

**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, 2024



Certified
Public
Accountants

SACRAMENTO COUNTY TOBACCO SECURITIZATION CORPORATION
(A Component Unit of the Tobacco Securitization Authority of Northern California)
For the Year Ended June 30, 2024

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Independent Auditor's Report

Board of Directors
Sacramento County Tobacco Securitization Corporation
Sacramento, California

Report on the Audit of the Financial Statements

Opinion

We have audited the 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, 2024, and the related notes to the financial statements, which collectively comprise the Corporation's basic financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of the Corporation, as of June 30, 2024, and the changes in financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States (*Government Auditing Standards*). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Corporation, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management 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, and 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Corporation's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we

- exercise professional judgment and maintain professional skepticism throughout the audit.
- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- obtain an understanding of internal control relevant to the audit 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 Corporation's internal control. Accordingly, no such opinion is expressed.
- evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- conclude whether, in our judgement, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Corporation's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Required Supplementary Information

Management has omitted the 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 September 3, 2024, 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
September 3, 2024

SACRAMENTO COUNTY TOBACCO SECURITIZATION CORPORATION
(A Component Unit of the Tobacco Securitization Authority of Northern California)
Statement of Net Position
For the Year Ended June 30, 2024

ASSETS

Current assets:

Cash	\$ 28,768
Tobacco settlement revenues receivable	<u>6,895,044</u>

Total assets	<u>6,923,812</u>
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DEFERRED OUTFLOWS OF RESOURCES

Tobacco settlement rights (net of accumulated amortization of \$70,662,952)	<u>157,136,930</u>
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LIABILITIES

Current liabilities:

Accounts payable	21,516
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Noncurrent liabilities:

Loan from Tobacco Securitization Authority of Northern California	157,136,930
Arbitrage Rebate Tax	<u>199,152</u>

Total liabilities	<u>157,357,599</u>
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NET POSITION

Unrestricted	<u>\$ 6,703,144</u>
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See accompanying notes to the basic financial statements.

SACRAMENTO COUNTY TOBACCO SECURITIZATION CORPORATION
(A Component Unit of the Tobacco Securitization Authority of Northern California)
Statement of Revenues, Expenses and Change in Net Position
For the Year Ended June 30, 2024

OPERATING REVENUES

Tobacco settlement revenues	\$ 12,953,634
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OPERATING EXPENSES

Fiscal charges	<u>122,777</u>
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Operating income	<u>12,830,857</u>
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NONOPERATING REVENUES (EXPENSES)

Interest expense on loan from Tobacco Securitization Authority of Northern California	(13,660,135)
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Contribution to Tobacco Securitization Authority of Northern California	(129,953)
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Arbitrage Rebate Tax	(199,152)
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Contribution from Tobacco Securitization Authority of Northern California – operating subsidy	<u>106,000</u>
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Total nonoperating expenses, net	<u>(13,883,240)</u>
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Change in net position	(1,052,383)
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Net position, beginning of year	<u>7,755,527</u>
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Net position, end of year	<u><u>\$ 6,703,144</u></u>
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See accompanying notes to the basic financial statements.

SACRAMENTO COUNTY TOBACCO SECURITIZATION CORPORATION
(A Component Unit of the Tobacco Securitization Authority of Northern California)
Statement of Cash Flows
For the Year Ended June 30, 2024

CASH FLOW FROM OPERATING ACTIVITIES:

Tobacco settlement revenues received	\$ 21,181,372
Payments to vendors	<u>(112,824)</u>
Net cash provided by operating activities	<u>21,068,548</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:

Payment of interest on loan from Tobacco Securitization Authority of Northern California	(13,660,135)
Payment of principal on loan from Tobacco Securitization Authority of Northern California	(7,391,284)
Operating contribution to Tobacco Securitization Authority of Northern California	(129,953)
Operating subsidy from Tobacco Securitization Authority of Northern California	<u>106,000</u>
Net cash used for noncapital financial activities	<u>(21,075,372)</u>
Net decrease in cash	(6,824)
Cash, beginning of year	<u>35,592</u>
Cash, end of year	<u>\$ 28,768</u>

Reconciliation of operating income to net cash provided by operating activities:

Operating income	\$ 12,830,857
Adjustments to reconcile operating income to net cash provided by operating activities	
Change in:	
Tobacco settlement revenues receivable	836,454
Tobacco settlement rights	7,391,284
Accounts payable	<u>9,953</u>
Net cash provided by operating activities	<u>\$ 21,068,548</u>

Noncash investing, capital and financing activities:

Arbitrage Rebate Tax	\$ 199,152
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See accompanying notes to the basic financial statements.

SACRAMENTO COUNTY TOBACCO SECURITIZATION CORPORATION
(A Component Unit of the Tobacco Securitization Authority of Northern California)
Notes to the Basic Financial Statements
For the Year Ended June 30, 2024

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Sacramento County Tobacco Securitization Corporation (the Corporation) was incorporated August 21, 2001, as 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 (Authority) because of the financial benefit/burden relationship of their activities, and the voting majority of the Authority's board is the same as the Corporation's board. The Corporation obtained its funding to purchase from the County its rights to receive tobacco settlement revenues through a loan from the Authority.

Basis of Presentation and Accounting

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.

SACRAMENTO COUNTY TOBACCO SECURITIZATION CORPORATION
(A Component Unit of the Tobacco Securitization Authority of Northern California)
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2024

**NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Deferred Outflows 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 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, which is the Tobacco Settlement Rights reported in the Statement of Net Position.

Net Position

The Corporation utilizes a net position presentation. Net position is categorized as net investment in capital assets, restricted and unrestricted. The Corporation's net position is reported as unrestricted.

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

Income Taxes

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

NOTE 2 – CASH

Cash in the amount of \$28,768 consists of cash in a separate checking account in the name of the Corporation.

Deposits

Custodial credit risk is the risk that, in the event of failure of a depository financial institution, the Corporation will not be able to receive its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Corporation does not have a deposit policy for custodial credit risk. The bank balance for the Corporation's deposit (cash in checking account) was \$28,768 at June 30, 2024 and is covered by federal depository insurance.

SACRAMENTO COUNTY TOBACCO SECURITIZATION CORPORATION
(A Component Unit of the Tobacco Securitization Authority of Northern California)
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2024

NOTE 3 – TOBACCO SETTLEMENT RIGHTS

In November 1998, 46 states (including California), six other United States jurisdictions, and participating cigarette manufacturers 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 (State) 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 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 \$157,136,930 at June 30, 2024.

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 \$157,136,930 at June 30, 2024.

NOTE 4 – LOAN FROM TOBACCO SECURITAZION AUTHORITY OF NORTHERN CALIFORNIA

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

	Balance July 1, 2023	Additions	Retirements	Balance June 30, 2024
Loan from Tobacco Securitization Authority of Northern California	\$ 164,528,214	\$ -	\$ (7,391,284)	\$ 157,136,930

The Corporation has direct borrowings totaling \$157,136,930, which represents all of the Corporation's long-term debt. The outstanding loan from the Authority is secured by the Corporation's Tobacco Assets as defined in the secured loan agreement.

SACRAMENTO COUNTY TOBACCO SECURITIZATION CORPORATION
(A Component Unit of the Tobacco Securitization Authority of Northern California)
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2024

NOTE 4 – LOAN FROM TOBACCO SECURITIZATION AUTHORITY OF NORTHERN CALIFORNIA (CONTINUED)

Arbitrage Liability

Arbitrage is earned when the proceeds of a tax-exempt or tax-advantaged bond issue are used to acquire investments that earn a yield in excess of the bond yield (or arbitrage yield), the average yield issuers pay to their bondholders. Liabilities are measured by computing the excess amount earned on investments over the amount that would have been earned if proceeds were invested at the bond yield. Unless the issuer can apply an exception or exemption to the arbitrage rebate and yield restriction requirements, excess earnings must be rebated to the Internal Revenue Service (IRS). At a minimum, the arbitrage rebate and yield restriction liabilities on an issue must be computed at least every five years and on the final redemption or maturity date.

The allowable yield for the Tobacco Settlement Asset-Backed Refunding Bonds, Series 2021 Senior Bonds (Bonds) is 2.448887%. For the period February 18, 2021 through May 31, 2024, the return on investments for the Bonds was 3.221485%, which produced an excess yield of 0.772597% for the period. As of June 30, 2024 the Cumulative Arbitrage Rebate Liability was \$199,152.

NOTE 5 – CONTINGENCIES AND CONCENTRATION OF RISK

The Corporation purchased the County's rights to receive TSRs from the 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 the TSRs. No assurance can be given that actual cigarette consumption in the United States during the term of the Authority's Series 2021 Refunding 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 2021 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 2021 Refunding Bonds. No assurance can be given that these structuring assumptions, upon which the projections of the Series 2021 Refunding 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.

SACRAMENTO COUNTY TOBACCO SECURITIZATION CORPORATION
(A Component Unit of the Tobacco Securitization Authority of Northern California)
Notes to the Basic Financial Statements (Continued)
For the Year Ended June 30, 2024

NOTE 6 – RISK MANAGEMENT (CONTINUED)

During the year ended June 30, 2024, the Corporation did not reduce insurance coverage from coverage levels in place as of June 30, 2023. There have been no insurance settlements or claims during the years ended June 30, 2024, 2023, and 2022.

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. 101 – In June 2022, GASB issued Statement No. 101, *Compensated Absences*. The objective of this Statement is to better meet the information needs of financial statement users by updating the recognition and measurement guidance for compensated absences. This Statement is effective for reporting period beginning after December 15, 2023 or the 2024-2025 fiscal year. The Corporation has determined that there is no effect on its financial statements.

GASB Statement No. 102 – In December 2023, GASB issued Statement No. 102, *Certain Risk Disclosures*. The objective of this Statement is to provide users of government financial statements with essential information about risks related to a government's vulnerabilities due to certain concentrations or constraints. This Statement defines a *concentration* as a lack of diversity related to an aspect of a significant inflow of resources or outflow of resources. A *constraint* is a limitation imposed on a government by an external party or by formal action of the government's highest level of decision-making authority. Concentrations and constraints may limit a government's ability to acquire resources or control spending. This Statement requires a government to assess whether a concentration or constraint makes the primary government reporting unit or other reporting units that report a liability for revenue debt vulnerable to the risk of a substantial impact. Additionally, this Statement requires a government to assess whether an event or events associated with a concentration or constraint that could cause the substantial impact have occurred, have begun to occur, or are more likely than not to begin to occur within 12 months of the date the financial statements are issued. The requirements of this Statement are effective for fiscal years beginning after June 15, 2024, or the 2024-2025 fiscal year. The Corporation has not determined the effect, if any, on the financial statements.

GASB issued Statement No. 103, *Financial Reporting Model Improvements*. The objective of this Statement is to improve key components of the financial reporting model to enhance its effectiveness in providing information that is essential for decision making and assessing a government's accountability. This Statement also addresses certain application issues: (1) Management's Discussion and Analysis, (2) Unusual or Infrequent Items, (3) Presentation of the Proprietary Fund Statement of Revenues, (4) Expenses, and Changes in Fund Net Position, (5) Major Component Unit Information, and (6) Budgetary Comparison Information. The requirements of this Statement are effective for fiscal years beginning after June 15, 2025, or the 2025-2026 fiscal year. The Corporation has not the determined the effect, if any, on the financial statements.

OTHER REPORT

**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 (*Government Auditing Standards*), 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, 2024, and the related notes to the financial statements, which collectively comprise the Corporation's basic financial statements, and have issued our report thereon dated September 3, 2024.

Report on 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) as a basis for designing 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 or significant deficiencies may exist that have not been identified.

Report on 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 financial statements. 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.

A handwritten signature in black ink that reads "Macias Gini E' O'Connell LPA". The signature is written in a cursive, flowing style.

Sacramento, California
September 3, 2024