Northern Tobacco Securitization Corporation

a component unit of the State of Alaska

Financial Statements

With Independent Auditors' Report

June 30, 2005 and 2004

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Independent Auditor's Report

To the Board of Directors
Northern Tobacco Securitization Corporation
Anchorage, Alaska

We have audited the accompanying financial statements of the governmental activities and major fund of Northern Tobacco Securitization Corporation (NTSC), a component unit of the State of Alaska, as of and for the year ended June 30, 2005, which collectively comprise 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 audit. The financial statements of NTSC as of June 30, 2004, were audited by other auditors whose report dated July 29, 2004, expressed unqualified opinions on those statements.

We conducted our audit 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 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 major fund of NTSC, as of June 30, 2005, 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.

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.

To the Board of Directors
Northern Tobacco Securitization Corporation
Anchorage, Alaska

The management's discussion and analysis on pages 3 through 7 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. 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.

Mikunda, Cottrell & Co.

July 30, 2005

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, 2005 and 2004. 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, 2005 and 2004 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 2005

	2005	2004
Investments	$ 28,587	$ 28,356
Total assets	31,975	32,079
Bonds, net	212,794	218,316
Total liabilities	213,769	219,324
Restricted net assets	28,465	28,113
Unrestricted net assets (deficit)	(210,259)	(215,358)
Total net assets (deficit)	(181,794)	(187,245)

There were no significant changes in total assets.

Total liabilities decreased $5.6 million as a result of the payment of principal on bonds outstanding.

The total net deficit decreased $5.5 million as a net result of the changes in the restricted net assets and the unrestricted net deficit balances. Restricted net assets had no significant changes. The deficit balance of unrestricted net assets decreased $5.1 million, primarily due to an excess of revenues over expenses during the year ended June 30, 2005.

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 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.

CONDENSED STATEMENT OF ACTIVITIES

(in thousands)

Analysis for fiscal year 2005

	2005	2004
Tobacco settlement revenue	$ 17,407	$ 17,151
Total revenue	18,620	18,399
Interest expense	12,668	13,025
Total expenses	13,169	13,563
Changes in net assets	5,451	4,836

Total revenues increased slightly during the year ended June 30, 2005, primarily due to an increase in tobacco settlement revenues received under the Master Settlement Agreement.

Total expenses decreased slightly primarily due to a decrease in bond interest expense for the year ended June 30, 2005.

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.

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) is 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, 2005, total assets increased slightly primarily due to a small increase in investments used for debt service payments. A corresponding increase in fund balance also occurred. Total liabilities were unchanged.

Total debt service revenues increased slightly primarily due to an increase in tobacco settlement revenue during fiscal year 2005. Total debt service expenses decreased $1.1 million due to a $775,000 decrease in principal redemptions and a $321,000 decrease in bond interest expense as a result of a lower long-term debt balance during fiscal year 2005 than in the previous fiscal year.

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.

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 2005.

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.

DEBT ADMINISTRATION

As of June 30, 2005, NTSC had $212.8 million of revenue bonds, net of discount, secured solely by future tobacco settlement revenue and investment earnings. Significant debt activity during fiscal year 2005 consisted of debt service payments totaling $18.3 million, of which $12.6 million represented interest and $5.7 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, 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 $19.4 million, of which $12.9 million represented interest and $6.5 million represented principal paydowns. As of June 30, 2004, there were no plans for NTSC to issue additional debt.

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, the primary revenue source for NTSC, 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.

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, 2005 and June 30, 2004

(in thousands of dollars)

	June 30, 2005				
	General Fund	**Debt Service Fund**	**Governmental Funds Balance Sheet Total**	**Adjustments***	**Statement of Net Assets Total**
ASSETS					
Investments	$ 185	$ 28,402	$ 28,587	$ -	$ 28,587
Interest receivable	-	63	63	-	63
Unamortized costs of issuance	-	-	-	3,325	3,325
Total Assets	185	28,465	28,650	3,325	31,975
LIABILITIES					
Bond interest payable	-	-	-	970	970
Intergovernmental payable	5	-	5	-	5
Long-term debt (Note E):					
Due after one year	-	-	-	214,655	214,655
Unamortized bond discount	-	-	-	(1,861)	(1,861)
Total Liabilities	5	-	5	213,764	213,769
FUND BALANCES					
Fund balances:					
Unreserved	180	-	180		
Reserved for debt service	-	28,465	28,465		
Total Fund Balances	180	28,465	28,645		
Total Liabilities and Fund Balances	$ 185	$ 28,465			
NET ASSETS					
Restricted for debt service					28,465
Unrestricted net assets, (deficit)					(210,259)
Total Net Assets (deficit)				$ (210,439)	$ (181,794)

*** 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.	3,325
Long-term debt and interest payable are not due and payable in the current period and therefore are not reported in the governmental funds.	(215,625)
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.	1,861
Net assets of governmental activities	$ (181,794)

See accompanying notes to the financial statements.

EXHIBIT A

June 30, 2004				
General Fund	**Debt Service Fund**	**Governmental Funds Balance Sheet Total**	**Adjustments***	**Statement of Net Assets Total**
$ 305	$ 28,051	$ 28,356	$ -	$ 28,356
-	62	62	-	62
-	-	-	3,661	3,661
305	28,113	28,418	3,661	32,079
-	-	-	995	995
13	-	13	-	13
-	-	-	220,365	220,365
-	-	-	(2,049)	(2,049)
13	-	13	219,311	219,324
292	-	292		
-	28,113	28,113		
292	28,113	28,405		
$ 305	$ 28,113			
				28,113
				(215,358)
			$ (215,650)	$ (187,245)
		3,661		
		(221,360)		
		2,049		
		$ (187,245)		

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, 2005 and June 30, 2004
(in thousands of dollars)

	June 30, 2005				
	General Fund	**Debt Service Fund**	**Total Governmental Funds**	**Adjustments (Exhibit C)**	**Statement of Activities**
GENERAL REVENUES					
Tobacco settlement revenues	$ -	$ 17,407	$ 17,407	$ -	$ 17,407
Investment interest	-	1,298	1,298	-	1,298
Net increase (decrease) in fair value of investments	-	(85)	(85)	-	(85)
Total revenues	-	18,620	18,620	-	18,620
EXPENDITURES/EXPENSES					
Current:					
Insurance and financing	100	-	100	-	100
General and administrative	12	-	12	-	12
Costs of issuance	-	-	-	246	246
(Gain)/loss on extinguishment of bonds	-	-	-	143	143
Debt Service:					
Principal	-	5,710	5,710	(5,710)	-
Interest	-	12,558	12,558	110	12,668
Total expenditures/expenses	112	18,268	18,380	(5,211)	13,169
Excess (deficiency) of revenues over (under) expenditures	(112)	352	240	5,211	5,451
Net change in fund balances	(112)	352	240	(240)	-
Change in net assets	-	-	-	5,451	5,451
FUND BALANCES and NET ASSETS (DEFICIT)					
Beginning of year	292	28,113	28,405	(215,650)	(187,245)
End of year	$ 180	$ 28,465	$ 28,645	$ (210,439)	$ (181,794)

See accompanying notes to the financial statements.

EXHIBIT B

June 30, 2004				
General Fund	Debt Service Fund	Total Governmental Funds	Adjustments (Exhibit C)	Statement of Activities
$ -	$ 17,151	$ 17,151	$ -	$ 17,151
-	1,286	1,286	-	1,286
-	(38)	(38)	-	(38)
-	18,399	18,399	-	18,399
101	-	101	-	101
8	-	8	-	8
-	-	-	254	254
-	-	-	175	175
-	6,485	6,485	(6,485)	-
-	12,879	12,879	146	13,025
109	19,364	19,473	(5,910)	13,563
(109)	(965)	(1,074)	5,910	4,836
(109)	(965)	(1,074)	1,074	-
-	-	-	4,836	4,836
401	29,078	29,479	(221,560)	(192,081)
$ 292	$ 28,113	$ 28,405	$ (215,650)	$ (187,245)

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, 2005 and June 30, 2004

(in thousands of dollars)

	2005	2004
Amounts reported for governmental activities in the Statement of Net Assets are different because:		
Net change in fund balances - total governmental funds	$ 240	$ (1,074)
Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets.	5,710	6,485
Governmental funds report costs of debt issuance as expenditures. The Statement of Activities amortizes such items over the life of the debt.	(246)	(254)
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.	(143)	(175)
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 ($135,000) and ($140,000) for FY 2005 and FY 2004, 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 $25,000 and ($6,000) for FY 2005 and FY 2004,	(110)	(146)
Governmental funds defer interest receivable not received within 60 days. The Statement of Activities recognizes interest income when earned.	-	-
Change in net assets of government activities	$ 5,451	$ 4,836

See accompanying notes to the financial statements.

FOOTNOTE INDEX

Notes to Financial Statements

FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

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.

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, 2005 and 2004 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.

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.

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.

NOTE D: INVESTMENTS

Deposit and 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.

Credit Risk

Credit risk is the risk of loss due to the failure of the security or backer. NTSC mitigates its credit risk by limiting investments to those permitted in the respective bond indentures, diversifying the investment portfolio, and pre-qualifying firms with which NTSC administers its investment activities.

The credit quality ratings of NTSC's investments as of June 30, 2005, as described by nationally recognized statistical rating organizations, are shown below (in thousands).

	Moody's	S & P	Investment Fair Value
Securities of U.S. Government agencies and corporations			
	Aaa	AAA	10,970
Money market funds			
	--	AAAm	292
Unrated investments:			
Bank investment contracts			17,325
			$ 28,587

Notes to Financial Statements

Concentration Risk

Concentration risk is the risk of loss attributed to the magnitude of NTSC's investment in a single issuer. Concentration limits are not established in the bond indentures and governing agreements for trust investments. NTSC has not established a formal concentration risk policy for its investments.

Investment Holdings Greater than Five Percent of Total Portfolio

The following investment holdings, summarized by issuer, are trusted investments which have no established concentration limits. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds are excluded from this summary. As of June 30, 2005, NTSC had investment balances greater than 5 percent of NTSC's total investments with the following issuers (in thousands):

Issuer	Investment Fair Value	Percentage of Total Portfolio
Bayerische Hypo-Und Vereinsban	17,325	60.6
Federal Home Loan Bank	10,970	38.4

Custodial Credit Risk

NTSC assumes levels of custodial credit risk for its deposits with financial institutions, investment agreements, and investments. For deposits, custodial credit risk is the risk that, in the event of a bank failure, NTSC's deposits may not be returned. For bank investment agreements and investments, custodial credit risk is the risk that, in the event of failure of the custodian or counterparty holding the investment, NTSC will not be able to recover the value of the investment. NTSC has not established a formal custodial credit risk policy for its investments.

Of NTSC's $28,587,000 total investments at June 30, 2005, investment contracts in the amount of $17,325,000 were uninsured, unregistered, and held by the counterparty or its agent, but not in NTSC's name.

Interest Rate Risk

Interest rate risk is the risk that the market value of investments will decline as a result of changes in general interest rates. NTSC mitigates interest rate risk by structuring investment maturities to meet cash requirements as outlined in the bond indentures and contractual agreements.

Modified Duration

Modified duration estimates the sensitivity of an investment to interest rate changes. The following table shows the modified duration of NTSC's investments (in thousands) as of June 30, 2005:

	Investment Fair Value	Modified Duration
Bank investment agreements	17,325	0.000
Securities of U.S. Government agencies and corporations –		
Federal agency discounts	10,970	0.413
Money market funds	292	0.000
	28,587	
Portfolio modified duration		0.413

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.

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 4.50% 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 2010 and in five year increments thereafter to maturity, categorized by each bond issue and in total, are shown below (in thousands):

Year Ending	Series 2000 Bonds		Series 2001 Bonds		Debt Service Requirements		
June 30	Principal	Interest	Principal	Interest	Principal	Interest	Total
2006	$ -	$ 6,357	$ -	$ 5,907	$ -	$ 12,264	$ 12,264
2007	-	6,357	-	5,907	-	12,264	12,264
2008	4,245	6,357	1,975	5,907	6,220	12,264	18,484
2009	4,490	6,128	2,065	5,818	6,555	11,946	18,501
2010	4,750	5,877	2,130	5,724	6,880	11,601	18,481
Total Five Years 2006 – 2010	13,485	31,076	6,170	29,263	19,655	60,339	79,994
Five Years Ending June 30							
2011 – 2015	15,280	25,416	21,585	26,595	36,865	52,011	88,876
2016 – 2020	20,450	20,842	25,250	19,946	45,700	40,788	86,488
2021 – 2025	20,545	14,794	28,040	13,361	48,585	28,155	76,740
2026 – 2030	26,635	7,417	30,950	4,407	57,585	11,824	69,409
2031	6,265	407	-	-	6,265	407	6,672
	$102,660	$99,952	$111,995	$93,572	$214,655	$193,524	$408,179

The activity for long-term debt for the year ended June 30, 2005 is summarized in the following schedule are (in thousands):

	July 1, 2004	Additions	Reductions	June 30, 2005	Due Within One Year
Series 2000 bonds payable	$ 104,980	$ -	$ (2,320)	$ 102,660	$ -
Less discount	(632)	-	58	(574)	-
Total Series 2000 bonds payable	104,348	-	(2,262)	102,086	-
Series 2001 bonds payable	115,385	-	(3,390)	111,995	-
Less discount	(1,417)	-	130	(1,287)	-
Total Series 2001 bonds payable	113,968	-	(3,260)	110,708	-
Total long-term debt	$ 218,316	$ -	$ (5,522)	$ 212,794	$ -

Notes to Financial Statements

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	107,511	-	(3,163)	104,348	-
Series 2001 bonds payable	118,640	-	(3,255)	115,385	-
Less discount	(1,552)	-	135	(1,417)	-
Total Series 2001 bonds payable	117,088	-	(3,120)	113,968	-
Total long-term debt	$ 224,599	$ -	$ (6,283)	$ 218,316	$ -

At June 30, 2005 and 2004 NTSC maintained debt service reserve accounts for the Series 2000 and 2001 bonds at $11,246,700 and $11,260,600 and $10,774,700 and $11,055,000, 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, 2005 or 2004.

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, 2005 and 2004 was approximately $6,000 each year. This amount was included as a portion of General and Administrative Expenditures/Expenses.