State of Montana

COMPREHENSIVE ANNUAL FINANCIAL REPORT

For the Fiscal Year Ended June 30, 2008

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Table of Contents

INTRODUCTORY SECTION

FINANCIAL SECTION

STATISTICAL SECTION

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements for the State of Montana have been prepared in accordance with Generally Accepted Accounting Principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

A. Reporting Entity

For financial reporting purposes, the State of Montana has included all funds which comprise the State of Montana (the primary government) and its component units. The component units are entities for which the State is financially accountable, or whose relationship with the State is such that exclusion would cause the State's financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the State to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the State.

Discretely Presented Component Units
These component units are entities that are legally separate from the State because they possess corporate powers, but are financially accountable to the State, or whose relationships with the State are such that exclusion would cause the State's financial statements to be misleading or incomplete. Complete financial statements of the individual component units, which issue separate financial statements, can be obtained from their respective administrative offices. The component unit columns of the combined financial statements include the financial data of the following entities.

Housing Authority – This authority, which is a legally separate entity, is governed by a quasi-judicial board appointed by the Governor. It was created in 1975 to facilitate the availability of decent, safe, and sanitary housing to persons and families of lower income. The board issues negotiable notes and bonds to fulfill its purposes. The total amount of notes and bonds outstanding at any time may not exceed $1.5 billion. Neither the faith and credit nor taxing power of the State of Montana may be pledged for the amounts so issued. The authority is audited annually by the State's Legislative Audit Division. The report is issued under separate cover and available at 301 South Park, Room 240, PO Box 200528, Helena, MT 59620-0528.

Facilities Finance Authority – This authority, which is a legally separate entity, is governed by a quasi-judicial board appointed by the Governor with the advice and consent of the Senate. The authority assists all eligible, non-profit Montana health care and other community-based service providers to obtain and maintain access to the broadest range of low-cost capital financing as possible. The board issues revenue bonds to fulfill its purposes. Neither the faith and credit nor taxing power of the State of Montana may be pledged for the amounts so issued. Individual audit reports are issued every two years by the State's Legislative Audit Division. The report is issued under separate cover and available at 2401 Colonial Drive, 3rd Floor, PO Box 200506, Helena, MT 59620-0506.

Montana State Fund (New and Old Fund) – The fund is a nonprofit, independent public corporation governed by a board appointed by the Governor. The fund provides workers compensation insurance. The fund consists of two separate entities: the New Fund and the Old Fund. The New Fund covers claims incurred after June 30, 1990, and is financed by member (employer) premiums. The Old Fund covers claims incurred before July 1, 1990. Administrative operations and budgets are reviewed by the Governor and the Legislature. The fund is audited annually by the State's Legislative Audit Division. The report is issued under separate cover and available at 5 South Last Chance Gulch, Helena, MT 59601.

Montana Surplus Lines – Montana Surplus Lines Agents Association is a legally separate entity appointed as an advisory organization by the Montana Insurance Commissioner, and primarily performs services as directed by the Commissioner, located within Montana State Auditor's Office. The Association operates the Montana State Insurance Commissioner's Surplus Lines stamping office. The Association regulates insurance companies that provide specialized insurance coverage, of an unusual or high risk nature, that is not provided by other insurance companies. The association is audited annually by Galusha, Higgins & Galusha, PC. The report is issued under separate cover, and is available at 840 Helena Avenue, Helena, MT 59601.

Universities and Colleges – The State Board of Regents has responsibility for the following institutions: The University of Montana - Missoula and the units under it including Montana Tech of the University of Montana, The University of Montana - Western and The University of Montana - Helena College of Technology; and Montana State University - Bozeman and the units under it including Montana State University - Billings, Montana State University -

Northern, and the Montana State University College of Technology - Great Falls. All units are funded through state appropriations, tuition, federal grants, and private donations and grants. The universities are audited annually by the State's Legislative Audit Division. The reports are issued under separate cover and are available at the President's Office on each of the campuses or by contacting the Commissioner of Higher Education, 46 North Last Chance Gulch, PO Box 203201, Helena, MT 59620-3201.

Though the following organizations perform functions related to the higher education units, they are not considered part of Montana's reporting entity: (1) Community Colleges which are considered part of local units of government; (2) the Montana Higher Education Student Assistance Corporation, a private non-profit corporation; and (3) the Student Assistance Foundation of Montana, a private non-profit corporation. Entities such as local school districts and local authorities of various kinds are considered part of local units of government and have not been included. The State's support of local public education systems is reported in the General Fund and the State Special Revenue Fund.

Fiduciary Fund Component Units

Teachers Retirement System (Pension Trust Fund) – This retirement plan is a legally separate entity with a board appointed by the Governor. Its purpose is to provide retirement, disability, death and lump-sum payments to members of Montana's public teaching profession. The administrative costs of the Teachers Retirement System are paid from investment earnings of the fund. The plan is funded from employer and employee contributions and investment earnings. The board is a discretely presented component unit. The plan is audited annually by the State's Legislative Audit Division. Its report is issued under separate cover and is available at 1500 East Sixth Avenue, PO Box 200139, Helena, MT 59620-0139.

Public Employees Retirement Board (Pension and Other Employee Benefit Trust Funds) – The board, appointed by the Governor, administers ten separate retirement plans for the purpose of providing retirement, disability, death, and lump-sum payments to each plan member. These legally separate plans include the Public Employees Defined Benefit Retirement Plan, Public Employees Defined Contribution Retirement Plan, the associated education funds, the Municipal Police Officers, the Game Wardens and Peace Officers, the Sheriffs, the Judges, the Highway Patrol Officers and the Firefighters Unified Retirement Systems, as well as the Volunteer Firefighters Compensation Act. The board also administers the State of Montana Deferred Compensation Program.

The Public Employees Retirement System (PERS) includes the Public Employees Defined Benefit Retirement Plan and the Public Employees Defined Contribution Retirement Plan, and is funded from employer and employee contributions, investment earnings and contributions from state, county, and local governments. The PERS also accounts for the administrative costs, paid from investment earnings, of the plan. The Municipal Police Officers Retirement System is funded from member, state, and city contributions. The Game Wardens and Peace Officers Retirement System is funded by employer and employee contributions. The Sheriffs Retirement System is funded by member, state, and county contributions. The Judges Retirement System is funded by member and state contributions. The Highway Patrol Officers Retirement System is funded by member and state contributions. The Firefighters Unified Retirement System is funded by employer and employee contributions as well as a portion of insurance premium taxes collected by the State. The Volunteer Firefighters Compensation Act is funded by contributions of a percentage of fire insurance premium taxes collected. The State of Montana Deferred Compensation Program is funded from member and investment earnings; there are two employers, Great Falls Transit and the town of Whitehall, that contribute to the program.

The board is a discretely presented component unit responsible for the ten separate public employee retirement plans including the Deferred Compensation Program. These are reported as pension and other employee benefit trust funds. The board is audited annually by the State's Legislative Audit Division. Its report is issued under separate cover and is available at 100 North Park, Suite 200, PO Box 200131, Helena, MT 59620-0131.

B. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all of the non-fiduciary activities of the State of Montana and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which are normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the State of Montana is reported separately from certain legally separate component units for which the State is financially accountable.

The Statement of Activities demonstrates the degree to which the direct expenses of a function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Certain indirect costs are included in the program expense reported for the individual functions and activities.

Program revenues include (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function; and (2) grants and contributions restricted to meeting the operational or capital requirements of a particular function. Taxes and other revenues not meeting the definition of program revenues are reported as general revenues.

Separate fund financial statements are provided for governmental, proprietary, and fiduciary funds. Fiduciary fund statements are reported only in the fund financial statements. Major individual governmental and major individual enterprise funds are reported as separate columns in the fund financial statements.

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Government-wide, Proprietary, and Fiduciary Fund Financial Statements
The government-wide, proprietary fund, and fiduciary fund (except for agency fund) financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are reported when earned; expenses are recorded when a liability is incurred regardless of the timing of the related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenues as soon as all of the eligibility requirements imposed by the provider are met. Agency funds have no measurement focus. These funds report only assets and liabilities, recognizing receivables and payables using the accrual basis of accounting.

Governmental Fund Financial Statements
Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they are realizable, measurable, earned, and available. Revenue is considered realizable when it is probable the amount will be collected. Revenue is considered measurable and realizable if the precise amount is known because the transaction is completed, or if there is enough information to provide a reasonable estimate of the net realizable revenue to be received. Revenue is considered to have been earned when the exchange of goods or services has taken place. Revenue is considered to be available if it is collectible within the current period, or soon enough thereafter, to pay liabilities of the current period. For this purpose, the State considers revenue to be available if it is 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 as well as expenditures relating to compensated absences and claims and judgments are recorded only when payment is due.

The major revenue sources considered susceptible to accrual are licenses and permits, natural resource taxes, individual income taxes, corporate income taxes, property taxes, fuel taxes, and certain federal revenues (reimbursable grants and U.S. mineral royalties). All other revenue is considered to be measurable and available when the cash is received.

Fund Financial Statements
The State uses funds to report on its financial position and the results of its operations. A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

The financial activities of the State of Montana are classified into fund categories as described below:

Governmental Funds
<u>General Fund</u> – To account for all governmental financial resources, except those required to be accounted for in another fund.

<u>Special Revenue Funds</u> – To account for the proceeds of specific revenue sources restricted to expenditure for specified purposes other than major capital projects.

<u>Debt Service Funds</u> – To account for resources accumulated for payment of principal and interest on general long-term obligation debt.

<u>Capital Projects Funds</u> – To account for resources used for the acquisition or construction of major capital facilities, other than those financed by proprietary or trust funds.

<u>Permanent Funds</u> – To account for resources that are permanently restricted to the extent that only earnings, not principal, may be used for the purposes of supporting the government's programs.

Proprietary Funds
<u>Enterprise Funds</u> – To account for operations (1) financed and operated similar to private business enterprises, where the intent of the Legislature is to finance or recover costs primarily through user charges; (2) where the Legislature has decided periodic determination of revenue earned, expenses incurred, or net income is appropriate; (3) where the activity is financed solely by a pledge of the net revenues from fees and charges of the activity; (4) when laws or regulations require that the activities' costs of providing services, including capital costs, be recovered with fees and charges rather than with taxes or similar revenues. The primary focus of fee revenues charged by

enterprise funds is users outside of the primary government.

Internal Service Funds – To account for the financing of goods and services provided by one department or agency to other departments, agencies, or other governmental entities on a cost-reimbursement basis.

The State of Montana reports two employee group benefits funds. The MUS Group Insurance Fund primarily charges its fees to Montana State University and the University of Montana. The universities are reported as discretely presented component units, which the State considers to be external users, and as such, reports the MUS Group Insurance Fund as an enterprise fund. The Employee Group Benefits Fund charges its fees to funds of the primary government, and as such, is reported as an internal service fund.

Fiduciary Funds
To account for assets held by the State in a trustee capacity or as an agent for individuals, private organizations, or other governments. These assets cannot be used to support the government's own programs.

Pension (and Other Employee Benefit) Trust Funds – These funds report resources that are required to be held in trust for the members and beneficiaries of the State's defined benefit plans, defined contribution plans, other retirement plans such as firefighters, police officers, teachers etc., and other post employment benefit plans. Plan members receive retirement, disability, death, and lump-sum payments from the fund. For detail on the individual plans, see Note 6.

Private-Purpose Trust Funds – These funds are used to account for assets held by the State in a trustee capacity, where both the principal and earnings benefit individuals, private organizations, or other governments. Examples include the State's escheated property fund, unliquidated security bonds held on deposit from self-insured employers, environmental reclamation bonds held in trust, and others.

Investment Trust Fund – This fund accounts for the receipt of monies by the Montana Board of Investments for investment in the Short-term Investment Pool (STIP), an external investment pool, and the distribution of related investment earnings to local government agencies.

Agency Funds – Account for assets held by the State as an agent for individuals, private organizations, and other governments. For example, various agencies including State Auditor, Fish, Wildlife and Parks, and the Department of Natural Resources and Conservation hold deposits pending compliance with performance agreements. Other examples include monies belonging to state institution residents and child support payments from parents.

Major Governmental Funds
The General Fund is the State's primary operating fund, as previously defined.

The State Special Revenue Fund accounts for activities funded from state sources, which are restricted either legally or administratively for particular costs of an agency, program, or function.

The Federal Special Revenue Fund accounts for activities funded from federal sources used in the operation of state government.

The Coal Tax Trust Permanent Fund, created by Article IX, Section 5 of the Montana State Constitution, receives 50% of all coal tax collections. The principal in this fund can be expended only upon affirmative vote of three-fourths of each house of the Legislature.

The Land Grant Permanent Fund accounts for lands granted to the State for support of public schools and state institutions.

Major Enterprise Funds
The Unemployment Insurance Fund accounts for employer contributions deposited with the Secretary of the Treasury of the United States to the credit of the State's unemployment trust fund. Unemployment benefits are paid from this fund to eligible recipients.

The Economic Development Bonds Fund accounts for the Economic Development Bond Act programs and the Municipal Finance Consolidation Act programs. These programs assist Montana's small businesses and local governments in obtaining long-term, fixed-rate financing through private Montana lending institutions.

Private sector standards of accounting and financial reporting issued prior to December 1, 1989, are generally followed by both the government-wide and proprietary fund financial statements to the extent they do not conflict with or contradict guidance of GASB. Governments also have the option of following subsequent private sector guidance for their business-type activities and enterprise funds. The State has elected not to follow subsequent private sector guidance.

As a general rule, material interfund revenues have been eliminated from the government-wide financial statements. These have not been eliminated where their elimination would distort the direct costs and program revenues of the functions involved.

The State does not allocate indirect expenses to functions in the Statement of Activities.

D. Proprietary Activity Accounting and Financial Reporting

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues generally result from providing services and delivering goods in connection with a proprietary fund's principal ongoing operations. Operating expenses for enterprise and internal service funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting these definitions are reported as non-operating.

E. Cash/Cash Equivalents

For all funds, cash and cash equivalents consist of amounts deposited in the State Treasurer's pooled cash account, cash deposits in checking accounts, cash invested in the Short-term Investment Pool (STIP), cash held by trustees, undeposited cash held by individual state agencies, and investments categorized as cash equivalents, which are short-term, highly liquid investments with original maturities of three months or less. For 2008, certain investments in STIP were reclassified as long-term investments. (See Note 3).

F. Receivables

This classification, net of estimated uncollectibles, consists primarily of receivables for goods sold and services provided; short-term loans and notes; interest and dividends; taxes due within 60 days of fiscal year-end; and income, withholding, and inheritance taxes that are past due. An allowance for uncollectible taxes is provided based upon historical analysis. Further detail relating to receivables is provided in Note 4.

Pledged receivables are disclosed in Note 2C.

G. Inventories

Inventories of materials and supplies are stated at cost. The State allows agencies to use any generally accepted inventory pricing method, but specifies the first-in, first-out method should be appropriate for most agencies.

Governmental funds use the "purchase method," meaning inventory purchases are recorded as expenditures. At fiscal year-end, significant amounts of inventory are shown as a reservation of fund balance, indicating they do not constitute available expendable resources.

Proprietary and fiduciary funds report using the "consumption method," meaning inventories are expensed as used.

H. Restricted Assets

Certain investments of the Economic Development Bonds Enterprise Fund are classified as restricted assets on the Statement of Net Assets for Proprietary Funds because their use is limited by applicable bond indenture agreements.

I. Equity in Pooled Investments

The Montana Board of Investments manages the State's Unified Investment Program, which includes several internal investment pools. Participation in the pools is restricted to permanent funds, private-purpose trust funds, investment trust funds, pension trust funds, Montana University System Units, and specific funds established within the State Special Revenue Fund. The participant investments in the pools are reported at fair value in the assets within the individual funds (See Note 3 on Cash/Cash Equivalents and Investments).

J. Investments

In accordance with the Montana Constitution and the statutorily mandated "Prudent Expert Rule," the State of Montana invests in various types of securities for each portfolio it manages. Certain securities including asset-backed securities, variable-rate instruments, zero-coupon bonds, preferred stocks, and mortgage-backed securities are purchased for portfolio diversification and a competitive rate of return. Most investments are reported at fair value in the Balance Sheet or Statement of Net Assets. Investments are reported by type in the disclosure of custodial credit risk for each investment portfolio (See Note 3 on Cash/Cash Equivalents and Investments).

K. Capital Assets

Capital asset valuation is based on actual historical cost or, in the case of donations, fair market value on the date donated. General government infrastructure capital assets are capitalized and reported in the government-wide financial statements. Infrastructure assets of proprietary funds are capitalized on the fund financial statements. Interest incurred during the construction of capital assets for proprietary funds and higher education units is capitalized. The State has chosen to use the depreciation approach for infrastructure assets and is reporting accumulated depreciation in the Statement of Net Assets and depreciation expense in the Statement of Activities for these assets.

Capital assets in proprietary, private-purpose trust, and pension trust funds are accounted for within their respective funds and are depreciated. Depreciation is on a straight-line basis with estimated useful lives of 25 to 60 years for buildings, 7 to 20 years for building improvements, 3 to 10 years for equipment, and 10 to 50 years for infrastructure. State agencies are also required to extend or shorten the useful lives of capital assets to reflect their actual experience or industry standards when appropriate.

The capitalization limit for buildings and building/land improvements is $25,000. The capitalization threshold for infrastructure is $500,000. Agencies are allowed to capitalize additions to collections and land acquisitions at any cost. The capitalization limit for other capital assets is set at $5,000. Purchases under these thresholds are recorded as expenditures/expenses in the current period.

L. Deferred Revenue

Deferred revenue in the government-wide, proprietary fund, and fiduciary fund financial statements relates to unearned revenue. A liability for unearned revenue is recorded when assets are recognized in connection with a transaction prior to the earnings process being completed.

Deferred revenue in the governmental fund financial statements relates to both unearned revenue (as discussed above) and unavailable revenue. A liability for unavailable revenue is recorded when assets are recognized in connection with a transaction, but those assets are not considered available to finance expenditures of the current fiscal period.

M. Long-term Obligations

Long-term obligations expected to be financed from governmental funds are reported in the government-wide financial statements. Long-term debt is recognized as a liability of a governmental fund when due, or when resources have been accumulated in the debt service fund for payment early in the following year. For other long-term obligations, only that portion expected to be financed from current expendable available financial resources is reported as a fund liability of a governmental fund in the fund financial statements. The remaining portion of such obligations is reported in the government-wide financial statements.

Long-term liabilities expected to be financed from proprietary and fiduciary fund operations are accounted for in those funds.

N. Capital Leases

A capital lease is generally defined by Financial Accounting Standards Board (FASB) Statement No. 13, Accounting for Leases, as one which transfers benefits and risks of ownership to the lessee. At the inception of a capital lease, in the government-wide, proprietary fund, and fiduciary fund financial statements, a capital asset and a capital lease liability are recorded at the present value of the future minimum lease payments. In the governmental fund financial statements, because the modified accrual basis of accounting is used, no asset or liability is recorded related to assets under capital leases. Rather, in the governmental fund financial statements, at the inception of a capital lease, a capital outlay expenditure and an other financing source (inception of lease/installment contract) are recorded at the net present value of the minimum lease payments.

O. Bond Discounts/Premiums/Issuance Costs

Bond premiums and discounts, as well as issuance costs, are recognized in the current period for governmental funds in the fund financial statements. Bond proceeds and bond premiums are reported as an other financing source, and bond discounts are reported as an other financing use. Issuance costs are reported as debt service expenditures whether or not they are withheld from the bond proceeds. In proprietary fund types and in governmental funds as presented in the government-wide financial statements, bond premiums and discounts are deferred and amortized over the life of the bonds, which approximates the effective interest method. Bonds payable are recorded net of any applicable premium or discount, while issuance costs are reported as deferred charges.

P. Compensated Absences

Full-time state employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Teachers employed by the State do not receive vacation leave. Vacation leave may be accumulated and carried over from one year to the next. The carryover is limited to two times the maximum number of days earned annually. Sick leave is earned at the rate of 12 days per year with no limit on accumulation. Each contribution year, an employee may contribute a maximum of 80 hours of sick or annual leave to a nonrefundable sick leave pool. Excess annual leave that is being forfeited can also be contributed, with no maximum contribution. Based on a review, the adjusted ending balance of the pool for June 30, 2007, was 2,561 hours. For fiscal year 2008, 1,349 sick leave hours, 63 annual leave hours, and 2,410 excess annual leave hours were contributed to the sick leave pool, and 2,608 hours were withdrawn, leaving a balance of 3,775 hours in the pool. No liability is reported in the accompanying financial statements because these hours are nonrefundable to contributors, except by grants approved through an application process.

Vested or accumulated leave for proprietary and fiduciary funds is recorded as an expense and liability of those funds in the fund financial statements. For governmental funds, the liability is not expected to be liquidated with expendable financial resources. The expenditure and liability for the governmental funds is reported only in the government-wide financial statements. Upon retirement or termination, an employee is paid for 100% of unused vacation leave and 25% of unused sick leave.

Q. Advances to Other Funds

Noncurrent portions of long-term interfund receivables are reported as advances and are offset equally by a fund balance reserve account in the fund financial statements, which indicates that they do not constitute expendable available financial resources. The transaction is recognized by the receiving fund as advances from other funds.

R. Fund Balance/Net Assets

The State reserves those portions of fund balance not appropriable for expenditure or legally segregated for a specific future use. Designated fund balances represent tentative plans for the future use of financial resources. The debt service funds designated fund balances represent management's desire to maintain fund balance for future debt service payments.

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowing used for the acquisition, construction, or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use either through constitutional provisions or enabling legislation or through external restrictions imposed by creditors, grantors, or laws or regulations of other governments. The government-wide Statement of Net Assets reported restricted net assets (in thousands) of $2,954,471, of which $1,073,360 is restricted by enabling legislation.

S. Property Taxes

Real property taxes are levied in October and are payable in two installments on November 30 and May 31. These taxes attach as an enforceable lien immediately if not paid when due.

Personal property tax levies are set each August, and notices are normally mailed the following March or April. Half of mobile home taxes are due in 30 days and the remaining half on September 30. Taxes on all other types of personal property are to be paid in full 30 days after receipt of the notice. Personal property taxes attach as an enforceable lien immediately if not paid when due. Property taxes are collected by each of Montana's 56 counties. The counties then remit the State's portion to the State Treasury. The majority of these taxes help fund public school systems and higher education.

T. Other Taxes

On the Statement of Revenues, Expenditures and Changes in Fund Balances for Governmental Funds, the revenue category "Other Taxes" in the General, State Special Revenue, and Nonmajor Governmental funds consists of the following taxes (in thousands):

	General Fund	State Special Revenue Fund	Nonmajor Governmental Funds	Total
Accommodations	$ 12,876	$17,744	$ -	$ 30,620
Agriculture sales	-	4,150	-	4,150
Cigarette/tobacco	40,671	50,942	2,075	93,688
Fire protection	-	3,155	-	3,155
Insurance premium	63,823	11	-	63,834
Livestock	-	3,689	-	3,689
Other taxes	24,563	7,156	-	31,719
Public Service Commission	-	3,541	-	3,541
Telephone license	22,408	-	-	22,408
Video gaming	63,133	14	-	63,147
Total other taxes	$227,474	$90,402	$2,075	$319,951

NOTE 2. OTHER ACCOUNTING ISSUES

A. New Accounting Guidance Implemented

For the year ended June 30, 2008, the State of Montana and its component units implemented the provisions of the Governmental Accounting Standards Board (GASB) Statements No. 43 and 45 – "Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans" and "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions", respectively. GASB No. 43 applies to a trustee or administrator of an other postemployment benefit (OPEB) plan. The State of Montana and the Office of the Commissioner of Higher Education both administer OPEB plans. Therefore, GASB No. 43 specifies how these plans are to be disclosed in the footnotes. GASB No. 45 establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial statements of state governmental employers. GASB No. 45 applies to the State of Montana, its component units, and the university system. The effects of applying these standards are disclosed in Note 7.

For the year ended June 30, 2008, the State of Montana implemented the provisions of the GASB Statement No. 48 – "Sales and Pledges of Receivables and Future Revenues, and Intra-Entity Transfers of Assets and Future Revenues". GASB 48 establishes accounting and financial reporting standards for transactions in which a government receives, or is entitled to, resources in exchange for future cash flows generated by collecting specific receivables or specific future revenues. Future revenues do not include potential revenues from a source not in existence at the time of the transaction. GASB 48 also contains provisions that apply to certain situations in which a government does not receive resources but, nevertheless, pledges or commits future cash flows generated by collecting specific future revenues. In addition, this statement establishes accounting and financial reporting standards that apply to all intra-entity transfers of assets and future revenues. This statement does not apply to a government's pledge of its "full faith and credit" as security for its own debt or the debt of a component unit. (See Note 2C.)

B. Prior Period Adjustments

Prior period adjustments reported in the accompanying financial statements relate to corrections of errors from prior periods. No significant corrections were made for fiscal year 2008.

C. Pledged Receivables

During the year ended June 30, 2002, the common school mineral royalties' income stream, which included oil, coal, gas, gravel, and metalliferous royalties over 30 years totaling approximately $138.9 million, were sold to the Department of Natural Resources and Conservation (DNRC). The present value of the future revenues, at the date of sale, was estimated to be $46.4 million. The Secretary of State reviewed the provisions of the transactions as specified in Senate Bill (SB) 495, and determined that a discount rate of 9.8% would represent the fair market value, since the amount of the royalties dedicated is fixed, and the risk is limited to variation in the timing of receipts.

As of June 30, 2008, $37 million of the $138.9 million is yet to be collected.

NOTE 3. CASH/CASH EQUIVALENTS AND INVESTMENTS

This note details the following asset classifications (in thousands):

Cash/cash equivalents	$2,645,734
Equity in pooled investments	$8,980,996
Investments	$2,439,593

Carrying amounts for the bank balance for Cash Deposits and fair values for the State's cash equivalents and investments are presented in Tables 1 through 4.

A. General

(1) Cash and cash equivalents consist of funds deposited by individual funds in the State Treasurer's pooled cash account, cash deposits in checking accounts, cash invested in the Short-term Investment Pool, cash held by trustees, undeposited cash held by individual state agencies, and investments categorized as cash equivalents.

Cash deposited with the State Treasurer's pooled cash account is invested by the Montana Board of Investments (BOI) in short-term securities and other investments. Because these funds are immediately available to the individual funds, their investment in the pooled cash account is reported as a cash equivalent. In addition to the State Treasurer's pooled cash account, there is the Short-term Investment Pool (STIP) maintained by the BOI. This investment fund provides individual state agencies and local governments an opportunity to invest excess cash in a money market fund. Because these pooled funds are invested in short-term, highly liquid investments, the individual fund investments in the STIP are reported as a cash equivalent.

Although STIP, an external investment pool, is not registered with the Securities and Exchange Commission (SEC) as an investment company, the BOI has as policy that STIP will, and does, operate in a manner consistent with the SEC Rule 2a7. By meeting certain conditions, STIP, as a 2a7-like pool, is allowed to use amortized cost rather than fair value to report net assets to compute unit values. The portfolio is carried at amortized cost or book value. State agencies that are allowed to retain their interest earnings within their funds are required to invest in STIP. Local government participation in STIP is voluntary. Separately issued external investment pool financial statements may be obtained by contacting the Montana Board of Investments, 2401 Colonial Drive, 3rd Floor, PO Box 200126, Helena, MT 59620-0126.

The State's cash equivalents and investments are detailed in Table 2 - Cash Equivalents, Table 3 - Equity in Pooled Investments, and Table 4 - Investments to disclose the level of investment risk, when applicable, assumed by the State at June 30, 2008.

(2) All securities are reported by investment portfolio and type in Table 2 - Cash Equivalents, Table 3 - Equity in Pooled Investments, and Table 4 - Investments. The State invests in certain types of securities, including U.S. government direct-backed, U.S. government indirect-backed, corporate stock/bonds, foreign government bonds, common stock, municipals, equity index, preferred stock, convertible equity securities, asset-backed securities, American Depositary Receipts (ADRs), equity derivatives, commingled funds, venture capital, leveraged buyout, mezzanine, diversified real estate portfolio, distressed debt, special situation and secondary investments, and cash equivalents, to provide a diversified investment portfolio and an overall competitive rate of return.

U.S. government direct-backed securities include direct obligations of the U.S. Treasury and obligations explicitly guaranteed by the U.S. government. U.S. government indirect-backed obligations include U.S. government agency and mortgage-backed securities. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages.

Common stock represents ownership units (shares) of a public corporation. Common stock owners are entitled to vote on director selection and other important matters, as well as receive dividends on their holdings. Equity index investments are investments in selected mutual funds whose equity portfolios match a broad based index or composite. Preferred stock, as a class of stock, pays dividends at a specified rate and has preference in the payment of dividends and liquidation of assets. Preferred stock holders, ordinarily, do not have voting rights. Convertible securities are securities carrying the right to exchange, or "convert" the instrument for other securities of the issuer or of another issuer. This definition most often applies to preferred stocks or corporate bonds carrying the right to exchange for a fixed number of shares of the issuer's common stock. ADRs are receipts issued by a U.S. depositary bank representing shares of a foreign stock or bonds held abroad by the foreign sub-custodian of the American depositary bank. Equity derivatives "derive" their value from other equity instruments such as futures and options. An institutional commingled fund combines assets from several institutional investors that are blended or pooled together, to reduce management and administration costs. The investor buys shares in the fund.

Venture capital represents private equity investments in early stage financing of rapidly growing companies with an innovative product or service. Leveraged buyouts (LBOs) permit an investment group to acquire a company by leveraging debt, as a financing technique, to establish a significant ownership position on behalf of the company's current management team. Mezzanine investments are the subordinated debt and/or equity of privately-owned companies. The debt holder participates in equity appreciation through conversion features, such as rights, warrants, and/or options. These investments are made via limited partnership agreements in which BOI and other institutional investors invest as limited partners in funds managed by a general partner. These investments are riskier with higher potential return than public equity investments, and are less liquid because the funds are usually committed for at least ten years. Because of the risk and illiquidity, these investments are limited to sophisticated investors only.

Distressed debt represents the private and public debt of companies that appear unlikely to meet their financial obligations.

Special situation investments include the investment in the exploration for oil and/or gas reserves or in the development of proven reserves, investment in land to harvest timber, and investments that have a special component usually related to geographical, economic, or social issues. Secondary investments are investments in previously owned limited partnerships. These investments may be direct or via a general partner specializing in secondary investments. Private equity investments are long-term, by design, and extremely hard to value.

Diversified real estate portfolio includes investments in core, value-added, and opportunistic real estate. Core investments are the least risky with the lowest return, and are usually managed in commingled accounts in which the investor purchases shares. Value-added and opportunistic real estate investments provide more risk. Opportunistic investments are less liquid than core investments. These investments are usually made through limited partnership agreements.

Investments are presented in the Statement of Net Assets at fair value. Fair values for investment pool securities are determined primarily by reference to market prices supplied to the BOI by BOI's custodial bank, State Street Bank. Amortized cost represents the original cost, adjusted for premium and discount amortization, where applicable. Premiums and discounts are amortized/accreted using the straight-line or scientific method to the call, average life or maturity date of the securities. Amortized cost may also be referred to as book value.

Under the provisions of state statutes, the State has, via a Securities Lending Authorization Agreement, authorized the State's agent to lend the State's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the State receives a fee and the agent must initially receive collateral equal to 102% to 105% of the fair value of the loaned securities and maintain collateral equal to not less than 100% of the fair value of the loaned security. During the fiscal year, the State's agent loaned, on behalf of the State, certain securities held by the agent and received U.S. dollar and foreign currency cash, U.S. government securities, sovereign debt rated A or better, convertible bonds, and .

irrevocable bank letters of credit as collateral. The State's agent does not have the ability to pledge or sell collateral securities unless the borrower defaults. The State retains all rights and risks of ownership during the loan period. At year-end, the BOI has no credit risk exposure to borrowers because the amount the BOI owes the borrowers exceeds the amount the borrowers owe the system.

B. Cash/Cash Equivalents

(1) Cash Deposits – The State requires collateralization based on the average daily bank balance in the depository bank holding the main State bank account. For other depository banks, state statutes require collateralization at 50% of the bank balance. The cash deposits amount includes both primary government and component unit deposits.

Table 1 - Cash Deposit Amounts
(in thousands)

	Carrying Amount
Cash held by State/State's agent	$154,231
Uninsured and uncollateralized cash	2,052
Undeposited cash	658
Cash in U.S. Treasury	276,374
Cash in MSU component units	7,602
Cash in UM component units	13,214
Less: outstanding warrants	(55,389)
Total cash deposits	$398,742

As of June 30, 2008, the carrying amount of deposits for component units was $126,045,990, as included in Table 1.

(2) Cash Equivalents – consists of cash in the State Treasury invested by individual funds in the Short-term Investment Pool (STIP), the State Treasurer's pooled cash account, and in identifiable securities and investments considered to be cash equivalents. Cash equivalents, generally, are short-term, highly liquid investments with original maturities of three months or less. Cash equivalents may be under the control of the Board of Investments or other agencies, as allowed by law.

Table 2 - Cash Equivalents
(in thousands)

	Fair Value	Credit Quality Rating	WAM in Months
Commercial paper	$1,278,678	A1	0.94
Corporate fixed	179,972	A1+	1.60
Corporate variable-rate	79,998	A1+	3.27
Municipal variable-rate	149,353	NR	0.03
Money market	55,000	A1+	0.03
U.S. government indirect-backed	439,008	A1+	3.57
Repurchase agreement (1)	12,123	NR	NA
Government direct-indirect (2)	111,212	AAA	NA
Money market	61,891	NR	NA
Less: STIP included in pooled investment balance	(120,243)		
Total cash equivalents	$2,246,992		1.52
Securities lending collateral investment pool	$ 101,755		

(1) As of June 30, 2008, a repurchase agreement, per contract, was collateralized at 102% for $12,368,170 by a Federal National Mortgage FNCI maturing September 1, 2018. This security carries a AAA credit quality rating.

(2) The government direct-indirect securities are included in the credit quality rating and effective duration table in Note 3 D (Investments).

As of June 30, 2008, local governments invested $453,295,572 in STIP.

As of June 30, 2008, component units of the State of Montana had investments in cash equivalents with a book value and fair value of $319,504,169.

Investment Risk Disclosures
The investment risk disclosures are described in the following paragraphs and are identified by the specific pools or securities to which they pertain, when applicable.

Credit Risk
Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The STIP securities have credit risk as measured by major credit rating services. This risk is that the issuer of a STIP security may default in making timely principal and interest payments. The Board of Investment's policy requires that STIP securities be rated an investment grade as defined by at least one of the Nationally Recognized Statistical Rating Organizations (NRSRO).

Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk, and do not require disclosure of credit quality per GASB Statement 40.

STIP investments are categorized above to disclose credit risk as of June 30, 2008. Credit risk reflects the security quality rating, by investment security type, as of the June 30 report date. If a security investment type is unrated, the quality type is indicated by NR (not rated). Although the STIP investments have been rated by investment security type, STIP, as an external investment pool, has not been rated by the NRSRO.

Custodial Credit Risk
Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2008, all STIP securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the board's custodial bank, State Street Bank, or the State's name.

Concentration of Credit Risk
Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a

single issuer. The STIP had concentration of credit risk exposure to the Federal Home Loan Bank of 6.86%, Federal National Mortgage Association (Fannie Mae) of 7.55 % and the Federal Home Loan Mortgage Corp. (Freddie Mac) of 5.71% as of June 30, 2008.

The concentration of credit risk for the rated securities is included in the disclosure in Note 3 D (Investments).

Interest Rate Risk

STIP interest rate risk is determined using the weighted average maturity (WAM) method. The WAM measure expresses investment time horizons: the time when investments are due and payable in months or years, weighted to reflect the dollar size of individual investments within an investment type.

Legal and Credit Risk

In January 2007, BOI purchased a $25 million par issue of Orion Finance USA. In April 2007, BOI purchased two issues of Axon Financial Funding totaling $90 million par and another $25 million par issue of Orion Finance USA. As of June 30, 2007, these Structured Investment Vehicle (SIV) securities held in the STIP portfolio carried a combined amortized cost of $139,991,131, representing 5.02% of the total portfolio. At the time of purchase, and as of June 30, 2007, these four issues received the highest investment grade rating of AAA by Standard & Poors and Aaa by Moody's. As of June 30, 2008, these issues carried a D rating by Standard & Poors. On November 20, 2007, an insolvency event was declared by Axon Finance USA. Orion Financial Funding declared an insolvency event on January 14, 2008. On the January and April 2008 maturity dates, these securities matured at their amortized cost of $140 million. BOI has determined that it is currently in the best interest of the STIP to continue to hold these securities in the investment portfolio. These SIV securities are currently undergoing restructuring while the underlying securities in the vehicle generate cash.. At this time, there is no certain date for completion of the restructuring, which will likely include the creation of new securities to replace the original securities.

Of the $5,687,990 interest receivable total as of June 30, 2008, $2,729,889 is attributable to the above securities for interest accrued to their respective maturity dates. While payment of the Orion Finance USA interest receivable of $903,922 remains unknown as of November 21, 2008, BOI received payment of $1,825,967 on the Axon Financial Funding interest receivable on November 14,2008.

A STIP reserve account was established in November 2007. Income is distributed to STIP participants based on accrued interest and discount amortization. To avoid distributing cash to participants based on accrued interest on certain SIVs that may be uncollectible; the accrued interest amount was deposited in this account. Additional accrued income was deposited in the account to pay for any incidental direct expenses incurred as a part of any SIV restructuring activity not to be paid from SIV assets. Accrued income was also deposited in the account to offset any potential principal loss on these securities in the future.

C. Equity in Pooled Investments

These securities consist of investments held by pooled investment funds. The Montana Domestic Equity Pool (MDEP), Trust Funds Bond Pool (TFBP), Retirement Funds Bond Pool (RFBP), Montana International Equity Pool (MTIP), Montana Private Equity Pool (MPEP), and Montana Real Estate Pool (MTRP) were created to allow qualifying funds to participate in diversified investment pools. Purchases are subject to the statutorily mandated "Prudent Expert Principle" *(see Table 3 – Equity in Pooled Investments).*

Table 3 – Equity in Pooled Investments
(in thousands)

	Carrying Amount	Fair Value
MDEP:		
Domestic equity pool	$2,949,751	$2,965,611
TFBP:		
Corporate bonds (rated)	755,582	747,119
Corporate bonds (unrated)	8,032	5,391
Municipal government bonds (rated)	1,120	1,126
Municipal government bonds (unrated)	1,508	1,508
U.S. government direct-backed	109,800	113,103
U.S. government indirect-backed	622,625	632,681
STIP	40,865	40,865
STIP Structured Investment Vehicle	4,153	4,153
RFBP:		
Corporate bonds (rated)	1,011,467	996,726
Corporate bonds (unrated)	17,127	13,016
U.S. government direct-backed	123,947	127,133
U.S. government indirect-backed	770,923	783,061
STIP	65,030	65,030
STIP Structured Investment Vehicle	6,735	6,735
MTIP:		
International stock pool	132,310	1,437,641
MPEP:		
Private equity pool	640,012	744,099
MTRP:		
Real estate pool	315,976	325,725
STIP	3,124	3,124
STIP Structured Investment Vehicle	337	337
Total pooled investments	7,580,424	9,014,184
Pool adjustments (net)	(33,188)	(33,188)
Total equity in pooled investments	$7,547,236	$8,980,996

At June 30, 2008, the carrying and fair value of the underlying securities on loan was $545,100,993 and $1,699,688,269, respectively. The collateral provided for the securities on loan totaled $1,196,806,513.

As of June 30, 2008, component units of the State of Montana had equity in pooled investments with a book value of $5,039,349,945 and a fair value of $7,483,013,574, as included in Table 3.

Investment Risk Disclosures
The investment risk disclosures are described in the following paragraphs, and are identified by the specific pools to which they pertain, when applicable.

<u>Credit Risk</u>
Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of the U.S. government securities, the pool fixed-income instruments have credit risk as measured by major credit rating services. This risk is that the issuer of a fixed-income security may default in making timely principal and interest payments. The Board of Investment's policy requires pool fixed-income investments, at the time of purchase, to be rated an investment grade as defined by Moody's

or by Standard & Poor's (S&P) rating services. The U.S. government securities are guaranteed directly or indirectly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. The credit ratings presented in the following tables are provided by S& P's rating services. If an S&P rating is not available, a Moody's rating has been used.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of fiscal year end, all the fixed-income securities were registered in the nominee name for the Montana Board of Investments. The Equity Index, US Bank repurchase agreement, real estate, mortgage, and loan investments were purchased and recorded in BOI's name. Commingled fund investments are registered in the name of the Montana Board of Investments.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Investments issued or explicitly guaranteed by the U.S. government are excluded from the concentration of credit risk requirement.

Although the RFBP investment policy does not address concentration of credit risk, the TFBP investment policy states: "with the exception of U.S. government/agency securities, additional purchases will not be made in a credit if the credit risk exceeds 2 percent of the portfolio at the time of purchase". The RFBP had concentration of credit risk exposure to the Federal National Mortgage Association (Fannie Mae) of 9.62% as of June 30, 2008, while the TFBP had concentration of credit risk exposure to the same issuer of 12.96% as of June 30, 2008. The RFBP had concentration of credit risk exposure to the Federal Home Loan Mortgage Corp. (Freddie Mac) of 23.01% as of June 30, 2008, while the TFBP had concentration of credit risk exposure to the same issuer of 22.79% as of June 30, 2008. As of June 30, 2008, MDEP had no single issue investments that exceeded 5% of its portfolio.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with GASB Statement 40, the board has selected the effective duration method to disclose interest rate risk. This information, as provided by the custodial bank, is "An option-adjusted measure of a bond's (or portfolio's) sensitivity to changes in interest rates. Duration is calculated as the average percentage change in a bond's value (price plus accrued interest) under shifts of the Treasury curve plus/minus 100 basis points. The effective duration method incorporates the effect of the embedded options for bonds and changes in prepayments for mortgage-backed securities (including pass-throughs, CMOs, and ARMs)."

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

As reported in the U.S. government agency category, the RFBP portfolio held REMIC securities totaling $249,844 at amortized cost as of June 30, 2008, while the TFBP portfolio held REMIC securities totaling $46,806 at amortized cost. REMICs (Real Estate Mortgage Investment Conduits) are pass-through vehicles for multiclass mortgage-backed securities. These securities are based on separate or combined cash flows from principal and interest payments on underlying mortgages.

The Bond Pools and AOF portfolio fixed income securities pay a fixed rate of interest until maturity while the variable rate (floating rate) securities pay a variable rate of interest until maturity. As of June 30, 2008, these portfolios held six variable rate issues. These securities float with LIBOR (London Interbank Offered Rate).

As of June 30, 2008, the Bond Pools and AOF portfolio held five Collateralized Debt Obligations (CDO). A CDO is security backed by a pool of bonds, loans, and other assets. CDOs do not specialize in one type of debt, but are often non-mortgage loans or bonds. These CDO positions, totaling $135 million par, are categorized as rated corporate debt in the three portfolios.

Legal Risk

As of June 30, 2008, BOI was not aware of any legal risks regarding investments.

State of Montana investments are categorized below to disclose credit and interest rate risk as of June 30, 2008, as required for applicable pools. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date. Interest rate risk is disclosed using effective duration. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Both the credit quality ratings and duration have been calculated excluding cash equivalents. If duration has not been calculated, duration is indicated by NA (not applicable).

TFBP
Credit Quality Rating and Effective Duration as of June 30, 2008
(in thousands)

Security Investment Type	Fair Value	Credit Quality Rating	Effective Duration
Corporate bonds (rated)	$ 747,119	A+	4.39
Corporate bonds (unrated)	5,391	NR	5.58
Municipal government bonds (rated)	1,126	AA	7.92
Municipal government bonds (unrated)	1,508	NR	4.94
U.S. government direct-backed	113,103	AAA	6.72
U.S. government indirect-backed	632,681	AAA	4.60
STIP	45,018	NR	NA
Total fixed-income investments	$1,545,946	AA	4.66
Securities lending collateral investment pool	$ 86,356	NR	NA

RFBP
Credit Quality Rating and Effective Duration as of June 30, 2008
(in thousands)

Security Investment Type	Fair Value	Credit Quality Rating	Effective Duration
Corporate bonds (rated)	$ 996,726	A	4.77
Corporate bonds (unrated)	13,016	NR	6.43
U.S. government direct-backed	127,133	AAA	5.23
U.S. government indirect-backed	783,062	AAA	4.33
STIP	71,764	NR	NA
Total fixed-income investments	$1,991,701	AA	4.63
Securities lending collateral investment pool	$ 100,299	NR	NA

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The MPEP, MTRP, and MTIP U.S. dollar cash and equity positions, by currency, are reported in the tables below.

MPEP and MTRP Investments by Foreign Currency
(in thousands)

		2008	
Currency	Fund Manager Name	Carrying Value	Fair Value
EURO	Terra Firma Fund III	$12,173	$13,311
EURO	Carlyle Europe Real Estate Partners III	6,344	6,093
Total MPEP and MTRP		$18,517	$19,404

The U.S. dollar balances of the MTIP cash and investments are disclosed by currency in the following table.

MTIP
Cash by Currency
(in thousands)

	2008	
Cash	**Carrying Amount**	**Fair Value**
Australian Dollar	$ 389	$ 393
Brazilian Real	18	19
Canadian Dollar	730	732
Danish Krone	64	67
Hong Kong Dollar	1,279	1,280
Indonesian Rupiah	1	1
Euro	2,530	2,566
Israeli Shekel	18	18
Japanese Yen	1,815	1,830
South Korean Won	9	9
Malaysian Ringgit	13	13
Mexican Peso	70	70
New Zealand Dollar	7	7
Norwegian Krone	496	503
Philippine Peso	1	1
Singapore Dollar	471	475
Swedish Krona	863	883
Swiss Franc	47	49
New Taiwan Dollar	74	74
Thailand Baht	6	6
UK British Pound	464	469
US Dollar	4	4
Total cash	$9,369	$9,469

The U.S. dollar balances of the MTIP equities by currency are presented in the following table.

MTIP
Equities by Currency
(in thousands)

	2008	
Cash	**Carrying Amount**	**Fair Value**
Australian Dollar	$ 35,668	$ 47,035
Brazilian Real	6,284	6,966
Canadian Dollar	41,841	49,716
Czech Koruna	419	770
Danish Krone	8,648	12,176
Euro	304,810	300,349
Hong Kong Dollar	44,312	44,072
Indonesian Rupiah	1,463	1,404
Israeli Shekel	1,323	1,973
Japanese Yen	175,133	168,175
South Korean Won	17,699	18,270
Malaysian Ringgit	1,922	1,857
Mexican Peso	5,723	5,915
New Zealand Dollar	344	245
Norwegian Krone	10,467	13,131
Philippine Peso	1,108	1,100
Polish Zloty	925	997
Singapore Dollar	11,685	13,422
South African Rand	4,467	4,658
Swedish Krona	9,727	8,781
Swiss Franc	40,894	42,438
New Taiwan Dollar	8,326	8,560
Thailand Baht	2,096	2,083
Turkish Lira	1,404	1,745
UK British Pound	135,919	129,715
Total equity	$872,607	$885,553

D. Investments

Article VIII of Montana's Constitution, with supporting statutes, authorizes the Board of Investments (BOI) to manage the State's unified investment program. Long-term investments are administered by the following agencies, as allowed by state law, Title 17, Chapter 6, Part 201, MCA:

Long-term Investments

Department	**Percent Administered**
Board of Investments	69.13%
PERA (Public Employee Retirement Administration)	15.25
Board of Housing	7.88
College Savings Plan	5.66
Montana State University/University of Montana	1.08
Other (1)	1.00
Total	100.00%

(1) Other consists of the Commissioner of Higher Education, the Department of Administration, the Department of Natural Resources and Conservation, the Department of Public Health and Human Services, the Montana State Auditor's Office, and the Department of Revenue.

The BOI must employ the "Prudent Expert Rule" in managing the State's investment portfolio. Investments are presented at fair value. Investment fair values for publicly traded securities are determined primarily by reference to market prices supplied to the BOI's custodial bank or trustee. Amortized cost, or carrying value, represents the original cost, adjusted for premium and discount amortization where applicable.

Table 4 – Investments
(in thousands)

	Carrying Amount	Fair Value
Primary government		
Corporate (rated) (1)	$ 24,802	$ 24,449
U.S. govt direct/indirect (rated) (1)	50,656	52,536
U.S. govt mortgage-backed (rated) (1)	1,481	1,517
Govt securities	24,706	25,060
STIP/SIV investments	118,542	118,542
MUS Workers Compensation	100	103
Other equities	194,385	194,464
Total	$ 414,672	$ 416,671
Component units/fiduciary funds		
Corporate (rated) (1)	$ 490,300	$ 475,348
U.S. govt direct/indirect (rated) (1)	360,750	369,310
U.S. govt mortgage-backed (rated) (1)	776	794
Govt securities	188,470	187,005
Other equities	68,525	87,569
Deferred compensation	279,892	296,903
Defined contribution	39,746	42,751
College Savings Plan	119,057	119,057
VEBA	976	896
Investments of MSU component units	142,031	142,031
Investments of UM component units	162,394	162,394
Real estate	16,965	17,282
Mortgages	112,759	111,348
STIP/SIV investments	10,234	10,234
Total	$1,992,875	$2,022,922
Total investments	$2,407,547	$2,439,593
Securities lending collateral investment pool	$ 189,348	$ 189,348

(1) The credit quality rating and duration are included below for the rated investments.

All Other Funds - Rated Securities
Credit Quality Rating and Effective Duration as of June 30, 2008
(in thousands)

Security Investment Type	Fair Value	Credit Quality Rating	Effective Duration
Corporate (1)	$ 499,797	A	3.68
U.S. government direct-backed (1)	63,655	AAA	5.56
U.S. government indirect-backed (1)	524,207	AAA	3.03
Total	$1,087,659	AA	3.06

(1) These rated securities are reported on both Table 2 – Cash Equivalents and Table 4 – Investments.

The PERS Defined Contribution Retirement Plan and the deferred compensation plan's fixed assets were invested and managed on behalf of the plans by Pacific Investment Management Company (PIMCO) and State Street Bank Kansas City (SSKC). The third party record keeper, Great West Retirement Services, tracks and reports the daily trading and valuations of all investment options, including the assets held by the individual mutual fund companies. When participants invest in the fixed investment, they are guaranteed a rate of return. The PERS-DCRP fixed money is invested in a PIMCO mutual fund. The minimum average portfolio quality must be an A rating; the minimum issue quality must be a BB-rating; and the minimum commercial paper quality must be A2/P2. Variable investments are held and managed by a selection of retail and institutional mutual funds, which cover all standard asset classes and categories. VEBA (Voluntary Employee Benefit Association) investments are made in mutual fund equities and mutual fund fixed-income funds. The Montana 529 College Savings Plan is invested in Pacific Life mutual funds.

Investment Risk Disclosures

The investment risk disclosures are described in the following paragraphs and are identified by the specific securities to which they pertain, when applicable.

Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of the U.S. government securities, the AOF (All Other Funds) fixed-income instruments have credit risk as measured by major credit rating services. This risk is that the issuer of a fixed-income security may default in making timely principal and interest payments. The Board of Investment's policy requires AOF fixed-income investments, at the time of purchase, to be rated an investment grade as defined by Moody's and/or Standard & Poor's (S&P) rating services. The U.S. government securities are guaranteed directly or indirectly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. The credit ratings presented in the above table are provided by S&P's rating services. If an S&P rating is not available, a Moody's rating has been used. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2008, all the fixed-income and other equity securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the board's custodial bank, State Street Bank. The Equity Index, Real Estate, Mortgage and Loan investments are registered in the name of the Montana Board of Investments. State Street and US Bank repurchase agreements were purchased in the State of Montana Board of Investments name.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. With the exception of one fund, the 20 remaining BOI investment policy statements for various state agencies do not address concentration of credit risk. One fund requires credit risk to be limited to 3 % in any one name except AAA rated issues will be limited to 6%. Investments issued or explicitly guaranteed by the U.S. government and investments by various state agencies are excluded from the concentration of credit risk requirement. As of June 30, 2008, Montana had concentration of credit risk exposure to Federal National Mortgage Association of 6.03%.

This concentration of credit risk includes the rated securities from Table 2 – Cash Equivalents and Table 4 – Investments.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The All Other Funds' investment policies do not formally address interest rate risk. In accordance with GASB Statement 40, the board has selected the effective duration method to disclose interest rate risk.

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

Interest rate risk is disclosed using effective duration. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Both the credit quality ratings and duration have been calculated excluding cash equivalents. If duration has not been calculated, duration is indicated by NA (not applicable).

NOTE 4. DISAGGREGATION OF ACCOUNTS RECEIVABLE AND PAYABLE

A disaggregation of the net receivables and accounts payable (by fund type) as of June 30, 2008, follows (amounts in thousands):

A. Receivables

	Governmental Funds					
Receivables	**General Fund**	**State Special Revenue**	**Federal Special Revenue**	**Coal Severance Tax Permanent**	**Land Grant Permanent**	**Nonmajor Governmental**
Licenses and permits	$ 1,322	$ 7,226	$ -	$ -	$ -	$ -
Taxes	219,688	84,004	-	5,190	-	1,430
Charges for services/ fines/forfeitures	1,969	30,372	1,317	-	40,956	-
Investment income	1,309	5,843	41	3,784	4,796	4,101
Contributions/premiums	10	122	-	-	-	-
Other	6,710	52,938	11,476	-	-	576
Total receivables	231,008	180,505	12,834	8,974	45,752	6,107
Less: allowance for doubtful accounts	(4,875)	(9,104)	(1,113)	-	-	-
Receivables, net	$226,133	$171,491	$11,721	$8,974	$45,752	$6,107

	Proprietary Funds			
Receivables	**Unemployment Insurance**	**Economic Development Bonds**	**Nonmajor Enterprise**	**Internal Service**
Charges for services	$ -	$ -	$17,660	$ 471
Investment income	-	10,658	8	262
Contributions/premiums	8,131	-	5,683	4,217
Other	-	-	129	119
Total receivables	8,131	10,658	23,480	5,069
Less: allowance for doubtful accounts	(4,734)	-	-	-
Receivables, net	$ 3,397	$10,658	$23,480	$5,069

B. Payables

Payables	Governmental Funds General Fund	State Special Revenue	Federal Special Revenue	Coal Severance Tax Permanent	Land Grant Permanent	Nonmajor Governmental
Tax refunds	$120,060	$ -	$ -	$-	$ -	$ -
Vendors/individuals	64,534	62,078	133,385	-	-	4,789
Payroll	18,711	17,933	6,476	-	-	52
Accrued interest	-	475	-	-	4,679	544
Other	272	1,098	958	-	-	54
Total	$203,577	$81,584	$140,819	$-	$4,679	$5,439

Payables	Proprietary Funds Unemployment Insurance	Economic Development Bonds	Nonmajor Enterprise	Internal Service
Vendors/individuals	$1,564	$ -	$8,855	$12,346
Payroll	-	15	811	2,786
Accrued interest	-	1,147	-	1
Total	$1,564	$1,162	$9,666	$15,133

NOTE 5. CAPITAL ASSETS

A. Primary Government

Changes in capital asset balances for the fiscal year ended June 30, 2008, are reflected in the following table (in thousands):

Primary Government

	Beginning Balance	Increases (1)	Decreases (1)	Ending Balance
Governmental activities				
Capital assets, not being depreciated				
Land	$ 416,428	$ 18,533	$ (850)	$ 434,111
Construction work in progress	353,738	27,906	(173,817)	207,827
Other	151,928	4,183	(5)	156,106
Total capital assets, not being depreciated	922,094	50,622	(174,672)	798,044
Capital assets, being depreciated				
Infrastructure	3,509,995	544,897	(368,277)	3,686,615
Land improvements	21,642	3,767	(594)	24,815
Buildings/improvements	394,557	36,770	(1,603)	429,724
Equipment	281,198	25,747	(8,586)	298,359
Other	7,864	2,430	(3,944)	6,350
Total capital assets, being depreciated	4,215,256	613,611	(383,004)	4,445,863
Less: accumulated depreciation for:				
Infrastructure	(1,399,514)	(138,588)	221,799	(1,316,303)
Land improvements	(4,161)	(1,119)	95	(5,185)
Buildings/improvements	(181,597)	(30,949)	1,229	(211,317)
Equipment	(175,907)	(19,835)	7,087	(188,655)
Other	(3,604)	(225)	93	(3,736)
Total accumulated depreciation	(1,764,783)	(190,716)	230,303	(1,725,196)
Total capital assets, being depreciated, net	2,450,473	422,895	(152,701)	2,720,667
Intangible assets	29,467	20,864	(15,451)	34,880
Governmental activity capital assets, net	$ 3,402,034	$ 494,381	$(342,824)	$ 3,553,591

(1) The increases and decreases noted above include adjustments related to prior periods and corrections of errors.

Primary Government *(continued)*

	Beginning Balance	Increases (1)	Decreases (1)	Ending Balance
Business-type activities				
Capital assets, not being depreciated				
Land	$ 800	$ -	$ -	$ 800
Construction work in progress	459	108	-	567
Total capital assets, not being depreciated	1,259	108	-	1,367
Capital assets, being depreciated				
Infrastructure	884	-	-	884
Land improvements	2,343	-	-	2,343
Buildings/improvements	7,316	15	-	7,331
Equipment	5,286	639	(94)	5,831
Total capital assets, being depreciated	15,829	654	(94)	16,389
Less: accumulated depreciation for:				
Infrastructure	(539)	(17)	-	(556)
Land improvements	(345)	(107)	-	(452)
Buildings/improvements	(4,158)	(199)	-	(4,357)
Equipment	(3,623)	(305)	84	(3,844)
Total accumulated depreciation	(8,665)	(628)	84	(9,209)
Total capital assets, being depreciated, net	7,164	26	(10)	7,180
Intangible assets	275	62	(151)	186
Business-type activity capital assets, net	$ 8,698	$ 196	$(161)	$ 8,733

(1) The increases and decreases noted above include adjustments related to prior periods and corrections of errors.

Depreciation expense was charged to governmental functions as follows (in thousands):

	Amount
General government	$ 4,779
Public safety/corrections	6,429
Transportation (including depreciation of the highway system maintained by the State)	107,593
Health/social services	1,967
Education/cultural	19,985
Resource/recreation/environment (including depreciation of the State's dams).	17,210
Economic development/assistance	624
Depreciation and amortization on capital assets held by the State's internal service funds is charged to the various functions based on their usage of the assets.	12,123
Total depreciation expense – governmental activities	$170,710

Depreciation expense was charged to business-type activities as follows (in thousands):

	Amount
Liquor Stores	$ 95
State Lottery	43
General Government Services	164
Prison Funds	323
Total depreciation expense – business-type activities	$625

B. Discretely Presented Component Units

The following table summarizes net capital assets reported by the discretely presented component units (in thousands). All component units, other than higher education units, are included under the "Other" caption for this schedule:

Discretely Presented Component Units

	Montana State University (MSU)	University of Montana (UM)	Other	Total
Capital assets, not being depreciated				
Land	$ 6,934	$ 7,533	$ 1,139	$ 15,606
Construction work in progress	12,409	47,187	4,377	63,973
Capitalized collections	7,924	16,531	-	24,455
Livestock for educational purposes	3,042	-	-	3,042
Total capital assets, not being depreciated	30,309	71,251	5,516	107,076
Capital assets, being depreciated				
Infrastructure	33,321	-	-	33,321
Land improvements	15,097	12,753	-	27,850
Buildings/improvements	397,317	372,364	-	769,681
Equipment	109,090	53,249	4,878	167,217
Other	60,783	52,233	-	113,016
Total capital assets, being depreciated	615,608	490,599	4,878	1,111,085
Less: accumulated depreciation	(329,736)	(272,963)	(3,478)	(606,177)
Total capital assets, being depreciated, net	285,872	217,636	1,400	504,908
Intangible assets	1,322	299	3,170	4,791
Capital assets (net) of MSU component units	10,847	-	-	10,847
Capital assets (net) of UM component units	-	4,352	-	4,352
Discretely presented component units Total capital assets, net	$ 328,350	$ 293,538	$10,086	$ 631,974

NOTE 6. RETIREMENT PLANS

A. General

The Public Employees Retirement Board (PERB), a discretely presented component unit of the State of Montana, administers eight defined benefit plans: Public Employees Retirement System (PERS-DBRP), Municipal Police Officers Retirement System (MPORS), Firefighters Unified Retirement System (FURS), Sheriffs Retirement System (SRS), Highway Patrol Officers Retirement System (HPORS), Judges Retirement System (JRS), Game Wardens and Peace Officers Retirement System (GWPORS), and Volunteer Firefighters Compensation Act (VFCA). The PERB also administers two defined contribution plans: The Public Employees Retirement System-Defined Contribution Retirement Plan (PERS-DCRP) and the 457 – Deferred Compensation Plan. The PERB prepares a publicly issued comprehensive annual financial report that includes financial statements and required supplementary information for PERS-DBRP, MPORS, FURS, SRS, HPORS, JRS, GWPORS, VFCA, as well as the two defined contribution plans, PERS-DCRP and 457 plans. Separately issued financial statements can be obtained at 100 North Park, Suite 200, PO Box 200131, Helena, MT 59620-0131.

The financial statements for PERS-DBRP include activity for the defined benefit and the associated education fund. The PERS-DCRP financial statements include activity for the defined contribution and the associated education and disability funds.

The Teachers Retirement System (TRS) is a discretely presented component unit of the State of Montana and administered by the Teachers Retirement Board. The plan prepares a publicly issued financial report that includes financial statements and required supplementary information for TRS. Separately issued financial statements can be obtained at 1500 Sixth Avenue, PO Box the 200139, Helena, MT 59620-0319.

B. Plan Descriptions

The State contributes to and/or administers ten plans in two categories: (1) the State as the single employer; and (2) the State as an employer contributor to cost-sharing, multiple-employer plans.

The number of years required to obtain vested rights varies among the plans. All plans provide early retirement options, death benefits, termination, and disability benefits. The post-retirement benefits of each of the plans are included in the tables that follow.

The funding policies for each plan provide for periodic employer and employee contributions (except VFCA) at rates specified by state law. An actuary determines the actuarial implications of the funding requirement in an annual actuarial valuation. The actuarial method used to determine the implications of the statutory funding level is the entry-age normal-cost method, with both normal cost and amortization of the unfunded actuarial liability determined as a level percentage of payrolls. To maintain a fund on an actuarially sound basis, the rate of contributions should fund the normal cost, in addition to amortizing the unfunded liability over a period not to exceed 30 years.

C. Public Employee Defined Benefit Retirement Plans

(1) State as the Single Employer

A summary of government employees participating in HPORS and JRS by employer type at June 30, 2008, follows:

Employers	HPORS	JRS
State agencies	1	1
Total	1	1

HPORS – Highway Patrol Officers Retirement System – HPORS is a single-employer defined benefit pension plan, established in 1971 and governed by Title 19, Chapters 2 & 6 of the Montana Code Annotated (MCA), provides retirement benefits for all members of the Montana Highway Patrol, including supervisory personnel. Members or their survivors may be eligible for an annual supplemental lump sum payment distributed each September. Many factors must be considered for eligibility, including the number of years the recipient has received a benefit and the recipient's age. This lump-sum payment is funded by the General Fund at the request of the PERB. The average payment in September 2008 was $2,596. This enhancement is limited to non-GABA (Guaranteed Annual Benefit Adjustment) members.

JRS – Judges Retirement System – JRS is a single-employer defined benefit pension plan established in 1967 and governed by Title 19, Chapters 2 & 5 of the MCA, provides retirement benefits for all Montana judges of district courts, justices of the Supreme Court, and the Chief Water Judge.

For the funded status, and funding progress of the HPORS and JRS, plans refer to the Required Supplementary information on page 133.

(2) State as an Employer Contributor to Cost-Sharing, Multiple-Employer Plans

A summary of government employers participating in PERS-DBRP, MPORS, FURS, SRS, GWPORS, and TRS by employer type at June 30, 2008, follows:

Employers	PERS-DBRP	MPORS	FURS	SRS	GWPORS	TRS
State agencies	34		1	1	4	8
Counties	55			56		
Cities/towns	96	27	18			
Colleges/universities	5				3	5
School districts	239					355
Other	99					
Total	528	27	19	57	7	368

PERS-DBRP – Public Employees Retirement System - Defined Benefit Retirement Plan – PERS is a defined benefit cost sharing, multiple-employer public retirement system established in 1945 and governed by Title 19, Chapters 2 & 3 of the MCA, provides retirement benefits to substantially all public employees not covered by another public plan.

Actuarial Status: The Montana Constitution, Article VIII, Section 15, requires public retirement plans be funded on an actuarially sound basis. The statutory funding rate is tested in the valuation to determine if it is sufficient to cover the normal cost rate plus an amortization payment of the unfunded actuarial liability, if any, over no more than 30 years. Based on the current actuarial value of assets and all future experience emerging as assumed, the unfunded actuarial liability will be amortized over the next 24.8 years. This amortization period does not reflect the sunset provision for the additional contributions under Title 19, Chapter 3, Part 316, MCA. Without the additional contributions effective July 1, 2007 and July 1, 2009, the amortization period for the unfunded actuarial liability would be 29 years.

MPORS – Municipal Police Officers Retirement System – MPORS is a defined benefit cost-sharing, multiple-employer retirement system established in 1974 and governed by Title 19, Chapters 2 & 9 of the MCA, covers all municipal police officers of first- and second-class cities and other cities that adopt the plan. It is a cost-sharing defined benefit plan with a special funding situation.

As of July 1, 2002, eligible members of MPORS have the opportunity to participate in the Deferred Retirement Option Plan (DROP) by filing a one-time irrevocable election with the PERB. The DROP is governed by Title 19, Chapter 9, Part 12, MCA. An eligible member must have completed at least 20 years of membership service. They may elect to participate in the DROP for a minimum of one month and a maximum of 60 months and may participate in the DROP only once. A participant remains a member of the MPORS, but will not receive membership service or service credit in the plan for the duration of the member's DROP period. During the participation in the DROP, all mandatory contributions continue to be made to the retirement plan. A monthly benefit is calculated based on salary and years of service to the date of the beginning of the DROP period. The monthly benefit is paid into the DROP account until the end of the DROP participation period. At the end of the DROP period, the participant may receive the balance of the DROP account in a lump-sum payment or in a direct rollover to another eligible plan, as allowed by the IRS. If the participant continues employment after the DROP period ends, the participant will again accrue membership service, and the DROP account cannot be distributed until employment is formally terminated.

FURS – Firefighters Unified Retirement System – This is a defined benefit cost-sharing, multiple-employer retirement system established in 1981 and governed by Title 19, Chapters 2 & 13 of the MCA, The plan provides retirement benefits for firefighters employed by first- and second-class cities and other cities that adopt the plan, and to firefighters hired by the Montana Air National Guard on or after October 1, 2001.

SRS – Sheriffs Retirement System – This is a defined benefit cost-sharing, multiple-employer retirement system established in 1974 and governed by Title 19, Chapters 2 & 7 of the MCA. The plan covers State Department of Justice criminal investigators hired after July 1, 1993, all detention officers hired after July 1, 2005, and all Montana sheriffs.

Actuarial Status: The Montana Constitution, Article VIII, Section 15, requires public retirement plans be funded on actuarially sound basis. The statutory funding rate is tested in the valuation to determine if it is sufficient to cover the normal cost rate plus an amortization payment of the unfunded actuarial liability, if any, over no more than 30 years. Based on the current actuarial value of assets and all future experience emerging as assumed, the unfunded actuarial liability will be amortized over the next 16.3 years. This amortization period does not reflect the sunset provision for the additional contributions under Title 19, Chapter 3, Part 316, MCA, or the guaranteed annual benefit adjustment. Without the additional contributions effective July 1, 2007 and July 1, 2009, the amortization period for the unfunded actuarial liability would be 26.6 years.

GWPORS – Game Wardens & Peace Officers Retirement System – This is a defined benefit cost-sharing, multiple-employer retirement system established in 1963 and governed by Title 19, Chapters 2 & 8 of the MCA. The plan provides retirement benefits for all persons employed as game wardens, warden supervisory personnel, or state peace officers.

VFCA – Volunteer Firefighters Compensation Act – This compensation program, established in 1965 and governed by Title 19, Chapters 2 and 17 of the MCA, provides pension, disability and survivorship benefits for all volunteer firefighters who are members of qualified volunteer fire companies in unincorporated areas of the state. VFCA also provides limited benefits for death or injuries incurred in the line of duty. VFCA is a plan with a special funding situation.

TRS – Teachers Retirement System – This mandatory plan, established in 1937 and governed by Title 19, Chapter 20 of the MCA, provides retirement services to all persons employed as teachers or professional staff of any public elementary or secondary school, or unit of the university system.

Actuarial Status: The Montana Constitution, Article VIII, Section 15, requires public retirement plans be funded on actuarially sound basis. The statutory funding rate is tested in the valuation to determine if it is sufficient to cover the normal cost rate plus an amortization payment of the unfunded actuarial liability, if any, over no more than 30 years. Based on the current actuarial value of assets and all future experience emerging as assumed, the unfunded actuarial liability will be amortized over the next 31.3 years. The 2007 Legislature appropriated an additional $50 million; and increased the State's General Fund contribution rate from 0.11 to 2.11%, and the university system's supplemental contribution rate from 4.04 to 4.72%, effective July 1, 2007. The plan's actuary has determined that as of July 1, 2008, the current employer contribution rate of 7.47% plus the General Fund contribution of 2.11% of members' salaries is sufficient to meet the actuarial cost. The unfunded actuarial accrued liability of $794.6 million is included in the retirement plan's financial statements in the schedule of funding progress.

D. Public Employee Defined Contribution Retirement Plans

A summary of government employers participating in the PERS-DCRP and 457 plans by employer type at June 30, 2008 follows:

Employers	PERS-DCRP	457
State agencies	28	1
Counties	42	2
Cities/towns	42	3
Colleges/universities	4	6
School districts	86	2
Other	31	3
Total	233	17

PERS-DCRP – Public Employees Retirement System - Defined Contribution Retirement Plan – This plan is a multiple-employer plan created by the 1999 Legislature and is governed by Title 19, Chapters 2 & 3 of the MCA. The plan began receiving contributions on July 1, 2002.

All new hires initially are members of the Public Employees Retirement System - Defined Benefit Retirement Plan (PERS-DBRP). New hires have a 12-month window during which they may choose to transfer to the PERS-DCRP or remain in the current PERS-DBRP. Members may not be members of both the defined contribution and defined benefit retirement plans. The choice is irrevocable. Members of the defined contribution retirement plan will decide how to invest their contributions and a portion of their employer contributions among the offered investment options. The remaining portion of employer contributions will be used to maintain funding of the defined benefit plan, to provide disability benefits, and to fund an employee education program. The employer and employee plan contributions as of June 30, 2008, were $3,254,857 and $5,117,841, respectively.

457 – Deferred Compensation Plan – The 457 plan was established in 1976 and is governed by Title 19, Chapter 50, MCA, in accordance with Internal Revenue Service Code (IRC) 457. All employees of the State, the Montana University System, and contracting political subdivisions are eligible to participate.

The 457 plan is a voluntary, supplemental retirement savings plan. Assets of the 457 plan are required to be held in trusts, custodial accounts, or insurance company contracts for the exclusive benefit of participants and their beneficiaries. Participants elect to defer a portion of their salary, within IRC limits. The deferred salary is not available to employees until separation from service, retirement, death, or upon an unforeseeable emergency while still employed and must meet IRC-specified criteria. Participant rights are fully vested in their accounts at the time of deposit. The employer and employee plan contributions as of June 30, 2008, were $70,485 and $19,107,055, respectively.

E. Optional Retirement Program

ORP – Optional Retirement Program – Effective January 1, 1988 through June 30, 1993, eligible employees of the Montana University System (MUS) could elect to participate in the Optional Retirement Program (ORP). The ORP is a defined contribution retirement plan governed by Title 19, Chapter 21 of the Montana Code Annotated. The plan is underwritten by the Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF); only faculty and staff with contracts under the authority of the Board of Regents may participate. Those faculty and staff members who did not elect the ORP, participate in the Teachers Retirement System or the Public Employees Retirement System benefit plans. Beginning July 1, 1993, membership in the ORP was mandatory for eligible employees new to the MUS. The MUS is the only employer contributing to this plan.

The benefits at retirement depend upon the amount of contributions, amount of investment gains and losses, and the employee life expectancy at retirement. Under the ORP, each employee enters into an individual contract with TIAA-CREF. Individuals are immediately vested with all contributions. Higher education units record employee/employer contribution expenditures in the affected higher education sub-fund when remitting contributions to the Commissioner of Higher Education. These monies are recorded in the Custodial Accounts Agency Fund. The Commissioner's Office then wire-transfers the contributions to TIAA-CREF. The MUS is not liable for asset management or for providing benefits after the required contributions have been made to TIAA-CREF.

Required employee contributions were 7.03% of salary; required employer contributions were 5.64% of salary, for a total of 12.67% of salary contributed to the ORP (refer to the following table).

	TIAA-CREF *(in thousands)*
Covered payroll	$177,416
Total payroll	337,443
Employer contributions	$ 10,003
Percent of covered payroll	5.64%
Employee contributions	$ 12,469
Percent of covered payroll	7.03%

F. Summary of Significant Accounting Policies

The pension trust funds' financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to each plan are recognized when due and when the employer has made a formal commitment to provide the contributions. Benefits and refund distributions are recognized when due and payable in accordance with the terms of each plan.

G. Method Used to Value Investments

The Montana Board of Investments (BOI) manages the investments for the defined benefit retirement plans. Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Mortgages are valued on the basis of future principal and interest payments and are discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on a discounted cash flow. Investments that do not have an established market are reported at estimated fair value. These values are based on market prices supplied to the BOI by its custodial bank, State Street Bank, and various brokerage services. The retirement plans have no investments with a single issuer whose fair value equals 5% or more of the retirement plans net assets available for benefits.

H. Long-term Contracts for Contributions

The Montana Legislature enacted a provision of the Employee Protection Act (EPA) (Title 19, Chapter 2, Part 706, MCA), allowing state and university system employees, eligible for a service retirement, whose positions have been eliminated, to have their employer pay a portion of the total cost of purchasing up to three years of "1 for 5" additional service. As of June 30, 2008, 183 employees have taken advantage of the provision.

The employer has up to ten years to complete payment for the service purchases and is charged 8% interest on the unpaid balance. Total retirement incentive contributions received, including interest, during fiscal year 2008 were $2,729. June 30, 2008, outstanding balances were $29,151.

A summary of contribution rates, funding progress, employer and employee contributions, and eligibility and benefits for each retirement plan is provided in the tables on the following pages.

The information presented in this schedule was determined as part of the actuarial valuations at the dates indicated in the table below. Additional information as of the latest actuarial valuation follows:

Pension Plan Information
Single Employer Systems

	HPORS	JRS
Contributions (in thousands)		
Employer	$3,949	$1,315
Employee	1,082	385
License and registration fees	290	
Actuarial valuation date	6/30/2008	6/30/2008
Actuarial cost method	Entry age	Entry age
Amortization method	Level percentage of total salaries, open	Level percentage of total salaries, open
Remaining amortization period	17.4 years	Currently, the surplus is not expected to be exhausted (1)
Asset valuation method	4-year smoothed market	4-year smoothed market
Actuarial assumptions:		
Investment rate of return	8.0%	8.0%
Projected salary increases	4.25%	4.25%
(includes inflation factor)	3.25%	3.25%
Merit	0%-7.3%	None
Benefit adjustments		
GABA	3% after 1 year	3% after 1 year
Non-GABA	2% per year of service, not to exceed 5%, for probationary officer's base pay	Biennial increase to salary of active member in like position

(1) Assets are larger than the past service liability, creating an unfunded credit; the credit is amortized over future costs.

Schedule of Contribution Rates
Fiscal Year 2008

Plan	Member	Employer	State
PERS-DBRP	**6.9%** [19-3-315, MCA]	**7.035%** State & University **6.935%** Local Governments **6.8%** School Districts (K-12) [19-3-316, MCA]	**0.1%** Local Government payroll - paid from the General Fund [19-3-319, MCA] **0.235%** School Districts (K-12) payroll – paid from the General Fund [19-3-319, MCA]
MPORS	**5.8%** - hired on or before 6/30/1975 & not electing GABA [19-9-710(a), MCA] **7.0%** - hired after 6/30/1975 & prior to 7/1/1979 & not electing GABA [19-9-710(b), MCA] **8.5%** - hired after 6/30/1979 & prior to 7/1/1997 & not electing GABA [19-9-710(c), MCA] **9.0%** - hired after 6/30/1997 & members electing GABA [19-9-710(d), MCA] & 19-9-710(2), MCA]	**14.41%** [19-9-703, MCA]	**29.37%** of salaries - paid from the General Fund [19-9-702, MCA]
FURS	**9.5%** - hired prior to 7/1/1997 & not electing GABA [19-13-601(2)(a), MCA] **10.7%** - hired after 6/30/1997 & members electing GABA [19-13-601(2)(b), MCA]	**14.36%** [19-13-605, MCA]	**32.61%** of salaries - paid from the General Fund [19-13-604, MCA]
SRS	**9.245%** [19-7-403, MCA]	**9.825%** [19-7-404, MCA]	
HPORS	**9.0%** - hired prior to 7/1/1997 & not electing GABA **9.05%** - hired after 6/30/1997 & members electing GABA [19-6-402, MCA]	**26.15%** [19-6-404(1), MCA] **10.18%** of salaries - paid from the General Fund [19-6-404(2), MCA]	
JRS	**7.0%** [19-5-402, MCA]	**25.81%** [19-5-404, MCA]	
GWPORS	**10.56%** [19-8-502, MCA]	**9.0%** [19-8-504, MCA]	
VFCA			**5.0%** of fire insurance premiums - paid from the General Fund [19-17-301, MCA]
PERS-DCRP	**6.9%** [19-3-315, MCA]	**7.035%** State & University **6.935%** Local Governments **6.8%** School Districts (K-12) [19-3-316, MCA]	**0.1%** Local Government payroll - paid from the General Fund **0.235%** School Districts (K-12) payroll – paid from the General Fund [19-3-319, MCA]
TRS	**7.15%** [19-20-602, MCA]	[**9.47%** State & University [19-20-605, MCA]	**0.11%** of members' salaries [19-20-604, MCA] **2%** contribution of the total earned compensation of school district and community college active members [19-20-607, MCA]

Pension Plan Information
Schedules of Funding Progress
(in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability(AAL) Entry Age (b)	Unfunded (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as Percentage of Covered Payroll ((b-a)/c)
			Single Employer Systems			
HPORS (1)						
6/30/2008	101,505	134,683	33,183	75.36%	10,866	305.38%
JRS (1)						
6/30/2008	62,040	39,435	(22,605)	157.32%	5,096	(443.58%)
			Multiple Employer Systems			
PERS-DBRP						
6/30/2008	4,065,307	4,504,743	439,436	90.25%	955,113	46.01%
MPORS						
6/30/2008	212,312	327,556	115,244	64.82%	32,181	358.11%
FURS						
6/30/2008	206,127	287,218	81,091	71.77%	29,158	278.11%
SRS						
6/30/2008	199,453	204,549	5,096	97.51%	47,196	10.80%
GWPORS						
6/30/2008	77,511	83,449	5,938	92.88%	32,365	18.35%
TRS						
7/1/2008	3,159,100	4,110,800	794,600	79.90%	689,500	115.20%
			Nonemployer Contributor			
VFCA						
6/30/2008	27,544	32,735	5,191	84.14%	N/A	N/A

(1) The multiyear schedule of funding progress for the HPORS and JRS are presented in the Required Supplementary Information (RSI) following the notes to the financial statements.

Pension Plan Information
Schedules of Employer Contributions and Other Contributing Entities
(in thousands)

System	Fiscal Year Ended June 30	Annual Required Contributions	Percentage Contributed	Annual Required State Contribution	Percentage Contributed
		Single Employer Systems			
HPORS					
	2006	2,862	101.50%	277	100.00%
	2007	3,581	101.48%	285	100.00%
	2008	3,948	100.03%	290	100.00%
JRS					
	2006	113	1,089.03%		
	2007	(230)	(542.23%)		
	2008	(274)	(479.47%)		
		Multiple Employer Systems			
PERS-DBRP					
	2006	69,312	91.54%	443	100.00%
	2007	60,253	110.41%	446	100.00%
	2008	65,425	110.42%	378	100.00%
MPORS					
	2006	3,983	101.30%	8,119	100.77%
	2007	4,258	100.58%	8,679	100.00%
	2008	4,637	111.19%	9,452	100.00%
FURS					
	2006	3,291	101.14%	7,473	100.80%
	2007	3,482	101.09%	7,908	100.63%
	2008	4,187	106.68%	9,568	100.63%
SRS					
	2006	3,897	90.42%		
	2007	4,176	105.04%		
	2008	4,444	108.78%		
GWPORS					
	2006	2,337	102.34%		
	2007	2,218	118.94%		
	2008	2,541	117.23%		
TRS					
	2006	158,962 (1)	223.00%		
	2007	112,664 (2)	130.00%		
	2008	81,423	100.00%		
		Nonemployer Contributor			
VFCA					
	2006			1,610	100.00%
	2007			1,661	100.00%
	2008			1,562	100.00%

(1) Annual required contribution amount includes a $100 million one-time contribution made by the State in fiscal year 2006.

(2) Annual required contribution amount includes a $50 million one-time contribution made by the State in fiscal year 2007.

Summary of Eligibility and Benefits

Plan	Member's Highest Average Compensation (HAC)	Years of Service Required and/or Age Eligible for Benefit	Vesting
PERS-DBRP	Highest average compensation during any consecutive 36 months	Service retirement: 30 years, any age; Age 60, 5 years of service; or Age 65, regardless of service Early retirement, actuarially reduced: Age 50, 5 years of service; or Any age, 25 years of service	5 years membership service
MPORS	Hired prior to 7/1/1977 – average monthly compensation of final year of service; hired after 6/30/1977 – final average compensation (FAC) for last consecutive 36 months	20 years, regardless of age; age 50, 5 years of service	5 years membership service
FURS	Hired prior to 7/1/1981 and not electing GABA – highest monthly compensation (HMC); hired after 6/30/1981 and those electing GABA – highest average compensation (HAC) during any consecutive 36 months	20 years, regardless of age; age 50, 5 years of service	5 years membership service
SRS	Highest average compensation during any consecutive 36 months	20 years membership service, regardless of age; age 50, 5 years of service, actuarially reduced	5 years membership service
HPORS	Highest average compensation during any consecutive 36 months	20 years of service, regardless of age; 5 years of membership service, actuarially reduced from age 60	5 years membership service
JRS	Hired prior to 7/1/1997 and non-GABA prior to 1/1/1988 or 12/1/2005 – monthly compensation at time of retirement; hired after 6/30/1997 or electing GABA prior to 1/1/1988 or 12/1/2005 – HAC during any consecutive 36 months (relates directly to monthly benefit formula)	Age 60, 5 years of membership service; any age with 5 years of membership service – involuntary termination, actuarially reduced	5 years membership service
GWPORS	Highest average compensation during any consecutive 36 months	Age 50, 20 years of membership service; age 55, 5 years of membership service	5 years membership service
VFCA		Age 55, 20 years of credited service (full benefit); age 60, 10 years of service (partial benefit). As of 4/25/2005 (Senate Bill 197), members may retire with greater than 20 years of service, but not more than 30 years of service.	10 years of service credit
PERS-DCRP		Termination of service	Immediate for participant's contributions and attributable income; 5 years for employer's contributions to individual accounts and attributable income
TRS	Final average compensation during any consecutive 36 months	Age 60, 5 years of service, or any age with at least 25 years of service. Vested employees may retire at or after age 50 and receive reduced benefits.	5 years of membership service

Summary of Eligibility and Benefits *(continued)*

Plan	Monthly Benefit Formula	Guaranteed Annual Benefit Adjustment (GABA)	Minimum Benefit Adjustment (Non-GABA)
PERS-DBRP	Less than 25 years of membership service: 1.785% of HAC per year of service credit; 25 years of service or more: 2% of HAC per year of service credit	After the member has completed 12 full months of retirement, the member's benefit increases each January by a maximum of 3% for members hired before 7/1/2007, 1.5% for members hired on or after 7/1/2007, inclusive of all other adjustments to the member's benefit.	
MPORS	2.5% of FAC per year of service credit	Hired after 6/1/1997, or those electing GABA - after the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other adjustments to the member's benefit.	If hired before 7/1/1997 and member did not elect GABA, the monthly retirement, disability or survivor's benefit may not be less than 1/2 the compensation of a newly confirmed officer in the city that the member was last employed.
FURS	Members hired prior to 7/1/1981 and not electing GABA are entitled to the greater of: 2.5% of HAC per year of service credit; or (1) if less than 20 years of service, 2% of HMC for each year of service; or (2) if more than 20 years of service, 50% of the member's HMC plus 2% of the member's HMC for each year of service credit over 20 years. Members hired after 6/30/1981 and those electing GABA receive 2.5% of HAC per year of service credit.	Hired after 6/1/1997, or those electing GABA -after the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other adjustments to the member's benefit.	If hired before 7/1/1997 and member did not elect GABA, the monthly retirement, disability or survivor's benefit may not be less than 1/2 the compensation of a newly confirmed firefighter employed by the city that last employed the member (provided the member has at least 10 years of service credit).
SRS	2.5% of HAC per year of service credit	After the member has completed 12 full months of retirement, the member's benefit increases each January by a maximum of 3% for members hired before July 1, 2007, 1.5% for members hired on or after July 1, 2007, inclusive of other adjustments to the member's benefit.	
HPORS	2.5% of HAC per year of service	Hired after 7/1/1997, or those electing GABA – after the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of other adjustments to the member's benefit.	Hired prior to 7/1/1997 – monthly benefits for non-GABA members are increased each July when they fall below a statutorily guaranteed minimum. Any annual increase is limited to 5% over the current benefit and may not exceed 60% of the current base salary of a probationary officer.
JRS	3.333% of current salary (non-GABA) or HAC (GABA) per year of service for the first 15 years, plus 1.785% per year for each year after 15 years	Hired after 7/1/1997, or those electing GABA – after the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other adjustments to the member's benefit.	Hired prior to 7/1/1997 – current salary of an active member is used in the calculation of the monthly benefit each time the Legislature increases salaries for active judges.
GWPORS	2.5% of HAC per year of service credit	After the member has completed 12 full months of retirement, the member's benefit increases each January by a maximum of 3% for members hired before July 1, 2007, 1.5% for members hired on or after July 1, 2007, inclusive of other adjustments to the member's benefit.	
VFCA	$7.50 per year of credited service, maximum $225; if greater than 20 years of service (but not more than 30 years), maximum $225		
PERS-DCRP	Dependent upon individual account balance. Various payout options available, including taxable lump sums, periodic payments per participant direction, and IRS permitted rollovers.		
TRS	1.6667% of average final compensation (AFC) per year of service	A guaranteed annual benefit adjustment (GABA) of 1.5% is payable each January if the retiree has received at least 36 monthly retirement benefit payments prior to January 1 of the year in which the adjustment is to be made.	

NOTE 7. OTHER POSTEMPLOYMENT BENEFITS (OPEB)

A. General

The State of Montana and the Montana University System (MUS) provide optional postemployment health care benefits in accordance with MCA 2-18-704 to the following employees and dependents who elect to continue coverage and pay administratively established premiums: (1) employees and dependents who retire under applicable retirement provisions, and (2) surviving dependents of deceased employees. Retirement eligibility criteria differ by retirement plan (See Note 6). Medical, dental, and vision benefits are available through this plan.

In accordance with MCA 2-18-704, the Montana University System (MUS) provides post-retirement health insurance benefits to employees who are eligible to receive retirement benefits from the Teachers Retirement System, the Public Employee Retirement System, or an annuity under the Optional Retirement Plan, and have been employed by the MUS for at least five years, are age 50, or have worked 25 years with the MUS. Spouses, unmarried dependent children, and surviving spouses are also eligible.

B. Plan Description

Both the State of Montana and MUS are agent multiple employer plans. The participating employers under the State Plan are Facility Finance Authority, Housing Authority, Public Employees Retirement System (PERS), Montana State Fund (New Fund), and Teachers Retirement System (TRS). The participating employers under the MUS plan are Dawson Community College (Dawson CC), Flathead Community College (Flathead CC), , Miles Community College (Miles CC), Montana State University – Billings (MSU-Billings), Montana State University – Bozeman (MSU-Bozeman), Montana State University – Great Falls College of Technology (MSU-GFCOT), Montana State University – Northern (MSU-Northern), University of Montana – MT Tech (UM-MT Tech), Office of Commission on Higher Education (OCHE), State Bar, University of Montana – Helena College of Technology (UM-HCOT), University of Montana – Missoula (UM-Missoula), and University of Montana – Western (UM-Western). Each participating employer is required by GASB Statement No. 43 to disclose additional information with regards to funding policy, the employer's annual OPEB cost and contributions made, the funded status and funding progress of the employer's individual plan, and actuarial methods and assumptions used.

Both of these plans allow retirees to participate, as a group, at a rate that does not cover all of the related costs. This results in the reporting of an "implied rate" subsidy in the related financial statements and footnotes. While this liability is disclosed for financial statement purposes, it does not represent a legal liability of the State or any of its component units.

Both plans are reported as agency funds. There are no assets or liabilities as only contributions collected and distributions made are reflected in these funds. See the funding policy that follows.

C. Basis of Accounting

OPEB is recorded on an accrual basis for all enterprise and internal service funds as well as component units. OPEB is recorded on a modified accrual basis for the governmental funds. Plan member contributions are recognized in the period in which the contributions are made. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

The plan document states "an employee enrolled in the State Plan who (a) is eligible to draw a state retirement benefit at the time he or she leaves active state employment; and (b) makes arrangements with the EBB (Employee Benefits Bureau) within 60 days of the date active employee coverage ends to continue post-retirement coverage, may continue with the state group on a self-pay basis, retroactive back to the date active employee coverage was lost." Therefore, the plan does not include terminated employees who have accumulated benefits but are not yet receiving them. There have been no significant changes in the number covered or the type of coverage as of June 30, 2008.

The number of state participants as of December 31, 2007, the effective date of the annual OPEB valuation, follows:

State Plan Participants

Enrollment	State	Facility Finance Authority	Housing Authority	PERS	Montana State Fund (New Fund)	TRS	Total
Active employees	11,852	1	14	31	278	15	12,191
Retired employees, spouses, and surviving spouses (1)	3,271						3,271
Total	15,123	1	14	31	278	15	15,462

(1) Due to the inability to determine, without considerable effort, the last place an employee worked before retiring, all retires are listed as State; however, an allocation method was used based on the accrued liability and ARC for active employees by component unit for the determination of the inactive liability by component unit.

The number of MUS participants as of June 30, 2008, the effective date of the annual OPEB valuation, follows.

MUS Plan Participants

Enrollment	MSU-Billings	MSU-Bozeman	MSU-GFCOT	MSU-Northern	OCHE	UM-HCOT	UM-Missoula	UM-MT Tech	UM-Western	Other	Total
Active employees	507	2,815	124	200	105	72	2,222	384	176	298	6,903
Retired employees, spouses, and surviving spouses	200	1,025	28	108	21	30	753	142	92	70	2,469
Total	707	3,840	152	308	126	102	2,975	526	268	368	9,372

D. Funding Policy

The State of Montana and MUS pay for postemployment health care benefits on a pay-as-you-go basis. Montana Code Annotated, Title 2, Chapter 18, Part 8 gives authority for establishing and amending the funding policy to the Department of Administration.

The State plan's administratively established retiree medical premiums vary between $160 and $776 per month depending on the medical plan selected, family coverage, and Medicare eligibility. Administratively established dental premiums vary between $31.00 and $53.20, and vision premiums vary between $7.64 and $22.26 depending on the coverage selected.

The MUS plan's administratively established retiree medical premiums vary between $210 and $673 per month and are revised annually. The plan provides different coinsurance amounts depending on whether members use preferred, non-preferred, or other hospitals. After an annual $600 deductible for most non-Medicare-eligible retirees, the MUS plan reimburses 75% for the first $1,250 in medical claims and 100% thereafter. After a $400 deductible for Medicare-eligible retirees, the plan reimburses 75% for the first $1,250 in medical claims and 100% thereafter. There is an optional $1,500 deductible plan available to retirees with a reduced premium. After the $1,500 annual deductible, the plan pays 75% of the first $2,500 and $100% thereafter. The plan automatically reduces claim reimbursement for members eligible for Medicare, even if the member is not enrolled in Medicare. As of June 30, 2008, 1,516 retirees (policyholders) were enrolled in the MUS plan.

E. Annual Other Postemployment Benefit Cost and Contributions

The annual required contribution (ARC), an actuarially determined rate in accordance with the parameters of GASB Statement No. 45, represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years. The current State's ARC of $41.551 million is 7.99% of annual covered payroll. The State's annual covered payroll is $519.969 million. The current MUS' ARC of $17.332 million is 4.96% of annual covered payroll. The MUS' annual covered payroll is $349.259 million.

There are no long-term contracts for contributions to either plan. Contributions refer to contributions made in relation to the ARC. Since the State and MUS do not fund their plans, no contributions were made.

The following table presents the OPEB cost for the year, the amount contributed, and changes in the OPEB plan for fiscal year 2008 (dollar amounts in thousands):

Annual OPEB Cost

	State	MUS
Annual required contribution/OPEB cost	$41,551	$17,332
Contributions made	-	-
Increase in net OPEB obligation	41,551	17,332
Net OPEB obligation – beginning of year	-	-
Net OPEB obligation – end of year	$41,551	$17,332

The State's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for fiscal year 2008 was as follows (dollar amounts in thousands):

Contribution Ratio

	Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OBEB Cost Contributed	Net OPEB Obligation
State	6/30/2008	$41,551	0%	$41,551
MUS	6/30/2008	$17,332	0%	$17,332

F. Actuarial Methods and Assumptions

As of December 31, 2007, the State's actuarially accrued liability (AAL) for benefits was $449.321 million, with no actuarial value of assets, resulting in an unfunded actuarial accrued liability (UAAL) of $449.321 million, and the ratio of the UAAL to the covered payroll was 86.41%. The UAAL is being amortized as a level dollar amount over an open basis for 30 years.

In the December 31, 2007, actuarial valuation, the projected unit credit funding method was used for the State. The actuarial assumptions included a 4.25% discount rate and a 3.00% payroll growth rate. The projected annual healthcare cost trend rate is 7.00% for medical and 13.30% for prescription drugs, initially. Prescription drugs are reduced by decrements to a rate of 5.00% after eight years. Medical costs increase to 8.00% for the next three years. Then, these costs are reduced by decrements to a rate of 5.00% after five additional years.

As of June 30, 2008, the MUS actuarially accrued liability (AAL) for benefits was $182.597 million, with no actuarial value of assets, resulting in an unfunded actuarial accrued liability (UAAL) of $182.597 million, and the ratio of the UAAL to the covered payroll was 52.28%. The UAAL is being amortized as a level dollar amount over an open basis for 30 years.

In the June 30, 2008, actuarial valuation, the projected unit credit funding method was used for MUS. The actuarial assumptions included a 4.25% discount rate and a 3.00% payroll growth rate. The projected annual healthcare cost trend rate is 7.00% for medical and 13.30% for prescription drugs, initially. Prescription drugs are reduced by decrements to a rate of 5.00% after eight years. Medical costs increase to 8.00% for the next three years. Then, these costs are reduced by decrements to a rate of 5.00% after five additional years.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revisions as actual results are compared with past expectations, and new estimates are made about the future. Actuarial calculations reflect a long-term perspective. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, is designed to present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial liabilities for benefits.

Projections of benefits for financial reporting progress are based on the substantive plan (the plan as understood by the employer and the plan members), and includes the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

Additional information as of the latest actuarial valuation for the State follows:

Other Postemployment Benefits
State Agent Multiple Employer Plan

	Retiree/Surviving Spouse	Spouse
Contributions (in thousands)		
Before Medicare eligibility	$5,579	$1,994
After Medicare eligibility	2,211	1,815
Actuarial valuation date	1/1/2007	
Actuarial cost method	Projected unit credit funding	
Amortization method	Level percent of payroll, open	
Remaining amortization period	30 years	
Asset valuation method	Not applicable since no assets meet the definition of plan assets under GASB 43 or 45	
Actuarial assumptions:		
Discount rate	4.25%	
Projected payroll increases	3.00%	
Participation		
Future retirees	47%	
Future eligible spouses	60%	
Marital status at retirement	71.80%	

Additional information as of the latest actuarial valuation for MUS follows:

Other Postemployment Benefits
MUS Agent Multiple Employer Plan

	Retiree/Surviving Spouse	Spouse
Contributions (in thousands)		
Before Medicare eligibility	$5,671	$1,515
After Medicare eligibility	2,961	1,186
Actuarial valuation date	7/1/2007	
Actuarial cost method	Projected unit credit funding	
Amortization method	Level percent of payroll, open	
Remaining amortization period	30 years	
Asset valuation method	Not applicable since no assets meet the definition of plan assets under GASB 43 or 45	
Actuarial assumptions:		
Discount rate	4.25%	
Projected payroll increases	3.00%	
Participation		
Future retirees	45%	
Future eligible spouses	59%	
Marital status at retirement	59.00%	

NOTE 8. RISK MANAGEMENT

There are three primary government public entity risk pools and one claims-servicing pool that are reported within the enterprise fund. These pools include Hail Insurance, the Montana University System (MUS) Group Benefits Plan, the MUS Workers Compensation funds, and the Subsequent Injury claims-servicing pool. The two component unit pools include Montana State Fund (New Fund) and Montana State Fund (Old Fund). Unpaid claims and claim adjustment expenses are estimated based on the ultimate cost of settling the claims including the effects of inflation and other societal/economic factors. The primary government reports its own risk management activity within two internal service funds: Group Employees Comprehensive Medical and Dental Plan and Property and Casualty Insurance Plans. In all of these funds, there are no significant reductions in insurance coverage from the prior year, nor any insurance settlements exceeding insurance coverage for the last three years. These funds use the accrual basis of accounting. By statute, these funds cannot invest in common stock, except for the Montana State Funds' funds. Investments are recorded at fair value. Premiums and discounts are amortized using the straight-line method over the life of the securities.

A. Public Entity Risk Pools

(1) Hail Insurance – Any Montana producer engaged in growing crops subject to destruction or damage by hail may participate in the Hail Insurance program. The Hail Insurance program issued 2,269 policies during the 2008 growing season. This fund accounts for premium assessments paid by producers for crop acreage insured, investment and interest earnings, administrative costs, and claims paid for hail damage. Depending upon the actuarial soundness of the reserve fund and the damage in a season, producers may receive a premium refund. Anticipated investment income is considered in computing a premium deficiency, of which there is none.

A claim must be submitted to the State Board of Hail Insurance within 14 days of a loss occurrence. The claim must indicate whether the grain is stemming, in the boot, heading out, in the milk, in the stiff dough, ready to bind, or combine. If beans, peas, or other crops are damaged, the growth-stage must also be indicated. Inspection of a crop will occur as promptly as possible after claim receipt. The liability on all insured crops expires after October 1. The insurance only covers loss or damage to growing grain that exceeds 5% destruction by hail.

The fund recorded a liability of $3,474,608 based on estimated claims through June 30, 2008. Any crop insurance liability is paid to producers within one year of occurrence; therefore, liabilities are not discounted. The fund has no excess insurance, reinsurance, or annuity contracts.

(2) Montana University System (MUS) Group Benefits Plan – This plan was authorized by the Board of Regents to provide medical, dental, and vision insurance coverage to employees of the Montana University System and the State Bar of Montana, as well as their dependents, retirees, and COBRA members. The MUS Group Benefits Plan is fully self-insured, except for life insurance, long-term disability, accidental death and dismemberment, long-term care, and vision insurance. Allegiance Benefit Plan Management is the claims administrator for the self-insured indemnity plan and a managed care plan. New West Health Services, Blue Cross/Blue Shield of Montana, and Peak administer claims for the three other managed care plans. Star Point has a contract for utilization management; the utilization management program consists of hospital pre-authorization and medical necessity review. Premiums are collected from employees through payroll deductions and recorded in the MUS Group Insurance Enterprise Fund. The claims liability is calculated by Mercer Consultants and estimated to be $6,500,000 as of June 30, 2008, based on prior year experience. A liability is reported in the accompanying financial statements for these estimated claims.

(3) Montana University System (MUS) Workers Compensation Program – This fund was formed to provide self-insured workers compensation coverage for employees of the Montana University System. The Montana University System Board of Regents provides workers compensation coverage under Compensation Plan Number One (Title 39, Chapter 71, Part 2101, MCA). The program is self-insured for workers compensation claims to a maximum of $500,000 per each occurrence. Losses in excess of $500,000 are covered by reinsurance with a commercial carrier. Employer's liability claims are covered to a maximum of $1,000,000 above the self-insured amount of $500,000. During fiscal year 2008, the program ceded $220,378 in premiums to reinsurers.

Premium rates for all participating employees are based on rates established by the MUS Workers Compensation Program Committee. Premium rates are adjusted periodically based on inflation, claims experience, and other factors. Premiums are recorded as revenue in the MUS Workers Compensation Program in the period for which coverage is provided. Members may be subject to supplemental assessments in the event of deficiencies. The program considers anticipated investment income in determining if a premium deficiency exists.

The fund recorded a liability of $6,357,000 for estimated claims at June 30, 2008. The liability is based on the estimated ultimate cost of settling the reported and unreported claims, and claims reserve development including the effects of inflation and other societal and economic factors. Estimated amounts of subrogation and reinsurance recoverable on unpaid claims are deducted from the liability for unpaid claims. Estimated claims liabilities are recomputed periodically based on current review of claims information, experience with similar claims, and other factors. Adjustments to estimated claims liabilities are recorded as an increase or decrease in claims expense in the period the adjustments are made.

(4) Subsequent Injury – This fund provides benefits to workers, certified as disabled at the time of hiring, who are subsequently injured on the job and entitled to benefits under the Workers Compensation or Occupational Disease Act at the time of injury. The liability of the insurer for payment of compensation benefits is limited to 104 weeks of benefits actually paid. This fund will reimburse the insurer for all benefits paid after this 104-week time period.

Workers compensation insurance premium experience modification factors are influenced by the two-year limitation, and employers may experience an insurance premium reduction. Therefore, this fund provides employers with a potential incentive for hiring a person with a certified disability.

This fund makes no provision for insured events of the current year. All Montana insurers are annually assessed a percentage of their paid losses sufficient to cover paid losses reimbursed from the fund in the preceding calendar year and the expenses of administration, less other income. An estimated liability is recorded based on a projected cost analysis (case-by-case) of each injured person with a certified disability. As of June 30, 2008, the amount of this liability was estimated to be $3,560,310. Since each insurer is responsible for its own claim liabilities, the pool is acting as a claims service and there is no transfer or pooling of risk.

(5) State Fund (New Fund) – This fund provides liability coverage to employers for injured employees who are insured under the Workers Compensation and Occupational Disease Acts of Montana and workers compensation claims occurring on or after July 1, 1990, are reported in the New Fund. The New Fund is a self-supporting, competitive State fund, and functions as the insurer of last resort. At June 30, 2008, approximately 27,947 employers were insured with the New Fund. Anticipated investment income is considered for computing a premium deficiency, and employers must pay premiums to the New Fund within specified time frames.

An actuarial study prepared by Tillinghast-Towers Perrin, as of June 30, 2008, estimated the cost of settling claims that have been reported, but not settled; and claims that have been incurred, but not reported. Because actual claim costs depend on such complex factors as inflation and changes in the law, claim liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and societal factors.

A provision for inflation is implicit in the calculation of estimated future claim costs because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. As of June 30, 2008, $752,253,300 of unpaid claims and claim adjustment expenses were presented at face value. When the New Fund purchases annuity contracts, the claim is settled in full and on a final basis, and all liability of the New Fund is terminated.

Acquisition costs represent costs associated with the acquisition of new insurance contracts or renewal of existing contracts and include agent commissions and expenses incurred in the underwriting process. New Fund acquisition costs are capitalized and amortized ratably over the subsequent year. The amount of capitalized acquisition costs for the fiscal year ended June 30, 2008, was $5,091,054. For the fiscal year ended June 30, 2008, $3,874,087 of acquisition costs was amortized.

Statute requires the New Fund set premiums at least annually at a level sufficient to insure adequate funding of the insurance program during the period the rates will be in effect. Statute also requires the New Fund to establish a minimum surplus above risk-based capital requirements to secure the New Fund against risks inherent in the business of insurance.

For the fiscal year ended June 30, 2008, the New Fund ceded premiums to other reinsurance companies to limit the exposure arising from large losses. These arrangements consist of excess of loss contracts that protect against individual occurrences over stipulated amounts, and an aggregate stop loss contract which protects the New Fund against the potential that aggregate losses will exceed expected levels expressed as a percentage of premium. The excess of loss contracts provide coverage of $95 million for fiscal year 2008. During fiscal year 2008, the New Fund retained the first $5 million for the first layer of reinsurance coverage. Individual, per person coverage was provided up to $5 million per any one individual loss for fiscal year 2008.

The term of the current aggregate stop loss contract was July 1, 2005 through June 30, 2008. The contract provides coverage based on the New Fund's premium levels at a maximum of $33.8 million per year and a minimum of $28.5 million, but in aggregate not to exceed 80.0% of the sum of the annual limits for all contract years. In the event reinsurers are unable to meet their obligations, under either the excess of loss contracts or the aggregate stop loss contract, the New fund would remain liable for all losses, as the reinsurance agreements do not discharge the New Fund from its primary liability to the policyholders.

Premium revenue was reduced by premiums paid for reinsurance coverage of $14.7 million in fiscal year 2008.

Estimated claim reserves were reduced by $14 million for fiscal year 2008 for the amount of reinsurance estimated to be ultimately recoverable on incurred losses due to the excessive loss reinsurance contract. In fiscal year 2008, estimated claim reserves were reduced by an additional $10.8 million for the amount of reinsurance estimated to be ultimately recoverable on incurred losses due the aggregate stop loss contract.

(6) State Fund (Old Fund) – The liability and payment of workers compensation claims for incidents occurring before July 1, 1990, are reported in the Old Fund.

An actuarial study prepared by Tillinghast-Towers Perrin, as of June 30, 2008, estimated the cost of settling claims that have been reported, but not settled; and claims that have been incurred, but not reported. At June 30, 2008, $86,732,627 of unpaid claims and claim adjustment expenses was reported at a net present value of $68,434,910, discounted at a 4.5% rate.

(7) Changes in Claims Liabilities for the Past Two Years – As indicated above, these funds establish liabilities for both reported and unreported insured events including estimates of future payments of losses and related claim adjustment expenses. The following tables present changes (in thousands) in those aggregate liabilities during the past two years. All information in these tables is presented at face value and has not been discounted.

	Primary Government					
	Hail Insurance		MUS Group Benefits		MUS Workers Compensation Program	
	2008	2007	2008	2007	2008	2007
Unpaid claims and claim adjustment expenses at beginning of year	$ 519	$ 94	$ 6,250	$ 6,250	$ 5,503	$ 4,538
Incurred claims and claim adjustment expenses: provision for insured events of the current year	5,435	1,206	54,564	54,158	2,693	2,600
Increase (decrease) in provision for Insured events of prior years	4,259	381	-	-	(181)	(499)
Total incurred claims and claim adjustment expenses	9,694	1,587	54,564	54,158	2,512	2,101
Payments: Claims and claim adjustment expenses attributable to insured events of the current year	(1,960)	(687)	(54,314)	(54,158)	(433)	(368)
Claims and claim adjustment expenses attributable to insured events of prior years	(4,778)	(475)	-	-	(1,225)	(768)
Total payments	(6,738)	(1,162)	(54,314)	(54,158)	(1,658)	(1,136)
Total unpaid claims and claim adjustment expenses at end of year	$ 3,475	$ 519	$ 6,500	$ 6,250	$ 6,357	$ 5,503

	Component Units			
	Montana State Fund (New Fund)		Montana State Fund (Old Fund)	
	2008	2007	2008	2007
Unpaid claims and claim adjustments expenses at beginning of year	$ 679,209	$ 590,688	$ 98,233	$ 97,769
Incurred claims and claim adjustment expenses: Provision for insured events of the current year	195,325	189,203	-	-
Increase (decrease) in provision for insured events of prior years	17,612	34,046	(212)	11,209
Total incurred claims and claim adjustment expenses	212,937	223,249	(212)	11,209
Payments: Claims and claim adjustment expenses attributable to insured events of the current year	(35,773)	(38,677)	-	-
Claims and claim adjustment expenses attributable to insured events of prior years	(104,120)	(96,051)	(11,288)	(10,745)
Total payments	(139,893)	(134,728)	(11,288)	(10,745)
Total unpaid claims and claim adjustment expenses at end of year	$ 752,253	$ 679,209	$ 86,733	$ 98,233

(8) Risk Management Trend Information – The following tables only present risk management trend information for the State Fund (New Fund) and the MUS Workers Compensation Insurance. Both funds have a three to five-year development cycle contemplated by GASB Statement 10. The State Fund (Old Fund) does not charge a premium for its services. The Hail Insurance Fund pays claims within a calendar year cycle that parallels the growing season from spring planting to fall harvesting; therefore, it has no three to five-year development cycle. The MUS Group Benefits Fund pays claims within the calendar year, and the plan limits the timing for submission of claims; therefore, it has no three to five-year development cycle. State statute limits the payment of claims and the collection of premiums (and penalties) for the Subsequent Injury Fund from any developmental cycle.

The tables illustrate how the earned revenues (net of reinsurance) of the funds and their investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the funds as of the end of the fiscal year (in thousands). Section 3 shows the funds' incurred claims and allocated claim adjustment expense (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred. Section 4 shows the cumulative amounts paid as of the end of successive years for each policy year. Section 6 shows how each policy year's incurred claims increased or decreased as of the end of successive years. This annual re-estimation results from new information received on known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known. Section 7 compares the latest re-estimated incurred claims amount to the amount originally established (Section 3) and shows whether this latest estimate of claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and re-estimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature policy years. This table will be revised as data for successive policy years develops.

MUS Workers Compensation Program

	2004	2005	2006	2007	2008
1. **Premiums and investment revenue**					
Earned	$2,425	$3,048	$3,709	$4,392	$4,997
Ceded	(151)	(197)	(199)	(238)	(220)
Net earned	$2,274	$2,851	$3,510	$4,154	$4,777
2. **Unallocated expenses including overhead**	$ 228	$ 280	$ 264	$ 259	$ 387
3. **Estimated losses and expenses end of accident year**					
Incurred	$2,174	$2,366	$2,453	$2,600	$2,693
Ceded	-	-	-	-	-
Net incurred	$2,174	$2,366	$2,453	$2,600	$2,693
4. **Net paid (cumulative) as of:**					
End of policy year	$ 552	$ 382	$ 391	$ 367	$ -
One year later	1,020	1,002	910	933	
Two years later	1,124	1,228	1,254		
Three years later	1,148	1,526			
Four years later	1,165				
5. **Re-estimated ceded losses and expenses**	$ -	$ -	$ -	$ -	$ -
6. **Re-estimated net incurred losses and expense:**					
End of policy year	$2,174	$2,366	$2,453	$2,600	$2,693
One year later	2,174	2,565	2,267	2,600	
Two years later	2,037	2,459	2,267		
Three years later	1,830	2,459			
Four years later	1,830				
7. **Increase (decrease) in estimated net incurred losses and expenses from end of policy year**	$ (344)	$ 93	$ (186)	$ -	$ -

(State Fund (New Fund) Table presented on next page)

	State Fund (New Fund)									
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
1. **Premiums and investment revenue**										
Earned	$91,931	$94,199	$111,632	$118,964	$156,240	$163,906	$221,679	$240,860	$276,876	$256,096
Ceded	260	855	2,952	(465)	5,654	6,563	6,788	13,618	14,856	14,676
Net earned	$91,671	$93,344	$108,680	$119,429	$150,586	$157,343	$214,891	$227,242	$262,020	$241,420
2. **Unallocated expenses including overhead**	$18,729	$21,759	$ 26,389	$ 28,988	$ 31,817	$ 38,013	$ 39,627	$ 41,332	$ 43,488	$ 50,697
3. **Estimated losses and expenses end of accident year**										
Incurred	$64,645	$65,957	$ 68,267	$ 81,560	$110,153	$120,705	$134,290	$155,057	$170,652	$177,100
Ceded	-	-	-	-	-	-	-	-	-	-
Net incurred	$64,645	$65,957	$ 68,267	$ 81,560	$110,153	$120,705	$134,290	$155,057	$170,652	$177,100
4. **Net paid (cumulative) as of:**										
End of policy year	$13,723	$13,177	$ 14,140	$ 16,693	$ 22,982	$ 26,123	$ 25,721	$ 30,977	$ 32,708	$ 31,002
One year later	29,976	29,218	32,888	38,185	48,861	50,888	57,239	66,063	67,928	
Two years later	39,298	37,555	45,218	52,359	63,773	66,140	72,229	84,014		
Three years later	45,748	43,649	55,248	60,029	72,957	74,697	82,647			
Four years later	49,984	48,322	61,846	64,922	79,060	80,233				
Five years later	54,212	52,027	66,031	68,343	84,340					
Six years later	56,974	54,473	69,553	71,566						
Seven years later	59,935	57,077	72,367							
Eight years later	62,158	59,228								
Nine years later	64,339									
5. **Re-estimated ceded losses and expenses**	$ -	$ -	$ -	$ -	$ 8,600	$ 2,183	$ -	$ -	$ -	$ -
6. **Re-estimated net incurred losses and expense:**										
End of policy year	$64,645	$65,957	$ 68,267	$ 81,560	$110,153	$120,705	$134,290	$155,057	$170,652	$177,100
One year later	64,348	66,421	71,094	86,799	110,532	112,609	136,235	157,711	171,783	
Two years later	66,660	66,662	81,053	91,241	112,443	124,413	138,447	163,433		
Three years later	69,345	70,302	88,157	94,615	117,245	127,827	144,484			
Four years later	72,435	72,492	92,329	99,755	115,414	129,051				
Five years later	73,710	73,423	95,727	100,925	119,976					
Six years later	75,537	76,048	98,124	105,651						
Seven years later	78,046	77,930	102,847							
Eight years later	80,116	80,680								
Nine years later	84,880									
7. **Increase (decrease) in estimated net incurred losses and expenses from end of policy year**	$20,235	$14,723	$ 34,580	$ 24,091	$ 9,823	$ 8,346	$ 10,194	$ 8,376	$ 1,131	$ -

B. Entities Other Than Pools

(1) Employee Group Benefits – The medical and dental health plans provided by the State are fully self-insured with the State assuming the risk for claims incurred by employees of the State, elected officials, retirees, former employees covered by COBRA benefits, and their dependents. The State contracts with Blue Cross/Blue Shield, PEAK, New West, and CVS Caremark for administration of its self-insured plans. Premiums are collected through payroll deductions, deductions through the Public Employees Retirement Administration, the Legislative Branch, and self-payments, and are recorded as revenue in the Employee Group Benefits Internal Service Fund. At June 30, 2008, estimates for claims liabilities, which include both incurred but not reported claims and grandfathered claims resulting from a 1998 change in period for which the benefit coverage is available, as well as other actuarially determined liabilities, were $10,100,000 based on a formula provided by Actuaries Northwest, a consulting actuarial firm, of which $8,787,000 is estimated to be paid in fiscal year 2009.

(2) Administration Insurance Plans – This self-insurance plan provides coverage for general liability, automobile liability, automobile physical damage, foster care liability, and state-administered foreclosure of housing units. The State self-insures the $250,000 deductible per occurrence for most property insurance, as well as various deductible amounts for other state property. The State also self-insures against losses of property below $250,000 of value, with state agencies paying the first $1,000. Commercial property insurance protects approximately $3.9 billion of state-owned buildings and contents. The State's property insurance includes separate earthquake and flood protection coverage, with deductibles of $250,000 for earthquake and $250,000 for flood per occurrence. Premiums are collected from all state agencies, including component units, and recorded as revenue in the Administration Insurance Internal Service Fund.

An annual actuarial study, prepared by Tillinghast-Towers Perrin Company, and issued for the accident period July 1, 1998 through June 30, 2008, is the basis for estimating the liability for unpaid claims and is supported by historical loss data. The June 30, 2008, estimated claims liability was $16,498,123.

(3) Changes in Claims Liabilities for the Past Two Years – These funds establish liabilities for both reported and incurred, but not reported, claims. The following table presents changes in the balances of claims liabilities during the past two fiscal years (in thousands):

	Group Employees Benefits		Administration Insurance	
	2008	2007	2008	2007
Amount of claims liabilities at the beginning of each fiscal year	$ 12,508	$ 12,517	$15,121	$16,216
Incurred claims:				
Provision for insured events of the current year	101,540	90,932	6,271	5,539
Increases (decreases) in provision for insured events of prior years	(2,408)	(9)	5,869	(635)
Total incurred claims	99,132	90,923	12,140	4,904
Payments:				
Claims attributable to insured events of the current year	(88,340)	(77,292)	(1,462)	(653)
Claims attributable to insured events of prior years	(13,200)	(13,640)	(9,301)	(5,346)
Total payments	(101,540)	(90,932)	(10,763)	(5,999)
Total claims liability at end of each fiscal year	$ 10,100	$ 12,508	$16,498	$15,121

NOTE 9. COMMITMENTS

A. Highway Construction

At June 30, 2008, the Department of Transportation had contractual commitments of approximately $189.9 million for construction of various highway projects. Funding for these highway projects is to be provided from federal grants and matching state special revenue funds.

B. Capital Construction

At June 30, 2008, the Department of Administration, Architecture & Engineering Division, had commitments of approximately $42.6 million for capital projects construction. The primary government will fund $23.3 million of these projects, with the remaining $19.3 million coming from the state university system.

C. Coal Tax Loan and Mortgage Commitments

The Board of Investments (BOI) makes firm commitments to fund loans from the Coal Severance Tax Permanent Trust Fund. These commitments have expiration dates and may be extended according to BOI policies. As of June 30, 2008, the BOI had committed,. but not yet purchased, $26,138,839 in loans from Montana lenders. In addition to the above commitments, lenders had reserved $7,474,356 for loans as of June 30, 2008.

The BOI makes reservations to fund mortgages from the Public Employees and Teachers retirement funds. As of June 30, 2008, the BOI had mortgage reservations/commitments totaling $394,947.

D. Proprietary Fund Commitments

Budgets are administratively established in the enterprise and internal service funds, excluding depreciation, compensated absences, and bad debt expense. Appropriations may be committed for goods/services that are not received as of fiscal year-end. These executory commitments are included in unrestricted net assets in the accompanying financial statements as follows (in thousands):

	Amount
Enterprise funds	
Secretary of State Business Services	$ 54
Liquor Warehouse	41
HUD Section 8 Housing	2
State Lottery	1
Subtotal-Enterprise funds	$ 98
Internal service funds	
Highway Equipment	$ 809
Information Technology Services	227
Buildings & Grounds	127
FWP Equipment	97
Motor Pool	89
Administration Insurance	52
Administration Supply	30
Administration Central Services	26
Labor Central Services	23
DEQ Indirect Cost Pool	6
SABHRS Finance & Budget Bureau	5
Commerce Central Services	4
Print & Mail Services	1
Subtotal-Internal service funds	$1,496
Total	$1,594

NOTE 10. LEASES/INSTALLMENT PURCHASES PAYABLE

The State has entered into various capital and operating leases for land, buildings, equipment, and computer software. Lease contracts are required by law to contain a clause indicating continuation of the lease is subject to funding by the Legislature. It is expected, in the normal course of operations, that most of these leases will be replaced by similar leases.

A. Capital Leases/Installment Purchases

Obligations under capital leases/installment purchases at June 30, 2008, were as follows (in thousands):

	Primary Government	Discretely Presented Component Units		
Fiscal Year Ending June 30	Governmental Activities	Montana State University	University of Montana	Total
2009	$ 546	$25	$293	$318
2010	455	9	232	241
2011	262	-	118	118
2012	288	-	73	73
Thereafter	10	-	17	17
Total minimum pmts	1,561	34	733	767
Less: interest	(140)	(3)	(96)	(99)
Present value of minimum payments	$1,421	$31	$637	$668

B. Operating Leases

Primary government rental payments for operating leases in fiscal year 2008 totaled $17,083,000. Future rental payments under operating leases are as follows (in thousands):

Fiscal Year Ending June 30	Primary Government	Discretely Presented Component Units
2009	$16,092	$ 2,619
2010	12,852	2,647
2011	11,562	2,022
2012	9,041	1,867
2013	7,440	1,810
2014-2018	25,632	9,103
2019-2023	8,892	1,013
Thereafter	1,259	-
Total future rental payments	$92,770	$21,081

NOTE 11. STATE DEBT

A. General Information

The State has no constitutional limit on its power to issue obligations or incur debt, other than a provision that no debt may be created to cover deficits incurred because appropriations exceeded anticipated revenues. The Board of Examiners (consisting of the Governor, Secretary of State, and Attorney General) is authorized, pursuant to various enabling acts, to issue bonds and notes of the State.

B. Short-term Debt

The Board of Examiners, upon recommendation of the Department of Administration, may issue notes in anticipation of the receipt of taxes and revenues. No notes may be issued to refund outstanding notes.

The State issued two bond anticipation notes and two revenue anticipation notes during fiscal year 2008 pertaining to drinking water and water pollution control. The bond and revenue anticipation notes were issued to match Environmental Protection Agency capitalization grants. The proceeds were used to loan funds to local governments, to construct and rehabilitate drinking water and wastewater systems. The following schedule summarizes the activity for the year ended June 30, 2008 (in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance
BANs				
Drinking Water	$-	$500	$500	$ -
Water Pollution Control	-	500	500	-
RANs				
Drinking Water	-	800	150	650
Water Pollution Control	-	400	400	-

The Board of Investments (BOI) of the State of Montana is authorized to issue Intermediate Term Capital (INTERCAP) bonds under the Municipal Finance Consolidation Act. These bonds may not aggregate more than $190 million as amended by the 2007 Legislature. The purpose of the bonds is to provide funds for the BOI to make loans to eligible government units. The bonds are limited obligations of the BOI, payable solely from (1) repayments of principal and interest on loans made by the BOI to participating eligible governmental units, (2) investment income under the indenture, and (3) an irrevocable pledge by the BOI. The BOI has no taxing power. Bondholders may elect to have their bonds purchased by the trustee on March 1 of each year until maturity. These issues are considered to be demand bonds and are included in short-term debt. The amounts issued and outstanding at June 30, 2008, were as follows (in thousands):

Series	Amount Issued	Balance June 30, 2008
1994	7,500	$ 6,685
1995	7,500	6,875
1997	10,000	9,520
1998	12,500	12,110
2000	15,000	14,750
2003	15,000	14,735
2004	18,500	18,370
2007	15,000	15,000
Total		$98,045

The following schedule summarizes the activity relating to the demand bonds during the year ended June 30, 2008 (in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance
Demand bonds	$98,460	$-	$415	$98,045

C. Long-term Debt

The full faith, credit, and taxing powers of the State are pledged for the payment of all general obligation debt. Revenue and mortgage bonds are secured by a pledge from the facilities to which they relate and by certain other revenues, fees, and assets of the State and the various colleges and universities. Primary government bonds and notes outstanding at June 30, 2008, were as follows (in thousands):

Governmental Activities	Series	Amount Issued	Interest Range (%) (1)	Principal Payments: Fiscal Year 2009	Principal Payments: In Year of Maturity (2)	Balance June 30, 2008
General obligation bonds						
Wastewater Treatment Works Revolving Fund (3)	1998A	$ 3,510	3.75-5.15	$ 915	225 (2016)	$ 2,295
Long-Range Bldg Program	1998B	34,545	4.2-5.1	1,690	1,765 (2010)	3,455
Long-Range Bldg Program Refunding	1998D	14,855	4.4-5.0	1,290	1,720 (2015)	10,450
Long-Range Bldg Program	1999C	16,990	4.0-5.0	785	785 (2009)	785
Drinking Water Revolving Fund (3)	1998F	3,065	3.6-4.85	150	230 (2019)	2,050
Drinking Water Revolving Fund (3)	2000A	2,990	4.25-5.6	125	240 (2021)	2,270
Water Pollution Control Revolving Fund (3)	2000B	3,325	4.25-5.6	135	270 (2021)	2,530
Long-Range Bldg Program	2000C	17,195	5.0-5.55	720	800 (2011)	2,280
Long-Range Bldg Program	2001B	11,430	4.1-5.75	470	830 (2021)	8,175
Information Technology	2001C	1,600	3.85-4.2	170	185 (2011)	530
Energy Conservation Program (5)	2001D	1,250	3.85-4.2	130	145 (2011)	415
Renewable Resource Program (4)	2001E	1,040	5.2-6.8	440	80 (2013)	730
Drinking Water Revolving Fund (3)	2001G	3,190	4.0-5.0	135	235 (2022)	2,500
Water Pollution Control Revolving Fund (3)	2001H	2,690	4.0-5.0	115	200 (2022)	2,100
Long-Range Bldg Program	2002B	10,475	3.35-4.7	460	730 (2023)	8,420
Hard Rock Mining Reclamation	2002C	2,500	3.5-4.7	95	200 (2023)	2,095
Long-Range Bldg Program Refunding	2002D	15,805	2.5-3.7	1,410	1,685 (2014)	9,230
Long-Range Bldg Program	2003A	9,730	2.37-4.0	425	655 (2024)	8,195
Energy Conservation Program (5)	2003B	1,250	2.0-3.0	120	145 (2014)	795
Renewable Resource Program Refunding (4)	2003C	1,970	1.45-5.25	60	90 (2019)	805
Water Pollution Control Revolving Fund (3)	2003D	2,730	2.0-3.1	165	190 (2014)	1,065
Drinking Water Revolving Fund (3)	2003E	1,675	2.0-3.1	100	115 (2014)	645
Long-Range Bldg Program Refunding	2003G	26,610	2.0-5.0	2,075	2,310 (2017)	18,500
Information Technology Refunding	2003H	8,725	2.0-4.0	2,150	2,225 (2010)	4,375
Water Pollution Control Revolving Fund (3)	2004A	2,665	2.0-3.8	155	185 (2015)	1,185
Long-Range Bldg Program	2004B	3,125	3.0-4.75	165	170 (2025)	2,670
Long-Range Bldg Program Refunding	2005A	14,945	3.0-5.25	420	1,205 (2019)	14,875
Long-Range Bldg Program	2005B	1,670	3.25-4.3	65	120 (2026)	1,565
Energy Conservation Program (5)	2005C	2,500	3.25-4.0	235	290 (2016)	2,075
CERCLA Program (6)	2005D	2,000	3.25-4.3	75	140 (2026)	1,870
Drinking Water Revolving Fund (3)	2005F	3,875	4.0-4.75	210	350 (2021)	3,515
Water Pollution Control Revolving Fund (3)	2005G	2,110	4.0-4.75	115	190 (2021)	1,910
Long-Range Bldg Program Refunding	2005H	10,055	3.0-5.0	45	1,300 (2020)	9,845
Long-Range Bldg Program	2006A	31,350	4.0-5.0	1,315	1,930 (2027)	30,360
Energy Conservation Program (5)	2006B	3,750	4.0-6.0	190	330 (2022)	3,600
CERCLA Program (6)	2006C	1,000	4.0	90	120 (2017)	925
Renewable Resource Program (4)	2006D	950	5.6-6.0	45	90 (2022)	915
Long-Range Bldg Program Refunding	2007A	16,740	4.25-5.0	-	2,465 (2018)	16,740
Long-Range Bldg Program	2007D	11,720	4.375-4.75	380	3,865 (2028)	11,720
Long-Range Bldg Program	2008D	3,100	3.375-4.35	205	220 (2028)	3,100
Total general obligation bonds		$365,980		$18,040		$201,560
Special revenue bonds						
State Hospital Project (7)	1997	$ 25,915	4.0-5.05	$ 965	1,820 (2022)	$ 18,910
Renewable Resource Program (8)	1997A	1,205	6.0-7.3	115	115 (2009)	115
Renewable Resource Program (8)	1997B	2,660	3.75-5.37	130	210 (2018)	1,670

Governmental Activities	Series	Amount Issued	Interest Range (%) (1)	Principal Payments Fiscal Year 2009	Principal Payments In Year of Maturity (2)	Balance June 30, 2008
Renewable Resource Program (8)	2001A	420	3.65-5.59	20	30 (2021)	315
Renewable Resource Program (8)	2001B	1,750	5.2-7.1	70	150 (2021)	1,370
Renewable Resource Program Refunding (8)	2001C	12,155	2.55-4.3	655	790 (2013)	3,605
Broadwater Power Proj Refunding (8)	2001D	21,450	2.25-4.7	1,240	1,795 (2018)	14,885
Renewable Resource Program (8)	2001E	885	2.1-4.85	35	65 (2022)	685
Renewable Resource Program (8)	2001F	900	3.3-6.2	35	75 (2022)	725
Developmental Center Project Refunding (7)	2003	11,510	3.0-5.0	635	970 (2019)	8,665
Renewable Resource Program (8)	2003A	3,000	1.05-4.05	120	215 (2024)	2,550
Renewable Resource Program Refunding (8)	2004A	5,070	2.15-2.95	500	500 (2009)	500
Renewable Resource Program (8)	2004B	430	4.45-5.45	25	40 (2020)	370
U.S. Highway 93 GARVEES (9)	2005	122,795	3.65-5.19	6,685	11,315 (2020)	105,330
U.S. Highway 93 GARVEES (9)	2008	44,670	3.5-5.0	2,385	3,925 (2023)	44,670
Total special revenue bonds		$254,815		$13,615		$204,365
Notes payable						
Water Conservation (Little Dry Project) (10)		$ 50	5.0	$ 2	1 (2012)	$ 9
Water Conservation (Petrolia Project) (10)		50	5.0	2	2 (2016)	19
Middle Creek Dam Project (11)		3,272	8.125	53	208 (2034)	2,691
Tongue River Dam Project (12)		11,300	-	290	290 (2038)	8,692
Total notes payable		$ 14,672		$ 347		$ 11,411
Subtotal governmental activities, before deferred balances						417,336
Deferred amount on refunding						(4,149)
Unamortized discount						(119)
Unamortized premium						9,635
Total governmental activities		$635,467		$32,002		$422,703
Business-type Activities						
Bonds/notes payable						
Economic Development Bonds (13)						
Municipal Finance Consolidation Act Bonds (Irrigation Program) (14)	1988	$ 4,976	6.60-7.75	$ 45	70 (2014)	$ 345
Conservation Reserve Enhancement Program (CRP Bonds) (15)		1,508	6.0-7.50	372	98 (2014)	1,508
Total bonds/notes payable		6,484		417		1,853
Total business-type activities		$ 6,484		$ 417		$ 1,853

(1) The interest range is over the life of the obligation.

(2) Year of maturity refers to fiscal year.

(3) These bonds provide matching funds to enable the State to obtain capitalization grants from the U.S Environmental Protection Agency for water system development loans to state political subdivisions.

(4) The general obligation Renewable Resource Program Bonds are secured additionally by a pledge of, and payable from, certain coal severance taxes. The bonds are also secured by a pledge of loan repayments from loans made from the bond proceeds.

(5) Bonds issued for financing the design, construction, and installation of energy conservation projects at various state buildings.

(6) The CERCLA (Comprehensive Environmental Response, Compensation, and Liability Act) Program Bonds were issued for the purpose of financing the costs of State of Montana participation in the remedial actions under Section 104 of the CERCLA 42 United States Code Sections 9601-9657, and State of Montana costs for maintenance of sites under CERCLA. The CERCLA Bonds are secured additionally by a pledge of monies received by the State as cost recovery payments and revenues derived from the resource indemnity and groundwater assessment tax in the event cost recovery payments are insufficient.

(7) Facility Finance Authority loan to the Department of Public Health and Human Services for the Montana Developmental Center Project and the Montana State Hospital Project.

(8) Issued by the Department of Natural Resources and Conservation and backed by a pledge of coal severance taxes and project revenues.

(9) The U.S. Highway 93 GARVEES (Grant Anticipation Revenue Vehicles) Bonds were issued for the purpose of improving a 44.8-mile stretch of U.S. Highway 93. Repayment of the bonds is secured by a pledge of certain federal aid revenues.

(10) Loans obtained from Farmers Home Administration for the purpose of acquiring an irrigation (pumping) system for water distribution in the vicinity of Sidney, Montana (Little Dry Project) and to rehabilitate the Petrolia Reservoir and Canal in the vicinity of Winnett, Montana (Petrolia Project). A portion of the revenues generated by the facilities is pledged for repayment of the loans. In the fiscal year 2004 CAFR, the Little Dry Project Loan was incorrectly listed as a special revenue bond and the Petrolia Project Loan was incorrectly excluded from the long-term debt reported.

(11) U.S. Bureau of Reclamation loan to Montana Department of Natural Resources & Conservation. The outstanding balance includes $215,850 of interest owed.

(12) Northern Cheyenne Tribe loan to the Montana Department of Natural Resources & Conservation. The loan will not accrue interest and will be repaid over 39 years. Loan repayment is secured by the issuance of a coal severance tax bond to the tribe.

(13) Economic Development Bonds & Municipal Finance Consolidation Act Bonds – This program is directed by the Board of Investments, which is attached to the Department of Commerce for administrative purposes. The program assists Montana's small businesses and local governments in obtaining low-cost financing.

(14) These bonds were issued to obtain funds for the Board of Investments, State of Montana, to purchase the refunding bonds of participating Irrigation Districts for the purpose of prepaying the U.S. Department of Interior, Bureau of Reclamation Projects Loans. The Irrigation Bonds, and the interest thereon, are payable solely from the collection of a special tax or assessment, which is a lien against real property in the Irrigation District. The Irrigation Bonds are limited obligations of the Board of Investments, due to an irrevocable pledge to lend money for deposit by the trustee of the Irrigation District Pooled Loan Program Reserve Account E in an amount equal to any deficiencies therein, on any payment date. The indenture does not permit the issuance of additional bonds.

(15) The Conservation Reserve Enhancement Program is funded by the Montana Trust Funds Bond Pool.

D. Debt Service Requirements

Primary government debt service requirements at June 30, 2008, were as follows (in thousands):

Governmental Activities

Year Ended June 30	General Obligation Bonds		Special Revenue Bonds		Notes Payable	
	Principal	Interest	Principal	Interest	Principal	Interest
2009	$ 18,040	$ 8,151	$ 13,615	$ 9,353	$ 347	$ 44
2010	17,415	7,745	13,400	8,903	349	43
2011	15,355	7,071	14,030	8,324	351	42
2012	15,650	6,451	14,645	7,701	352	41
2013	16,275	5,807	15,310	7,051	353	40
2014-2018	72,130	18,615	83,385	24,345	1,841	181
2019-2023	32,860	6,384	49,765	5,456	1,931	145
2024-2028	13,835	1,638	215	4	2,043	102
2029-2033	-	-	-	-	2,188	49
2034-2038	-	-	-	-	1,656	2
Total	$201,560	$61,862	$204,365	$71,137	$11,411	$689

Business-type Activities

Year Ended June 30	Economic Development Bonds	
	Principal	Interest
2009	$ 417	$125
2010	347	96
2011	307	73
2012	329	52
2013	285	29
2014-2018	168	9
Total	$1,853	$384

Debt service requirements of discretely presented component units at June 30, 2008, were as follows (in thousands):

Year Ended June 30	Housing Authority		Montana State University		University of Montana	
	Principal	Interest	Principal	Interest	Principal	Interest
2009	$ 14,230	$ 46,649	$ 3,518	$ 6,425	$ 5,675	$ 6,896
2010	15,255	46,044	3,759	6,492	5,813	6,678
2011	15,885	45,384	3,711	6,466	5,642	6,440
2012	16,585	44,677	3,849	6,427	5,876	6,223
2013	17,980	43,924	5,777	4,570	6,135	5,958
2014-2018	107,739	205,802	32,100	18,998	34,690	25,302
2019-2023	141,355	176,080	32,920	11,090	44,060	15,546
2024-2028	191,540	134,532	12,815	6,098	26,620	4,483
2029-2033	219,075	81,142	12,330	3,311	8,190	927
2034-2038	176,165	27,320	7,310	467	-	-
2039-2043	20,450	2,444	-	-	-	-
2044-2048	970	35	-	-	-	-
Total	$937,229	$854,033	$118,089	$70,344	$142,701	$78,453

E. Summary of Changes in Long-term Liabilities Payable

Primary government long-term liability activity for the year ended June 30, 2008, was as follows (in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year	Amounts Due In More Than One Year
Governmental activities						
Bonds/notes payable						
General obligation bonds	$208,015	$ 14,820	$ 21,275	$201,560	$18,040	$183,520
Special revenue bonds	171,080	44,670	11,385	204,365	13,615	190,750
Notes payable	11,755	-	344	11,411	347	11,064
	390,850	59,490	33,004	417,336	32,002	385,334
Deferred amount on refunding	(4,840)	691	-	(4,149)	-	(4,149)
Unamortized discount	(133)	14	-	(119)	-	(119)
Unamortized premium	10,090	829	1,284	9,635	-	9,635
Total bonds/notes payable	395,967	61,024	34,288	422,703	32,002	390,701
Other liabilities						
Lease/installment purchase payable	1,057	1,068	704	1,421	475	946
Compensated absences payable (1)	84,131	41,417	34,424	91,124	34,428	56,696
Early retirement benefits payable (1)	48	247	251	44	5	39
Arbitrage rebate tax payable (1)	363	254	297	320	1	319
Estimated insurance claims (1)	27,629	111,272	112,303	26,598	13,442	13,156
OPEB implicit rate subsidy (2)	-	40,029	-	40,029	-	40,029
Total other liabilities	113,228	194,287	147,979	159,536	48,351	111,185
Total governmental activities Long-term liabilities	$509,195	$255,311	$182,267	$582,239	$80,353	$501,886
Business-type activities						
Bonds/notes payable						
Economic Development Bonds	$ 2,677	$ -	$ 824	$ 1,853	$ 417	$ 1,436
MUS Workers Compensation	430	-	430	-	-	-
Total bonds/notes payable	3,107	-	1,254	1,853	417	1,436
Other liabilities						
Compensated absences payable	1,299	789	548	1,540	544	996
Arbitrage rebate tax payable	59	84	104	39	25	14
Estimated insurance claims	15,478	67,125	62,711	19,892	11,481	8,411
OPEB implicit rate subsidy (2)	-	713	-	713	-	713
Total other liabilities	16,836	68,711	63,363	22,184	12,050	10,134
Total business-type activities Long-term liabilities	$ 19,943	$ 68,711	$ 64,617	$ 24,037	$12,467	$ 11,570

(1) The compensated absences liability attributable to the governmental activities will be liquidated by several of the governmental and internal service funds. The early retirement benefits payable will be liquidated by the general, state special revenue, and federal special revenue funds. The arbitrage rebate tax payable will be liquidated by debt service funds. The Employee Group Benefits and Administration Insurance internal service funds will liquidate the estimated insurance claims liability.

(2) The OPEB plan allows retirees to participate, as a group, at a rate that does not cover all the related costs. This results in the reporting of an "implicit rate" subsidy in the related financial statements. While this liability is disclosed for financial purposes, it does not represent a legal liability of the State, or any of its component units.

Long-term liability activity of discretely presented component units for the year ended June 30, 2008, was as follows (in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year	Amounts Due In More Than One Year
Discretely presented component units						
Bonds/notes payable						
Housing Authority	$ 914,854	$108,577	$ 76,520	$ 946,911	$ 14,230	$ 932,681
Montana State University (MSU)	127,486	17,958	21,784	123,660	4,983	118,677
University of Montana (UM)	146,052	500	6,076	140,476	5,675	134,801
Total bonds/notes payable (1)	1,188,392	127,035	104,380	1,211,047	24,888	1,186,159
Other liabilities						
Lease/installment purch pay	490	425	247	668	265	403
Compensated absences pay	48,826	23,782	22,399	50,209	23,338	26,871
Arbitrage rebate tax payable	1,197	-	320	877	544	333
Estimated insurance claims	754,272	212,937	146,521	820,688	147,247	673,441
Due to federal government	31,392	394	-	31,786	-	31,786
Other	2,095	-	-	2,095	-	2,095
OPEB implicit rate subsidy (2)	-	17,226	-	17,226	-	17,226
Total other liabilities	838,272	254,764	169,487	923,549	171,394	752,155
	$2,026,664	$381,799	$273,867	$2,134,596	$196,282	$1,938,314
Long-term liabilities of MSU component units					92	519
Long-term liabilities of UM component units					427	101
Total discretely presented component units Long-term liabilities					$196,801	$1,938,934

(1) When applicable, this amount includes deferred refunding costs, unamortized discounts, and unamortized premiums.

(2) The OPEB plan allows retirees to participate, as a group, at a rate that does not cover all the related costs. This results in the reporting of an "implicit rate" subsidy in the related financial statements. While this liability is disclosed for financial purposes, it does not represent a legal liability of the State, or any of its component units.

F. Refunded and Early Retired Debt

Primary Government

Pre-payments

During fiscal year 2008, the Department of Natural Resources and Conservation (DNRC) used current available resources to make the following pre-payments on outstanding bonds: $200,000 of special revenue Series 2004A and $1,055,000 of general obligation Series 2004A.

Defeased Debt Outstanding

The State of Montana has defeased certain general obligation and special revenue bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the financial statements. At June 30, 2008, $66,440,000 of bonds outstanding was considered defeased.

Universities

Defeased Debt Outstanding

Montana State University and the University of Montana have defeased certain bond issues by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the financial statements. At June 30, 2008, $1,535,000 and $49,029,871 of bonds outstanding were considered defeased for Montana State University and the University of Montana, respectively.

G. No-Commitment Debt

Information is presented below for financing authorities participating in debt issues. The State has no obligation for this debt. Accordingly, these bonds and notes are not reflected in the accompanying financial statements.

Primary Government

Montana Board of Investments (BOI)

Under the Economic Development Act, the BOI is authorized to issue stand-alone industrial revenue bonds to finance projects for qualifying borrowers. Assets and revenues of the borrower are pledged to repay the bonds. At June 30, 2008, industrial revenue bonds outstanding aggregated $189.2 million.

The BOI is also authorized to issue Qualified Zone Academy Bonds (QZAB) under the Municipal Finance Consolidation Act. The revenues, and in some cases, the taxing power of the borrower are pledged to repay the bonds. At June 30, 2008, QZAB debt outstanding aggregated $7.2 million.

Neither the industrial revenue bonds nor the QZAB debt issued by the BOI constitutes a debt, liability, obligation, or pledge of faith and credit of the State of Montana.

Beginning Farm Loan Program

The Montana Department of Agriculture is authorized to request issuance of bonds by the BOI to finance projects for beginning farmers within the State, if it appears, after a properly noticed public hearing, that the project is in the public interest of the State. These non-recourse, industrial development revenue bonds do not constitute a debt, liability, or obligation of the State of Montana. The amount issued and outstanding at June 30, 2008, was as follows: Hershberger Project – issued $129,412, outstanding $109,601; Young Project – issued $223,300, outstanding $198,125.

Discretely Presented Component Units

Facility Finance Authority (FFA)

The FFA is authorized to issue bonds and notes to finance projects for qualifying health care and other community-based service providers. The revenue bonds are payable solely from loan repayments to be made by eligible facilities pursuant to loan agreements, and further, from the funds created by the indentures and investment earnings thereon. The notes are payable solely from loan repayments pursuant to loan agreements. The revenue bonds and notes payable issued by the FFA do not constitute a debt, liability, obligation, or pledge of faith and credit of the State of Montana. At June 30, 2008, revenue bonds outstanding aggregated $880.6 million, and notes payable outstanding aggregated $10.5 million.

The BOI and the FFA have entered into a capital reserve account agreement for certain bond issues. See Note 16.C (Miscellaneous Contingencies) for more information.

Housing Authority (HA)

The HA is authorized to issue bonds and make mortgage loans in order to finance housing which will provide decent, safe, and sanitary housing for persons and families of lower income in the State of Montana. The bonds are special, limited obligations, payable solely from pledged revenues and assets, not general obligations of the HA. The bonds issued by the HA do not constitute a debt, liability, obligation, or pledge of faith and credit of the State of Montana. At June 30, 2008, bonds outstanding aggregated $8,985,264.

H. Derivative Transactions Related to Long-term Debt

Interest Rate Exchange Agreements

In March 2005, Montana State University (MSU) entered into a forward-starting interest rate swap agreement (“swaption”) with Deutsche Bank AG (“DBAG”). The notional amount of the swap as of June 30, 2008, was $25,250,000, and equaled MSU’s Revenue Bonds Series J 2005 bond principal outstanding. The instrument was intended to synthetically fix the Series J 2005 bonds issued July 21, 2005, from a variable rate to an intended rate of 3.953%.

DBAG has the option to unwind the swap in 2016, exposing MSU to rollover risk for the Series J bonds’ remaining term. If the swaption is not exercised in 2016, the swap terminates in November, 2035, at which time the Series J 2005 bonds mature.

At June 30, 2008, the negative fair value of the swap was ($1,608,366). Such value was provided to MSU by an independent valuation firm, and is calculated using mid-market levels as of the close of business on June 30.

In August 2005, the University of Montana (UM) entered into a forward SWAP agreement (“swaption”) with Wachovia Bank, NA (“counterparty”) to hedge the interest rate risk associated with the potential future issuance of variable-rate revenue bonds. The swaption gives the counterparty the right to require that UM execute a floating-to-fixed swap in May 2010, based on a notional amount of $47,000,000. Should the counterparty exercise its option, UM would expect to issue Series K 2010 taxable, variable-rate bonds at the $47,000,000 notional amount of the swap. The intention of UM in entering into the swaption was to refund its outstanding Series F 1999 Revenue Bonds and lower the cost of its borrowing.

The counterparty has the right to exercise the swap on May 15, 2010, the call date of the Series F 1999 Revenue Bonds. If the swaption is exercised, it will also become effective on May 15, 2010. Under terms of the swap, UM will pay the counterparty a fixed rate substantially equal to the fixed rate on the refunded bonds, and receive a variable payment based on the one-month LIBOR rate, plus 30 basis points.

Once the refunded Series F 1999 Revenue Bonds escrow matures in 2019, the floating-rate Series K 2010 Parity Bonds will be converted to tax-exempt bonds, and the swap will convert to tax-exempt rates as well. Should the option to enter the swap not be exercised by the counterparty, UM would not be required to repay the swaption purchase price.

At June 30, 2008, the swaption has a negative fair value of ($2,309,206). If the option is exercised and variable-rate Series K 2010 Parity Bonds are not issued by the UM, the Series F 1999 Revenue Bonds would not be refunded, and UM would make net swap payments as required by the terms of the swap.

Constant Maturity Swap
In July 2006, MSU entered into a forward-starting basis swap agreement ("constant maturity swap") with Morgan Stanley Capital Services, Inc. ("Morgan Stanley"). The agreement took effect November 15, 2007, at a notional amount of $25,250,000, decreasing to $1,550,000 by November 15, 2034, at which time the instrument expires.

At June 30, 2008, the negative fair value of the constant maturity swap was ($65,445). Such value was provided to the university by an independent valuation firm, and was calculated using mid-market levels as of the close of business on June 30.

NOTE 12. INTERFUND BALANCES AND TRANSFERS

A. Balances Due From/To Other Funds

Balances due from/to other funds arise when there is a time lag between the dates that reimbursable expenditures and interfund services provided/used are recorded in the accounting system, and the dates on which payments are made. Balances also arise when there is a time lag between the dates that transfers between funds are recorded, and the dates on which payments are made. Balances due from/to other funds also includes the current portion of balances related to amounts loaned by the Economic Development Bonds Fund to other funds, under the Board of Investments INTERCAP loan program. Balances due from/to other funds are expected to be repaid within one year from the date of the financial statements.

Balances due from/to other funds at June 30, 2008, consisted of the following (in thousands):

	Due To Other Funds					
	Coal Severance Tax Permanent	Economic Development Bonds	Federal Special Revenue	General Fund	Internal Service Funds	Nonmajor Enterprise Funds
Due From Other Funds						
Economic Development Bonds	$ -	$ -	$ -	$ -	$2,327	$ -
Federal Special Revenue	-	-	-	109	14	10
General Fund	5,443	1	318	-	142	12,664
Internal Service Funds	34	2	1,426	3,144	521	188
Nonmajor Enterprise Funds	-	-	6	346	65	-
Nonmajor Governmental Funds	-	-	198	1,091	-	-
State Special Revenue	41	-	2,595	5,184	20	112
Total	$5,518	$3	$4,543	$9,874	$3,089	$12,974

	Nonmajor Governmental Funds	State Special Revenue	Total
Due From Other Funds *(continued)*			
Economic Development Bonds	$ 6	$ 1,800	$ 4,133
Federal Special Revenue	-	1,308	1,441
General Fund	37	49,919	68,524
Internal Service Funds	15	1,996	7,326
Nonmajor Enterprise Funds	-	48	465
Nonmajor Governmental Funds	-	144	1,433
State Special Revenue	3,351	-	11,303
Total	$3,409	$55,215	$94,625

B. Interfund Loans Receivable/Payable

Montana statutes include a provision for interfund loans when the expenditure of an appropriation is necessary and the cash balance in the account from which the appropriation was made is insufficient to pay the expenditure. Interfund loans receivable/payable are expected to be repaid within one year from the date of the financial statements.

Interfund loans receivable/payable at June 30, 2008, consisted of the following (in thousands):

	Interfund Loans Payable				
	Federal Special Revenue	Internal Service Funds	Nonmajor Enterprise Funds	State Special Revenue	Total
Interfund Loans Receivable					
General Fund	$19,664	$ 801	$ 70	$2,586	$23,121
Internal Service Funds	570	-	225	13	808
Nonmajor Enterprise Funds	141	18	-	-	159
State Special Revenue	44,077	493	-	-	44,570
Total	$64,452	$1,312	$295	$2,599	$68,658

C. Advances To/From Other Funds

Advances to/from other funds represents the portion of interfund loans that are not expected to be repaid within one year from the date of the financial statements. Advances to/from other funds also includes the noncurrent portion of balances related to amounts loaned by the Economic Development Bonds Fund to other funds, under the Board of Investments INTERCAP loan program.

Advances to/from other funds at June 30, 2008, consisted of the following (in thousands):

	Advances from Other Funds				
	Federal Special Revenue	Internal Service Funds	Nonmajor Governmental Funds	State Special Revenue	Total
Advances to Other Funds					
Coal Severance Tax Permanent	$ -	$ -	$ -	$ 3,112	$ 3,112
Economic Development Bonds	-	4,228	650	16,700	21,578
General Fund	-	2,644	-	-	2,644
Nonmajor Enterprise Funds	75	-	-	-	75
Nonmajor Governmental Funds	-	-	-	2,816	2,816
State Special Revenue	1,491	-	15,170	-	16,661
Total	$1,566	$6,872	$15,820	$22,628	$46,886

Additional detail for certain advance balances at June 30, 2008, follows (in thousands):

Advances from the Economic Development Bonds Fund under the INTERCAP Loan Program

Department	Balance
Natural Resources and Conservation	$ 650
Environmental Quality	1,299
Justice	15,401
Transportation	4,228
Total	$21,578

Advances from the Coal Severance Tax Permanent Fund

Department	Balance
Justice	$3,112
Total	$3,112

D. Interfund Transfers

Routine transfers between funds are recorded to (1) transfer revenues from the fund legally required to receive the revenue to the fund authorized to expend the revenue, (2) transfer resources from the General Fund and special revenue funds to debt service funds to support principal and interest payments, (3) transfer resources from enterprise funds to the General Fund to finance general government expenditures, and (4) provide operating subsidies.

Interfund transfers for the year ended June 30, 2008, consisted of the following (in thousands):

	Transfers In					
	Coal Severance Tax Permanent	Federal Special Revenue	General Fund	Internal Service Funds	Land Grant Permanent	Nonmajor Enterprise Funds
Transfers Out						
Coal Severance Tax Permanent	$ -	$ -	$28,855	$ -	$ -	$ -
Federal Special Revenue	-	-	1,865	17	-	-
General Fund	-	7	-	634	146	51
Internal Service Funds (1)	-	-	4	-	-	-
Land Grant Permanent	-	-	-	-	-	-
Nonmajor Enterprise Funds	-	1	36,545	-	-	-
Nonmajor Governmental Funds	365	-	1,567	-	-	-
State Special Revenue	283	384	6,631	2,802	1	58
Unemployment Insurance	-	1,299	-	-	-	-
Total	$648	$1,691	$75,467	$3,453	$147	$109

	Nonmajor Governmental Funds	State Special Revenue	Total
Transfers Out *(continued)*			
Coal Severance Tax Permanent	$ 237	$ 8,704	$ 37,796
Federal Special Revenue	16,822	12,384	31,088
General Fund	109,290	82,936	193,064
Internal Service Funds (1)	-	-	4
Land Grant Permanent	982	63,000	63,982
Nonmajor Enterprise Funds	-	5,272	41,818
Nonmajor Governmental Funds	2,758	22,963	27,653
State Special Revenue	9,986	-	20,145
Unemployment Insurance	-	-	1,299
Total	$140,075	$195,259	$416,849

(1) Total transfers-out for internal service funds on the financial statements is reported as $3,661,480. The difference of $3,657,739 between the amount reported above of $3,541 and the amount reported on the financial statements relates to the movement of capital assets between a governmental fund type and the internal service fund type. When assets were transferred between these funds, the transferring fund recorded the net book value of the capital asset as a capital contribution, and the receiving fund type recorded the net book value of the capital asset as a transfer-out.

NOTE 13. FUND DEFICITS

The following funds have a deficit fund balance/net assets position at June 30, 2008, (in thousands):

Fund Type/Fund	Deficit
Enterprise funds	
Subsequent Injury	$(2,692)
Surplus Property	$ (41)
Internal service funds	
Justice Legal Services	$ (92)
Personnel Training	$ (10)

NOTE 14. RESERVED FUND BALANCES

Special Revenue Funds – The State and Federal Special Revenue Funds reserved fund balances are for the following purposes (in thousands):

Fund Type/Purpose	Amount
State Special Revenue funds	
General Government	$ 39,841
Public Safety/Corrections	197,095
Transportation	115,706
Health/Social Services	67,127
Education/Cultural	23,784
Resource/Recreation/Environment	410,210
Economic Development/Assistance	50,192
Total state special revenue funds	$903,955
Federal Special Revenue funds	
General Government	$ 3,375
Public Safety/Corrections	790
Health/Social Services	3,022
Education/Cultural	18,797
Resource/Recreation/Environment	323
Economic Development/Assistance	332
Total federal special revenue funds	$26,639

Coal Severance Tax Permanent Trust Fund – The reserve for trust principal is comprised of the following (in thousands):

Purpose	Amount
Big Sky Economic Development Fund	$ 36,824
Coal Severance Tax Bond Fund	9,348
Treasure State Endowment Fund	169,805
Treasure State Endowment Regional Water System Fund	43,249
Coal Severance Tax Permanent Fund	520,534
Coal Severance Tax Income Fund	1,238
Total	$780,998

NOTE 15. RELATED PARTY TRANSACTIONS

The Montana Board of Regents (Regents), an agency within the State, is the guarantor of the loans owned by the Montana Higher Education Student Assistance Corporation (MHESAC), a private non-profit corporation and by the Student Assistance Foundation of Montana (SAF) and subsidiaries. The Regents and MHESAC have three common board members. Approximately 76.88% of the Regents' outstanding loan volume, $1,479,231,629, is held by either MHESAC or SAF and subsidiaries. During fiscal year 2000, MHESAC undertook a reorganization under which its operating staff and assets were transferred to the Student Assistance Foundation of Montana, and MHESAC entered into agreements with SAF to provide management and loan servicing to MHESAC. The Board of Regents and SAF have three common board members. The Office of Commissioner of Higher Education (OCHE) paid SAF during fiscal year 2008 for its share of various costs, such as personnel costs for employees of SAF who performed services that were of direct benefit to the State, equipment leases, computer maintenance costs, utilities, and other shared operating expenses. The total amount of these expenses for fiscal year 2008 amounted to $425,267. Additionally, the Montana Guaranteed Student Loan Program (MGSLP) paid $124,926 to SAF for leased space in the building MSGLP occupies with SAF at 2500 Broadway, Helena, MT 59601.

A staff member in the Department of Administration, Health Care and Benefits Division, serves as a Director of the Montana Association of Health Care Purchasers for no remuneration. The Department pays this association $1 per member per year to maintain its membership as well as a monthly fee of $3 on behalf of each employee who participates in a managed care plan. These fees are payment for data analysis, actuarial analysis, and consulting services performed by association staff on behalf of member employers.

NOTE 16. CONTINGENCIES

A. Litigation

The State is party to legal proceedings, which normally occur in government operations. The legal proceedings are not, in the opinion of the State's legal counsel and the Department of Administration, likely to have a material adverse impact on the State's financial position, except where listed below.

In State of Montana v. Philip Morris, Inc., No. CDV 97-306 (Mont. 1st Jud. Dist. Lewis & Clark County), the State of Montana filed various claims against six tobacco manufacturers seeking recovery of an unspecified amount of damages, penalties, and attorney's fees. The lawsuit was resolved eventually through two settlements. The State first settled its claims against one of the manufacturers, Liggett & Meyers, Inc., for $1 million to be paid over a 20-year period. It next settled its claims against the remaining manufacturers in November 1998 for a base settlement amount of $832 million payable over 26 years. The base amount was augmented by $90 million in 1999, with the additional amount to be paid in equal installments over a 10-year period beginning in 2007.

The settlement provides that the cigarette manufacturers may offset against their payment in any year certain amounts of money if it is found that the original settling manufacturers (known as OPMs) have lost more than 2% of their market share to non-settling manufacturers (known as NPMs), and that the disadvantages imposed by the settlement were a "significant factor" in the market share loss. The settlement further provides that the offset, known as the "NPM adjustment" may not be taken against the payments to any state that has enacted a "qualifying statute" and diligently enforced the statute during the year in question. Montana enacted such a qualifying statute in 1999, Title 16, Chapter 11, Parts 401 – 404, MCA.

In March 2006, a determination was made pursuant to the settlement that the OPMs had lost sufficient market share in 2003 to trigger an NPM adjustment analysis, and that disadvantages caused by the settlement were a significant factor in the market share loss. The State has filed a motion in the lawsuit seeking a declaration that it diligently enforced its qualifying statute during 2003. The OPMs moved to compel arbitration of the question, and the court has granted that motion. The State has appealed the order to the Montana Supreme Court, where the appeal remains pending. In the opinion of the counsel, good factual arguments exist to show that the State diligently enforced its statute during the year in question. However, legal and procedural uncertainties exist that make an adverse determination reasonably possible. An adverse determination on the diligent enforcement issue could result in the loss of some or all of the State's 2003 payment, which would be recouped through an offset of payments due in future years. At present, the NPM case involves roughly $1.8 million that was withheld from the April 2006 payment to the State. The OPMs have asserted claims for NPM adjustments for later years as well. The outcome of these claims is also uncertain.

This settlement has also formed the basis for other lawsuits against the State. On July 1, 2002, a group of cigarette manufacturers and marketers filed suit against the Attorneys General of 31 states, including Montana, in the United States District Court for the Southern District of New York, seeking a declaration that the provisions of Title 16, Chapter 11, Part 4, MCA, violate several provisions of the United States Constitution, and seeking injunctive relief against the enforcement of the statutes. Grand River Enterprises Six Nations, Ltd., v. Pryor et al., Docket No. 02 CV 5068 (U.S. Dist. Ct., S.D.N.Y.). An adverse outcome could threaten the ability of the State to continue to receive payments from the tobacco companies under the settlement of the Mazurek case discussed above. The potential loss to the Treasury could amount to $30-35 million annually. The federal district court had dismissed the complaint, but the United States Court of Appeals for the Second Circuit has reversed the trial court and remanded one of the claims for further proceedings. The United States Supreme Court has denied review, and the case has been remanded for further proceedings. In the opinion of counsel, good defenses exist to the claims, and an adverse result impairing or preventing receipt of the State's payment is possible, but unlikely.

In September 2002, a coalition of school districts, teachers, and parents filed an action, Columbia Falls Elementary School District v. State of Montana, No. BDV-2002-528 (Mont. 1st Jud. Dist. Lewis & Clark County), that alleges that Montana's system for funding public education violates the requirements of the Montana Constitution. The complaint seeks a declaratory judgment that the system violates the Montana Constitution and declaratory and injunctive relief compelling the State to (1) study and determine the components of free quality public elementary and secondary education and the costs of delivering such education; (2) implement a funding system based on educationally relevant factors; (3) fully fund and equitably distribute the State's share of the costs of public elementary and secondary education; (4) include a cost adjustment factoring the funding system; and (5) establish a mechanism for monitoring and adjusting the funding system and an award of attorney's fees. The court denied the State's motion for summary judgment.

The district court sat for the trial in this case from January 20, 2004 through February 4, 2004. Both parties submitted witness, exhibits, and cross-examined witnesses. On April 15, 2004, the court entered its order holding the school funding system unconstitutional. The State appealed the judgment, and the plaintiffs cross-appealed certain aspects of the judgment as well. The Supreme Court heard oral argument on the appeal and cross-appeal on October 20, 2004, and the Montana Supreme Court issued an order that the school funding system violates the Montana Constitution, and upheld the District order that the State had until October 2005 to address this issue. In February 2008, the plaintiffs filed a motion seeking further relief under the 2004 judgment. The Court held a five-day hearing on the motion in October 2008. The motion remains pending in the district court. On December 9, 2008, a preliminary decision was issued in Helena District Court in favor of the State. The decision said public schools aren't entitled to any "supplementary relief" from the State. Significant additional expenditures on K-12 education may be required in future years, and further litigation in this case or future new lawsuits are possible regarding school funding.

Beginning in February 2001, the Montana Department of Fish, Wildlife and Parks became the defendant in a number of lawsuits challenging the constitutionality and enforcement of Initiative Measure 143, which banned the issuance of new licenses for game farms in Montana, prohibiting the transfer of existing licenses, and prohibited game farm licenses from allowing the shooting of game farm animals on a game farm for a fee or other remuneration. Most of these cases sought declaratory and injunctive relief, but several cases are now pending in which game farmers have alleged that I-143 takes their property without just compensation in violation of the state and federal constitutions, and in which they seek damages from the State for the alleged uncompensated taking. The State believes valid defenses exist to the claims asserted in these cases. One of the cases, Spoklie v. State of Montana, U.S. District Ct., D. Mont. Docket No. CV-02-102-GF-SHE, has been dismissed in its entirety, and the dismissal has now been affirmed by the Ninth Circuit of Appeals. In a second case, Kafka v. Montana Department of Fish Wildlife, and Parks, Hill County Docket No. DV-02-059, the state district court has denied the taking claim and entered final judgment in favor of the State. In Buhlmann et al. v. State of Montana et al., Lewis and Clark Docket No. DV-2002-555, the court has entered judgment in favor of the State on the taking claims, and appeal has been taken to the Montana Supreme Court. Both the Kafka and Buhlman decisions are on appeal before the Montana Supreme Court. Royal Tine Ranch v. State, Flathead County Docket No. DV-02-606C, is submitted on cross-motions for summary judgment. Wallace v. State of Montana, Ravalli County Docket No. 02-254, has been dismissed without prejudice, and the Bowman v. Montana Fish, Wildlife and Parks, Fergus County Docket No. DV-2002-02, case has been dismissed without prejudice for failure to prosecute. Spoklie v. Montana Department of Fish, Wildlife and Parks, Sheridan County Docket No. 11013, and Mesaros v. Department of Fish, Wildlife and Parks, Cascade County Docket No. BDV 03-0119, are in varying stages of pretrial preparation. Based on the courts' treatment of the cases thus far, in the opinion of counsel, good defenses exist to all of these claims, although adverse decisions remain possible. The amount of loss cannot be estimated at this time.

In Montana Association for Disability Services, Inc., et al., v. Schweitzer, et al., filed in Montana First Judicial District Court, Lewis and Clark County, Cause No. BDV 2002 558, a class-action lawsuit was filed on the part of individually-named developmentally disabled persons and the Montana Association for Independent Disability Services, Inc., (MAIDS) a consortium of community-based private facilities serving the developmentally disabled population. The plaintiffs allege that the named defendants, Brian Schweitzer, Joan Miles, and Joe Mathews, in their official capacities, "configure" the wage and benefit structure of employees at community-based facilities serving developmentally disabled persons at a level that is lower than the level established at Eastmont and MDC. It is alleged this causes employees to leave the community-based facilities at a higher rate, thereby jeopardizing the quality and quantity of the services provided in the community-based facilities. This allegedly has the effect of precluding individuals with developmental disabilities from living in the community in the least restrictive, most independent circumstances possible. The wage configuration by the defendants allegedly constitutes a violation of statutes concerning the objective of placing developmentally disabled individuals in independent living situations, the establishment of uniform reimbursement rates equivalent to Medicaid covered services, the right to enjoy life, liberty, safety, health, and happiness (Article II, Section 3, Montana Constitution), to dignity and equal protection (Article II, Section 4, Montana Constitution), and of the requirement of Article XII, Section 3 that the State and Legislature provide assistance to those in need. The plaintiffs seek declaratory and injunctive relief concerning the proper establishment of reimbursement rates, attorney's fees, and costs. The court entered an order on March 30, 2004, granting the Motion for Class Certification. The parties have entered into a Class Action Settlement Agreement. Signatures of the named plaintiffs are being obtained, after which the settlement agreement will be presented to the court for its approval. It is anticipated that a court hearing will be necessary to allow input into the decision whether the settlement agreement is fair and acceptable to the class plaintiffs. Under the terms of the settlement, there will be no monetary damages and no attorney fees will be awarded.

In Terry Blanton v. DPHHS, filed in Montana Twentieth Judicial District Court, Lake County, Cause No. DV-06-37, a class-action lawsuit was filed on the part of plaintiffs who seek to "force DPHHS to obey federal Medicaid and anti-lien laws and the state 'made whole' doctrine." The lawsuit seeks payment from DPHHS of money allegedly wrongfully collected from third-party settlements or recoveries of Medicaid recipients. The lawsuit also seeks interest, costs, attorney fees, and declaratory and injunctive relief. On September 5, 2007, the court issued an order granting class certification. There is currently no trial date and no pretrial schedule. The state defendants do not feel that the material facts in the case have been sufficiently developed to permit a determination of the likelihood of success on the merits. In addition, the fiscal impact on the State, should the plaintiffs prevail, and the amount of any potential award of attorney fees and costs, is also not determinable at this time.

Lori Brenneman v. Gallatin County, Ron Carlstrom, Todd Kessner, Cynde Hertzog, and Does 1-10, Eighteenth Judicial District, Gallatin County, Cause No. DV 05-358, involves the plaintiff's claims of disability discrimination, gender discrimination, wrongful discharge, and retaliation. The State is providing a defense for Carlstrom and Kessner. The plaintiff seeks compensatory and exemplary damages, costs, and attorney fees. The case is set for trial in February, 2009. The state defendants do not feel that the material facts in the case have been sufficiently developed to permit a determination of the likelihood of success on the merits. In addition, the fiscal impact on the State, should the plaintiff prevail, and the amount of any potential award of attorney fees and costs, is also not determinable at this time.

In Satterlee v. Lumberman's Mutual Casualty Company et al., WCC No. 2003-840, was filed before the Workers Compensation Court on July 18, 2003. The *Satterlee, Zenahlik & Foster vs. Lumberman's Mutual Casulty Company and Montana State Fund* case challenges the constitutionality of state statute, (Section 39-71-710. MCA) passed by the Montana Legislature in 1981. That statute authorizes termination of permanent total disability benefits and rehabilitation benefits when a claimant receives or becomes eligible to receive full Social Security retirement benefits or an alternative to that plan. Should the statute be found unconstitutional as applied to permanent total benefits, *Satterlee, et al.* request payment of permanent total disability lifetime benefits. In addition, the petition requests certification of this case as a class action or the establishment of a common fund for similarly situated claimants. Petitioners filed a motion and brief for summary judgment on the constitutional issue. The Worker's Compensation Court provided an opportunity for any workers' compensation insurer to intervene until June 6, 2005. The Worker's Compensation Court rendered its decision on December 12, 2005, holding that MCA, Section 39-71-710, is constitutional as applied to PTD benefits. *Satterlee, et al.* appealed to the Montana Supreme Court on December 11, 2007. Montana's Supreme Court issued an order dismissing *Satterlee, et al.* without prejudice as two constitutional issues remained for ruling by the lower court (Rule 54(b)). MSF prevailed on the additional issues (section 39-71-710, MCA does not violate *Satterlee, et al.'s* due process rights or discriminate based on age) before the Worker's Compensation Court. On July 1, 2008 *Satterlee, et al.* again appealed to the Montana Supreme Court. Should Section 39-71-710, MCA ultimately be held unconstitutional as applied to permanent total disability payments by the Montana Supreme Court, and also be found to apply retroactively, the cost has been estimated for non-settled claims arising on or after July 1, 1990 through December 22, 2004 at $135 to $186 million. The estimated cost of retroactively applying the decision to the Old Fund, for non-settled permanent total disability claims that occurred before July 1, 1990 is $93 million to $116 million. Actual cost impact is unknown. The potential for liability for MSF and the state of Montana is reasonably possible, but following the second Worker's Compensation Court decision in MSF's favor, the probability or liability for MSF and the state of Montana is reduced.

Working Rx, Inc., v. Montana State Fund, Ed Heinrich, (Chairman of the Board of Directors of the Montana State Fund), Laurence Hubbard (President of the Montana State Fund), National Medical Health Card Systems, Inc, and John Does 1-20. This complaint was served in September 2006, but has since been dismissed to provide for the presentation of the claim to the Department of Administration as required in Title 2, Chapter 9, Section 301, MCA. Whether Montana State Fund has any responsibility to Working Rx for payment of pharmacy claims is the basis of the claim. Montana State Fund does not have sufficient information to determine potential liability or cost impact.

Martin Heth, Jr. vs. Montana State Fund, WCC No. 2006-1758, was decided by the Worker's Compensation Court on April 25, 2008. The Worker's Compensation Court decision included the following summary: "Petitioner was in a single vehicle accident involving the septic pumper truck he drove for his employer. Petitioner's blood alcohol content (BAC) tested at .0874 shortly after the accident and beer cans were found in and around the truck. Respondent argued that is not liable for Petitioner's workers' compensation claim because alcohol was the major contributing cause of the accident. Petitioner argued that alcohol was not the major contributing cause of the accident, and in any event, his employer knew that he drank alcohol while performing his job and therefore he is not barred from recovery under Section 39-71-407(4), MCA." The Worker's Compensation Court then held: "Although the respondent proved that alcohol was the major contributing cause of the accident, Petitioner proved that his employer knew he used alcohol while performing his job duties. Therefore, petitioner is eligible for workers' compensation benefits." Montana State Fund appealed the Worker's Compensation Court decision to the Montana Supreme Court on June 13, 2008, and among other grounds asserts an improper interpretation of "employer knowledge" exception by the Worker's Compensation Court. MSF believes there is a basis for the reversal of the Worker's Compensation Court decision in the favor of MSF. The potential for the Supreme Court to affirm the lower court decision against MSF is probable. The estimated cost of the case, should the Supreme Court affirm the lower court decision, is over $1,000,000 with estimates to $2,800,000. However, actual cost would depend on an evaluation of all available information at that time.

Quick vs. Montana State Fund, WCC No. 2006-1788, was decided by the Worker's Compensation Court on June 4, 2008. Quick was injured on June 15, 1984, and is a case in the "Old Fund". Quick requested retroactive and future domiciliary care benefits, a higher rate of pay for domiciliary care provided by Quick's wife, a 20% penalty, attorney's fees, and costs. Quick argued Montana State Fund (MSF) was on notice of domiciliary care since the 1984 accident. MSF argued that it did not have notice that domiciliary care was needed until receipt of a medical opinion on February 1, 2007, stating that domiciliary care was needed. Prior to the trial MSF conceded that Quick required 24 hour domiciliary care and began paying the rate of $7.50 per hour, effective February 1, 2007. The Worker's Compensation Court held Quick is not entitled to retroactive domiciliary care prior to February 1, 2007. The court also held the rate of $7.50 per hour was unreasonable as the evidence establishes that Quick's care needs to be by a person with RN skills. The court found $20.00 per hour to be a reasonable rate of pay. The court awarded a 20% penalty on the difference of $7.50 per hour and the $20 per hour ordered by the court on June 4, 2008. Quick appealed to the Montana Supreme Court on July 1, 2008, and MSF filed a cross-appeal on the penalty on July 15, 2008. It is remote that the Supreme Court will find additional liability for the state of Montana (this is an "Old Fund" claim) by reversing the lower court decision denying the retroactive domiciliary care. It is reasonably possible that liability will be affirmed for the penalty awarded by the lower court. The cost of this case, should the Montana Supreme Court reverse the lower court decision and award retroactive domiciliary care prior to February 1, 2007 is estimated at $1.9 million. Attorney fees would be an additional 40% of the retroactive award.

Coles, Individually and as Personal Representatives for the Estate of Steven Bearcrane v. Black Ranches, Inc., Crow Tribal Court No. CAV 07-044, is a tort case filed against a policy holder of Montana State Fund. The case involves a wrongful death claim by the estate of an employee of the policyholder. Montana State Fund is providing a defense under a complete reservation of rights to the policy holder under Part Two of the State Fund's insurance policy, also known as employers' liability coverage. The policy limits in this case are $1,000,000. The exclusive remedy provisions of MCA Section 39-71-411 should bar this type of tort claim against the policy holder. However, if the plaintiffs are successful in convincing the court that MCA Section 39-71-411 does not provide a defense, that the employer-policyholder was at fault in causing the death of its employee, and that the State Fund's policy provides indemnity, the damages to be awarded may be substantial. Actual potential cost impact to the State Fund is not known at this time. Liability for Montana State Fund, up to its policy limits ($1,000,000), is reasonably possible.

B. Federal Contingencies

USDA Commodities – In fiscal year 2008, the State distributed $8,170,792 in commodities. The value of the commodities stored in the State's warehouses was $2,173,511 at June 30, 2008, for which the State is liable in the event of loss.

C. Miscellaneous Contingencies

Loan Guarantees – As of June 30, 2008, the Board of Investments (BOI) had provided loan guarantees from the Coal Severance Tax Permanent Trust Fund to the Economic Development Bonds Enterprise Fund and the Facility Finance Authority, (a component unit of the State of Montana), totaling $182,393,408. The BOI's exposure to bond issues of the Economic Development Bonds Enterprise Fund was $98,390,000, while exposure to bond issues, surety bonds and designated loans of the Facility Finance Authority was $84,003,408.

Gain Contingencies – Certain natural resource and corporation tax assessments are not reported on the State's financial statements because they are being protested administratively. As of June 30, 2008, the following assessments (by fund type) were outstanding (in thousands):

Taxes	General	State Special Revenue	Permanent Trust	Debt Service	Capital Projects
Coal severance	$3,557	$1,110	$6,891	$126	$1,593
Corporation tax	30,601	-	-	-	-
Total	$34,158	$1,110	$6,891	$126	$1,593

Collectibility of these contingencies is dependent upon the decisions of the court, other authorities, or agreed upon settlements. Interest related to Corporation Tax Assessments is distributed to the General Fund.

Loss Contingencies – Certain corporations have requested refunds that are not reported on the State's financial statements as of June 30, 2008. The corporations have appealed the decision. As of June 30, 2008, these include $3,468,231 of General Fund corporation tax refunds.

Certain companies have protested property taxes that have been included as revenue on the State's financial statements as of June 30, 2008. As of June 30, 2008, these include $6,899,098 of protested property taxes recorded in the General Fund and $7,849,129 recorded in the State Special Revenue Fund.

NOTE 17. SUBSEQUENT EVENTS

Bond/Loan Issues

In August 2008, the State of Montana received $16 million from a litigation settlement for which the State filed a lawsuit against Atlantic Richfield Company (ARCO) and ASARCO for damage to natural resources at the Upper Blackfoot River site.

On September 11, 2008, the State of Montana Board of Housing issued $31 million Single Family Program Bonds, Series 2008A. The bonds will mature on June 1, 2010 through December 1, 2039, with interest rates from 2.55% to 5.50%. Bond proceeds will be used to purchase single family mortgage loans for the Board's Homeownership Program. The 2008A bond series is not a debt of the State, and the State is not liable for the bonds. Neither the State's faith or credit or taxing power is pledged to the payment of bond principal or interest.

On September 19, 2008, the State of Montana issued a $700,000 General Obligation Bond Revenue Anticipation Note, Series 2008F. This obligation is authorized pursuant to the Montana Waste Water Treatment Revolving Act, Montana Code Annotated, Title 75, Chapter 5, Part 1122.

On October 17, 2008, the State of Montana issued $2,150,000 General Obligation Renewable Resource Program Bonds, Series 2008E. This obligation is authorized pursuant to the Montana Code Annotated, Title 85, Chapter 1, Part 6.

On October 28, 2008, the State of Montana received $168 million from a litigation settlement for which the State filed a lawsuit against ARCO for damage to natural resources at the Clark Fork River Site.

Investment Related Issues

On July 1, 2008, the Board of Investments enhanced an additional $30 million in Montana Facility Finance Authority bonds.

The Federal National Mortgage Association and Federal Home Loan Mortgage Corp. were put into conservatorship on September 7, 2008.

On September 14, 2008, Lehman Brothers filed for Chapter 11 bankruptcy. The Bond Pool and All Other Funds (AOF), as included in Note 3D, portfolios held a $15 million position in Lehman Brothers Holdings, Inc., 2.778%, 05/25/2010. The AOF portfolio includes a $5 million position in Lehman Brothers Holdings, Inc., 5%, 01/14/2011. As of September 30, 2008, the book value of these bond positions was written down to 80% of par. On October 30, 2008, the book value of these bonds was further written down to 65% of par.

On September 16, 2008, the U.S. Government acquired 80% of AIG stock and extended $85 billion in financing to the company. The loan will be repaid by the sale of AIG assets. The loan is collateralized by all the company's assets, valued at $1.05 trillion as of June, 30, 2008. The two STIP AIG securities matured on July 21, 2008 and July 30, 2008, respectively.

On September 26, 2008, Washington Mutual filed for Chapter 11 bankruptcy. The bonds are now in default following the seizure of the bank by the Office of Thrift

Supervision on September 25, 2008. The Bond Pool and AOF portfolios held a $20 million position in Washington Mutual, Inc. 4.2%, 01/15/2010. On September 26, 2008, the Board sold $10 million par, at a price of $38, with an October 1, 2008 settlement date. This sale generated a loss of $6.2 million. As of September 30, 2008, the book value of the remaining $10 million bond position was written down to 85% of par. On October 20, 2008, the remaining $10 million position was sold for a realized loss of $1,684,700.

On October 30, 2008, the book value of the Galena CDO bonds was written down to 70% of par. The Bond Pool and AOF portfolios hold a $25 million position in this security.

While payment of the Orion Finance USA interest receivable of $903,922 remains unknown as of November 21, 2008, the State of Montana Board of Investments received payment of $1,825,967 on the Axon Financial Funding interest receivable on November 14, 2008. In addition to the above interest receivable payment, the State of Montana Board of Investments received payment of $10,000,933 in principal and $1,390,471 in interest compensation in excess of the accrued interest receivable from Axon Financial Funding. The November 14, 2008, Axon Financial Funding payment totaled $13,217,371.

NOTE 18. MATERIAL VIOLATIONS OF FINANCE-RELATED LEGAL PROVISIONS

Constitutionality of Retirement Plan Funding

The Montana Constitution, Article VIII, Section 15 states that public retirement plans shall be funded on an actuarially sound basis. As of June 30, 2008, the Teachers Retirement System (TRS) was not in compliance. Detailed information for the retirement plan can be found in Note 6.