SACRAMENTO COUNTY
TOBACCO SECURITIZATION CORPORATION
(A Component Unit of the Tobacco
Securitization Authority of Northern California)

Independent Auditor's Reports
and Basic Financial Statements

For the Year Ended June 30, 2020

MGO Certified Public Accountants

SACRAMENTO COUNTY TOBACCO SECURITIZATION CORPORATION
FOR THE YEAR ENDED JUNE 30, 2020

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Independent Auditor's Report

Board of Directors
Sacramento County Tobacco Securitization Corporation
Sacramento, California

Report on the Financial Statements

We have audited the accompanying financial statements of the Sacramento County Tobacco Securitization Corporation (Corporation), a component unit of the Tobacco Securitization Authority of Northern California, as of and for the year ended June 30, 2020, and the related notes to the financial statements, which collectively comprise the Corporation'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 an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Corporation, as of June 30, 2020, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated August 26, 2020, on our consideration of the Corporation'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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Corporation's 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 the Corporation's internal control over financial reporting and compliance.

Macias Gini & O'Connell LLP

Sacramento, California
August 26, 2020

SACRAMENTO COUNTY TOBACCO SECURITIZATION CORPORATION
STATEMENT OF NET POSITION
JUNE 30, 2020

ASSETS	
Current assets:	
Cash	$ 97,777
Tobacco settlement revenues receivable	6,977,150
Total assets	7,074,927
DEFERRED OUTFLOWS OF RESOURCES	
Tobacco settlement rights (net of accumulated amortization of $45,186,525)	190,004,642
LIABILITIES	
Current liabilities:	
Accounts payable	27,677
Noncurrent liabilities:	
Loan from Tobacco Securitization Authority of Northern California	190,004,642
Total liabilities	190,032,319
NET POSITION	
Unrestricted	$ 7,047,250

See accompanying notes to the basic financial statements.

SACRAMENTO COUNTY TOBACCO SECURITIZATION CORPORATION
STATEMENT OF REVENUES, EXPENSES, AND CHANGE IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2020

OPERATING REVENUES	
Tobacco settlement revenues	$ 13,654,018
OPERATING EXPENSES	
Fiscal charges	79,782
Operating income	13,574,236
NONOPERATING REVENUES (EXPENSES)	
Interest expense on loan from Tobacco Securitization Authority of Northern California	(13,774,445)
Contribution to Tobacco Securitization Authority of Northern California	(179,854)
Contribution from Tobacco Securitization Authority of Northern California – operating subsidy	75,000
Total nonoperating revenues (expenses)	(13,879,299)
Change in net position	(305,063)
Net position, beginning of year	7,352,313
Net position, end of year	$ 7,047,250

See accompanying notes to the basic financial statements.

SACRAMENTO COUNTY TOBACCO SECURITIZATION CORPORATION
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2020

CASH FLOW FROM OPERATING ACTIVITIES:	
Tobacco settlement revenues received	$ 16,566,191
Fiscal charges paid to vendors	(57,330)
Net cash provided by operating activities	16,508,861
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVTIES:	
Payment of interest on loan from Tobacco Securitization Authority of Northern California	(13,774,445)
Payment of principal on loan from Tobacco Securitization Authority of Northern California	(2,611,892)
Operating contribution to Tobacco Securitization Authority of Northern California	(179,854)
Operating subsidy from Tobacco Securitization Authority of Northern California	75,000
Net cash used for noncapital financial activities	(16,491,191)
Net increase in cash	17,670
Cash, beginning of year	80,107
Cash, end of year	$ 97,777

Reconciliation of operating income to net cash provided by operating activities:	
Operating income	$ 13,574,236
Adjustments to reconcile operating income to net cash provided by operating activities	
Change in:	
Tobacco settlement revenues receivable	300,281
Tobacco settlement rights	2,611,892
Accounts payable	22,452
Net cash provided by operating activities	$ 16,508,861

See accompanying notes to the basic financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

<u>Reporting Entity</u>

Sacramento County Tobacco Securitization Corporation (the Corporation) was incorporated August 21, 2001. It is a nonprofit public benefit organization as defined by *Internal Revenue Code* Section 501(c)(3).

The purpose of the Corporation is to purchase from the County of Sacramento (County) its rights to receive tobacco settlement revenues, borrow monies necessary to pay the purchase price for such tobacco settlement revenues, secure such borrowing with the tobacco settlement revenues, receive tobacco settlement revenues and residual payments regarding tobacco settlement revenues of the County, and invest monies, incur expenses and otherwise distribute money for the benefit of the County and its residents.

The Corporation meets the criteria set forth in accounting principles generally accepted in the United States of America for inclusion as a blended component unit of the Tobacco Securitization Authority of Northern California (the Tobacco Authority) because of the financial benefit/burden relationship of their activities. The Corporation obtained its funding to purchase from the County its rights to receive tobacco settlement revenues via a loan from the Authority.

<u>Basis of Presentation and Accounting</u>

The Corporation prepares its financial statements on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this method, revenues are recorded when earned and expenses are recorded when liabilities are incurred.

Operating revenues and expenses are distinguished from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the principal ongoing operations. The principal operating revenues of the Corporation are tobacco settlement revenues. Operating expenses consist of fiscal charges. Contribution from the Authority is reported as a nonoperating revenue and interest expense on the loan from the Authority and contribution to the Authority are reported as nonoperating expenses. Because annual tobacco settlement revenues are based on cigarette sales from the preceding calendar year, the Corporation accrues an estimate of tobacco settlement revenues derived from sales from January 1 to the fiscal year-end.

<u>Deferred Outflows of Resources</u>

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 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. The Corporation only has one item that qualifies for reporting in this category. It is the Tobacco Settlement Rights reported in the Statement of Net Position.

<u>Use of Estimates</u>

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 certain reported financial statement amounts and disclosures. Actual results could differ from those estimates.

<u>Income Taxes</u>

The Corporation is a tax-exempt corporation under section 501(c)(3) of the *Internal Revenue Code*.

NOTE 2 – CASH

The Corporation maintains a separate checking account in the name of the Corporation. At June 30, 2020, the reported amount of the Corporation's deposits and bank balance is $97,777, which is entirely covered by federal depository insurance.

NOTE 3 – TOBACCO SETTLEMENT RIGHTS

In November 1998, 46 states (including California), six other United States jurisdictions, and participating cigarette manufactures entered into a Master Settlement Agreement (the MSA) in settlement of certain cigarette smoking litigation. The MSA calls for the cigarette manufacturers to make annual payments to the settling states, beginning in 2000, and continuing in perpetuity. The State of California entered into a separate Memorandum of Understanding (the MOU) with all California counties and certain affected cities regarding the distribution and use of the State's share of Tobacco Settlement Revenues (TSRs). The MOU calls for 45% of the State's allocation to be distributed to the counties and certain affected cities based on population.

During the year ended June 30, 2002, the County entered into a purchase and sales agreement with the Corporation, a separate legal entity, whereby the County sold its rights, title, and interest in, to, and under the MSA and the MOU to the Corporation in exchange for cash consideration of $171,965,922. At the same time, the Corporation also entered into a loan agreement with the Tobacco Authority to borrow the funds necessary to purchase those rights from the County. In return, the Corporation is obligated to pay all TSRs it receives to the Authority.

During the year ended June 30, 2006, the Corporation was able to borrow an additional $63,225,245 from the Authority as a result of the issuance of the 2005 Tobacco Securitization Refunding Bonds. These funds were granted by the Corporation to the County in accordance with a grant agreement dated November 15, 2005. The outstanding loan balance is $190,004,642 at June 30, 2020.

The obligation to the Authority is limited to the Corporation's interest in the Tobacco Settlement Rights. The unamortized Tobacco Settlement Rights, reported as deferred outflows of resources is $190,004,642 at June 30, 2020.

NOTE 4 – LOAN FROM TOBACCO SECURITAZION AUTHORITY OF NORTHERN CALIFORNIA

The following summarizes the long-term debt activity during the year:

	Balance July 1, 2019	Additions	Retirements	Balance June 30, 2020
Loan from Tobacco Securitization Authority of Northern California	$ 192,616,534	$ -	$ (2,611,892)	$ 190,004,642

The Corporation has direct borrowings totaling $190,004,642, which represents all of the Corporation's long-term debt. The outstanding loan from the Tobacco Authority is secured by Corporation Tobacco Assets as defined in the secured loan agreement.

NOTE 5 – CONTINGENCIES AND CONCENTRATION OF RISK

The Corporation purchased the County's rights to receive TSRs from the State of California (State). There are a number of risks associated with receipts of such TSRs, including litigation affecting the participating manufacturers and possible bankruptcy as a result thereof, increased growth of non-participating manufacturer's market share, a decline in cigarette consumption materially beyond forecasted levels, reduction in investment earnings due to unforeseen market conditions, and future adjustments to the calculation of the TSRs.

The Corporation's financial existence is contingent upon receiving the TSRs from the State. The risk of non-collection of the TSRs is considered remote; however, no assurance can be given as to the timing of the collections of TSRs. No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2005 Bonds will be as assumed, or that the other assumptions underlying the bond structuring assumptions, including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the bond structuring assumptions, the amount of TSRs available to make Turbo Redemption Payments will be affected and the resulting weighted average lives of the Turbo Term Bonds will vary. Any reinvestment risks from faster amortization or extension risks from slower amortization of the Series 2005 Term Bonds than anticipated will be borne entirely by the Holders of the Turbo Term Bonds. In addition, future increases in the rate of inflation above 3% per annum in the absence of other factors would materially shorten the life of the Series 2005 Bonds. No assurance can be given that these structuring assumptions, upon which the projections of the Series 2005 Bonds Turbo Redemptions are based, will be realized.

NOTE 6 – RISK MANAGEMENT

The Corporation is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, for which the Corporation purchases commercial insurance.

During the year ended June 30, 2020, the Corporation did not reduce insurance coverage from coverage levels in place as of June 30, 2019. There have been no insurance settlements or claims during 2018, 2019, and 2020.

NOTE 7 – FUTURE ACCOUNTING PRONOUNCEMENTS

The Governmental Accounting Standards Board (GASB) releases new accounting and financial reporting standards which may have a significant impact on the Corporation’s financial reporting process. Future new standards which may impact the Corporation include the following:

GASB Statement No. 84 – In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*. The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. This Statement is effective for reporting periods beginning after December 15, 2019, or the 2020-2021 fiscal year, as postponed by GASB Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*. The Corporation has determined that there is no effect on its financial statements.

NOTE 7 – FUTURE ACCOUNTING PRONOUNCEMENTS (Continued)

GASB Statement No. 87 – In June 2017, GASB issued Statement No. 87 – *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. This Statement is effective for reporting periods beginning after June 15, 2021, or the 2021-2022 fiscal year, as postponed by GASB Statement No. 95. The Corporation has determined that there is no effect on its financial statements.

GASB Statement 90 – In August 2018, GASB issued Statement No. 90, *Majority Equity Interests–An Amendment of GASB Statements No. 14 and No. 61*. The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. This Statement is effective for reporting periods beginning after December 15, 2019, or the 2020-2021 fiscal year, as postponed by GASB Statement No. 95. The Corporation has determined that there is no effect on its financial statements.

GASB Statement No. 91 – In May 2019, GASB issued Statement No. 91, Conduit Debt Obligations. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement is effective for reporting periods beginning after December 15, 2021, or the 2022-2023 fiscal year, as postponed by GASB Statement No. 95. The Corporation has determined that there is no effect on its financial statements.

GASB Statement No. 92 – In January 2020, GASB issued Statement No. 92, *Omnibus 2020*. The primary objectives of this Statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics and includes specific provisions about the following: (1) The effective date of Statement No. 87, *Leases*, and Implementation Guide No. 2019-3, *Leases*, for interim financial reports; (2) reporting of intra-entity transfers of assets between a primary government employer and a component unit defined benefit pension plan or defined benefit other postemployment benefit (OPEB) plan; (3) the applicability of Statements No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, as amended, and No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, to reporting assets accumulated for postemployment benefits; (4) the applicability of certain requirements of Statement No. 84, *Fiduciary Activities*, to postemployment benefit arrangements; (5) measurement of liabilities (and assets, if any) related to asset retirement obligations (AROs) in a government acquisition; (6) reporting by public entity risk pools for amounts that are recoverable from reinsurers or excess insurers; (7) reference to nonrecurring fair value measurements of assets or liabilities in authoritative literature; and (8) terminology used to refer to derivative instruments. This Statement is effective for reporting periods beginning after June 15, 2021, or the 2021–2022 fiscal year, as postponed by GASB Statement No. 95. The Corporation has determined that there is no effect on its financial statements.

NOTE 7 – FUTURE ACCOUNTING PRONOUNCEMENTS (Continued)

GASB Statement No. 93 – In March 2020, GASB issued Statement No. 93, *Replacement of Interbank Offered Rates*. The primary objectives of this Statement is to address those and other accounting and financial reporting implications that result from the replacement of an IBOR (Interbank Offered Rate). The removal of London Interbank Offered Rate (LIBOR) as an appropriate benchmark interest rate is effective for reporting periods ending after December 31, 2021, or the 2022-2023 fiscal year. All other requirements of this Statement are effective for reporting periods beginning after June 15, 2021, or the 2021-2022 fiscal year, as postponed by GASB Statement No. 95. The Corporation has determined that there is no effect on its financial statements.

GASB Statement No. 94 – In March 2020, GASB issued Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements (PPPs). A PPP is an arrangement in which a government (the transferor) contracts with an operator (a governmental or nongovernmental entity) to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital asset, for a period of time in an exchange or exchange-like transaction. This Statement is effective for reporting periods beginning after June 15, 2022, or the 2022-2023 fiscal year. The Corporation has determined that there is no effect on its financial statements.

GASB Statement No. 96 – In May 2020, GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. The primary objective of this Statement is to provide guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset – an intangible asset – and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. This Statement is effective for reporting periods beginning after June 15, 2022, or the 2022-2023 fiscal year. The Corporation has determined that there is no effect on its financial statements.

GASB Statement No. 97 – In June 2020, GASB issued statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans – An Amendment of GASB Statements No. 14 and No. 84, and a Supersession of GASB Statement No. 32*. The primary objectives of this Statement are to (1) increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which a potential component unit does not have a governing board and the primary government performs the duties that a governing board typically would perform; (2) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution other postemployment benefit (OPEB) plans, and employee benefit plans other than pension plans or OPEB plans (other employee benefit plans) as fiduciary component units in fiduciary fund financial statements; and (3) enhance the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans. This Statement is effective for reporting periods beginning after June 15, 2021, or the 2021-2022 fiscal year. The Corporation has determined that there is no effect on its financial statements.

NOTE 8 – COVID-19

In March 2020, the World Health Organization declared coronavirus COVID-19 a global pandemic. This contagious disease outbreak, which has continued to spread, and any related adverse public health developments, has adversely affected workforces, customers, economies, and financial markets globally. Due to the nature of the Corporation's operation, there was no impact of COVID-19 on the Corporation's financial statements, nor is it anticipated to impact the Corporation in the future.

OTHER REPORT

MGO 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*

Board of Directors
Sacramento County Tobacco Securitization Corporation
Sacramento, California

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 Sacramento County Tobacco Securitization Corporation (the Corporation), a component unit of the Tobacco Securitization Authority of Northern California, as of and for the year ended June 30, 2020, and the related notes to the financial statements, which collectively comprise the Corporation's basic financial statements, and have issued our report thereon dated August 26, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Corporation'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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of the Corporation'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 the Corporation'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.

Macias Gini & O'Connell LLP

Sacramento, California
August 26, 2020