

**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, 2011
And Independent Auditors' Reports*

NIAGARA TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Niagara, New York)
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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, 2011, 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, 2011, 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, 2012, 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.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

 Duesch & Malchi LLP

March 22, 2012

NIAGARA TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Niagara, New York)
Management's Discussion and Analysis
Year Ended December 31, 2011

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, 2011. 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 \$60,234,433 at December 31, 2011. This compares to total government-wide liabilities of NTASC exceeding government-wide assets by \$59,399,264 at December 31, 2010.
- ◆ NTASC's net assets decreased by \$835,169, which increased its net deficit, for the year ended December 31, 2011. The increase in NTASC's net deficit was largely due to accreted interest costs coupled by the declining cigarette sales which may be attributed to recent increases 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 7-8 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 9-11 of this report.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 12-20 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 \$60,234,433 at December 31, 2011, as compared to \$59,399,264 at December 31, 2010. Table 1, shown below, presents the condensed statements of net assets (deficit) for NTASC at December 31, 2011 and December 31, 2010.

Table 1—Condensed statements of net assets (deficit)

	December 31,	
	2011	2010
Current assets	\$ 4,588,319	\$ 4,706,113
Total assets	<u>4,588,319</u>	<u>4,706,113</u>
Current liabilities	1,215,102	1,155,740
Noncurrent liabilities	<u>63,607,650</u>	<u>62,949,637</u>
Total liabilities	<u>64,822,752</u>	<u>64,105,377</u>
Net assets (deficit)	<u>\$ (60,234,433)</u>	<u>\$ (59,399,264)</u>

At December 31, 2011, total NTASC assets were \$4,558,319; and, \$4,706,113 at December 31, 2010. The largest asset held by NTASC for both years was cash and cash equivalents. NTASC had no noncurrent assets at December 31, 2011 and December 31, 2010.

NTASC's liabilities totaled \$64,822,752 at December 31, 2011; and, \$64,105,377 at December 31, 2010. The largest portion of the liabilities is outstanding debt, net of related issuance costs, totaling \$64,492,650 and \$63,769,637 at December 31, 2011 and 2010, respectively.

The statement of revenues, expenses and changes in net assets (deficit) presents revenues received and expenses paid by NTASC. Presented as Table 2, is the condensed statement of revenues, expenses and changes in net assets for the years ended December 31, 2011 and 2010.

Table 2—Condensed statements of revenues, expenses and changes in net assets (deficit)

	Year Ended December 31,	
	2011	2010
General revenues	\$ 3,797,121	\$ 3,630,804
Expenses—governmental activities	(4,286,788)	(4,354,691)
Transfer to County	(345,502)	-
Change in net assets	(835,169)	(723,887)
Net assets (deficit)—beginning	(59,399,264)	(58,675,377)
Net assets (deficit)—ending	<u>\$ (60,234,433)</u>	<u>\$ (59,399,264)</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.

A summary of sources of revenues for the years ended December 31, 2011 and December 31, 2010 is presented below in Table 3.

Table 3—Sources of revenues

	2011	2010	Change	Change
Tobacco settlement revenues	\$ 3,559,166	\$ 3,389,648	\$ 169,518	5.0 %
Interest and net earnings from investments	237,955	241,156	(3,201)	(1.3)%
Total revenues	<u>\$ 3,797,121</u>	<u>\$ 3,630,804</u>	<u>\$ 166,317</u>	4.6 %

For the year ended December 31, 2011, overall revenues increased by 4.6%, which was due to an unanticipated increase of tobacco settlement revenues.

The most significant source of revenue, for both years, was tobacco settlement revenues, which was 93.7% and 93.3% of total revenues for the years ended December 31, 2011 and 2010, respectively. The next largest source of revenue each year was interest and net earnings from investments which comprised 6.3% and 6.6% of total revenues in the years ended December 31, 2011 and December 31, 2010, respectively.

A summary of operating expenses for the years ended December 31, 2011 and December 31, 2010 is presented below in Table 4.

Table 4—Operating expenses

	<u>2011</u>	<u>2010</u>	<u>Change</u>	<u>Change</u>
General government	\$ 85,542	\$ 79,534	\$ 6,008	7.6 %
Interest and fiscal charges	<u>4,201,246</u>	<u>4,275,157</u>	<u>(73,911)</u>	(1.7)%
Total operating expenses	<u>\$ 4,286,788</u>	<u>\$ 4,354,691</u>	<u>\$ (67,903)</u>	(1.6)%

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, 2011 and the year ended December 31, 2010.

NTASC total operating expenses for the year ended December 31, 2011, decreased by 1.6% from the previous year. The decrease was primarily due to a decrease in interest and fiscal charges paid on long term debt.

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.

BASIC FINANCIAL STATEMENTS

NIAGARA TOBACCO ASSET SECURITIZATION CORPORATION
(A Component Unit of the County of Niagara, New York)
Statement of Net Assets (Deficit)
December 31, 2011

	Governmental Activities
ASSETS	
Cash and cash equivalents	\$ 4,588,319
Total assets	4,588,319
 LIABILITIES	
Current liabilities:	
Accrued interest payable	330,102
Noncurrent liabilities:	
Due within one year—bonds	885,000
Due in more than one year—bonds	40,750,000
Subordinate Turbo CABs payable, net of related bond issuance costs	22,857,650
Total liabilities	64,822,752
 NET ASSETS (DEFICIT)	
Restricted	4,259,736
Unrestricted	(64,494,169)
Total net assets (deficit)	\$ (60,234,433)

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, 2011

Functions/Programs	Expenses	Program Revenues	Net (Expenses) and Changes in Net Asset
Governmental activities:			
General government support	\$ 85,542	\$ -	\$ (85,542)
Interest and fiscal charges	<u>4,201,246</u>	<u>-</u>	<u>(4,201,246)</u>
Total governmental activities	<u>4,286,788</u>	<u>-</u>	<u>(4,286,788)</u>
General revenues:			
Dividend Income			120
Interest earnings			237,835
Tobacco settlement revenue			<u>3,559,166</u>
Total general revenues			3,797,121
Transfer to County			<u>(345,502)</u>
Change in net assets (deficit)			(835,169)
Net assets (deficit)—beginning			<u>(59,399,264)</u>
Net assets (deficit)—ending			<u><u>\$(60,234,433)</u></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, 2011

	Governmental Fund Types		
	General	Debt Service	Total
ASSETS			
Cash and cash equivalents	\$ 328,583	\$ 4,259,736	\$ 4,588,319
Total assets	<u>\$ 328,583</u>	<u>\$ 4,259,736</u>	<u>\$ 4,588,319</u>
LIABILITIES AND FUND BALANCES			
Fund balances:			
Restricted for debt service	\$ -	\$ 4,259,736	\$ 4,259,736
Unassigned	328,583	-	328,583
Total fund balances	<u>328,583</u>	<u>4,259,736</u>	<u>4,588,319</u>
Total liabilities and fund balances	<u>\$ 328,583</u>	<u>\$ 4,259,736</u>	4,588,319

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. (64,492,650)

To recognize interest accrual on long term debt. Accrued interest for general obligation bonds is \$330,102 at year end. (330,102)

Net assets (deficit) of governmental activities \$ (60,234,433)

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, 2011

	<u>Governmental Fund Types</u>		
	<u>General</u>	<u>Debt Service</u>	<u>Total</u>
REVENUES			
Tobacco settlement revenue	\$ -	\$ 3,559,166	\$ 3,559,166
Interest earnings	1,107	236,728	237,835
Dividend income	-	120	120
Total revenues	<u>1,107</u>	<u>3,796,014</u>	<u>3,797,121</u>
 EXPENDITURES			
Current:			
General government	80,542	5,000	85,542
Debt service:			
Principal	-	820,000	820,000
Interest	-	2,663,871	2,663,871
Total expenditures	<u>80,542</u>	<u>3,488,871</u>	<u>3,569,413</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(79,435)</u>	<u>307,143</u>	<u>227,708</u>
 OTHER FINANCING SOURCES (USES)			
Transfers in	105,000	-	105,000
Transfers out	-	(105,000)	(105,000)
Transfer to County	-	(345,502)	(345,502)
Total other financing sources and (uses)	<u>105,000</u>	<u>(450,502)</u>	<u>(345,502)</u>
 Net change in fund balances	25,565	(143,359)	(117,794)
 Fund balances – beginning	<u>303,018</u>	<u>4,403,095</u>	<u>4,706,113</u>
Fund balances – ending	<u>\$ 328,583</u>	<u>\$ 4,259,736</u>	<u>\$ 4,588,319</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, 2011

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

Net change in fund balances—total governmental funds		\$ (117,794)
The repayment of the principal effects the current financial resources of governmental funds. These transactions, however, have no effect on net assets.		820,000
Amortization of bond issuance costs that are not recorded in the statement of governmental funds, but are recorded in the statement of activities:		(7,482)
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	\$ 5,638	
Subordinate Turbo CAB's	<u>(1,535,531)</u>	<u>(1,529,893)</u>
Change in net assets (deficit) of governmental activities		<u>\$ (835,169)</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)
Notes to the Financial Statements
December 31, 2011

1. ORGANIZATION

The Niagara Tobacco Asset Securitization Corporation ("NTASC") is a special purpose, bankruptcy remote, local development corporation organized under the Not-for-Profit Corporation Law of the State of New York. NTASC is an instrumentality of, but separate, and apart from the County of Niagara, New York (the "County"). Although legally separate from the County, NTASC is a component unit of 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 is the person who is the Chairman of the Board of Legislators of the County of Niagara, New York. The Member is also be a member of the Board of Directors of NTASC. The Board of Directors of NTASC has seven 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.

Adoption of New Accounting Pronouncement—During the year ended December 31, 2011, the NTASC adopted the provisions of Governmental Accounting Standards Board (“GASB”) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which requires the NTASC to change its fund balance classifications for governmental funds. The new classifications are explained below:

Nonspendable fund balance—Amounts that are not in a spendable form (such as inventory or prepaids) or are required to be maintained intact (such as the corpus of an endowment fund).

Restricted fund balance—Amounts constrained to specific purposes by their providers (such as grantors, bondholders, and higher levels of government) through constitutional provisions or by enabling legislation.

Committed fund balance—Amounts constrained to specific purposes by a government itself using its highest level of decision-making authority (NTASC Board); to be reported as committed, amounts cannot be used for any other purpose unless the government takes the same highest-level action to remove or change the constraint.

Assigned fund balance—Amounts a government intends to use for a specific purpose; intent can be expressed by the governing body or by an official or body to which the governing body delegates the authority.

Unassigned fund balance—Amounts that are available for any purpose; these amounts are reported only in the general fund.

Additionally, during the year ended December 31, 2011, NTASC completed the process of evaluating the impact that will result from adopting GASB Statement No. 59, *Financial Instruments Omnibus* effective for the year ending December 31, 2011. GASB Statement No. 59 did not have a material impact on NTASC’s financial position or results from operations.

Future impacts of accounting pronouncements—NTASC has not completed the process of evaluating the impact that will result from adopting GASB Statements 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*, No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* and No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53*, 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. 57, 60, 61, 62, 63 and 64 will have on its financial position and results of operations when such statements are adopted.

3. CASH AND CASH EQUIVALENTS

At December 31, 2011, 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, 2011, NTASC's cash and cash equivalents consisted of the following:

Description	Maturity Date	Fair Value at 12/31/2011
Cash and cash equivalents:		
Cash on deposit		\$ 328,074
Treasury money market funds		7,524
Discount notes	1/17/2012	4,252,721
		<u>\$ 4,588,319</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)	\$ 250,759	\$ 250,759
Uninsured:		
Collateral held by bank's agent in the Town's name	77,315	77,315
Total	<u>\$ 328,074</u>	<u>\$ 328,074</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	\$ 7,524	\$ 7,524
Discount Note	4,252,721	4,252,721
	<u>\$ 4,260,245</u>	<u>\$ 4,260,245</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, 2011, 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, 2011 is as follows:

Description	Year of Maturity	Yield	Beginning Balance 1/1/2011	Additions	Deletions	Ending Balance 12/31/2011
Tobacco Settlement Bonds:						
Series A	2030	various	\$ 42,455,000	\$ -	\$ 820,000	\$ 41,635,000

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
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	1,330,000	2,359,775	3,689,775
2017-2021	10,665,000	9,942,120	20,607,120
2022-2026	13,445,000	5,927,032	19,372,032
2027-2030	12,075,000	1,507,344	13,582,344
	<u>\$ 41,635,000</u>	<u>\$ 29,860,931</u>	<u>\$ 71,495,931</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.

A summary of the Subordinate Turbo CABS net bond balance activity for the year ended December 31, 2011 follows:

	Interest Rate	Original Principal	Beginning Balance 1/1/2011	Annual Net Interest Accretion	Turbo Redemption Payments	Ending Balance 12/31/2011
Subordinate	6.00% -					
Turbo CABS	7.85%	<u>\$ 17,754,556</u>	<u>\$ 21,622,958</u>	<u>\$ 1,535,531</u>	<u>\$ -</u>	<u>\$ 23,158,489</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, 2011, NTASC did not make any redemption payments. 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, 2011 follows:

Description	Beginning			Ending
	Balance	Additions	Deletions	Balance
	1/1/2011			12/31/2011
Bond issuance costs	<u>\$ 308,321</u>	<u>\$ -</u>	<u>\$ 7,482</u>	<u>\$ 300,839</u>

5. FUND BALANCE

In the fund financial statements, restricted fund balances are amounts constrained to specific purposes (such as grantors, bondholders, and higher levels of government) through constitutional provisions or by enabling legislation. At December 31, 2011, NTASC reported \$4,259,736 of fund balance restricted for debt service that must be used toward the future repayment of bonded debt.

If NTASC must use funds for emergency expenditures it shall expend funds first from funds classified under GASB 54 as nonspendable (if funds become available) then restricted funds. The use of committed and assigned funds as classified by GASB 54 will occur after the exhaustion of available restricted funds. Finally, if no other fund balances are available NTASC will use unassigned fund balance.

6. CONTINGENCIES

Certain smokers, consumer groups, cigarette importers, cigarette wholesalers, cigarette distributors, cigarette manufacturers, Native American tribes, taxpayers, taxpayers' groups and other parties have instituted lawsuits against various tobacco manufacturers, including the participating manufacturers, as well as against certain of the settling States and other public entities. The lawsuits allege, among other things, that the MSA violates certain provisions of the United States Constitution, state constitutions, the federal antitrust laws, federal civil rights laws, state consumer protection laws and unfair competition laws, some of which actions, if ultimately successful, could result in a determination that the MSA is void or unenforceable. The lawsuits seek, among other things, an injunction against one or more of the settling States from collecting any monies under the MSA and barring the participating manufacturers from collecting cigarette price increases related to the MSA and/or a determination that the MSA is void or unenforceable. In addition, class action lawsuits have been filed in several federal and state courts alleging that under the federal Medicaid law, any amount tobacco settlement funds that the settling State receive in excess of what they paid through the Medicaid program to treat tobacco-related diseases should be paid directly to Medicaid recipients.

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 adverse effect on the amount of TSRs available to the TASCs to pay the Series 2005 Bonds which could adversely affect the amount of pass-through funds available to pay Turbo redemptions, principal of and interest on the Series 2005 NYCTT Bonds and could result in the complete loss of an owner's investment.

7. SUBSEQUENT EVENTS

Management has evaluated subsequent events through March 22, 2012, 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.

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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, 2011, and have issued our report thereon dated March 22, 2012. 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

Management of NTASC is responsible for establishing and maintaining effective 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 purposes 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.



March 22, 2012