Northern Tobacco Securitization Corporation

(a component unit of the State of Alaska)

Financial Statements

June 30, 2001

With Independent Auditors' Report

Table of Contents

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Independent Auditors' Report

The Board of Directors
Northern Tobacco Securitization Corporation:

We have audited the accompanying financial statements of the Northern Tobacco Securitization Corporation, (A Component Unit of the State of Alaska), as of June 30, 2001, and for the period from September 29, 2000 (Inception) through June 30, 2001, listed in the foregoing table of contents. These financial statements are the responsibility of Northern Tobacco Securitization Corporation's management. Our responsibility is to express an opinion 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. 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 opinion.

In our opinion, the 2001 financial statements referred to above present fairly, in all material respects, the financial position of the Northern Tobacco Securitization Corporation (A Component Unit of the State of Alaska), as of June 30, 2001, and the results of its operations for the period from September 29, 2000 (Inception) through June 30, 2001, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

October 12, 2001

COMBINED BALANCE SHEET, ALL FUND TYPES AND ACCOUNT GROUP

June 30, 2001

(in thousands)

	Governmental Fund Types: General	Governmental Fund Types: Debt Service	General Long-Term Debt Account Group	Totals (Memorandum Only)
ASSETS AND OTHER DEBITS:				
Assets:				
Investments	$ 618	15,406	-	16,024
Other debits:				
Amounts to be provided for retirement of general long-term debt	-	-	115,172	115,172
TOTAL ASSETS AND OTHER DEBITS	$618	15,406	115,172	131,196
LIABILITIES AND FUND BALANCES				
Liabilities:				
Bonds payable	-	-	115,172	115,172
Intergovernmental payable	320	-	-	320
TOTAL LIABILITES	320	-	115,172	115,492
COMMITMENT AND CONTINGENCY (NOTE 6)				
Fund balances:				
Designated for subsequent years expenditures	298	-	-	298
Reserved for debt service	-	15,406	-	15,406
TOTAL FUND BALANCES	298	15,406	-	15,704
TOTAL LIABILITIES & FUND BALANCES	$618	15,406	115,172	131,196

The accompanying notes are an integral part of the financial statements.

Combined Statement of Revenues, Expenditures & Changes in Fund Balances, All Governmental Fund Types

For the Period from September 29, 2000 (Inception) through June 30, 2001

(in thousands)

	Governmental Fund Types: General	Governmental Fund Types: Debt Service	Totals (Memorandum Only)
Revenues:			
Investment interest	$ -	774	774
Total revenues	-	774	774
Other financing sources:			
Principal amount of bonds issued	116,050	-	116,050
Bond discount	(878)	-	(878)
Total revenue & other financing sources	115,172	774	115,946
Expenditures:			
Current:			
Cost of bond issue	2,894	-	2,894
Purchase of 40% of future tobacco settlement revenues from the State of Alaska	93,000	-	93,000
General & administrative	54	-	54
Debt service:			
Interest	-	4,294	4,294
Total expenditures	95,948	4,294	100,242
Other Financing uses:			
Operating transfers (in) out	18,926	(18,926)	-
Total expenditures & other financing uses	114,874	(14,632)	100,242
Excess of revenues & other financing sources over expenditures & other financing uses	298	15,406	15,704
Fund balances:			
Beginning of period	-	-	-
End of period	$ 298	15,406	15,704

The accompanying notes are an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

FOOTNOTE INDEX

NOTES TO THE FINANCIAL STATEMENTS
FOR THE PERIOD FROM SEPTEMBER 29, 2000 (INCEPTION) THROUGH JUNE 30, 2001

1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting entity

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 Housing Finance Corporation Act, 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). As a subsidiary of AHFC, NTSC is a government instrumentality of the State but has legal existence independent of and separate from the State of Alaska.

The purpose of NTSC is to purchase Tobacco Settlement Revenues from the State. NTSC is authorized to issue bonds necessary to provide sufficient funds for carrying out its purpose. In October 2000, NTSC issued revenue bonds that are the sole obligation of NTSC. Neither AHFC nor the State is liable for any debt issued by NTSC.

The Board of Directors of NTSC are the Commissioners of the Departments of Revenue, Health & Social Services, and Community & Economic Development, or their designees; and two independent members of the public appointed by the Governor.

In October 2000, pursuant to a Purchase and Sale Agreement with the State, the State via AHFC, sold to NTSC 40% of its future right, title and interest in the Tobacco Settlement Revenues (TSRs) under the Master Settlement Agreement and the Consent Decree and Final Judgement (the "MSA"). These rights include the State's share of 40% of Tobacco Settlement Revenues received starting January 10, 2002 and in perpetuity to be received under the MSA. When NTSC's obligations with the bonds have been fulfilled, the TSRs revert back to the State under the residual certificate. Consideration paid by NTSC through AHFC to the State for TSRs consisted of a cash amount sent to the State of Alaska custodial trust accounts and a residual certificate assigned to the State.

NTSC's rights 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;
- future legal and legislative challenges against the tobacco manufacturers and the master settlement agreement that provides for the TSRs payments.

The bonds of NTSC are an asset-backed instrument that is secured solely by the tobacco settlement revenues.

Total columns on the combined statements are captioned "memorandum only" to indicate that they are presented only to facilitate financial analysis. Data in these columns do not present financial position, results of operations, or cash flows in conformity with generally accepted accounting principles. Nor are such data comparable to a consolidation. Interfund eliminations have not been made in the aggregation of these data.

B. Measurement Focus, basis of accounting and basis of presentation

The accounts of NTSC are organized and operated on the basis of funds and account groups. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements. Account groups are a reporting device to account for certain assets and liabilities of the governmental funds not recorded directly in those funds.

NTSC has the following fund type and account group:

Governmental funds are used to account for NTSC's general government activities. Governmental fund types use the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when "measurable and available"). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to pay liabilities of the current period. NTSC considers all revenues available if they are collected within 60 days after year end. Expenditures are recorded when the related fund liability is incurred, except for unmatured interest on general long-term debt that is recognized when due, and certain compensated absences and claims and judgments that are recognized when the obligations are expected to be liquidated with expendable available financial resources.

Governmental funds include the following fund types:

The *general fund* is NTSC's primary operating fund. It accounts for all financial resources associated with NTSC except for those required to be accounted for in another fund

The *Debt service fund* accounts for the accumulation of resources for payment of principal and interest on general long-term debt.

Account Groups: The *general long-term debt account group* is used to account for the revenue bonds payable.

C. Assets, Liabilities and Fund Equity

Investments

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

Intergovernmental Payable

Outstanding balance due to Alaska Housing Finance Corporation. The balance is the net result of payments made by AHFC to vendors on behalf of NTSC and the periodic reimbursements to AHFC from NTSC for those vendor expenses.

Long-term obligation

NTSC reports long-term debt of governmental funds at face value in the general long-term debt account group. For governmental fund types, bond discounts as well as issuance costs, are recognized during the current period.

Fund balances

Reservation of fund balance represent amounts that are not appropriable or are legally segregated for a specific purpose. Designation of fund balance represent tentative management plans that are subject to change. The financial activities and balances of NTSC are restricted by the bond resolution and designated by legislative intent.

D. 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 disclosures of contingent assets and liabilities at 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.

NOTES TO THE FINANCIAL STATEMENTS

E. New Accounting and Reporting Standards

GASB Statement No. 34

In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis*. The Statement establishes new financial reporting requirements (new reporting model) for state and local governments. NTSC will adopt Statement 34 for the year ending June 30, 2002. Management has not yet completed the process of evaluating the impact that will result from adopting this statement and is therefore unable to disclose the effect it will have on NTSC's financial position and results of operations at this time.

GASB Statements No. 37 & 38

In June 2001, the GASB issued Statement No. 37 *Basic Financial Statements-and Management's Discussion and Analysis: Omnibus*, *an amendment of GASB statements No. 21 and No. 34,* and Statement No. 38*, Certain Financial Statement Note Disclosures*. Statement 37 modifies the requirements of Statement 34 which includes changing the minimum level of detail required for business-type activities in the statement of activities from segments to different identifiable activities. Statement 38 modifies or rescinds disclosure requirements that were effective before 1995, while establishing others. NTSC will adopt Statements 37 & 38 for the year ended June 30, 2002. Management has not yet completed the process of evaluating the impact that will result from adopting these statements and is therefore unable to disclose the effect they will have on NTSC's financial position and results of operations at this time.

2 INVESTMENTS

Custodial Credit Risk

NTSC assumes levels of custodial credit risk for its bank investment agreements and other investments. Bank investment agreements are categorized as:

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 categorized as:

1) insured, registered, or held by NTSC or its agent in NTSC's name;
2) uninsured and unregistered, held by the counter party's trust department or agent in the NTSC's name;
3) uninsured and unregistered investments that are held by a counter party, or by its trust department or agent, but not NTSC's name.

NOTES TO THE FINANCIAL STATEMENTS

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

	Category 1	Category 2	Category 3	June 30, 2001
Bank investment agreements	$ -	$ -	$16,023	$16,023
	$ -	$ -	$16,023	
Money market funds				1
Total investments				$16,024

Investment Policies

Investments are made under terms of the indenture or agreement. The following are eligible for investment thereunder:

- 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.

Investment Term

The value of debt security investments by contractual maturity is shown below (in thousands). 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.

	June 30, 2001
Due in one year or less	$16,024
Due after one year through five years	-
Due after five years through ten years	-
Due after ten years	-
	$16,024

3 REVENUE BONDS

On October 13, 2000, NTSC issued $116,050,000 of revenue bonds, Series 2000 containing both serial and term bonds. The revenue bonds were issued to purchase the TSRs from the State. The 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. The Bonds bears interest at a fixed annual rate, between 5.40% and 6.50%, payable semi-annually until the principal is redeemed. The Series 2000 serial bonds mature on June 1, 2008 through June 1, 2013 the Series 2000 term bonds have a scheduled sinking fund maturity of June 1, 2022 and 2031. The Series 2000 term bonds contain a turbo redemption feature which requires all TSR collections in excess of operating expenditures and scheduled debt service be applied to the redemption of the 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.

Principal and interest debt service payments for the required scheduled is as follows (in thousands):

	Scheduled maturities		
	Principal	**Interest**	**Total Debt Service**
Year Ending June 30			
2002	$ -	$7,188	$7,188
2003	-	7,188	7,188
2004	-	7,188	7,188
2005	-	7,188	7,188
2006	-	7,188	7,188
2007 – 2011	18,395	33,969	52,364
2012 – 2016	27,645	26,793	54,438
2017 – 2021	20,295	18,945	39,240
2022 – 2026	21,585	12,785	34,370
2027 – 2031	28,130	4,771	32,901
	$116,050	$133,203	$249,253

The changes in liabilities are as follows (in thousands):

Bonds Payable:	**Balance at Inception**	**Additions**	**Reductions**	**June 30, 2001 Balance**
Revenue Bonds	$ -	$116,050	$ -	$116,050
Less bond discount	$ -	(878)	$ -	(878)
Total bonds payable	$ -	$115,172	$ -	$115,172

4 YIELD RESTRICTION AND ARBITRAGE REBATE

Most of the investments made under the Corporation'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 the Internal Revenue Service. There were no excess earnings recorded and paid for the period from September 29, 2000 (Inception) through June 30, 2001.

5 RELATED PARTY TRANSACTION

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 Indenture and the related agreements for a monthly fee. NTSC also entered into a Sub Lease Agreement with AHFC for office space and overhead and operating services from AHFC for a monthly fee. The cost to NTSC for these services provided by AHFC was $ 4,500 for the period from September 29, 2000 (Inception) through June 30, 2001.

6 OTHER COMMITMENT, CONTINGENCY AND SUBSEQUENT EVENT

Subsequent event

On August 2, 2001, NTSC issued $126,790,000 of Series 2001 revenue bonds to purchase the "2001 pledged receipts", consisting of an additional 40 percent of all amounts required to be paid to the State of Alaska beginning January 10, 2002 under the MSA, with interest rates on the bonds of 3.50% to 5.50% and maturity dates ranging from 2003 to 2029.

Litigation

In October 2000, a complaint was filed in the Superior Court for the State of Alaska, Third Judicial District (Myers v. State of Alaska, Alaska Housing Finance Corporation and Northern Tobacco Securitization Corporation), seeking a declaratory judgment determining that the sale of the 2000 Pledged Receipts by the State to AHFC or to NTSC is a dedication of State funds for a special purpose, in violation of Section 7, Article IX, of the Alaska Constitution. On October 24, 2000, Superior Court Judge Hensley ruled that such sale of the 2000 Pledged Receipts did not violate the Alaska Constitution. Plaintiff thereafter appealed to the Alaska Supreme Court; oral arguments have been heard. Any adverse decision in the Myers litigation will likely adversely affect the validity of the sale of the 2000 Pledged Receipts to NTSC, and NTSC's ability to repay bondholders.

Contingency

Future Tobacco Settlement Revenues, in accordance with the MSA, are subject to adjustment based upon tobacco consumption, inflation and other factors. Pursuant to the Bond Indenture these adjustments, could affect the amount of funds available under the Bond Indenture and the scheduled debt service requirements.