

**State of Montana**  
**COMPREHENSIVE ANNUAL FINANCIAL REPORT**  
For the Fiscal Year Ended June 30, 2006

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**State of Montana**  
**COMPREHENSIVE ANNUAL FINANCIAL REPORT**  
For the Fiscal Year Ended June 30, 2006

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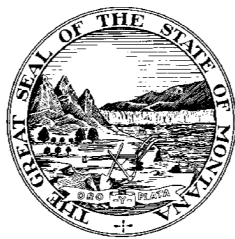
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# INTRODUCTORY SECTION



**DEPARTMENT OF ADMINISTRATION  
DIRECTOR'S OFFICE**



BRIAN SCHWEITZER, GOVERNOR

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**STATE OF MONTANA**

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December 21, 2006

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

In accordance with Title 17, Chapter 2, Part 110, Montana Code Annotated (MCA), I am pleased to submit the Comprehensive Annual Financial Report (CAFR) of the State of Montana for the fiscal year ended June 30, 2006. Responsibility for the accuracy of the data presented and the completeness and fairness of the presentation rests with the Department of Administration. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds of the State of Montana. All disclosures necessary to enable the reader to gain an understanding of the State's financial activities are included.

**DESCRIPTION OF THE CAFR**

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

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

This report includes all funds of those entities that comprise the State of Montana (the primary government) and its component units. The component units are entities that are legally separate from the State, but for which the State is financially accountable, or whose relationship with the State is such that exclusion would cause the State's financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body; and (1) the State is able to impose its will on that organization; or (2) there is the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the State. The following component units are included in the State's financial reporting entity: Housing Authority, Facility Finance Authority, State Compensation Insurance Fund (Old and New), Montana Surplus Lines, Montana State University, University of Montana, Public Employees Retirement Board, and Teachers Retirement System. These component units are discretely presented in the State's financial statements.

**PROFILE OF THE GOVERNMENT**

Montana became the 41st state when it was admitted to the Union in 1889, 25 years after the attainment of territorial status. With an area of 145,552 square miles, Montana is the nation's fourth largest state. With an estimated current population of 927,000, it is also one of the nation's most sparsely populated states. It is a vast land: a land including rolling plains, the Northern Rocky Mountains, two national parks, wheat farms and cattle ranches, tribal lands, and extensive natural resources.

In 1972, a constitutional convention convened, rewriting the State's constitution and establishing the current governmental structure. As shown in the organizational chart on page 13, state government is divided into three separate branches: legislative, executive, and judicial. Montana's Legislature consists of 50 senators and 100 representatives elected from single-member districts. The Legislature meets in regular biennial sessions for 90 days in odd-numbered years. Montana is governed by its constitution, and its laws are administered by its executive branch officers and various

boards and commissions. State government services provided to citizens include building and maintaining roads; providing public safety, health, and environmental protection services to protect the general welfare of the State's citizens; helping adults, children, and families through difficult times such as abuse, divorce, illness, death, and unemployment; fostering an attractive business climate to encourage economic growth; and protecting public lands and natural resources for conservation and recreational activities. The State also provides significant financial support to its higher education institutions, local governments, and school districts to help those entities meet the specific needs of their constituents.

## **ECONOMIC CONDITION AND OUTLOOK**

Montana's economy continues to grow at a high rate. The current estimated growth rate for Montana's economy in calendar year 2006 is estimated at over 4% and this trend is expected to continue through 2007. Montana's economic base remains concentrated in agriculture, mining, wood products and other manufacturing, nonresident travel, and government. This continued high growth rate is reflected in a strong State financial position at the end of the fiscal year and the related second quarter 2006 income increases in all sectors of Montana's economy. Montana's income tax revenues increased primarily as a result of this internal income growth and external factors such as trends in the stock market and the continued low level of U.S. interest rates. Montana corporate income tax revenues also increased due to increased overall profits of intrastate and interstate corporations. For a more in-depth analysis of the impact of this growth on the State's financial position, the reader should refer to Management's Discussion and Analysis and the financial statements contained in this document.

Montana's wheat yields were down in 2006, with winter wheat yields falling to 82.6 million bushels, 20% lower than the 2005 level. Spring and durum wheat yields are expected to reach 63.8 and 6.7 million bushels, respectively. This represents a decrease in spring and durum wheat of 22% and 59%, respectively. Montana's wheat production is projected to reach 153.1 million bushels, well below the State's 2005 production level of 192.5 million bushels. Barley production fell about 21% to an estimated 31 million bushels. The decrease in winter wheat production was primarily due to the seeding of fewer acres. The decreases in spring and durum wheat and barley are primarily due to the impacts of a very hot, dry summer. At this time, wheat prices should remain high in the U.S. due to lower overall production in the U.S. and Australia.

With an estimated 2.4 million head, Montana ranked twelfth in the U.S. cattle and calf industry. Montana's 2005 receipts from cattle sales exceeded \$1.1 billion.

As of the end of calendar year 2005, Montana's manufacturing sector improved slightly for a second year. Employment in this industry increased, with over 25,000 workers employed at the end of 2005, as compared to 24,000 workers at the end of 2004. Employee earnings in the manufacturing industry increased to over \$1.1 billion in 2005. The manufacturing sector continued to produce about \$5 billion in output and account for 20% of Montana's economic base. Production, sales and earnings were up in 2005, reflecting the strong U.S. economy. Factors limiting growth in Montana's manufacturing industry included high energy prices; labor availability; raw material shortages, especially in the timber, steel, and petroleum based products areas; and freight availability and prices.

Prices for lumber and other wood products decreased slightly at the end of 2005. This price decrease continued during 2006. This price decrease, coupled with the unavailability of raw materials, has led to a continuing decline in production. Limited timber availability was a primary cause of the Owens and Hurst sawmill closure in Eureka in 2005. Estimated total sales value of the State's primary wood and paper products in 2005 was \$1.17 billion, down about \$300 million from 2004. At about 9,700 the total wood products industry employment for 2005 was slightly lower than the actual 2004 level of 9,800 workers. Montana's estimated lumber production remained stable at about 1 billion board feet in 2005. Montana's timber production decreased during the first half of 2006. The June 2006 production level of 491 million board feet represents a 25 million board feet decrease over the same period in 2005.

Nonresident travel to Montana in 2005 increased an estimated 5% to over 10 million visitors. The visitor numbers for Glacier and Yellowstone national parks were mixed. While Yellowstone Park posted a 1% decrease in visitors, and Glacier Park saw a 5% decrease in the number of drivers, the visitations to the attractions within these parks was virtually unchanged. Motel occupancy posted a slight increase of 3.6% from the 2004 levels. Current estimates indicate that the travel industry will increase by approximately 2% in 2006. Nonresident travelers contribute to the tax base by paying the lodging tax, excise taxes such as those on gasoline, and indirectly, by supporting employment in industries that pay corporate taxes and whose workers pay income, property, and other taxes. Estimated travel expenditures in Montana totaled \$2 billion in 2005, which is a 2% increase from the 2004 level. The direct economic impact of

nonresident travel is estimated at \$2.5 billion, down slightly from 2005. Combined with the indirect and induced economic benefits, the economic benefit of nonresident travel on Montana should remain at approximately \$3.6 billion.

An estimated 364 million barrels of proven oil reserves exist under Montana's land. Due to the continued high crude oil and natural gas prices, the State has seen a continuation of the production and exploration activity that began in 2004. This continues to translate into a positive economic impact for the State as a whole and a much needed economic benefit for eastern areas of the State. This high level of oil and natural gas production and exploration activity continues to offset some of the negative impacts that related price increases have on the State's economy. With the oil price increase appearing to be demand rather than supply driven, it appears the additional production and exploration activity may be of a long-term nature.

Historically, metals mining has been a significant part of Montana's economy. While there is no published data on proven reserves for metals mining, Montana has produced copper, molybdenum, lead, zinc, palladium, gold, silver, nickel, chromate, and other metals. The state currently has five active metals mines producing primarily palladium, platinum, copper, molybdenum, gold, silver, lead, and zinc. These active mines employ over 900 employees. With the continued high metals prices driven by world-wide demand, potential exists for the development of additional metals mines in Montana. Regulatory and siting issues, in addition to the high cost of the fuel and power required to extract these metals, will impact the potential future development in metals mining within the State.

Montana's total coal reserves were estimated at 119,280 million short tons with recoverable reserves of 74,989 million short tons. This represents 24% of the total, and 28% of the recoverable, reserves in the U.S. During 2005 Montana's coal production grew slightly to 40,354 thousand short tons. The continued high cost of oil and natural gas has led to an agreement to develop one of the nation's first coal-to-liquids plants in Montana. Additionally, siting and permitting is in process for construction of the first new major power transmission line in Montana since the 1970s. Both of these actions represent a move toward the development of value-added processing of coal within the State, in addition to the State's traditional coal mining.

## **MAJOR INITIATIVES**

In December of 2005, a special legislative session was held to meet the court order to provide constitutionally required school funding. The session resulted in an additional \$37 million in ongoing funding to K-12 schools beginning in fiscal year 2007. In addition, one-time appropriations for a study of school facilities, current faculty and rapidly increasing utility costs totaled \$34 million. This special session also provided \$125 million in transfers from the general fund to the retirement systems to reduce their actuarially calculated unfunded liabilities. \$100 million was transferred to the Teachers Retirement System and \$25 million was transferred to the Public Employees Retirement System.

## **FINANCIAL INFORMATION**

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

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

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



### **General Fund Balance**

The unreserved, undesignated fund balance of the General Fund increased from \$289.7 million at June 30, 2005, to \$408.9 million at June 30, 2006. This represents an increase of \$117.5 million (or 40.6%).

### **Pension Trust Fund Operations**

The State contributes to eight retirement plans and is the administrator of two additional plans. The two largest plans, in terms of dollars contributed and employees covered, are the Public Employees Retirement System - Defined Benefit Retirement Plan and the Teachers Retirement System.

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

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

### **Cash Management**

The uniform investment program established by the 1972 Montana Constitution directs that the Board of Investments has sole authority to invest state funds. The board operates under the "prudent person principle", which requires the board to (1) discharge its duties in the same manner as that of a prudent person acting in a like capacity with the same resources and aims; (2) diversify the holdings of each fund to minimize the risk of loss and maximize the rate of return; and (3) discharge duties solely in the interest of, and for the benefit of, the funds managed. Permissible investments include bonds, notes, debentures, equipment obligations, common stock (pension trust and higher education funds only), commercial paper, bankers acceptances, interest bearing deposits in Montana financial institutions, real estate, and any other investment in a Montana business that continues existing jobs or creates new jobs. These investments are subject to statutory restrictions for quality and size of holdings.

Unless otherwise provided by law, treasury cash is pooled for investment regardless of the fund from which it is deposited, and the pool investment earnings are credited to the General Fund. The board reported total investment income from investments under its management of \$376 million, an increase of 7.7% from the \$349 million earned last year. The book value of board-managed investments increased by approximately \$886 million, or 9%, to \$10.7 billion at fiscal year-end 2006. The board publishes an annual audited report of all its investment activity. That report may be referenced for more in-depth investment information.

### **Risk Management**

Wage loss and medical expense benefits for injured state employees, excluding the Montana University System, are provided by the State Compensation Insurance Fund (State Fund). The State Fund is a nonprofit, independent public corporation that is managed and controlled by a seven-member board of directors. The Governor appoints the board members for four-year terms. Funding is primarily derived from the premiums paid by policyholders.

The Montana University System Workers Compensation Program provides self-insured workers compensation coverage for employees of the Montana University System. The program is self-insured for workers compensation claims to a maximum of \$500,000 per each occurrence. Losses in excess of \$500,000 are covered by reinsurance with a commercial carrier. Employer's liability claims are covered to a maximum of \$1,000,000 above the self-insured amount of \$500,000.

The State maintains self-insurance plans for employee comprehensive medical, prescription drug and dental coverage, and state property. Under the State Employee Group Benefits Plan, the State assumes all the risk for claims incurred by plan members including state employees, elected officials, retirees and their dependents with the following exceptions: the Vision Service Plan (VSP) Insurance Company insures vision care services; the Standard (Standard) Insurance Company insures life, accidental death and dismemberment, and long-term disability coverage; and UNUM Life Insurance Company insures the long-term care coverage offered to participants. Premiums are collected through payroll deductions, deductions through the Public Employees Retirement System, and self-payment.

The Montana University System (MUS) Group Benefits Plan offers medical, dental, life, and vision insurance coverage to employees of the Montana University System, the community colleges, 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 a voluntary vision plan administered by VSP serving employees, retirees and their dependents and life insurance administered by Standard. Blue Cross/Blue Shield is the claims administrator for the self-insured indemnity plan. The plan includes three self-insured HMOs that are administered by Blue Cross, New West Health Services, and Peak. Managed Care Montana (APS) has a contract for utilization management. The utilization management program consists of hospital pre-authorization, case management, and medical necessity review.

The state insurance program provides property/casualty insurance coverage for a broad range of risks including, but not limited to, accidental death/dismemberment, auto liability, auto comprehensive collision, aircraft, airports, boilers and machinery, crime, fine arts, foster care, general liability, professional liability, and property. Commercial excess insurance is purchased to cover catastrophic losses. Deductibles range from \$10,000 per occurrence to \$1,000,000 per occurrence. The state property program insures over \$2.8 billion of state-owned and leased buildings and contents with policy limits of 500,000,000 per occurrence (various sub limits and coverage restrictions apply). The State is entirely self-funded for auto liability and general liability, subject to the terms and conditions of the Montana Tort Claims Act (Title 2, Chapter 9, Part 305, MCA). The state's statutory caps are set by the Legislature at \$750,000 per claim/\$1,500,000 per occurrence (Title 2, Chapter 9, Part 108, MCA). Agency insurance premiums are allocated based upon risk exposure and loss experience.

### **INDEPENDENT AUDIT**

The financial statements contained in Montana's Comprehensive Annual Financial Report were audited in accordance with generally accepted auditing standards by the State's Legislative Audit Division. The Legislative Auditor is appointed by and reports to the Legislative Audit Committee. The Deputy Legislative Auditor issued an unqualified opinion on the State's financial statements for fiscal year 2006.

The Deputy Legislative Auditor added an additional paragraph to the unqualified opinion for 2006 emphasizing four of the retirement systems are not actuarially sound and have an unfunded actuarially accrued liability as of June 30, 2006. The actuarial condition of these plans is fully disclosed and reported as required by Generally Accepted Accounting Principles (GAAP), and explained in greater detail in Notes 6 and 18 of the financial statements. The unfunded actuarial liability is long-term in nature and does not translate into an inability of these plans to meet their current obligations in the near future. The State is very aware of this situation and is taking steps to address it.

In this additional paragraph, the Deputy Legislative Auditor also discusses the underfunding of the Sheriffs Retirement System. This is fully disclosed and reported as required by GAAP, and explained in greater detail in Notes 6 and 18 of the financial statements. This does not translate into an inability of the plan to meet current obligations in the near future.

### **CERTIFICATE OF ACHIEVEMENT**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Montana for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2005. This was the sixteenth year out of seventeen years that the State received this prestigious award. In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized CAFR, whose contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

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

## ACKNOWLEDGEMENTS

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Janet R. Kelly". The signature is fluid and cursive, with the first name being the most prominent.

Janet R. Kelly, Director  
Department of Administration

A handwritten signature in black ink, appearing to read "Paul A. Christofferson". The signature is highly stylized and cursive, with a large initial 'P'.

Paul A. Christofferson, CPA, Administrator  
Administrative Financial Services Division  
Department of Administration

# Certificate of Achievement for Excellence in Financial Reporting

Presented to

## State of Montana

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2005

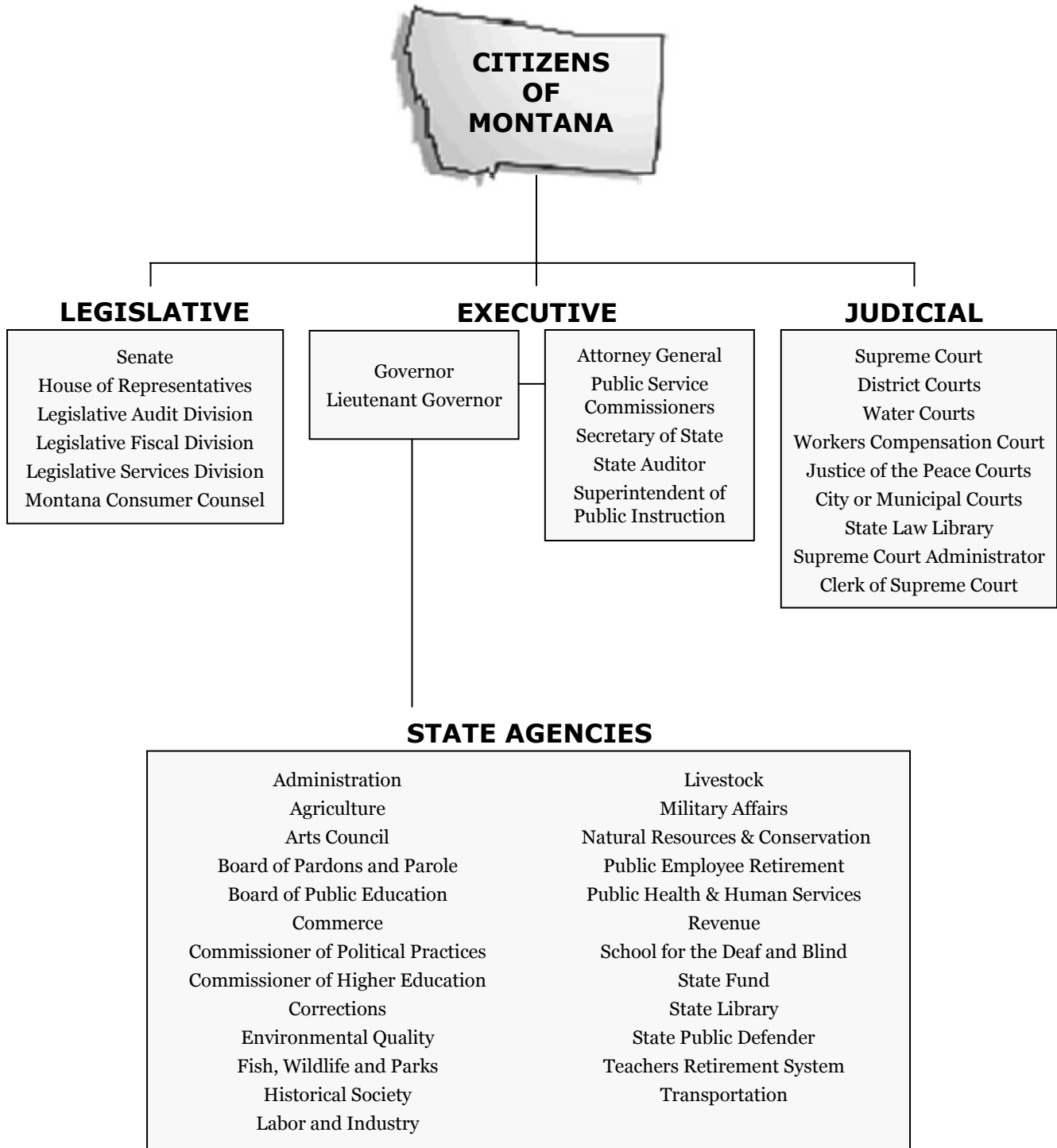
A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards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



President

Executive Director

# STATE OF MONTANA ORGANIZATION CHART



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

**EXECUTIVE**

Brian Schweitzer

Governor

John Bohlinger

Lieutenant Governor

**JUDICIAL**

Karla Gray

Chief Justice

**LEGISLATIVE**

Jon Tester

President of the Senate

Gary Matthews

Speaker of the House