

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

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## 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 which 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 these 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 \$975 million. 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 Legislative Auditor. The report is issued under separate cover and available at 301 South Park, Room 204, Helena, MT 59620-0545.

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 by the Legislative Auditor every two years. The report is issued under separate cover and available at 2401 Colonial Drive, 3<sup>rd</sup> Floor, PO Box 200506, Helena, MT 59620-0506.

State Compensation Insurance Fund (New and Old) – 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. In 1999, the 56th Legislature determined that the Old Fund was adequately funded and discontinued the Old Fund Liability Tax. Administrative operations and budgets are reviewed by the Governor and the legislature. The fund is audited annually by the Legislative Auditor. The report is issued under separate cover and available at 5 South Last Chance Gulch, 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. Individual audit reports are issued by the Legislative Auditor annually. 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, 2500 Broadway, PO Box 203101, Helena, MT 59620.

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; (3) the Student Assistance Foundation of Montana, a private non-profit corporation; and (4) private foundations supporting public education, over which the State exercises neither financial nor administrative control (see Note 15). 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.

#### **Fiduciary Fund Component Units**

Teachers Retirement System (Pension Trust Fund) – This retirement system 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 system is funded from employer and employee contributions and investment earnings. The board is a discretely presented component unit. The system is audited annually by the Legislative Auditor. Its report is issued under separate cover and is available at 1500 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 systems for the purpose of providing retirement, disability, death, and lump-sum payments to each system 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) is funded from employer and employee contributions, investment earnings and state contributions from city, county, and local governments. The PERS also accounts for the administrative costs, paid from investment earnings, of the system. 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 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 contributions and investment earnings.

The board is a discretely presented component unit responsible for the ten separate public employee retirement systems and the Deferred Compensation Program. These are reported as pension and other employee benefit trust funds. The board is audited annually by the Legislative Audit Division. Its report is issued under separate cover and is available at 100 N Park, 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 only reported on 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

The government-wide, proprietary fund, and fiduciary 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.

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 both measurable and available. Revenues are considered to be available if they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the State considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures as well as expenditures relating to compensated absences and claims and judgments are recorded only when payment is due. Significant intrafund transactions and balances have been eliminated.

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

General Fund – To account for all governmental financial resources except those required to be accounted for in another fund.

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

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

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

Permanent Funds – 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

Enterprise Funds – 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

Trust and Agency 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. These include: (1) pension (and other employee benefit) trust funds; (2) agency funds, (3) investment trust funds, and (4) private-purpose trust funds.

The State reports the following funds as major as defined under GASB 34:

#### Major Governmental Funds

The General Fund is the State's primary operating fund, as defined above.

The State Special Revenue Fund accounts for all 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 all 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 Proprietary 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, except the Housing Authority in the component unit proprietary funds, 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 (STIP), 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. The Housing Authority considers cash and cash equivalents to be cash held by the State Treasurer, cash held by trustees, and cash invested in STIP (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.

#### **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. An exception is the Federal Special Revenue Fund food stamp inventory balance, which is offset by deferred revenue.

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



## H. 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).

## 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, higher education units, and specific trusts established within the State Special Revenue Fund. The participant investments in the pools are reported at fair value in the Balance Sheet within the individual funds (See Note 3 on Cash/Cash Equivalents and Investments).

## J. 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 primary government and component unit proprietary activities 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. The Montana Department of Transportation added the retroactive highway infrastructure to the state accounting system during fiscal year 2003. As a result the state is now reporting the infrastructure required under GASB 34 in its entirety.

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.

## K. Deferred Revenue

Deferred revenues arise when a potential revenue does not meet both the measurable and available criteria for recognition in the current period. Deferred revenues also arise when resources are received by the government before it has a legal claim to them, as when grant monies are received prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met, or when the State has a legal claim to the resources, the liability for deferred revenue is removed and revenue is recognized.

## L. 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 fund operations are accounted for in those funds.

## M. Capital Leases

A capital lease is generally defined by Statement of Financial Accounting Standards No. 13, "Accounting for Leases", as one which transfers benefits and risks of ownership to the lessee. Leases meeting the criteria of a capital lease, as defined, are recorded at inception as expenditures and other financing sources in governmental fund types and as assets and liabilities at

the present value of the future minimum lease payments, using the interest rates stated in the leases.

#### **N. 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.

#### **O. 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 40 hours of sick leave to a nonrefundable sick leave pool. Based on a review, the adjusted ending balance of the pool for June 30, 2002, was 1,499 hours. For fiscal year 2003, 2,038 hours were contributed to the sick leave pool and 2,539.5 hours were withdrawn leaving a balance of 997.5 hours in the pool. No liability is reported in the accompanying financial statements because these hours are nonrefundable to participants 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 percent of unused vacation leave and 25 percent of unused sick leave.

#### **P. 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.

#### **Q. Fund Balance**

In the fund financial statements, reservations represent those portions of fund balance or net assets not appropriate for expenditure or legally segregated for a specific future use. Designated fund balances represent tentative plans for the future use of financial resources. In fiscal year 2003, the General Fund and Special Revenue Funds do not have fund balance designations. The Debt Service Funds designated fund balances represent management's desire to maintain fund balance in relation to bonds payable.

#### **R. 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. The State recognizes property tax revenues as available if they are collectible within 60 days after fiscal year-end. Material delinquent and total uncollected current year property taxes receivable are recorded as receivables (net of uncollectibles).

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.

S. 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
Video gaming	\$ 45,706	\$ -	\$ -	\$ 45,706
Insurance premium	47,167	-	-	47,167
Inheritance	12,140	-	-	12,140
University system millage	884	11,894	-	12,778
Cigarette/tobacco	15,073	1,924	1,716	18,713
Accommodations	2,304	10,681	-	12,985
Telephone license	21,039	-	-	21,039
Alcoholic beverage	4,077	1,534	-	5,611
Electrical energy	7,801	-	-	7,801
Public contractor	3,082	-	-	3,082
Livestock	-	2,956	-	2,956
Public Service Commission	-	2,068	-	2,068
Freight line	1,484	-	-	1,484
Fire protection	2,701	2,404	-	5,105
Agriculture sales	-	2,100	-	2,100
Consumer Counsel	-	852	-	852
Miscellaneous	161	180	-	341
Total other taxes	<u>\$163,619</u>	<u>\$36,593</u>	<u>\$1,716</u>	<u>\$201,928</u>

NOTE 2. OTHER ACCOUNTING ISSUES

All changes reported in the accompanying financial statements that resulted in the restatement of beginning fund balance/net assets were made to correct errors of prior periods. All retroactive highway infrastructure was added to the state accounting system during fiscal year 2003, resulting in a \$1 billion prior period adjustment on the government-wide Statement of Activities.

For reporting purposes the State combined the non-major enterprise Prison Industries and Prison Ranch funds into one Prison Industries fund. The Prison Industries Training Program, a sub-fund of the Prison Industries Enterprise Fund, was moved to the Prison Industries Internal Service Fund. This resulted in net assets increase of \$116,000 in the Prison Industries Internal Service Fund with a corresponding decrease in the enterprise fund.

Additionally, because internal service funds are included with governmental activities in the government-wide financial statements, this fund reclassification resulted in a beginning net assets increase of \$116,000 in governmental activities, and a corresponding decrease in beginning net assets of the business-type activities.

NOTE 3. CASH/CASH EQUIVALENTS AND INVESTMENTS

This note details the following Balance Sheet classifications (in thousands):

Cash/cash equivalents	\$ 1,817,161
Equity in pooled investments	\$6,206,654
Investments	\$1,557,651

Carrying amounts and fair values (Bank Balance for Cash Deposits) for the State's cash/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, 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 funds 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 of the Investment Company Act of 1940. In 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. Investments held are reported at fair value, annually, and the difference between amortized cost and fair value is reflected as an unrealized gain or loss in the investments managed. The portfolio is carried at amortized cost or book value. State agencies that are allowed to retain their investment earnings within their funds are only allowed to invest in STIP. Local government participation in STIP is also voluntary. Separately issued external investment pool financial statements may be obtained by contacting the Montana Board of Investments, 2401 Colonial Drive, 3<sup>rd</sup> Floor, PO Box 200126, Helena, MT 59620-0126.

Deposits with financial institutions are categorized to indicate the level of risk assumed by the State. Category 1 consists of deposits that are insured or collateralized with securities held by the State or by its agent in the State's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the State's name. Category 3 deposits are uncollateralized. The State's cash deposits are categorized in Table 1.

The State's cash equivalents and investments are categorized to indicate the risk level assumed by the State in Table 2 - Cash Equivalents, Table 3 - Equity in Pooled Investments, and Table 4 - Investments to disclose the level of risk assumed by the State at fiscal year-end.

Category 1 includes investments that are insured or registered securities held by the State or its agent in the State's name. Category 2 includes uninsured and unregistered investments where the securities are held by the counter party's trust department or agent in the State's name. Category 3 includes uninsured and unregistered investments in which the securities are held by the counter party, or by its trust department or agent, but not in the State's name. None of the State's

cash equivalents or investments are classified in Category 3 at fiscal year-end. Not Categorized includes investments held by broker-dealers under securities loans with cash collateral.

(2) The State invests in certain types of securities including asset-backed securities, variable-rate instruments, zero-coupon bonds, preferred stocks (convertible equity securities), and mortgage-backed securities, in addition to other long-term investment securities, to provide a diversified investment portfolio and an overall competitive rate of return. All securities are reported by investment portfolio and type in Table 2 - Cash Equivalents, Table 3 - Equity in Pooled Investments, and Table 4 - Investments.

Asset-backed securities represent debt securities collateralized by a pool of non-mortgage assets such as trade and loan receivables, equipment leases, credit cards, etc. These securities have less credit risk than do securities not backed by pledged assets, while market risk for asset-backed securities is the same as market risk for similar non asset-backed securities.

Variable-rate instruments pay a variable rate of interest until maturity. The variable rate floats with the 91-day treasury bill or the London Interbank Offered Rate (LIBOR). Variable-rate instruments have credit risk identical to similar fixed-rate securities; however, their market risk (income) is more sensitive to interest rate changes. Their market risk (value/price) may be less volatile than fixed-rate securities because their value will usually remain near par as a result of interest rates being periodically reset to maintain a current market yield.

Zero-coupon bonds and preferred stocks include securities whose structure differs from the basic convertible security structure. These include PENS (Participating Equity Notes), PERCs (Preferred Equity Redemption Coupons), DECS (Dividend Enhanced Common Stock), and ACES (Automatically Convertible Equity Securities). PENS are corporate bonds offering the investor a choice at maturity of receiving the greater of the bond's par value or the value of a preset ratio of an established index. PERCs reflect an investor's acceptance of a cap in a security's price appreciation in exchange for a higher income yield. DECS and ACES are issued and traded at a premium to the underlying common stock in exchange for a higher dividend yield. The State's investment policy requires convertible debt and zero-coupon bonds to be rated at a specific level at time of purchase as a credit risk control measure. These securities carry market risk and the potential for change in market value. Market value changes may occur due to interest rate changes, declines in the value of underlying common stock, or the triggering of a call feature and other factors.

Mortgage-backed securities reflect participation in a pool of residential mortgages. These securities include structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). Some REMICs are principal-only strips (POS) and interest-only strips (IOS). These securities are based on the cash flows from the principal and interest payments on underlying mortgages, respectively. These securities have credit risk as measured by major credit rating services. The State's investment policy requires these investments to be rated investment grade at the time of purchase. Market risk for these securities is caused by changes in the price or principal value of the securities due to changes in interest rates.

As of June 30, 2003, investments in Enron and Burlington Industries, Inc. presented legal and higher credit risk to the State.

(3) 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 securities on loan and maintain collateral equal to not less than 100% of the fair value of the loaned security. During fiscal year 2003, the State's agent loaned, on behalf of the State, certain securities held by the agent and received US dollar currency cash, US government securities, and irrevocable bank letters of credit. 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 for the loaned securities. On June 30, 2003, the State had no credit risk exposure to borrowers.

**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 Deposits (in thousands)**

<b>Risk Category</b>	<b>Carrying Amount</b>	<b>Bank Balance</b>	<b>Fund</b>
1 Insured (FDIC)	\$ 1,759	\$1,759	Various
Collateral held by State/State's agent	17,314	15,721	Various
2	3,443	3,443	Various
3	685	685	Various
<b>Uncategorized:</b>			
Undeposited cash	4,213		
Cash in U.S. Treasury	190,537		
Less: outstanding warrants	(64,781)		
<b>Total cash deposits</b>	<b>\$153,170</b>		

As of June 30, 2003, the carrying amount of deposits for component units was \$70,444,265 and the bank balance was \$64,030,077. Of the bank balance, \$64,030,077 was fully insured or collateralized with securities held by the component units or their agents in the unit's name, and \$5,062,392 was collateralized with securities held by the pledging institution's trust department or its agent in the respective component unit's name.

**(2) Cash Equivalents** – consists of cash in the State Treasury invested by individual funds in the Short-term Investment Pool (STIP) and the Treasurer’s Cash Pool in identifiable securities and investments considered to be cash equivalents. Cash equivalents, except for the Housing Authority in the component unit proprietary fund, generally are short-term, highly liquid investments with original maturities of three months or less. The Housing Authority considers cash and cash equivalents to be cash held by the State Treasurer, other cash deposits, and cash invested in STIP. 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)**

	<b>Risk Category 1</b>			<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Fund</b>
	<b>Securities Not on Loan</b>	<b>On Loan for* Securities Collateral</b>	<b>Not* Categorized</b>			
Asset-backed securities	\$733,398	\$-	\$-	\$ 733,398	\$ 733,410	Various
Government securities	59,789	-	-	59,789	61,722	Various
Repurchase agreements	196,005	-	-	196,005	196,005	Various
Variable-rate short term securities	631,006	-	-	631,006	630,978	Various
Direct investments:						
Money markets				43,793	43,793	Various
<b>Total cash equivalents</b>				<b>\$1,663,991</b>	<b>\$1,665,908</b>	
Securities lending collateral						
Investment pool			\$-	\$	-	\$

\* At June 30, 2003, no securities were loaned for securities and cash collateral under a security lending agreement with the State's agent.

As of June 30, 2003, local governments invested \$664,570,962 in STIP.

As of June 30, 2003, component units of the State of Montana had investments in cash equivalents with a book value and fair value of \$344,338,285.

C. Equity in Pooled Investments

These securities consist of investments held by pooled investment funds. The Montana Domestic Equity/Montana Stock Pool (MDEP), Trust Funds Bond Pool (TFBP), Retirement Funds Bond Pool (RFBP), Montana International Equity Pool (MTIP), and Montana Private Equity Pool (MPEP) were created to allow qualifying funds to participate in diversified investment pools. Participation is restricted to permanent funds, private-purpose trust funds, investment trust funds, pension trust funds, higher education units, and specific trusts established within the State Special Revenue Fund. Purchases are subject to statutory restrictions for quality and size of holdings.

Table 3 - Equity In Pooled Investments (in thousands)

	Risk Category 1			Carrying Amount	Fair Value
	Securities Not on Loan	On Loan for Securities Collateral*	Not Categorized*		
<b>MTCP:</b>					
Common Stock Pool	\$1,655,693	\$-	\$ 19,578	\$1,675,271	\$1,817,071
Equity Index Fund	710,000	-	-	710,000	661,785
DFA Small Cap Subtrust	55,000	-	-	55,000	62,981
SPIFF	34,576	-	-	34,576	35,622
<b>TFBP:</b>					
Corporate Asset-backed	12,255	-	-	12,255	12,255
Corporate Stocks	604,885	-	6,505	611,390	664,571
US Govt. Mortgage-backed	76,291	-	-	76,291	79,160
US Govt. Direct	245,586	-	51,050	296,636	340,815
Yankee Bonds	92,470	-	-	92,470	104,278
State and Local Government	13,885	-	-	13,885	13,887
<b>RFBP:</b>					
Corporate Asset-backed	10,000	-	-	10,000	10,000
Corporate Stocks	839,198	-	9,278	848,476	930,781
US Govt. Mortgage-backed	74,506	-	-	74,506	77,402
US Govt. Direct	326,001	-	53,620	379,621	449,443
Yankee Bonds	81,280	-	995	82,275	91,918
<b>MTIP:</b>					
BGI MSCI Europe Index	40,000	-	-	40,000	41,095
BOI Internal International	114,469	-	18,460	132,929	132,271
Pyford International	107,654	-	15,172	122,826	109,476
Schroder Capital Management	98,496	-	21,876	120,372	113,041
SG Pacific Asset Management	53,497	-	19,759	73,256	74,848
<b>MPEP:</b>					
Private Equities	254,002	-	-	254,002	280,310
State Street SPIFF	24,789	-	-	24,789	25,040
Total pooled investments	5,524,533	-	216,293	5,740,826	6,128,050
Other pool assets (net)	-	-	-	78,604	78,604
Total equity in pooled investments	\$5,524,533	\$-	\$216,293	\$5,819,430	\$6,206,654
Securities lending collateral					
Investment pool			\$256,472	\$ 256,472	\$ 256,472

\* At June 30, 2003, these underlying securities, with fair values of \$79,703,155 and \$164,012,395, respectively, were loaned for securities and cash under a security lending agreement with the State's agent.

As of June 30, 2003, component units of the State of Montana had equity in pooled investments with a book value of \$3,894,331,482 and a fair value of \$4,945,815,590.

**D. Investments**

Long-term investments are primarily administered by three state agencies. Article 8 of Montana's Constitution, with supporting statutes, authorizes the Board of Investments (BOI) to manage the State's unified investment program. State law specifies which agencies may hold investments outside the administration of the BOI. The BOI, as the State's primary administrator of long-term investments, actively manages 73.7% of those investments; the Board of Housing, 9.7%; and the Department of Administration's Public Employees Retirement Board, 14.7% for the State's Deferred Compensation Plan and Defined Contribution Retirement Plan. The Department of Natural Resources and Conservation manages 1.2% of total investments for bond-related activities. Additionally, the Montana University System manages 0.7% of total investments.

The BOI must employ the "Prudent Expert Rule" in managing the State's investment portfolio. Investments are presented in the Balance Sheet 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 (Risk Categories) (in thousands)**

	<u>Risk Category 1</u> Securities Not on Loan	Risk Category 2	Not Categorized*	Carrying Amount	Fair Value
<b>Primary government</b>					
Corporate bonds	\$ 30,401	\$ -	\$ 3,987	\$ 34,388	\$ 36,910
Corporate asset-backed	11,687	-	-	11,687	12,042
Government securities	41,289	-	44,897	86,186	91,565
Government mortgage-backed	9,539	-	-	9,539	9,941
Total	<u>\$ 92,916</u>	<u>\$ -</u>	<u>\$48,884</u>	<u>\$ 141,800</u>	<u>\$ 150,458</u>
<b>Component units</b>					
Corporate bonds	\$208,038	\$ -	\$ -	\$ 208,038	\$ 225,970
Corporate asset-backed	15,506	-	-	15,506	16,027
Government securities	191,807	56,654	-	248,461	265,519
Government mortgage-backed	79,751	-	-	79,751	82,801
International bonds	18,480	-	480	18,960	20,604
Savings & loans	258	-	-	258	258
Repurchase agreement	-	91,096	-	91,096	91,096
Foundations	-	-	3,087	3,087	1,899
Other investments	-	-	7,562	7,562	8,767
Total	<u>513,840</u>	<u>147,750</u>	<u>11,129</u>	<u>672,719</u>	<u>712,941</u>
Total	<u>\$606,756</u>	<u>\$147,750</u>	<u>\$60,013</u>	<u>\$ 814,519</u>	<u>\$ 863,399</u>
<b>Direct investments:</b>					
<b>Primary government</b>					
Commercial loans				188,552	188,552
Total				<u>\$ 188,552</u>	<u>\$ 188,552</u>
<b>Component units</b>					
Real estate				\$ 13,512	\$ 13,927
Mortgages				205,861	207,548
Other				79,000	69,958
Deferred compensation				214,394	205,028
Defined contribution				10,428	9,239
Total				<u>523,195</u>	<u>505,700</u>
Total investments				<u>\$1,526,266</u>	<u>\$1,557,651</u>
Securities lending collateral Investment pool			\$56,643	\$ 56,643	\$ 56,643

\* At June 30, 2003, the underlying securities, with fair values of \$55,128,809 were loaned for cash collateral under a securities lending agreement with the State's agent.



**NOTE 4. DISAGGREGATION OF ACCOUNTS RECEIVABLE AND PAYABLE**

A disaggregation of the net receivables and accounts payable (by fund type) as of June 30, 2003, follows (amounts in thousands):

**A. Receivables**

Receivables	Governmental Funds					
	General Fund	State Special Revenue	Federal Special Revenue	Coal Severance Tax Permanent	Land Grant Permanent	Other Governmental
Licenses and permits	\$ 6,672	\$ 1,472	\$ -	\$ -	\$ -	\$ -
Taxes	151,362	37,554	-	3,372	-	778
Charges for services/ fines/forfeitures	160	10,523	4,430	-	-	-
Investment income	908	5,658	5	4,228	5,441	3,357
Contributions/premiums	-	-	-	-	-	-
Other	7,104	2,804	5,410	-	-	275
Total receivables	166,206	58,011	9,845	7,600	5,441	4,410
Less: allowance for doubtful accounts	(17,709)	(2,400)	-	-	-	-
Receivables, net	\$148,497	\$55,611	\$9,845	\$7,600	\$5,441	\$4,410

Receivables	Proprietary Funds			
	Unemployment Insurance	Economic Development Bonds	Other Enterprise	Internal Service
Charges for services	\$ -	\$ -	\$14,764	\$ 84
Investment income	-	1,050	20	76
Contributions/premiums	5,559	-	2,214	3,037
Other	-	6,357	-	-
Total receivables	5,559	7,407	16,998	3,197
Less: allowance for doubtful accounts	(207)	-	(261)	-
Receivables, net	\$5,352	\$7,407	\$16,737	\$3,197

**B. Payables**

Payables	Governmental Funds					
	General Fund	State Special Revenue	Federal Special Revenue	Coal Severance Tax Permanent	Land Grant Permanent	Other Governmental
Refunds	\$ 81,252	\$ -	\$ -	\$ -	\$ -	\$ -
Tax distributions to other govt	-	10,120	-	-	-	-
Vendors/individuals	27,976	47,451	73,156	-	-	1,587
Payroll	9,574	9,178	3,857	-	-	3
Accrued interest	-	-	-	-	5,317	-
Other	178	871	35	2	-	10
<b>Total</b>	<b>\$118,980</b>	<b>\$67,620</b>	<b>\$77,048</b>	<b>\$2</b>	<b>\$5,317</b>	<b>\$1,600</b>

Payables	Proprietary Funds			
	Unemployment Insurance	Economic Development Bonds	Other Enterprise	Internal Service
Vendors/individuals	\$1,228	\$ 2	\$6,187	\$5,082
Payroll	-	9	390	1,490
Accrued interest	-	650	-	44
<b>Total</b>	<b>\$1,228</b>	<b>\$661</b>	<b>\$6,577</b>	<b>\$6,616</b>

**NOTE 5. CAPITAL ASSETS**

**A. Primary Government**

Changes in capital asset balances for the fiscal year ended June 30, 2003, are reflected in the following table; intrafund transfers of capital assets have not been eliminated (in thousands):

**Primary Government**

	<b>Beginning Balance</b>	<b>Increases</b>	<b>Decreases</b>	<b>Ending Balance</b>
<b>Governmental activities</b>				
Capital assets, not being depreciated				
Land	\$ 266,230	\$ 34,262	\$ (246)	\$ 300,246
Construction work in progress	170,884	140,314	(136,830)	174,368
Capitalized collections	63,681	782	(408)	64,055
Total capital assets, not being depreciated	500,795	175,358	(137,484)	538,669
Capital assets, being depreciated				
Infrastructure	253,676	2,706,013	(138,096)	2,821,593
Land improvements	9,661	1,517	-	11,178
Buildings/improvements (1)	305,144	20,364	(1,926)	323,582
Equipment	229,841	21,511	(15,569)	235,783
Other	2,958	1,305	(940)	3,323
Total capital assets, being depreciated	801,280	2,750,710	(156,531)	3,395,459
Less: accumulated depreciation for:				
Infrastructure	(22,712)	(1,432,832)	8,363	(1,447,181)
Land improvements	(205)	(1,016)	51	(1,170)
Buildings/improvements (1)	(138,163)	(9,093)	2,153	(145,103)
Equipment	(137,562)	(16,490)	13,396	(140,656)
Other	(2,155)	(379)	7	(2,527)
Total accumulated depreciation	(300,797)	(1,459,810)	23,970	(1,736,637)
Total capital assets, being depreciated, net	500,483	1,290,900	(132,561)	1,658,822
Intangible assets	37,514	5,691	(15,369)	27,836
Governmental activity capital assets, net	<b>\$1,038,792</b>	<b>\$1,471,949</b>	<b>\$(285,414)</b>	<b>\$2,225,327</b>

Primary Government (continued)

	Beginning Balance	Increases	Decreases	Ending Balance
<b>Business-type activities</b>				
Capital assets, not being depreciated				
Land	\$ 800	\$ -	\$ -	\$ 800
Construction work in progress	71	-	-	71
Total capital assets, not being depreciated	871	-	-	871
Capital assets, being depreciated				
Infrastructure	884	-	-	884
Land improvements	222	1,158	-	1,380
Buildings/improvements (1)	8,906	-	(2,808)	6,098
Equipment	9,449	551	(118)	9,882
Other	1,154	-	(1,154)	-
Total capital assets, being depreciated	20,615	1,709	(4,080)	18,244
Less: accumulated depreciation for:				
Infrastructure	(4)	(455)	-	(459)
Land improvements	-	(1,092)	-	(1,092)
Buildings/improvements (1)	(3,167)	(331)	162	(3,336)
Equipment	(4,180)	(2,701)	1,659	(5,222)
Other	(996)	-	996	-
Total accumulated depreciation	(8,347)	(4,579)	2,817	(10,109)
Total capital assets, being depreciated, net	12,268	(2,870)	(1,263)	8,135
Intangible assets	1,472	-	(284)	1,188
Business-type activity capital assets, net	\$14,611	\$(2,870)	\$(1,547)	\$10,194

- (1) For reporting purposes, the Prison Industries Training Program, a sub-fund of the Prison Industries Enterprise Fund, was moved to the Prison Industries Internal Service Fund. As a result of this fund reclassification, the beginning balances of the governmental activities buildings/improvements and related accumulated depreciation increased by \$58,000 and \$11,000, respectively. A corresponding decrease is reflected in the beginning balances of the business-type activities.

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

	Amount
General government	\$ 1,623
Public safety/corrections	4,572
Transportation (including depreciation of the highway system maintained by the State).	9,207
Health/social services	3,988
Education/cultural	4,575
Resource development/recreation (including depreciation of the State's dams).	2,432
Economic development/assistance	610
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.	9,888
Total depreciation expense – governmental activities	\$36,895

**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**

	<b>Montana State University</b>	<b>University of Montana</b>	<b>Other</b>	<b>Total</b>
Capital assets, not being depreciated				
Land	\$ 4,276	\$ 6,936	\$ -	\$ 11,212
Construction work in progress	5,886	7,319	-	13,205
Capitalized collections	7,767	14,720	-	22,487
Livestock for educational purposes	2,752	-	-	2,752
Total capital assets, not being depreciated	20,681	28,975	-	49,656
Capital assets, being depreciated				
Infrastructure	31,336	-	-	31,336
Land improvements	13,416	9,246	-	22,662
Buildings/improvements	283,641	304,501	-	588,142
Equipment	80,493	43,777	3,060	127,330
Other	52,821	45,188	-	98,009
Total capital assets, being depreciated	461,707	402,712	3,060	867,479
Less: accumulated depreciation	(247,738)	(207,009)	(1,897)	(456,644)
Total capital assets, being depreciated, net	213,969	195,703	1,163	410,835
Intangible assets	2,119	843	2,185	5,147
Discretely presented component units				
Total capital assets, net	\$236,769	\$225,521	\$3,348	\$465,638

**NOTE 6. RETIREMENT SYSTEMS**

**Defined Contribution Plans**

**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, a defined benefit plan discussed in the next section. 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 subfund 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. As of June 30, 2003, 1,878 employees were members of the ORP. Required employee contributions were 7.044% of salary; required employer contributions were 4.956% of salary, for a total of 12% of salary contributed to the ORP.

	<b>TIAA-CREF (in thousands)</b>
Covered payroll	\$ 113,843
Total payroll	277,763
Employer contributions	\$ 5,639
Percent of covered payroll	4.954%
Employee contributions	\$ 8,020
Percent of covered payroll	7.045%

**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 join 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.

Participant rights are fully vested in their accounts at the time of deposit in regard to participant contributions and interest. Employer contributions and interest are vested after 5 years of service.

The PERS-DCRP has received a long-term loan through the Montana Department of Administration, with the BOI to fund the plan start-up/implementation costs. Authorization for the loan was provided by the Legislature, Chapter 471, Laws of 1999. As of June 30, 2003, the balance of the loan taken by the PERS-DCRP totaled \$1,498,000. Principal repayments on this loan began August 15, 2003, and will be completed during the 2010 fiscal year.

An inter-entity loan was taken from the PERS-DBRP Education Fund on August 18, 2003, to help cover the costs of the PERS-DCRP expenses. The inter-entity loan is due in two years, and interest will be repaid at the same rate as STIP.

For information on the repayment schedules on these loans, please see the separately issued PERS-DCRP financial statements.

### **Deferred Compensation Plan**

**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, Montana University System, and contracting political subdivisions are eligible to participate. As of June 30, 2003, the net assets of the plan were \$208,342,000.

The 457 plan is a voluntary, tax-deferred retirement plan designed to supplement state service retirement, Social Security, and other retirement plans and savings. 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 IRS-specified criteria. Participant rights are fully vested in their accounts at the time of deposit.

### **Defined Benefit 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), Highway Patrol Officers Retirement System (HPORS), Judges Retirement System (JRS), Game Wardens and Peace Officers Retirement System (GWPORS), Sheriffs Retirement System (SRS), Municipal Police Officers Retirement System (MPORS), Firefighters Unified Retirement System (FURS), and Volunteer Firefighters Compensation Act (VFCA). The board prepares a publicly issued comprehensive annual financial report that includes financial statements and required supplementary information for PERS, HPORS, JRS, GWPORS, SRS, MPORS, FURS, VFCA, as well as the two defined contribution plans, PERS-DCRP and 457 plan.

The eight retirement systems administered by the PERB have actuarial gains and losses smoothed over four years and only one-fourth of each previous year's actuarial loss has been recognized in the amortization period as of July 1, 2002. The amortization period as of July 1, 2004, will include all the losses for fiscal year 2001, most of the losses for fiscal year 2002, and the investment income in fiscal year 2003. Because of this issue, there is uncertainty with respect to the adequacy of funding for the Public Employees Retirement System - Defined Benefit Retirement Plan, the Game Wardens and Peace Officers Retirement System, and the Sheriffs Retirement System.

The financial statements for PERB include activity for a defined benefit and the associated education fund.

The Teachers Retirement System (TRS) is a discretely presented component unit of the State of Montana. The system prepares a publicly issued financial report that includes financial statements and required supplementary information for TRS.

The Teachers Retirement System actuarial gains and losses are smoothed over five years and only one-fifth of each previous year's actuarial loss has been recognized in the amortization period as of July 1, 2002. This leaves almost \$443 million in unrecognized investment losses, which must be recognized over the

next three to four years. This unrecognized loss, if not offset by future gains, will cause the amortization period of the unfunded actuarial accrued liability in future valuations to fall outside the measures accepted as actuarially sound.

A summary of government employers participating in PERB, SRS, MPORS, HPORS, FURS, GWPORS, JRS, and TRS by employer type at June 30, 2003, follows:

	Retirement System/Plan									
	PERS-DBRP	PERS-DCRP	SRS	MPORS	HPORS	FURS	GWPORS	JRS	457	TRS
<b>Employers</b>										
State agencies	34	25	1		1	1	5	1	34	8
Counties	55	42	55							
Cities/towns	93	29		22		15				
Colleges/universities	5	4					3		6	5
School districts	237	68								374
High schools	5									
Other	92	21							2	
<b>Total</b>	<b>521</b>	<b>189</b>	<b>56</b>	<b>22</b>	<b>1</b>	<b>16</b>	<b>8</b>	<b>1</b>	<b>42</b>	<b>387</b>

**B. Plan Descriptions**

The State contributes to and/or administers ten plans in four categories: (1) the State as the single employer; (2) the State as an employer contributor to cost-sharing multiple-employer plans; (3) the State as a nonemployer contributor to cost-sharing multiple employer plans; and (4) the State as a nonemployer contributor.

The number of years required to obtain vested rights varies among the systems. All systems provide early retirement options, death benefits, termination, and disability benefits. The post-retirement benefits of each of the systems are included in the plan descriptions below. In addition, the 1999 Legislature passed a guaranteed annual benefit adjustment (GABA) to the PERS-DBRP, MPORS, GWPORS, SRS, JRS, HPORS, and FURS that will provide a maximum benefit increase of 3% each January, inclusive of all other adjustments to the member's benefit, if the recipient has been receiving a retirement benefit for at least 12 months.

The funding policies for each system 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 a biennial 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 accrued liability determined as a level percentage of payroll. 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.

**(1) State as the Single Employer**

**HPORS – Highway Patrol Officers Retirement System** – This system, 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. Rights are vested after five years of service. Member contributions are 9% of total salaries of active highway patrol officers hired prior to July 1, 1997 and not electing GABA coverage; and 9.05% for members hired after June 30, 1997, and members electing GABA coverage. The employer contribution rate is 36.33% of active officer's salaries. For members, there is no minimum age, but minimum service is 20 years for benefit eligibility. The service retirement benefit is based on a formula of 2.5% times the number of years of service times the highest average compensation. Post-retirement benefits, for non-GABA members, are in the form of minimum benefit supplements which insure the retiree's benefit is no less than 2% of a probationary highway patrol officer's salary for each year of the retiree's service, with the annual increase not to exceed 5% of the benefit paid nor 60% of the current base salary of a probationary officer. Members retired prior to July 1, 1991, who are at least age 55 and have been retired a minimum of five years, may be eligible for an annual lump-sum payment distributed in September. This lump-sum payment is funded by a registration fee of 25

cents per vehicle registration. The average payment in September 2002 was \$2,231. This enhancement is limited to non-GABA members.

**JRS – Judges Retirement System** – This system, established in 1967 and governed by Title 19, chapters 2 & 5 of the MCA, provides retirement benefits for all Montana judges of district court, justices of the Supreme Court, and the Chief Water Judge. Members contribute 7% of their salaries while the State contributes 25.81% of active judges' salaries. Rights are vested after five years of membership service. Benefit eligibility is age 60 with at least 5 years of service, or any age with 5 years of service actuarially reduced with involuntary terminations. The monthly retirement benefit formula is 3 1/3% per year of the member's highest average compensation for the first 15 years of credited service, plus 1.785% per year for each year of credited service after 15 years. For non-GABA members, the percentages are based on the member's current salary, instead of the highest average compensation.

## (2) State as an Employer Contributor to Cost-Sharing Multiple-Employer Systems

**PERS-DBRP – Public Employees Retirement System - Defined Benefit Retirement Plan** – This mandatory 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 system. Member contributions are 6.9% of covered compensation. Each state agency and university system employer contributed 6.9% of PERS-covered payroll. Participating local governments and school district employers contributed 6.8% of PERS-covered payroll. The State contributed 0.1% for local governments and school district employers from the State General Fund. Benefit eligibility is age 60 with at least 5 years of service, age 65 regardless of service, or 30 years of service, regardless of age. Actuarially reduced benefits may be taken with 25 years of service or at age 50 with at least five years of service. Monthly retirement benefits are determined by taking 2% times the number of years of service times the highest average compensation times any early retirement reduction, if necessary. Members' rights are vested after five years of membership service.

**TRS – Teachers Retirement System** – This mandatory system, 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. Member and employer contributions are 7.15% and 7.47%, respectively, of earned compensation. Benefit eligibility is age 60 with at least 5 years of creditable service, or at any age with

at least 25 years of creditable service. The formula for annual benefits is 1.6667% times creditable service years times the average final compensation. Rights are vested after five years of creditable service. Vested employees may retire at or after age 50 and receive reduced retirement benefits. Effective January 1, 1988, university system employees eligible to participate in the Teachers Retirement System could elect to participate in an Optional Retirement Plan established by the Board of Regents. A supplemental employer contribution to TRS is required to be amortized by July 1, 2033, for the amount that would not be paid for by contributions of university system members. The fiscal year 2003 contribution percentage of the total compensation of employees participating in the ORP program was 4.04% and the contribution was \$4.46 million. The unfunded actuarial accrued liability of \$495.3 million is included in the Schedules of Funding Progress.

**SRS – Sheriffs Retirement System** – This system, established in 1974 and governed by Title 19, chapters 2 & 7 of the MCA, covers State Department of Justice criminal investigators hired after July 1, 1993 and all Montana sheriffs. The member contribution is 9.245% of salary; the employer contribution is 9.535% of SRS-covered payroll. Benefit eligibility is age 50 with at least 5 years of service, or 20 years of service regardless of age. The service retirement benefit is calculated at 2.5% of the highest average compensation for each year of membership service. Reduced benefits for early retirement may be taken with a minimum of five years of service and a minimum age of 50. Rights are vested after five years of membership service.

**GWPORS – Game Wardens & Peace Officers Retirement System** – This system, established in 1963 and governed by Title 19, chapters 2 & 8 of the MCA, provides retirement benefits for all persons employed as a game warden, warden supervisory personnel, and state peace officers not eligible to join the SRS, HPORS and MPORS systems. The member contributes 10.56% of salary while the State contributes 9.0% of covered active employee salaries. Benefit eligibility is age 50 with at least 20 years of service, or age 55 with at least 5 years of service. The yearly retirement benefit formula is 2.5% times the number of years of service times the highest average compensation. Rights are vested after five years of membership service.

Enacted legislation opened the GWPORS to all state peace officers. The active membership increased from 494 in fiscal year 2000 to 609 in fiscal year 2002. Based on the 2002 actuarial assumptions, the current normal cost is more than the statutory contribution rate due to the inclusion of additional state peace officers in the GWPORS. The actuary was asked to reevaluate the assumptions of the GWPORS. The actuary surmised that the Funded Status of the system would have been a



slight Actuarial Surplus instead of a slight Unfunded Actuarial Liability. The conclusion is that, based on the data, method, and assumptions contained in the 2002 Actuarial Valuation, including the modification to the assumed termination rates, the current statutory contribution rate is actuarially sound.

### **(3) State as a Nonemployer Contributor to Cost-Sharing Multiple-Employer Systems**

**MPORS – Municipal Police Officers Retirement System** – The system, established in 1974 and governed by Title 19, chapters 2 & 9 of the MCA, covers all municipal police officers of cities covered by the plan. It is a cost-sharing defined benefit plan with a special funding situation. The member contribution is 5.8% of salary for members employed prior to July 1, 1975; 7% of salary for members employed after June 30, 1975, and prior to July 1, 1979; 8.5% of salary for members employed after June 30, 1979, and prior to July 1, 1997; and 9% for members hired on or after July 1, 1997, and members electing GABA. Employer contributions are 14.41% of MPORS-covered payroll. The State contributes 29.37% of compensation paid to members. The State's contribution is funded from the General Fund. Rights are vested after five years of membership service. Benefit eligibility is age 50 with at least 5 years of service, or at any age with at least 20 years of service. The service retirement benefit is 2.5% times the number of years of service times the final average compensation. For non-GABA members, a minimum benefit adjustment is required to insure that the retired members benefit is not less than one-half of the compensation paid to newly confirmed police officers in the city that last employed the member.

Beginning July 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 Board. The DROP is governed by Title 19, Chapter 9, Part 12, MCA. An eligible member must have completed at least 5 years of membership service and reached age 50. They may elect to participate in the DROP for a minimum of one month and a maximum of five years 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 system 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 system. 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 they will again accrue membership service and service credit and the DROP account cannot be distributed until employment is formally terminated.

Legislation in 2003 amended the previous DROP provisions so that a DROP participant must have 20 years of service to participate in the DROP. This legislative change became effective April 9, 2003. Members with 20 years of service and previously ineligible to participate in the DROP became eligible to retroactively apply for DROP benefits.

**FURS – Firefighters Unified Retirement System** – This system, established in 1981 and governed by Title 19, chapters 2 & 13 of the MCA, provides retirement benefits for firefighters employed by first and second-class cities and other cities that wish to adopt the plan and to firefighters hired by the Montana Air National Guard on or after October 1, 2001. It is a cost-sharing defined benefit plan with a special funding situation. The member contribution is 9.5% of compensation for members hired prior to July 1, 1997; and 10.7% for members hired after June 30, 1997, and for members electing GABA coverage. City contributions are 14.36% of total annual compensation. The state contribution is 32.61% of total annual compensation for all firefighters and is paid out of the General Fund. Benefit eligibility is 20 years regardless of age, or age 50 with at least 5 years of service. For members not electing GABA and hired prior to July 1, 1981, monthly retirement benefit is 50% of final average compensation, plus 2% per year for each year in excess of 20 years, or 2.5% of final average compensation per year. Members hired before July 1, 1981, with less than 20 years, receive a retirement benefit of 2% per year of service. Members electing GABA and hired after July 1, 1981, receive 2.5% of final average compensation. Post-retirement benefits, for non-GABA members, require that each retiree receive at least 50% of the salary paid a newly confirmed firefighter in the city where last employed. Rights are vested after five years of membership service.

### **(4) State as a Nonemployer Contributor**

**VFCA – Volunteer Firefighters Compensation Act** – This compensation program, established in 1965 and governed by Title 19, chapter 17 of the MCA, provides pension, disability and death benefits for all volunteer firefighters who are members of eligible volunteer fire companies in unincorporated areas of the state. VFCA also provides limited medical expenses for injuries incurred in the line of duty. VFCA is a plan with a special funding situation. The state contribution is 5% of fire insurance premium taxes collected. Rights are vested after ten years of qualified service. Benefit eligibility is age 55 with at least 20 years of service, or age 60 with at least 10 years of service.

The 2003 legislature amended the law so that members of the VFCA can accumulate more than 20 years of service beginning when they are age 55, if they already have 20 years of service (effective 7/1/2003).

### C. 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 refunds are recognized when due and payable in accordance with the terms of each plan.

### D. Method Used to Value Investments

The Montana Board of Investments (BOI) manages the investments for the retirement systems. 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 systems have no investments of any commercial or industrial organization whose fair value equals 5% or more of the retirement systems net assets available for benefits.

### E. Long-term Contracts for Contributions

The 1993 Montana Legislature enacted House Bill 517 - Retirement Incentive Program (RIP) providing PERS-DBRP members (eligible for a service retirement) an

incentive to terminate between June 25, 1993, and December 31, 1993. Local government employers participated, through election, on or before June 1, 1993. The employer purchased, on the members behalf, one year of additional service for each five years of qualified service ("1 for 5"), up to a maximum of three years, for any retirement eligible member who terminated employment during the defined time period. A total of 898 members took advantage of the program (630 from 32 state agencies, 95 from 6 universities, and 173 from 48 local government agencies). All payments were complete as of June 30, 2003.

The Montana Legislature also provided a new provision of the Employee Protection Act (EPA) (Section 19-2-706, MCA) allowing state employees, eligible for a service retirement, whose positions have been eliminated, to have their employer purchase up to three years of "1 for 5" additional service. As of June 30, 2003, 280 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 2003 totaled \$404,473. June 30, 2003, outstanding balances were \$451,741.

### F. Actuarial Data

Actuarial valuations are performed every two years. Milliman USA prepared the July 2002 actuarial reports for the retirement systems, including TRS. Employee Benefit Resources, LLP, of Helena, MT, prepared the July 1, 1998, actuarial reports for the retirement systems, excluding TRS. Milliman & Robertson, Inc., of Seattle, WA, performed the actuarial valuation for TRS for July 1, 1998, and July 1, 2000. Milliman & Robertson, of Portland, OR, prepared the July 1, 2000, actuarial reports for the retirement systems, excluding TRS.

**G. Funding Policy and Annual Pension Cost**

The following tables provide information concerning funding policies and annual pension costs (in thousands):

**Single Employer Systems**

	<b>HPORS</b>	<b>JRS</b>
Annual pension cost	\$3,047	\$1,032
Contributions		
Employer	\$2,770	\$1,032
Employee	693	280
License and registration fees	309	
Actuarial valuation date	7/01/02	7/01/02
Actuarial cost method	Entry age	Entry age
Amortization method	Level percentage of total salaries, open	Level percentage of total salaries, open
Remaining amortization period	8.7 years	30 years
Asset valuation method	4 year smoothed market	4 year smoothed market
Actuarial assumptions:		
Investment rate of return	8.0%	8.0%
Projected salary increases (includes inflation factor)	4.5%	4.5%
Merit	0%-7.3%	None
Postretirement benefit increases	None	None

Single Employer Systems

Year Ended	Annual Pension Costs (APC)	Percentage of APC Contributed	Net Obligation
<b>HPORS</b>			
06/30/01	3,006	101.6%	NONE
06/30/02	3,047	101.3%	NONE
06/30/03	3,191	100.9%	NONE
<b>JRS</b>			
06/30/01	944	100.0%	NONE
06/30/02	1,032	100.0%	NONE
06/30/03	1,052	100.0%	NONE

Multiple Employer Systems

Year Ended	Annual Required Contribution (ARC)	Percentage of ARC Contributed
<b>PERS</b>		
06/30/01	52,843	100.7%
06/30/02	55,369	100.5%
06/30/03	58,114	99.1%
<b>MPORS</b>		
06/30/01	9,149	100.1%
06/30/02	9,732	101.1%
06/30/03	10,196	101.0%
<b>FURS</b>		
06/30/01	7,854	98.6%
06/30/02	8,432	98.1%
06/30/03	8,740	100.8%
<b>SRS</b>		
06/30/01	2,159	103.1%
06/30/02	2,338	102.1%
06/30/03	2,435	101.7%
<b>GWPORS</b>		
06/30/01	1,339	101.9%
06/30/02	1,544	103.3%
06/30/03	1,803	101.8%
<b>TRS</b>		
06/30/01	51,524	100.0%
06/30/02	51,519	100.0%
06/30/03	53,277	100.0%

H. Schedules of Funding Progress

Single Employer Systems

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)
<b>HPORS</b>						
07/01/98	59,531	78,722	19,191	75.62%	6,201	309.48%
07/01/00	77,810	76,397	(1,413)	101.85%	6,952	(20.33)%
07/01/02	81,734	94,850	13,116	86.17%	7,536	174.04%
<b>JRS</b>						
07/01/98	31,646	29,017	(2,629)	109.06%	3,144	(83.62)%
07/01/00	42,043	27,365	(14,678)	153.64%	3,483	(421.42)%
07/01/02	44,963	30,882	(14,081)	145.60%	4,000	(352.03)%

Multiple Employer Systems

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)
<b>PERS</b>						
07/01/98*	2,128,065	2,300,328	172,263	92.51%	660,579	26.08%
07/01/00	2,843,347	2,273,407	(569,940)	125.07%	725,692	(78.54)%
07/01/02	3,076,781	3,077,764	983	99.97%	808,747	0.12%
<b>MPORS</b>						
07/01/98	94,908	173,642	78,734	54.66%	17,873	440.52%
07/01/00	129,826	181,109	51,283	71.68%	20,252	253.22%
07/01/02	143,516	226,827	83,311	63.27%	22,229	374.79%
<b>FURS</b>						
07/01/98	89,988	169,006	79,018	53.25%	15,104	523.15%
07/01/00	123,492	162,329	38,837	76.08%	16,547	235.00%
07/01/02	136,392	197,946	61,554	68.90%	17,953	342.86%
<b>SRS</b>						
07/01/98	92,160	81,077	(11,083)	113.67%	20,127	(55.06)%
07/01/00	126,338	87,836	(38,502)	143.83%	21,559	(178.59)%
07/01/02	138,590	121,625	(16,965)	113.95%	24,521	(69.19)%
<b>GWPORS</b>						
07/01/98	23,190	22,412	(778)	103.47%	7,839	(9.92)%
07/01/00	32,966	23,922	(9,044)	137.81%	11,875	(76.00)%
07/01/02	38,730	39,109	379	99.03%	17,151	2.21%
<b>TRS</b>						
07/01/98*	1,809,037	2,342,690	533,653	77.2%	529,795	100.7%
07/01/00	2,247,500	2,648,300	400,800	84.9%	537,500	74.6%
07/01/02	2,484,800	2,980,100	495,300	83.4%	563,200	87.9%

\* PERS July 1, 1998, results adjusted by actuary.

\*\* TRS July 1, 1998, results adjusted for 1.5% guaranteed annual benefit adjustment and \$500 minimum benefit for legislation which passed in April 1999 and the new salary scale adopted in November 1998.

Nonemployer Contributor

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)
<b>VFCA</b>						
07/01/98	13,941	18,354	4,413	75.96%	N/A	N/A
07/01/00	17,769	16,752	(1,017)	106.07%	N/A	N/A
07/01/02	19,254	26,808	7,554	71.82%	N/A	N/A

**NOTE 7. OTHER POSTEMPLOYMENT BENEFITS**

In addition to the pension benefits described in Note 6, Retirement Systems, the following postemployment benefits are provided:

The State provides 18 to 36 months optional postemployment health care benefits in accordance with Public Law 99-272, known as the Consolidated Omnibus Budget Reconciliation Act (COBRA), to the following employees and dependents who elect to continue and pay administratively established premiums: (1) employees who are covered by the State Group Benefits Plan at the time they discontinue state employment and (2) spouses or other dependents who lose dependent eligibility. At June 30, 2003, 66 certificate holders were receiving these benefits.

In accordance with section 2-18-704, MCA, the State also provides optional postemployment health care benefits 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 system (See Note 6). Administratively established retiree medical premiums vary between \$177 and \$537 per month depending on the medical plan selected, family coverage, and Medicare eligibility. Administratively established dental premiums vary between \$28.60 and \$46.60 depending on the coverage selected. The State acts as secondary payor for retired Medicare-eligible claimants. As of June 30, 2003, 3,173 retirees were covered for health care benefits.

The State reimburses all validated medical claims less member obligations (annual deductibles and co-insurance of the members selected medical plan). Dental claims are reimbursed at 50% to 100% depending on the services provided. The State funds claims on a pay-as-you-go basis. During the fiscal year, expenditures of \$17,095,343 were recognized for postemployment health care benefits. Premium

contributions received from former employees amounted to \$13,051,876 leaving \$4,043,467 of claims paid in excess of premium revenue received by the State.

In accordance with section 2-18-702, MCA, the Montana University System (MUS) provides postretirement health insurance benefits to eligible employees who receive a retirement benefit from the Teachers Retirement System, Public Employees Retirement System, or an annuity under the Optional Retirement Plan and have been employed by the MUS at least 5 years. Spouses, unmarried dependent children, and surviving spouses are also eligible. Administratively established premiums vary between \$217 and \$566 per month and are revised annually. Medicare-eligible plan members are assumed to be insured by Medicare. After an annual \$575 deductible for non-Medicare-eligible retirees, the MUS plan reimburses 65% to 80% of the first \$10,000 in medical claims and 100% thereafter. After a \$400 deductible for Medicare-eligible retirees, the plan reimburses 65% to 80% for the first \$5,000 in medical claims 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, 2003, 1,414 retirees were enrolled in the MUS plan. Funding for the retiree health plan is on a pay-as-you-go basis. Based on amounts recorded through June 2003, estimated expenditures of \$6,188,319 were recognized for postemployment health care benefits. Of this amount, \$4,862,220 was paid by retirees through premiums, and the balance of \$1,326,099 was paid by the MUS.

**NOTE 8. RISK MANAGEMENT**

There are three primary government public entity risk pools that are reported within the enterprise fund type and two component unit public entity risk pools. Primary government pools include Hail Insurance, Subsequent Injury, and the Montana University System (MUS) Group Benefits Plan Funds; component unit pools include State Compensation Insurance (New Fund) and State Compensation Insurance (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. These funds use the accrual basis of accounting. By statute, these funds cannot invest in common stock. 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 2,134 policies during the 2003 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 which exceeds 5% destruction by hail.

The fund recorded a liability of \$298,414 based on estimated claims through June 30, 2003. 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) 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. In Montana, there are 3,225 individuals with certified disabilities.

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, 2003, the amount of this liability was estimated to be \$2,363,565.

**(3) Montana University System (MUS) Group Benefits Plan** – This plan was authorized by the 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, and vision insurance. Blue Cross/Blue Shield of Montana is the claims administrator for the self-insured indemnity plan and an HMO plan. New West Health Services and Peak administers claims for the two other self-insured plans. 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. Premiums are collected from employees through payroll deductions and recorded in the MUS Group Insurance enterprise fund. The claims liability is calculated by Buck Consultants and estimated to be \$3,443,727 as of June 30, 2003, based on prior year experience. A liability is reported in the accompanying financial statements for these estimated claims.

**(4) State Compensation Insurance (New Fund)** – 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 fiscal year-end, approximately 25,977 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, 2003, 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, 2003, \$413,400,000 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 in fiscal years ended June 30, 2003 and 2002, were \$1,474,338 and \$878,106, respectively. For the fiscal years ended June 30, 2003 and 2002, \$878,106 and \$389,051 of acquisition costs were amortized, respectively.

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.

**(5) State Compensation Insurance (Old Fund) –**

The liability and payment of workers compensation claims for incidents occurring before July 1, 1990, are reported in the Old Fund. Funding for claim payments was accumulated through an Old Fund Liability Tax. In 1999, the 56th Legislature determined that the fund was adequately funded and discontinued the OFLT.

An actuarial study prepared by Tillinghast-Towers Perrin, as of June 30, 2003, 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, 2003, \$113,180,563 of unpaid claims and claim adjustment expenses were reported at a net present value of \$80,900,000, discounted at a 5.25% rate.



**(6) 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.

<b>Primary government</b>	<b>Hail Insurance</b>		<b>Subsequent Injury</b>		<b>MUS Group Benefits</b>	
	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>
Unpaid claims and claim adjustment expenses at beginning of year	\$ 43	\$ 520	\$2,100	\$2,719	\$ 2,982	\$ 2,378
Incurred claims and claim adjustment expenses:						
provision for insured events of the current year	1,696	2,076	-	-	33,675	29,642
Increase (decrease) in provision for Insured events of prior years	(6)	(395)	797	(352)	461	604
Total incurred claims and claim adjustment expenses	1,690	1,681	797	(352)	34,136	30,246
Payments:						
Claims and claim adjustment expenses attributable to insured events of the current year	(1,392)	(2,034)	(35)	-	(33,674)	(29,642)
Claims and claim adjustment expenses attributable to insured events of prior years	(43)	(124)	(498)	(267)	-	-
Total payment	(1,435)	(2,158)	(533)	(267)	(33,674)	(29,642)
Total unpaid claims and claim adjust. exp. at end of the year	\$ 298	\$ 43	\$2,364	\$2,100	\$ 3,444	\$ 2,982

<b>Component units</b>	<b>State Compensation Insurance (New Fund)</b>		<b>State Compensation Insurance (Old Fund)</b>	
	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>
Unpaid claims and claim adjustments expenses at beginning of year	\$346,400	\$325,900	\$128,902	\$148,476
Incurred claims and claim adjustment expenses:				
Provision for insured events of the current year	116,598	84,370	-	-
Increase (decrease) in provision for insured events of prior years	35,366	5,361	(1,448)	(6,690)
Total incurred claims and claim adjustment expenses	151,964	89,731	(1,448)	(6,690)
Payments:				
Claims and claim adjustment expenses attributable to insured events of the current year	(22,982)	(16,693)	-	-
Claims and claim adjustment expenses attributable to insured events of prior years	(61,982)	(52,538)	(14,273)	(12,884)
Total payments	(84,964)	(69,231)	(14,273)	(12,884)
Total unpaid claims and claim adjust. exp. at end of the year	\$413,400	\$346,400	\$113,181	\$128,902

**(7) Risk Management Trend Information** – The following table only presents risk management trend information for the State Compensation Insurance (New Fund). Only the New Fund has a three to five-year development cycle contemplated by GASB Statement 10. The State Compensation Insurance (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 table below illustrates how the earned revenues (net of reinsurance) of the New Fund and its investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the fund as of the end of the fiscal year (in thousands).

Section 3 shows the fund's 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.

*(Table presented on next page)*

	State Compensation Insurance (New Fund)									
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
<b>1. Premiums and investment revenue</b>										
Earned	\$233,699	\$192,548	\$136,432	\$103,780	\$89,010	\$80,594	\$89,213	\$113,226	\$125,437	\$129,608
Ceded	319	269	519	348	303	260	855	2,952	(465)	5,654
Net earned	\$233,380	\$192,279	\$135,913	\$103,432	\$88,707	\$80,334	\$88,358	\$110,274	\$125,902	\$123,954
<b>2. Unallocated expenses including overhead</b>	\$ 8,637	\$ 14,772	\$ 17,839	\$ 13,006	\$14,831	\$19,472	\$22,718	\$ 27,555	\$ 31,020	\$ 36,484
<b>3. Estimated losses and expenses end of accident year</b>										
Incurred	\$199,890	\$164,628	\$ 95,067	\$ 76,067	\$64,983	\$64,645	\$65,957	\$ 68,267	\$ 81,560	\$110,153
Ceded	-	-	-	-	-	-	-	-	-	-
Net incurred	\$199,890	\$164,628	\$ 95,067	\$ 76,067	\$64,983	\$64,645	\$65,957	\$ 68,267	\$ 81,560	\$110,153
<b>4. Net paid (cumulative) as of:</b>										
End of policy year	\$ 18,693	\$ 18,137	\$ 15,818	\$ 12,589	\$12,943	\$13,723	\$13,177	\$ 14,140	\$ 16,693	\$ 22,982
One year later	45,947	40,473	32,890	28,451	28,222	29,976	29,218	32,888	38,185	
Two years later	60,971	52,073	42,361	35,706	35,753	39,298	37,555	45,218		
Three years later	67,576	58,722	47,283	39,860	41,004	45,748	43,649			
Four years later	72,212	62,419	50,267	43,105	44,478	49,984				
Five years later	75,799	65,919	52,791	46,478	47,584					
Six years later	78,306	68,541	54,962	48,505						
Seven years later	80,861	70,816	57,654							
Eight years later	83,150	72,803								
Nine years later	85,238									
<b>5. Re-estimated ceded losses and expenses</b>	\$ -	\$ -	\$ -	\$ 6,235	\$ 259	\$ 1,197	\$ -	\$ -	\$ -	\$ -
<b>6. Re-estimated net incurred losses and expense:</b>										
End of policy year	\$199,890	\$164,628	\$ 95,067	\$ 76,067	\$64,983	\$63,807	\$65,957	\$ 68,267	\$ 81,560	\$110,153
One year later	184,920	124,123	88,923	67,235	64,308	64,348	66,421	71,094	86,799	
Two years later	135,472	107,074	77,286	59,054	60,467	66,660	66,662	81,053		
Three years later	116,756	95,456	73,864	60,811	61,989	69,345	70,302			
Four years later	107,656	94,517	74,022	64,439	64,944					
Five years later	105,052	92,231	73,197	59,079	67,312					
Six years later	106,039	91,771	74,329	60,528						
Seven years later	105,668	92,637	76,955							
Eight years later	105,606	93,637								
Nine years later	107,039									
<b>7. Increase (decrease) in estimated net incurred losses and expenses from end of policy year</b>	\$ (92,851)	\$ (70,991)	\$ (18,112)	\$ (15,539)	\$ 2,329	\$ 7,790	\$ 4,345	\$ 12,786	\$ 5,239	\$ -

**B. Entities Other Than Pools**

**(1) Group Employee Comprehensive Medical and Dental Plan** – With the exception of vision care services, this plan is 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. Vision care services are insured by the Vision Service Plan. The State contracts with Blue Cross/Blue Shield, PEAK, and New West for administration of its self-insured plans. Premiums are collected through payroll deductions, deductions through the Public Employees Retirement Division, and self-payments, and are recorded as revenue in the Employee Group Benefits Internal Service Fund. At June 30, 2003, estimates for claims liabilities, which include incurred but not reported claims, were \$9,591,000 based on a formula provided by Buck Consultants, a consulting actuarial firm, of which \$6,051,000 is estimated to be paid in fiscal year 2004.

In addition, at June 30, 2003, the Group Employee Medical and Dental Plan established a liability for the estimated dollar amount of future claim reimbursements for claims incurred in the month following the month of termination for members who continued to be covered by the State plan since July 31, 1998 through the current date. On August 1, 1998, the plan changed its effective coverage period for new members, to include the first month of employment with the State, and provided that coverage terminates on the last day of the month in which the member terminates his participation in the State plan. Prior to this change, new members were not eligible to participate in the health plan until the second month of their employment, after premiums had been collected through the payroll process, and coverage extended through the month subsequent to the month in which they terminated their membership. Members who are grandfathered into the coverage period that was recognized prior to August 1, 1998, retain the benefit of claim coverage through the last day

of the month following that month in which they terminate their membership without paying premiums for this coverage. Prior to fiscal year 2003, the State had not booked a liability for these estimated claims. Instead they were tracked as part of the unreserved fund balance. At June 30, 2003, a liability of \$1,896,000 was reported in the financial statements in recognition of the grandfathered claims; \$137,400 of which is estimated to be paid in fiscal year 2004.

A combined liability of \$11,487,000, for incurred but not reported claims and grandfathered claims, is reported in the accompanying financial statements. The current portion of this estimated liability is \$6,188,000 as of June 30, 2003.

**(2) Property & Casualty Insurance Plans** – This self-insurance plan provides coverage for general liability, automobile liability, automobile physical damage, foster care liability, and state-administered foreclosure 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 \$2.4 billion of state-owned buildings and contents. The State's property insurance includes separate earthquake and flood protection coverage, with deductibles of \$1 million for earthquake and \$500,000 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, 1993 through June 30, 2003, is the basis for estimating the liability for unpaid claims and is supported by historical loss data. The June 30, 2003, estimated claims liability of \$30,927,035 is reported in the accompanying financial statements.

**(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):

	<u>Group Employees Medical &amp; Dental</u>		<u>Prop. &amp; Casualty Insurance</u>	
	2003	2002	2003	2002
Amount of claims liabilities at the beginning of each fiscal year	\$ 9,164	\$ 7,181	\$29,848	\$25,234
Incurred claims:				
Provision for insured events of the current year	72,085	68,434	7,544	6,877
Increases (decreases) in provision for insured events of prior years	2,323	1,983	(602)	3,286
Total incurred claims	74,408	70,417	6,942	10,163
Payments:				
Claims attributable to insured events of the current year	(66,300)	(61,440)	(742)	(633)
Claims attributable to insured events of prior years	(5,785)	(6,994)	(5,121)	(4,916)
Total payments	(72,085)	(68,434)	(5,863)	(5,549)
Total claims liability at end of each fiscal year	\$ 11,487	\$ 9,164	\$30,927	\$29,848

**NOTE 9. COMMITMENTS**

end. These executory commitments are included in unrestricted net assets in the accompanying financial statements as follows (in thousands):

**A. Highway Construction**

At June 30, 2003, the Department of Transportation had contractual commitments of approximately \$217.4 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, 2003, the Department of Administration, Architecture & Engineering Division, had commitments of approximately \$8.1 million for capital projects construction. The primary government will fund \$6.1 million of these projects, with the remaining \$2.0 million coming from the state university system.

**C. 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-

<u>Primary Government</u>	<u>Amount</u>
<u>Enterprise funds</u>	
Historical Society Publications	\$ 5
Lottery	4
Subtotal-enterprise funds	\$ 9
<u>Internal service funds</u>	
DEQ Indirect Cost Pool	\$100
Info Tech Services Division	87
Building and Grounds	56
FWP Equipment	38
L&I Central Services	29
Admin Supply	28
FWP Warehouse Inventory	11
Employee Group Benefits	5
Payroll Processing	2
Commerce Central Services	1
Subtotal-internal service funds	\$357
Total-primary government	\$366
<u>Component units</u>	
Facility Finance Authority	\$ 22
Total-component units	\$ 22

**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, 2003, were as follows (in thousands):

Fiscal Year Ending June 30	Primary Government	Discretely Presented Component Units			
	Governmental Activities	State Comp Insurance (New Fund)	Montana State University	University of Montana	Total
2004	\$1,569	\$180	\$112	\$ 598	\$ 890
2005	814	180	29	426	635
2006	538	120	21	216	357
2007	294	23	10	179	212
2008	51	-	-	13	13
2009-2013	288	-	-	-	-
Total minimum pmts	3,554	503	172	1,432	2,107
Less: interest	(268)	(33)	(21)	(180)	(234)
Present value of minimum payments	<u>\$3,286</u>	<u>\$470</u>	<u>\$151</u>	<u>\$1,252</u>	<u>\$1,873</u>

**B. Operating Leases**

Primary government rental payments for operating leases in fiscal year 2003 totaled \$11,852,000. Future rental payments under operating leases are as follows (in thousands):

Fiscal Year Ending June 30	Primary Government	Discretely Presented Component Units
2004	\$10,583	\$ 656
2005	9,398	583
2006	8,115	433
2007	7,464	185
2008	7,129	23
2009-2013	24,444	-
2014-2018	9,595	-
2019-2023	2,215	-
Total future rental payments	<u>\$78,943</u>	<u>\$1,880</u>

**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 notes must be redeemed by the end of the fiscal year in which issued.

The State issued tax and revenue (TRANS) and bond anticipation notes (BANs) during fiscal year 2003. The proceeds of the tax anticipation notes were used to meet anticipated cash flow deficits during the fiscal year. The bond anticipation notes were issued to provide funds for loans to private water groups and associations for water projects until the related Department of Natural Resources and Conservation Series 2003A Special Revenue bonds were issued. Both the TRANS and the BANs were fully repaid by the end of the fiscal year. The following schedule summarizes the above activity for the year ended June 30, 2003 (in thousands):

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
TRANS	\$-	\$92,800	\$92,800	\$-
BANs	\$-	\$1,450	\$1,450	\$-

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 \$120 million as amended by the 2003 Legislature. Previously, INTERCAP bonds could not aggregate more than \$80 million through June 30, 2011 and then \$75 million thereafter. 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 repayments of principal and interest on loans made by the BOI to participating eligible governmental units, investment income under the indenture, and 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, 2003, were as follows (in thousands):

<u>Series</u>	<u>Amount Issued</u>	<u>Balance June 30, 2003</u>
1992	\$6,500	\$ 6,075
1994	7,500	6,975
1995	7,500	7,115
1997	10,000	9,740
1998	12,500	12,285
2000	15,000	15,000
2003	15,000	15,000
Total		<u>\$72,190</u>

The following schedule summarizes the activity relating to the demand bonds during the year ended June 30, 2003 (in thousands):

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Demand bonds	\$57,290	\$15,000	\$100	\$72,190

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, 2003, were as follows (in thousands):

Governmental Activities	Series	Amount Issued	Interest Range (%) (12)	Principal Payments		Balance June 30, 2003
				FY 2004	In Year of Maturity (7)	
<b>General obligation bonds</b>						
Water Development Program (1)	1989B	\$ 500	8.55	\$ 65	\$ 65 (2004)	\$ 65
Energy Conservation Program (2)	1993A	1,500	2.5-4.75	180	180 (2004)	180
Long-Range Bldg Program	1993B	3,185	2.5-4.25	310	310 (2004)	310
Renewable Resource Program (1)	1993C	750	3.5-5.65	95	95 (2004)	95
Wastewater Treatment Works						
Revolving Fund	1994B	2,200	4.2-6.1	90	180 (2016)	1,680
Long-Range Bldg Program	1994C	21,955	5.125-7.0	950	1,000 (2005)	1,950
Energy Conservation Program (2)	1994D	1,600	4.9-7.0	190	200 (2005)	390
Energy Conservation Program (2)	1996A	1,650	3.5-4.4	180	195 (2006)	560
Wastewater Treatment Works						
Revolving Fund	1996C	2,765	3.75-5.75	125	120 (2017)	2,165
Renewable Resource Program (1)	1997A	2,000	6.8-8.0	110	210 (2013)	1,545
Long-Range Bldg Program	1997B	12,640	4.5-5.0	790	595 (2018)	9,135
Wastewater Treatment Works						
Revolving Fund	1998A	3,510	3.75-5.15	135	260 (2019)	3,020
Long-Range Bldg Program	1998B	34,545	3.5-4.85	1,375	2,555 (2018)	28,355
Information Technology	1998C	41,390	4.5-5.0	3,455	4,075 (2008)	18,785
Long-Range Bldg Program Refunding	1998D	14,855	4.4-5.0	100	1,720 (2015)	14,265
Energy Conservation Program (2)	1998E	1,250	3.6-4.6	125	150 (2008)	680
Renewable Resource Program (1)	1999	1,035	6.0-6.5	50	105 (2015)	895
Long-Range Bldg Program	1999C	16,990	4.0-5.0	640	1,250 (2019)	14,425
Drinking Water Revolving Fund (10)	1998F	3,065	3.6-4.85	125	230 (2019)	2,720
Drinking Water Revolving Fund (10)	2000A	2,990	4.25-5.6	100	240 (2021)	2,805
Water Pollution Control Revolving Fund (10)	2000B	3,325	4.25-5.6	105	270 (2021)	3,125
Long-Range Bldg Program	2000C	17,195	5.0-5.55	545	1,320 (2020)	14,930
Information Technology	2000D	18,000	5.0-5.25	1,650	2,250 (2010)	13,550
Long-Range Bldg Program	2001B	11,430	4.1-5.75	390	830 (2021)	10,265
Information Technology	2001C	1,600	3.85-4.2	140	185 (2011)	1,285
Energy Conservation Program (2)	2001D	1,250	3.85-4.2	110	145 (2011)	1,000
Renewable Resource Program (1)	2001E	1,040	5.2-6.8	45	105 (2017)	995
Drinking Water Revolving Fund (10)	2001G	3,190	4.0-5.0	110	235 (2022)	3,095
Water Pollution Control Revolving Fund (10)	2001H	2,690	4.0-5.0	95	200 (2022)	2,610
Long-Range Bldg Program	2002B	10,475	3.35-4.7	365	730 (2023)	10,475
Hard Rock Mining Reclamation	2002C	2,500	3.5-4.7	65	200 (2023)	2,500
Long-Range Bldg Program Refunding	2002D	15,805	2.5-3.7	1,350	1,685 (2014)	15,805
Long-Range Bldg Program	2003A	9,730	2.375-4	-	655 (2024)	9,730
Energy Conservation Program (2)	2003B	1,250	2.0-3.0	-	145 (2014)	1,250
Renewable Resource Program Refunding (1)	2003C	1,970	1.45-5.25	-	90 (2019)	1,970
Water Pollution Control Revolving Fund (10)	2003D	2,730	2.0-3.75	-	225 (2019)	2,730
Drinking Water Revolving Fund (10)	2003E	1,675	2.0-3.75	-	140 (2019)	1,675
Long-Range Bldg Program Refunding	2003G	26,610	2.0-5.0	-	2,310 (2017)	26,610
<b>Total general obligation bonds</b>		<b>\$302,840</b>		<b>\$14,160</b>		<b>\$227,625</b>
<b>Special revenue bonds</b>						
Water Conservation (3)	-	\$ 50	5.0	\$ 2	\$ 1 (2012)	\$ 20
Dept of Transportation Refunding	1993	72,375	2.5-5.2	3,705	3,705 (2004)	3,705
Developmental Center Project (6)	1994	13,100	4.4-6.4	415	1,015 (2019)	10,665
Renewable Resource Program Refunding (4)	1996A	14,985	3.7-5.2	1,110	110 (2017)	8,170



Governmental Activities	Series	Amount Issued	Interest Range (%) (12)	Principal Payments		Balance June 30, 2003
				FY 2004	In Year of Maturity (7)	
State Hospital Project (6)	1997	25,915	4.0-5.05	770	1,820 (2022)	23,130
Renewable Resource Program (4)	1997A	1,205	6.0-7.3	40	110 (2018)	1,035
Renewable Resource Program (4)	1997B	2,660	3.75-5.375	100	210 (2018)	2,225
Renewable Resource Program (4)	2001A	420	3.65-5.59	15	30 (2021)	390
Renewable Resource Program (4)	2001B	1,750	5.2-7.1	50	150 (2021)	1,655
Renewable Resource Program Refunding (4)	2001C	12,155	2.55-4.3	1,685	790 (2013)	8,830
Broadwater Power Proj Refunding (4)	2001D	21,450	2.25-4.7	1,025	1,795 (2018)	20,505
Renewable Resource Program (4)	2001E	885	2.1-4.85	35	65 (2022)	860
Renewable Resource Program (4)	2001F	900	3.3-6.2	30	75 (2022)	880
Renewable Resource Program (4)	2003A	3,000	1.05-4.05	-	215 (2024)	3,000
<b>Total special revenue bonds</b>		<b>\$170,850</b>		<b>\$ 8,982</b>		<b>\$ 85,070</b>
<b>Notes payable (17)</b>						
Middle Creek Dam Project (5)		\$ 3,272	8.125	\$ 44	124 (2034)	\$ 2,930
Tongue River Dam Project (9)		11,300	-	290	290 (2038)	10,141
Dept of Justice INTERCAP Loan (8)		2,796	Variable	269	149 (2012)	2,420
Dept of Environmental Quality INTERCAP Loan (8)		2,212	Variable	214	58 (2013)	1,573
Dept of Corrections Resident Accounting System Loan (11)		320	5.73	67	71 (2005)	139
Office of the Commissioner of Higher Education INTERCAP Loan (8)		372	Variable	100	105 (2005)	206
Dept of Transportation (Motor Pool) INTERCAP Loan (8)		9,214	Variable	1,703	7 (2009)	3,538
Historical Society INTERCAP Loan (8)		200	Variable	73	75 (2005)	148
Dept of Natural Resources INTERCAP Loan (8)		243	Variable	29	37 (2009)	204
<b>Total notes payable</b>		<b>\$ 29,929</b>		<b>\$ 2,789</b>		<b>\$ 21,299</b>
Deferred amount on refunding						333,994
Unamortized discount						(4,594)
Unamortized premium						(182)
<b>Total governmental activities</b>		<b>\$503,619</b>		<b>\$25,931</b>		<b>\$330,808</b>

**Business-type Activities**

<b>Bonds/notes payable</b>						
State Lottery Note Payable		\$ 5,025	5.12	\$ 1,110	\$1,110 (2004)	\$ 1,110
<b>Economic Development Bonds (13)</b>						
Municipal Finance Consolidation Act Bonds (Irrigation Program) (14)	1998	4,976	6.60-7.75	520	130 (2014)	1,708
Municipal Finance Consolidation Act Bonds (School District Pooled Refunding Program) (15)	1991	6,234	4.75-6.5	287	294 (2005)	581
Conservation Reserve Enhancement Program (CRP Bonds) (16)		6,977	6-8	1,270	30 (2011)	6,977
<b>Subtotal economic dev bonds</b>		<b>18,187</b>		<b>2,077</b>		<b>9,266</b>
<b>Total business-type activities</b>		<b>\$ 23,212</b>		<b>\$ 3,187</b>		<b>\$ 10,376</b>

- (1) All Water Development Program Bonds and the 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.
- (2) Bonds issued for financing the design, construction, and installation of energy conservation projects at various state buildings.
- (3) Bonds sold to Farmers Home Administration.
- (4) Issued by the Department of Natural Resources and Conservation (DNRC) and backed by a pledge of coal severance taxes and project revenues.
- (5) U.S. Bureau of Reclamation loan to Montana Department of Natural Resources & Conservation. The outstanding balance includes \$236,731 of interest owed.
- (6) 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.

- (7) Year of maturity refers to fiscal year.
- (8) Montana Board of Investments loans to departments from the INTERCAP loan program.
- (9) Northern Cheyenne Tribe loan to the Montana Dept. of Natural Resources & Conservation (DNRC). 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.
- (10) 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.
- (11) Norwest loan to provide funds for the development of a Y2K-compliant resident accounting system.
- (12) The interest range is over the life of the bonds.
- (13) Economic Development & Municipal Finance Consolidation Act Bonds (EDB) – This program is directed by the nine-member Board of Investments, which is attached to the Department of Commerce for administrative purposes. This program assists Montana's small businesses and local governments in obtaining long-term, fixed rate financing through private Montana lending institutions.
- (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 not obligations of the State of Montana. However, 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 Reserve Account E in an amount to any deficiencies therein, on any payment date. The indenture does not permit the issuance of additional bonds.
- (15) These bonds were issued for the purpose of providing funds for the Board of Investments, State of Montana, to purchase the general obligation refunding bonds of participating Montana school districts. The School District Refunding Bonds, and the interest thereon, are payable from real property taxes levied within the school district. These bonds are limited obligations of the Board of Investments and are not a debt or liability of the State of Montana, and neither the faith and credit nor the taxing power of the State is pledged to the payment of principal of or interest on the bonds.
- (16) The Conservation Reserve Enhancement Program is funded by the Montana Trust Funds Bond Pool.
- (17) The INTERCAP loan balances may consist of several loans with varying maturities. The principal payment in the year of maturity refers to the total principal payments due on all loans in the latest year of maturity.

**D. Debt Service Requirements**

Primary government debt service requirements at June 30, 2003, 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
2004	\$ 14,160	\$ 9,827	\$ 8,982	\$ 3,831	\$ 2,789	\$ 273
2005	17,080	9,614	5,632	3,531	2,076	204
2006	17,680	8,844	5,392	3,315	1,529	152
2007	17,850	8,051	4,697	3,105	1,152	118
2008	18,325	7,230	4,063	2,914	836	94
2009-2013	67,370	25,859	23,314	11,428	3,261	282
2014-2018	57,220	10,469	23,020	5,947	1,832	165
2019-2023	17,285	1,599	9,755	1,183	1,928	133
2024-2028	655	13	215	4	2,041	94
2029-2033	-	-	-	-	2,185	44
2034-2038	-	-	-	-	1,670	2
<b>Total</b>	<b>\$227,625</b>	<b>\$81,506</b>	<b>\$85,070</b>	<b>\$35,258</b>	<b>\$21,299</b>	<b>\$1,561</b>

Governmental activities notes payable includes INTERCAP loans with an interest rate that varies based on the underlying bond rate of the Montana Board of Investments Municipal Finance Consolidation Act Bonds (INTERCAP Revolving Program) and is adjusted annually.

**Business-type Activities**

Year Ended June 30	Economic Development Bonds		State Lottery	
	Principal	Interest	Principal	Interest
2004	\$2,077	\$ 587	\$1,110	\$36
2005	1,785	549	-	-
2006	1,354	431	-	-
2007	1,326	321	-	-
2008	1,415	214	-	-
2009-2013	1,178	231	-	-
2014	131	5	-	-
<b>Total</b>	<b>\$9,266</b>	<b>\$2,338</b>	<b>\$1,110</b>	<b>\$36</b>

Debt service requirements of discretely presented component units at June 30, 2003, were as follows (in thousands):

Year Ended June 30	Housing Authority		Montana State University		University of Montana	
	Principal	Interest	Principal	Interest	Principal	Interest
2004	\$ 9,169	\$ 34,834	\$ 5,072	\$ 4,154	\$ 4,176	\$ 6,884
2005	9,662	34,220	5,286	3,927	4,440	6,709
2006	10,041	33,722	5,324	3,671	4,362	6,518
2007	10,875	33,225	4,141	3,434	4,497	6,328
2008	11,558	32,676	3,057	4,475	4,609	6,128
2009-2013	70,113	153,173	14,995	21,497	24,503	27,382
2014-2018	90,147	135,086	23,880	10,678	30,429	21,037
2019-2023	113,355	104,544	24,745	3,721	39,430	11,892
2024-2028	144,635	67,912	3,045	263	14,005	2,441
2029-2033	122,965	25,808	-	-	5,000	719
2034-2038	25,065	4,857	-	-	-	-
2039-2043	7,435	923	-	-	-	-
<b>Total</b>	<b>\$625,020</b>	<b>\$660,980</b>	<b>\$89,545</b>	<b>\$55,820</b>	<b>\$135,451</b>	<b>\$96,038</b>

Montana State University and the University of Montana bonds/notes payable includes INTERCAP loans with an interest rate that varies based on the underlying bond rate of the Montana Board of Investments Municipal Finance Consolidation Act Bonds (INTERCAP Revolving Program) and is adjusted annually.

**E. Summary of Changes in Long-term Liabilities Payable**

Primary government long-term liability activity for the year ended June 30, 2003, was as follows (in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year	Amounts Due In More Than One Year
<b>Governmental activities</b>						
Bonds/notes payable						
General obligation bonds	\$ 214,135	\$ 72,745	\$ 59,255	\$ 227,625	\$ 14,160	\$ 213,465
Special revenue bonds	100,337	3,000	18,267	85,070	8,982	76,088
Notes payable	23,203	1,207	3,111	21,299	2,789	18,510
	337,675	76,952	80,633	333,994	25,931	308,063
Deferred amount on refunding	(987)	(3,981)	(374)	(4,594)	-	(4,594)
Unamortized discount	(130)	(65)	(13)	(182)	-	(182)
Unamortized premium	-	1,720	130	1,590	-	1,590
Total bonds/notes payable	336,558	74,626	80,376	330,808	25,931	304,877
Other liabilities						
Lease/installment purchase payable (1)	4,532	1,140	2,386	3,286	1,431	1,855
Compensated absences payable (2)	66,456	42,533	37,856	71,133	37,843	33,290
Early retirement benefits payable (2)	336	95	115	316	58	258
Arbitrage rebate tax payable (2)	1,451	44	1,348	147	62	85
Estimated insurance claims (2)	39,012	81,349	77,948	42,413	13,472	28,941
Total other liabilities	111,787	125,161	119,653	117,295	52,866	64,429
Total governmental activities Long-term liabilities	\$ 448,345	\$199,787	\$200,029	\$ 448,103	\$ 78,797	\$ 369,306
<b>Business-type activities</b>						
Bonds/notes payable						
Economic Development Bonds	\$ 11,749	\$ 477	\$ 2,960	\$ 9,266	\$ 2,077	\$ 7,189
State Lottery	2,165	-	1,055	1,110	1,110	-
Total bonds/notes payable	13,914	477	4,015	10,376	3,187	7,189
Other liabilities						
Compensated absences payable	978	619	500	1,097	503	594
Arbitrage rebate tax payable	172	70	72	170	73	97
Estimated insurance claims	5,125	36,622	35,642	6,105	3,975	2,130
Total other liabilities	6,275	37,311	36,214	7,372	4,551	2,821
Total business-type activities Long-term liabilities	\$ 20,189	\$ 37,788	\$ 40,229	\$ 17,748	\$7,738	\$ 10,010

- (1) Governmental activities lease/installment purchase payable beginning balance has been restated to reflect leases that existed prior to fiscal year 2003, that were not previously recorded.
- (2) 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.

Long-term liability activity of discretely presented component units for the year ended June 30, 2003, was as follows (in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year	Amounts Due In More Than One Year
<b>Discretely presented component units</b>						
Bonds/notes payable						
Housing Authority	\$ 689,923	\$144,967	\$210,801	\$ 624,089	\$ 9,169	\$ 614,920
Montana State University	96,592	2,146	5,422	93,316	5,072	88,244
University of Montana	116,988	19,955	3,466	133,477	4,176	129,301
Total bonds/notes payable	903,503	167,068	219,689	850,882	18,417	832,465
Other liabilities						
Lease/installment purch pay (1)	1,773	1,063	963	1,873	763	1,110
Compensated absences pay	39,328	19,922	17,394	41,856	17,939	23,917
Arbitrage rebate tax payable	1,503	478	844	1,137	463	674
Estimated insurance claims	437,301	151,964	94,965	494,300	97,783	396,517
Due to federal government	28,684	494	21	29,157	-	29,157
Total other liabilities	508,589	173,921	114,187	568,323	116,948	451,375
Total discretely presented component units						
Long-term liabilities	\$1,412,092	\$340,989	\$333,876	\$1,419,205	\$135,365	\$1,283,840

(1) Discretely presented component unit lease/installment purchase payable beginning balance has been restated to reflect duplicate leases that were incorrectly recorded in fiscal year 2002.

**F. Refunded and Early Retired Bonds**

**Primary Government**

Pre-payments and Early Retirements

During fiscal year 2003, the Department of Natural Resources and Conservation (DNRC) used current available resources to make the following pre-payments on general obligation bonds: \$35,000 of Series 1989B Water Development Program, \$70,000 of Series 1991A Water Development Program, \$140,000 of Series 1996B Renewable Resource Development and \$110,000 of Series 1996E Renewable Resource Development (Series 1991A, 1996B and 1996E were also refunded in the fiscal year – see below). DNRC also used current available resources to redeem Series 1994E Renewable Resource Program general obligation bonds in the amount of \$200,000.

During fiscal year 2003, DNRC used current available resources to make the following pre-payments on special revenue bonds: \$150,000 of Series 2001B Renewable Resource Program and \$945,000 of Series 2001D Renewable Resource Program.

Advance Refundings

On October 15, 2002, the Montana Department of Administration (DofA) issued \$15,805,000 of Series 2002D General Obligation Long-Range Building Program Refunding bonds to advance refund \$14,920,000 of Series 1994A General Obligation Long-Range Building Program bonds. The net proceeds of \$15,647,431 (including an original issue premium of \$50,871 and after payment of \$208,439 in underwriting

fees and other issuance costs) were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust, with an escrow agent, to provide for future debt service payments. As a result, the Series 1994A General Obligation Long-Range Building Program bonds are considered to be defeased, and the liability for those bonds has been removed from the financial statements. The defeasance resulted in a reduction of debt service to maturity of \$717,498 and an economic gain of \$613,645.

On June 15, 2003, DNRC issued \$1,970,000 of 2003C General Obligation Renewable Resource Program Refunding bonds. Proceeds from the 2003C issuance, in the principal amount of \$915,000 was used to advance refund \$245,000 of Series 1991A General Obligation Water Development bonds, \$300,000 of Series 1996B General Obligation Renewable Resource Program bonds and \$370,000 of 1996E General Obligation Renewable Resource Program bonds. The proceeds of \$915,000 plus an additional \$104,852 of certain other available funds were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust, with an escrow agent, to provide for future debt service payments. As a result, the Series 1991A, 1996B and 1996E bonds are considered to be defeased, and the liability for those bonds has been removed from the financial statements. The defeasance resulted in a reduction of debt service to maturity of \$67,036 and an economic gain of \$64,406.

On June 15, 2003, DofA issued \$26,610,000 of Series 2003G General Obligation Long-Range Building

Program Refunding bonds to advance refund \$3,050,000 of Series 1992 General Obligation Refunding Long-Range Building Program bonds and \$23,930,000 of Series 1996D General Obligation Long-Range Building Program bonds. The net proceeds of \$27,845,351 (including a reoffering premium of \$1,562,426 and after payment of \$327,074 in underwriting fees and other issuance costs) plus an additional \$2,388,098 of certain other available funds were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust, with an escrow agent, to provide for future debt service payments. As a result, the Series 1992 and 1996D bonds are considered to be defeased, and the liability for those bonds has been removed from the financial statements. The defeasance resulted in a reduction of debt service to maturity of \$1,533,677 and an economic gain of \$1,296,821.

Deferred loss on primary government refundings at June 30, 2003, was \$4,594,000.

#### Prior-year Defeasance of Debt

In prior years, 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, 2003, \$51,120,000 of bonds outstanding are considered defeased.

#### **Discretely Presented Component Units**

##### Current Refundings

**Housing Authority** – On April 30, 2003, Series 2003A bonds were issued in the amount of \$52,520,000, the proceeds of which were used to refund Series 1992RA bonds on June 1, 2003. The refunding resulted in an increase of debt service to maturity of \$18,358,000 and an economic gain of \$2,429,000. The refunding issue is at a substantially lower interest rate, but a negative cash flow resulted because the debt service payments of the refunding debt were extended for 10 years beyond the debt service payments of the refunded debt.

Deferred loss on Housing Authority refundings at June 30, 2003, was \$1,461,000.

##### Prior-year Defeasance of Debt

In prior years, Montana State University and the University of Montana 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, 2003, \$5,640,000 and \$53,429,655 of bonds outstanding are 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.

**(1) Montana Board of Investments (BOI)** – The BOI is authorized to issue industrial revenue bonds to finance projects for qualifying borrowers. Assets and revenues of the borrower are pledged to repay the bonds. The industrial revenue bonds issued by BOI do not constitute a debt, liability, obligation, or pledge of faith and credit of the State of Montana. At June 30, 2003, industrial revenue bonds outstanding aggregated \$214.6 million.

**(2) Beginning Farm Loan Program** – The Montana Department of Agriculture is authorized to request issuance of bonds by the Montana Board of Investments 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, 2003, was as follows: Hershberger Project – issued \$129,412; outstanding \$129,412.

**(3) Facility Finance Authority (FFA) - Component Unit** – 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 to be made by health institutions 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, 2003, revenue bonds outstanding aggregated \$604 million, and notes payable outstanding aggregated \$18 million.

The Board of Investments (BOI) and the FFA have entered into a capital reserve account agreement for certain bond issues. In accordance with the agreement, the BOI irrevocably committed to lend the FFA funds sufficient to insure timely payments of principal and interest on the bonds. If necessary, the loans will be made by the BOI from the Coal Severance Tax Permanent Trust Fund, a Trust Fund Bond Pool participant, or any other legally available funds administered by the BOI.

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 then 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 are expected to be repaid within one year from the date of the financial statements.

Balances due from/to other funds at June 30, 2003, 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	Land Grant Permanent
<b>Due From Other Funds</b>						
Coal Severance Tax Permanent	\$ -	\$-	\$ -	\$ -	\$ -	\$ -
Federal Special Revenue	-	-	-	29	1	-
General Fund	6,153	1	1,152	-	263	-
Internal Service Funds	34	6	1,358	2,046	366	-
Land Grant Permanent	-	-	-	-	-	-
Nonmajor Enterprise Funds	-	-	24	122	53	-
Nonmajor Governmental Funds	-	-	75	252	208	-
State Special Revenue	-	-	826	9,128	19	10,654
Unemployment Insurance	-	-	3	-	-	-
<b>Total</b>	<b>\$6,187</b>	<b>\$7</b>	<b>\$3,438</b>	<b>\$11,577</b>	<b>\$910</b>	<b>\$10,654</b>

	Nonmajor Enterprise Funds	Nonmajor Governmental Funds	State Special Revenue	Unemployment Insurance	Total
<b>Due From Other Funds (continued)</b>					
Coal Severance Tax Permanent	\$ -	\$ 1	\$ -	\$ -	\$ 1
Federal Special Revenue	-	34	799	633	1,496
General Fund	8,424	19	2,072	1	18,085
Internal Service Funds	124	81	2,793	10	6,818
Land Grant Permanent	-	28	203	-	231
Nonmajor Enterprise Funds	1	-	29	-	229
Nonmajor Governmental Funds	-	303	17	-	855
State Special Revenue	109	2,762	-	-	23,498
Unemployment Insurance	-	-	-	-	3
<b>Total</b>	<b>\$8,658</b>	<b>\$3,228</b>	<b>\$5,913</b>	<b>\$644</b>	<b>\$51,216</b>

**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, 2003, consisted of the following (in thousands):

	<b>Interfund Loans Payable</b>					Total
	Federal Special Revenue	Internal Service Funds	Nonmajor Enterprise Funds	Nonmajor Governmental Funds	State Special Revenue	
<b>Interfund Loans Receivable</b>						
Federal Special Revenue	\$ -	\$ -	\$ -	\$111	\$ 80	\$ 191
General Fund	22,782	2,500	-	-	20,086	45,368
Internal Service Funds	100	-	250	-	184	534
Nonmajor Enterprise Funds	105	-	-	-	-	105
State Special Revenue	37,337	1,532	-	255	-	39,124
<b>Total</b>	<b>\$60,324</b>	<b>\$4,032</b>	<b>\$250</b>	<b>\$366</b>	<b>\$20,350</b>	<b>\$85,322</b>

**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 at June 30, 2003, consisted of the following (in thousands):

	<b>Advances From Other Funds</b>				Total
	Federal Special Revenue	Internal Service Funds	Nonmajor Governmental Funds	State Special Revenue	
<b>Advances To Other Funds</b>					
Coal Severance Tax Permanent	\$ -	\$ -	\$ -	\$48,429	\$48,429
Federal Special Revenue	-	300	-	-	300
General Fund	100	-	-	-	100
Nonmajor Enterprise Funds	75	255	-	-	330
Nonmajor Governmental Funds	-	-	-	3,188	3,188
State Special Revenue	76	-	10,496	-	10,572
<b>Total</b>	<b>\$251</b>	<b>\$555</b>	<b>\$10,496</b>	<b>\$51,617</b>	<b>\$62,919</b>



**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, 2003, consisted of the following (in thousands):

	<b>Transfers In</b>					
	Coal Severance Tax Permanent	Federal Special Revenue	General Fund	Internal Service Funds	Nonmajor Enterprise Funds	Nonmajor Governmental Funds
<b>Transfers Out</b>						
Coal Severance Tax Permanent	\$ -	\$ -	\$36,298	\$ -	\$ -	\$ 780
Economic Development Bonds	-	-	-	297	-	-
Federal Special Revenue	-	-	692	-	-	5,596
General Fund	-	-	-	279	52	19,348
Internal Service Funds	-	8	400	-	-	590
Land Grant Permanent	-	-	-	-	-	809
Nonmajor Enterprise Funds	-	-	24,251	95	-	-
Nonmajor Governmental Funds	-	164	-	933	-	3,440
State Special Revenue	3,307	153	1,744	475	13	10,757
Unemployment Insurance	-	4,315	-	-	-	-
<b>Total</b>	<b>\$3,307</b>	<b>\$4,640</b>	<b>\$63,385</b>	<b>\$2,079</b>	<b>\$65</b>	<b>\$41,320</b>

	State Special Revenue	Total
<b>Transfers Out (continued)</b>		
Coal Severance Tax Permanent	\$ 4,500	\$ 41,578
Economic Development Bonds	-	297
Federal Special Revenue	23,036	29,324
General Fund	14,822	34,501
Internal Service Funds	1	999
Land Grant Permanent	54,003	54,812
Nonmajor Enterprise Funds	3,472	27,818
Nonmajor Governmental Funds	19,404	23,941
State Special Revenue	-	16,449
Unemployment Insurance	-	4,315
<b>Total</b>	<b>\$119,238</b>	<b>\$234,034</b>

**NOTE 13. FUND DEFICITS**

The following funds have a deficit fund balance/net assets as found on the combining operating statements for June 30, 2003, (in thousands):

<b>Fund Type/Fund</b>	<b>Deficit</b>
<b><u>Capital projects funds</u></b>	
Capital Land Grant	\$ (74)
<b><u>Enterprise funds</u></b>	
Subsequent Injury	\$ (410)
<b><u>Internal service funds</u></b>	
Administration Insurance	\$(33,651)
OPI – Central Services	\$ (17)
Justice – Legal Services	\$ (82)
<b><u>Pension (and other employee benefit) trust funds</u></b>	
Voluntary Employee Benefit Association	\$ (153)

The net assets deficit in the Administration Insurance and Subsequent Injury funds are due to recording the expense for estimated claims including claims incurred, but not reported. Refer to Note 8 for further discussion of these funds.

**NOTE 14. RESERVED FUND BALANCES**

Coal Tax Trust Permanent Fund – The reserve for trust principal is comprised of the following: Permanent Coal Tax Trust \$552,415 and the Treasure State Endowment Fund \$126,536 (in thousands).

maintenance costs, utilities, and other shared operating expenses. The total amount of these expenses for fiscal year 2003 amounted to \$542,947. SAF also pays OCHE reimbursement for services such as telephones, postage, and computer services. During fiscal year 2003, SAF paid OCHE a total of \$214,535.

**NOTE 15. RELATED PARTY TRANSACTIONS**

The Montana Board of 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. The Board of Regents and MHESAC have four common board members. Approximately 59.31% of the Regents' outstanding loan volume, or \$473,311,712, is held by MHESAC. During fiscal year 2000, MHESAC undertook a reorganization under which its operating staff and assets were transferred to the Student Assistance Foundation of Montana (SAF), and MHESAC entered into agreements with SAF to provide management and loan servicing to MHESAC. The Board of Regents and SAF have four common board members. Lewis & Clark County owns the building that houses the staff of the Board of Regents and the Office of the Commissioner of Higher Education (OCHE). Upon satisfaction of the financing obligations, SAF has the option to purchase the building. OCHE paid SAF during fiscal year 2003 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

There is a foundation affiliated with each university and college unit that solicits contributions and manages those funds for the benefit of that unit. Although each foundation is a separate legal entity, each unit exercises significant influence over its affiliated foundation. The units generally provide the foundations with office space, some staff, and related office expenses for an annually contracted fee. The units paid their foundations approximately \$1,665,189 in fiscal year 2003. In return the universities received from their foundations approximately \$15,435,726 during fiscal year 2003 for scholarships and academic/institutional support. In addition to support from their affiliated foundations, the University of Montana-Missoula, University of Montana-Western, Montana State University-Billings, and Montana State University-Bozeman received a total of \$4,128,978 from their related athletic associations/booster organizations and affiliated museums and public broadcasting radio stations.

The FWP Foundation is affiliated with the Department of Fish, Wildlife & Parks. Its purpose is to provide private support for the efforts of the department and to take a leading role in insuring the protection of Montana's natural, cultural, and recreational resources for future generations. In fiscal year 2003, the department provided \$71,500 in support of the

Foundation, and the Foundation provided \$13,000 to the department.

A staff member in the Department of Administration, Personnel Division, serves as 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.

The State of Montana is involved in a lawsuit with the potential for substantial recovery of monetary relief against private parties. State of Montana v. Atlantic Richfield Co., No CV-83-317-H-PHG(D.Mont.), is a case where natural resource damage claims have been asserted under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, with respect to environmental injury to Clark Fork River Basin. The State and Atlantic Richfield settled a portion of the case for \$215 million, but unresolved is a claim by the State for \$180 million. Atlantic Richfield filed a counterclaim against the State, the amount of which is unspecified and therefore could reduce or exceed the State's remaining claim. The State believes it has meritorious defenses to the counterclaim. Any recovery in this litigation must be used under federal and state law to further reclamation and recovery efforts or to offset attorney fees and assessment costs incurred by the State.

In Travis D., et al. v. Eastmont Human Services Center, et al., filed in the United States District Court, District of Montana, Helena Division, Civil Action No. CV 96-63-H-CCL, plaintiffs allege that the State of Montana, in its operation of the Eastmont Human Services Center and the Montana Development Center, is not placing residents in the "least restrictive environment." In addition, plaintiffs' second amended complaint, dated November 2, 2001, expanded their claims to demand services for those Medicaid eligible recipients who are "at risk" of being institutionalized or on a "waiting list" for services but cannot be served due to limited funding

provided by the Montana legislature for the "home and community services program" for the developmentally disabled. Their claims are based upon alleged violations of the Americans with Disabilities Act, Title XIX of the Social Security Act (Medicaid), and a constitutional equal protection and due process. The case has been certified by the Court as a class action but limited to a more narrow group of individuals than requested by the plaintiffs. The class, by Court certification, includes those individuals who are patients at Eastmont and MDC or who have been committed to those facilities since 1996. Portions of the case have been appealed to the Ninth Circuit Federal Court of Appeals. A trial on the remaining issues is scheduled for September 2004. The amount of loss in monetary terms (based on the amended complaint) is estimated at \$7 million dollars, all of which is General Fund.

In Swingley, et al. v. Montana Highway Patrol, filed in Lewis and Clark County, Highway Patrol officers brought an administrative wage claim seeking payment for overtime hours. In this case, the court held that there was a waiver of sovereign immunity and, therefore, the Fair Labor Standards Act (FLSA) applies. If the class is defined based on the FLSA statute of limitations, that class includes in excess of 200 officers and seeks overtime compensation for all lunch hours for a period of 3 ½ years, and seeks to have overtime and retirement contributions and benefits recalculated based on the contention that subsistence pay which was to cover meals, travel, uniform maintenance and a home telephone for each officer should have been included in the officers' base pay. Depending upon the size of the class as defined by the court, the State's potential exposure is \$9 million to \$20 million.

### B. Federal Contingencies

Federal Financial Assistance – The State receives federal financial assistance for specified purposes, which is subject to review and audit in accordance with the Single Audit Act Amendments of 1996. Any disallowances resulting from these audits would become the liability of the State. There are no disallowances reported as of June 30, 2003.

USDA Commodities – In fiscal year 2003, the State distributed \$7,483,780 in commodities. The value of the commodities stored in the State's warehouses was \$2,579,050 at June 30, 2003, for which the State is liable in the event of loss.

### C. Miscellaneous Contingencies

Commitment Fees – The Board of Investments (BOI) and the Facility Finance Authority (FFA) have entered into a capital reserve account agreement for certain

bond issues. In accordance with the agreement, the BOI irrevocably committed to lend the FFA funds sufficient to insure timely payments of principal and interest on the bonds. If necessary, the loans will be made by the BOI from the Coal Severance Tax Permanent Trust Fund. The total amount of these bonds outstanding as of June 30, 2003, was \$36,118,317.

The BOI has issued Municipal Finance Consolidation bonds backed by commitments from the Coal Severance Tax Permanent Trust Fund. The total amount of these bonds outstanding as of June 30, 2003, was \$74,478,374.

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, 2003, the following assessments (by fund type) were outstanding (in thousands):

<b>Taxes</b>	<b>General</b>	<b>State Special Revenue</b>	<b>Permanent Trust</b>	<b>Debt Service</b>	<b>Capital Projects</b>
Coal severance	\$ 2,604	\$474	\$3,941	\$75	\$788
Oil & gas	1,676	-	-	-	-
Corporation tax	20,857	-	-	-	-
<b>Total</b>	<b>\$25,137</b>	<b>\$474</b>	<b>\$3,941</b>	<b>\$75</b>	<b>\$788</b>

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, 2003. The corporations have appealed the decision. As of June 30, 2003, these include \$5,535,000 of General Fund corporation tax refunds.

On October 28, 2003, the State of Montana issued \$8.725 million of general obligation refunding bonds, Series 2003H.

On October 30, 2003, the State of Montana issued \$73.4 million in tax and revenue anticipation notes.

Certain companies have protested property taxes that are not reported on the State's financial statements as of June 30, 2003. As of June 30, 2003, these include \$6,400,000 of General Fund property taxes.

On November 6, 2003, the Montana Board of Housing issued \$40.5 million in bonds under the Single Family Program bonds, Series 2003C.

On December 1, 2003, \$53.14 million of Montana Board of Housing, Single Family I Indenture bonds were redeemed with prepayments on mortgages.

**NOTE 17. SUBSEQUENT EVENTS**

**Bond Issues**

On August 14, 2003, the Montana Board of Housing issued \$70.7 million in bonds under the Single Family II Indenture. \$20 million of the proceeds were used for a replacement refunding of a portion of the 1995 B-1 bonds on September 1, 2003. In addition, \$16.695 million of Single Family II Indenture bonds were redeemed with prepayments on mortgages on October 1, 2003.

On December 1, 2003, \$12.716 million of Montana Board of Housing, Single Family II Indenture bonds were redeemed with prepayments on mortgages.

On October 15, 2003, Montana State University issued \$18.76 million in Municipal Auction Rate Securities as Series 2003G Revenue bonds. Of this total, \$16.745 million was used for a current refunding of the Series 1993-A bonds, and \$2.015 million was used for an advance refunding of the Series 1994C bonds.