

**State of Montana**  
**COMPREHENSIVE ANNUAL FINANCIAL REPORT**

For the Fiscal Year Ended June 30, 2002

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**State of Montana**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
For the Fiscal Year Ended June 30, 2002

**INTRODUCTION**

Management of the State of Montana provides this *Management's Discussion and Analysis* of the State of Montana's Comprehensive Annual Financial Report (CAFR) for readers of the State's financial statements. This narrative overview and analysis of the financial activities of the State of Montana is for the fiscal year ended June 30, 2002. We encourage readers to consider this information in conjunction with the additional information that is furnished in the State's financial statements, which follow.

Because the State of Montana is implementing new reporting standards of the Governmental Accounting Standards Board's Statement No. 34 for this fiscal year, which involves significant changes in content and structure, much of the information is not easily comparable to prior years. However, in future years, comparisons will be more meaningful and will go further in explaining the State's financial position and results of operations.

**FINANCIAL HIGHLIGHTS – PRIMARY GOVERNMENT**

**Government-wide Highlights**

The assets of the State exceeded its liabilities at the end of fiscal year 2002 by \$2.9 billion (reported as net assets). Of this amount, \$157.3 million (reported as unrestricted net assets) may be used to meet the government's general obligations to citizens and creditors. Component units reported net assets of \$653.7 million.

**Fund Highlights**

As of the close of fiscal year 2002, the State's governmental funds reported combined ending fund balances of \$2.1 billion. Of this amount, \$554 million is available for spending at the government's discretion (reported as unreserved fund balance). The remaining amount of \$1.52 billion is restricted for specific purposes, such as education. At the end of the fiscal year, unreserved fund balance for the General Fund was \$81.3 million.

**Long-term Debt**

The State's total long-term debt obligations decreased by \$41.8 million (or 9.3 percent) during the fiscal year.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis are intended to serve as an introduction to the State of Montana's basic financial statements. The State's basic financial statements include three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. The report also contains additional required supplementary information (budgetary schedules). These components are described below:

**Basic Financial Statements**

The basic financial statements include two kinds of financial statements that present different views of the State – the *government-wide financial statements* and the *fund financial statements and combining major component unit financial statements*. These financial statements also include the *notes to the financial statements* that explain some of the information in the financial statements and provide more detail.

## **Government-wide Financial Statements**

The *government-wide financial statements* provide a broad view of the State's operations in a manner similar to a private-sector business. The statements provide both short-term and long-term information about the State's financial position, which assists in assessing the State's economic condition at the end of the fiscal year. These are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means they follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year, even if cash involved has not been received or paid. The government-wide financial statements include two statements.

The *Statement of Net Assets* presents all of the government's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases or decreases in the State's net assets may serve as a useful indicator of whether the financial position of the State is improving or deteriorating.

The *Statement of Activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the State.

Both of the above financial statements have separate sections for three different types of state programs or activities. These three types of activities are:

*Governmental Activities* – The activities in this section are mostly supported by taxes and intergovernmental revenues (federal grants). Most services normally associated with state government fall into this category, including education (support for both K-12 public schools and higher education), general government, health services, legal and judiciary services, museums, natural resources, public safety and defense, regulatory services, social services, and transportation.

*Business-type Activities* – These functions are normally intended to recover all or a significant portion of their costs through user fees and charges to external users of goods and services. The business-type activities of the State include the Unemployment Insurance Fund and the Industrial Development Bond Program that assists Montana's small businesses and local governments in obtaining long-term fixed-rate financing through private Montana lending institutions.

*Discretely Presented Component Units* – These are operations for which the State has financial accountability but they have certain independent qualities as well. For the most part, these entities operate similar to private sector businesses and the business-type activities described above. The State has three authorities and two universities that are reported as discretely presented component units of the State.

## **Fund Financial Statements (Reporting the State's Major Funds)**

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The State, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The fund financial statements focus on individual parts of the state government, reporting the State's operations in more detail than the government-wide statements. All of the funds of the State can be divided into three categories. It is important to note that these fund categories use different accounting approaches and should be interpreted differently. The three categories of funds are:

*Governmental Funds Financial Statements* – Most of the basic services provided by the State are financed through governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental fund financial statements focus on near-term inflows and outflows of spendable resources. They also focus on the balances of spendable resources

available at the end of the fiscal year. Such information may be useful in evaluating the government's near-term financing requirements. This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the State's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the State.

The State has five governmental funds that are considered major funds for presentation purposes. That is, each major fund is presented in a separate column in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances. The State's five major governmental funds are – the General Fund, the State Special Revenue Fund, the Federal Special Revenue Fund, the Coal Severance Tax Fund, and the Land Grant Fund.

*Proprietary Funds Financial Statements* – When the State charges customers for the service it provides, whether to outside customers or to other agencies within the State, these services are generally reported in proprietary funds. Proprietary funds (enterprise and internal service) utilize accrual accounting, the same method used by private sector businesses. Enterprise funds report activities that provide supplies and services to the general public. An example is the State Lottery. Internal service funds report activities that provide supplies and services for the State's other programs and activities such as the Motor Pool.

*Fiduciary Funds* – These funds are used to account for resources held for the benefit of parties outside the state government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of these funds are not available to support the State's own programs. Fiduciary funds use the accrual basis of accounting.

#### **Notes to the Financial Statements**

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes to the financial statements can be found immediately following the component unit financial statements.

#### **Required Supplementary Information**

The basic financial statements are followed by a section of required supplementary information. This section includes a budgetary comparison schedule, which includes the reconciliation between the statutory fund balance for budgetary purposes and the fund balance for the General Fund, as presented in the governmental fund financial statements.

## **GOVERNMENT-WIDE FINANCIAL ANALYSIS**

#### **Net Assets**

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The State's combined net assets (government and business-type activities) totaled \$2.9 billion at the end of fiscal year 2002.

The largest portion of the State's net assets reflects its investment in capital assets such as land, buildings, equipment and infrastructure (roads, bridges, and other immovable assets), less any related debt used to acquire those assets that is still outstanding. The State uses these capital assets to provide services to citizens; consequentially, these assets are not available for future spending. Although the State's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the State's net assets (66.4%) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets may be used to meet the State's ongoing obligations to citizens and creditors. Internally imposed designations of resources are not presented as restricted net assets.

At the end of the current fiscal year, the State is able to report positive balances in all three categories of net assets, both for the government as a whole, as well as for its separate governmental and business-type activities.

**Net Assets as of June 30, 2002**  
*(expressed in thousands)*

	<b>Governmental Activities</b>	<b>Business-type Activities</b>	<b>Total Primary Government</b>
Current and Other Assets	\$2,627,061	\$309,293	\$2,936,354
Capital Assets	1,038,746	14,658	1,053,404
Total Assets	3,665,807	323,951	3,989,758
Long-term Liabilities	356,517	14,890	371,407
Other Liabilities	613,027	75,632	688,659
Total Liabilities	969,544	90,522	1,060,066
Invested in Capital Assets, Net of Related Debt	814,026	12,496	826,522
Restricted	1,742,193	203,710	1,945,903
Unrestricted	140,044	17,223	157,267
Total Net Assets	\$2,696,263	\$233,429	\$2,929,692



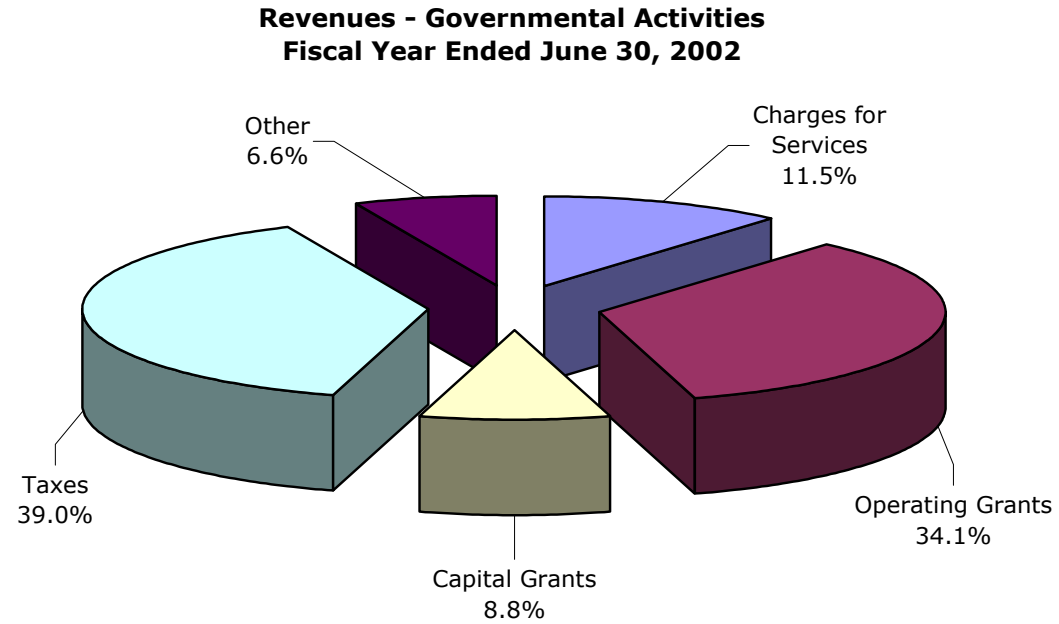
The following condensed financial information was derived from the government-wide Statement of Activities and reflects how the State's net assets changed during the fiscal year:

**Changes in Net Assets**  
**For Fiscal Year Ended June 30, 2002**  
*(expressed in thousands)*

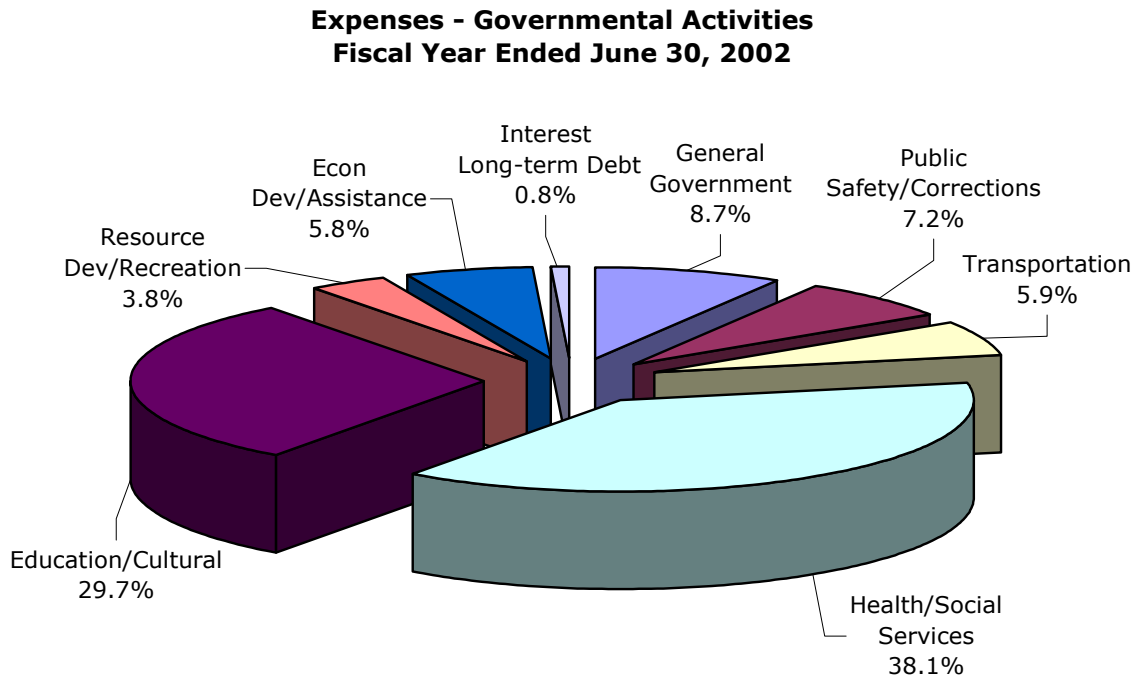
	<b>Governmental Activities</b>	<b>Business-type Activities</b>	<b>Total Primary Government</b>
<b>Revenues:</b>			
Program Revenues			
Charges for Services	\$ 364,614	\$189,771	\$ 554,385
Operating Grants	1,080,374	29,335	1,109,709
Capital Grants	280,489	602	281,091
General Revenues			
Taxes	1,238,151	12,907	1,251,058
Other	207,193	17,419	224,612
Total Revenues	<u>3,170,821</u>	<u>250,034</u>	<u>3,420,855</u>
<b>Expenses:</b>			
General Government	248,089	-	248,089
Public Safety/Corrections	205,983	-	205,983
Transportation	169,282	-	169,282
Health/Social Services	1,086,012	-	1,086,012
Educational/Cultural	845,324	-	845,324
Resource Dev/Recreation	108,642	-	108,642
Econ Dev/Assistance	164,761	-	164,761
Interest on Long-term Debt	22,763	-	22,763
Unemployment Insurance	-	83,944	83,944
Liquor Stores	-	38,074	38,074
State Lottery	-	26,585	26,585
Economic Dev Bonds	-	3,251	3,251
Hail Insurance	-	2,045	2,045
Gen Gov't Services	-	11,134	11,134
Prison Funds	-	5,444	5,444
MUS Group Insurance	-	34,594	34,594
Total Expenses	<u>2,850,856</u>	<u>205,071</u>	<u>3,055,927</u>
Increase (decrease) in Net Assets Before Transfers	319,965	44,963	364,928
Transfers	26,756	(26,756)	-
Change in Net Assets	346,721	18,207	364,928
Net Assets, Beg of Year (restated)	2,349,542	215,222	2,564,764
Net Assets, End of Year	<u>\$2,696,263</u>	<u>\$233,429</u>	<u>\$2,929,692</u>

**Governmental Activities**

The following chart depicts revenues of the governmental activities for the fiscal year:



The following chart depicts expenses of the governmental activities for the fiscal year:



### **Business-type Activities**

Net assets of the business-type activities increased by \$18.2 million during the fiscal year. The majority of this increase is because in fiscal year 2002 the Unemployment Insurance Program received \$18.5 million from the Reed Act. These dollars may be used to fund Wagner Peyser activities, unemployment insurance administration, or pay unemployment benefits.

## **FINANCIAL ANALYSIS OF THE STATE'S INDIVIDUAL FUNDS**

As the State completed the year, its governmental funds reported fund balances of \$2.1 billion. Of this total amount, \$554 million, or 26.4%, constitutes unreserved fund balance, which is available for spending at the government's discretion. The remainder of fund balance is reserved and is not available for new spending because it has already been dedicated for various commitments.

### **General Fund**

The General Fund is the chief operating fund of the State. At the end of the current fiscal year, unreserved fund balance of the General Fund was \$81.3 million. Total fund balance diminished during the fiscal year by \$93.2 million, primarily because of lower tax collections and the slowing of the economy.

### General Fund Budgetary Highlights

Differences between the original budget and the final budget were relatively minor (\$45 million) and can be briefly summarized as follows:

1. The Department of Natural Resources and Conservation received a supplemental appropriation of \$3.3 million to fight fires.
2. Office of Public Instruction moved \$34.9 million of their budget for special education from FY2003 to FY2002. This program has a biennial appropriation that is split into two fiscal years, but the agency was required to transfer the entire appropriation from FY2003 into FY2002, even though they only needed \$4,000 in FY2002.
3. Agencies requested \$696,325 in carry forward authority for 30 percent of their reverted appropriations in FY2002 per 17-7-304(4), MCA.
4. Department of Public Health and Human Services requested \$3.9 million in authority be moved from FY2003 to FY2002 to cover shortfalls in Medicaid hospital, physician services and mental health services, and child support enforcement services.
5. Department of Public Health and Human Services requested \$1.2 million of their biennial appropriation for the Mental Health Program be moved from FY2003 to FY2002 to cover expenditures in FY2002.
6. Department of Justice requested \$200,000 of their biennial appropriation for major litigation be moved from FY2003 to FY2002 to cover FY2002 expenditures. They also requested \$112,894 of their biennial appropriation for prisoner per diem costs be moved from FY2003 to FY2002 to cover FY2002 expenditures.

The supplemental appropriations were funded from available fund balance.

## **CAPITAL ASSETS AND DEBT ADMINISTRATION**

### **Capital Assets**

The State's investment in capital assets for its governmental and business-type activities as of June 30, 2002, amounts to \$1.4 billion, net of accumulated depreciation of \$309 million, leaving a net book value of \$1.1 billion. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure, and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the State, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The total increase in the State's investment in capital assets for the current fiscal year was approximately 69% in terms of net book value. The significant increase in capital assets is the inclusion of infrastructure assets and highway construction. Most of the year's capital expenditures were for construction or reconstruction of roads and bridges. Depreciation charges for the year totaled \$30 million. Additional information on the State's capital assets can be found in Note 4 of the notes to the financial statements .

**Debt Administration**

Montana receives excellent bond ratings from both Moody's Investor Service (Aa3) and Standard and Poor's Corporation (AA-). State debt may be authorized either by a two-thirds vote of the members of each house of the legislature or by a favorable vote of a majority of the State's electors voting thereon. There is no constitutional limit on the amount of debt that may be incurred by the State. The Montana Constitution does, however, prohibit the incurring of debt to cover deficits caused by appropriations exceeding anticipated revenue. State debt may be authorized by a two-thirds vote of the members of each house of the Legislature or by a majority of the electors voting thereon.

The State of Montana's general obligation debt decreased from \$236.732 million at June 30, 2001, to \$214.135 million at June 30, 2002.

The ratio of general obligation debt to assessed valuation and the amount of general obligation debt per capita are:

	<b>Amount</b> <i>(in thousands)</i>	<b>Ratio</b> <b>Debt to 2001</b> <b>Assessed Value</b>	<b>State Debt</b> <b>Per Capita*</b>
General Obligation Debt	\$214,135	.38%	\$236.88

\*Based on a 2001 estimated Montana population

More detailed information regarding the State's long-term obligations is presented in Note 11 to the financial statements.

**ECONOMIC CONDITION AND OUTLOOK**

The unemployment rate for the State of Montana was 3.4 percent in the third quarter of 2002, which is a decrease from a rate of 3.8 percent during the third quarter of 2001. This compares favorably with the nation's average unemployment rate of 6.2 percent.

In November 2001, a significant downturn in General Fund revenues was identified, and in the last half of fiscal year 2002, revenues dropped off from regular Legislative session estimates by \$153 million. The primary reasons for the decline in revenues were a sharp decline in net capital gains income due to the prolonged decline in equity markets, a sharp economic recession, and federal economic stimulus legislation that impacted state income tax revenues. The Governor directed statutory spending reductions of \$23 million, and the Legislature came into special session to adopt \$59 million in budget balancing actions, leaving an ending fund balance projection of \$40 million.

**REQUESTS FOR INFORMATION**

This financial report is designed to provide a general overview of the State of Montana's finances for all of Montana's citizens, taxpayers, customers, investors and creditors. The financial report seeks to demonstrate the State's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the State of Montana, Administrative Financial Services Division, Room 255 Mitchell Building, Capitol Complex, Helena, Montana 59620.