

HB

119

<TARGET><BILL>HB 119</BILL><SUBJECT>HB
119</SUBJECT><COMM>HL&C30</COMM></TARGET>



THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

**Department of Commerce, Community,
and Economic Development**

OFFICE OF THE COMMISSIONER

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MEMORANDUM

TO: Representative Sam Kito
Chairman, House Labor and Commerce

DATE: Wednesday, February 15, 2017

FROM: Chris Hladick, Commissioner

RE: Hearing request for HB 119

Please accept this request to schedule HB 119 – AIDEA: Dividend to State; Income; Valuation – for consideration by the House Labor and Commerce Committee.

Looming accounting changes and application of the existing General Accounting Standards Board statement 31 will trigger increased volatility in the AIDEA dividend available to the state treasury due to compounding of “mark-to-market” adjustment entries on statutorily defined “net income”. While AIDEA is required to make these adjustments to secure an audited financial statement, the Legislature previously determined it was prudent to “exclude” certain adjustments prior to calculation of the AIDEA dividend. Unfortunately, numerous rules were not anticipated when the previous policy instruction was implemented.

In addition, certain write-downs and impairment results should be excluded from determining net income in order to not penalize the state or AIDEA when such entries are appropriate.

HB 119 was introduced to correct these two problems while also providing the state with a more consistent dividend that will aid in budgeting and planning purposes.

Gene Therriault with AIDEA will be present when the measure is considered and will be assisted by additional personnel via teleconference.

Enclosures

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Governor Bill Walker
STATE OF ALASKA

February 10, 2017

The Honorable Bryce Edgmon
Speaker of the House
Alaska State Legislature
State Capitol Room 208
Juneau, AK 99801-1182

Dear Speaker Edgmon:

Under the authority of Article III, Section 18, of the Alaska Constitution, I am transmitting a bill relating to the Alaska Industrial Development and Export Authority (AIDEA) annual dividend payments to the State. The bill is intended to clarify or modify accounting matters that affect the calculation of AIDEA's dividends. The overall intent of the bill is to have AIDEA's dividends better reflect the cash-based realized net income of the funds from which AIDEA's dividends are paid.

Under AS 44.88.088, AIDEA is required to pay a dividend each year of between 25 and 50 percent of the "net income" for each of its statutorily-created funds, but not more than the total "unrestricted net income" of each fund. The terms "net income" and "unrestricted net income" are defined in AS 44.88.088 as meaning the change in net position of each fund as reported in AIDEA's audited financial statements each year, excluding consideration of certain designated items. The bill would modify the excluded items that are not considered in determining the change in the net position of each of AIDEA's funds.

Specifically, the bill proposes to eliminate from consideration in calculating AIDEA's dividends: (1) impairment losses on a project or development to the extent financed with State or federal grants or appropriations; (2) any current or future mark-to-market fair value based accounting requirements imposed by the Government Accounting Standards Board (GASB) such as those in Statements No. 31 and No. 72; and, (3) non-cash accounting entries related to retirement obligations such as those required under GASB Statement No. 68.

The proposed change to the language on losses in AS 44.88.172 is meant to remove the restriction that the loss must occur with respect to a development project. Under current law, AIDEA may finance different types of projects and developments, not just development projects. Instead of restricting consideration to losses only to development projects, the bill amends the language on excluding consideration of losses to tie the losses to the use of State or federal grants or appropriations to finance a project or development. The amended language in the bill means that, when an investment in a project or development is made with State or federal grants or

The Honorable Bryce Edgmon
Transmittal AIDEA Dividend Payments to the State
February 10, 2017
Page 2

appropriations, a loss as to that investment will not be compounded by having AIDEA's dividend to the State reduced because of it. At the same time, however, a loss on a project or development funded by AIDEA's own cash will be reflected in the calculation of the dividend.

The bill's amendments directed at GASB Statements No. 31, No. 72, and No. 68 are meant to exclude unrealized "paper" gains or losses AIDEA must record in its financial statements from impacting AIDEA's dividends. Under GASB Statements No. 31 and No. 72, AIDEA must make accounting entries based on the mark-to-market values of its investments at the close of its fiscal year each year. Given the vagaries of the market, these values can and likely will fluctuate significantly from year to year. Under GASB Statement No. 68, AIDEA must make accounting entries for fluctuating actuarial computations on pension obligations. The accounting entries AIDEA must make to comply with these GASB statements do not reflect the actual results of AIDEA's operations, which should be the basis for its dividend to the State. The accounting required by these GASB statements may cause great fluctuations from year to year in the net income of AIDEA's funds. Removing these accounting adjustments from the dividend calculation would stabilize AIDEA's dividend payment to the State and improve predictability as to the amount of the annual dividends.

I urge your prompt and favorable action on this measure.

Sincerely,

A handwritten signature in blue ink that reads "Bill Walker". The signature is written in a cursive, flowing style.

Bill Walker
Governor

Enclosure



House Bill 119

AIDEA: Dividend to State; Income; Valuation

Sectional Analysis

Section 1: Section 1 amends AS 44.88.088(b) to include a definition for “mark-to-market fair value” adjustments that are mandated by the General Accounting Standards Board (GASB) and Generally Accepted Accounting Principles (GAAP). It then adds these adjustments and noncash accounting entries relating to pension obligations and benefits to the existing statutory list of items that are to be excluded from “net income” prior to calculation of AIDEA’s dividend to the state treasury.

Section 1 also adjusts the existing scope of project losses that are to be excluded from the definition of AIDEA’s statutory net income (dividend base). The Legislature previously instructed that amounts attributable to intergovernmental transfers, capital contributions and grants were to be excluded so as not to impact the dividend base. Additionally, losses on development projects financed under AS44.88.172 were also excluded. However, the prior policy instruction did not anticipate periodic write offs for projects financed outside of AS44.88.172 with funds from non AIDEA sources. In these limited cases, project losses would affect AIDEA financial statement net income which could, in turn lower the calculated dividend.

Finally, Section 1 applies the mark-to-market adjustment, noncash pension and other postemployment benefit adjustments and redefined project loss exclusions discussed above to all AIDEA funds subject to the dividend statute to remove unnecessary volatility from the yearly dividend.

Section 2: Section 2 provides for an immediate effective date.

Fiscal Note

State of Alaska
2017 Legislative Session

| | |
|---------------------|-----------|
| Bill Version: | HB 119 |
| Fiscal Note Number: | 1 |
| (H) Publish Date: | 2/13/2017 |

Identifier: DCCED-AIDEA-12-19-16
 Title: AIDEA:DIVIDEND TO
 STATE;INCOME;VALUATION
 Sponsor: RLS BY REQUEST OF THE GOVERNOR
 Requester: Governor

Department: Department of Commerce, Community and
 Economic Development
 Appropriation: Alaska Industrial Development and Export
 Authority
 Allocation: Alaska Industrial Development and Export
 Authority
 OMB Component Number: 1234

Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

| | FY2018 | Included in | Out-Year Cost Estimates | | | | |
|-------------------------------|-------------------------|---------------------------|-------------------------|------------|------------|------------|------------|
| | Appropriation Requested | Governor's FY2018 Request | FY 2019 | FY 2020 | FY 2021 | FY 2022 | FY 2023 |
| OPERATING EXPENDITURES | FY 2018 | FY 2018 | | | | | |
| Personal Services | | | | | | | |
| Travel | | | | | | | |
| Services | | | | | | | |
| Commodities | | | | | | | |
| Capital Outlay | | | | | | | |
| Grants & Benefits | | | | | | | |
| Miscellaneous | | | | | | | |
| Total Operating | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

Fund Source (Operating Only)

| | | | | | | | |
|--------------|------------|------------|------------|------------|------------|------------|------------|
| None | | | | | | | |
| Total | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

Positions

| | | | | | | | |
|-----------|--|--|--|--|--|--|--|
| Full-time | | | | | | | |
| Part-time | | | | | | | |
| Temporary | | | | | | | |

Change in Revenues

| | | | | | | | |
|--------------|------------|------------|------------|------------|------------|------------|------------|
| None | | | | | | | |
| Total | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

Estimated SUPPLEMENTAL (FY2017) cost: 0.0 *(separate supplemental appropriation required)*
(discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY2018) cost: 0.0 *(separate capital appropriation required)*
(discuss reasons and fund source(s) in analysis section)

ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? No
 If yes, by what date are the regulations to be adopted, amended or repealed? N/A

Why this fiscal note differs from previous version:

Not applicable; initial version.

| | | | |
|--------------|--|--------|---------------------|
| Prepared By: | John Springsteen, Executive Director | Phone: | (907)771-3000 |
| Division: | Alaska Industrial Development and Export Authority | Date: | 12/19/2016 02:00 PM |
| Approved By: | Catherine Reardon, Director | Date: | 01/13/17 |
| Agency: | Division of Administrative Services, DCCED | | |

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2017 LEGISLATIVE SESSION

Analysis

AIDEA pays an annual dividend to the State of Alaska based upon its statutorily defined net income for general state government use. The average dividend paid in FY2007-FY2017 was \$18.3 million. Currently, the statutorily defined net income includes mark-to-market adjustments as required by GASB 31. These mark-to-market adjustments are the actual posting of gains or losses that did not actually occur, resulting in an increase or decrease to AIDEA's real net income.

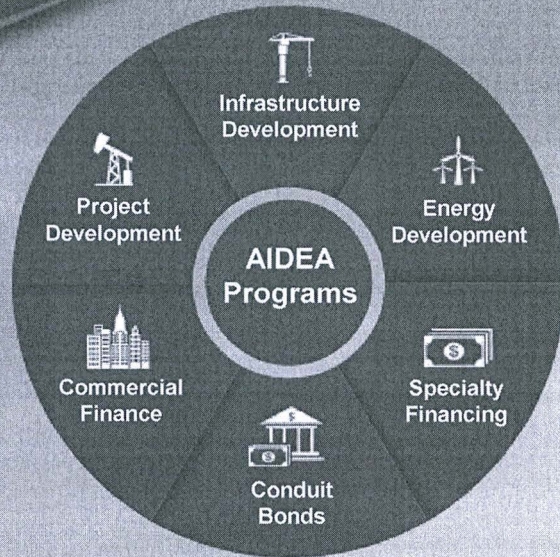
Implementation of GASB 31, by itself, created volatility in AIDEA's dividend to the State of Alaska. A historical analysis of the past ten years demonstrates that the effect of GASB 31 mark-to-market entries have impacted AIDEA's net income by up to \$22.0 million in one year, with the dividend impact being up to \$11.0 million for FY2013.

The future impacts of AIDEA's net income from implementing GASB 68 (pension obligations) in FY2015, GASB 72 (fair value measurement) in FY2016 and GASB 75 (other post-employment benefits) in FY2018 are indeterminate, but are anticipated to contribute to the GAAP based net income volatility. The ten year history of booking GASB 31 entries and their impact on net income and the dividend is shown below:

Historic GASB 31 Mark-to-Market Net Income and Dividend Impact

| Fiscal Year | Net Income Gain / (Loss) | Dividend Impact |
|-------------|--------------------------|-----------------|
| 2007 | 4.8 MM | 2.4 MM |
| 2008 | 1.8 MM | 0.9 MM |
| 2009 | 3.2 MM | 1.6 MM |
| 2010 | 18.1 MM | 9.0 MM |
| 2011 | (0.9) MM | (0.5) MM |
| 2012 | 7.1 MM | 3.6 MM |
| 2013 | (22.0) MM | (11.0) MM |
| 2014 | 4.7 MM | 2.4 MM |
| 2015 | (3.3) MM | (0.8) MM |
| 2016 | 12.1 MM | 4.1 MM |

The legislation also includes language to limit the scope of impairment losses (the re-evaluation of assets at the end of a fiscal year) to the extent that AIDEA has paid for the asset, excluding any state or federal grants or appropriations. Additionally, the legislation seeks to stabilize AIDEA's dividend to the State by removing these market value entries from the statutory net income calculation. A prediction of future market conditions, future actuarial estimates, or potential impairments, and thereby, their effect on AIDEA's dividend to the State of Alaska cannot be made.



ALASKA'S DEVELOPMENT FINANCE AUTHORITY

*HB 119 - Proposed Language Changes to
Modernize AIDEA's Dividend Statute*

Investing in Alaskans



AIDEA's Dividend: History, Goal, Statutory Language, and Two Accounting Problems Working to Fix

Dividend Statute Language Needs Modernizing, As Accounting Rules Have Evolved Over Time



3 Accounting Transaction Types, #3 Causes Dividend Problems:

1. Entries from “**real transactions**” that actually occurred, they are historic in nature. *Examples: booking what was paid for an asset, revenue that is generated, payroll that is paid, taxes paid, what was cash received and why, etc.*
2. Entries from “**estimates and allocations**”. *Examples: booking depreciation and amortization expenses which recognizes and records that an asset used up some of its estimated useful life over the period of operations.*
3. Entries from “**market value adjustments**”. These are entries related to transactions that didn't happen, but, AIDEA must record them for the audit as though they did to comply with G.A.S.B. and have a G.A.A.P. audit. (HB 119 proposes to update the existing “excluding...” statutory language and remove G.A.S.B. “market value” impacts on the AIDEA dividend calculation) *Example: booking the gain or loss that would have resulted from selling your marketable securities on the last day of the year (GASB 31).*

Sec. 44.88.088. Payment of dividend to state.



The Pertinent Language:

The authority **shall** adopt a policy for payment of a dividend... to the state each fiscal year.

... The amount of the dividend payable... may not be less than 25 percent nor more than 50 percent of the **net income** ...for the base fiscal year...

...“**net income**” means **the change in net position**, or the equivalent term under **generally accepted accounting principles**, ... as set out in the **audited financial statements** of the authority for the base fiscal year, **excluding amounts attributable to intergovernmental transfers, capital contributions, grants, or impairment losses on development projects financed under AS 44.88.172;**

Dividend Problem #1: "Market Value" Adjusting Entries



Problem #1:

1. **G.A.A.P. keeps evolving**, requiring booking/recording "market value" adjusting entries. Essentially, act like something happened that didn't happen, and book it as though it did...
2. The result: **AIDEA's "net income" swings**, sometimes materially, which means **the State's dividend swings** sometimes materially year-over-year,
3. Ultimately, the **dividend payment is a cash based transaction**. (*Paying it when cash hasn't been earned is a problem -- for AIDEA. Not paying it when cash has been earned is a problem -- for the State.*)



Problem #1 Analogy of



"Market Value" Entries Impacts

\$ Based Tax Payer Analogy

Form 1040 Department of the Treasury—Internal Revenue Service **2015** U.S. Individual Income Tax Return

OMB No. 1545-0047 IRS Use Only—Do not write or staple in this space

For the year Jan. 1-Dec. 31, 2015, or other tax year beginning 2015, ending 20

Your first name and initial Last name See separate instructions. Your social security number

If a joint return, spouse's first name and initial Last name Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions Apt. no. Make sure the SSN(s) above and on line 6c are correct.

City, town or post office, state, and ZIP code. If you have a foreign address, also complete space below (see instructions).

Foreign country name Foreign province/state/county Foreign postal code Presidential Election Campaign Check here if you, or your spouse (if filing jointly), want \$3 to go to this fund. Checking a box below will not change your tax or refund. Yes Spouse

Filing Status 1 Single 4 Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶

Check only one box. 2 Married filing jointly (even if only one had income) 3 Married filing separately. Enter spouse's SSN above and full name here. ▶ 5 Qualifying widow(er) with dependent child

Exemptions 6a Yourself. If someone can claim you as a dependent, do not check box 6a. 6b Spouse

Dependents: (1) First name Last name (2) Dependent's social security number (3) Dependent's relationship to you (4) If child under age 17 qualifying for child tax credit (see instructions)

If more than four dependents, see instructions and check here

Total number of exemptions claimed

Income 7 Wages, salaries, tips, etc. Attach Form(s) W-2 7 100,000

8a Taxable interest. Attach Schedule B if required 8a 1,500

b Tax-exempt interest. Do not include on line 8a 8b

9a Ordinary dividends. Attach Schedule B if required 9a 6,000

b Qualified dividends 9b

10 Taxable refunds, credits, or offsets of state and local income taxes 10

11 Alimony received 11

12 Business income or (loss). Attach Schedule C or C-EZ 12

13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ 13

14 Other gains or (losses). Attach Form 4797 14

15a IRA distributions 15a b Taxable amount 15b

16a Pensions and annuities 16a b Taxable amount 16b

17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E 17

18 Farm income or (loss). Attach Schedule F 18

19 Unemployment compensation 19

20a Social security benefits 20a b Taxable amount 20b

21 Other income. List type and amount 21 1,500

22 Combine the amounts in the far right column for lines 7 through 21. This is your total income ▶ 22 109,000

Adjusted Gross Income 23 Educator expenses 23

24 Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ 24

25 Health savings account deduction. Attach Form 8889 25

26 Moving expenses. Attach Form 3903 26

27 Deductible part of self-employment tax. Attach Schedule SE 27

28 Self-employed SEP, SIMPLE, and qualified plans 28

29 Self-employed health insurance deduction 29

30 Penalty on early withdrawal of savings 30

31a Alimony paid b Recipient's SSN ▶ 31a 31b

32 IRA deduction 32

33 Student loan interest deduction 33

34 Tuition and fees. Attach Form 8917 34

35 Domestic production activities deduction. Attach Form 8903 35

36 Add lines 23 through 35 36

37 Subtract line 36 from line 22. This is your adjusted gross income ▶ 37

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 112205 Form 1040 (2015) 7

Investing in Alaskans

Form 1040 Impact Analogy



Income 7 Wages, salaries, tips, etc. Attach Form(s) W-2 7 100,000

8a Taxable interest. Attach Schedule B if required 8a 1,500

b Tax-exempt interest. Do not include on line 8a 8b

9a Ordinary dividends. Attach Schedule B if required 9a 6,000

b Qualified dividends 9b

10 Taxable refunds, credits, or offsets of state and local income taxes 10

11 Alimony received 11

12 Business income or (loss). Attach Schedule C or C-EZ 12

13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ 13

14 Other gains or (losses). Attach Form 4797 14

15a IRA distributions 15a b Taxable amount 15b

16a Pensions and annuities 16a b Taxable amount 16b

17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E 17

18 Farm income or (loss). Attach Schedule F 18

19 Unemployment compensation 19

20a Social security benefits 20a b Taxable amount 20b

21 Other income. List type and amount 21 1,500

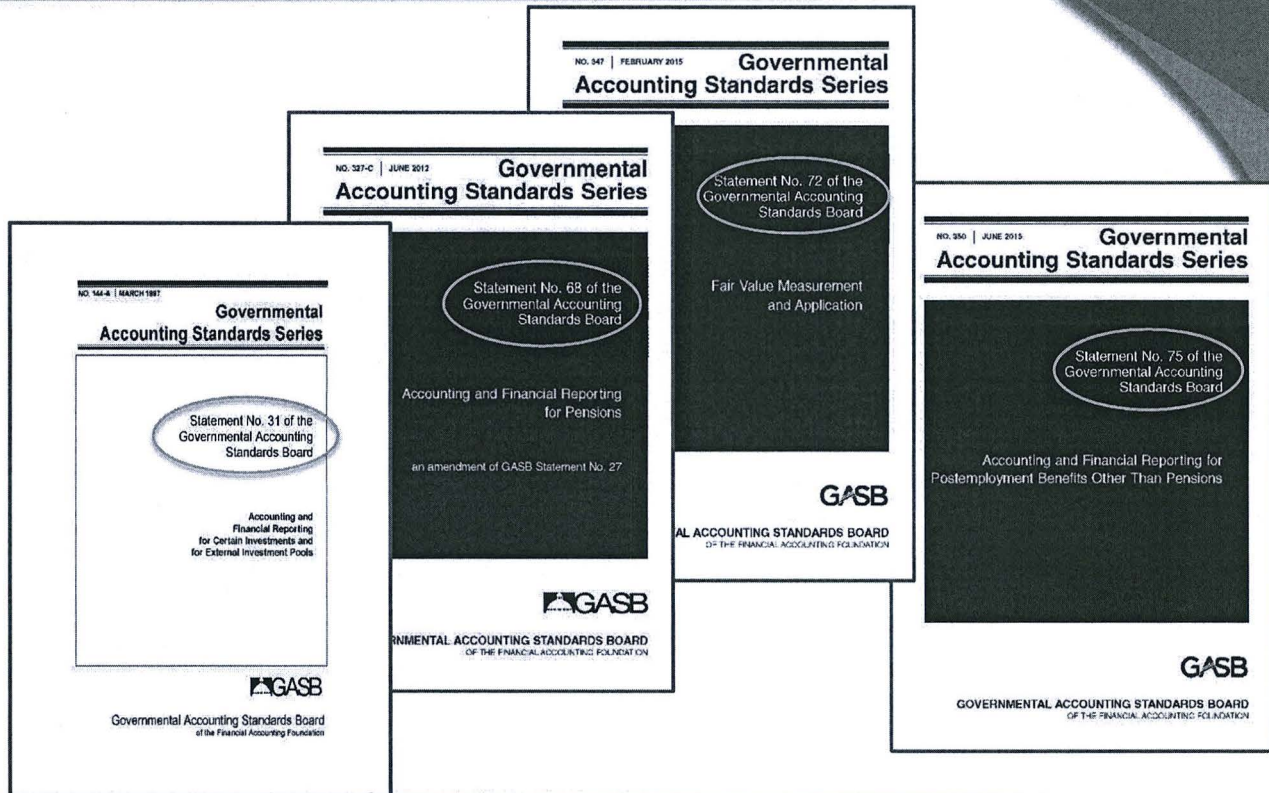
22 Combine the amounts in the far right column for lines 7 through 21. This is your total income ▶ 22 109,000

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

Investing in Alaskans

GASB Statements 31, 68, 72, & 75



Form 1040 Analogy – Add GASB Impacts



(Now adjust your **1040 total income** as if “GASB Type” adjustments were required at year-end)

| Income | 7 | Wages, salaries, tips, etc. Attach Form(s) W-2 | 7 | 100,000 |
|--------|-----|---|-----|---------|
| | 8a | Taxable interest. Attach Schedule B if required | 8a | 1,500 |
| | 9a | Tax-exempt interest. Do not include on line 8a | 9a | 6,000 |
| | 10 | Ordinary dividends. Attach Schedule B if required | 10 | |
| | 11 | Qualified dividends | 11 | |
| | 12 | Taxable refunds, credits, or offsets of state and local income taxes | 12 | |
| | 13 | GASB 31 - Unrealized gain or loss on marketable securities (10% on \$250k portfolio) | 13 | 25,000 |
| | 14 | Business income or (loss). Attach Schedule C or C-EZ | 14 | |
| | 15a | Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/> | 15a | |
| | 16a | Other gains or (losses). Attach Form 4797 | 16a | |
| | 17 | IRA distributions | 17 | |
| | 18 | GASB 68 – Value adjustment from Retirement 401k Account (5% on \$200k growth) | 18 | 10,000 |
| | 19 | Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E | 19 | |
| | 20a | GASB 72 – Fair value adjustment for your rental property (5% on \$400k value) | 20a | 20,000 |
| | 21 | Unemployment compensation | 21 | |
| | 22 | GASB 75 – Fair value adjustment for your other post employment benefits | 22 | 5,000 |
| | 23 | Other income. List type and amount | 23 | 1,500 |
| | 24 | Combine the amounts in the far right column for lines 7 through 23. This is your total income | 24 | 169,000 |

Under this analogy you'd have \$60,000 more income that you'd have to pay taxes on if you had to recognize "market value" adjustments on your personal tax return, without having earned the \$ to pay the taxes... (Note: any of these adjustments could go in either direction.)

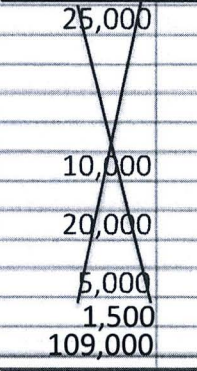
HB 119 Impact To 1040 Analogy



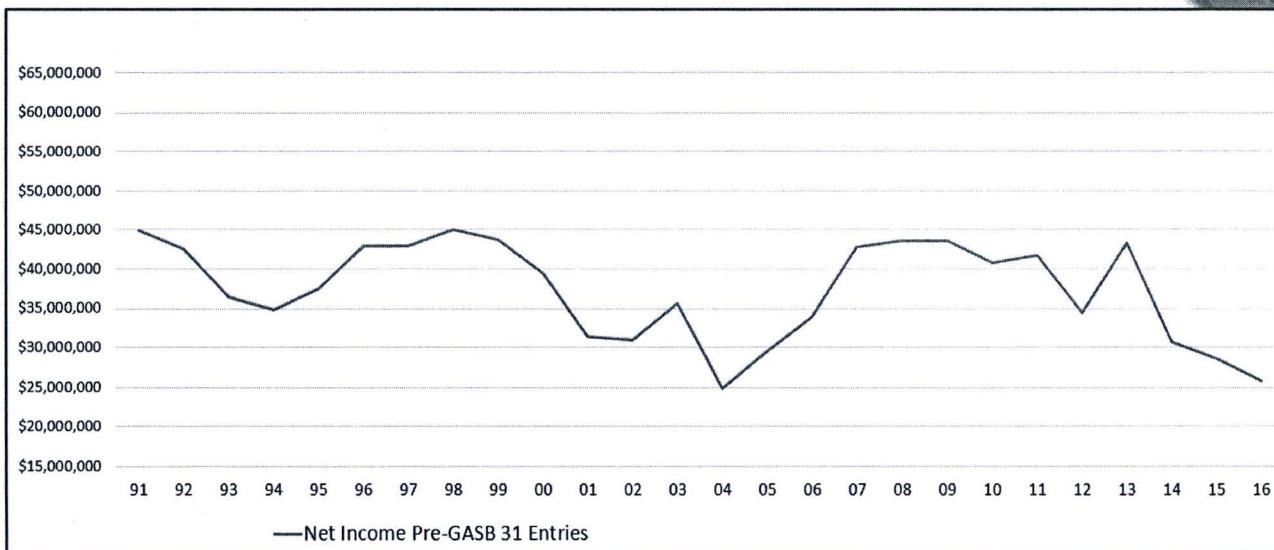
The "market value" unrealized adjustments would be excluded from "Net Income."

| Income | 7 | Wages, salaries, tips, etc. Attach Form(s) W-2 | 7 | 100,000 |
|--------|-----|---|-----|--------------------|
| | 8a | Taxable interest. Attach Schedule B if required | 8a | 1,500 |
| | b | Tax-exempt interest. Do not include on line 8a | 8b | |
| | 9a | Ordinary dividends. Attach Schedule B if required | 9a | 6,000 |
| | b | Qualified dividends | 9b | |
| | 10 | Taxable refunds, credits, or offsets of state and local income taxes | 10 | |
| | 11 | GASB 31 - Unrealized gain or loss on marketable securities (10% on \$250k portfolio) | 11 | 25,000 |
| | 12 | Business income or (loss). Attach Schedule C or C-EZ | 12 | |
| | 13 | Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/> | 13 | |
| | 14 | Other gains or (losses). Attach Form 4797 | 14 | |
| | 15a | IRA distributions | 15a | |
| | b | Taxable amount | 15b | |
| | 16a | GASB 68 - Value adjustment from Retirement 401k Account (5% on \$200k growth) | 16a | 10,000 |
| | 17 | Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E | 17 | |
| | 18 | GASB 72 - Fair value adjustment for your rental property (5% on \$400k value) | 18 | 20,000 |
| | 19 | Unemployment compensation | 19 | |
| | 20a | GASB 75 - Fair value adjustment for your other post employment benefits | 20a | 5,000 |
| | 21 | Other income. List type and amount | 21 | 1,500 |
| | 22 | Combine the amounts in the far right column for lines 7 through 21. This is your total income | 22 | 109,000 |
| | | Revised line 22 total taxable income post market value if recognized | | 169,000 |

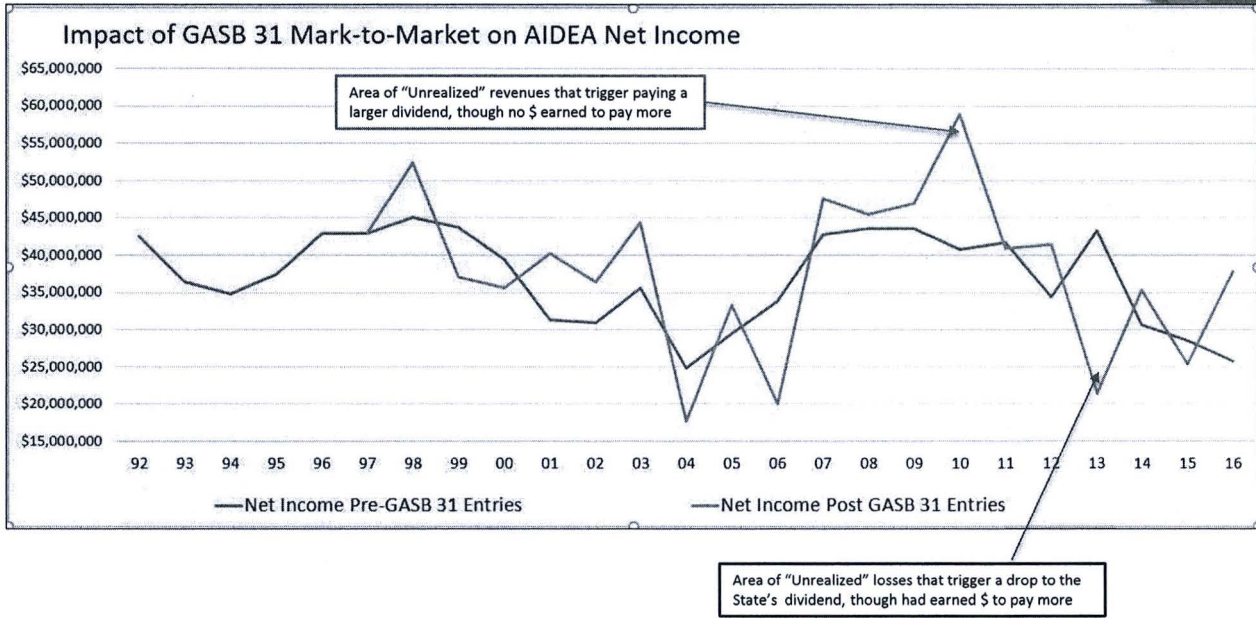
HB 119 removes these impacts



AIDEA's Net Income, Pre-G.A.S.B. 31 "Market Value" Adjusting Entries



GASB 31 Impact to *Net Income*



Problem #2 "Dividend Penalty" Adjusting Entries

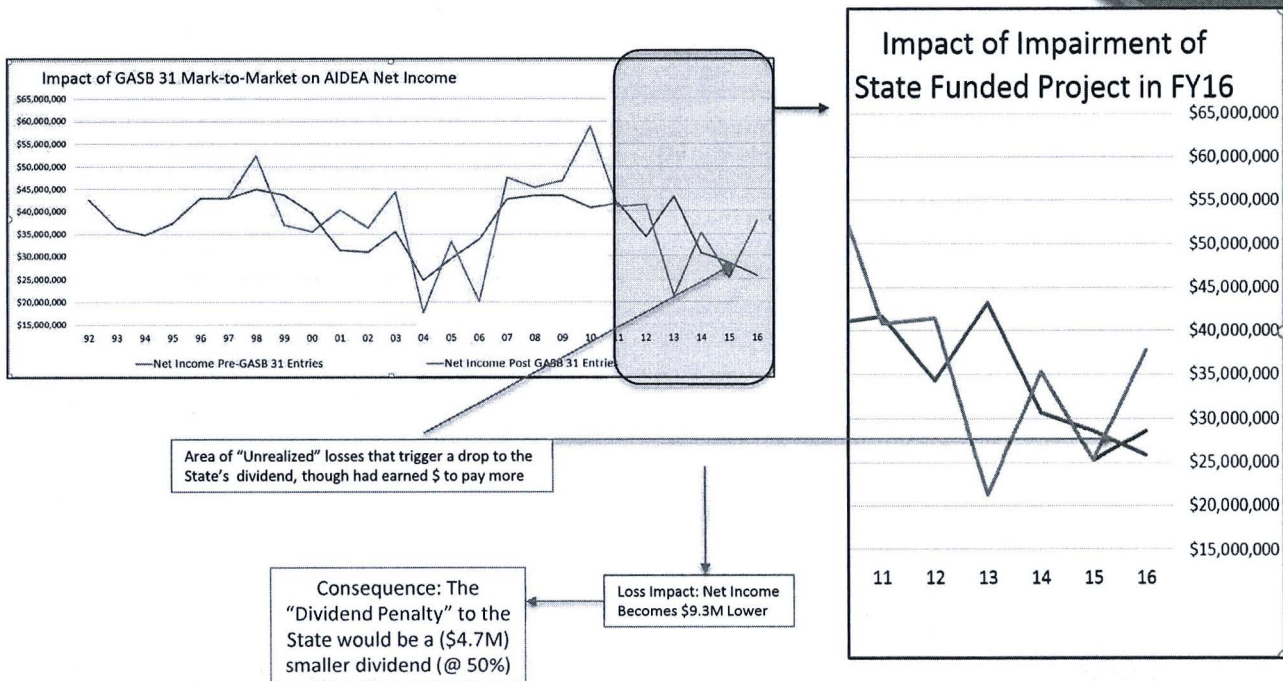
Dividend Problem #2: "Dividend-Penalty" Effect Adjusting Entries



Problem #2:

1. When the **value** of a project has been determined to have been **permanently reduced**, G.A.A.P. requires recording an adjusting entry between the Balance Sheet and the Income Statement to *reduce some or all of the value of an asset or a project from AIDEA's Balance Sheet*.
2. The resulting entry **reduces net income**. The consequence could either reduce the State's dividend from a project it funded or have AIDEA adjusting its dividend calculation to offset the reduction in project value.
3. Thus, **there could be** up to a 25% to 50% "dividend penalty" from an adjusting entry.

Hypothetical State Funded Non-172 Project, if Stopped, Impact to "Net Income"



Proposed Statutory Language Explanation

Summary

The proposed statutory change of HB 119:

- 1) Removes the “*market value*” entries that impact the dividend, thus better stabilizing the dividend amount paid to the State year-over-year.
- 2) Removes the “*dividend-penalty*” resulting from an investment project that did not materialize as originally planned.
- 3) Modernizes and aligns statutory language to the fact that the dividend is a check to the State, and thus, is a cash based transaction. Language changes better connect the payment to the actual realized results of operations.



Alaska Industrial Development and Export Authority

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#AIDEA



www.aidea.org

