NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION
(Component Unit of Nassau County)

BASIC FINANCIAL STATEMENTS

December 31, 2014

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FINANCIAL SECTION

Independent Auditor's Report

To the Board of Directors
Nassau County Tobacco Settlement Corporation
Mineola, New York

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

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of 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 NCTSC, as of December 31, 2014, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note E to the financial statements, a correction for errors was required to apply the provisions of GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues,* in a manner consistent with Nassau County and to reclassify amounts between net position (deficit) balances previously reported in order to conform with accounting principles generally accepted in the United States of America. Accordingly, the components of net position (deficit) as of January 1, 2014 have been restated. Our opinions are not modified with respect to this matter.

Other Matters

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3-8 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 May 1, 2015 and July 22, 2015 (solely for the matter disclosed in Note E.1) on our consideration of NCTSC'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 NCTSC's internal control over financial reporting and compliance.

McGladrey LLP

New York, New York
May 1, 2015,
and July 22, 2015 (solely for the matter disclosed in Note E.1)

REQUIRED SUPPLEMENTARY INFORMATION
Management's Discussion and Analysis
(unaudited)

The following is a discussion and analysis of the Nassau County Tobacco Settlement Corporation's ("NCTSC" or "Corporation") financial performance, which provides an overview of NCTSC's financial activities for the year ended December 31, 2014. Please read this in conjunction with the financial statements, which immediately follow this section.

FINANCIAL HIGHLIGHTS

- NCTSC's liabilities exceeded its assets and deferred outflows of resources by $424,638 (total net deficit) for the year ended December 31, 2014.
- NCTSC's total net deficit increased by $4,545.
- NCTSC's governmental funds reported total ending fund balance of $24,234 for the year ended December 31, 2014.
- At the end of the current year, unassigned fund balance for the general fund was $203 or 166% of total general fund expenditures.
- NCTSC's total bonds payable increased by $4,829 or 1.06% during the current year. This increase is due to the accretion of interest on outstanding bonds and the amortization of bond discounts, less principal paid during the year.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

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

Reporting on NCTSC as a Whole

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

The statement of net position reports all assets, liabilities, deferred outflows/inflows of resources and net position. The net position (deficit) is displayed as one of two categories: restricted and unrestricted. Over time, changes in NCTSC's net position (deficit) is one indicator of whether its financial health is improving or deteriorating. The reader should consider other nonfinancial factors, such as regulatory changes and tobacco consumption, to assess the overall health of the Corporation.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited) (in thousands, unless noted)

OVERVIEW OF THE FINANCIAL STATEMENTS (continued)

Reporting on NCTSC's Most Significant Funds

The fund financial statements begin on page 11 and provide detailed information about the most significant funds. The Board of Directors (the "Board"), per the Amended and Restated Indenture by and between Nassau County Tobacco Settlement Corporation, as Issuer, and Deutsche Bank Trust Company Americas, as Trustee dated as of March 1, 2006 ("Indenture Agreement" or "Indenture"), established funds to help control and manage money for particular purposes and to demonstrate that it is meeting legal responsibilities for using certain money.

- *Governmental funds* – NCTSC's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted into cash. The governmental fund statements provide a detailed short-term view of NCTSC's general government operations. We describe the relationship (or differences) between governmental activities (reported in the statement of net position and the statement of activities) and governmental funds in reconciliations on pages 12 and 14.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the information provided in the government-wide and fund financial statements. The notes to the basic financial statements can be found beginning with page 15.

Restatement

Management has determined a correction for errors in previously issued financial statements was necessary to eliminate the deferral of cost from the purchase of future TSRs previously recorded ($308.1 million as of December 31, 2013) to be consistent with the prospective adoption of GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* (GASB 48), by Nassau County (the "County") and to reclassify amounts historically recorded in net position (deficit) balances to properly conform with accounting principles generally accepted in the United States of America ("GAAP"). The reclassification restatement allocates the restricted balance to unrestricted. The restricted investment balance was funded by debt proceeds and, therefore, the asset is offset by the related debt and has no net position effect. The reclassification restatement had no effect on the statement of activities or other financial statements in prior years. NCTSC restated fiscal year 2013 net position (deficit) as follows:

	2013 (as restated)	2013 (as reported)
Net Position (Deficit)		
Restricted	$ -	$ 23,151
Unrestricted	(420,093)	(135,063)
Total Net Deficit	$ (420,093)	$ (111,912)

MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited) (in thousands, unless noted)

FINANCIAL ANALYSIS OF NCTSC AS A WHOLE

Our analysis below focuses on the net position (deficit) and changes in the net position (deficit) of NCTSC as a whole.

Net Position (Deficit)

Condensed Statement of Net Position (Deficit)
As of December 31,

				(As Restated)
		2014		2013
Assets				
Current assets	$	225	$	218
Non-current assets, net		24,013		23,151
Total Assets		24,238		23,369
Deferred Outflows of Resources				
Deferred loss on refunding		13,563		14,152
Total Deferred Outflows of Resources		13,563		14,152
Liabilities				
Current liabilities		1,607		1,611
Non-current liabilities		460,832		456,003
Total Liabilities		462,439		457,614
Net Position (Deficit)				
Unrestricted		(424,638)		(420,093)
Total Net Deficit	$	(424,638)	$	(420,093)

As of December 31, 2014, total assets and deferred outflows of resources of NCTSC were $37,801, an increase of $280 or .75% from the prior year. The increase is primarily attributable to the increase in the restricted investments account offset by the decrease in the deferred loss on refunding due to amortization.

Total liabilities increased by $4,825 or 1.05% to $462,439. The increase is attributable to the combination of additional accretion of interest on outstanding bonds and amortization of bond discounts. The overall net position (deficit) increased over the prior year by ($4,545) to a current net position (deficit) of ($424,638).

MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited) (in thousands, unless noted)

FINANCIAL ANALYSIS OF NCTSC AS A WHOLE (continued)

Changes in Net Position (Deficit)

Condensed Statement of Activities
Years ended December 31,

	2014	(As Restated) 2013
General Revenues		
Tobacco settlement revenues	$ 21,733	$ 19,210
Interest on investments	3	3
Total General Revenues	21,736	19,213
Expenses		
General government support	122	123
Interest on debt	26,159	25,858
Total Expenses	26,281	25,981
Change in Net Position	(4,545)	(6,768)
Net Deficit at Beginning of Year, as restated (see Note E)	(420,093)	(413,325)
Net Position (Deficit) at End of Year	$ (424,638)	$ (420,093)

For the year ended December 31, 2014, total general revenues were $21,736, an increase of $2,523, which is primarily attributable to the release of 2003 disputed payment funds from the MSA Trustee. For the year ended December 31, 2014, total expenses were $26,281, an increase from the prior year of $300. This increase is primarily attributable to the accreted interest accrual. As a result of expenses exceeding revenues, the net position (deficit) as of the year ended December 31, 2014 was ($424,638), an increase in the deficit of $4,545 from the prior year.

FINANCIAL ANALYSIS OF NCTSC'S FUNDS

Governmental Funds

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

At December 31, 2014, NCTSC's governmental funds reported combined ending fund balances of $24,234, an increase of $865 in comparison with the prior year. Of this total, $203 constitutes unassigned fund balance, which is available for spending at NCTSC's discretion. The remainder of fund balance is non-spendable or restricted to indicate that it is not available for new spending.

General Fund

The general fund is the principal operating fund of NCTSC. At December 31, 2014 and 2013, total fund balance of the general fund was $221 and $218, respectively. The fund balance of NCTSC's general fund increased by $3 for the year ended December 31, 2014. This increase was primarily due to operating expenditures incurred throughout the year, offset by the transfer from the debt service fund.

FINANCIAL ANALYSIS OF NCTSC'S FUNDS (continued)

Debt Service Fund

The debt service fund is used to account for the proceeds of specific revenue sources and the accumulation of resources for payment of general long-term bond principal and interest that are legally restricted to expenditures for specified purposes such as funding required debt service obligations and making required transfers in accordance with the Indenture Agreement.

This fund also includes the Senior Liquidity Reserve Account. In accordance with the Indenture Agreement, the Senior Liquidity Reserve Account was fully funded at its required level of $24,009. As a result of sufficient TSRs received in April 2014, $858 was transferred to the reserve to increase the balance to the required level of the Senior Liquidity Reserve Account as of December 31, 2014.

In accordance with the Indenture, amounts on deposit in the Senior Liquidity Reserve Account will be available to pay principal and interest of the Series 2006 Bonds when due.

At December 31, 2014, total fund balance was $24,013 and is restricted to pay future debt service. The fund balance of the debt service fund increased by $862 for the year ended December 31, 2014. This increase is due to excess revenue over expenditures primarily as a result of the $858 required transfer to the Senior Liquidity Reserve. Revenues consisted solely of TSRs and interest earned on investments. Financing uses consisted of amounts transferred to the general fund from TSRs received. Expenditures include payments of interest and principal on NCTSC's outstanding bonds.

DEBT ADMINISTRATION

Debt

NCTSC's total bonded debt increased by $4,829 or 1.06% during the current year. This increase is due to the accretion of interest on outstanding bonds and amortization of bond discounts less principal paid during the year. More detailed information about NCTSC's long-term liabilities is presented in the notes to the basic financial statements.

For 2014, the aggregate Master Settlement Agreement ("MSA") receipt was 18.46% lower than the amount in 2013. This drop is due to a one-time settlement payment received by 20 settling states and territories from the tobacco companies in 2013 regarding the Non-Participating Manufacturers dispute. This decline was offset by the release of 2003 disputed payments made to the remaining states, resulting in an overall increase in TSRs, which included NCTSC.

NCTSC's bond rating, as assigned by Fitch Ratings, were affirmed during 2014, for the Series 2006A-1 Senior Bonds, due on June 1, 2021, a rating of BB+, with a negative outlook, Series 2006A-2 Senior Convertible Bonds, due June 1, 2026, a rating of B with a negative outlook, Series 2006A-3 Senior Bonds, due June 1, 2035, a rating of B with a negative outlook, Series 2006A-3 Senior Bonds, due June 1, 2046, a rating of B with a negative outlook, Series 2006B Capital Appreciation Turbo Term Bonds, due June 1, 2046, a rating of B- with a negative outlook, Series 2006C Capital Appreciation Turbo Term Bonds, due June 1, 2046, a rating of B- with a negative outlook and Series 2006D Capital Appreciation Turbo Term Bonds, due June 1, 2060, a rating of B- with a negative outlook.

The last available bond ratings, as assigned by Standard and Poor's, for the Series 2006A-1 Senior Bonds, due on June 1, 2021, is B+, Series 2006A-2 Senior Convertible Bonds, due June 1, 2026, is B-, Series 2006A-3 Senior Bonds, due June 1, 2035, is B- and Series 2006A-3 Senior Bonds, due June 1, 2046, is B- with a negative outlook.

In April 2014, NCTSC received sufficient TSRs to refund the Senior Liquidity Reserve Account to its required amount and to fund a turbo payment of $1,467 for the Tobacco Settlement Asset-Backed Bonds, Series 2006. This was due to the release of the 2003 disputed payment funds from the MSA Trustee.

FUTURE ECONOMIC FACTORS

The amount of TSRs received is dependent on many economic factors, including, but not limited to, future domestic cigarette consumption, the financial capability of the Participating Manufacturers (the "PMs"), litigation affecting the MSA and related legislation, enforcement of state legislation related to the MSA and the tobacco industry. Payments by the PMs under the MSA are subject to certain adjustments, which may be material.

ADDITIONAL FINANCIAL INFORMATION

This financial report is designed to provide NCTSC's interested parties with an overview of NCTSC's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact the Nassau County Tobacco Settlement Corporation, One West Street, 1st Floor, Mineola, New York 11501.

BASIC FINANCIAL STATEMENTS

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION
GOVERNMENT-WIDE FINANCIAL STATEMENT
STATEMENT OF NET POSITION (DEFICIT) (in thousands)
December 31, 2014

ASSETS		
Current Assets:		
Cash and cash equivalents	$	207
Prepaids		18
Total Current Assets		225
Non-Current Assets:		
Restricted investments - special reserves		24,013
Total Non-Current Assets		24,013
Total Assets		24,238
DEFFERRED OUTFLOWS OF RESOURCES		
Deferred loss on refunding		13,563
Total Deferred Outflows of Resources		13,563
LIABILITIES		
Current Liabilities:		
Accounts payable and accrued liabilities		4
Accrued interest payable		1,603
Total Current Liabilities		1,607
Non-Current Liabilities:		
Bonds payable		460,832
Total Non-Current Liabilities		460,832
Total Liabilities		462,439
NET POSITION (DEFICIT)		
Unrestricted		(424,638)
Total Net Position (Deficit)	$	(424,638)

See notes to the financial statements.

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION
GOVERNMENT-WIDE FINANCIAL STATEMENT
STATEMENT OF ACTIVITIES (in thousands)
Year Ended December 31, 2014

Expenses:		
General government support	$	122
Interest on debt		26,159
Total Expenses		26,281
General Revenues:		
Tobacco settlement revenues		21,733
Interest on investments		3
Total General Revenues		21,736
Change in Net Position (Deficit)		(4,545)
Net Position (Deficit) at Beginning of Year, as restated (See Note E)		(420,093)
Net Position (Deficit) at End of Year	$	(424,638)

See notes to the financial statements.

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION
GOVERNMENTAL FUNDS
BALANCE SHEET (in thousands)
December 31, 2014

	MAJOR FUNDS		
	General Fund	Debt Service Fund	Total Governmental Funds
ASSETS			
Cash and cash equivalents	$ 207		$ 207
Investments - restricted		$ 24,013	24,013
Prepaids	18		18
Total Assets	$ 225	$ 24,013	$ 24,238
LIABILITIES			
Accounts payable and accrued liabilities	$ 4		$ 4
Total Liabilities	4		4
FUND BALANCES			
Non-spendable:			
Prepaids	18		18
Restricted:			
Debt service		$ 24,013	24,013
Unassigned	203		203
Total Fund Balances	221	24,013	24,234
Total Liabilities and Fund Balances	$ 225	$ 24,013	$ 24,238

See notes to the financial statements.

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET POSITION (DEFICIT) (in thousands)
December 31, 2014

Total Fund Balances - Governmental Funds	$	24,234
Amounts reported for governmental activities in the statement of net position (deficit) are different because:		
Governmental funds report loss on debt refunding as an expenditure when those costs are first incurred because they require the use of current financial resources. However, loss on debt refunding must be included as a deferred outflows of resources in government-wide financial statements:		
Unamortized balance of deferred outflows of resources on loss on refunding		13,563
Long-term liabilities applicable to NCTSC's governmental activities are not due and payable in the current period and accordingly are not reported in the funds. However these liabilities are included in the statement of net position (deficit):		
Bonds payable		(460,832)
Accrued interest payable applicable to NCTSC's governmental activities are not due and payable in the current period and accordingly are not reported in the funds. However these liabilities are included in the statement of net position (deficit).		(1,603)
Net Position (Deficit) of Governmental Activities	$	(424,638)

See notes to the financial statements.

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION
GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES (in thousands)
Year Ended December 31, 2014

	MAJOR FUNDS		
	General Fund	Debt Service Fund	Total Governmental Funds
REVENUES			
Tobacco settlement revenues		$ 21,733	$ 21,733
Interest on investments		3	3
Total Revenues		21,736	21,736
EXPENDITURES			
General government support	$ 122		122
Debt service:			
Principal		1,467	1,467
Interest		19,282	19,282
Total Expenditures	122	20,749	20,871
Excess (Deficiency) of Revenues Over (Under) Expenditures	(122)	987	865
OTHER FINANCING SOURCES (USES)			
Transfers in	125		125
Transfers out		(125)	(125)
Total Other Financing Sources (Uses)	125	(125)	-0-
Net Change in Fund Balances	3	862	865
Fund Balance at Beginning of Year	218	23,151	23,369
Fund Balance at End of Year	$ 221	$ 24,013	$ 24,234

See notes to the financial statements.

NASSAU COUNTY TOBACCO SETTLEMENT CORPORATION
RECONCILIATION OF THE GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
TO THE STATEMENT OF ACTIVITIES (in thousands)
Year Ended December 31, 2014

Net Change in Fund Balances	$ 865
The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources:	
Repayment of bond principal	1,467
Governmental funds report loss on debt refunding as an expenditure when those costs are first incurred because they require the use of current financial resources. However, loss on debt refunding must be included as a deferred outflows of resources in government-wide financial statements and amortized in the statement of activities.	(590)
Bond interest is recorded as an expenditure on the fund statements when it is paid, and on the statement of activities when it is incurred.	(6,287)
Change in Net Position (Deficit) of Governmental Activities	$ (4,545)

See notes to the financial statements.

A. ORGANIZATION

The Nassau County Tobacco Settlement Corporation ("NCTSC") is a special-purpose local development corporation, and is an instrumentality of, but separate and apart from Nassau County (the "County"), New York, incorporated under the provisions of the New York State Not-For-Profit Corporation Law. Although legally separate from and independent of the County, the Corporation is considered an affiliated organization. Accordingly, the Corporation is being reported as a blended component unit for financial reporting purposes in the County's financial statements.

The Board of Directors of NCTSC has three members, one of which must meet certain requirements of independence: (i) one appointed by a majority vote of the County Legislature, (ii) one who must be the County Treasurer, ex officio, designated by the County Executive, and (iii) one selected by (i) and (ii). For the year ending December 31, 2014, one position was vacant.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of NCTSC have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") as applied to governmental units. The Governmental Accounting Standards Board ("GASB") is the accepted standard setting body for establishing governmental accounting and financial reporting principles.

The more significant of NCTSC's accounting policies are described below.

1. BASIS OF PRESENTATION

NCTSC's basic financial statements include both government-wide (reporting on NCTSC as a whole) and fund financial statements (reporting on NCTSC's most significant funds).

Government-Wide Financial Statements

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

In the government-wide statement of net position, NCTSC's governmental activities are presented on a consolidated basis and are reported on a full accrual, economic resources basis, which recognizes all long-term assets and receivables (except for TSRs as discussed in note B.2), as well as long-term debt and obligations. NCTSC's net position (deficit) is reported in two parts – restricted net position and unrestricted net position (deficit).

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

The government-wide statements focus is more on the sustainability of NCTSC as an entity and the change in NCTSC's net position (deficit) resulting from the current year's activities.

Fund Financial Statements

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

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

1. BASIS OF PRESENTATION (continued)

Fund Financial Statements (continued)

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

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

NCTSC reports the following major governmental funds:

General Fund – is the principal operating fund of NCTSC. This fund is used to account for and report all financial resources not accounted for and reported in other funds.

Debt Service Fund – is used to account for and report resources that are restricted, committed, or assigned for payment of general long-term bond principal and interest, and also includes the Senior Liquidity Reserve Account. In accordance with the Indenture Agreement, the Senior Liquidity Reserve Account was fully funded at its required level of $24,009 in 2014.

2. BASIS OF ACCOUNTING/MEASUREMENT FOCUS

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

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

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

3. ASSETS, DEFERRED OUTFLOWS/INFLOWS OF RESOURCES, LIABILITIES AND FUND EQUITY

CASH, CASH EQUIVALENTS AND INVESTMENTS

NCTSC’s cash and cash equivalents consist of demand deposits.

Investments consist of shares in an investment fund which invests in short-term U.S. Treasury securities and in repurchase agreements backed by U.S. Treasury securities and are stated at fair value.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3. ASSETS, DEFERRED OUTFLOWS/INFLOWS OF RESOURCES, LIABILITIES AND FUND EQUITY (continued)

RESTRICTED ASSETS

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

PREPAIDS

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items.

DEFERRED OUTFLOWS/INFLOWS OF RESOURCES

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflow of resources, represents a consumption of net position that is applicable to future reporting period(s) and therefore will not be recognized as an outflow of resources (expense/expenditure) until that time. NCTSC currently has one item that qualifies for reporting in this category, deferred loss on refunding.
Deferred loss on refunding is the difference between the reacquisition (refunding) price and the net carrying amount of the old debt and it is recognized as a component of interest expense over the shorter of the life of the refunded or refunding debt.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period(s) and therefore will not be recognized as an inflow of resources (revenues) until that time. NCTSC did not have any items qualifying for reporting in this category.

LONG-TERM OBLIGATIONS

In the government-wide financial statements, long-term debt obligations are reported as liabilities in the statement of net position. Debt premiums and discounts are netted against debt payable. Unamortized debt discounts are deferred and amortized over the life of the debt using the straight-line method and recognized as a component of interest expense.

In the fund financial statements, governmental fund types recognize debt premiums and discounts during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3. ASSETS, DEFERRED OUTFLOWS/INFLOWS OF RESOURCES, LIABILITIES AND FUND EQUITY (continued)

EQUITY CLASSIFICATIONS

In the government-wide statements, equity net position is displayed in one component:

Unrestricted component of net position – is the net amount of assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of any other component of net position.

When both restricted and unrestricted resources are available for use, it is NCTSC's practice to use restricted resources first, then unrestricted resources as needed.

In the fund financial statements there are five classifications of fund balance:

Non-spendable – Includes amounts that cannot be spent because they are either not in spendable form, not available within a year, or legally or contractually required to be maintained intact. Non-spendable fund balance includes prepaid expenses recorded in the general fund.

Restricted – Includes amounts with constraints placed on the use of resources either externally imposed by creditors, grantors, contributors or laws or regulations of other governments; or imposed by law through constitutional provisions or enabling legislation. Restricted fund balance includes all amounts reported in the debt service fund per the requirements of the Indenture.

Committed – Includes amounts that are subject to a purpose constraint imposed by a formal action of the NCTSC's highest level of decision-making authority. NCTSC is not empowered to establish law; accordingly NCTSC will not have committed fund balances.

Assigned – Includes amounts that are constrained by NCTSC's intent to be used for specific purposes, but are not restricted. NCTSC has no assigned fund balances as of December 31, 2014.

Unassigned – Includes all other general fund balances that do not meet the definition of the above four classifications and are deemed to be available for general use by NCTSC. It is also used to report negative fund balances in other governmental funds.

Order of Use of Restricted and Unrestricted Funds

In circumstances where an expenditure is incurred for a purpose for which amounts are available in multiple fund balance classifications, management will assess the current financial condition of NCTSC and then determine the order of application of expenditures to which fund balance classification will be charged. It is the intention of the NCTSC that the expenditure is to be spent first from the restricted fund balance to the extent appropriated by budget and then from the unrestricted fund balance. Expenditures incurred in the unrestricted fund balances shall be applied first to the assigned fund balance to the extent that there is an assignment, and then to the unassigned fund balance.

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4. REVENUES AND EXPENDITURES

TOBACCO SETTLEMENT REVENUES

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

Per the Agreement, TSRs shall be transferred directly to NCTSC. Under the MSA, amounts shall be paid by the participating manufacturers to the escrow agent on or before April 15th of each year. The escrow agent will then disburse these funds to NCTSC's Indenture Trustee. NCTSC collected $21,733 of TSRs, of which $125 was transferred to the general fund to pay operating expenses and the balance was used to pay the debt service requirements and fund the Senior Liquidity Reserve Account to the required balance.

INTERFUND TRANSACTIONS

Interfund transactions have been eliminated from the government-wide financial statements. In the funds statement, the interfund transactions include payments to the general fund to cover various operating costs and are presented as other financing sources (uses).

5. USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

6. SUBSEQUENT EVENTS

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

7. RECENT ACCOUNTING PRONOUNCEMENT

In February 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application* (GASB 72). GASB 72 addresses accounting and financial reporting issues related to fair value measurements and provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015. NCTSC has not completed the process of evaluating the impact of GASB 72.

NOTES TO FINANCIAL STATEMENTS (in thousands, unless noted)

C. DETAIL NOTES ON ALL FUNDS

1. CASH, CASH EQUIVALENTS AND INVESTMENTS

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

Deposits are required to be disclosed as exposed to custodial credit risk if they are not covered by depository insurance, and the deposits are either:

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

At December 31, 2014, NCTSC's deposit balances were $207, which were fully covered by the Federal Deposit Insurance Corporation.

At December 31, 2014, NCTSC's investments were $24,013. Investments consisted of shares of an investment fund which invests in short-term U.S. Treasury securities paying a fixed or variable interest rate and in repurchase agreements backed by U.S. Treasury securities.

At December 31, 2014, NCTSC did not have any investments subject to credit risk, interest-rate risk or concentration of credit risk.

2. DEFERRED OUTFLOWS OF RESOURCES

Deferred outflows of resources from the deferred loss on refunding are as follows for the year ended December 31, 2014.

Deferred outflows of resources from	
Loss on refunding	$ 18,869
Less accumulated amortization	(5,306)
	$ 13,563

3. INTERFUND TRANSFERS

For the year ended December 31, 2014, interfund transfers represent payments from the collections account in the debt service fund to the general fund to pay operating costs per the Indenture. Interfund transfers are stated as follows

	Transfer In	Transfer Out
General Fund	$ 125	
Debt Service Fund		$ 125
	$ 125	$ 125

C. DETAIL NOTES ON ALL FUNDS (continued)

4. LONG-TERM DEBT

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

NCTSC used the proceeds from the Series 2006 Bonds, along with other funds, to: (i) refund all of the 1999 Bonds then-currently outstanding in the aggregate principal amount of $272,125; (ii) fund a Senior Liquidity Reserve for the Series 2006 Senior Bonds of $24,009; (iii) pay the costs of issuance of the Series 2006 Bonds; (iv) fund certain projected requirements for the Operating Account; (v) fund interest on the Series 2006 Bonds through the December 1, 2007 payment; and (vi) pay certain amounts to the NCTSC Residual Trust as registered owner of the Residual Certificate. Pursuant to the Indenture, TSRs received on or after April 1, 2008, are subject to the lien of the Indenture. Interest and principal paid on these bonds in 2014 totaled $19,282 and $1,467.

Any additional revenues received above the required debt service payments are required to fund sinking fund installments and/or Turbo Redemptions. NCTSC received sufficient TSRs to fund the required debt service payment on its Series 2006 Bonds during 2014. NCTSC transferred $858 to the Senior Liquidity Reserve Account to increase the balance to the required level.

Payments with respect to the Series 2006 Bonds are dependent upon receipt of TSRs. The Series 2006 Bonds are special obligations of NCTSC payable solely from the pledged revenues, the Senior Liquidity Reserve Account, and other funds and accounts as provided in the Indenture. NCTSC has no other assets available for the payment of the Series 2006 Bonds.

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

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

NOTES TO FINANCIAL STATEMENTS (in thousands, unless noted)

C. DETAIL NOTES ON ALL FUNDS (continued)

4. LONG-TERM DEBT (continued)

A summary of changes in long-term liabilities for the year ended December 31, 2014 is as follows:

	Balance 1/1/14	Increases	Reductions	Balance 12/31/14	Due within one year	Due in more than one year
Bonds	$ 420,129		$ 1,467	$ 418,662	$ -0-	$ 418,662
Plus: accreted interest	42,632	$ 6,014		48,646		48,646
Less: bond discount	(6,758)	282		(6,476)		(6,476)
Total bonds	$ 456,003	$ 6,296	$ 1,467	$ 460,832	$ -0-	$ 460,832

Bonds outstanding at December 31, 2014, are as follows:

Description	Original Date Issued	Original Amount	Interest Rate	Maturity Date	Amount Outstanding	Amount Outstanding Including Acc. Interest
2006A1	04/05/06	$ 42,645	6.830%	6/1/2021	$ 30,273	$ 30,273
2006A2	04/05/06	37,906	5.250%	6/1/2026	37,906	44,640
2006A3(2035)	04/05/06	97,005	5.000%	6/1/2035	97,005	97,005
2006A3(2046)	04/05/06	194,535	5.125%	6/1/2046	194,535	194,535
2006B	04/05/06	10,670	5.800%	6/1/2046	10,670	17,587
2006C	04/05/06	9,867	6.000%	6/1/2046	9,867	16,542
2006D	04/05/06	37,604	6.400%	6/1/2060	37,604	65,219
2006E	04/05/06	802	7.350%	6/1/2060	802	1,507
					$ 418,662	467,308
Unamortized Bond Discount						(6,476)
						$ 460,832

The following table summarizes NCTSC's minimum future debt service requirements as of December 31, 2014:

	Principal	Interest	Total Principal and Interest
2015	$ -	$ 19,231	$ 19,231
2016	-	19,231	19,231
2017	-	19,231	19,231
2018	-	19,231	19,231
2019	-	19,231	19,231
2020-2024	30,273	88,920	119,193
2025-2029	37,906	84,351	122,257
2030-2034	-	74,101	74,101
2035-2039	97,005	52,275	149,280
2040-2044	-	49,850	49,850
2045-2049	215,072	206,383	421,455
2050-2054	-	-	-
2055-2059	-	-	-
2060	38,406	1,141,809	1,180,215
	$ 418,662	$ 1,793,844	$ 2,212,506

NOTES TO FINANCIAL STATEMENTS (in thousands, unless noted)

D. RESIDUAL TRUST

Approximately $140 million of the proceeds of the Series 2006 Bonds and unpledged TSRs were deposited into the Residual Trust, a Delaware statutory trust, on behalf of the County as the beneficial owner of the Residual Certificate. Such proceeds are held to provide monies to the County in accordance with the tax certificates executed in connection with the Series 2006 Bonds. The original 1999 purchase price paid by NCTSC to the County under the Agreement consisted of: (i) the net proceeds of the sale of the 1999 Bonds and (ii) a 100% beneficial ownership interest in the Trust. This Agreement was amended and restated as of March 1, 2006. Under the amended Agreement, TSRs received from April 5, 2006 to March 31, 2008, were not pledged to the holders of the Series 2006 Bonds and, therefore, all TSRs received during that time were transferred to the Trust on behalf of the County.

E. RESTATEMENT OF BALANCES

Management has determined a correction for errors in previously issued financial statements was necessary to:

1. Eliminate the deferral of cost from the purchase of future TSRs previously reported to be consistent with the prospective adoption of the provisions of GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* (GASB 48), by the County. In 2007, the County elected to apply the deferral provisions of GASB 48 prospectively and NCTSC, therefore, determined it should not have recognized the deferral of cost from the purchase of TSRs ($308.1 million as of December 31, 2013) as a deferred outflow of resources. The impact of this on the prior year statement of activities is a change in the increase in net deficit from $16.6 million to $6.8 million.

2. Reclassify amounts historically recorded to net position (deficit) balances to properly conform with GAAP. The reclassification restatement allocates the restricted balance to unrestricted. The restricted investment balance was funded by debt proceeds and, therefore, the asset is offset by the related debt and has no net position effect. The restatement has no effect on the statement of activities or other financial statements in prior years.

NCTSC restated fiscal year 2013 net position (deficit) as follows:

	2013 (as restated)	**2013** (as reported)
Net Position (Deficit)		
Restricted	$ -	$ 23,151
Unrestricted	(420,093)	(135,063)
Total Net Deficit	$ (420,093)	$ (111,912)

McGladrey

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
Nassau County Tobacco Settlement Corporation
Mineola, New York

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities and each major fund of Nassau County Tobacco Settlement Corporation (NCTSC), a component unit of the County of Nassau, New York, as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise NCTSC's basic financial statements, and have issued our report thereon dated May 1, 2015 and July 22, 2015 (solely for the matter disclosed in Note E.1). Our report included an emphasis of matter paragraph regarding a restatement for corrections for errors.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered NCTSC'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 NCTSC's internal control. Accordingly, we do not express an opinion on the effectiveness of NCTSC'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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. 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. We did identify a deficiency in internal control, described below, that we consider to be a significant deficiency.

Finding 2014-01

A correction of an error in previously issued financial statements was necessary to reclassify amounts historically recorded to net position balances to properly conform with accounting principles generally accepted in the United States of America ("GAAP"). The restatement allocates the restricted balance to unrestricted. The restricted investment balance was funded by debt proceeds and, therefore, the asset is offset by the related debt and has no net position effect. The restatement has no effect on the statement of activities or other financial statements in prior years.

Further, a correction of an error in previously issued financial statements was necessary to eliminate the deferral of cost from the purchase of future TSRs previously reported to be consistent with the prospective adoption of the provisions of GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* (GASB 48), by Nassau County (the "County"). In 2007, the County elected to apply the deferral provisions of GASB 48 prospectively and NCTSC, therefore, determined it should not have recognized the deferral of cost from the purchase of TSRs as a deferred outflow of resources

Management's Response
Management has reviewed the restated presentation of net position (deficit) and is in agreement with the reclassification and correction.

Compliance and Other Matters
As part of obtaining reasonable assurance about whether NCTSC'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*.

NCTSC's Response to Findings
NCTSC's response to the finding identified in our audit has been described previously. NCTSC's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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.

McGladrey LLP

New York, New York
May 1, 2015
and July 22, 2015 (solely for the matter disclosed in Note E.1)