

**NIAGARA TOBACCO ASSET
SECURITIZATION CORPORATION**
(A Component Unit of the County of Niagara, New York)

*Basic Financial Statements and Required
Supplementary Information for the
Year Ended December 31, 2010
And Independent Auditors' Reports*

NIAGARA TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Niagara, New York)
Table of Contents
Year Ended December 31, 2010

	Page
Independent Auditors' Report	1
Management's Discussion and Analysis (MD&A)	3
Basic Financial Statements:	
Government-wide Financial Statements:	
Statement of Net Assets (Deficit)	10
Statement of Activities.....	11
Fund Financial Statements:	
Balance Sheet—Governmental Funds and Reconciliation of the Balance Sheet of Governmental Funds to the Statement of Net Assets (Deficit)	12
Statement of Revenues, Expenditures and Changes in Fund Balances—Governmental Funds	13
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities.....	14
Notes to the Financial Statements	15
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	23



Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Niagara Tobacco Asset Securitization Corporation

We have audited the accompanying financial statements of the governmental activities and each major fund of the Niagara Tobacco Asset Securitization Corporation (the "NTASC"), a component unit of the County of Niagara, New York, as of and for the year ended December 31, 2010, which collectively comprise NTASC's basic financial statements as listed in the foregoing table of contents. These financial statements are the responsibility of the NTASC's management. 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of NTASC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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 NTASC, at December 31, 2010, and the respective changes in financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 22, 2011, on our consideration of the NTASC's internal control over financial reporting and 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis on pages 3 through 9 is not a required part of the basic financial statements, but is supplementary information required by the accounting principles generally accepted in the United States of America. This supplementary information is the responsibility of NTASC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Dwight S. Mahan LLP

March 22, 2011

NIAGARA TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Niagara, New York)
Management's Discussion and Analysis
Year Ended December 31, 2010

As management of the Niagara Tobacco Asset Securitization Corporation ("NTASC"), a blended component unit of the County of Niagara (the "County"), we offer readers of NTASC's financial statements this narrative overview and analysis of the financial activities of NTASC for the fiscal year ended December 31, 2010. We encourage readers to consider the information presented here in conjunction with additional information contained in the financial statements and notes to the financial statements. All amounts, unless otherwise indicated, are expressed in dollars.

Financial Highlights

- ◆ Total government-wide liabilities of NTASC exceeded government-wide assets by \$59,399,264 at December 31, 2010. This compares to total government-wide liabilities of NTASC exceeding government-wide assets by \$58,675,377 at December 31, 2009.
- ◆ NTASC's net assets decreased by \$723,887, which increased its net deficit, for the year ended December 31, 2010. The increase in NTASC's net deficit was largely due to the declining cigarette sales which may be attributed to the increase in cigarette taxes.

Overview of the Financial Statements

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

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

The *statement of net assets* presents information on all NTASC's assets and liabilities, assets denote resources available to continue the operations of NTASC, while liabilities indicate how much NTASC owes lending institutions. The difference between the two is reported as *net assets (deficit)*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of NTASC is improving or deteriorating.

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

The government-wide financial statements can be found on pages 10-11 of this report.

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

Governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

NTASC maintains two individual governmental funds, the General Fund and the Debt Service Fund. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balance for the both funds.

The basic governmental fund financial statements can be found on pages 12-14 of this report.

Notes to the financial statement. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 15-21 of this report.

Financial Analysis

As noted earlier, net assets (deficit) may serve over time as a useful indicator of a government's financial position. In the case of NTASC, liabilities exceeded assets by \$59,399,264 at December 31, 2010, as compared to \$58,675,377 at December 31, 2009. Table 1, shown below, presents the condensed statements of net assets (deficit) for NTASC at December 31, 2010 and December 31, 2009.

Table 1—Condensed statements of net assets (deficit)

	December 31,	
	2010	2009
Current assets	\$ 4,706,113	\$ 5,252,363
Total assets	<u>4,706,113</u>	<u>5,252,363</u>
Current liabilities	1,155,740	1,131,573
Noncurrent liabilities	<u>62,949,637</u>	<u>62,796,167</u>
Total liabilities	<u>64,105,377</u>	<u>63,927,740</u>
Net assets (deficit)	<u>\$ (59,399,264)</u>	<u>\$ (58,675,377)</u>

At December 31, 2010, total NTASC assets were \$4,706,113; and, \$5,252,363 at December 31, 2009. The largest asset held by NTASC for both years was cash and cash equivalents. NTASC had no noncurrent assets at December 31, 2010 and December 31, 2009.

NTASC's liabilities totaled \$64,105,177 at December 31, 2010; and, \$63,927,740 at December 31, 2009. The largest portion of the liabilities is outstanding debt, net of related issuance costs, totaling \$63,769,637 and \$63,586,167 at December 31, 2010 and 2009, respectively.

NTASC had a favorable current ratio of 4.1 at December 31, 2010 and 4.6 at December 31, 2009; such a ratio implies that NTASC has sufficient assets on hand to cover its liabilities that will come due in the coming year. Table 2, below, presents the current ratio for NTASC at December 31, 2010 and December 31, 2009.

Table 2—Current assets and current liabilities

	December 31,	
	2010	2009
Current assets	\$4,706,113	\$5,252,363
Current liabilities	1,155,740	1,131,573
Ratio of current assets to current liabilities	4.1	4.6

The statement of revenues, expenses and changes in net assets (deficit) presents revenues received and expenses paid by NTASC. Presented as Table 3, is the condensed statement of revenues, expenses and changes in net assets for the years ended December 31, 2010 and 2009.

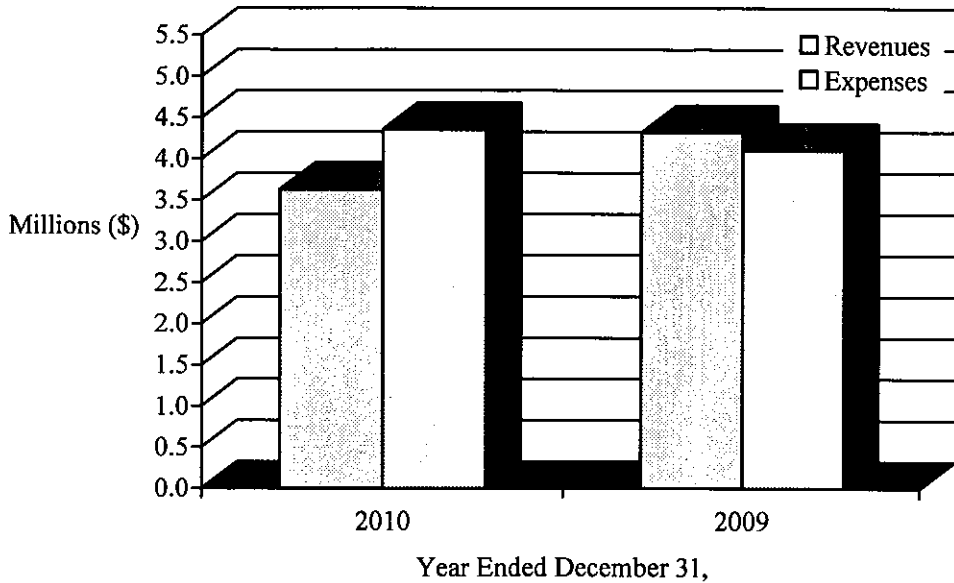
Table 3—Condensed statements of revenues, expenses and changes in net assets (deficit)

	Year Ended December 31,	
	2010	2009
General revenues	\$ 3,630,804	\$ 4,319,042
Expenses—governmental activities	<u>(4,354,691)</u>	<u>(4,100,230)</u>
Change in net assets	(723,887)	218,812
Net assets (deficit)—beginning	<u>(58,675,377)</u>	<u>(58,894,189)</u>
Net assets (deficit)—ending	<u>\$ (59,399,264)</u>	<u>\$ (58,675,377)</u>

General revenues are received from the tobacco settlement and from investments. Expenses—governmental activities, are those expenses associated with meeting debt service requirements and the administrative and maintenance costs associated with operating NTASC.

As shown below in Figure 1, operating revenues for the year ended December 31, 2010 decreased 15.9% from the year ended December 31, 2009, while operating expenses increased by 6.2% from the year ended December 31, 2009.

Figure 1—Comparison of operating revenues and operating expenses



A summary of sources of revenues for the years ended December 31, 2010 and December 31, 2009 is presented below in Table 4.

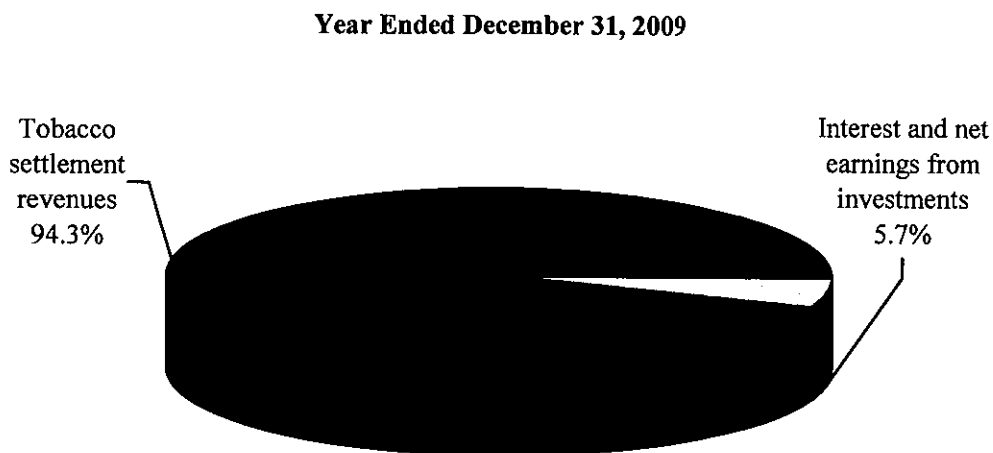
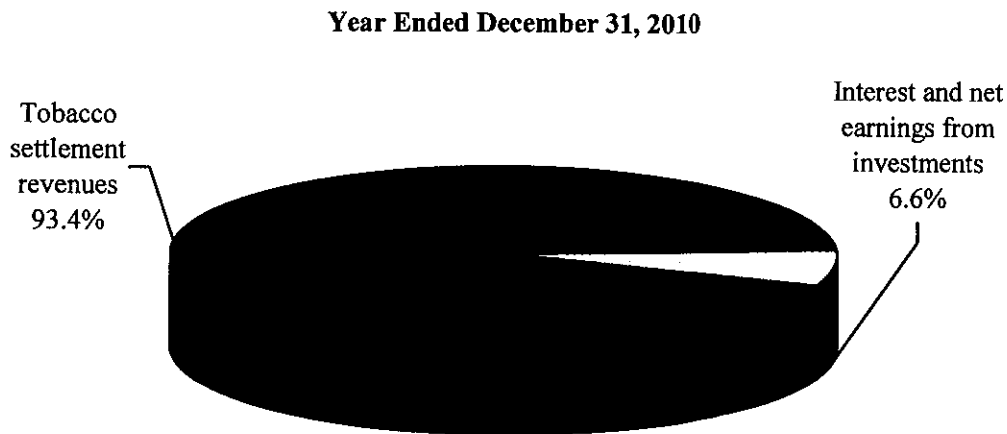
Table 4—Sources of revenues

	Year Ended December 31,		Dollar Change	Percentage Change
	2010	2009		
Tobacco settlement revenues	\$ 3,389,648	\$ 4,073,112	\$ (683,464)	(16.8)%
Interest and net earnings from investments	241,156	245,930	(4,774)	(1.9)%
Total revenues	<u>\$ 3,630,804</u>	<u>\$ 4,319,042</u>	<u>\$ (688,238)</u>	(15.9)%

For the year ended December 31, 2010, overall operating revenues decreased by 15.9%, which was due to a decrease of 16.8% in tobacco settlement revenues offset by a decrease in interest and net earnings from investments.

As presented in Figure 2, below, the most significant source of revenue, for both years, was tobacco settlement revenues, which was 93.4% and 94.3% of total revenues for the years ended December 31, 2010 and 2009, respectively. The next largest source of revenue each year was interest and net earnings from investments which comprised 6.6% and 5.7% of total revenues in the years ended December 31, 2010 and December 31, 2009, respectively.

Figure 2—Components of revenue



A summary of operating expenses for the years ended December 31, 2010 and December 31, 2009 is presented below in Table 5.

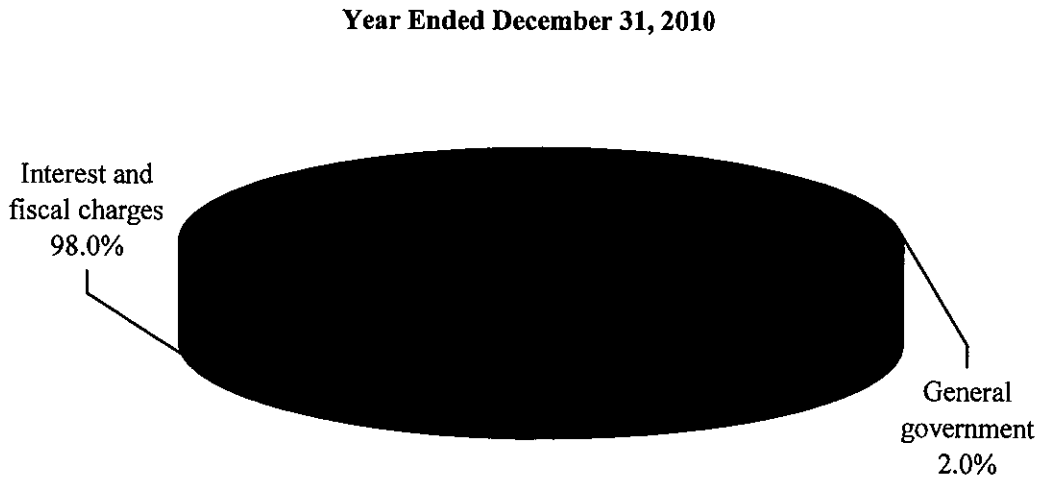
Table 5—Operating expenses

	December 31,		Dollar Change	Percentage Change
	2010	2009		
General government	\$ 79,534	\$ 82,244	\$ (2,710)	(3.3)%
Interest and fiscal charges	<u>4,275,157</u>	<u>4,017,986</u>	<u>257,171</u>	6.4 %
Total operating expenses	<u>\$ 4,354,691</u>	<u>\$ 4,100,230</u>	<u>\$ 254,461</u>	6.2 %

NTASC total operating expenses for the year ended December 31, 2010, increased by 6.2% from the previous year. The increase was primarily due to an increase in interest and fiscal charges paid on long term debt.

As presented in Figure 3, NTASC's most significant expense items are interest and fiscal charges and general government, which comprised 98.0% and 2.0%, respectively, of total expenses for both the year ended December 31, 2010 and the year ended December 31, 2009.

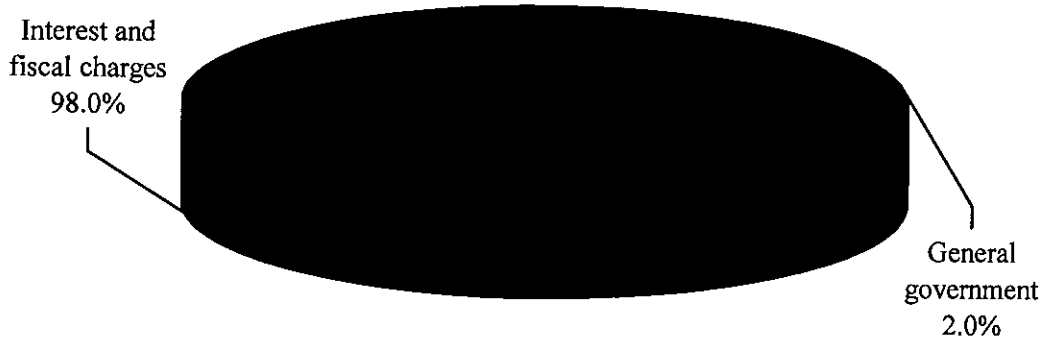
Figure 3—Components of total operating expenses



(continued)

(concluded)

Year Ended December 31, 2009



Request for Information

This financial report is designed to provide a general overview of NTASC's finances for all those with an interest in NTASC's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Niagara Tobacco Asset Securitization Corporation Secretary/Treasurer, 175 Hawley Street, Lockport, New York, 14094-2740.

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BASIC FINANCIAL STATEMENTS

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NIAGARA TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Niagara, New York)
Statement of Net Assets (Deficit)
December 31, 2010

	<u>Governmental Activities</u>
ASSETS	
Cash and cash equivalents	\$ 4,706,113
Total assets	<u>4,706,113</u>
 LIABILITIES	
Current liabilities:	
Accrued interest payable	335,740
Noncurrent liabilities:	
Due within one year—bonds	820,000
Due in more than one year—bonds	41,635,000
Subordinate Turbo CABs payable, net of related bond issuance costs	<u>21,314,637</u>
Total liabilities	<u>64,105,377</u>
 NET ASSETS (DEFICIT)	
Restricted	4,403,095
Unrestricted	<u>(63,802,359)</u>
Total net assets (deficit)	<u>\$ (59,399,264)</u>

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

NIAGARA TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Niagara, New York)
Statement of Activities
Year Ended December 31, 2010

Functions/Programs	Expenses	Program Revenues	Net (Expenses) and Changes in Net Asset
Governmental activities:			
General government support	\$ 79,534	\$ -	\$ (79,534)
Interest and fiscal charges	<u>4,275,157</u>	<u>-</u>	<u>(4,275,157)</u>
Total governmental activities	<u>4,354,691</u>	<u>-</u>	<u>(4,354,691)</u>
General revenues:			
Interest earnings			239,520
Net earnings on investments			1,636
Tobacco settlement revenue			<u>3,389,648</u>
Total general revenues			<u>3,630,804</u>
Change in net assets (deficit)			(723,887)
Net assets (deficit)—beginning			<u>(58,675,377)</u>
Net assets (deficit)—ending			<u>\$ (59,399,264)</u>

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

NIAGARA TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Niagara, New York)
Balance Sheet—Governmental Funds and
Reconciliation of the Balance Sheet of Governmental Funds
to the Statement of Net Assets (Deficit)
December 31, 2010

	Governmental Fund Types		Total
	General	Debt Service	
ASSETS			
Cash and cash equivalents	\$ 303,018	\$ 4,403,095	\$ 4,706,113
Total assets	<u>\$ 303,018</u>	<u>\$ 4,403,095</u>	<u>\$ 4,706,113</u>
FUND BALANCES			
Fund balances:			
Reserved for debt service	\$ -	\$ 4,403,095	\$ 4,403,095
Unreserved	<u>303,018</u>	<u>-</u>	<u>303,018</u>
Total fund balances	<u>303,018</u>	<u>4,403,095</u>	<u>4,706,113</u>
Total liabilities and fund balances	<u>\$ 303,018</u>	<u>\$ 4,403,095</u>	<u>4,706,113</u>

Amounts reported for governmental activities in the statement of net assets are different because:

Long-term liabilities, including bonds payable and accumulated interest on capital appreciation bonds, are not due and payable in the current period and therefore are not reported in the funds.	(63,769,637)
To recognize interest accrual on long term debt. Accrued interest for general obligation bonds is \$335,740 at year end.	<u>(335,740)</u>
Net assets (deficit) of governmental activities	<u>\$ (59,399,264)</u>

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

NIAGARA TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Niagara, New York)
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
Year Ended December 31, 2010

	Governmental Fund Types		Total
	General	Debt Service	
REVENUES			
Tobacco settlement revenue	\$ -	\$ 3,389,648	\$ 3,389,648
Interest earnings	1,012	238,508	239,520
Net earnings on investments	-	1,636	1,636
Total revenues	<u>1,012</u>	<u>3,629,792</u>	<u>3,630,804</u>
EXPENDITURES			
Current:			
General government	74,534	5,000	79,534
Debt service:			
Principal	-	790,000	790,000
Interest	-	2,706,220	2,706,220
Redemption payments	-	600,775	600,775
Total expenditures	<u>74,534</u>	<u>4,101,995</u>	<u>4,176,529</u>
Deficiency of revenues under expenditures	<u>(73,522)</u>	<u>(472,203)</u>	<u>(545,725)</u>
OTHER FINANCING SOURCES (USES)			
Transfers in	105,000	-	105,000
Transfers out	-	(105,000)	(105,000)
Total other financing sources and (uses)	<u>105,000</u>	<u>(105,000)</u>	<u>-</u>
Net change in fund balances	31,478	(577,203)	(545,725)
Fund balances – beginning	<u>271,540</u>	<u>4,980,298</u>	<u>5,251,838</u>
Fund balances – ending	<u>\$ 303,018</u>	<u>\$ 4,403,095</u>	<u>\$ 4,706,113</u>

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

NIAGARA TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Niagara, New York)
Reconciliation of the Statement of Revenues, Expenditures and Changes in
Fund Balances of Governmental Funds to the Statement of Activities
Year Ended December 31, 2010

Amounts reported for governmental activities in the statement of activities are different because:

Net change in fund balances—total governmental funds \$ (545,725)

The repayment of the principal effects the current financial resources of governmental funds. These transactions, however, have no effect on net assets:

Principal	\$ 790,000	
Redemption payment	<u>600,775</u>	1,390,775

Amortization of bond issuance costs that are not recorded in the statement of governmental funds, but are recorded in the statement of activities: (7,483)

Interest is recognized as an expenditure in the governmental funds when it is due. In the statement of activities, interest expense is recognized as it accrues, regardless of when it is due. The net effect of the difference in accrued interest for general obligation bonds and accreted interest for Subordinate Turbo CAB's between the beginning of the year and the end of the year is:

General obligation bonds	\$ 5,308	
Subordinate Turbo CAB's	<u>(1,566,762)</u>	<u>(1,561,454)</u>

Change in net assets (deficit) of governmental activities \$ (723,887)

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

NIAGARA TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Niagara, New York)
Notes to the Financial Statements
December 31, 2010

1. ORGANIZATION

The Niagara Tobacco Asset Securitization Corporation (“NTASC”) is a special purpose local development corporation organized under the Not-for-Profit Corporation Law of the State of New York. NTASC is a component unit of the County of Niagara, New York (the “County”). Based on the nature and significance of NTASC’s relationship with the County and the criteria set forth in GASB Statement No. 14, *The Financial Reporting Entity*, as amended by GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*, NTASC is included within the County basic financial statements as a blended component unit.

The sole Member of NTASC shall be the person who is the Chairman of the Board of Legislators of the County of Niagara, New York. The Member may also be a member of the Board of Directors of NTASC. The Board of Directors of NTASC has five members, one of which must meet certain requirements of independence, hence, the Independent Director. All members of the Board of Directors shall be appointed by the Member of NTASC.

The NTASC was incorporated on October 6, 2000 for the purpose of issuing Asset Backed Bonds in order to provide funds to purchase from the County certain of the County’s right, title and interest under the Master Settlement Agreement (the “MSA”) and the Consent Decree and Final Judgment (the “Decree”) as described herein.

The MSA was entered into on November 23, 1998, among the attorneys general of 46 states (including New York), the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Territory of the Northern Marianas and for the four largest United States tobacco manufacturers: Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown and Williamson Tobacco Company and Lorillard Tobacco Company (collectively the “Original Participating Manufacturers” or “OPMs”) in settlement of certain smoking-related litigation and the Decree entered in New York Supreme Court, including the County’s right to receive certain initial and annual payments to be made by the OPMs under the MSA.

The County dedicated the discounted net proceeds of the sale of the bonds first to the payment of certain currently outstanding County bonds and to the extent available to finance certain capital projects identified in the County capital program. NTASC disbursed the net proceeds of the sale of bonds on behalf of the County as follows: \$23,076,566 to Escrow Agent to defease certain County bonds; \$19,077,644 to the County to finance certain capital projects, and; \$3,973,906 to the Liquidity Reserve Account held by the Indenture Trustee.

Subsequent to the initial sale of the bonds, the County has the right to receive net proceeds of future bond issuances and the revenues of NTASC that are in excess of NTASC’s expenses, debt service and contractual obligations, pursuant to the Indenture. In the current year, there were no payments to the County resulting from these excess revenues.

During the year ended December 31, 2009, a residual amount that had gone to the County was deposited into this “trapping account” to protect investors. This is in response to the first “trapping event” that occurred in prior years. The first trapping event occurred because Phillip Morris’ bond rating was downgraded.

Additionally, during the year ended December 31, 2006, a second “trapping event” occurred, involving a dispute over the applicability of an MSA provision, the “Non-Participating Manufacturers (NPM) adjustment.” The NPM adjustment is designed to shield tobacco companies participating in the MSA from making payments disproportionate to their market share. This adjustment has recently been the subject of a dispute that may potentially have a significant impact on tobacco settlement securitizations. Under certain conditions, the TSA payments can be reduced by an amount proportionate to the loss in market share of the tobacco companies that resulted from their participation in the MSA. As a result, during 2006, Reynolds American and Lorillard held a portion of their TSA payment due for 2006 (about 32% and 16% respectively) in an escrow account for disputed payments.

During the year ended December 31, 2009, one OPM that was previously below the allowable threshold, which led to a Downgrade Trapping Event, was upgraded to a rating above the threshold. Therefore in accordance with the MSA Report, this NPM Trapping Event is no longer occurring. As a result, the funds that NTASC had reserved for the trapping event were released and were used to make an additional payment on the 2005 New York Counties Tobacco Trust V Subordinate Turbo Capital Appreciation Bonds.

The following *acronyms* that have been used throughout this report:

CAB	Capital Appreciation Bond
FDIC	Federal Depository Insurance Corporation
FHLMC	Federal Home Loan Mortgage Corporation
FNMA	Federal National Mortgage Association
GASB	Governmental Accounting Standards Board
MSA	Master Settlement Agreement
NPM	Non-Participating Manufacturers
NTASC	Niagara Tobacco Asset Securitization Corporation
NYCTT	New York Counties Tobacco Trust V
OPMs	Original Participating Manufacturers
TSR	Tobacco Settlement Revenues

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General—In its accounting and financial reporting in conformity with accounting principles generally accepted in the United States of America, NTASC follows all applicable GASB pronouncements.

Government-wide and fund financial statement—The government-wide financial statements (i.e., statement of net and the statement of changes in net assets) report information on all the nonfiduciary activities of NTASC. Interfund activity has been removed from these statements. *Governmental activities*, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support.

The statement of governmental activities demonstrates the degree to which the direct expenses of a given function is offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function. Indirect expenses have been included as part of the program expenses reported for the various functional activities. *Program revenues* include 1) charges to those who purchase, use or directly benefit from goods, services or privileges provided by a given function and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Items not properly included among program revenues are reported instead as *general revenues*.

Separate financial statements are provided for governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements.

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

Governmental fund statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, NTASC considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when the payment is due. NTASC reports the following major governmental funds:

General Fund—The General Fund is used for all financial resources associated with NTASC except for those required to be accounted for in another fund. Revenue is recognized when received.

Debt Service Fund—The Debt Service Fund is used to account for the accumulation of resources for, and for the payment of long-term bond principal, interest and related costs.

Cash and cash equivalents—Cash includes amounts in demand deposits as well as short-term investments with original maturities of three months or less from the date acquired by NTASC. Cash and cash equivalents are stated at fair value based on quoted market prices.

Investments – Investments are recorded on the balance sheet at fair value and all investment income, including changes in the fair value of investments, is reported as revenue in the statement of revenues, expenditures and changes in fund balance.

Expenditures—Expenditures are recorded on a modified accrual basis of accounting. Payments to the County are recorded when the obligation is incurred. General administration costs consist of operating expenses for professional service fees and paid from General Fund revenues.

Use of estimates—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

Tax status—NTASC is a local development corporation organized pursuant to Section 1411 of the Not-for-Profit Corporation Law of the State of New York and is exempt from Federal income taxes and New York State taxes. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

Prepayments and deferrals—NTASC utilizes the nonallocation method of accounting for prepayments and deferrals. Therefore, no asset for the prepayment or deferral is created, and no expenditure allocation to future accounting periods is required.

Future impacts of accounting pronouncements—NTASC has not completed the process of evaluating the impact that will result from adopting GASB Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* and No. 59, *Financial Instruments Omnibus*, effective for the year ending December 31, 2011; GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*; No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, effective for the year ending December 31, 2012; and GASB Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34*, effective for the year ending December 31, 2013. NTASC is therefore unable to disclose the impact that adopting GASB Statements No. 54, 57, 59, 60, 61 and 62 will have on its financial position and results of operations when such statements are adopted.

NTASC has completed the process of evaluating the impact that will result from adopting GASB Statement No. 51 *Accounting and Financial Reporting for Intangible Assets*, GASB Statement No. 53 *Accounting and Financial Reporting for Derivative Instruments*, and No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*. They did not have a material impact on NTASC’s financial position or results of operation.

3. CASH AND CASH EQUIVALENTS

At December 31, 2010, NTASC’s cash was insured by either the Federal Depository Insurance Corporation (“FDIC”) or collateralized by securities held in the pledging bank’s trust department in NTASC’s name. NTASC’s investment policy provides for eligible investments in defeasance collateral, obligations of FHLMC, FNMA, or the Federal Farm Credit System, demand and time deposit accounts and certificates of deposit, general obligations of states and guaranteed state obligations, commercial or finance company paper, repurchase obligations, corporate securities bearing interest or sold at discount, taxable money market funds, investment agreements or guaranteed investment contracts, and other obligations or securities that are non-callable.

At December 31, 2010, NTASC’s cash and cash equivalents consisted of the following:

<u>Description</u>	<u>Maturity Date</u>	Fair Value at <u>12/31/2010</u>
Cash and cash equivalents:		
Cash on deposit		\$ 303,018
Treasury money market funds		127,147
Discount notes	1/15/2011	<u>4,275,948</u>
		<u>\$ 4,706,113</u>

Deposits: All deposits including cash in bank and certain investments (i.e. certificates of deposit) are carried at fair value.

	Carrying Amount	Bank Balance
Insured (FDIC)	\$ 251,801	\$ 251,801
Uninsured:		
Collateral held by bank's agent in the Town's name	<u>51,217</u>	<u>51,217</u>
Total	<u>\$ 303,018</u>	<u>\$ 303,018</u>

Investments – Investments include money market accounts and a discount note with a maturity date within three months of year end and are, therefore, considered to be cash equivalents. These investments are carried at fair value.

	Carrying Amount	Bank Balance
Money Market	\$ 127,147	\$ 127,147
Discount Note	<u>4,275,948</u>	<u>4,275,948</u>
	<u>\$ 4,403,095</u>	<u>\$ 4,403,095</u>

Custodial credit risk—deposits—Custodial credit risk is the risk that in the event of a bank failure, the NTASC's deposits may not be returned to it. As noted above, by State statute all deposits in excess of FDIC insurance coverage must be collateralized. As of December 31, 2010, the NTASC's deposits were FDIC insured or collateralized.

4. LONG-TERM DEBT

In 2000, NTASC issued \$47,920,000 of Tobacco Settlement Asset Backed Bonds, Series A pursuant to an indenture dated as of November 1, 2000. The net proceeds of Series A Bonds were used to purchase from the County all of the County's right, title and interest, under the MSA and the Decree, including the Tobacco Settlement Revenues ("TSR").

The payment of the Series A Bonds is dependent on the receipt of TSRs. The amount of TSRs actually collected is dependent on many factors including cigarette consumption and the continued operations of the OPMs. Such bonds are secured by and payable solely from TSRs and investment earnings pledged under the Bond Indenture and amounts established and held in accordance with the Bond Indenture.

In the event sufficient funds are not available to meet Planned Payment Maturities, Rated Maturity dates will be used.

Each Series A Bond has a Rated Maturity Date and a Planned Principal Payment Date. Planned Principal Payment Dates are based upon a maturity of debt that began May 15, 2002 extending through 2030 at variable rates. Interest is payable May 15 and November 15 of each year. Planned Principal Payments and Rate Maturities are scheduled only on May 15 of each year although principal could be paid semiannually if actual principal payments are slower than Planned Principal Payments. Failure to pay interest on the Series A Bonds when due or principal of the Series A Bonds when due on a Rated Maturity Date will constitute a default.

On November 15, 2005, NTASC participated in New York Counties Tobacco Trust V (“NYCTT”), along with 23 other New York County Tobacco Corporations, and issued Tobacco Settlement Pass-Through Bonds—Subordinate Turbo CABs in various series for the purpose of securitizing additional future tobacco settlement revenues. The proceeds of these bonds, \$17,408,824 (after the deduction of \$345,732 in bond issuance and underwriter costs), was transferred to the County for the partial defeasance of various bond issuances. The County has deposited \$17,189,240 in an irrevocable trust to pay future debt payments on the partially defeased issuances. The issuance has four components and payments on the Subordinate Turbo CABs are subordinate to the Series A bonds.

Changes in Tobacco Settlement Bonds, Series A, for the year ended December 31, 2010 is as follows:

Description	Year of Maturity	Yield	Beginning Balance 1/1/2010	Additions	Deletions	Ending Balance 12/31/2010
Tobacco Settlement Bonds:						
Series A	2030	various	<u>\$ 43,245,000</u>	<u>\$ -</u>	<u>\$ 790,000</u>	<u>\$ 42,455,000</u>

NTASC debt service requirements based upon planned principal payments for Tobacco Settlement Bonds, Series A are as follows:

Year ended December 31,	Principal	Interest	Total
2011	\$ 820,000	\$ 2,663,369	\$ 3,483,369
2012	885,000	2,616,481	3,501,481
2013	975,000	2,564,113	3,539,113
2014	1,085,000	2,504,888	3,589,888
2015	1,175,000	2,439,178	3,614,178
2016-2020	9,430,000	10,620,326	20,050,326
2021-2025	13,140,000	6,764,226	19,904,226
2026-2030	<u>14,945,000</u>	<u>2,351,719</u>	<u>17,296,719</u>
	<u>\$ 42,455,000</u>	<u>\$ 32,524,300</u>	<u>\$ 74,979,300</u>

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

As discussed in Note 1, during the year ended December 31, 2009, the rating of Reynolds American rose above the allowable threshold resulting in the termination of the Downgrade Trapping Event. NTASC used amounts previously reserved for the Downgrade Trapping Event to make a \$2,522,132 payment on its Subordinate Turbo CABs, of which \$2,033,672 represented a redemption payment on principal and \$543,360 on accreted interest payable.

A summary of the Subordinate Turbo CABs net bond balance activity for the year ended December 31, 2010 follows:

	Interest Rate	Original Principal	Beginning Balance 1/1/2010	Annual Net Interest Accretion	Turbo Redemption Payments	Ending Balance 12/31/2010
Subordinate	6.00% -					
Turbo CABs	7.85%	<u>\$ 17,754,556</u>	<u>\$ 20,656,971</u>	<u>\$ 1,566,762</u>	<u>\$ 600,775</u>	<u>\$ 21,622,958</u>

Redemption of the Subordinate Turbo CABs as outlined in the original official statement totaled \$89,094,053 and is scheduled to be paid from 2015 through 2038, while early payment is allowed. During the year ended December 31, 2010, NTASC made \$600,775 of redemption payments, including amounts for original principal and accreted interest. Any debt service amounts not paid in accordance with the Turbo Redemption Payments schedule will be due and payable on the following maturity dates:

Series 2005 S1	June 1, 2038
Series 2005 S2	June 1, 2050
Series 2005 S3	June 1, 2055
Series 2005 4B	June 1, 2060

Bond Issuance Costs—Costs associated with the issuance of the Subordinate Turbo CABs are amortized over the life of the bonds. Subordinate Turbo CABs payable are reported net of the related bond issuance costs. A summary of bond issuance costs activity for the year ended December 31, 2010 follows:

Description	Beginning Balance 1/1/2010	Additions	Deletions	Ending Balance 12/31/2010
Bond issuance costs	<u>\$ 315,804</u>	<u>\$ -</u>	<u>\$ 7,483</u>	<u>\$ 308,321</u>

5. CONTINGENCIES

With respect to all matters of litigation that have been brought and may in the future be brought against the OPMs, or involving the enforceability of the MSA or constitutionality of the Model Statute or the enforcement of the right to the annual payments or otherwise filed in connection with the tobacco industry, the outcome of such litigation, in general, cannot be determined with certainty and depends, among other things, on (i) the issues being appropriately presented and argued before the courts (including the applicable appellate courts) and (ii) on the courts, having been presented with such issues, correctly applying applicable legal principles in reaching appropriate decisions regarding the merits. In addition, the courts may, in their exercise of equitable jurisdiction, reach judgments based not upon the legal merits but upon a balancing of the equities among the parties. Accordingly, no assurance can be given as to the outcome of any such litigation and any such adverse outcome could have a material and adverse impact on the payment of interest on the Series 2005 NYCTT Bonds when due, principal of the Series 2005 NYCTT Bonds and NYCTT Bonds Turbo Redemption Payments.

6. SUBSEQUENT EVENTS

Management has evaluated subsequent events through March 22, 2011, which is the date the financial statements are available for issuance, and have determined there are no subsequent events that require disclosure under generally accepted accounting principles.

* * * * *

Certified Public Accountants

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

To the Board of Directors
Niagara Tobacco Asset Securitization Corporation

We have audited the financial statements of Niagara Tobacco Asset Securitization Corporation ("NTASC"), a component unit of the County of Niagara, New York, as of and for the year ended December 31, 2010, and have issued our report thereon dated March 22, 2011. 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 *Governmental Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered NTASC's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the NTASC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the NTASC's internal control over financial reporting.

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 misstatements on a timely basis. *A material weakness* is a deficiency, or 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.

Our consideration of internal control over financial reporting was for the limited purposed described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the NTASC's financial statements are free of 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 that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the NTASC's Board of Directors and others within the NTASC, the Niagara County Legislators, the Office of the State Comptroller of New York, and the Authority Budget Office of New York State and is not intended to be and should not be used by anyone other than these specified parties.

 Doreen S. Malachuk LLP

March 22, 2011