

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

Prepared By:

Department of Administration

Janet Kelly, Director

Sheryl Olson, Deputy Director

Administrative Financial Services Division

Paul Christofferson, CPA, Administrator

Accounting Bureau

Julie Feldman, Bureau Chief

Accounting Principles/Financial Reporting Section

Janet Atchison, Accountant

Darla Cole, Accountant

Charles Idehen, CPA

Karen Simpson, CPA

Operations Section

Mark Curtis, Computer Applications Software Engineer

Linda Gaughan, Accountant, Supervisor

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

Table of Contents

INTRODUCTORY SECTION

	Page
Title Page.....	1
Table of Contents.....	2
Letter of Transmittal.....	6
Certificate of Achievement for Excellence in Financial Reporting.....	12
State Organization Chart.....	13
Selected State Officials.....	14

FINANCIAL SECTION

Independent Auditor's Report.....	16
Management's Discussion and Analysis.....	18

Basic Financial Statements

Government-wide Financial Statements	
Statement of Net Assets.....	30
Statement of Activities.....	32
Governmental Fund Financial Statements	
Balance Sheet.....	36
Reconciliation of Balance Sheet – Governmental Funds to the Statement of Net Assets.....	37
Statement of Revenues, Expenditures, and Changes in Fund Balances.....	38
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds to the Statement of Activities.....	40
Proprietary Fund Financial Statements	
Statement of Net Assets.....	44
Statement of Revenues, Expenses, and Changes in Fund Net Assets.....	46
Statement of Cash Flows.....	48
Fiduciary Fund Financial Statements	
Statement of Fiduciary Net Assets.....	52
Statement of Changes in Fiduciary Net Assets.....	53
Component Unit Financial Statements	
Combining Statement of Net Assets.....	56
Combining Statement of Activities.....	58
Notes to the Financial Statements	
Note 1 – Summary of Significant Accounting Policies.....	60
Note 2 – Other Accounting Issues.....	67
Note 3 – Cash/Cash Equivalents and Investments.....	67
Note 4 – Disaggregation of Accounts Receivable and Payable.....	78
Note 5 – Capital Assets.....	80
Note 6 – Retirement Plans.....	83
Note 7 – Other Postemployment Benefits.....	91
Note 8 – Risk Management.....	92

Notes to the Financial Statements (<i>continued</i>)	
Note 9 – Commitments.....	99
Note 10 – Leases/Installment Purchases Payable.....	100
Note 11 – State Debt.....	101
Note 12 – Interfund Balances and Transfers.....	109
Note 13 – Fund Deficits.....	112
Note 14 – Reserved Fund Balances.....	112
Note 15 – Related Party Transactions.....	112
Note 16 – Contingencies.....	113
Note 17 – Subsequent Events.....	117
Note 18 – Material Violations of Finance-Related Legal Provisions.....	117

Required Supplementary Information

Budgetary Comparison Schedule – General and Major Special Revenue Funds.....	120
Notes to the Required Supplementary Information – Budgetary Reporting.....	122
Pension Plan Information – Single Employer Systems – Schedule of Funding Progress.....	123
Notes to the Required Supplementary Information – Pension Plan Information.....	123

Supplementary Information – Combining Statements and Individual Fund Statements and Schedules

Nonmajor Governmental Funds	
Combining Balance Sheet – Governmental Funds by Fund Type.....	126
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds by Fund Type.....	127
Combining Balance Sheet – Debt Service Funds.....	130
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances – Debt Service Funds.....	132
Combining Balance Sheet – Capital Projects Funds.....	136
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances – Capital Projects Funds.....	137
Combining Balance Sheet – Permanent Funds.....	140
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances – Permanent Funds.....	142
Proprietary Funds	
Nonmajor Enterprise Funds	
Combining Statement of Net Assets.....	146
Combining Statement of Revenues, Expenses, and Changes in Fund Net Assets.....	154
Combining Statement of Cash Flows.....	158
Internal Service Funds	
Combining Statement of Net Assets.....	168
Combining Statement of Revenues, Expenses, and Changes in Fund Net Assets.....	172
Combining Statement of Cash Flows.....	176
Fiduciary Funds	
Pension (and Other Employee Benefit) Trust Funds	
Combining Statement of Fiduciary Net Assets.....	186
Combining Statement of Changes in Fiduciary Net Assets.....	188
Private-Purpose Trust Funds	
Combining Statement of Fiduciary Net Assets.....	192
Combining Statement of Changes in Fiduciary Net Assets.....	194
Agency Funds	
Combining Statement of Fiduciary Net Assets.....	198
Combining Statement of Changes in Assets and Liabilities.....	200

STATISTICAL SECTION

Schedule 1 – Net Assets by Component – Last Five Fiscal Years	204
Schedule 2 – Change in Net Assets – Last Five Fiscal Years.....	206
Schedule 3 – Fund Balances, Governmental Funds – Last Five Fiscal Years	208
Schedule 4 – Changes in Fund Balances, Governmental Funds – Last Five Fiscal Years	209
Schedule 5 – Personal Income by Industry – Last Ten Calendar Years	210
Schedule 6 – Personal Income Tax Rates – Last Ten Calendar Years.....	211
Schedule 7 – Personal Income Tax Filers and Liability by Income Level – Latest Completed Calendar Year and Five Years Ago	212
Schedule 8 – Ratios of Outstanding Debt by Type – Last Five Fiscal Years	213
Schedule 9 – Pledged Revenue Coverage – Last Ten Fiscal Years	214
Schedule 10 – Ratios of General Bonded Debt Outstanding – Last Five Fiscal Years.....	220
Schedule 11 – Demographic and Economic Statistics – Last Ten Calendar Years	221
Schedule 12 – Principal Employers – Current Fiscal Year and Nine Fiscal Years Ago	222
Schedule 13 – Full-Time Equivalent State Employees by Function/Program – Last Five Fiscal Years	223
Schedule 14 – Operating Indicators by Function/Program – Last Five Fiscal Years	224
Schedule 15 – Capital Asset Statistics by Function/Program – Last Five Fiscal Years.....	226

MANAGEMENT'S DISCUSSION AND ANALYSIS

INTRODUCTION

Management of the State of Montana provides this *Management's Discussion and Analysis* of the State of Montana's Comprehensive Annual Financial Report (CAFR) for readers of the State's financial statements. This narrative overview and analysis of the financial activities of the State of Montana is for the fiscal year ended June 30, 2006. We encourage readers to consider this information in conjunction with the additional information that is furnished in the State's financial statements, which follow.

FINANCIAL HIGHLIGHTS – PRIMARY GOVERNMENT

Government-wide Highlights

The assets of the State exceeded its liabilities at the end of fiscal year 2006 by \$6 billion (reported as net assets) compared with \$5.4 billion at the end of fiscal year 2005. Of this amount, \$665.7 million (reported as unrestricted net assets) may be used to meet the government's general obligations to citizens and creditors. Component units reported net assets of \$991.8 million compared with \$943.3 million at fiscal year 2005.

Fund Highlights

As of the close of fiscal year 2006, the State's governmental funds reported combined ending fund balances of \$2.9 billion compared with \$2.7 billion at fiscal year 2005. Of this amount, \$409.4 million is available for spending at the government's discretion (reported as unreserved fund balance). The remaining amount of \$2.4 billion is restricted for specific purposes, such as education. At the end of the fiscal year, unreserved fund balance for the General Fund was \$408.6 million compared with \$289.7 million in fiscal year 2005, which is an increase of \$118.9 million (or 41%).

The State's business-type activity funds reported net assets at the close of fiscal year 2006 in the amount of \$296.9 million compared with the fiscal year-end 2005 net assets of \$266.9 million. \$269.7 million of the business-type activity fund equity was restricted at fiscal year-end 2006 leaving an unrestricted balance of \$18.5 million. This represents a \$1.8 million (or 10.8%) increase from the fiscal year-end 2005 business-type activity fund unrestricted net asset balance of \$16.7 million.

Long-term Debt

The State's total bonds and notes payable for governmental activities increased by \$6.9 million, from \$421.6 million in fiscal year 2005 to \$428.5 million (or 6.9%) in fiscal year 2006.

Business-type activities reported bonds and notes payable of \$3.9 million at fiscal year-end 2006. This represents a decrease of \$1.3 million (or 25%) over the fiscal year-end 2005 reported amount of \$5.2 million.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Basic Financial Statements

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

Government-wide Financial Statements

The *government-wide financial statements* provide a broad view of the State's operations in a manner similar to a private-sector business. The statements provide both short-term and long-term information about the State's financial position, which assists in assessing the State's economic condition at the end of the fiscal year. These are prepared using

the flow of economic resources measurement focus and the accrual basis of accounting. This basically means they follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year, even if cash involved has not been received or paid. The government-wide financial statements include two statements.

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

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

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

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

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

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

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

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

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

Governmental Funds Financial Statements – Most of the basic services provided by the State are financed through governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental fund financial statements focus on near-term inflows and outflows of spendable resources. They also focus on the balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the government's near-term financing requirements. This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the State's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the State.

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

the State Special Revenue Fund, the Federal Special Revenue Fund, the Coal Severance Tax Fund, and the Land Grant Fund.

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

Fiduciary Funds – These funds are used to account for resources held for the benefit of parties outside state government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of these funds are not available to support the State’s own programs. Fiduciary funds use the accrual basis of accounting. A retirement fund is an example of a fiduciary fund.

Notes to the Financial Statements

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

Required Supplementary Information

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

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Montana’s overall financial position improved over the last fiscal year. This improvement was caused by the combination of budgetary cuts enacted in the previous legislative session and stronger than expected statewide economic performance.

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government’s financial position. The State’s combined net assets (government and business-type activities) totaled \$6 billion at the end of fiscal year 2006. Net assets of the governmental activities increased \$599.8 million (or 11.8%), and business-type activities had a \$30 million (or 11.2%) increase.

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

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

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

Net Assets
As of Fiscal Year Ended June 30
(expressed in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2005	2006	2005	2006	2005	2006
Current and other assets	\$3,407,149	\$3,562,620	\$373,018	\$410,309	\$3,780,167	\$3,972,929
Capital assets	2,805,658	3,240,577	9,670	9,110	2,815,328	3,249,687
Total assets	<u>6,212,807</u>	<u>6,803,197</u>	<u>382,688</u>	<u>419,419</u>	<u>6,595,495</u>	<u>7,222,616</u>
Long-term liabilities	451,012	451,014	7,150	9,766	452,005	460,780
Other liabilities	675,235	659,701	108,682	112,724	783,917	772,425
Total liabilities	<u>1,120,090</u>	<u>1,110,715</u>	<u>115,832</u>	<u>122,490</u>	<u>1,235,922</u>	<u>1,233,205</u>
Invested in capital assets, net of related debt	2,528,808	2,842,708	9,670	8,703	2,538,478	2,851,411
Restricted	2,159,185	2,202,592	240,514	269,687	2,399,699	2,472,279
Unrestricted	404,724	647,182	16,672	18,539	421,396	665,721
Total net assets	<u>\$5,092,717</u>	<u>\$5,692,482</u>	<u>\$266,856</u>	<u>\$296,929</u>	<u>\$5,359,573</u>	<u>\$5,989,411</u>

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

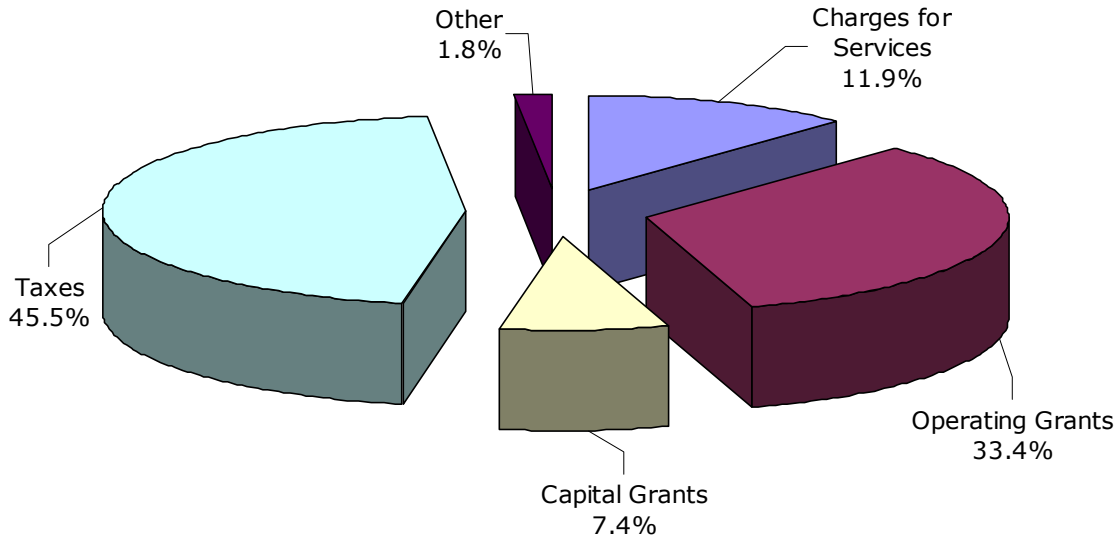
Changes in Net Assets
For Fiscal Year Ended June 30
(expressed in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2005	2006	2005	2006	2005	2006
Revenues:						
Program revenues						
Charges for services	\$ 443,984	\$ 487,767	\$236,365	\$257,729	\$ 680,349	\$ 745,496
Operating grants	1,391,026	1,371,109	58,433	58,051	1,449,459	1,429,160
Capital grants	319,434	305,345	159	378	319,593	305,723
General revenues						
Taxes	1,657,668	1,871,808	15,624	17,317	1,673,292	1,889,125
Other	85,497	73,388	3,135	5,162	88,630	78,550
Total revenues	<u>3,897,609</u>	<u>4,109,417</u>	<u>313,716</u>	<u>338,637</u>	<u>4,211,323</u>	<u>4,448,054</u>
Expenses:						
General government	305,819	525,981	-	-	305,819	525,981
Public safety/corrections	258,610	245,810	-	-	258,610	245,810
Transportation	281,074	216,942	-	-	281,074	216,942
Health/social services	1,182,281	1,270,056	-	-	1,182,281	1,270,056
Educational/cultural	900,542	976,046	-	-	900,542	976,046
Resource/rec/enviro	197,539	142,460	-	-	197,539	142,460
Econ dev/assistance	144,777	150,449	-	-	144,777	150,449
Interest on long-term debt	14,375	19,569	-	-	14,375	19,569
Unemployment Insurance	-	-	75,291	72,661	75,291	72,661
Liquor Stores	-	-	45,503	50,514	45,503	50,514
State Lottery	-	-	27,681	31,020	27,681	31,020
Economic Dev Bonds	-	-	2,630	3,441	2,630	3,441
Hail Insurance	-	-	3,153	4,632	3,153	4,632
Gen Govt Services	-	-	50,329	51,017	50,329	51,017
Prison Funds	-	-	5,268	5,356	5,268	5,356
MUS Group Insurance	-	-	40,524	52,139	40,524	52,139
MUS Workers Comp	-	-	2,842	2,978	2,842	2,978
Total expenses	<u>3,285,017</u>	<u>3,547,313</u>	<u>253,221</u>	<u>273,758</u>	<u>3,538,238</u>	<u>3,821,071</u>
Increase (decrease) in net assets before transfers	612,592	562,104	60,495	64,879	673,085	626,983
Transfers	29,871	34,802	(29,871)	(34,802)	-	-
Change in net assets	642,463	596,906	30,624	30,077	673,085	626,983
Net assets, beg of year (restated)	4,450,254	5,095,576	236,232	266,852	4,686,488	5,362,428
Net assets, end of year	<u>\$5,092,717</u>	<u>\$5,692,482</u>	<u>\$266,856</u>	<u>\$296,929</u>	<u>\$5,359,573</u>	<u>\$5,989,411</u>

Governmental Activities

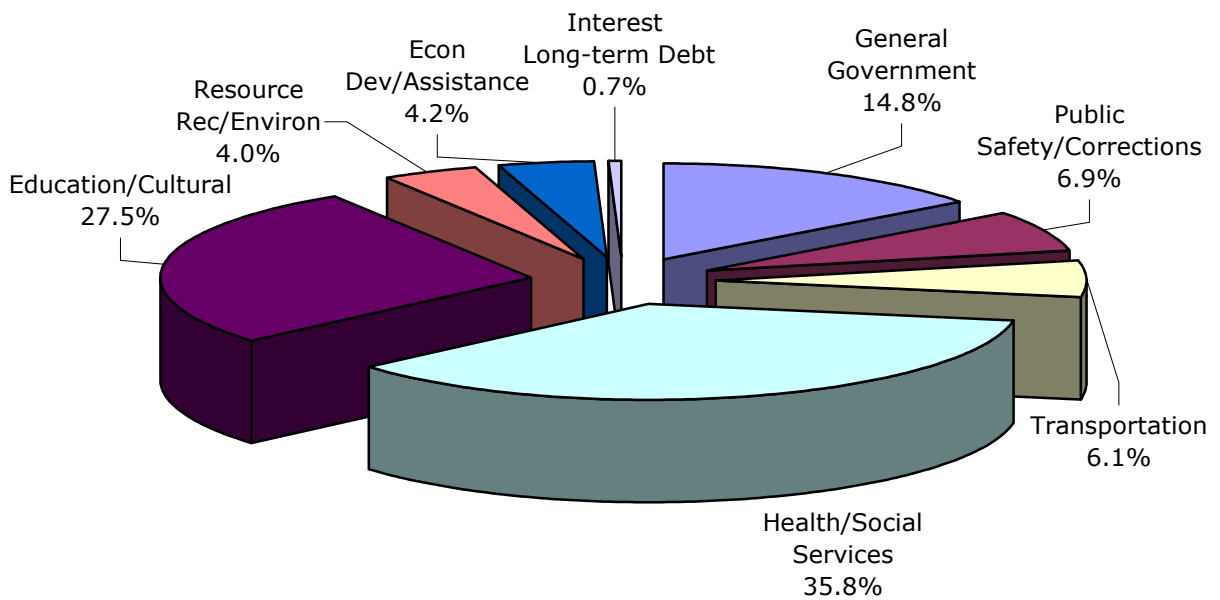
The following chart depicts revenues of the governmental activities for the fiscal year:

**Revenues - Governmental Activities
Fiscal Year Ended June 30, 2006**



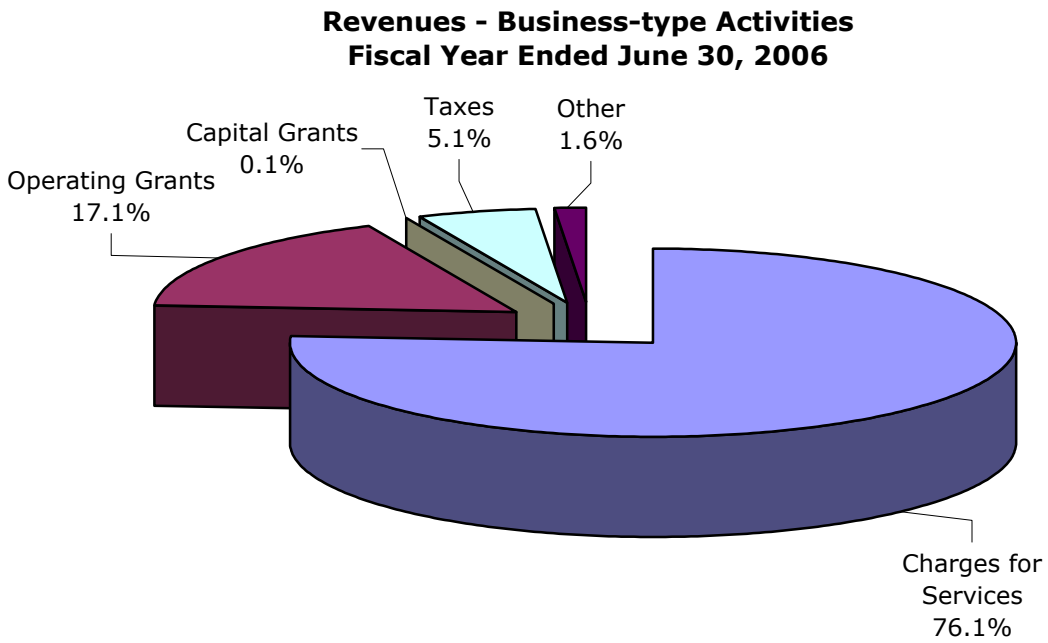
The following chart depicts expenses of the governmental activities for the fiscal year:

**Expenses - Governmental Activities
Fiscal Year Ended June 30, 2006**

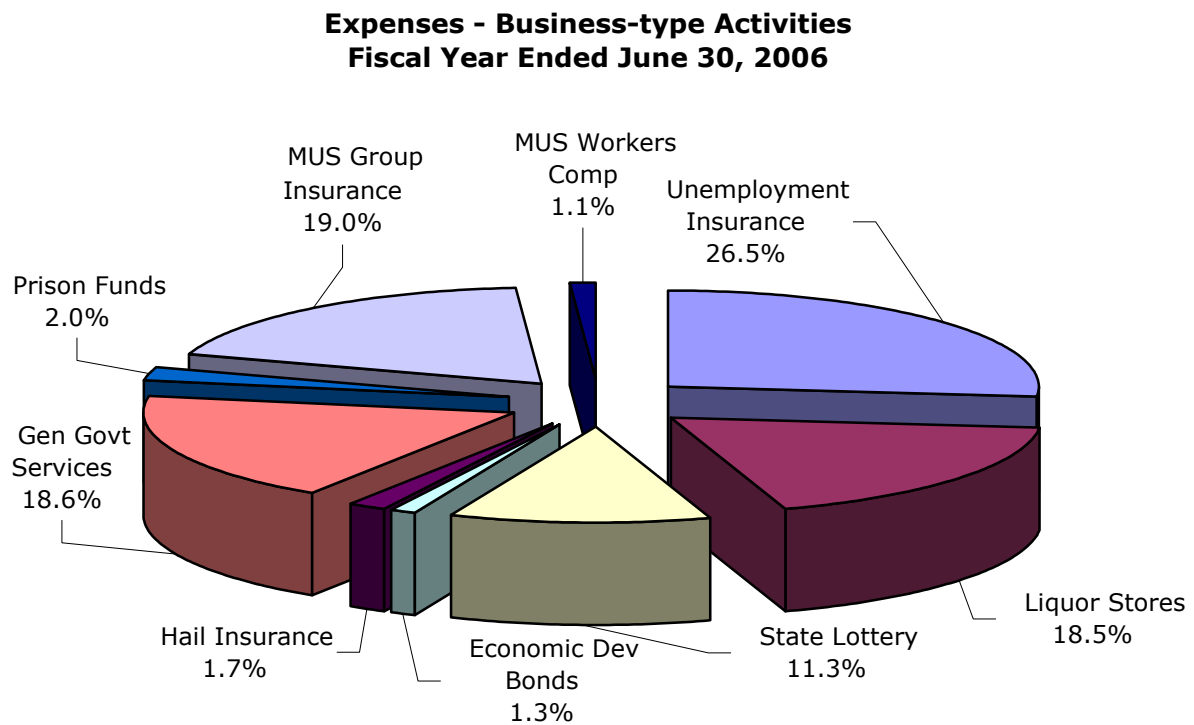


Business-type Activities

The following chart depicts revenues of the business-type activities for the fiscal year:



The following chart depicts expenses of the business-type activities for the fiscal year:



FINANCIAL ANALYSIS OF THE STATE'S MAJOR FUNDS

As the State completed the year, its governmental funds reported fund balances of \$2.9 billion. Of this total amount, \$409.4 million (or 14.1%) constitutes unreserved fund balance, which is available for spending at the government's discretion. The remainder of fund balance is reserved because it is legally segregated for a specific future use, or is not available for new spending, as it has already been dedicated for various commitments.

General Fund

The General Fund is the chief operating fund of the State. At the end of the current fiscal year, unreserved fund balance of the General Fund was \$408.6 million. Unreserved fund balance increased during the fiscal year by \$118.9 million, primarily because of increased taxes (natural resource, individual income, corporate income, and property), and licenses and permits revenue.

General Fund Budgetary Highlights – The ending General Fund unreserved fund balance of \$409 million is \$181 million higher than the anticipated \$228 million; \$165 million of this increase is the result of revenue increases as discussed below.

Supplemental Development – General Fund supplementals approved by the Legislature included \$10.6 million for the Department of Corrections, \$5.06 million for wildfire suppression, \$2.8 million for the Department of Public Health and Human Services, and \$2.7 million for public defender costs. Additional guarantee account revenue available in the educational special revenue guarantee State Special Revenue sub-fund resulted in a reduction in General Fund expenditures by \$17 million.

Higher Revenues Than Anticipated – The General Fund experienced revenue growth significantly higher than expected in fiscal year 2006. General Fund revenues were up by \$182.8 million (or 12.5%). This represents a \$98.5 million (or 6.4%) increase over the revenue projections. The increase was primarily due to the individual and corporate income tax revenue increase of \$63.1 and \$55.7 million, respectively. Continued economic growth within Montana and the recovery of the investment market contributed to this income tax growth. Higher energy and metals prices led to increased oil, gas, and metals production within the State. This increased activity resulted in a \$30.9 million increase in natural resource tax revenues between fiscal years 2005 and 2006.

General Fund Expenditures – General Fund expenditures increased by \$214 million (or 16.1%) in 2006. This increase was primarily in General Government with a \$125 million contribution to the retirement funds resulting from the special session. Other major increases resulting from the special session and the supplemental process were in the following functions: Education/Cultural, \$43.5 million; Health and Social Services, \$30.4 million; and Corrections, \$16 million.

State Special Revenue Fund

At the end of the current fiscal year, the fund balance of the State Special Revenue Fund was \$936.8 million. Fund balance increased during the fiscal year by \$29.5 million (or 3.2%).

In the State Special Revenue Fund, natural resource taxes increased by \$40.1 million (or 47.4%), other tax revenues by \$27.7 million (or 51.2%) as discussed in Note 1, fuel taxes by \$21.4 million (or 11.2%), and licenses and permits by \$13.1 million (or 11.2%). These increased revenues were offset by a significant decrease in investment income of \$12.1 million (or -44%).

Within the State Special Revenue Fund, expenditures increased \$42.8 million in the General Government function. This primarily was due to increased oil production tax distributions of \$31.3 million to the counties. The Education/Cultural functional expenditures increased by \$14.4 million, primarily as a result of an increase in land trust (natural resource tax) distributions to the State's K-12 schools of \$11.1 million. Department of Transportation highway expenditures increased by \$68.5 million as the result of increased materials costs and internal funding adjustments.

Federal Special Revenue Fund

Fund balance in the Federal Special Revenue Fund decreased by less than 1%.

Overall revenues or expenditures did not increase significantly in the Federal Special Revenue Fund during fiscal year 2006. Significant changes within the functional categories were caused by (1) Transportation - decreased federal highway construction expenditures of \$31.8 million; (2) Public Safety/Corrections - decreased Disaster and Emergency Services funding to the State of \$5.3 million; (3) Health and Social Services - increased Medicaid Federal Medical Assistance Percentages (FMAPs) reimbursement of \$32.7 million, increased Low-Income Energy Assistance Program

administration of \$4.4 million, increased Child Health Insurance Program of \$3.9 million, and increased Food Stamp benefits of \$3 million.

Coal Severance Tax Permanent Fund

Reserved fund balance in the Coal Severance Tax Permanent Fund decreased by \$6.4 million (or .9%). This was primarily caused by decreases in natural resource taxes of \$3.2 million (or -16%) and investment income of \$34.2 million (or -71%). This was caused by decreases in the taxable valuation on the coal produced in the State and the valuation of the investments held by the fund.

Land Grant Permanent Fund

Reserved fund balance in the Land Grant Permanent Fund decreased by \$18.1 million (or 4.1%). This was caused by a decline in investment income of \$31.6 million (or 92.1%) due to the fund's lower investment valuation. Rentals and leases and royalties income increased by \$19.7 million (or 46.5%). This increase corresponds to higher natural resource production within the State during 2006 as the result of continued high gas, oil, and metals prices.

Unemployment Insurance Enterprise Fund

Net assets restricted for unemployment compensation increased by \$24.6 million (or 11.9%). Unemployment premium collections increased by \$3.9 million (or 5.3%). Unemployment benefits paid decreased by \$1.3 million. Both of these factors contributed to the increase in net assets, and are reflective of Montana's continued strong economy during 2006.

Economic Development Bonds Enterprise Fund

Net assets did not change significantly in this fund during 2006. Operating activity within this fund also did not change significantly during the year.

General Governmental Functions

Revenue sources for general governmental functions, which include the general, special revenue, debt service, capital projects, and permanent funds, increased 6.5% from fiscal year 2005 to fiscal year 2006. Revenues from various sources for fiscal year 2006, and the amount and percentage of increases and decreases in relation to prior year revenues are shown in the following table (amounts in thousands):

Revenue Source	Amount	2006 Percent of Total	Increase (Decrease) from 2005	Percent Increase (Decrease)
Licenses/permits	\$ 259,073	6.3%	\$ 13,829	5.6
Taxes	1,880,838	45.8	252,980	15.5
Chg srv/fines/forfeits/settle	162,520	4.0	17,285	11.9
Investment earnings	62,977	1.5	(80,960)	(56.2)
Securities lending income	7,511	0.2	2,342	45.3
Sales doc/merch/property	21,412	0.5	(1,243)	(5.5)
Rentals/leases/royalties	63,318	1.5	19,595	44.8
Contributions/premiums	8,785	0.2	1,041	13.4
Grants/contracts/donations	25,987	0.6	(1,997)	(7.1)
Federal	1,530,795	37.2	27,856	1.9
Federal indir cost rcv	81,922	2.0	872	1.1
Other revenues	4,693	0.2	353	8.1
Total revenues	\$4,109,831	100.0%	\$251,953	6.5%

Total expenditures for all governmental functions increased 11% from fiscal year 2005 to fiscal year 2006. Expenditures by function for fiscal year 2006, and the amount and percentage of increases or decreases in relation to the previous year amounts are depicted in the table below:

Expenditure Function	Amount (in thousands)	2006 Percent of Total	Increase (Decrease) from 2005	Percent Increase (Decrease)
General government	\$ 466,886	11.6%	\$173,078	58.9%
Public safety/corrections	254,381	6.3	15,452	6.5
Transportation	559,695	13.9	36,673	7.0
Health/social services	1,274,947	31.7	88,485	7.5
Education/cultural	976,446	24.3	71,296	7.9
Resource/recreation/environment	204,413	5.1	(2,490)	(1.2)
Economic development/assistance	151,020	3.8	4,714	3.2
Securities lending	7,663	0.2	2,758	56.2
Debt service	53,291	1.3	11,917	28.8
Capital outlay	69,505	1.8	(1,346)	(1.9)
Total expenditures	\$4,018,247	100.0%	\$400,537	11.1%

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The State’s investment in capital assets for its governmental and business-type activities as of June 30, 2006, amounts to \$5 billion, net of accumulated depreciation of \$1.7 billion, leaving a net book value of \$3.3 billion. This investment in capital assets includes land, buildings, improvements, equipment, infrastructure, and construction in progress. Infrastructure assets are items that are normally immovable and of value only to the State, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The total increase in the State’s investment in capital assets for the current fiscal year was approximately 17.9% in terms of net book value. Most of the year’s capital expenditures were for construction or reconstruction of roads and bridges. Additional information on the State’s capital assets can be found in Note 5 of the notes to the financial statements.

Debt Administration

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

The State of Montana’s general obligation debt increased from \$213.2 million at June 30, 2005, to \$230.1 million at June 30, 2006.

The ratio of general obligation debt to personal income and the amount of general obligation debt per capita are:

	Amount (in thousands)	Percentage of Personal Income (1)	State Debt Per Capita (2)
General obligation debt	\$230,065	0.85%	\$244.69

- (1) Personal income is for calendar year 2005.
- (2) Based on estimated 2006 Montana population.

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

ECONOMIC CONDITION AND OUTLOOK

The unemployment rate for the State of Montana was 3.5% in the second quarter of 2006, which is a significant improvement from the rate of 4.4% during the second quarter of 2005. This compares favorably with the nation's average unemployment rate of 4.6% during the same time period.

The 59th Legislative Session adjourned on April 21, 2005, with a projected General Fund balance for the 2007 biennium of \$76.0 million. During fiscal year 2006, economic conditions continued to improve with the General Fund balance, as of June 30, 2006, ending at the \$408.9 million level.

Four of the State's 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 addition, the Sheriffs Retirement System is underfunded. 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.

REQUESTS FOR INFORMATION

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