

**State of Montana**  
**COMPREHENSIVE ANNUAL FINANCIAL REPORT**  
For the Fiscal Year Ended June 30, 2003

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# INTRODUCTORY SECTION



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December 10, 2003

To the Citizens, Governor and Members of the Legislature of the State of Montana:

In accordance with Section 17-2-110, Montana Code Annotated (MCA), I am pleased to submit the Comprehensive Annual Financial Report (CAFR) of the State of Montana for the fiscal year ended June 30, 2003. Responsibility for the accuracy of the data presented and the completeness and fairness of the presentation rests with the Department of Administration. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds of the State of Montana. All disclosures necessary to enable the reader to gain an understanding of the State's financial activities are included.

**DESCRIPTION OF THE CAFR**

This report and the accompanying financial statements and statistical tables were prepared in accordance with standards set forth by the Governmental Accounting Standards Board (GASB).

This CAFR is divided into three main sections: introductory, financial and statistical. The introductory section includes an organization chart for the State, a table of contents and this transmittal letter. The financial section contains management's discussion and analysis, the independent auditor's report, government-wide financial statements, fund financial statements, notes to the financial statements, combining statements by fund type, and other schedules. The statistical section includes financial, economic and demographic data.

This report includes all funds of those entities that comprise the State of Montana (the primary government) and its component units. The component units are entities that are legally separate from the State but 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 State is able to impose its will on that organization or (2) there is the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the State. The following component units are included in the State's financial reporting entity: Housing Authority, Facility Finance Authority, State Compensation Insurance Fund (Old and New), Montana State University, University of Montana, Public Employees Retirement Board, and Teachers Retirement System. These component units are discretely presented in the State's financial statements.

**ECONOMIC CONDITION AND OUTLOOK**

Montana avoided the impacts of both the 2001 recession and the September 11 attack because its economic base is concentrated in agriculture, mining, wood products and other manufacturing, nonresident travel and the federal government. However, despite the relatively good economic conditions, Montana faces a severe budget crisis. The reason for the budget shortfall is that a portion of the State's tax revenues is more dependent on the national economy than the state economy. Montana's income tax revenues from capital gains and dividends, interest and rent depend to a great degree on trends in the stock market and the level of U.S. interest rates. Montana corporate income tax revenues are affected by the overall profits of interstate corporations.

Montana's wheat yields fell about 25 percent below normal in 2002, although they were 3 percent higher than in 2001. Because of expanded wheat acreage, Montana's total wheat crop was up 18 percent from 2001. Fortunately for Montana farmers, drought conditions also persisted throughout much of the country in the summer of 2002. As a result, U.S. wheat output fell to its lowest level in 30 years and wheat prices rallied 35 percent in the past year.

The cattle market continues to be bolstered by strong demand and dwindling supplies of beef, as cattle inventory numbers have fallen for six consecutive years. Although 2002 cattle prices were strong by historical standards, Montana's average steer price did slip by 4.5 percent from the record highs of 2001. Higher-than-expected production in 2002 was the primary reason for the dip in cattle prices.

Despite two years of declining production and employment, Montana's manufacturing sector continues to employ about 28,000 workers earning just over \$900 million annually, producing about \$4.5 billion in output annually and accounting for 20 to 25 percent of Montana's economic base. After substantial declines in 2001 – including the loss of 800 workers – manufacturing employment lost another 400 workers in 2002. In 2001, the declines were attributable to the national and global recession, and to extremely high electricity costs during the first half of the year. In 2002, Montana manufacturers faced an improving, but still under-performing, U.S. economy and persistent global economic woes. Despite the difficulties of the last two years, Montana manufacturing employment has grown by about 1,300 workers in the last decade. Two positive developments in the last year include: 1) Columbia Falls Aluminum Company restarted aluminum refining; and 2) Jore Manufacturing was purchased out of bankruptcy, preserving several hundred jobs in the Mission Valley.

Low prices for lumber and other wood products plagued Montana's forest products industry for the third year in a row during 2002. Despite low wood products prices, production increased very slightly in Montana, and employment was near 2001 levels of 9,900 workers. Estimated total sales value of the State's primary wood and paper products in 2002 was \$940 million, down about \$10 million from 2001. Montana's estimated lumber production was 1.11 billion board feet in 2002, up from 1.08 billion board feet in 2001. Estimated timber harvest volumes also increased slightly from 2001 to 2002.

Primary estimates of nonresident travel to Montana in 2002 show a 2 percent increase over 2001 – to 9.77 million visitors. Other signs of improvement in 2002 are in the visitor numbers for both Glacier and Yellowstone national parks. Even after the latest-ever opening of Going-to-the-Sun Road, Glacier Park rebounded significantly, with a visitation increase of almost 13 percent over 2001. Yellowstone's visitation numbers increased as well, with a jump of slightly over 8 percent. Montana has a statewide lodging facility use tax of 4 percent on overnight accommodations. That tax increased in June 2003 to 7 percent. In addition, nonresident travelers contribute to the tax base by paying excise taxes such as those on gasoline, and indirectly by supporting employment in industries that pay corporate taxes and whose workers pay income, property and other taxes. Travel expenditures in Montana totaled \$1.806 billion in 2002, which is an increase of 2.3 percent from 2001.

## **MAJOR INITIATIVES**

In fiscal year 2003, the General Fund unreserved, undesignated fund balance increased over projections. The primary reasons for the increase is revenues were higher than expected. Individual income tax collections and oil and gas production tax, U.S. mineral royalties, estate tax and the lottery exceeded revenue forecasts. However, revenue from corporation license tax, institutional reimbursements, and investment earnings were less than projected.

The 58th Legislature met in regular session on January 6, 2003, and adjourned on April 26, 2003. For the first time in over a decade, the Legislature experienced a substantial General Fund budget deficit of \$230.4 million for the 2005 biennium. The primary reasons for this deficit were the estimated decline in individual and corporation income taxes, reduced investment earnings, and higher human service and corrections costs.

The Legislature eliminated the projected General Fund deficit through a combination of operating reductions, revenue enhancements and a fund balance reserve adjustment reduction. Nearly all agency General Fund budgets were reduced below fiscal year 2002 spending levels, for an average reduction of 4.3 percent. However, a large portion of this reduction was accomplished by funding switches, which allowed those agencies to continue to maintain adequate services.

In the area of revenue enhancements, the Legislature eliminated the requirement on the State Fund (Old), to reserve an additional 10 percent above the total cost of future benefits remaining to be paid and the cost of administering those claims. This change resulted in a transfer of \$20.2 million to the General Fund. Income taxes were reduced, and this reduction was offset with an increased tax on cigarettes and other tobacco products, and implementation of a 3 percent increase in the accommodation tax on lodging, and a 4 percent sales tax on rental vehicles.

K-12 education's General Fund budget was decreased by \$1.6 million due to declining enrollment but increased \$65.1 million in federal grants for the biennium, most of which is related to the "No Child Left Behind" program. Department of Public Health and Human Service's budget increased \$11.4 million in the General Fund and \$286.4 million in total funds for the biennium due to increased caseloads and new and expanded federal grants as well as expanded Medicaid coverage. Department of Transportation's budget increased \$46.3 million for the biennium to cover increased construction, airport rehabilitation and planning, and \$78.7 million to expend bond proceeds to accelerate reconstruction and safety improvements on US Highway 93 from Evaro Hill to Polson. The Department of Correction's General Fund budget increased \$15.5 million over the biennium, due primarily to population increases.

## **FINANCIAL INFORMATION**

Montana's Statewide Budgeting, Accounting and Human Resource System (SABHRS) is a centrally maintained, fully computerized, double-entry accounting system. SABHRS records are computer-edited.

Management of the State is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the State are protected from loss or misuse and that adequate accounting data are compiled to allow for the preparation of financial statements in accordance with generally accepted accounting principles. In developing and evaluating the State's accounting system, consideration is given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance that the above objectives are met. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived, and that the evaluation of costs and benefits requires estimates and judgments by management.

Budgetary restrictions are imposed via appropriations approved by the Legislature or established administratively as provided for by state law. Appropriations are required by state law for the general, state and federal special revenue, and capital projects funds. The level of budgetary control is generally established by fund. SABHRS is designed to provide budgetary control by preventing spending in excess of legislative and administrative authority and/or available cash. SABHRS also provides for encumbrance accounting as a technique for accomplishing budgetary control.

### **General Fund Balance**

The unreserved, undesignated fund balance of the General Fund decreased from \$78.1 million at June 30, 2002, to \$43.1 million at June 30, 2003. This represents a decrease of \$35.0 million, or 45 percent.

### **Pension Trust Fund Operations**

The State contributes to eight retirement systems and is the administrator of two additional systems. The two largest systems, in terms of dollars contributed and employees covered, are the Public Employees Retirement System - Defined Benefit Retirement Plan and the Teachers Retirement System. Montana implemented GASB Statement 25 - Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined contribution Plans and GASB Statement 27 - Accounting for Pensions by State and Local Governmental Employers in fiscal year 1996.

The 1997 Legislature enacted legislation that establishes a guaranteed annual benefit adjustment (GABA) for enrolled members or surviving beneficiaries under each of the statewide public employee retirement systems. The annual maximum adjustment of 3 percent begins 36 months after a beneficiary's initiation date. The benefit adjustment, when combined with other benefit adjustments already in law, must equal a maximum of 3 percent per year. The GABA automatically covers beneficiaries in the retirement systems for public employees, sheriffs and game wardens. Beneficiaries in the retirement systems for highway patrol officers, municipal police officers, firefighters unified and judges may choose to be covered by GABA or by benefits adjustment mechanisms already in place. The legislation establishing the GABA also provides a mechanism to actuarially fund the Judges Retirement System.

The 1999 Legislature enacted legislation that also establishes a guaranteed annual benefit adjustment (GABA) for certain benefit recipients in the Teachers Retirement System. A benefit recipient is eligible for the maximum benefit adjustment of 3 percent if the retiree's most recent retirement effective date is at least 36 months prior to January 1 of the year in which the adjustment is to be made.

### **Cash Management**

The uniform investment program established by the 1972 Montana Constitution directs that the Board of Investments have sole authority to invest state funds. The Board operates under the "prudent person principle" which requires the Board to 1) discharge its duties in the same manner as that of a prudent person acting in a like capacity with the same resources and aims; 2) diversify the holdings of each fund to minimize the risk of loss and maximize the rate of return;



and 3) discharge duties solely in the interest of, and for the benefit of, the funds managed. Permissible investments include bonds, notes, debentures, equipment obligations, common stock (pension trust and higher education funds only), commercial paper, bankers acceptances, interest bearing deposits in Montana financial institutions, real estate and any other investment in a Montana business that continues existing jobs or creates new jobs. These investments are subject to statutory restrictions for quality and size of holdings.

Unless otherwise provided by law, treasury cash is pooled for investment regardless of the fund from which it is deposited and the pool investment earnings are credited to the General Fund. The Board reported total investment income from investments under its management of \$385.1 million, a decrease of 2.6 percent from the \$395.4 million earned last year. The book value of Board-managed investments remained at \$8.5 billion, which was the same as the fiscal year 2002 book value. The Board publishes an annual audited report of all its investment activity. That report may be referenced for more in-depth investment information.

### **Risk Management**

The State of Montana provides benefit coverage for injured state employees through participation in the State Compensation Insurance Fund (State Fund). The State Fund is a nonprofit, independent public corporation that is managed and controlled by a seven-member board of directors. The Governor appoints the board members for four-year terms. Funding is primarily derived from the premiums paid by policyholders.

The State maintains self-insurance plans for employee comprehensive medical and dental coverage and state property. Under the State Employee Group Benefits Plan, the State assumes all the risk for claims incurred by plan members including state employees, elected officials, retirees and their dependents, with one exception. The Vision Service Plan Insurance Company insures vision care services. Premiums are collected through payroll deductions, deductions through the Public Employees Retirement System and self-payment.

The Montana University System (MUS) Group Benefits Plan offers medical, dental, and vision insurance coverage to employees of the Montana University System, the Student Assistance Foundation (SAF), and the State Bar of Montana, as well as their dependents, retirees, and COBRA members. The MUS Group Benefits Plan is fully self-insured with three exceptions. The three insured products are HMOs administered by New West Health Services serving some employees and dependents in Missoula, Helena, Havre and Billings; Big Sky Health Plan serving some employees and dependents in Butte; and a voluntary vision plan administered by VSP serving employees, retirees and their dependents. Blue Cross/Blue Shield is the claims administrator for the self-insured plan. Managed Care Montana (APS) has a contract for utilization management. The utilization management program consists of hospital pre-authorization, case management and medical necessity review.

The State's property insurance plan provides coverage for general liability, automobile liability, automobile physical damage, and state-administered foreclosure housing units. The State self-insures the \$150,000 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 equipment below \$150,000 of value, with state agencies paying the first \$1,000. Commercial property insurance protects over \$2.2 billion of state-owned buildings and contents. The flood and earthquake liability limit is \$100 million per occurrence with a \$1million deductible for earthquakes and a \$500,000 deductible for floods. Premiums for the plan are collected from all state agencies, including component units.

### **INDEPENDENT AUDIT**

The financial statements contained in Montana's Comprehensive Annual Financial Report were audited in accordance with generally accepted auditing standards by the Legislative Audit Division. The Legislative Auditor is appointed by and reports to the Legislative Audit Committee. The Deputy Legislative Auditor issued an unqualified opinion on the State's financial statements for fiscal year 2003.

### **CERTIFICATE OF ACHIEVEMENT**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Montana for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2002. This was the fourteenth year out of fifteen years that the State received this prestigious award. In order to be awarded a Certificate of Achievement, a governmental unit must publish

an easily readable and efficiently organized CAFR, whose contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current CAFR continues to conform to the Certificate of Achievement Program requirements; we are submitting it to GFOA to determine its eligibility for another certificate.

#### **ACKNOWLEDGEMENTS**

The preparation of this report on a timely basis could not be accomplished without the efficient and dedicated service of the entire staff of the Accounting Bureau and the cooperation of accounting personnel at the individual state agencies. I would like to express my appreciation to Accounting Bureau and other agency personnel who participated in the preparation of this document. I would also like to thank the Legislature and all state agencies for their interest and support in planning and conducting the financial operations of Montana in a professionally responsible and progressive manner.

Respectfully submitted,

A handwritten signature in black ink that reads "Scott Darkenwald". The signature is written in a cursive, flowing style.

Scott Darkenwald, Director  
Department of Administration

# Certificate of Achievement for Excellence in Financial Reporting

Presented to

## State of Montana

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2002

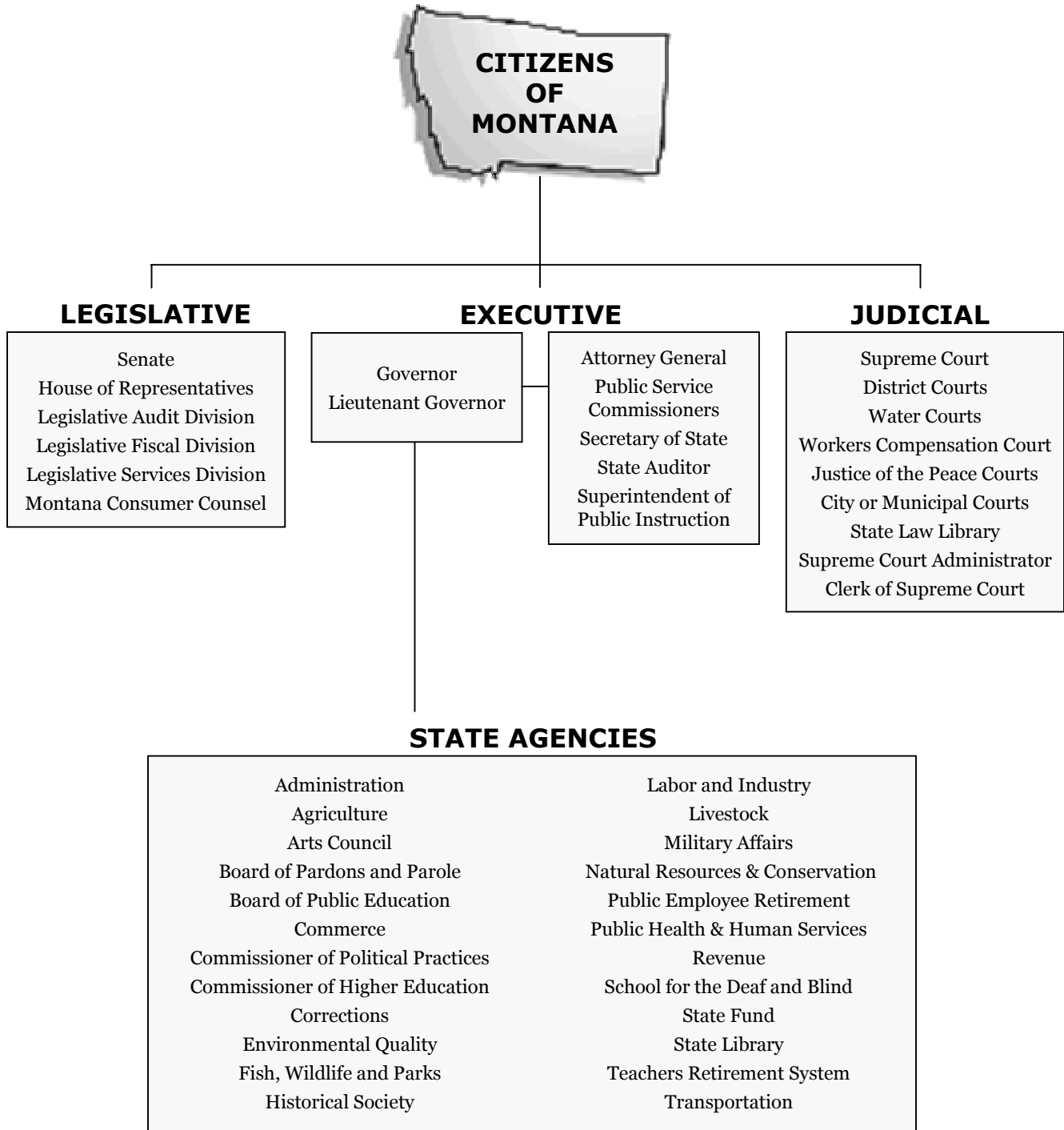
A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

# STATE OF MONTANA ORGANIZATION CHART



**State of Montana**  
**SELECTED STATE OFFICIALS**

**EXECUTIVE**

Judy Martz

Governor

Karl Ohs

Lieutenant Governor

**JUDICIAL**

Karla Gray

Chief Justice

**LEGISLATIVE**

Tom Beck

President of the Senate

Dan McGee

Speaker of the House