Northern Tobacco Securitization Corporation

a component unit of the State of Alaska

Financial Statements

With Independent Auditors' Report

June 30, 2003 and 2002

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701 West Eighth Avenue
Suite 600
Anchorage, AK 99501

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, 2003 and 2002, 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 audit.

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, 2003 and 2002, 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 Notes A and H 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 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

September 12, 2003

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, 2003 and 2002. 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 in 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 the notes to financial statements. Comparative financial statements for June 30, 2002 are also 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 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 current year's 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 a full understanding of the data provided in the government-wide financial statements. The notes to the financial statements follow Exhibit C.

During the year ended June 30, 2002, NTSC adopted the provisions of Statement No. 34 of the Governmental Accounting Standards Board (GASB 34). GASB 34 requires that governmental fund financial statements be presented in both entity-wide and governmental fund format.

CONDENSED STATEMENT OF NET ASSETS

(in thousands)

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.

Total liabilities decreased $8 million due to debt service payments on the bonds.

The total net assets deficit balance decreased $7 million as a net result of the changes in the restricted net assets and unrestricted net assets deficit balances. Restricted net assets decreased $374,000 due to the decrease in investments and increase in tobacco settlement revenue. The unrestricted net assets deficit balance decreased $8 million, primarily due to an excess of revenues over expenses during the year.

Analysis for fiscal year 2002

	2002	2001
Investments	$ 29,954	$ 16,024
Total assets	34,429	18,913
Bonds and notes, net	232,863	115,203
Total liabilities	234,008	116,122
Restricted net assets	29,452	15,406
Unrestricted net assets	(229,031)	(112,615)
Total net assets (deficit)	(199,579)	(97,209)

Investments increased $14 million, due primarily to $11 million in bond proceeds deposited in the debt service reserve account as required under the current year bond issue, and reinvestment of $1 million in investment earnings for the current year.

Total assets increased $16 million, of which $14 million was related to investments.

Bonds and notes, net of discount, increased $118 million, due entirely to the $127 million current year bond issue less $8 million in principal redemptions.

Total liabilities increased $118 million primarily as a result of the increase in bonds and notes, net of discount.

Restricted net assets increased $14 million, mirroring the increase in investments.

The deficit balance of unrestricted net assets increased $116 million, primarily representing the purchase of an additional $110 million in rights to tobacco settlement revenues from the State of Alaska. The deficit is a result of current accounting standards requiring that the purchase of the rights to the tobacco settlement revenues be expensed rather than capitalized.

Total net deficit increased $102 million as a net result of the changes in the restricted net assets and unrestricted net deficit balances.

CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

(in thousands)

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 (deficit)	7,498	(102,370)

Total revenues increased $166,000. Tobacco settlement revenue increased $126,000, which includes a payment in transit to NTSC at year end.

Total expenses decreased $110 million. NTSC purchased no additional rights to tobacco settlement revenues during the year ending June 30, 2003, thus resulting in a decrease of $110 million in expenses over the prior year.

Analysis for fiscal year 2002

	2002	2001
Tobacco settlement revenue	$ 19,918	$ --
Total revenue	21,278	864
Purchase of a portion of rights to tobacco settlement revenue	109,943	93,000
Interest expense	13,117	4,923
Total expenses	123,648	98,073
Changes in net assets (deficit)	(102,370)	(97,209)

Tobacco settlement revenues increased $20 million, as the current year amount represents the first scheduled annual payment. No such revenues were received during the prior fiscal year.

Total revenues increased $20 million, comprised primarily of the tobacco settlement revenues.

Rights to tobacco settlement revenues increased $17 million, representing the larger relative portion of bond issue proceeds that was transferred to the State of Alaska from the current year bond issue as compared to the prior year issue.

Interest expense increased $8 million, with $6 million and $3 million representing the current and prior year bond issues, respectively.

Total expenses increased $26 million, including the $17 million change in rights to tobacco settlement revenues and $8 million change in interest expense.

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.

There were no significant changes to the assets or liabilities 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 million due to a $1 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 unlike in the previous fiscal year.

For the year ended June 30, 2002 total assets increased $14 million, comprised primarily of $11 million of invested bond proceeds held in the debt service reserve account for the current year bond issue. A corresponding increase in total net assets also occurred. Total liabilities were unchanged.

Total bond interest expense for fiscal year 2002 increased $8 million, of which $5 million was related to the current year bond issue and $3 million to the prior year bond issue.

GENERAL FUND

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

For fiscal year 2003 NTSC issued no additional bonds, thus the proceeds from the issuance of bonds decreased by $125 million and the costs of issuance decreased $2 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 $110 million in expenses over the prior year.

For fiscal year 2002 proceeds from the issuance of bonds increased by $12 million over the prior year, due to the relative sizes of the debt issuances. Similarly, rights to tobacco settlement revenues increased $17 million, representing the larger relative portion of bond issue proceeds that was transferred to the State of Alaska from the current year bond issue as compared to the prior year issue.

DEBT ADMINISTRATION

As of June 30, 2003, NTSC had $225 million of revenue bonds, net of discount, secured solely by future tobacco settlement revenue and investment earnings. Significant debt activity during the year consisted of debt service payments totaling $21 million, of which $13 million represented interest and $8 million represented principal paydowns. As of the date of this statement, there are no plans for the Corporation to issue additional debt.

As of June 30, 2002, NTSC had $233 million of revenue bonds, net of discount, secured solely by future tobacco settlement revenue and investment earnings.

Significant debt activity during fiscal year 2002 consisted of the issuance of $127 million in revenue bonds to purchase the rights to an additional forty percent of future tobacco settlement revenues. Debt service payments totaled $20 million, of which $12 million represented interest and $8 million represented principal paydowns.

Ratings on the Corporation's bonds are subject to change as the companies that rate the bonds analyze changes in 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.

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, 2003 and 2002
(in thousands of dollars)

	June 30, 2003				
	General Fund	Debt Service Fund	Governmental Funds Balance Sheet Total	Adjustments*	Statement of Net Assets Total
ASSETS					
Investments	$ 401	$ 28,786	$ 29,187	$ -	$ 29,187
Interest receivable	-	64	64	-	64
Tobacco revenues receivable	-	228	228	-	228
Intergovernmental receivable	-	-	-	-	-
Unamortized costs of issuance	-	-	-	4,028	4,028
Total Assets	401	29,078	29,479	4,028	33,507
LIABILITIES					
Bond interest payable	-	-	-	989	989
Long-term debt (Note E):			-		-
Due within one year	-	-	-	-	-
Due after one year	-	-	-	226,850	226,850
Unamortized bond discount	-	-	-	(2,251)	(2,251)
Total Liabilities	-	-	-	225,588	225,588
FUND BALANCES					
Fund balances:					
Unreserved	401	-	401		
Reserved for debt service	-	29,078	29,078		
Total Fund Balances	401	29,078	29,479		
Total Liabilities and Fund Balances	$ 401	$ 29,078	29,479		
NET ASSETS					
Restricted for debt service					29,078
Unrestricted net assets, (deficit)					(221,159)
Total Net Assets (deficit)				$ (221,560)	$ (192,081)

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

Interest receivable not received within 60 days from the end of the period is not available to pay for current period expenditures and, therefore, is deferred in the governmental funds. The statement of net assets recognizes investment interest when earned.	-
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.	4,028
Long-term debt and interest payable are not due and payable in the current period and therefore are not reported in the governmental funds.	(227,839)
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.	2,251
Net assets of governmental activities	$ (192,081)

See accompanying notes to the financial statements.

EXHIBIT A

June 30, 2002				
General Fund	Debt Service Fund	Governmental Funds Balance Sheet Total	Adjustments*	Statement of Net Assets Total
$ 502	$ 29,452	$ 29,954	$ -	$ 29,954
-	-	-	23	23
-	-	-	-	-
5	-	5	-	5
-	-	-	4,447	4,447
507	29,452	29,959	4,470	34,429
-	-	-	1,145	1,145
		-		
-	-	-	490	490
-	-	-	234,855	234,855
-	-	-	(2,482)	(2,482)
-	-	-	234,008	234,008
507	-	507		
-	29,452	29,452		
507	29,452	29,959		
$ 507	$ 29,452	29,959		
				29,452
				(229,031)
			$ (229,538)	$ (199,579)
		23		
		4,447		
		(236,490)		
		2,482		
		$ (199,579)		

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 Years Ended June 30, 2003 and 2002

(in thousands of dollars)

	June 30, 2003				
	General Fund	**Debt Service Fund**	**Total Governmental Funds**	**Adjustments (Exhibit C)**	**Statement of Activities**
GENERAL REVENUES					
Tobacco settlement revenues	$ -	$ 20,044	$ 20,044	$ -	$ 20,044
Investment interest	-	1,391	1,391	(23)	1,368
Net increase in fair value of investments	-	32	32	-	32
Total revenues	-	21,467	21,467	(23)	21,444
EXPENDITURES/EXPENSES					
Current:					
Insurance and financing	100	-	100	-	100
General and administrative	6	-	6	-	6
Costs of issuance	-	-	-	266	266
Purchase of a portion of rights to tobacco settlement revenues from the State of Alaska	-	-	-	-	-
(Gain)/loss on extinguishment of bonds	-	-	-	237	237
Debt Service:					-
Principal	-	8,495	8,495	(8,495)	-
Interest	-	13,346	13,346	(9)	13,337
Total expenditures/expenses	106	21,841	21,947	(8,001)	13,946
Excess (deficiency) of revenues over expenditures	(106)	(374)	(480)	7,978	7,498
Other financing sources/uses:					
Principal amount of bonds issued	-	-	-	-	-
Bond discount	-	-	-	-	-
Transfers - internal activities	-	-	-	-	-
Total other financing sources (uses)	-	-	-	-	-
Net change in fund balances	(106)	(374)	(480)	480	-
Change in net assets				7,498	7,498
FUND BALANCES and NET ASSETS (DEFICIT)					
Beginning of year	507	29,452	29,959	(229,538)	(199,579)
End of year	$ 401	$ 29,078	$ 29,479	$ (221,560)	$ (192,081)

See accompanying notes to the financial statements.

EXHIBIT B

	June 30, 2002				
	General Fund	Debt Service Fund	Total Governmental Funds	Adjustments (Exhibit C)	Statement of Activities
	$ -	$ 19,918	$ 19,918	$ -	$ 19,918
	-	1,217	1,217	(67)	1,150
	-	210	210	-	210
	-	21,345	21,345	(67)	21,278
	95	-	95	-	95
	19	-	19	-	19
	2,050	-	2,050	(1,790)	260
	109,943	-	109,943	-	109,943
	-	(5)	(5)	219	214
	-	7,495	7,495	(7,495)	-
	-	12,431	12,431	686	13,117
	112,107	19,921	132,028	(8,380)	123,648
	(112,107)	1,424	(110,683)	8,313	(102,370)
	126,790	-	126,790	(126,790)	-
	(1,852)	-	(1,852)	1,852	-
	(12,622)	12,622	-	-	-
	112,316	12,622	124,938	(124,938)	-
	209	14,046	14,255	(14,255)	-
				(102,370)	(102,370)
	298	15,406	15,704	(112,913)	(97,209)
	$ 507	$ 29,452	$ 29,959	$ (229,538)	$ (199,579)

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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 Years Ended June 30, 2003 and 2002

(in thousands of dollars)

	2003	2002
Amounts reported for governmental activities in the statement of net assets are different because:		
Net change in fund balances - total governmental funds	$ (480)	$ 14,255
Bond proceeds provide current financial resources to governmental funds, but debt issued increases long-term liabilities in the statement of net assets.	-	(126,790)
Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.	8,495	7,495
Governmental funds report costs of debt issuance as expenditures. The statement of activities amortizes such items over the life of the debt.	(266)	1,790
Governmental funds report bond discounts as other financing uses. The statement of activities amortizes such items to interest expense over the life of the debt.	-	1,852
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.	(237)	(219)
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.	(147)	(140)
Bond interest is reported as an expenditure in governmental funds when paid. Interest expense is reported in the statement of activities when incurred.	156	(546)
Governmental funds defer interest receivable not received within 60 days. The statement of activities recognizes interest income when earned.	(23)	(67)
Change in net assets of government activities	$ 7,498	$ (102,370)

See accompanying notes to the financial statements.

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Notes to Financial Statements

FOOTNOTE INDEX

Notes to Financial Statements

FOR THE YEAR ENDED JUNE 30, 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 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) and is presented in 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 cigarette smoking-related litigation between the settling states and the Participating Manufacturers (PMs), released the PMs from past and present smoking-related claims, and provides for a continuing release of future smoking-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.

NTSC is authorized to issue bonds necessary to provide sufficient funds for carrying out its purpose. In October 2000, and again in August 2001, NTSC issued revenue bonds that are the sole obligation of NTSC. Neither AHFC nor the State is liable for any debt issued by NTSC.

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 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 with the bonds have been fulfilled, the TSRs revert back to the State under a residual certificate. Consideration paid by NTSC through AHFC 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 via AHFC 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 with the bonds have been fulfilled, the TSRs revert back to the State under a residual certificate. Consideration paid by NTSC through AHFC 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.

Pursuant to the bond indentures, these adjustments 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 information for FY 2002 is also presented and is 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 general obligation debt of governmental funds.

NOTE C: ASSETS, LIABILITIES AND FUND EQUITY

Use of Estimates

The preparation of financial statements in accordance with generally accepted accounting 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 receivable, the tobacco revenue was accrued and a receivable recorded for financial reporting in both the governmental fund and government-wide financial statements.

Intergovernmental Receivable

The outstanding balance is receivable from 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. Bond premiums, 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 premiums and discounts, as well as bond issuance costs, 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 debt service 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 from available current resources in the individual governmental fund financial statements.

Fund Balances

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

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, 2003	June 30, 2002
Bank investment agreements	$ -	$ -	$ 17,785	$ 17,785	$ 3,288
U.S. agency securities	11,089	-	-	11,089	11,055
	$ 11,089	$ -	$ 17,785	28,874	14,343
Money market funds				313	15,611
Total investments				$ 29,187	$ 29,954

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.

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, 2003 and June 30, 2002 was $29,187,000 and $29,954,000, 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, 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.

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 2008 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 Principal	Series 2000 Bonds Interest	Series 2001 Bonds Principal	Series 2001 Bonds Interest	Debt Service Requirements Principal	Debt Service Requirements Interest	Debt Service Requirements Total
2004	$ -	$ 6,702	$ -	$ 6,223	$ -	$ 12,925	$ 12,925
2005	-	6,701	-	6,223	-	12,924	12,924
2006	-	6,702	-	6,223	-	12,925	12,925
2007	-	6,701	-	6,223	-	12,924	12,924
2008	4,245	6,702	1,975	6,222	6,220	12,924	19,144
Total Five Years 2004 - 2008	4,245	33,508	1,975	31,114	6,220	64,622	70,842
Five Years Ending June 30							
2009 - 2013	24,520	29,703	20,545	20,395	45,065	50,098	95,163
2014 - 2018	19,010	11,771	28,535	11,406	47,545	23,177	70,722
2019 - 2023	18,710	8,603	24,165	8,048	42,875	16,651	
2024 - 2028	23,935	5,307	34,825	4,190	58,760	9,497	68,257
2029 - 2031	17,790	1,178	8,595	236	26,385	1,414	27,799
	$108,210	$90,070	$118,640	$75,389	$226,850	$165,459	$392,309

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, 2003, NTSC maintained debt service reserve accounts for the Series 2000 and 2001 bonds at $11,336,562 and $11,158,170, respectively, and at June 30, 2002, at $11,324,034 and $11,056,171, 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, 2003 or June 30, 2002.

NOTE G: CONTINGENCIES

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 TSRs 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 30, 2000, Superior Court Judge Hensley ruled that such sale of the 2000 TSRs did not violate the Alaska Constitution. Plaintiff thereafter appealed to the Alaska Supreme Court.

On April 18, 2003 the Alaska Supreme Court rendered its decision. The court affirmed the superior court decision which was rendered on October 30, 2000. In affirming the superior court decision, the supreme court concluded that the securitization of the revenue stream of funds from the tobacco lawsuit settlement did not violate the anti-dedication provisions of Alaska's constitution.

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, 2003 and June 30, 2002 was $6,000 and $6,000, respectively. This amount was included as a portion of General and Administrative Expenditures/Expenses.

NOTE I: SUBSEQUENT EVENTS

Tobacco Litigation Risk

In March 2003, a major participating manufacturer (PM) was found liable of fraud in its marketing of "light" cigarettes, and plaintiffs in the class-action suit were awarded $10.1 billion in damages in an Illinois court. Because there is no cap on bonding requirements for appeals in Illinois, the bond-posting requirement allowing the PM to seek an appeal of the trial court's decision was set at $12 billion. This requirement was later reduced to approximately $6 billion on appeal to the Illinois Supreme Court. In its decision, the Illinois Supreme Court also agreed to hear the PM's appeal of the original judgment.

The PM had previously stated that if the original $12 billion bonding requirement was not reduced, it might not have been able to meet its obligations under the MSA. Although the PM has prevailed in its attempt to reduce the bonding requirement, there is still the possibility of an adverse outcome on its appeal of the original judgment, with $10.1 billion potentially due should such an appeal be unsuccessful. Arguments have not yet been heard by the Illinois Supreme Court.

Additionally, litigation risk is not limited to a single PM. Other PMs face similar allegations in suits filed against them. Any adverse outcome in these suits could materially affect the ability of the PMs to meet their obligations under the MSA.

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