BLANK **

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of the Erie Tobacco Asset Securitization Corporation ("ETASC") have been prepared in conformity with accounting principles generally accepted in the United States of America applied to government units. The Governmental Accounting Standards Board (the "GASB") is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The more significant of ETASC's accounting policies are described below.

***Description of Government-Wide Financial Statements***

The government-wide financial statements (i.e., statement of net position and the statement of changes in net position) report information on all the nonfiduciary activities of ETASC. All fiduciary activities are reported only in the fund financial statements. *Governmental activities*, which are normally supported by taxes, intergovernmental revenues, and other nonexchange transactions, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support. ETASC reports no business-type activities.

***Reporting Entity***

ETASC is a special purpose, bankruptcy remote, local development corporation organized under the Not-for-Profit Corporation Law of the State of New York. ETASC is an instrumentality of, but separate, and apart from the County of Erie, New York (the "County"). Although legally separate from the County, ETASC is a component unit of the County. Based on the nature and significance of ETASC's relationship with the County and the criteria set forth by GASB, ETASC is included within the County basic financial statements as a blended component unit.

ETASC was incorporated on August 15, 2000, for the purpose of issuing tobacco settlement asset-backed bonds (the "2000 Series Bonds") in order to provide funds to purchase from the County all of the County's right, title, and interest under the Master Settlement Agreement ("MSA") and the Consent Decree and Final Judgment (the "Decree") as described herein.

The sole member of ETASC is the County Executive of the County. The board of directors of ETASC has five directors. One director shall be the County Executive, one director shall be the County Comptroller, and one director (the "Designated Director") shall be designated jointly by the Chairperson of the County Legislature and the Minority Leader of the County Legislature; two independent directors shall be designated jointly by a majority of the other three directors in accordance with the provisions of the by-laws of the Corporation.

The MSA was entered into on November 23, 1998, among the attorney generals of 46 states (including New York), the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa, and the Territory of the Northern Marianas and for the four largest United States tobacco product manufacturers: Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown and Williamson Tobacco Company, and Lorillard Tobacco Company (collectively the "Original Participating Manufacturers" or "OPMs") in settlement of certain smoking-related

litigation and the Decree entered in New York Supreme Court, including the County's right to receive certain initial and annual payments to be made by the OPMs under the MSA.

In conjunction with the sale of the 2000 Series Bonds, the County had dedicated the discounted net proceeds of the sale as a source of funds for certain capital expenditures and the defeasance of debt. ETASC allocated the net proceeds of the sale of bonds on behalf of the County as follows: $211,722,302 was allocated to the County to finance certain capital projects and $25,046,347 was disbursed to the Liquidity Reserve Accounts and Debt Service Accounts held by the Indenture Trustee. Tobacco proceeds of $151,722,302 allocated to the County were disbursed to the County in 2000. The remaining $60,000,000 was deposited by ETASC in eligible investments on behalf of the County. All cash and investments remaining of the original $60,000,000 had been remitted to the County in 2005.

In August 2005, ETASC entered into an agreement (the "2005 Bonds") to defease the original 2000 Series Bonds and to securitize additional proceeds to be received under the MSA for years subsequent to 2016. The total debt issued in 2005 amounted to $318,834,680. Net proceeds after issuance cost and discounts amounted to $305,330,026, with $265,013,936 used to fund a defeasance escrow account and enable the ETASC to release previously restricted funds for debt service and trapping events to the County. Trapping events are defined economic circumstances that trigger a mandatory deposit of all residual payments into a trapping account. See Note 5 for additional information related to long-term debt.

In January 2006, ETASC issued $17,694,750 Tobacco Settlement Asset-Backed Bonds, Series 2006A, subordinate to the 2005 Bonds. These bonds are payable from and secured by all Tobacco Settlement Revenues ("TSRs") allocated to the County under the MSA; investment earnings on amounts in certain funds and accounts established under the ETASC Indenture; any amounts on deposit in such funds and accounts held as security for the ETASC's Series 2006A bonds; and certain amounts expected to become available from funds and accounts created under the ETASC Indenture as security for prior bonds upon their retirement. The Series 2006A bonds are subject to mandatory redemption from amounts on deposit in the Turbo Redemption Account and ETASC with 100% of all surplus revenues, if any. A turbo redemption occurs when all excess revenues, after the payment of operation expenses, interest and rated principal, are used to retire term bonds early in order of maturity. Disbursements to the County from 2006 bond proceeds totaled $15,673,077 for the year ended December 31, 2006.

Payments for principal and interest on the bonds (Series 2005 and Series 2006A) are contingent upon the receipt of TSRs which are driven by the consumption levels of the OPMs tobacco products. Additionally, as disclosed with the issuances, the bonds shall not be a debt of either the State of New York or the County, and neither the State of New York nor the County shall be liable thereon, nor shall they be payable out of any funds other than those of ETASC pledged therefor.

In accordance with the Bond Indenture and to the extent contained in the Master Settlement Agreement ("MSA") Report, a trapping event is occurring. A Consumption Decline Trapping Event occurs when shipments of cigarettes in or to the 50 United States, the District of Columbia and Puerto Rico as measured under the MSA, are less in any year preceding a deposit date than the amount opposite such year under the "Consumption Decline Trapping Event" definition, which number for the year 2013 is 285,975,111,088. According to the MSA Report, the amount shown as relevant shipments for the year 2013 was less than the shipment amount specified above, and therefore, a Consumption Decline Trapping Event has occurred.

***Basis of Presentation – Government-wide Financial***

While separate government-wide and fund financial statements are presented, they are interrelated. The governmental activities column incorporates data from governmental funds. Separate financial statements are provided for governmental funds.

***Basis of Presentation – Fund Financial Statements***

The fund financial statements provide information about ETASC's funds. Separate statements for governmental funds are presented. The emphasis of fund financial statements is on major governmental funds, each displayed in a separate column in the fund financial statements.

ETASC reports the following major governmental funds:

- *General Fund*—The General Fund constitutes the primary operating fund of ETASC and includes all operations not required to be recorded in other funds

- *Debt Service Fund*—The Debt Service Fund is used to account for the accumulation of resources that are restricted for the payment principal and interest on long-term obligations of governmental funds.

During the course of operations the government has activity between funds for various purposes. Any residual balances outstanding at year end are reported as due from/to other funds and advances to/from other funds. While these balances are reported in fund financial statements, certain eliminations are made in the preparation of the government-wide financial statements. Balances between the funds included in governmental activities are eliminated so that only the net amount is included as internal balances in the governmental activities column.

Further, certain activity occurs during the year involving transfers of resources between funds. In fund financial statements these amounts are reported at gross amounts as transfers in/out. While reported in fund financial statements, certain eliminations are made in the preparation of the government-wide financial statements. Transfers between the funds included in governmental activities are eliminated so that only the net amount is included as transfers in the governmental activities column.

***Measurement Focus and Basis of Accounting***

The accounting and financial reporting treatment is determined by the applicable measurement focus and basis of accounting. Measurement focus indicates the type of resources being measured such as *current financial resources* or *economic resources.* The basis of accounting indicates the timing of transactions or events for recognition in the financial statements.

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting.* Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows.

Tobacco settlement revenues are exchange transactions, based on the notion that the payments are made to the settling states in exchange for their agreement to release the tobacco companies from present and future litigation. Under the terms of the MSA, the tobacco companies have agreed to make annual payments in perpetuity. The MSA includes a schedule of projected annual base payments, subject to certain adjustments based on future events or circumstances. The most

significant factor affecting the annual payments is a *volume adjustment,* which creates a direct relationship between domestic shipments of cigarettes and the annual payments. Based on the MSA, the tobacco companies have no obligation to make settlement payments until cigarettes are shipped.

The event that results in the recognition of an asset and revenue by a settling government is the domestic shipment of cigarettes (sales). Therefore, ETASC recognizes a receivable and revenue for tobacco settlement revenues when that event occurs. Because annual tobacco settlement revenue payments are based on cigarette sales from the preceding calendar year, ETASC estimates accrued tobacco settlement revenues that derive from sales from January 1 to their respective fiscal year ends. Under the modified accrual basis of accounting, revenue should be recognized to the extent that the event occurs and resources become *available.*

The governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting.* Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, ETASC considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when the payment is due. Issuance of long-term debt and acquisitions under capital leases are reported as other financing sources.

Interest associated with the current fiscal period is considered to be susceptible to accrual and so has been recognized as revenue of the current fiscal period. Entitlements are recorded as revenues when all eligibility requirements are met, including any time requirements, and the amount is received during the period of availability. Expenditure driven grants are recognized as revenue when the qualifying expenditures have been incurred and all other eligibility requirements are met and amount is received during the period of availability. All other revenue items are considered to be measurable and available only when cash is received by ETASC.

***Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position/Fund Balance***

***Cash, Cash Equivalents and Investments***—ETASC's cash, cash equivalents and investments consist of cash on hand, demand deposits, time deposits and short-term, highly liquid investments with original maturities of three months or less from the date of acquisition. Investments for ETASC are reported at fair value (generally based on quoted market prices).

***Prepaid Items***—Certain payments reflect costs applicable to future accounting periods and are recorded as prepaid items in both the government-wide and fund financial statements. The cost of prepaid items is recorded as expenses/expenditures when consumed rather than when purchased.

***Deferred outflows/inflows of resources***—In addition to assets, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources,* represents a consumption of net position that applies to a future period(s) and so will *not* be recognized as an outflow of resources (expense/expenditure) until then.

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources,* represents an acquisition of net position that applies to a future period(s) and so will *not* be recognized as an inflow of resources (revenue) until that time.

At December 31, 2014, ETASC reported deferred outflows of resources in the amount of $8,236,389 and $18,798,936, relating to the accumulated increase in fair value of its forward purchase agreement swap and deferred losses on the defeasance of debt, respectively.

***Net position flow assumption***—Sometimes ETASC will fund outlays for a particular purpose from both restricted (e.g., restricted bond proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted – net position and unrestricted – net position in the government-wide financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is ETASC's policy to consider restricted – net position to have been depleted before unrestricted – net position is applied.

***Fund balance flow assumption***—Sometimes ETASC will fund outlays for a particular purpose from both restricted and unrestricted resources (the total of committed, assigned, and unassigned fund balance). In order to calculate the amounts to report as restricted, committed, assigned, and unassigned fund balance in the governmental fund financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. If ETASC must use funds for emergency expenditures it shall expend funds first from funds classified under GASB as nonspendable (if funds become available) then restricted funds. The use of committed and assigned funds as classified by GASB will occur after the exhaustion of available restricted funds. Finally, if no other fund balances are available ETASC will use unassigned fund balance.

***Fund balance policies***—Fund balance of governmental funds is reported in various categories based on the nature of any limitations requiring the use of resources for specific purposes. ETASC itself can establish limitations on the use of resources through either a commitment (committed fund balance) or an assignment (assigned fund balance).

The committed fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of ETASC's highest level of decision-making authority (ETASC Board). The governing board is the highest level of decision-making authority for the government that can, by adoption of an ordinance prior to the end of the fiscal year, commit fund balance. Once adopted, the limitation imposed by the ordinance remains in place until a similar action is taken (the adoption of another ordinance) to remove or revise the limitation.

Amounts in the assigned fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as committed. The governing board (ETASC Board) has by resolution authorized the sole Member to assign fund balance. The Board may also assign fund balance as it does when appropriating fund balance to cover a gap between estimated revenue and appropriations in the subsequent year's appropriated budget. Unlike commitments, assignments generally only exist temporarily. In other words, an additional action does not normally have to be taken for the removal of an assignment. Conversely, as discussed above, an additional action is essential to either remove or revise a commitment.

***Revenues and Expenses/Expenditures***

***Program Revenues***—Amounts reported as *program revenues* include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions (including special assessments) that are restricted to meeting the operational or capital requirements of a particular function or segment. There are no program revenues in the current year. Items not properly included among program revenues are reported instead as *general revenues.*

***Tobacco Settlement Revenues***—During the fiscal year ended December 31, 2014, ETASC received increased tobacco settlement revenues as a result of the settlement of a lawsuit disputing MSA payments in sales years 2003 through 2012. The lawsuit was brought about by Participating Manufactures (tobacco companies) on the basis that certain settling states, including New York State, did not diligently enforce their respective Qualifying Statues in each of those years. The Arbitration Panel determined that New York State diligently enforced its Qualifying Statues during sales year 2003 and therefore is not subject to the NPM Adjustment for 2003 pursuant to the MSA.

***Expenses/Expenditures***—Expenditures are recorded on a modified accrual basis of accounting. Payments to the County are recorded when the obligation is incurred. General administration costs consist of operating expenses for professional service fees and are paid from General Fund revenues. *Direct expenses* are those that are clearly identifiable with a specific function. Indirect expenses have been included as part of the program expenses reported for the various functional activities.

***Reconciliation of Government-Wide and Fund Financial Statements***

***Explanation of Certain Differences between the Governmental Fund Balance Sheet and the Government-Wide Statement of Net Position***—The governmental fund balance sheet includes a reconciliation between *fund balance – total governmental funds* and *net position – governmental activities* as reported in the government-wide statement of net position. One element of that reconciliation explains that "long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds." The details of this $322,249,809 difference are as follows:

| | |
|---|---|
| Tobacco Settlement bonds payable | $ 258,340,000 |
| Subordinate turbo CABs payable | 92,666,743 |
| Less: Issuance discount | (11,068,998) |
| Less: Accrued loss on defeasance | (18,798,936) |
| Accrued interest payable | 1,111,000 |
| Net adjustment to reduce *fund balance - total governmental funds* to arrive at *net position - governmental activities* | $ 322,249,809 |

***Explanation of Certain Differences between the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances and the Government-Wide Statement of Activities***—The governmental fund statement of revenues, expenditures, and changes in fund balances includes a reconciliation between *net changes in fund balances – total governmental funds* and *changes in net position of governmental activities* as reported in the government-wide statement of activities. The one element of that reconciliation states that "the issuance of long-term debt (e.g., bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction,

however, has any effect on net position. Also, governmental funds report the effect of premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statements of activities. This amount is the net effect of these differences in the treatment of long-term debt and related items." The details of this $1,960,694 difference are presented below.

| | |
|---|---|
| Debt issued or incurred: | |
| Accreted interest on subordinate turbo CABs | $ 5,995,614 |
| Amortization of bond discount | 81,880 |
| Amortization of loss on defeasance | 763,200 |
| Change in accrued interest payable | (25,000) |
| Principal repayments on tobacco settlement bonds | (4,855,000) |
| Net adjustment to decrease *changes in fund balances - total governmental funds* to arrive at *changes in net position of governmental activities* | $ 1,960,694 |

***Other***

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

***Adoption of New Accounting Pronouncements***—During the year ended December 31, 2014, ETASC implemented GASB Statement No. 67, *Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25,* GASB Statement No. 69, *Government Combinations and Disposals of Government Operations,* and GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees.* The objective of GASB Statement No. 67 is to improve financial reporting by state and local governmental pension plans. This Statement replaces GASB Statement No. 25 and Statement No. 50. The objective of GASB Statement No. 69 is to standardize accounting and financial reporting related to government combinations and disposals of government operations. The objective of GASB Statement No. 70 is to improve financial reporting by state and local governments that extend and receive nonexchange financial guarantees. GASB Statement Nos. 67, 69, and 70 did not have a material impact on the ETASC's financial position or results from operations.

***Future Impacts of Accounting Pronouncements***—ETASC has not completed the process of evaluating the impact that will result from adopting GASB Statements No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27;* No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—and amendment of GASB Statement No. 68,* effective for the year ending December 31, 2015; and No. 72, *Fair Value Measurement and Application,* effective for the year ending December 31, 2016. ETASC is, therefore, unable to disclose the impact that adopting GASB Statement Nos. 68, 71 and 72 will have on its financial position and results of operations.

## 2. CASH AND INVESTMENTS

ETASC's investment policies are governed by New York State statutes. All deposits are carried at fair value. Collateral is required for demand deposit accounts, time deposit accounts and certificates of deposit not covered by Federal deposit insurance. ETASC has entered into custodial agreements with the various banks which hold their deposits. These agreements authorize the obligation that may be pledged as collateral. Obligations that may be pledged as collateral are outlined in Chapter 623 of the laws of the State of New York.

Cash and cash equivalents at December 31, 2014, are as follows:

| | General Fund | Debt Service Fund | Total |
|---|---|---|---|
| Deposits | $35,027 | $ 592,025 | $ 627,052 |

***Deposits***—All deposits of cash in the bank are carried at fair value. Additionally ETASC has $592,025 of cash on deposit with its investment bank, which is subject to their investment agreement.

| | Bank Balance | Carrying Amount |
|---|---|---|
| FDIC Insured | $ 58,845 | $ 35,027 |
| Cash held by investment bank's agent in ETASC's name | 592,025 | 592,025 |
| Total | $ 650,870 | $ 627,052 |

***Investments***—Investments are carried at fair value and held by a third party in ETASC's name.

Investments at December 31, 2014 are as follows:

| Description | Fair Value |
|---|---|
| Investments: | |
| Institutional liquidity funds | $ 409,939 |
| Corporate commercial paper | 19,600,448 |
| Total | $ 20,010,387 |

***Custodial Credit Risk—Deposits***—Custodial credit risk is the risk that in the event of a bank failure, ETASC's deposits may not be returned to it. As noted above, by New York State statute all deposits in excess of FDIC insurance coverage must be collateralized. At December 31, 2014, ETASC's deposits were either FDIC insured or collateralized with securities held by the pledging bank's agent in ETASC's name.

***Custodial Credit Risk—Investments***—For investments, this is the risk that, in the event of the failure of the counterparty, ETASC will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. For deposits, this is the risk that in the event of a bank failure, ETASC's deposits may not be returned to it.

***Interest Rate Risk***—As a means of limiting its exposure to fair value losses arising from fluctuating interest rates, it is ETASC's practice to generally limit investments to 180 days or less.

## 3. RECEIVABLES

***Due from New York State***—Represents amounts owed to ETASC for tobacco settlement revenue earned in 2014. ETASC has accrued $16,946,189 within governmental activities only, as it is not recognized on the modified accrual basis of accounting.

## 4. DERIVATIVE INSTRUMENT

In connection with the $318,834,680 Series 2005 Bonds, ETASC entered into a forward purchase agreement and an effective swap of variable market rate returns with a fixed rate return with Merrill Lynch Capital Services, Inc. (MLCS) and The Bank of New York (the "Trustee"). Under the terms of such agreement, MLCS shall deliver to the Trustee qualified securities selected by MLCS or any dealer in eligible securities selected by MLCS (the "Qualified Dealer"). At the time of such delivery, the Trustee shall, out of the funds provided by ETASC, purchase such qualified security and pay to the Qualified Dealer or MLCS, an amount equal to the price which will produce a rate of return equal to a fixed rate of 4.168% for the period commencing on either June 1 or December 1 and terminating on the following June 1 or December 1, respectively.

Concurrently with the delivery of any qualified securities, the Trustee shall pay the Qualified Dealer or MLCS the market value thereof. If the Qualified Dealer requires that the Trustee purchase qualified securities at a price higher than the fixed rate, MLCS shall pay to the Trustee an amount equal to the excess of the price at which the Qualified Dealer requires the Trustee to purchase such qualified securities over the fixed rate of such qualified securities.

The forward purchase agreement will expire by its terms on the final maturity of the asset-backed bonds on June 1, 2055. ETASC entered into this forward purchase agreement to facilitate investment of the monies in the Debt Service Reserve Fund while the 2005 ETASC bonds are outstanding.

From ETASC's perspective, the relevant risks associated with the forward purchase agreement are credit risks, termination risk, and market risk. The credit risks to ETASC, i.e., the risk that MLCS will not fulfill its obligations, will occur if MLCS becomes insolvent or fails to deliver qualified securities to the trustee as required. The credit rating for Bank of America Corporation, the parent company of MLCS at December 31, 2014 was A as issued by Standard and Poor's. The termination risk to ETASC will occur if the agreement is terminated at a point of the securities purchase and sale process at which ETASC would be required to make a termination payment to MLCS. The market risk to ETASC will occur given the market gains or losses of the securities purchased under the agreement, resulting in a required forward purchase agreement fair value disclosure of the asset or liability position of the agreement at each period end date. These risks are mitigated by the credit rating of the counterparty and the level of eligible securities and guarantees contained in the agreement.

ETASC has evaluated the forward purchase agreement using the consistent critical terms method and deemed it to be effective. As of December 31, 2014, the notional amount of the agreement totals $19,218,750, the fair value is $8,236,389, and net cash flows during the year totaled $784,197.

## 5. LONG-TERM DEBT

In 2000, ETASC issued $246,325,000 of tobacco settlement asset-backed bonds, Series 2000, pursuant to an indenture dated as of September 1, 2000. The $246,325,000 bond issuance was comprised of $196,985,000 tobacco settlement asset-backed bonds Series 2000A and $49,340,000 tobacco settlement asset-backed bonds Series 2000B. The net proceeds of the Series 2000 Bonds were used to purchase from the County all of the County's right, title, and interest to TSR to which the County would otherwise be entitled under the MSA and the Decree.

On August 15, 2005, ETASC issued $318,834,680 in tobacco settlement asset-backed bonds (Series 2005A, E) and capital appreciation bonds ("CABs") (Series 2005B, C, D), with interest rates ranging from 5.00% to 6.75% to advance refund $239,060,000 of outstanding Series 2000 Bonds bearing interest rates ranging from 5.0% to 6.5% originally issued in 2000. The net proceeds amounted to $305,330,026 after original issuance discount and payment of $13,504,654 for underwriting fees, insurance, and other issuance costs, of which $267,037,311 was used to fund an irrevocable trust to defease the remaining original bonds. This transaction enabled ETASC to release $55,231,709 in previously restricted funds for debt service and trapping events to the County.

On September 15, 2005, ETASC entered into an agreement with the bondholders to replace the government securities in the irrevocable trust with government agency securities. This transaction generated a savings of $2,802,806. Of this, $1,331,893 was transferred to the County and the remainder less costs of sale was paid to the bondholders for their concessions. During 2010, the bonds were called and the balance in the irrevocable trust was used to satisfy all required debt payments.

On January 5, 2006, ETASC issued $17,694,720 of tobacco settlement asset-backed CABs, Series 2006A, with an interest rate of 7.65%. ETASC entered into a purchase and sale agreement with the County on January 1, 2006, in which ETASC purchased the County's sole undivided beneficial interest in and to the trust established by ETASC pursuant to the Declaration and Agreement of Trust dated September 1, 2000, between ETASC and the Wilmington Trust Company ("2000 Residential Trust"), in its capacity as trustee, including the County's right to receive residual tobacco settlement revenues payable to the County, as sole beneficiary of the 2000 Residential Trust. The net proceeds of $15,638,465 were transferred to the County.

The payment of the Series 2005 and 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 OPMs. Such bonds are secured by and payable solely from TSRs and investment earnings pledged under the Indenture and amounts established and held in accordance with the Indenture. ETASC has no financial assets other than the collections and reserves and amounts held in the other funds and accounts established under the Indenture.

ETASC has covenanted to apply 100% of all surplus revenues, if any, in the turbo redemption account to the special mandatory redemption ("Turbo Redemption") of the authorized denominations of the Series 2005 Bonds in order of maturity and then to the Series 2006A Bonds to the extent that there exists excess funds. Any such surplus revenues shall be applied on each distribution date beginning on June 1, 2006.

Interest on the Series 2005A and E bonds are payable each June 1 and December 1. The 2005 Series B, C, and D and the Series 2006A are subordinate CABs and accrue interest throughout the life of the bonds but is payable at redemption. Series 2005B, C, and D CABs are subject to redemption at the option of ETASC beginning in years after 2016. The Series 2006A CABs may be redeemed after May 31, 2017.

Details of long-term debt as of December 31, 2014, are as follows:

Series 2005
$318,834,680
Term Bond

| Issue Amount | Rate | Description | Final Turbo Redemption Date |
|---|---|---|---|
| $ 30,330,000 | 5.000 % | Series 2005A Bonds due June 1, 2031, Semiannual interest-only payments through maturity, may be redeemed at the option of the ETASC at anytime in whole or in part after June 1, 2015. | June 1, 2031 |
| 74,685,000 | 5.000 | Series 2005A Bonds due June 1, 2038, Semiannual interest-only payments through maturity, may be redeemed at the option of the ETASC at anytime in whole or in part after June 1, 2015. | June 1, 2038 |
| 111,480,000 | 5.000 | Series 2005A Bonds due June 1, 2045, Semiannual interest-only payments through maturity, may be redeemed at the option of the ETASC at anytime in whole or in part after June 1, 2015. | June 1, 2045 |
| 9,163,000 | 5.750 | Series 2005B Bonds due June 1, 2047, Semiannual interest accrued but not payable until maturity, subject to redemption at the option of ETASC anytime after June 1, 2015 at accreted values as follows: June 1, 2015 through May 31, 2016, 102%; June 1, 2016 through May 31, 2017, 101%; and June 1, 2017 and thereafter, 100%. | June 1, 2047 |
| 12,565,080 | 6.250 | Series 2005C Bonds due June 1, 2050, Semiannual interest accrued but not payable until maturity, subject to redemption at the option of ETASC anytime after June 1, 2015 at accreted values as follows: June 1, 2015 through May 31, 2016, 102%; June 1, 2016 through May 31, 2017, 101%; and June 1, 2017 and thereafter, 100%. | June 1, 2050 |
| 11,141,600 | 6.750 | Series 2005D Bonds due June 1, 2055, Semiannual interest accrued but not payable until maturity, subject to redemption at the option of ETASC anytime after June 1, 2015 at accreted values as follows: June 1, 2015 through May 31, 2016, 102%; June 1, 2016 through May 31, 2017, 101%; and June 1, 2017 and thereafter, 100%. | June 1, 2055 |
| 69,470,000 | 6.000 | Series 2005E Taxable Bonds due June 1, 2028, Semiannual interest only payments through maturity, may be redeemed at the option of the ETASC at anytime in whole or in part after June 1, 2015. | June 1, 2028 |

(Continued)

Series 2006
$17,694,720
Term Bond

| Issue Amount | Rate | Description | Final Turbo Redemption Date |
|---|---|---|---|
| $ 17,694,720 | 7.650 % | Series 2006A Taxable Bonds due June 1, 2060, Semiannual interest accrued but not payable until maturity, subordinate to the Series 2005A-E Bonds, subject to redemption at the option of ETASC anytime after June 1, 2016 at accreted values as follows: June 1, 2016 through May 31, 2017, 102%; June 1, 2017 through May 31, 2018, 101%; and June 1, 2018 and thereafter, 100%. | June 1, 2060 |

(Concluded)

Changes in bonds payable for the year ended December 31, 2014, are as follows:

| Description | Beginning Balance 1/1/2014 | Additions | Deletions | Ending Balance 12/31/2014 |
|---|---|---|---|---|
| Tobacco Settlement Bonds: | | | | |
| 2005A | $ 216,495,000 | $ - | $ - | $ 216,495,000 |
| 2005E | 46,700,000 | - | 4,855,000 | 41,845,000 |
| Total Tobacco Settlement Bonds | 263,195,000 | - | 4,855,000 | 258,340,000 |
| Less: | | | | |
| Bond discount | (9,638,539) | - | (70,775) | (9,567,764) |
| Net Tobacco Settlement Bonds | $ 253,556,461 | $ - | $ 4,784,225 | $ 248,772,236 |

The ETASC's debt service requirements for the Series 2005A and 2005E as of December 31, 2014, are as follows:

| Years Ending December 31 | Principal | Interest | Total Debt Service |
|---|---|---|---|
| 2015 | $ - | $ 13,335,450 | $ 13,335,450 |
| 2016 | - | 13,335,450 | 13,335,450 |
| 2017 | - | 13,335,450 | 13,335,450 |
| 2018 | - | 13,335,450 | 13,335,450 |
| 2019 | - | 13,335,450 | 13,335,450 |
| 2020-2024 | - | 66,677,250 | 66,677,250 |
| 2025-2029 | 41,845,000 | 62,911,200 | 104,756,200 |
| 2030-2034 | 30,330,000 | 48,816,000 | 79,146,000 |
| 2035-2039 | 74,685,000 | 40,939,875 | 115,624,875 |
| 2040-2044 | - | 27,870,000 | 27,870,000 |
| 2045 | 111,480,000 | 2,787,000 | 114,267,000 |
| | $ 258,340,000 | $ 316,678,575 | $ 575,018,575 |

***Subordinate CABs—Series 2005B, 2005C, 2005D and 2006A***—Interest on the Subordinate CABs is compounded semiannually on June 1 and December 1, but is not payable until bond maturity. Interest accretes until both principal and accreted interest are paid. Future interest accretion has been recorded as bond discount and amortized as the current interest accretes. The accreted interest on the Subordinate CABs is reflected within the Subordinate CABs payable liability.

A summary of the Subordinate CABs net bond balance activity for the year ended December 31, 2014 follows:

| | Beginning Balance 1/1/2014 | Additions & Annual Net Interest Accretion | Deletions & Turbo Redemption Payments | Ending Balance 12/31/2014 |
|---|---|---|---|---|
| Subordinate CABs | $ 86,671,129 | $ 5,995,614 | $ - | $ 92,666,743 |
| Less: | | | | |
| Bond discount | (1,512,339) | - | (11,105) | (1,501,234) |
| Net Subordinate CABs | $ 85,158,790 | $ 5,995,614 | $ (11,105) | $ 91,165,509 |

## 6. NET POSITION AND FUND BALANCE

The government-wide financial statements utilize a net position presentation. Net position is categorized as restricted and unrestricted components.

- ***Restricted for Debt Service***—This category restricts a portion of net position for payment of the debt service obligations of ETASC. At December 31, 2014, the balance of this restriction was $20,602,412.

- ***Unrestricted Component of Net Position***—This component represents net position of ETASC not restricted for any other purpose.

In the fund financial statements, nonspendable amounts represent net current financial resources that cannot be spent because they are either not in spendable form or legally or contractually required to be maintained intact. Nonspendable fund balance maintained by ETASC at December 31, 2014 includes:

- ***Prepaid items***—Represents amounts prepaid to ratings and surveillance agencies, to the Trustee for administration fees, and to ETASC's insurance provider that are applicable to future accounting periods. The General Fund reported a nonspendable fund balance in the amount of $35,200.

In the fund financial statements, restricted fund balances are amounts constrained to specific purposes (such as grantors, bondholders, and higher levels of government) through constitutional provisions or by enabling legislation. At December 31, 2014, ETASC reported $20,602,412 of fund balance restricted for debt service that must be used toward the future repayment of bonded debt. Under the indenture, the trustee will hold a segregated Liquidity Reserve Account totaling $19,998,588 at December 31, 2014. The Liquidity Reserve Account will be terminated when no current interest bonds remain outstanding. Such amounts are not available to make Turbo Redemption Payments.

As of December 31, 2014, ETASC reported no committed or assigned fund balances.

## 7. CONTINGENCIES

The ability of ETASC to meet debt service payments of bonds is contingent upon the receipt of TSRs. TSRs are principally dependent upon future levels of domestic consumption. A significant decline in the overall consumption of cigarettes could have a material adverse effect on the payments by the OPMs under the MSA and the amounts available to ETASC to make payments of principal and interest on their bonds.

Certain smokers, smokers' rights organizations, consumer groups, cigarette importers, cigarette distributors, cigarette manufacturers, Native American tribes, taxpayers, taxpayers' groups and other parties have filed actions against some, and in certain cases all, of the signatories to the MSA. In the event of an adverse court ruling in such types of litigation, Bondholders could incur a complete loss of their investment.

Additionally, the OPM's are also exposed to liability from various lawsuits including individual lawsuits, class action lawsuits and health care cost recovery litigation. Ultimately, the outcome of these and any other pending or future lawsuits is uncertain. One or more adverse judgments could result in delays in, or reductions of amounts available for, payments on the bonds.

## 8. SUBSEQUENT EVENTS

Management has evaluated subsequent events through March 11, 2015, which is the date the financial statements are available for issuance, and have determined there are no subsequent events that require disclosure under generally accepted accounting principles.

* * * * * *

** THIS PAGE INTENTIONALLY LEFT BLANK **

**Drescher & Malecki LLP**
*3083 William Street, Suite 5*
*Cheektowaga, New York 14227*
*Telephone: 716.565.2299*
*Fax: 716.565.2201*

*Certified Public Accountants*

**INDEPENDENT AUDITOR'S 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
Erie Tobacco Asset Securitization Corporation:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities and each major fund of Erie Tobacco Asset Securitization Corporation ("ETASC") as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise ETASC's basic financial statements, and have issued our report thereon dated March 11, 2015.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered ETASC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of ETASC's internal control. Accordingly, we do not express an opinion on the effectiveness of the ETASC's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether ETASC's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Drescher & Malecki LLP

March 11, 2015