

Northern Tobacco Securitization Corporation

a component unit of the State of Alaska

Financial Statements

With Independent Auditors' Report

June 30, 2004 and 2003

TABLE OF CONTENTS

<u>EXHIBITS</u>		<u>PAGE NUMBER</u>
	INDEPENDENT AUDITORS' REPORT	1
	MANAGEMENT'S DISCUSSION AND ANALYSIS [MD&A]	3 – 7
	BASIC FINANCIAL STATEMENTS:	
A	Governmental Funds Balance Sheet / Statement of Net Assets	8 – 9
B	Statement of Governmental Fund Revenues, Expenditures and Changes in Fund Balances / Statement of Activities	10 – 11
C	Reconciliation of the Statement of Governmental Fund Revenues, Expenditures and Changes in Fund Balances to the Statement of Activities	12
	Notes to Financial Statements	13 – 21

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KPMG LLP
701 West Eighth Avenue
Suite 600
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Independent Auditors' Report

To the Board of Directors
Northern Tobacco Securitization Corporation:

We have audited the accompanying financial statements of the governmental activities and each major fund of the Northern Tobacco Securitization Corporation (NTSC), a component unit of the State of Alaska, as of and for the years ended June 30, 2004 and 2003, which collectively comprise the NTSC's basic financial statements as listed in the table of contents. These financial statements are the responsibility of NTSC's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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 NTSC, as of June 30, 2004 and 2003, and the respective change in financial position, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A to the financial statements, NTSC's repayment of long-term debt is dependent on several factors, including the continued financial capability of participating cigarette manufacturers to pay tobacco settlement revenues and future cigarette consumption.

The accompanying management's discussion and analysis on pages 1 – 4 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

July 29, 2004



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MANAGEMENT'S DISCUSSION AND ANALYSIS

This discussion and analysis is designed to assist the reader in focusing on significant financial issues and activities and to identify significant changes in the financial position of Northern Tobacco Securitization Corporation (NTSC) during the years ended June 30, 2004 and 2003. This information should be read in conjunction with the Independent Auditors' Report, financial statements and accompanying notes.

NTSC is a component unit of the State of Alaska ("the State") and is presented as a component of the special revenue funds in the State's financial statements.

OVERVIEW OF THE FINANCIAL STATEMENTS

NTSC's annual financial statements consist of two parts: Management's Discussion and Analysis and basic financial statements. The basic financial statements include government-wide presentation, governmental fund presentation and Notes to Financial Statements. Comparative financial statements for June 30, 2004 and 2003 are presented and are intended to facilitate and enhance understanding of NTSC's financial position and results of operations for the current fiscal year in comparison to the prior fiscal year.

The government-wide financial statements of NTSC, which include the *Statement of Net Assets* and the *Statement of Activities*, are presented to display information about NTSC as a whole and are prepared using the economic resources measurement focus and the accrual basis of accounting, similar to the accounting used by most private-sector companies. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows.

The *Statement of Net Assets* (Exhibit A) answers the question, "How is our financial health at the end of the year?" This statement includes all assets and liabilities. Over time, changes in net assets may serve as a useful indicator of whether the financial position of NTSC is improving or deteriorating.

The *Statement of Activities* (Exhibit B) accounts for all of the revenues and expenses. This statement measures the success of NTSC's operations over the past year and can be used to determine whether NTSC has successfully recovered all of its costs through its revenue sources. This statement helps answer the question "Is NTSC as a whole better off or worse off as a result of the year's activities?"

The *Notes to Financial Statements* provide additional information that is essential to obtain a full understanding of the data provided in the government-wide financial statements. The Notes to Financial Statements follow Exhibit C.

CONDENSED STATEMENT OF NET ASSETS

(in thousands)

Analysis for fiscal year 2004		
	2004	2003
Investments	\$ 28,356	\$ 29,187
Total assets	32,079	33,507
Bonds and notes, net	218,316	224,599
Total liabilities	219,324	225,588
Restricted net assets	28,113	29,078
Unrestricted net assets (deficit)	(215,358)	(221,159)
Total net assets (deficit)	(187,245)	(192,081)

Total assets decreased by \$1.4 million mainly attributed to a decrease in investments of \$831,000 used for debt service payments during the year ended June 30, 2004.

Total liabilities decreased \$6.3 million as a result of the payment of principal of bonds outstanding.

The total net deficit decreased \$4.8 million as a net result of the changes in the restricted net assets and the unrestricted net deficit balances. Restricted net assets decreased \$1.0 million due to the decrease in

MANAGEMENT'S DISCUSSION AND ANALYSIS

investments. The deficit balance of unrestricted net assets decreased \$5.8 million, primarily due to an excess of revenues over expenses during the year ended June 30, 2004.

Analysis for fiscal year 2003

	2003	2002
Investments	\$ 29,187	\$ 29,954
Total assets	33,507	34,429
Bonds and notes, net	224,599	232,863
Total liabilities	225,588	234,008
Restricted net assets	29,078	29,452
Unrestricted net assets	(221,159)	(229,031)
Total net assets (deficit)	(192,081)	(199,579)

Total assets decreased by \$922,000 mainly attributed to a decrease in investments of \$767,000 used for debt service payments during the year ended June 30, 2003.

Total liabilities decreased \$8.4 million as a result of the payment of principal of bonds outstanding.

The total net deficit decreased \$7.5 million as a net result of the changes in the restricted net assets and unrestricted net deficit balances. Restricted net assets decreased \$374,000 due primarily to the decrease in investments. The deficit balance of unrestricted net assets decreased \$7.9 million, primarily due to an excess of revenues over expenses during the year ended June 30, 2003.

CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
(in thousands)

Analysis for fiscal year 2004

	2004	2003
Tobacco settlement revenue	\$ 17,151	\$ 20,044
Total revenue	18,399	21,444
Interest expense	13,025	13,337
Total expenses	13,563	13,946
Changes in net assets	4,836	7,498

Total revenues decreased \$3.0 million during the year ended June 30, 2004, primarily due to a decrease in tobacco settlement revenue resulting from changes in the national consumption of tobacco products.

Total expenses decreased \$383,000 primarily due to a decrease in bond interest expense for the year ended June 30, 2004.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Analysis for fiscal year 2003

	2003	2002
Tobacco settlement revenue	\$ 20,044	\$ 19,918
Total revenue	21,444	21,278
Purchase of a portion of rights to Tobacco settlement revenue	-	109,943
Interest expense	13,337	13,117
Total expenses	13,946	123,648
Changes in net assets	7,498	(102,370)

Total revenues increased \$166,000. Tobacco settlement revenue increased \$126,000, which includes a payment in transit to NTSC at June 30, 2003.

Total expenses decreased \$109.7 million, primarily because NTSC did not purchase any additional rights to tobacco settlement revenues during the year ended June 30, 2003.

MAJOR FUNDS

NTSC's governmental fund financial statements, which include the *Governmental Funds Balance Sheet* and the *Statement of Governmental Fund Revenues, Expenditures and Changes in Fund Balances*, are presented using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they become both measurable and available to finance expenditures in the current period.

The adjustment detail on the *Governmental Funds Balance Sheet / Statement of Net Assets* and the *Reconciliation of the Statement of Governmental Fund Revenues, Expenditures and Changes in Fund Balances to the Statement of Activities* (Exhibit C) are provided to assist readers in understanding the differences between government-wide and governmental fund financial statements.

An analysis of the significant balances and transactions in the individual funds is as follows:

DEBT SERVICE FUND

This fund is restricted solely to debt service activities.

For the year ended June 30, 2004, total assets decreased by \$965,000 primarily due to a decrease of \$735,000 in investments used for debt service payments. A corresponding decrease in fund balance also occurred. Total liabilities were unchanged.

Total debt service revenues decreased by \$3.1 million primarily due to a decrease in tobacco settlement revenue during fiscal year 2004. Total debt service expenses decreased \$2.5 million due to a \$2.0 million decrease in principal redemptions and a \$467,000 decrease in bond interest expense as a result of a lower long-term debt balance during fiscal year 2004 than in the previous fiscal year.

There were no significant changes to the assets, liabilities or fund balance on the Balance Sheet during the year ended June 30, 2003.

Total debt service revenues for fiscal year 2003 remained consistent with the prior year. Total debt service expenses increased \$2.0 million due to a \$1.0 million increase in principal redemptions and a \$915,000 increase in bond interest expense resulting from a larger long-term debt balance being carried for all of fiscal year 2003 compared to the previous fiscal year.

MANAGEMENT'S DISCUSSION AND ANALYSIS

GENERAL FUND

The general fund is the operating fund of NTSC. It represents all of NTSC's activities not presented in another fund.

There were no significant changes on the Balance Sheet or on the Statement of Governmental Fund Revenues, Expenditures and Changes in Fund Balances for fiscal year 2004.

During fiscal year 2003 NTSC issued no additional bonds, thus the proceeds from the issuance of bonds decreased by \$124.9 million and the costs of issuance decreased \$2.0 million over the prior year, when bonds were issued. Similarly, NTSC purchased no additional rights to tobacco settlement revenues during the year ended June 30, 2003, thus resulting in a decrease of \$109.9 million in expenses over the prior year.

DEBT ADMINISTRATION

As of June 30, 2004, NTSC had \$218.3 million of revenue bonds, net of discount, secured solely by future tobacco settlement revenue and investment earnings. Significant debt activity during fiscal year 2004 consisted of debt service payments totaling \$19.3 million, of which \$13.0 million represented interest and \$6.3 million represented principal paydowns. As of the date of this statement, there are no plans for NTSC to issue additional debt.

As of June 30, 2003, NTSC had \$224.6 million of revenue bonds, net of discount, secured solely by future tobacco settlement revenue and investment earnings. Significant debt activity during fiscal year 2003 consisted of debt service payments totaling \$21.1 million, of which \$13.3 million represented interest and \$7.8 million represented principal paydowns.

Ratings on NTSC's bonds are subject to change as the companies that rate the bonds analyze numerous factors that may affect NTSC's ability to pay interest on and principal of its outstanding obligations. Therefore, there has been no attempt to list the ratings as of the date of this report. However, current ratings are available through the following Nationally Recognized Municipal Securities Repositories (NRMSIR):

Bloomberg Municipal Repository

100 Business Park Drive
Skillman, New Jersey 08558

DPC Data Inc.

One Executive Drive
Fort Lee, NJ 07024

FT Interactive Data

Attn: NRMSIR
100 William Street
New York, New York 10038

Standard & Poor's J. J. Kenny Repository

55 Water Street
45th Floor
New York, NY 10041

Additional information on NTSC's long-term debt can be found in the Notes to Financial Statements.

ECONOMIC FACTORS

Tobacco settlement revenue is the primary revenue source for NTSC. Tobacco settlement revenue is dependent on future tobacco product sales. If the consumption of tobacco products increases, then NTSC's tobacco settlement revenue will increase; if consumption decreases, revenue will also decrease. If consumption remains consistent, tobacco settlement revenue will remain stable.

MANAGEMENT'S DISCUSSION AND ANALYSIS

CONTACTING NTSC'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of NTSC's finances and to show NTSC's accountability for the money it receives. If you have any questions about this report or need additional financial information, please contact NTSC at (907) 330-8396.

NORTHERN TOBACCO SECURITIZATION CORPORATION

(A Component Unit of the State of Alaska)

GOVERNMENTAL FUNDS BALANCE SHEET / STATEMENT OF NET ASSETS

June 30, 2004 and June 30, 2003

(in thousands of dollars)

June 30, 2004					
	General Fund	Debt Service Fund	Governmental Funds Balance Sheet Total	Adjustments*	Statement of Net Assets Total
ASSETS					
Investments	\$ 305	\$ 28,051	\$ 28,356	\$ -	\$ 28,356
Interest receivable	-	62	62	-	62
Tobacco revenues receivable	-	-	-	-	-
Unamortized costs of issuance	-	-	-	3,661	3,661
Total Assets	<u>305</u>	<u>28,113</u>	<u>28,418</u>	<u>3,661</u>	<u>32,079</u>
LIABILITIES					
Bond interest payable	-	-	-	995	995
Intergovernmental payable	13	-	13	-	13
Long-term debt (Note E):					
Due after one year	-	-	-	220,365	220,365
Unamortized bond discount	-	-	-	(2,049)	(2,049)
Total Liabilities	<u>13</u>	<u>-</u>	<u>13</u>	<u>219,311</u>	<u>219,324</u>
FUND BALANCES					
Fund balances:					
Unreserved	292	-	292		
Reserved for debt service	-	28,113	28,113		
Total Fund Balances	<u>292</u>	<u>28,113</u>	<u>28,405</u>		
Total Liabilities and Fund Balances	<u>\$ 305</u>	<u>\$ 28,113</u>			
NET ASSETS					
Restricted for debt service					28,113
Unrestricted net assets, (deficit)					(215,358)
Total Net Assets (deficit)				<u>\$ (215,650)</u>	<u>\$ (187,245)</u>

*** Adjustments:**

Amounts reported for governmental activities in the Statement of Net Assets are different because:

Governmental funds report costs of debt issuance as expenditures. The Statement of Net Assets capitalizes the costs of issuance and amortizes such items over the life of the debt.

3,661

Long-term debt and interest payable are not due and payable in the current period and therefore are not reported in the governmental funds.

(221,360)

Governmental funds report bond discounts as other financing uses. The Statement of Net Assets records bond discounts as a contra-liability to long-term debt and amortizes such items to interest expense over the life of the debt.

2,049

Net assets of governmental activities

\$ (187,245)

See accompanying notes to the financial statements.

June 30, 2003				
General Fund	Debt Service Fund	Governmental Funds Balance Sheet Total	Adjustments*	Statement of Net Assets Total
\$ 401	\$ 28,786	\$ 29,187	\$ -	\$ 29,187
-	64	64	-	64
-	228	228	-	228
-	-	-	4,028	4,028
<u>401</u>	<u>29,078</u>	<u>29,479</u>	<u>4,028</u>	<u>33,507</u>
-	-	-	989	989
-	-	-	-	-
-	-	-	226,850	226,850
-	-	-	(2,251)	(2,251)
-	-	-	<u>225,588</u>	<u>225,588</u>
401	-	401		
-	29,078	29,078		
<u>401</u>	<u>29,078</u>	<u>29,479</u>		
<u>\$ 401</u>	<u>\$ 29,078</u>			
			29,078	
			(221,159)	
			<u>\$ (221,560)</u>	<u>\$ (192,081)</u>
		4,028		
		(227,839)		
		2,251		
	<u>\$ (192,081)</u>			

NORTHERN TOBACCO SECURITIZATION CORPORATION

(A Component Unit of the State of Alaska)

STATEMENT OF GOVERNMENTAL FUND REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

STATEMENT OF ACTIVITIES

For the Years Ended June 30, 2004 and June 30, 2003

(in thousands of dollars)

	June 30, 2004				
	General Fund	Debt Service Fund	Total Governmental Funds	Adjustments (Exhibit C)	Statement of Activities
GENERAL REVENUES					
Tobacco settlement revenues	\$ -	\$ 17,151	\$ 17,151	\$ -	\$ 17,151
Investment interest	-	1,286	1,286	-	1,286
Net increase in fair value of investments	-	(38)	(38)	-	(38)
Total revenues	<u>-</u>	<u>18,399</u>	<u>18,399</u>	<u>-</u>	<u>18,399</u>
EXPENDITURES/EXPENSES					
Current:					
Insurance and financing	101	-	101	-	101
General and administrative	8	-	8	-	8
Costs of issuance	-	-	-	254	254
(Gain)/loss on extinguishment of bonds	-	-	-	175	175
Debt Service:					
Principal	-	6,485	6,485	(6,485)	-
Interest	-	12,879	12,879	146	13,025
Total expenditures/expenses	<u>109</u>	<u>19,364</u>	<u>19,473</u>	<u>(5,910)</u>	<u>13,563</u>
Excess (deficiency) of revenues over expenditures	<u>(109)</u>	<u>(965)</u>	<u>(1,074)</u>	<u>5,910</u>	<u>4,836</u>
Net change in fund balances	(109)	(965)	(1,074)	1,074	-
Change in net assets	-	-	-	4,836	4,836
FUND BALANCES and NET ASSETS (DEFICIT)					
Beginning of year	401	29,078	29,479	(221,560)	(192,081)
End of year	<u>\$ 292</u>	<u>\$ 28,113</u>	<u>\$ 28,405</u>	<u>\$ (215,650)</u>	<u>\$ (187,245)</u>

See accompanying notes to the financial statements.

EXHIBIT B

June 30, 2003				
General Fund	Debt Service Fund	Total Governmental Funds	Adjustments (Exhibit C)	Statement of Activities
\$ -	\$ 20,044	\$ 20,044	\$ -	\$ 20,044
-	1,391	1,391	(23)	1,368
-	32	32	-	32
<u>-</u>	<u>21,467</u>	<u>21,467</u>	<u>(23)</u>	<u>21,444</u>
100	-	100	-	100
6	-	6	-	6
-	-	-	266	266
-	-	-	237	237
-	8,495	8,495	(8,495)	-
-	13,346	13,346	(9)	13,337
<u>106</u>	<u>21,841</u>	<u>21,947</u>	<u>(8,001)</u>	<u>13,946</u>
<u>(106)</u>	<u>(374)</u>	<u>(480)</u>	<u>7,978</u>	<u>7,498</u>
(106)	(374)	(480)	480	-
-	-	-	7,498	7,498
507	29,452	29,959	(229,538)	(199,579)
<u>\$ 401</u>	<u>\$ 29,078</u>	<u>\$ 29,479</u>	<u>\$ (221,560)</u>	<u>\$ (192,081)</u>

NORTHERN TOBACCO SECURITIZATION CORPORATION**EXHIBIT C**

(A Component Unit of the State of Alaska)

RECONCILIATION OF THE STATEMENT OF GOVERNMENTAL FUND REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES

For the Years Ended June 30, 2004 and June 30, 2003

(in thousands of dollars)

	<u>2004</u>	<u>2003</u>
Amounts reported for governmental activities in the Statement of Net Assets are different because:		
Net change in fund balances - total governmental funds	\$ (1,074)	\$ (480)
Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets.	6,485	8,495
Governmental funds report costs of debt issuance as expenditures. The Statement of Activities amortizes such items over the life of the debt.	(254)	(266)
Gains and losses on extinguishment of bonds include unamortized costs of issuance and bond discount amounts in the Statements of Activities. Governmental funds expense such items and thus do not include them in the gain/loss calculation.	(175)	(237)
Bond discounts and premiums are reported as an other financing source or use in governmental funds when the related bond proceeds are received. Bond discounts and premiums are amortized over the life of the bond issue into interest expense in the Statement of Activities, in the amount of (\$140,000) and (\$147,000) for FY 2004 and FY 2003, respectively. Bond interest is reported as an expenditure in governmental funds when paid. Interest expense is reported in the Statement of Activities when incurred, in the amount of (\$6,000) and \$156,000 for FY 2004 and FY 2003,	(146)	9
Governmental funds defer interest receivable not received within 60 days. The Statement of Activities recognizes interest income when earned.	-	(23)
Change in net assets of government activities	<u>\$ 4,836</u>	<u>\$ 7,498</u>

See accompanying notes to the financial statements.

Notes to Financial Statements

FOOTNOTE INDEX

NOTE	DESCRIPTION	PAGE
A	The Northern Tobacco Securitization Corporation	15
B	Summary of Significant Accounting Policies	16
C	Assets, Liabilities and Fund Equity	17
D	Investments	18 – 19
E	Long-Term Debt	19 – 21
F	Yield Restriction and Arbitrage Rebate	21
G	Contingencies	21
H	Related Party Transactions	21

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Notes to Financial Statements

FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

NOTE A: THE NORTHERN TOBACCO SECURITIZATION CORPORATION

The Northern Tobacco Securitization Corporation (NTSC) is a not-for-profit corporation. It was incorporated on September 29, 2000, under the Alaska Nonprofit Corporation Act and provisions of the Alaska Statutes creating the Alaska Housing Finance Corporation, as amended. NTSC was formed as a subsidiary of Alaska Housing Finance Corporation (AHFC) pursuant to House Bill No. 281 of the Alaska Legislature. NTSC is legally independent and separate from AHFC, and there is no financial accountability between NTSC and AHFC.

NTSC is a component unit of the State of Alaska (State) and is presented as a component of the special revenue funds in the State's financial statements. As a subsidiary of AHFC, NTSC is a government instrumentality of the State but has legal existence independent of and separate from the State. The Board of Directors of NTSC is comprised of the Commissioners of the Alaska Departments of Revenue, Health & Social Services, and Community & Economic Development, or their designees, and two independent members of the public appointed by the Governor.

The purpose of NTSC is to purchase from the State portions of its future right, title and interest in the Tobacco Settlement Revenues (TSRs) under the Master Settlement Agreement and the Consent Decree and Final Judgment (MSA). The MSA resolved tobacco-related litigation between the settling states and the Participating Manufacturers (PMs), released the PMs from past and present tobacco-related claims of the settling states, and provides for a continuing release of future tobacco-related claims, in exchange for certain payments to be made to the settling states, as well as certain tobacco advertising and marketing restrictions, among other things.

In October 2000, pursuant to a Purchase and Sale Agreement with the State, the State sold to NTSC 40% of its future right, title and interest in the TSRs. Specifically, these rights include a 40% share of TSRs received by the State starting January 10, 2002, and in perpetuity under the MSA. When NTSC's obligations under the bonds have been fulfilled, the TSRs revert back to the State under a residual certificate. Consideration paid by NTSC to the State for TSRs consisted of a cash amount sent to the State's custodial trust accounts and a residual certificate assigned to the State.

In August of 2001, pursuant to a Purchase and Sale Agreement with the State, the State sold to NTSC an additional 40% of its future right, title and interest in the TSRs. Specifically these rights include a 40% share of TSRs received by the State starting January 10, 2002, and in perpetuity under the MSA. This 40% share is above and beyond the 40% share originally purchased from the State by NTSC in October 2000. When NTSC's obligations under the bonds have been fulfilled, the TSRs revert back to the State under a residual certificate. Consideration paid by NTSC to the State for TSRs consisted of a cash amount sent to the State's custodial trust accounts and a residual certificate assigned to the State.

The bonds of NTSC are asset-backed instruments secured solely by the TSRs, and NTSC's right to receive TSRs is expected to produce funding for its obligations. The TSR payments are dependent on a variety of factors, some of which are:

- the financial capability of the participating cigarette manufacturers to pay TSRs,
- future cigarette consumption which impacts the TSR payment, and
- future legal and legislative challenges against the tobacco manufacturers and the master settlement agreement providing for the TSRs.

Changes in these factors could affect the amount of funds available to pay scheduled debt service requirements.

Notes to Financial Statements

NOTE B: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

NTSC's annual financial statements include a Management's Discussion and Analysis (MD&A) section and basic financial statements. The basic financial statements include a Governmental Funds Balance Sheet / Statement of Net Assets, a Statement of Governmental Fund Revenues, Expenditures and Changes in Fund Balances / Statement of Activities, a Reconciliation of the Statement of Governmental Fund Revenues, Expenditures and Changes in Fund Balances to the Statement of Activities and Notes to Financial Statements. Comparative financial statements for June 30, 2004 and 2003 are presented and are intended to facilitate and enhance understanding of NTSC's financial position and results of operations for the current fiscal year in comparison to the prior fiscal year.

Government-wide and Governmental Fund Financial Statements

The Statement of Net Assets and the Statement of Changes in Net Assets report information on all of the activities of NTSC. For the most part, the effect of interfund activity has been removed from these statements. The Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balances are provided for governmental funds.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

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

Governmental fund financial 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, NTSC 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 payment is due.

Major Funds

NTSC reports the following major governmental funds:

The *General Fund* is NTSC's primary operating fund. It accounts for all financial resources not required to be accounted for in another fund.

The *Debt Service Fund* accounts for the resources accumulated and payments made for principal and interest on long-term debt of governmental funds.

Notes to Financial Statements

NOTE C: ASSETS, LIABILITIES AND FUND EQUITY

Use of Estimates

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

Investments

All investments are stated at fair value based on quoted market prices.

Tobacco Revenues Receivable

A disbursement of tobacco settlement revenue to NTSC was made on June 30, 2003. These funds were received on July 3, 2003. Since these funds were both measurable and available, the tobacco revenue was accrued and a receivable was established for financial reporting in both the governmental fund and government-wide financial statements.

Intergovernmental Receivable and Intergovernmental Payable

The outstanding balance is receivable from or payable to Alaska Housing Finance Corporation, and is the net result of payments made by AHFC to vendors on behalf of NTSC and the periodic reimbursements and prepayments to AHFC from NTSC for those vendor expenses.

Long-Term Debt

NTSC reports long-term debt at face value, net of discounts. Bond discounts and issuance costs are capitalized and amortized over the life of the related debt in the entity-wide financial statements. The governmental fund financial statements recognize bond discounts, as well as bond issuance costs, in their entirety, during the current period. The face amount of debt issued is reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

Gains and losses associated with the extinguishment of long-term debt are recognized in the current period for both the entity-wide and governmental financial statements. In the entity-wide statements, such gains and losses arise from the difference between the repurchase price and the par value of the bonds, along with any forfeited unamortized bond discount and costs of issuance amounts. In the governmental fund statements, such gains and losses arise solely due to the difference between the repurchase price and the par value of the bonds, because bond discount and costs of issuance are expensed in the current period rather than capitalized and amortized over the life of the related debt.

Interest expense is recognized on the accrual basis in the entity-wide financial statements. Interest expenditures are recognized when paid in the individual governmental fund financial statements.

Fund Balances

The financial activities of NTSC are restricted by bond resolution and legislative intent.

Notes to Financial Statements

NOTE D: INVESTMENTS

GASB 3 Custodial Credit Risk

NTSC assumes levels of custodial credit risk for its bank investment agreements and other investments.

Bank investment agreements are classified into the following categories:

- 1) Insured by federal depository insurance or collateralized by securities held by NTSC's agent in NTSC's name
- 2) Collateralized with securities held by the bank's trust department or agent, but not in NTSC's name
- 3) Uninsured and uncollateralized

Investments are classified into the following categories:

- 1) Insured, registered, or held by NTSC or its agent in NTSC's name
- 2) Uninsured and unregistered, held by the counterparty's trust department or agent in NTSC's name
- 3) Uninsured and unregistered investments that are held by a counterparty, or by its trust department or agent, but not in NTSC's name.

The balance of bank investment agreements and other investments is categorized below (in thousands):

	Category 1	Category 2	Category 3	June 30, 2004	June 30, 2003
Bank investment agreements	\$ -	\$ -	\$17,301	\$17,301	\$17,785
U.S. agency securities	11,055	-	-	11,055	11,089
	<u>\$11,055</u>	<u>\$ -</u>	<u>\$17,301</u>	28,356	28,874
Money market funds				-	313
Total investments				<u>\$28,356</u>	<u>\$29,187</u>

Investment Policies

Investments are made under the terms of the governing bond indenture. The following types of investments are considered eligible:

- Direct obligations of, or obligations guaranteed as to timely payment of principal and interest by, FHLMC, FNMA or the Federal Farm Credit System;
- Demand and time deposits in, certificates of deposit of, and bankers' acceptances issued by, any bank, trust company, savings and loan, or savings bank provided such instruments have been rated at least "A-1+" by S&P, "P-1" by Moody's and "F1" by Fitch (if rated by Fitch);
- General obligations of, or obligations guaranteed by, any state of the United States or the District of Columbia receiving one of the two highest long-term unsecured debt rating categories available for such securities from S&P and Moody's and Fitch (if rated by Fitch);
- Commercial or finance company paper rated "A-1+" by S&P, "P-1" by Moody's and "F1" by Fitch (if rated by Fitch);
- Repurchase obligations rated in one of the two highest long-term rating categories by S&P and Moody's and Fitch (if rated by Fitch) or collateralized at a minimum level of 102%;
- Interest-bearing or discount securities issued by any corporation incorporated under the laws of the United States or any state thereof rated "A-1+" by S&P, "P-1" by Moody's and "F1" by Fitch (if rated by Fitch);
- Taxable money market funds rated in one of the two highest categories by Moody's and Fitch (if rated by Fitch), and at least "AAm" or "Aam-G" by S&P;
- Investment agreements or guaranteed investment contracts rated in one of the two highest long-term rating categories by S&P, Moody's and Fitch (if rated by Fitch) or collateralized at a minimum level of 102%;
- Other obligations, securities, agreements or contracts that are non-callable and acceptable to each rating agency.

Notes to Financial Statements

Investment Term

The investment term of all debt security investments by contractual maturity is one year or less. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The fair value of debt security investments at June 30, 2004 and 2003 was \$28,356,000 and \$29,187,000 respectively.

NOTE E: LONG-TERM DEBT

On October 13, 2000, NTSC issued \$116,050,000 of revenue bonds (the Series 2000 bonds) containing both serial and term components. The Series 2000 bonds were issued to purchase the initial 40% portion of TSRs from the State. On August 2, 2001, NTSC issued an additional \$126,790,000 of revenue bonds (the Series 2001 bonds), also containing both serial and term components. The Series 2001 bonds were issued to purchase the additional 40% portion of TSRs from the State. Both Series are secured by and payable solely from the TSRs and investment earnings pledged under their respective bond indentures and amounts established and held in accordance with those bond indentures.

The Series 2000 bonds bear interest at a fixed annual rate, between 5.40% and 6.50%, payable semi-annually until the principal is redeemed. The serial bonds mature on June 1, 2008, through June 1, 2013. The term bonds have scheduled sinking fund maturities of June 1, 2022 and 2031.

The Series 2001 bonds bear interest at a fixed annual rate, between 3.50% and 5.50%, payable semi-annually until the principal is redeemed. The serial bonds mature on June 1, 2008, through June 1, 2011. The term bonds have scheduled sinking fund maturities of June 1, 2015, 2021 and 2029.

The term bonds in both Series contain turbo redemption features which require that all TSR collections in excess of operating expenditures and scheduled debt service be applied to the redemption of the term bonds. The turbo redemptions are not scheduled amortization payments and are to be made only from surplus collections, if any. Failure to make a turbo principal payment will not constitute default.

Notes to Financial Statements

Debt Service Requirements

Debt service requirements represent the minimum amount of principal and interest that NTSC must pay as of the specific distribution dates in order to avoid a default. Debt service requirements through 2009 and in five year increments thereafter to maturity, categorized by each bond issue and in total, are shown below (in thousands):

Year Ending June 30	Series 2000 Bonds		Series 2001 Bonds		Debt Service Requirements		
	Principal	Interest	Principal	Interest	Principal	Interest	Total
2005	\$ -	\$ 6,501	\$ -	\$ 6,068	\$ -	\$ 12,569	\$ 12,569
2006	-	6,502	-	6,068	-	12,570	12,570
2007	-	6,501	-	6,068	-	12,569	12,569
2008	4,245	6,502	1,975	6,068	6,220	12,570	18,790
2009	4,490	6,272	2,065	5,980	6,555	12,252	18,807
Total Five Years							
2005 – 2009	8,735	32,278	4,040	30,252	12,775	62,530	75,305
Five Years Ending June 30							
2010 – 2014	20,030	27,293	21,000	27,891	41,030	55,184	96,214
2015 – 2019	19,200	22,164	26,865	21,352	46,065	43,516	89,581
2020 – 2024	19,590	16,033	26,070	14,783	45,660	30,816	76,476
2025 – 2029	25,240	9,057	37,410	6,465	62,650	15,522	78,172
2030 – 2031	12,185	1,199	-	-	12,185	1,199	13,384
	<u>\$104,980</u>	<u>\$108,024</u>	<u>\$115,385</u>	<u>\$100,743</u>	<u>\$220,365</u>	<u>\$208,767</u>	<u>\$429,132</u>

The activity for long-term debt for the year ended June 30, 2004 is summarized in the following schedule are (in thousands):

	July 1, 2003	Additions	Reductions	June 30, 2004	Due Within One Year
Series 2000 bonds payable	\$ 108,210	\$ -	\$ (3,230)	\$ 104,980	\$ -
Less discount	(699)	-	67	(632)	-
Total Series 2000 bonds payable	<u>107,511</u>	<u>-</u>	<u>(3,163)</u>	<u>104,348</u>	<u>-</u>
Series 2001 bonds payable	118,640	-	(3,255)	115,385	-
Less discount	(1,552)	-	135	(1,417)	-
Total Series 2001 bonds payable	<u>117,088</u>	<u>-</u>	<u>(3,120)</u>	<u>113,968</u>	<u>-</u>
Total long-term debt	<u>\$ 224,599</u>	<u>\$ -</u>	<u>\$ (6,283)</u>	<u>\$ 218,316</u>	<u>\$ -</u>

Notes to Financial Statements

The activity for long-term debt for the year ended June 30, 2003 is summarized in the following schedule are (in thousands):

	July 1, 2002	Additions	Reductions	June 30, 2003	Due Within One Year
Series 2000 bonds payable	\$112,240	\$ -	\$ (4,030)	\$ 108,210	\$ -
Less discount	(772)	73	-	(699)	-
Total Series 2000 bonds payable	111,468	73	(4,030)	107,511	-
Series 2001 bonds payable	123,105	-	(4,465)	118,640	-
Less discount	(1,710)	158	-	(1,552)	-
Total Series 2001 bonds payable	121,395	158	(4,465)	117,088	-
Total long-term debt	\$232,863	\$ 231	\$ (8,495)	\$ 224,599	\$ -

At June 30, 2004 and 2003 NTSC maintained debt service reserve accounts for the Series 2000 and 2001 bonds at \$10,774,700 and \$11,055,000 and \$11,336,600 and \$11,402,000, respectively, as required under the governing bond indentures.

NOTE F: YIELD RESTRICTION AND ARBITRAGE REBATE

Most of the investments made under NTSC's tax-exempt bond program are subject to rebate provisions or restricted as to yields. The rebate provisions require that a calculation be performed every five years and upon full retirement of the bonds to determine the amount, if any, of excess yield earned and owed to the Internal Revenue Service. There were no excess earnings recorded and paid for the periods ending June 30, 2004 or 2003.

NOTE G: CONTINGENCIES

Tobacco Litigation Risk

The amount of revenue recognized by NTSC could be adversely impacted by certain third party litigation involving tobacco companies and others.

NOTE H: RELATED PARTY TRANSACTIONS

NTSC entered into a Memorandum of Agreement with AHFC that retains AHFC as Administrator with respect to the preparation of all reports and other instruments and documents that are required by NTSC to prepare, execute, file or deliver pursuant to the bond indentures and the related agreements for a monthly fee. NTSC also entered into a Sub-Lease Agreement with AHFC for office space, overhead and operating services from AHFC for a monthly fee. The cost to NTSC for these services provided by AHFC for the years ended June 30, 2004, 2003 and 2002 was \$6,000 each year. This amount was included as a portion of General and Administrative Expenditures/Expenses.

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