# State of Montana

# COMPREHENSIVE ANNUAL FINANCIAL REPORT

For the Fiscal Year Ended June 30, 2006

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## 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 $1.5 billion. 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 State’s Legislative Audit Division. The report is issued under separate cover and available at 301 South Park, Room 204, PO Box 200528, 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 every two years by the State’s Legislative Audit Division. The report is issued under separate cover and available at 2401 Colonial Drive, 3rd 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. Administrative operations and budgets are reviewed by the Governor and the Legislature. The fund is audited annually by the State’s Legislative Audit Division. The report is issued under separate cover and available at 5 South Last Chance Gulch, Helena, MT 59601.

Montana Surplus Lines – Montana Surplus Lines Agents Association is a legally separate entity appointed as an advisory organization by the Montana Insurance Commissioner, and primarily performs services as directed by the Commissioner, located within Montana State Auditors' Office. The Association was reactivated in 1989 to operate the Montana State Insurance Commissioner's Surplus Lines stamping office. The Association regulates insurance companies that provide specialized insurance coverage, of an unusual or high risk nature, that is not provided by other insurance companies. The association was audited by Galusha, Higgins & Galusha, PC. The report is issued under separate cover at 840 Helena Avenue, 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. The universities are audited annually by the State's Legislative Audit Division. 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, 46 North Last Chance Gulch, 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; and (3) the Student Assistance Foundation of Montana, a private non-profit corporation. 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 and the State Special Revenue Fund.

**Fiduciary Fund Component Units**

Teachers Retirement System (Pension Trust Fund) – This retirement plan 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 plan is funded from employer and employee contributions and investment earnings. The board is a discretely presented component unit. The plan is audited annually by the State's Legislative Audit Division. 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 plans for the purpose of providing retirement, disability, death, and lump-sum payments to each plan 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) includes the Public Employees Defined Benefit Retirement Plan and the Public Employees Defined Contribution Retirement Plan, and is funded from employer and employee contributions, investment earnings and contributions from state, county, and local governments. The PERS also accounts for the administrative costs, paid from investment earnings, of the plan. 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, state, 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 and investment earnings; there is one employer, Great Falls Transit, that contributes to the program.

The board is a discretely presented component unit responsible for the ten separate public employee retirement plans including the Deferred Compensation Program. These are reported as pension and other employee benefit trust funds. The board is audited annually by the State's Legislative Audit Division. Its report is issued under separate cover and is available at 100 North Park, Suite 200, 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**

**Government-wide, Proprietary, and Fiduciary Fund Financial Statements**
The government-wide, proprietary fund, and fiduciary fund (except for agency fund) financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Agency funds have no measurement focus. These funds report only assets and liabilities, recognizing receivables and payables using 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**
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.

The major revenue sources considered susceptible to accrual are: licenses and permits, natural resource taxes, individual income taxes, corporate income taxes, property taxes, fuel taxes, and certain federal revenues (reimbursable grants and U.S. mineral royalties). All other revenue is considered to be measurable and available when the cash is received.

**Fund Financial Statements**
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**
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.

Pension (and Other Employee Benefit) Trust Funds – These funds report resources that are required to be held in trust for the members and beneficiaries of the State's defined benefit plans, defined contribution plans, other retirement plans such as firefighters, police officers, teachers etc, and other post employment benefit plans. Plan members receive retirement, disability, death, and lump-sum payments from the fund. A list of the plans is included on page 185.

Private-Purpose Trust Funds – These funds are used to account for assets held by the State in a trustee capacity, where both the principal and earnings benefit individuals, private organizations, or other governments. Examples include the State's escheated property fund, unliquidated security bonds held on deposit from self-insured employers, environmental reclamation bonds held in trust, and others.

Investment Trust Fund – This fund accounts for the receipt of monies by the Montana Board of Investments for investment in the Short-term Investment Pool (STIP), an external investment pool, and the distribution of related investment earnings to local government agencies.

Agency Funds – Account for assets held by the State as an agent for individuals, private organizations, and other governments. For example, various agencies including State Auditor, Fish, Wildlife and Parks, and the Department of Natural Resources and Conservation hold deposits pending compliance with performance agreements. Other examples include monies belonging to state institution residents and child support payments from parents.

**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 Enterprise 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, cash and cash equivalents consist of amounts deposited in the State Treasurer's pooled cash account, cash deposits in checking accounts, cash invested in the Short-term Investment Pool (STIP), cash held by trustees, 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. (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.

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

**H. Restricted Assets**

Certain investments of the Economic Development Bonds Enterprise Fund are classified as restricted assets on the Statement of Net Assets for Proprietary Funds because their use is limited by applicable bond indenture agreements.

**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, Montana University System Units, and specific funds established within the State Special Revenue Fund. The participant investments in the pools are reported at fair value in the assets within the individual funds (See Note 3 on Cash/Cash Equivalents and Investments).

**J. 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).

**K. 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 proprietary funds 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.

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.

**L. Deferred Revenue**

Deferred revenue in the government-wide, proprietary fund, and fiduciary fund financial statements relates to unearned revenue. A liability for unearned revenue is recorded when assets are recognized in connection with a transaction prior to the earnings process being completed.

Deferred revenue in the governmental fund financial statements relates to both unearned revenue (as discussed above) and unavailable revenue. A liability for unavailable revenue is recorded when assets are recognized in connection with a transaction, but those assets are not considered available to finance expenditures of the current fiscal period.

**M. 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 and fiduciary fund operations are accounted for in those funds.

**N. Capital Leases**

A capital lease is generally defined by GASB Statement 13, Accounting for Leases, as one which transfers benefits and risks of ownership to the lessee. At the inception of a capital lease, in the government-wide, proprietary fund, and fiduciary fund financial statements, a capital asset and a capital lease liability are recorded at the present value of the future minimum lease payments. In the governmental fund financial statements, because the modified accrual basis of accounting is used, no asset or liability is recorded related to assets under capital leases. Rather, in the governmental fund financial statements, at the inception of a capital lease, a capital outlay expenditure and an other financing source (inception of lease/installment contract) are recorded at the net present value of the minimum lease payments.

**O. 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.

**P. 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, 2005, was 1,588 hours. For fiscal year 2006, 1,956 hours were contributed to the sick leave pool and 964 hours were withdrawn, leaving a balance of 2,580 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% of unused vacation leave and 25% of unused sick leave.

**Q. 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.

**R. Fund Balance/Net Assets**

The State reserves those portions of fund balance not appropriable for expenditure or legally segregated for a specific future use. Designated fund balances represent tentative plans for the future use of financial resources. The debt service funds designated fund balances represent management's desire to maintain fund balance for future debt service payments.

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowing used for the acquisition, construction, or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use either through constitutional provisions or enabling legislation or through external restrictions imposed by creditors, grantors, or laws or regulations of other governments. The government-wide Statement of Net Assets reported restricted net assets (in thousands) of $2,472,279 of which $484,411 is restricted by enabling legislation.

**S. 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.

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.

**T. 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 |
|---|---|---|---|---|
| Accommodations | $ 10,548 | $14,552 | $ - | $ 25,100 |
| Agriculture sales | - | 3,540 | - | 3,540 |
| Cigarette/tobacco | 38,894 | 48,456 | 1,990 | 89,340 |
| Fire protection | - | 2,444 | - | 2,444 |
| Insurance premium | 58,596 | - | - | 58,596 |
| Livestock | - | 3,367 | - | 3,367 |
| Other taxes | 22,914 | 6,355 | - | 29,269 |
| Public Service Commission | - | 3,068 | - | 3,068 |
| Telephone license | 20,860 | - | - | 20,860 |
| Video gaming | 57,429 | 18 | - | 57,447 |
| Total other taxes | $209,241 | $81,800 | $1,990 | $293,031 |

## NOTE 2. OTHER ACCOUNTING ISSUES

### A. New Accounting Guidance Implemented

For the year ended June 30, 2006, the State implemented GASB Statement 43, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries. The State did not have any impairment of capital assets to disclose for fiscal year 2006.

GASB Statement 44, Economic Condition Reporting: The Statistical Section (an amendment of NCGA Statement 1) was also implemented for the year ended June 30, 2006.

In addition, for the year ended June 30, 2006, the State implemented GASB Statement 47, Accounting for Termination Benefits, which provides guidance on how employers should account for benefits associated with either voluntary or involuntary terminations. During fiscal year 2006, the State did not recognize a liability and expense for voluntary termination benefits (i.e., early-retirement incentives) or involuntary termination benefits such as severance benefits for its employees.

### B. Prior Period Adjustments

Prior period adjustments reported in the accompanying financial statements relate to corrections of errors from prior periods. The most significant of these adjustments affected the governmental activities column in the Statement of Activities, and related to various capital asset corrections.

## NOTE 3. CASH/CASH EQUIVALENTS AND INVESTMENTS

This note details the following asset classifications (in thousands):

| | |
|---|---|
| Cash/cash equivalents | $2,477,151 |
| Equity in pooled investments | $7,997,467 |
| Investments | $2,062,491 |

Carrying amounts for the bank balance for Cash Deposits and fair values for the State's 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, cash held by trustees, 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 fund 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. By 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 interest earnings within their funds are required to invest in STIP. Local government participation in STIP is voluntary. Separately issued external investment pool financial statements may be obtained by contacting the Montana Board of Investments, 2401 Colonial Drive, 3rd Floor, PO Box 200126, Helena, MT 59620-0126.

The State's cash equivalents and investments are detailed in Table 2 - Cash Equivalents, Table 3 - Equity in Pooled Investments, and Table 4 - Investments to disclose the level of investment risk, when applicable, assumed by the State at June 30, 2006.

**(2)** All securities are reported by investment portfolio and type in Table 2 - Cash Equivalents, Table 3 - Equity in Pooled Investments, and Table 4 - Investments. The State invests in certain types of securities, including U.S. government direct-backed, U.S. government indirect-backed, corporate stock/bonds, foreign government bonds, municipals, equity index, preferred stock, convertible equity securities, American Depositary Receipts (ADRs), equity derivatives, venture capital, leveraged buyout, mezzanine, distressed debt, special situation and secondary investments, and cash equivalents, to provide a diversified investment portfolio and an overall competitive rate of return.

U.S. government direct-backed securities include direct obligations of the U.S. Treasury and obligations explicitly guaranteed by the U.S. government. U.S. government indirect-backed obligations include U.S. government agency and mortgage-backed securities. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages.

Common stock represents ownership units (shares) of a public corporation. Common stock owners are entitled to vote on director selection and other important matters, as well as receive dividends on their holdings. Equity index investments are investments in selected mutual funds whose equity portfolios match a broad based index or composite. Preferred stock, as a class of stock, pays dividends at a specified rate and has preference in the payment of dividends and liquidation of assets. Preferred stock holders, ordinarily, do not have voting rights. Convertible securities are securities carrying the right to exchange, or “convert” the instrument for other securities of the issuer or of another issuer. This definition most often applies to preferred stocks or corporate bonds carrying the right to exchange for a fixed number of shares of the issuer’s common stock. ADRs are receipts issued by a U.S. depositary bank representing shares of a foreign stock or bonds held abroad by the foreign sub-custodian of the American depositary bank. Equity derivatives “derive” their value from other equity instruments such as futures and options.

Venture capital represents private equity investments in early stage financing of rapidly growing companies with an innovative product or service. Leveraged buyouts (LBOs) permit an investment group to acquire a company by leveraging debt, as a financing technique, to establish a significant ownership position on behalf of the company’s current management team. Mezzanine investments are the subordinated debt and/or equity of privately-owned companies. The debt holder participates in equity appreciation through conversion features, such as rights, warrants, and/or options.

Distressed debt represents the private and public debt of companies that appear unlikely to meet their financial obligations.

Special situation investments include the investment in the exploration for oil and/or gas reserves or in the development of proven reserves, investment in land to harvest timber, and investments that have a special component usually related to geographical, economic, or social issues. Secondary investments are investments in previously owned limited partnerships. These investments may be direct or via a general partner specializing in secondary investments. Private equity investments are long-term, by design, and extremely liquid.

Investments are presented in the Statement of Net Assets at fair value. Fair values for investment pool securities are determined primarily by reference to market prices supplied to the BOI by BOI’s custodial bank, State Street Bank. Amortized cost represents the original cost, adjusted for premium and discount amortization, where applicable. Premiums and discounts are amortized/accreted using the straight-line or scientific method to the call, average life or maturity date of the securities. Amortized cost may also be referred to as book value.

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 loaned securities and maintain collateral equal to not less than 100% of the fair value of the loaned security. During the fiscal year, the State’s agent loaned, on behalf of the State, certain securities held by the agent and received U.S. dollar currency cash, U.S. government securities, and irrevocable bank letters of credit as collateral. 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 during the loan period. At year-end, the BOI has no credit risk exposure to borrowers because the amount the BOI owes the borrowers exceed the amount the borrowers owe the system.

### 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 Deposit Amounts**
*(in thousands)*

| | Carrying Amount |
|---|---|
| Cash held by State/State's agent | $ 30,186 |
| Uninsured and uncollateralized cash | 4,917 |
| Undeposited cash | 1,418 |
| Cash in U.S. Treasury | 229,469 |
| Cash in MSU component units | 5,917 |
| Cash in UM component units | 8,334 |
| Less: outstanding warrants | (56,134) |
| Total cash deposits | $224,107 |

As of June 30, 2006, the carrying amount of deposits for component units was $92,306,495, as included in Table 1.

**(2) Cash Equivalents** – consists of cash in the State Treasury invested by individual funds in the Short-term Investment Pool (STIP), the Treasurer's Cash Pool, and in identifiable securities and investments considered to be cash equivalents. Cash equivalents, generally, are short-term, highly liquid investments with original maturities of three months or less. 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)*

| | Fair Value | Credit Quality Rating | Fund |
|---|---|---|---|
| Commercial paper | $1,421,009 | A1 | Various |
| Corporate fixed | 293,961 | A1+ | Various |
| Corporate variable-rate | 224,992 | A1+ | Various |
| Municipal variable-rate | 248,884 | A1+ | Various |
| Repurchase agreement (1) | 18,643 | NR | Various |
| Government direct-indirect (2) | 205,126 | AAA | Various |
| Money market | 65,289 | NR | Various |
| Less: STIP included in pooled investment balance | (224,859) | | |
| Total cash equivalents | $2,253,045 | | |
| Securities lending collateral investment pool | $ 36,072 | | |

(1) As of June 30, 2006, a repurchase agreement, per contract, was collateralized at 102% for $19,024,084 by a Federal Home Loan Mortgage Corporation REMIC maturing July 15, 2033.

(2) The government direct-indirect securities are included in the credit quality rating and effective duration table in Note 3 D (investments).

As of June 30, 2006, local governments invested $654,914,928 in STIP.

As of June 30, 2006, component units of the State of Montana had investments in cash equivalents with a book value and fair value of $393,690,026.

**Investment Risk Disclosures**
The investment risk disclosures are described in the following paragraphs and are identified by the specific pools or securities to which they pertain, when applicable.

Credit Risk
Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The STIP securities have credit risk as measured by major credit rating services. This risk is that the issuer of a STIP security may default in making timely principal and interest payments. The Board of Investment's policy requires that STIP securities have the highest investment grade rating in the short-term category by at least one of the Nationally Recognized Statistical Rating Organizations (NRSRO).

Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk, and do not require disclosure of credit quality per GASB Statement 40.

STIP investments are categorized above to disclose credit risk as of June 30, 2006. Credit risk reflects the security quality rating, by investment security type, as of the June 30 report date. If a security investment type is unrated, the quality type is indicated by NR (not rated). Although the STIP investments have been rated by investment security type, STIP, as an external investment pool, has not been rated by the NRSRO.

Custodial Credit Risk
Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2006, all STIP securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the board's custodial bank, State Street Bank, or the State's name.

Concentration of Credit Risk
Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The STIP Investment Policy Statement does not specifically address concentration of credit risk. The policy does provide for "a minimum of three (3%) percent or $15 million, whichever is higher, to be invested in repurchase agreements." The STIP investments had concentrations of credit risk exposure to the Federal Home Loan Bank of 6.59% as of June 30, 2006.

The concentration of credit risk for the rated securities is included in the disclosure in Note 3 D (investments).

Interest Rate Risk
Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. According to GASB Statement 40, interest rate disclosures are not required for STIP, since STIP is a "2a-7-like pool".

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

While variable-rate (floating-rate) securities have credit risk identical to similar fixed-rate securities, their interest rate risk is more sensitive to interest rate changes. However, their fair value may be less volatile than fixed-rate securities because their value will usually remain at or near par as a result of their interest rates being periodically reset to maintain a current market yield.

Legal Risk
As of June 30, 2006, Montana was not aware of any legal risks regarding any investments.

## C. Equity in Pooled Investments

These securities consist of investments held by pooled investment funds. The Montana Domestic Equity Pool (MDEP), Trust Funds Bond Pool (TFBP), Retirement Funds Bond Pool (RFBP), Montana International Equity Pool (MTIP), Montana Private Equity Pool (MPEP), and Montana Real Estate Pool (MTRP) were created to allow qualifying funds to participate in diversified investment pools. Purchases are subject to the statutorily mandated "Prudent Expert Principle".

**Table 3 – Equity in Pooled Investments**
*(in thousands)*

| | Carrying Amount | Fair Value |
|---|---|---|
| **MDEP:** | | |
| Common Stock Pool | $1,142,029 | $1,307,594 |
| Equity Index Funds | 1,248,314 | 1,428,148 |
| DFA Small Cap Subtrust | 133,994 | 213,902 |
| MidCap Equity Index Fund | 165,000 | 191,368 |
| SPIFF | 11,533 | 11,692 |
| **TFBP:** | | |
| Corporate bonds (rated) | 642,663 | 643,217 |
| Corporate bonds (unrated) | 3,756 | 3,813 |
| Foreign government bonds | 9,933 | 9,700 |
| Municipal government bonds (rated) | 1,135 | 1,168 |
| Municipal government bonds (unrated) | 2,656 | 2,656 |
| U.S. government direct-backed | 58,200 | 58,629 |
| U.S. government indirect-backed | 518,980 | 509,562 |
| Repurchase agreement (rated) | 269 | 269 |
| STIP | 85,583 | 85,583 |
| **RFBP:** | | |
| Corporate bonds (rated) | 932,793 | 930,858 |
| Corporate bonds (unrated) | 14,036 | 13,929 |
| Foreign government bonds | 4,967 | 4,850 |
| U.S. government direct-backed | 54,701 | 55,508 |
| U.S. government indirect-backed | 736,638 | 722,334 |
| Repurchase agreement (rated) | 448 | 448 |
| STIP | 109,117 | 109,117 |
| **MTIP:** | | |
| BGI MSCI Europe Index | 546,725 | 768,769 |
| BOI MSCI Pacific Index | 40,005 | 65,943 |
| DFA International Small Company | 78,149 | 93,071 |
| ISPIFF/SPIFF | 28,001 | 30,496 |
| Schroder Investment Management | 114,423 | 139,113 |
| Nomura Asset Management USA | 105,769 | 143,656 |
| **MPEP:** | | |
| Private equities | 321,925 | 369,684 |
| State Street SPIFF | 31,233 | 31,043 |
| **MTRP:** | | |
| STIP | 30,160 | 30,160 |
| Total pooled investments | 7,173,135 | 7,976,280 |
| Pool adjustments (net) | 21,187 | 21,187 |
| Total equity in pooled investments | $7,194,322 | $7,997,467 |

At June 30, 2006, the carrying and fair value of the underlying securities on loan was $188,635,282 and $193,032,691, respectively. The collateral provided for the securities on loan totaled $199,919,664.

As of June 30, 2006, component units of the State of Montana had equity in pooled investments with a book value of $4,570,282,809 and a fair value of $6,694,378,176, as included in Table 3.

**Investment Risk Disclosures**
The investment risk disclosures are described in the following paragraphs, and are identified by the specific pools to which they pertain, when applicable.

Credit Risk
Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of the U.S. government securities, the pool fixed-income instruments have credit risk as measured by major credit rating services. This risk is that the issuer of a fixed-income security may default in making timely principal and interest payments. The Board of Investment's policy requires pool fixed-income investments, at the time of purchase, to be rated an investment grade as defined by Moody's or by Standard & Poor's (S&P) rating services. The U.S. government securities are guaranteed directly or indirectly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. The credit ratings presented in the previous table are provided by S& P's rating services. If an S&P rating is not available, a Moody's rating has been used.

As of June 30, 2006, Northwest Airlines Inc. presented a higher credit risk to the board. The TFBP held a $9,255,000 par 4.64% Northwest Airlines Inc. real estate backed bond maturing July 7, 2010. The book value of this security was $9,255,000 as of June 30, 2006, and is secured by Northwest Airlines Inc.'s corporate headquarters building and land. The RFBP held a $5,745,000 par 4.64% Northwest Airlines Inc. real estate backed bond maturing July 7, 2010. The book value of this security was $5,745,000 as of June 30, 2006, and is secured by Northwest Airlines Inc.'s corporate headquarters building and land.

As of June 30, 2006, Burlington Industries, Inc. presented a legal and higher credit risk to the board. TFBP owns a Burlington Industries, Inc., $4 million par, 7.25% bond maturing September 15, 2005. RFBP owns a Burlington Industries, Inc., $6 million par, 7.25% bond maturing September 15, 2005. In September 2000, the company announced a reduction of stockholders equity. Due to an increasing senior bank line and declining credit trend, the bond ratings for these issues were downgraded, in May 2001, by the Moody's and Standard & Poor's rating agencies. During fiscal year 2001, the TFBP book value of Burlington Industries Inc. was reduced from the August 31, 2000 book value of $3,739,760 to $1,600,000. Due to the company's filing for Chapter 11 bankruptcy protection on November 11, 2001, the book value was reduced to $800,000. In October 2003, Burlington Industries, Inc. received court approval to sell its assets. Under the company's recovery plan, the TFBP received $969,974 in August 2004 for its unsecured claim. This transaction reduced the book value to $0 and generated a gain of $169,974. In February 2005 and May 2005, the TFBP received an additional $139,180 and $129,498, respectively, for its unsecured claim. In May 2006, the Board received an additional $105,519. During fiscal year 2001, the RFBP book value of Burlington Industries Inc. was reduced from the August 31, 2000 book value of $5,609,640 to $2,400,000. Due to the company's filing for Chapter 11 bankruptcy protection on November 11, 2001, the book value was reduced to $1,200,000. In October 2003, Burlington Industries, Inc. received court approval to sell its assets. Under the company's recovery plan, the RFBP received $1,454,961 in August 2004 for its unsecured claim. This transaction reduced the book value to $0 and generated a gain of $254,961. In February 2005 and May 2005, the RFBP received an additional $208,771 and $194,247, respectively, for its unsecured claim. In May 2006, the Board received an additional payment of $158,278. Both the TFBP and RFBP are expected to receive the final distribution in September 2006.

Custodial Credit Risk
Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of fiscal year end, all the fixed-income securities were registered in the nominee name for the Montana Board of Investments. The State Street repurchase agreement was purchased in the State of Montana Board of Investments name.

As of June 30, 2006, MTRP's single investment was in STIP.

Concentration of Credit Risk
Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Investments issued or explicitly guaranteed by the U.S. government are excluded from the concentration of credit risk requirement.

According to the TFBP and RFBP investment policies, with the exception of U.S. government indirect-backed (agency) securities, additional TFBP or RFBP portfolio purchases will not be made in a credit if the credit risk exceeds 2 percent of the portfolio at the time of purchase". As of June 30, 2006, the TFBP had concentration of credit risk exposure to the Federal Home Loan Mortgage Corp of 7.75%. As of June 30, 2006, the RFBP had concentration of credit risk exposure to the Federal Home Loan Mortgage Corp of 5.50%.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The TFBP and RFBP investment pool policies do not formally address interest rate risk. In accordance with GASB Statement 40, the board has selected the effective duration method to disclose interest rate risk. This information, as provided by our custodial bank, is "An option-adjusted measure of a bond's (or portfolio's) sensitivity to changes in interest rates. Duration is calculated as the average percentage change in a bond's value (price plus accrued interest) under shifts of the Treasury curve plus/minus 100 basis points. The effective duration method incorporates the effect of the embedded options for bonds and changes in prepayments for mortgage-backed securities (including pass-throughs, CMOs, and ARMs)."

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

According to GASB Statement 40, "interest rate disclosures are not required for pooled investments if the pool is a 2a-7 like pool". Because STIP operates as a 2a-7 like pool, this exclusion applies to MTRP.

As reported in the U.S. government indirect-backed category, the TFBP portfolio holds REMICs totaling $84,804 at amortized cost as of June 30, 2006. The RFBP portfolio holds REMICs totaling $387,052 in amortized cost as of June 30, 2006. These securities are based on separate or combined cash flows from principal and interest payments on underlying mortgages.

In regard to RFPB, the Interest Only (IO) securities are more sensitive to prepayments by mortgagees resulting from interest rate changes than other REMIC securities. The IO REMIC securities purchased in August and September 1992 carry an amortized cost of $3 as of June 30, 2006.

The TFBP holds one inverse variable-rate corporate $15 million par bond. The RFBP holds one inverse variable-rate corporate $25 million par bond. The quarterly coupon is calculated at a set rate less the 12-month LIBOR in arrears. As interest rates increase, the coupon paid will decline.

State of Montana investments are categorized below to disclose credit and interest rate risk as of June 30, 2006, as required for applicable pools. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date. Interest rate risk is disclosed using effective duration. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Both the credit quality ratings and duration have been calculated excluding cash equivalents. If duration has not been calculated, duration is indicated by NA (not applicable).

**TFBP**
**Credit Quality Rating and Effective Duration as of June 30, 2006**
*(in thousands)*

| Security Investment Type | Fair Value | Credit Quality Rating | Effective Duration |
|---|---|---|---|
| Corporate bonds (rated) | $ 643,217 | A | 4.93 |
| Corporate bonds (unrated) | 3,813 | NR | 1.48 |
| Foreign government bonds | 9,700 | BBB | 5.83 |
| Municipal government bonds (rated) | 1,168 | AA | 2.70 |
| Municipal government bonds (unrated) | 2,656 | NR | 3.94 |
| U.S. government direct-backed | 58,629 | AAA | 7.37 |
| U.S. government indirect-backed | 509,562 | AAA | 4.77 |
| State Street repurchase agreement (rated) (1) | 269 | AA- | NA |
| STIP | 85,583 | NR | NA |
| Total fixed-income investments | $1,314,597 | AA- | 4.97 |
| Securities lending collateral investment pool | $ 61,814 | NR | NA |

(1) At June 30, 2006, the State Street Bank repurchase agreement was collateralized at $269,625 by an AAA-rated Federal Home Loan Mortgage Corporation note maturing May 15, 2008.

**RFBP**
**Credit Quality Rating and Effective Duration as of June 30, 2006**
*(in thousands)*

| Security Investment Type | Fair Value | Credit Quality Rating | Effective Duration |
|---|---|---|---|
| Corporate bonds (rated) | $ 930,859 | A | 5.20 |
| Corporate bonds (unrated) | 13,929 | NR | 3.81 |
| Foreign government bonds | 4,850 | BBB | 5.83 |
| U.S. government direct-backed | 55,508 | AAA | 6.87 |
| U.S. government indirect-backed | 722,334 | AAA | 4.73 |
| State Street repurchase agreement (rated) (1) | 448 | AA- | NA |
| STIP | 109,116 | NR | NA |
| Total fixed-income investments | $1,837,044 | AA- | 5.05 |
| Securities lending collateral investment pool | $ 84,097 | NR | NA |

(1) At June 30, 2006, the State Street Bank repurchase agreement was collateralized at $449,375 by an AAA-rated Federal Home Loan Mortgage Corporation note maturing May 15, 2008.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. Several MPEP investments represent limited partnership investments in various foreign countries. Per GASB Statement 40, no foreign currency risk disclosure is required for these limited partnership investments. As provided for in the partnership agreements, currency exposures may be hedged, partially or fully, at the discretion of the manager, to preserve the U.S. dollar value of investments made. Currency speculation, such as over-hedging, reverse hedging or other trading activity not specifically aimed at preserving the U.S. dollar value of investments, is not authorized.

The U.S. dollar balances of the MTIP cash and investments are disclosed by currency in the following table.

**MTIP**
**Cash by Currency**
*(in thousands)*

| | 2006 | |
|---|---|---|
| Cash | Carrying Amount | Fair Value |
| Australian Dollar | $ 67 | $ 68 |
| Hong Kong Dollar | 700 | 699 |
| Japanese Yen | 1,305 | 1,317 |
| South Korean Won | 24 | 24 |
| Malaysian Ringgit | 8 | 8 |
| Philippine Peso | 2 | 3 |
| Singapore Dollar | 1,365 | 1,368 |
| New Taiwan Dollar | 168 | 168 |
| Total cash | $3,639 | $3,655 |

The MTIP, through the funds below, has significant investments in 11 foreign countries. Future economic and political developments in these countries could adversely affect the liquidity or value, or both, of the securities held by the funds in which MTIP is invested.

**MTIP**
**Investment by Security Type**
*(in thousands)*

| Security Investment Type | 2006 Carrying Amount | 2006 Fair Value |
|---|---|---|
| BGI MSCI Europe Index | $546,725 | $ 768,769 |
| BGI MSCI Pacific Index | 40,005 | 65,943 |
| DFA International Small Company | 78,149 | 93,071 |
| ISPIFF/SPIFF | 28,001 | 30,496 |
| Schroder Investment Management | 114,423 | 139,113 |
| Nomura Asset Management U.S.A., Inc. | 105,769 | 143,656 |
| Total investments | $913,072 | $1,241,048 |
| Securities lending collateral investment pool | $ 31,331 | $ 31,331 |

## D. Investments

Article VIII of Montana's Constitution, with supporting statutes, authorizes the Board of Investments (BOI) to manage the State's unified investment program. Long-term investments are administered by the following agencies:

**Long-term Investments**

| Department | Percent Administered |
|---|---|
| Board of Investments | 68.31% |
| PERA (Public Employee Retirement Administration) | 15.03 |
| Board of Housing | 11.32 |
| Montana State University/University of Montana | 3.93 |
| Other (1) | 1.41 |
| Total | 100.00% |

(1) Other consists of the Commissioner of Higher Education, the Department of Administration, the Department of Natural Resources and Conservation, the Department of Public Health and Human Services, and the Montana State Auditors's Office.

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

| | Carrying Amount | Fair Value | Credit Quality Rating | Effective Duration |
|---|---|---|---|---|
| **Primary government** | | | | |
| Corporate (rated) (1) | $ 96,371 | $ 95,454 | | |
| U.S. govt direct/indirect (rated) (1) | 66,491 | 65,750 | | |
| U.S. govt mortgage-backed (rated) (1) | 2,494 | 2,484 | | |
| Govt securities | 28,881 | 28,567 | | |
| MUS Workers Compensation | 2,016 | 1,954 | | |
| Other equities | 166,889 | 166,889 | | |
| Total | $ 363,142 | $ 361,098 | | |
| **Component units/fiduciary funds** | | | | |
| Corporate (rated) (1) | $ 365,828 | $ 357,517 | | |
| U.S. govt direct/indirect (rated) (1) | 327,563 | 320,864 | | |
| U.S. govt mortgage-backed (rated) (1) | 21,902 | 21,599 | | |
| Govt securities | 272,124 | 274,811 | | |
| Other equities | 68,486 | 83,456 | | |
| Deferred compensation | 241,774 | 247,944 | | |
| Defined contribution | 26,541 | 30,934 | | |
| VEBA | 484 | 482 | | |
| Investments of MSU component units | 124,653 | 124,653 | | |
| Investments of UM component units | 142,631 | 142,631 | | |
| Real estate | 16,477 | 16,693 | | |
| Mortgages | 80,751 | 79,809 | | |
| Total | $1,689,214 | $1,701,393 | | |
| Total investments | $2,052,356 | $2,062,491 | | |
| Securities lending collateral investment pool | $ 372,706 | $ 372,706 | NR | NA |

(1) The credit quality rating and duration are included below for the rated investments.

**AOF Rated Securities**
**Credit Quality Rating and Effective Duration as of June 30, 2006**
*(in thousands)*

| Security Investment Type | Fair Value | Credit Quality Rating | Effective Duration |
|---|---|---|---|
| Corporate (1) | $ 386,073 | A | 3.69 |
| U.S. government direct-backed (1) | 62,683 | AAA | 4.55 |
| U.S. government indirect-backed (1) | 620,037 | AAA | 2.39 |
| Total | $1,068,793 | | 2.99 |

(1) These rated securities are reported on both Table 2 – Cash Equivalents and Table 4 – Investments.

The PERS Defined Contribution Retirement Plan and the deferred compensation plan's fixed assets were invested and managed on behalf of the plans by Pacific Investment Management Company (PIMCO) and State Street Bank Kansas City (SSKC). The third party record keeper, Great West Retirement Services, tracks and reports the daily trading and valuations of all investment options, including the assets held by the individual mutual fund companies. When participants invest in the fixed investment, they are guaranteed a rate of return. The PERS-DCRP fixed money is invested in a PIMCO mutual fund. The minimum average portfolio quality must be an A rating; the minimum issue quality must be a BB-rating; and the minimum commercial paper quality must be A2/P2. Variable investments are held and managed by a selection of retail and institutional mutual funds, which cover all standard asset classes and categories. VEBA (Voluntary Employee Benefit Assoication) investments are made in mutual fund equities and mutual fund fixed-income funds.

**Investment Risk Disclosures**
The investment risk disclosures are described in the following paragraphs and are identified by the specific securities to which they pertain, when applicable.

Credit Risk
Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of the U.S. government securities, the AOF (All Other Funds) fixed-income instruments have credit risk as measured by major credit rating services. This risk is that the issuer of a fixed-income security may default in making timely principal and interest payments. The Board of Investment's policy requires AOF fixed-income investments, at the time of purchase, to be rated an investment grade as defined by Moody's and/or Standard & Poor's (S&P) rating services. The U.S. government securities are guaranteed directly or indirectly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. The credit ratings presented in the above table are provided by S&P's rating services. If an S&P rating is not available, a Moody's rating has been used. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date.

Custodial Credit Risk
Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2006, all the fixed-income and other equity securities were registered in the nominee name for the Montana Board of Investments and held in the possession of the board's custodial bank, State Street Bank. The Equity Index, Real Estate, Mortgage and Loan investments are registered in the name of the Montana Board of Investments. The US Bank Municipal Investors Account, State Street and US Bank repurchase agreements were purchased in the State of Montana Board of Investments name.

Concentration of Credit Risk
Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. With the exception of one fund, the 20 remaining BOI investment policy statements for various state agencies do not address concentration of credit risk. One fund requires credit risk to be limited to 3 % in any one name except AAA rated issues will be limited to 6%. Investments issued or explicitly guaranteed by the U.S. government and investments by various state agencies are excluded from the concentration of credit risk requirement. As of June 30, 2006, Montana had concentration of credit risk exposure to Federal Home Loan Banks of 6.27% and Federal National Mortgage Association of 9.82%.

This concentration of credit risk includes the rated securities from Table 2 – Cash Equivalents and Table 4 – Investments.

Interest Rate Risk
Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The All Other Funds' investment policies do not formally address interest rate risk. In accordance with GASB Statement 40, the board has selected the effective duration method to disclose interest rate risk.

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

Interest rate risk is disclosed using effective duration. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Both the credit quality ratings and duration have been calculated excluding cash equivalents. If duration has not been calculated, duration is indicated by NA (not applicable).

Specific Legal and Credit Risk
As of June 30, 2006, Montana was not aware of any specific legal or credit risks regarding any investments.

## NOTE 4. DISAGGREGATION OF ACCOUNTS RECEIVABLE AND PAYABLE

A disaggregation of the net receivables and accounts payable (by fund type) as of June 30, 2006, follows (amounts in thousands):

### A. Receivables

| | Governmental Funds | | | | | |
|---|---|---|---|---|---|---|
| **Receivables** | **General Fund** | **State Special Revenue** | **Federal Special Revenue** | **Coal Severance Tax Permanent** | **Land Grant Permanent** | **Nonmajor Governmental** |
| Licenses and permits | $ 6,962 | $ 362 | $ - | $ - | $ - | $ - |
| Taxes | 174,931 | 60,974 | - | 4,526 | - | 1,220 |
| Charges for services/ fines/forfeitures | 199 | 10,664 | 1,581 | - | - | - |
| Investment income | 1,972 | 5,593 | - | 3,932 | 5,468 | 3,355 |
| Contributions/premiums | - | - | - | - | - | - |
| Other | 6,532 | 11,969 | 11,027 | - | - | 494 |
| Total receivables | 190,596 | 89,562 | 12,608 | 8,458 | 5,468 | 5,069 |
| Less: allowance for doubtful accounts | (8,335) | (7,264) | (1,365) | (48) | - | - |
| Receivables, net | $182,261 | $82,298 | $11,243 | $8,410 | $5,468 | $5,069 |

| | Proprietary Funds | | | |
|---|---|---|---|---|
| **Receivables** | **Unemployment Insurance** | **Economic Development Bonds** | **Nonmajor Enterprise** | **Internal Service** |
| Charges for services | $ - | $ - | $16,000 | $ - |
| Investment income | - | 9,305 | 36 | 168 |
| Contributions/premiums | 8,441 | - | 3,103 | 4,133 |
| Other | - | - | 290 | 349 |
| Total receivables | 8,441 | 9,305 | 19,429 | 4,650 |
| Less: allowance for doubtful accounts | (5,925) | - | (128) | - |
| Receivables, net | $ 2,516 | $9,305 | $19,301 | $4,650 |

## B. Payables

| Payables | Governmental Funds | | | | | |
|---|---|---|---|---|---|---|
| | General Fund | State Special Revenue | Federal Special Revenue | Coal Severance Tax Permanent | Land Grant Permanent | Nonmajor Governmental |
| Refunds | $ 95,742 | $ - | $ - | $- | $ - | $ - |
| Tax distributions to other govt | - | 48,583 | - | - | - | - |
| Vendors/individuals | 43,338 | 50,997 | 92,500 | - | - | 1,932 |
| Payroll | 13,780 | 14,609 | 5,643 | - | - | 8 |
| Accrued interest | - | - | 3 | - | 5,344 | 5 |
| Other | 557 | 568 | 49 | - | - | 10 |
| Total | $153,417 | $114,757 | $98,195 | $- | $5,344 | $1,955 |

| Payables | Proprietary Funds | | | |
|---|---|---|---|---|
| | Unemployment Insurance | Economic Development Bonds | Nonmajor Enterprise | Internal Service |
| Vendors/individuals | $274 | $ 13 | $5,885 | $6,548 |
| Payroll | - | 11 | 580 | 2,285 |
| Accrued interest | - | 1,153 | 3 | - |
| Total | $274 | $1,177 | $6,468 | $8,833 |

## NOTE 5. CAPITAL ASSETS

### A. Primary Government

Changes in capital asset balances for the fiscal year ended June 30, 2006, are reflected in the following table (in thousands):

**Primary Government**

| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|---|---|---|---|
| **Governmental activities** | | | | |
| Capital assets, not being depreciated | | | | |
| Land | $ 354,857 | $ 37,421 | $ (13,795) | $ 378,483 |
| Construction work in progress | 201,936 | 118,546 | (3,715) | 316,767 |
| Other (1) | 70,033 | 81,390 | (1) | 151,422 |
| Total capital assets, not being depreciated | 626,826 | 237,357 | (17,511) | 846,672 |
| Capital assets, being depreciated | | | | |
| Infrastructure | 3,265,389 | 405,083 | (252,488) | 3,417,984 |
| Land improvements | 16,396 | 4,635 | (572) | 20,459 |
| Buildings/improvements | 366,291 | 25,256 | (5,581) | 385,966 |
| Equipment | 257,137 | 26,063 | (14,003) | 269,197 |
| Other | 3,548 | 118 | - | 3,666 |
| Total capital assets, being depreciated | 3,908,761 | 461,155 | (272,644) | 4,097,272 |
| Less: accumulated depreciation for: | | | | |
| Infrastructure | (1,479,468) | (142,193) | 243,826 | (1,377,835) |
| Land improvements | (2,143) | (1,006) | 19 | (3,130) |
| Buildings/improvements | (160,838) | (11,932) | 4,124 | (168,646) |
| Equipment | (156,947) | (18,240) | 8,740 | (166,447) |
| Other | (3,182) | (206) | - | (3,388) |
| Total accumulated depreciation | (1,802,578) | (173,577) | 256,709 | (1,719,446) |
| Total capital assets, being depreciated, net | 2,106,183 | 287,578 | (15,935) | 2,377,826 |
| Intangible assets (1) | 72,649 | 18,762 | (75,332) | 16,079 |
| Governmental activity capital assets, net | $ 2,805,658 | $ 543,696 | $(108,777) | $ 3,240,577 |

(1) Land easements were reclassified from intangible assets to other – nondepreciable assets.

**Primary Government** *(continued)*

| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|---|---|---|---|
| **Business-type activities** | | | | |
| Capital assets, not being depreciated | | | | |
| Land | $ 800 | $ - | $ - | $ 800 |
| Construction work in progress | 867 | 59 | (617) | 309 |
| Total capital assets, not being depreciated | 1,667 | 59 | (617) | 1,109 |
| Capital assets, being depreciated | | | | |
| Infrastructure | 884 | - | - | 884 |
| Land improvements | 2,343 | - | - | 2,343 |
| Buildings/improvements | 6,098 | 1,203 | - | 7,301 |
| Equipment | 10,062 | 448 | (5,333) | 5,177 |
| Total capital assets, being depreciated | 19,387 | 1,651 | (5,333) | 15,705 |
| Less: accumulated depreciation for: | | | | |
| Infrastructure | (505) | (17) | - | (522) |
| Land improvements | (131) | (107) | - | (238) |
| Buildings/improvements | (3,754) | (184) | - | (3,938) |
| Equipment | (7,655) | (1,092) | 5,328 | (3,419) |
| Total accumulated depreciation | (12,045) | (1,400) | 5,328 | (8,117) |
| Total capital assets, being depreciated, net | 7,342 | 251 | (5) | 7,588 |
| Intangible assets | 661 | - | (248) | 413 |
| Business-type activity capital assets, net | $ 9,670 | $ 310 | $ (870) | $ 9,110 |

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

| | Amount |
|---|---|
| General government | $ 4,634 |
| Public safety/corrections | 5,333 |
| Transportation (including depreciation of the highway system maintained by the State) | 119,536 |
| Health/social services | 2,464 |
| Education/cultural | 2,528 |
| Resource/recreation/environment (including depreciation of the State's dams). | 3,025 |
| Economic development/assistance | 770 |
| 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. | 11,091 |
| Total depreciation expense – governmental activities | $149,381 |

Depreciation expense was charged to business-type activities as follows (in thousands):

| | Amount |
|---|---|
| Liquor Stores | $ 97 |
| State Lottery | 668 |
| General Government Services | 186 |
| Prison Funds | 271 |
| Total depreciation expense – business-type activities | $1,222 |

### 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**

| | Montana State University (MSU) | University of Montana (UM) | Other | Total |
|---|---|---|---|---|
| Capital assets, not being depreciated | | | | |
| Land | $ 6,508 | $ 7,126 | $ - | $ 13,634 |
| Construction work in progress | 15,997 | 29,692 | 376 | 46,065 |
| Capitalized collections | 7,827 | 15,461 | - | 23,288 |
| Livestock for educational purposes | 3,000 | - | - | 3,000 |
| Total capital assets, not being depreciated | 33,332 | 52,279 | 376 | 85,987 |
| Capital assets, being depreciated | | | | |
| Infrastructure | 32,128 | - | - | 32,128 |
| Land improvements | 13,606 | 12,619 | - | 26,225 |
| Buildings/improvements | 306,565 | 331,305 | - | 637,870 |
| Equipment | 96,214 | 46,344 | 3,954 | 146,512 |
| Other | 59,331 | 49,323 | - | 108,654 |
| Total capital assets, being depreciated | 507,844 | 439,591 | 3,954 | 951,389 |
| Less: accumulated depreciation | (292,438) | (244,101) | (2,399) | (538,938) |
| Total capital assets, being depreciated, net | 215,406 | 195,490 | 1,555 | 412,451 |
| Intangible assets | 493 | 503 | 4,725 | 5,721 |
| Capital assets (net) of MSU component units | 8,026 | - | - | 8,026 |
| Capital assets (net) of UM component units | - | 4,949 | - | 4,949 |
| Discretely presented component units Total capital assets, net | $ 257,257 | $ 253,221 | $ 6,656 | $ 517,134 |

## NOTE 6. RETIREMENT PLANS

### 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 or the Public Employees Retirement System, benefit plans 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. Required employee contributions were 7.03% of salary; required employer contributions were 4.91% of salary, for a total of 11.9% of salary contributed to the ORP.

| | TIAA-CREF *(in thousands)* |
|---|---|
| Covered payroll | $145,294 |
| Total payroll | 308,615 |
| | |
| Employer contributions | $ 7,138 |
| Percent of covered payroll | 4.91% |
| | |
| Employee contributions | $ 10,210 |
| Percent of covered payroll | 7.03% |

**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 transfer to 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.

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. Five loan draws were taken in the total amount of $1,498,000. Interest repayments began immediately following the draws. Principal repayments began August 15, 2003, the year following the PERS-DCRP implementation date. The loan was renegotiated as a single sum in fiscal year 2004, to be repaid over a period of 15 years. The interest rate is variable and changes every February, impacting the interest due on the outstanding principal balance.

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

The PERS requested an inter-entity loan in the amount of $2,000 from the General Fund to the Municipal Police Officers Retirement System (MPORS) fund at the end of fiscal year 2006. This loan was repaid on August 8, 2006.

### 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, 2006, the net assets of the plan were $248,226,353.

The 457 plan is a voluntary, supplemental retirement savings plan. 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 IRC-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), Municipal Police Officers Retirement System (MPORS), Firefighters Unified Retirement System (FURS), Sheriffs Retirement System (SRS), Highway Patrol Officers Retirement System (HPORS), Judges Retirement System (JRS), Game Wardens and Peace Officers Retirement System (GWPORS), and Volunteer Firefighters Compensation Act (VFCA). The PERB prepares a publicly issued comprehensive annual financial report that includes financial statements and required supplementary information for PERS-DBRP, MPORS, FURS, SRS, HPORS, JRS, GWPORS, VFCA, as well as the two defined contribution plans, PERS-DCRP and 457 plan. Separately issued financial statements can be obtained at 100 North Park, PO Box 200131, Helena, MT 59620-0131.

The financial statements for PERS-DBRP include activity for the defined benefit and the associated education fund. The PERS-DCRP financial statements include activity for the defined contribution and the associated education and disability funds.

The Teachers Retirement System (TRS) is a discretely presented component unit of the State of Montana. The plan prepares a publicly issued financial report that includes financial statements and required supplementary information for TRS. Separately issued financial statements can be obtained at 1500 Sixth Avenue, PO Box 200139, Helena, MT 59620-0139.

A summary of government employers participating in PERS-DBRP, MPORS, FURS, SRS, HPORS, JRS, GWPORS, PERS-DCRP, 457, and TRS by employer type at June 30, 2006, follows:

**Retirement Plan**

| | PERS-DBRP | MPORS | FURS | SRS | HPORS | JRS | GWPORS | PERS-DCRP | 457 | TRS |
|---|---|---|---|---|---|---|---|---|---|---|
| **Employers** | | | | | | | | | | |
| State agencies | 36 | | 1 | 1 | 1 | 1 | 4 | 29 | 36 | 8 |
| Counties | 55 | | | 56 | | | | 43 | 2 | |
| Cities/towns | 94 | 22 | 16 | | | | | 41 | | |
| Colleges/universities | 5 | | | | | | 3 | 5 | 6 | 5 |
| School districts | 239 | | | | | | | 81 | 2 | 366 |
| Other | 95 | | | | | | | 30 | 2 | |
| Total | 524 | 22 | 17 | 57 | 1 | 1 | 7 | 229 | 48 | 379 |

**B. Plan Descriptions**

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

The number of years required to obtain vested rights varies among the plans. All plans provide early retirement options, death benefits, termination, and disability benefits. The post-retirement benefits of each of the plans are included in the tables that follow.

The funding policies for each plan 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 actuarial 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 plan, 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. Members or their survivors may be eligible for an annual supplemental lump sum payment distributed each September. Many factors must be considered for eligibility, including the number of year the recipient has received a benefit and the recipient's age. This lump-sum payment is funded by the General

Fund at the request of the PERB. The average payment in September 2006 was $3,139. This enhancement is limited to non-GABA (Guaranteed Annual Benefit Adjustment) members.

**JRS** – Judges Retirement System – This plan, established in 1967 and governed by Title 19, Chapters 2 & 5 of the MCA, provides retirement benefits for all Montana judges of district courts, justices of the Supreme Court, and the Chief Water Judge.

**(2) State as an Employer Contributor to Cost-Sharing, Multiple-Employer Plans**

**PERS-DBRP** – Public Employees Retirement System - Defined Benefit Retirement Plan – This mandatory plan, 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 plan.

Actuarial Status: The Montana Constitution, Article VIII, Section 15, requires public retirement plans be funded on actuarially sound basis. The statutory funding rate is tested in the valuation to determine if it is sufficient to cover the normal cost rate plus an amortization payment of the unfunded actuarial liability, if any, over no more than 30 years. Based on the current actuarial value of assets and all future experience emerging as assumed, the unfunded actuarial liability will not be amortized over the next 30 years. In general, the deterioration of the funded status is primarily due to recognizing prior investment losses due to returns less than the long-term assumed rate of 8% per year. Based on the actuarial assumptions as of June 30, 2006, an additional funding rate of 1.01% of payroll would be required to fund the current and projected benefits from the Defined Benefit plan in accordance with GASB standards and state law.

**MPORS** – Municipal Police Officers Retirement System – The plan, established in 1974 and governed by Title 19, Chapters 2 & 9 of the MCA, covers all municipal police officers of first and second-class cities covered by the plan. It is a cost-sharing defined benefit plan with a special funding situation.

As of July 1, 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 PERB. The DROP is governed by Title 19, Chapter 9, Part 12, MCA. An eligible member must have completed at least 20 years of membership service. 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 plan 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 plan. 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 the DROP account cannot be distributed until employment is formally terminated.

**FURS** – Firefighters Unified Retirement System – This plan, 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 adopt the plan and to firefighters hired by the Montana Air National Guard on or after October 1, 2001. It is a multiple-employer, cost-sharing defined benefit plan.

**SRS** – Sheriffs Retirement System – This plan, 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.

Effective July 1, 2005, Senate Bill 370 provided membership for county detention officers in the SRS. All detention officers hired after July 1, 2005, will be in the SRS. Existing detention officers may elect to remain in the PERS or elect to become a member of the SRS.

Actuarial Status: The Montana Constitution, Article VIII, Section 15, requires public retirement plans be funded on actuarially sound basis. The statutory funding rate is tested in the valuation to determine if it is sufficient to cover the normal cost rate plus an amortization payment of the unfunded actuarial liability, if any, over no more than 30 years. Based on the current actuarial value of assets and all future experience emerging as assumed, the unfunded actuarial liability will not be amortized over the next 30 years. In general, the deterioration of the funded status is primarily due to recognizing prior investment losses due to returns less than the long-term assumed rate of 8% per year. Based on the actuarial assumptions as of June 30, 2006, an additional funding rate of 1.84% of payroll would be required to fund the current and projected benefits from the retirement plan in accordance with GASB standards and state law.

**GWPORS** – Game Wardens & Peace Officers Retirement System – This plan, 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, or MPORS plans.

Actuarial Status: The Montana Constitution, Article VIII, Section 15, requires public retirement plans be funded on actuarially sound basis. The statutory funding rate is tested in the valuation to determine if it is sufficient to cover the normal cost rate plus an amortization payment of the unfunded actuarial liability, if any, over no more than 30 years. Based on the current actuarial value of assets and all future experience emerging as assumed, the unfunded actuarial liability will not be amortized over the next 30 years. In general, the deterioration of the funded status is primarily due to recognizing prior investment losses due to returns less than the long-term assumed rate of 8% per year. Based on the actuarial assumptions as of June 30, 2006, an additional funding rate of 0.04% of payroll would be required to fund the current and projected benefits from the retirement plan in accordance with GASB standards and state law.

**VFCA** – Volunteer Firefighters Compensation Act – This compensation program, established in 1965 and governed by Title 19, Chapters 2 and 17 of the MCA, provides pension, disability and survivorship benefits for all volunteer firefighters who are members of qualified 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 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 July 1, 2003).

**TRS** – Teachers Retirement System – This mandatory plan, 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.

Actuarial Status: The Montana Constitution, Article VIII, Section 15, requires public retirement plans be funded on actuarially sound basis. The statutory funding rate is tested in the valuation to determine if it is sufficient to cover the normal cost rate plus an amortization payment of the unfunded actuarial liability, if any, over no more than 30 years. Based on the current actuarial value of assets and all future experience emerging as assumed, the unfunded actuarial liability will not be amortized over the next 30 years. In general, the deterioration of the funded status is primarily due to recognizing prior investment losses due to returns less than the long-term assumed rate of 7.75% per year. The plan's actuary has determined that as of July 1, 2006, the current employer contribution rate of 7.47% plus the General Fund contribution of 0.11% of members' salaries are insufficient to meet the actuarial cost. The unfunded actuarial accrued liability of $863.1 million is included in the Schedules of Funding Progress.

A brief summary of contribution rates, eligibility and benefits for each retirement plan is provided in the tables on the following three pages.

**Schedule of Contribution Rates**
**Fiscal Year 2006**

| Plan | Member | Employer | State |
|---|---|---|---|
| **PERS-DBRP** | **6.9%** [19-3-315, MCA] | **6.9%** State & University<br><br>**6.8%** Local Governments [19-3-316, MCA] | **0.1%** of local government payroll – paid from the General Fund [19-3-319, MCA] |
| **MPORS** | **5.8%** - hired on or before 6/30/1975 & not electing GABA [19-9-710(a), MCA]<br><br>**7.0%** - hired after 6/30/1975 & prior to 7/1/1979 & not electing GABA [19-9-710(b), MCA]<br><br>**8.5%** - hired after 6/30/1979 & prior to 7/1/1997 & not electing GABA [19-9-710(c), MCA]<br><br>**9.0%** - hired after 6/30/1997 & members electing GABA [19-9-710(d), MCA] | **14.41%** [19-9-703, MCA] | **29.37%** of salaries – paid from the General Fund [19-9-702, MCA] |
| **FURS** | **9.5%** - hired prior to 7/1/1997 & not electing GABA [19-13-601(2)(a), MCA]<br><br>**10.7%** - hired after 6/30/1997 & members electing GABA [19-13-601(2)(b), MCA] | **14.36%** [19-13-605, MCA] | **32.61%** of salaries – paid from the General Fund [19-13-604, MCA] |
| **SRS** | **9.245%** [19-7-403, MCA] | **9.535%** [19-7-404, MCA] | |
| **HPORS** | **9.0%** - hired prior to 7/1/1997 & not electing GABA<br><br>**9.05%** - hired after 6/30/1997 & members electing GABA [19-6-402, MCA] | **26.15%** [19-6-404(1), MCA]<br><br>**10.18%** of salaries – paid from driver license fees [19-6-404(2), MCA] | |
| **JRS** | **7.0%** [19-5-402, MCA] | **25.81%** [19-5-404, MCA] | |
| **GWPORS** | **10.56%** [19-8-502, MCA] | **9.0%** [19-8-504, MCA] | |
| **VFCA** | | | **5.0%** of fire insurance premiums, paid by the General Fund [19-17-301, MCA] |
| **PERS-DCRP** | **6.9%** [19-3-315, MCA] | **6.9%** State & University<br><br>**6.8%** Local Governments [19-3-316, MCA] | **0.1%** of local government payroll – paid from the General Fund [19-3-319, MCA] |
| **TRS** | **7.15%** [19-20-602, MCA] | **7.47%** [19-20-605, MCA] | **0.11%** of members' salaries [19-20-604, MCA] |

**Summary of Eligibility and Benefits**

| Plan | Member's Highest Average Compensation (HAC) | Years of Service Required and/or Age Eligible for Benefit | Vesting |
|---|---|---|---|
| **PERS-DBRP** | Highest average compensation during any consecutive 36 months | Service retirement:<br>30 years, any age;<br>Age 60, 5 years of service; or<br>Age 65, regardless of service<br>Early retirement, actuarially reduced:<br>Age 50, 5 years of service; or<br>Any age, 25 years of service | 5 years membership service |
| **MPORS** | Hired prior to 7/1/1977 – average monthly compensation of final year of service; hired after 6/30/1977 – final compensation for last consecutive 36 months | 20 years, regardless of age; age 50, 5 years of service | 5 years membership service |
| **FURS** | Hired prior to 7/1/1981 and not electing GABA – highest monthly compensation (HMC); hired after 6/30/1981 and those electing GABA – highest average compensation (HAC) during any consecutive 36 months | 20 years, regardless of age; age 50, 5 years of service | 5 years membership service |
| **SRS** | Highest average compensation during any consecutive 36 months | 20 years membership service, regardless of age; age 50, 5 years of service, actuarially reduced | 5 years membership service |
| **HPORS** | Highest average compensation during any consecutive 36 months | 20 years of service, regardless of age; 5 years of membership service, actuarially reduced from age 60 | 5 years membership service |
| **JRS** | Hired prior to 7/1/1997 and non-GABA – monthly compensation at time of retirement; hired after 6/30/1997 or electing GABA – HAC during any consecutive 36 months (relates directly to monthly benefit formula) | Age 60, 5 years of membership service; any age with 5 years of membership service – involuntary termination, actuarially reduced | 5 years membership service |
| **GWPORS** | Highest average compensation during any consecutive 36 months | Age 50, 20 years of membership service; age 55, 5 years of membership service | 5 years membership service |
| **VFCA** | | Age 55, 20 years of credited service (full benefit); age 60, 10 years of service (partial benefit). As of 4/25/2005 (Senate Bill 197), members may retire with greater than 20 years of service, but not more than 30 years of service. | 10 years of service credit |
| **PERS-DCRP** | | Termination of service | Immediate for member's contributions and attributable income; 5 years for employer's contributions and attributable income |
| **TRS** | Final average compensation during any consecutive 36 months | Age 60, 5 years of service, or any age with at least 25 years of service. Vested employees may retire at or after age 50 and receive reduced benefits. | 5 years of membership service |

**Summary of Eligibility and Benefits** *(continued)*

| Plan | Monthly Benefit Formula | Guaranteed Annual Benefit Adjustment (GABA) | Minimum Benefit Adjustment (Non-GABA) |
|---|---|---|---|
| **PERS-DBRP** | Less than 25 years of membership service: 1.785% of HAC per year of service credit; 25 years of service or more: 2% of HAC per year of service credit | After the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of other adjustments to the member's benefit. | |
| **MPORS** | 2.5% of FAC per year of service credit | After the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other adjustments to the member's benefit. | If hired before 7/1/1997 and member did not elect GABA, the monthly retirement, disability or survivor's benefit may not be less than 1/2 the compensation of a newly confirmed officer in the city that the member was last employed. |
| **FURS** | Members hired prior to 7/1/1981 and not electing GABA are entitled to the greater of: 2.5% of HAC per year of service credit; or (1) if less than 20 years of service, 2% of HMC for each year of service; or (2) if more than 20 years of service, 50% of the member's HMC plus 2% of the member's HMC for each year of service credit over 20 years. Members hired after 6/30/1981 and those electing GABA receive 2.5% of HAC per year of service credit. | After the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other adjustments to the member's benefit. | If hired before 7/1/1997 and member did not elect GABA, the monthly retirement, disability or survivor's benefit may not be less than 1/2 the compensation of a newly confirmed firefighter employed by the city that last employed the member (provided the member has at least 10 years of service credit). |
| **SRS** | 2.5% of HAC per year of service credit | After the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other adjustments to the member's benefit. | |
| **HPORS** | 2.5% of HAC per year of service | Hired after 7/1/1997, or those electing GABA – after the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of other adjustments to the member's benefit. | Hired prior to 7/1/1997 – monthly benefits for non-GABA members are increased each July when they fall below a statutorily guaranteed minimum. Any annual increase is limited to 5% over the current benefit and may not exceed 60% of the current base salary of a probationary officer. |
| **JRS** | 3 1/3% of current salary (non-GABA) or HAC (GABA) per year of service for the first 15 years, plus 1.785% per year for each year after 15 years | Hired after 7/1/1997, or those electing GABA – after the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other benefit adjustments to the members. | Hired prior to 7/1/1997 – current salary is used in the calculation of the monthly benefit each time the Legislature increases salaries for active judges. |
| **GWPORS** | 2.5% of HAC per year of service credit | After the member has completed 12 full months of retirement, the member's benefit increases by a maximum of 3% each January, inclusive of all other adjustments to the member's benefit. | |
| **VFCA** | $7.50 per year of credited service, maximum $150; if greater than 20 years of service (but not more than 30 years), maximum $225 | | |
| **PERS-DCRP** | varies | | |
| **TRS** | 1.6667% of average final compensation (AFC) per year of service | | |

**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 refund distributions 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 defined benefit retirement plans. 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 plans have no investments with a single issuer whose fair value equals 5% or more of the retirement plans net assets available for benefits.

**E. Long-term Contracts for Contributions**

The Montana Legislature also enacted a provision of the Employee Protection Act (EPA) (Title 19, Chapter 2, Part 706. MCA), allowing state and university system employees, eligible for a service retirement, whose positions have been eliminated, to have their employer pay a portion of the total cost of purchasing up to three years of "1 for 5" additional service. As of June 30, 2006, 165 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 2006 were $123,784. June 30, 2006, outstanding balances were $49,261.

## NOTE 7. OTHER POSTEMPLOYMENT BENEFITS

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

The State and the Montana University System (MUS) provide 18 to 36 months optional postemployment health care and dental 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, 2006, 55 certificate holders were receiving these benefits for the State of Montana, 108 for the Montana University System.

In accordance with MCA 2-18-704, 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 plan (See Note 6). Administratively established retiree medical premiums vary between $155 and $675 per month depending on the medical plan selected, family coverage, and Medicare eligibility. Administratively established dental premiums vary between $27.80 and $45.80, and vision premiums vary between $8.44 and $21.94 depending on the coverage selected. The State acts as secondary payor for retired Medicare-eligible claimants. As of June 30, 2006, there were 3,318 retirees 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% of the allowable charges, depending on the services provided. Vision services are provided at prices ranging from a $10 copay to a $120 allowance depending on the services obtained and the network status of the provider. Vision coverage is fully insured; therefore premium contributions reflect the total cost to the State during the year. The State funds claims on a pay-as-you-go basis and, in addition, maintains a claims fluctuation reserve equivalent to three months projected claims and operating costs. During the fiscal year, expenditures of $21,206,622 were recognized for postemployment health care benefits. Premium contributions received from former employees amounted to $15,460,535 leaving $5,746,087 of claims paid in excess of premium revenue received by the State.

In accordance with MCA 2-18-702, the Montana University System 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 five years, are age 50 or have worked 25 years with the MUS. Spouses, unmarried dependent children, and surviving spouses are also eligible.

Administratively established premiums vary between $210 and $603 per month, and are revised annually. The plan provides different coinsurance amounts depending on whether members use preferred, non-preferred, or other hospitals. After an annual $575 deductible for most non-Medicare-eligible retirees, the MUS plan reimburses 80% of the first $2,500 in medical claims and 100% thereafter. After a $400 deductible for Medicare-eligible retirees, the plan reimburses 80% for the first $1,250 in medical claims and 100% thereafter. There is an optional $1,500 deductible plan available to retirees with a reduced premium. This plan has a small enrollment (77 enrollees). After the $1,500 annual deductible, the plan pays 75% of the first $8,000 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, 2006, 1,427 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 2006, expenditures of $8,678,927 were recognized for postemployment health care benefits. Of this amount, $6,248,223 was paid by retirees through premiums, and the balance of $2,430,704 was paid by the MUS.

As of July 1, 2006, retirees can now choose a managed care option, if available, in their area. The managed care premiums are lower and there are more first dollar benefits. After an in-network deductible of $300, the plan reimburses 75% for the first $2,000 and 100% thereafter. The managed care plans have a small enrollment (30 enrollees) for this first year offering to retirees.

For the fiscal year ending June 30, 2007, the State and the MUS will implement GASB Statement 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions. This statement requires the disclosure of the employer liability for retiree medical subsidies and other postemployment benefits. The annual required contribution (ARC) will be equal to an amount required each year to fully fund the liability over 30 years. The estimated ARC for the State and the MUS has been estimated at $29,892,000 and $21,477,000, respectively. The amount of the estimated OPEB liability at transition was determined in accordance with the Statement, and has been estimated at $306,150,000 for the State and $218,963,000 for the MUS. These estimates were prepared by Buck Consultants.

## NOTE 8. RISK MANAGEMENT

There are three primary government public entity risk pools and one claims-servicing pool that are reported within the enterprise fund. These pools include Hail Insurance, the Montana University System (MUS) Group Benefits Plan, the Montana University System Workers Compensation funds, and the Subsequent Injury claims-servicing pool. The two 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 for the last three years. These funds use the accrual basis of accounting. By statute, these funds cannot invest in common stock, except for the State Compensation Insurance funds. 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 2,107 policies during the 2006 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 that exceeds 5% destruction by hail.

The fund recorded a liability of $94,405 based on estimated claims through June 30, 2006. 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) Montana University System (MUS) Group Benefits Plan** – This plan was authorized by the Board of 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. Allegiance Benefit Plan Management is the claims administrator for the self-insured indemnity plan and a managed care plan. New West Health Services, Blue Cross/Blue Shield of Montana, and Peak administers claims for the three other managed care plans. Star Point has a contract for utilization management: the utilization management program consists of hospital pre-authorization 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 $6,250,000 as of June 30, 2006, based on prior year experience. A liability is reported in the accompanying financial statements for these estimated claims.

**(3) Montana University System (MUS) Workers Compensation Program** – This fund was formed to provide self-insured workers compensation coverage for employees of the Montana University System. The Montana University System Board of Regents elected to provide workers compensation coverage under Compensation Plan Number One (MCA 39-71-2101) as of July 1, 2003. Prior to that date, the Montana University System obtained its workers compensation coverage through the State Compensation Insurance Fund. 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. During fiscal year 2006, the program ceded $198,718 in premiums to reinsurers.

Premium rates for all participating employees are based on rates established by the MUS Workers Compensation Program Committee. Premium rates are adjusted periodically based on inflation, claims experience, and other factors. Premiums are recorded as revenue in the MUS Workers Compensation Program in the period for which coverage is provided. Members may be subject to supplemental assessments in the event of deficiencies. The program considers anticipated investment income in determining if a premium deficiency exists.

The fund recorded a liability of $4,538,528 for estimated claims at June 30, 2006. The liability is based on the estimated ultimate cost of settling the reported and unreported claims, and claims reserve development including the effects of inflation and other societal and economic factors. Estimated amounts of subrogation and reinsurance recoverable on unpaid claims are deducted from the liability for unpaid claims. Estimated claims liabilities are recomputed periodically based on current review of claims information, experience with similar claims, and other factors. Adjustments to estimated claims liabilities are recorded as an increase or decrease in claims expense in the period the adjustments are made.

**(4) 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.

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, 2006, the amount of this liability was estimated to be $2,976,711. Since each insurer is responsible for its own claim liabilities, the pool is acting as a claims service and there is no transfer or pooling of risk.

**(5) State Compensation Insurance (New Fund)** – This fund provides 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 June 30, 2006, approximately 28,410 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, 2006, 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, 2006, $590,688,000 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 for the fiscal year ended June 30, 2006, was $569,570. For the fiscal year ended June 30, 2006, $774,963 of acquisition costs were amortized.

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.

**(6) 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.

An actuarial study prepared by Tillinghast-Towers Perrin, as of June 30, 2006, 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, 2006, $97,768,808 of unpaid claims and claim adjustment expenses were reported at a net present value of $73,736,659, discounted at a 5.0% rate.

**(7) 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.

| | Primary Government | | | | | |
|---|---|---|---|---|---|---|
| | Hail Insurance | | MUS Group Benefits | | MUS Workers Compensation Program | |
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| Unpaid claims and claim adjustment expenses at beginning of year | $ 191 | $ 95 | $ 4,619 | $ 4,663 | $ 3,138 | $1,622 |
| Incurred claims and claim adjustment expenses: provision for insured events of the current year | 2,447 | 1,978 | 48,163 | 37,533 | 2,453 | 2,366 |
| Increase (decrease) in provision for Insured events of prior years | (320) | (285) | 1,631 | (44) | 62 | - |
| Total incurred claims and claim adjustment expenses | 2,127 | 1,693 | 49,794 | 37,489 | 2,515 | 2,366 |
| Payments: Claims and claim adjustment expenses attributable to insured events of the current year | (2,033) | (1,502) | (48,163) | (37,533) | (391) | (382) |
| Claims and claim adjustment expenses attributable to insured events of prior years | (191) | (95) | - | - | (724) | (468) |
| Total payments | (2,224) | (1,597) | (48,163) | (37,533) | (1,115) | (850) |
| Total unpaid claims and claim adjust. exp. at end of the year | $ 94 | $ 191 | $ 6,250 | $ 4,619 | $ 4,538 | $3,138 |

| | Component Units | | | |
|---|---|---|---|---|
| | State Compensation Insurance (New Fund) | | State Compensation Insurance (Old Fund) | |
| | 2006 | 2005 | 2006 | 2005 |
| Unpaid claims and claim adjustments expenses at beginning of year | $ 511,557 | $ 452,115 | $104,852 | $108,500 |
| Incurred claims and claim adjustment expenses: Provision for insured events of the current year | 170,399 | 149,542 | - | - |
| Increase (decrease) in provision for insured events of prior years | 35,439 | 10,070 | 3,811 | 6,691 |
| Total incurred claims and claim adjustment expenses | 205,838 | 159,612 | 3,811 | 6,691 |
| Payments: Claims and claim adjustment expenses attributable to insured events of the current year | (36,132) | (25,721) | - | - |
| Claims and claim adjustment expenses attributable to insured events of prior years | (90,575) | (74,449) | (10,894) | (10,339) |
| Total payments | (126,707) | (100,170) | (10,894) | (10,339) |
| Total unpaid claims and claim adjust. exp. at end of the year | $ 590,688 | $ 511,557 | $ 97,769 | $104,852 |

**(8) Risk Management Trend Information** – The following tables only present risk management trend information for the State Compensation Insurance (New Fund) and the MUS Workers Compensation Insurance. Both funds have 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 tables illustrate how the earned revenues (net of reinsurance) of the funds and their investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the funds as of the end of the fiscal year (in thousands). Section 3 shows the funds' 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.

| | | MUS Workers Compensation Program | |
|---|---|---|---|
| | **2006** | **2005** | **2004** |
| 1. **Premiums and investment revenue** | | | |
| Earned | $3,709 | $3,048 | $2,425 |
| Ceded | (199) | (197) | (151) |
| Net earned | $3,510 | $2,851 | $2,274 |
| 2. **Unallocated expenses including overhead** | $ 264 | $ 280 | $ 227 |
| 3. **Estimated losses and expenses end of accident year** | | | |
| Incurred | $2,453 | $2,366 | $2,174 |
| Ceded | - | - | - |
| Net incurred | $2,453 | $2,366 | $2,174 |
| 4. **Net paid (cumulative) as of:** | | | |
| End of policy year | $ 391 | $ 382 | $ 552 |
| One year later | | 1,002 | 1,020 |
| Two years later | | | 1,124 |
| 5. **Re-estimated ceded losses and expenses** | $ - | $ - | $ - |
| 6. **Re-estimated net incurred losses and expense:** | | | |
| End of policy year | $2,453 | $2,366 | $2,174 |
| One year later | | 2,565 | 2,174 |
| Two years later | | | 2,037 |
| 7. **Increase (decrease) in estimated net incurred losses and expenses from end of policy year** | $ - | $ 199 | $ (137) |

*(State Compensation Insurance (New Fund) Table presented on next page)*

| | State Compensation Insurance (New Fund) | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **1997** | **1998** | **1999** | **2000** | **2001** | **2002** | **2003** | **2004** | **2005** | **2006** |
| 1. **Premiums and investment revenue** | | | | | | | | | | |
| Earned | $105,417 | $90,808 | $82,760 | $91,565 | $116,548 | $129,886 | $166,146 | $174,388 | $222,230 | $170,973 |
| Ceded | (348) | (303) | (260) | (855) | (2,952) | 465 | (5,654) | (6,563) | (6,788) | (13,618) |
| Net earned | $105,069 | $90,505 | $82,500 | $90,710 | $113,596 | $130,351 | $160,492 | $167,825 | $215,442 | $157,355 |
| 2. **Unallocated expenses including overhead** | $ 12,536 | $14,322 | $18,923 | $22,019 | $ 26,670 | $ 29,393 | $ 32,497 | $ 39,057 | $ 41,543 | $ 45,558 |
| 3. **Estimated losses and expenses end of accident year** | | | | | | | | | | |
| Incurred | $ 76,067 | $64,983 | $64,645 | $65,957 | $ 68,267 | $ 81,560 | $110,153 | $120,705 | $134,290 | $155,057 |
| Ceded | - | - | - | - | - | - | - | - | - | - |
| Net incurred | $ 76,067 | $64,983 | $64,645 | $65,957 | $ 68,267 | $ 81,560 | $110,153 | $120,705 | $134,290 | $155,057 |
| 4. **Net paid (cumulative) as of:** | | | | | | | | | | |
| End of policy year | $ 12,589 | $12,943 | $13,723 | $13,177 | $ 14,140 | $ 16,693 | $ 22,982 | $ 26,123 | $ 25,721 | $ 30,977 |
| One year later | 28,451 | 28,222 | 29,976 | 29,218 | 32,888 | 38,185 | 48,861 | 50,888 | 57,239 | |
| Two years later | 35,706 | 35,753 | 39,298 | 37,555 | 45,218 | 52,359 | 63,773 | 66,140 | | |
| Three years later | 39,860 | 41,004 | 45,748 | 43,649 | 55,248 | 60,029 | 72,957 | | | |
| Four years later | 43,105 | 44,478 | 49,984 | 48,322 | 61,486 | 64,922 | | | | |
| Five years later | 46,478 | 47,584 | 54,212 | 52,027 | 66,031 | | | | | |
| Six years later | 48,505 | 50,188 | 56,974 | 54,473 | | | | | | |
| Seven years later | 50,402 | 52,240 | 59,935 | | | | | | | |
| Eight years later | 52,285 | 54,004 | | | | | | | | |
| Nine years later | 54,204 | | | | | | | | | |
| 5. **Re-estimated ceded losses and expenses** | $ 6,645 | $ 609 | $ 1,940 | $ - | $ - | $ - | $ 2,901 | $ - | $ - | $ - |
| 6. **Re-estimated net incurred losses and expense:** | | | | | | | | | | |
| End of policy year | $ 76,067 | $64,983 | $64,645 | $65,957 | $ 68,267 | $ 81,560 | $110,153 | $120,705 | $134,290 | $155,057 |
| One year later | 67,235 | 64,308 | 64,348 | 66,421 | 71,094 | 86,799 | 110,532 | 112,609 | 136,235 | |
| Two years later | 59,054 | 60,467 | 66,660 | 66,662 | 81,053 | 91,241 | 112,443 | 124,413 | | |
| Three years later | 60,811 | 61,989 | 69,345 | 70,302 | 88,157 | 94,615 | 117,245 | | | |
| Four years later | 64,439 | 64,944 | 72,435 | 72,492 | 92,329 | 99,755 | | | | |
| Five years later | 59,079 | 67,312 | 73,710 | 73,423 | 95,727 | | | | | |
| Six years later | 60,528 | 67,772 | 75,537 | 76,048 | | | | | | |
| Seven years later | 60,630 | 68,601 | 78,046 | | | | | | | |
| Eight years later | 60,774 | 69,764 | | | | | | | | |
| Nine years later | 62,446 | | | | | | | | | |
| 7. **Increase (decrease) in estimated net incurred losses and expenses from end of policy year** | $ (13,621) | $ 4,781 | $13,401 | $10,091 | $ 27,460 | $ 18,195 | $ 7,092 | $ 3,708 | $ 1,945 | $ - |

**B. Entities Other Than Pools**

**(1) Employee Group Benefits** – The medical and dental health plans provided by the State are 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. The State contracts with Blue Cross/Blue Shield, PEAK, New West, and PharmaCare for administration of its self-insured plans. Premiums are collected through payroll deductions, deductions through the Public Employees Retirement Administration, the Legislative Branch, and self-payments, and are recorded as revenue in the Employee Group Benefits Internal Service Fund. At June 30, 2006, estimates for claims liabilities, which include both incurred but not reported claims and grandfathered claims resulting from a 1998 change in period for which the benefit coverage is available, were $12,516,577 based on a formula provided by Buck Consultants, a consulting actuarial firm, of which $9,707,398 is estimated to be paid in fiscal year 2007.

**(2) Administration Insurance Plans** – This self-insurance plan provides coverage for general liability, automobile liability, automobile physical damage, foster care liability, and state-administered foreclosure of 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 $3.2 billion of state-owned buildings and contents. The State's property insurance includes separate earthquake and flood protection coverage, with deductibles of $250,000 for earthquake and $250,000 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, 1995 through June 30, 2006, is the basis for estimating the liability for unpaid claims and is supported by historical loss data. The June 30, 2006 estimated claims liability was $16,215,516.

**(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):

| | Group Employees Benefits | | Administration Insurance | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Amount of claims liabilities at the beginning of each fiscal year | $ 11,675 | $ 11,195 | $20,328 | $25,558 |
| Incurred claims: | | | | |
| Provision for insured events of the current year | 84,473 | 76,725 | 5,636 | 6,356 |
| Increases (decreases) in provision for insured events of prior years | 842 | 480 | (5,017) | (5,535) |
| Total incurred claims | 85,315 | 77,205 | 619 | 821 |
| Payments: | | | | |
| Claims attributable to insured events of the current year | (71,802) | (70,299) | (1,061) | (819) |
| Claims attributable to insured events of prior years | (12,671) | (6,426) | (3,670) | (5,232) |
| Total payments | (84,473) | (76,725) | (4,731) | (6,051) |
| Total claims liability at end of each fiscal year | $ 12,517 | $ 11,675 | $16,216 | $20,328 |

## NOTE 9. COMMITMENTS

### A. Highway Construction

At June 30, 2006, the Department of Transportation had contractual commitments of approximately $207.4 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, 2006, the Department of Administration, Architecture & Engineering Division, had commitments of approximately $42.2 million for capital projects construction. The primary government will fund $16.5 million of these projects, with the remaining $25.7 million coming from the state university system.

### C. Coal Tax Loan and Mortgage Commitments

The Board of Investments (BOI) makes firm commitments to fund loans from the Coal Severance Tax Permanent Trust Fund. These commitments have expiration dates and may be extended according to the BOI's policies. As of June 30, 2006, the BOI had committed but not yet purchased $76,503,977 in loans from Montana lenders. In addition to the above commitments, lenders had reserved $55,143,007 for loans as of June 30, 2006.

The BOI makes reservations to fund mortgages from the Public Employees and Teachers retirement funds. As of June 30, 2006, the BOI had mortgage reservations/commitments totaling $1,478,884. Effective December 1, 2005, all BOI residential mortgage purchases are processed by the Montana Board of Housing (MBOH). The MBOH does not differentiate between a mortgage reservation and a funding commitment.

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

| | Amount |
|---|---|
| **Enterprise funds** | |
| Liquor Warehouse | $ 99 |
| Historical Society Publications | 20 |
| Hail Insurance | 3 |
| Subtotal-enterprise funds | $ 122 |
| **Internal service funds** | |
| Info Tech Services Division | $1,212 |
| Buildings and Grounds | 620 |
| DEQ Indirect Cost Pool | 213 |
| FWP Equipment | 41 |
| Admin Supply | 24 |
| Employee Group Benefits | 4 |
| Payroll Processing | 2 |
| Subtotal-internal service funds | $2,116 |
| Total | $2,238 |

## 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, 2006, were as follows (in thousands):

| | Primary Government | Discretely Presented Component Units | | |
|---|---|---|---|---|
| Fiscal Year Ending June 30 | Governmental Activities | Montana State University | University of Montana | Total |
| 2007 | $1,031 | $32 | $284 | $316 |
| 2008 | 567 | 20 | 177 | 197 |
| 2009 | 296 | 11 | 154 | 165 |
| 2010 | 223 | 7 | 105 | 112 |
| 2011 | 320 | - | 26 | 26 |
| 2012-2016 | 326 | - | - | - |
| Total minimum pmts | 2,763 | 70 | 746 | 816 |
| Less: interest | (304) | (10) | (110) | (120) |
| Present value of minimum payments | $2,459 | $60 | $636 | $696 |

### B. Operating Leases

Primary government rental payments for operating leases in fiscal year 2006 totaled $14,410,000. Future rental payments under operating leases are as follows (in thousands):

| Fiscal Year Ending June 30 | Primary Government | Discretely Presented Component Units |
|---|---|---|
| 2007 | $13,834 | $ 1,959 |
| 2008 | 11,191 | 1,744 |
| 2009 | 10,245 | 1,518 |
| 2010 | 8,411 | 1,295 |
| 2011 | 7,574 | 697 |
| 2012-2016 | 26,050 | 3,362 |
| 2017-2021 | 8,136 | 1,339 |
| 2022-2026 | 1,835 | - |
| Total future rental payments | $87,276 | $11,914 |

## 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. No revenue anticipation notes were issued during fiscal year 2006.

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. 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, 2006, were as follows (in thousands):

| Series | Amount Issued | Balance June 30, 2006 |
|---|---|---|
| 1994 | 7,500 | $ 6,745 |
| 1995 | 7,500 | 6,915 |
| 1997 | 10,000 | 9,605 |
| 1998 | 12,500 | 12,200 |
| 2000 | 15,000 | 14,865 |
| 2003 | 15,000 | 14,815 |
| 2004 | 18,500 | 18,475 |
| Total | | $83,620 |

The following schedule summarizes the activity relating to the demand bonds during the year ended June 30, 2006 (in thousands):

| | Beginning Balance | Additions | Reductions | Ending Balance |
|---|---|---|---|---|
| Demand bonds | $84,280 | $- | $660 | $83,620 |

## 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, 2006, were as follows (in thousands):

| | | | | Principal Payments | | |
|---|---|---|---|---|---|---|
| Governmental Activities | Series | Amount Issued | Interest Range (%) (1) | Fiscal Year 2007 | In Year of Maturity (2) | Balance June 30, 2006 |
| **General obligation bonds** | | | | | | |
| Wastewater Treatment Works Revolving Fund (3) | 1996C | $ 2,765 | 3.75-5.75 | $ 1,765 | 1,765 (2007) | $ 1,765 |
| Renewable Resource Program (4) | 1997A | 2,000 | 6.8-8.0 | 435 | 435 (2007) | 435 |
| Long-Range Bldg Program | 1997B | 12,640 | 4.5-5.0 | 905 | 945 (2008) | 1,850 |
| Wastewater Treatment Works Revolving Fund (3) | 1998A | 3,510 | 3.75-5.15 | 150 | 260 (2019) | 2,600 |
| Long-Range Bldg Program | 1998B | 34,545 | 4.2-5.1 | 1,555 | 2,555 (2018) | 24,060 |
| Information Technology | 1998C | 41,390 | 4.5-5.0 | 3,905 | 4,075 (2008) | 7,980 |
| Long-Range Bldg Program Refunding | 1998D | 14,855 | 4.4-5.0 | 1,210 | 1,720 (2015) | 12,895 |
| Energy Conservation Program (5) | 1998E | 1,250 | 3.6-4.6 | 140 | 150 (2008) | 290 |
| Renewable Resource Program (4) | 1999 | 1,035 | 6.0-6.5 | 65 | 105 (2015) | 730 |
| Long-Range Bldg Program | 1999C | 16,990 | 4.0-5.0 | 720 | 785 (2009) | 2,255 |
| Drinking Water Revolving Fund (3) | 1998F | 3,065 | 3.6-4.85 | 140 | 230 (2019) | 2,335 |
| Drinking Water Revolving Fund (3) | 2000A | 2,990 | 4.25-5.6 | 110 | 240 (2021) | 2,500 |
| Water Pollution Control Revolving Fund (3) | 2000B | 3,325 | 4.25-5.6 | 125 | 270 (2021) | 2,785 |
| Long-Range Bldg Program | 2000C | 17,195 | 5.0-5.55 | 650 | 800 (2011) | 3,615 |
| Long-Range Bldg Program | 2001B | 11,430 | 4.1-5.75 | 435 | 830 (2021) | 9,060 |
| Information Technology | 2001C | 1,600 | 3.85-4.2 | 155 | 185 (2011) | 850 |
| Energy Conservation Program (5) | 2001D | 1,250 | 3.85-4.2 | 120 | 145 (2011) | 660 |
| Renewable Resource Program (4) | 2001E | 1,040 | 5.2-6.8 | 55 | 105 (2017) | 845 |
| Drinking Water Revolving Fund (3) | 2001G | 3,190 | 4.0-5.0 | 125 | 235 (2022) | 2,750 |
| Water Pollution Control Revolving Fund (3) | 2001H | 2,690 | 4.0-5.0 | 105 | 200 (2022) | 2,315 |
| Long-Range Bldg Program | 2002B | 10,475 | 3.35-4.7 | 430 | 730 (2023) | 9,290 |
| Hard Rock Mining Reclamation | 2002C | 2,500 | 3.5-4.7 | 85 | 200 (2023) | 2,270 |
| Long-Range Bldg Program Refunding | 2002D | 15,805 | 2.5-3.7 | 1,325 | 1,685 (2014) | 11,920 |
| Long-Range Bldg Program | 2003A | 9,730 | 2.37-4.0 | 405 | 655 (2024) | 9,010 |
| Energy Conservation Program (5) | 2003B | 1,250 | 2.0-3.0 | 115 | 145 (2014) | 1,030 |
| Renewable Resource Program Refunding (4) | 2003C | 1,970 | 1.45-5.25 | 255 | 90 (2019) | 1,120 |
| Water Pollution Control Revolving Fund (3) | 2003D | 2,730 | 2.0-3.1 | 160 | 190 (2014) | 1,385 |
| Drinking Water Revolving Fund (3) | 2003E | 1,675 | 2.0-3.1 | 95 | 115 (2014) | 840 |
| Long-Range Bldg Program Refunding | 2003G | 26,610 | 2.0-5.0 | 2,000 | 2,310 (2017) | 22,535 |
| Information Technology Refunding | 2003H | 8,725 | 2.0-4.0 | 2,015 | 2,225 (2010) | 8,470 |
| Water Pollution Control Revolving Fund (3) | 2004A | 2,665 | 2.0-3.8 | 150 | 230 (2020) | 2,540 |
| Long-Range Bldg Program | 2004B | 3,125 | 3.0-4.75 | 160 | 170 (2025) | 2,995 |
| Long-Range Bldg Program Refunding | 2005A | 14,945 | 3.0-5.25 | 35 | 1,205 (2019) | 14,945 |
| Long-Range Bldg Program | 2005B | 1,670 | 3.25-4.3 | 45 | 120 (2026) | 1,670 |
| Energy Conservation Program (5) | 2005C | 2,500 | 3.25-4.0 | 200 | 290 (2016) | 2,500 |
| CERCLA Program (6) | 2005D | 2,000 | 3.25-4.3 | 55 | 140 (2026) | 2,000 |
| Drinking Water Revolving Fund (3) | 2005F | 3,875 | 4.0-4.75 | 160 | 350 (2021) | 3,875 |
| Water Pollution Control Revolving Fund (3) | 2005G | 2,110 | 4.0-4.75 | 90 | 190 (2021) | 2,110 |
| Long-Range Bldg Program Refunding | 2005H | 10,055 | 3.0-5.0 | 45 | 1,300 (2020) | 9,935 |
| Long-Range Bldg Program | 2006A | 31,350 | 4.0-5.0 | - | 1,930 (2027) | 31,350 |
| Energy Conservation Program (5) | 2006B | 3,750 | 4.0-6.0 | - | 330 (2022) | 3,750 |
| CERCLA Program (6) | 2006C | 1,000 | 4.0 | - | 120 (2017) | 1,000 |
| Renewable Resource Program (4) | 2006D | 950 | 5.6-6.0 | - | 90 (2022) | 950 |
| Total general obligation bonds | | $340,220 | | $20,695 | | $230,065 |

| Governmental Activities | Series | Amount Issued | Interest Range (%) (1) | Principal Payments Fiscal Year 2007 | Principal Payments In Year of Maturity (2) | Balance June 30, 2006 |
|---|---|---|---|---|---|---|
| **Special revenue bonds** | | | | | | |
| State Hospital Project (7) | 1997 | $ 25,915 | 4.0-5.05 | $ 880 | 1,820 (2022) | $ 20,710 |
| Renewable Resource Program (8) | 1997A | 1,205 | 6.0-7.3 | 50 | 110 (2018) | 905 |
| Renewable Resource Program (8) | 1997B | 2,660 | 3.75-5.37 | 115 | 210 (2018) | 1,910 |
| Renewable Resource Program (8) | 2001A | 420 | 3.65-5.59 | 15 | 30 (2021) | 345 |
| Renewable Resource Program (8) | 2001B | 1,750 | 5.2-7.1 | 60 | 150 (2021) | 1,495 |
| Renewable Resource Program Refunding (8) | 2001C | 12,155 | 2.55-4.3 | - | 790 (2013) | 3,605 |
| Broadwater Power Proj Refunding (8) | 2001D | 21,450 | 2.25-4.7 | 1,160 | 1,795 (2018) | 17,245 |
| Renewable Resource Program (8) | 2001E | 885 | 2.1-4.85 | 35 | 65 (2022) | 755 |
| Renewable Resource Program (8) | 2001F | 900 | 3.3-6.2 | 30 | 75 (2022) | 790 |
| Developmental Center Project Refunding (7) | 2003 | 11,510 | 3.0-5.0 | 585 | 970 (2019) | 9,855 |
| Renewable Resource Program (8) | 2003A | 3,000 | 1.05-4.05 | 115 | 215 (2024) | 2,780 |
| Renewable Resource Program Refunding (8) | 2004A | 5,070 | 2.15-2.95 | 1,290 | 905 (2009) | 3,130 |
| Renewable Resource Program (8) | 2004B | 430 | 4.45-5.45 | 20 | 40 (2020) | 410 |
| U.S. Highway 93 GARVEES (9) | 2005 | 122,795 | 3.65-5.19 | 6,130 | 11,315 (2020) | 117,835 |
| Total special revenue bonds | | $210,145 | | $10,485 | | $181,770 |
| **Notes payable** | | | | | | |
| Water Conservation (Little Dry Project) (10) | | $ 50 | 5.0 | $ 2 | 1 (2012) | $ 14 |
| Water Conservation (Petrolia Project) (10) | | 50 | 5.0 | 2 | 2 (2016) | 22 |
| Middle Creek Dam Project (11) | | 3,272 | 8.125 | 49 | 208 (2034) | 2,791 |
| Tongue River Dam Project (12) | | 11,300 | - | 290 | 290 (2038) | 9,272 |
| Total notes payable | | $ 14,672 | | $ 343 | | $ 12,099 |
| Subtotal governmental activities, before deferred balances | | | | | | 423,934 |
| Deferred amount on refunding | | | | | | (5,709) |
| Unamortized discount | | | | | | (145) |
| Unamortized premium | | | | | | 10,458 |
| Total governmental activities | | $565,037 | | $31,523 | | $428,538 |
| **Business-type Activities** | | | | | | |
| **Bonds/notes payable** | | | | | | |
| Economic Development Bonds (13) | | | | | | |
| Municipal Finance Consolidation Act Bonds (Irrigation Program) (14) | 1988 | $ 4,976 | 6.60-7.75 | $ 40 | 70 (2014) | $ 430 |
| Conservation Reserve Enhancement Program (CRP Bonds) (15) | | 3,028 | 6.0-7.50 | 898 | 108 (2011) | 2,656 |
| Subtotal economic dev bonds | | 8,004 | | 938 | | 3,086 |
| MUS Workers Compensation Bonds Payable | | 2,050 | 2.8 | 420 | 430 (2008) | 850 |
| Total business-type activities | | $ 10,054 | | $ 1,358 | | $ 3,936 |

(1) The interest range is over the life of the obligation.

(2) Year of maturity refers to fiscal year.

(3) These bonds 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.

(4) The general obligation 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.

(5) Bonds issued for financing the design, construction, and installation of energy conservation projects at various state buildings.

(6) The CERCLA (Comprehensive Environmental Response, Compensation, and Liability Act) Program Bonds were issued for the purpose of financing the costs of State of Montana participation in the remedial actions under Section 104 of the CERCLA 42 United States Code Sections 9601-9657, and State of Montana costs for maintenance of sites under CERCLA. The CERCLA Bonds are secured additionally by a pledge of monies received by the State as cost recovery payments and revenues derived from the resource indemnity and groundwater assessment tax in the event there are not sufficient cost recovery payments.

(7) 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.

(8) Issued by the Department of Natural Resources and Conservation and backed by a pledge of coal severance taxes and project revenues.

(9) The U.S. Highway 93 GARVEES (Grant Anticipation Revenue Vehicles) Bonds were issued for the purpose of improving a 44.8-mile stretch of U.S. Highway 93. Repayment of the bonds is secured by a pledge of certain federal aid revenues.

(10) Loans obtained from Farmers Home Administration for the purpose of acquiring an irrigation (pumping) system for water distribution in the vicinity of Sidney, Montana (Little Dry Project) and to rehabilitate the Petrolia Reservoir and Canal in the vicinity of Winnett, Montana (Petrolia Project). A portion of the revenues generated by the facilities is pledged for repayment of the loans. In the fiscal year 2004 CAFR, the Little Dry Project Loan was incorrectly listed as a special revenue bond and the Petrolia Project Loan was incorrectly excluded from the long-term debt reported.

(11) U.S. Bureau of Reclamation loan to Montana Department of Natural Resources & Conservation. The outstanding balance includes $220,927 of interest owed.

(12) Northern Cheyenne Tribe loan to the Montana Department of Natural Resources & Conservation. 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.

(13) Economic Development Bonds & Municipal Finance Consolidation Act Bonds – This program is directed by the Board of Investments, which is attached to the Department of Commerce for administrative purposes. The program assists Montana's small businesses and local governments in obtaining low-cost financing.

(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 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 Program Reserve Account E in an amount equal to any deficiencies therein, on any payment date. The indenture does not permit the issuance of additional bonds.

(15) The Conservation Reserve Enhancement Program is funded by the Montana Trust Funds Bond Pool.

**D. Debt Service Requirements**

Primary government debt service requirements at June 30, 2006, 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 |
| 2007 | $ 20,695 | $ 8,647 | $ 10,485 | $ 8,569 | $ 343 | $ 46 |
| 2008 | 20,285 | 8,561 | 10,500 | 8,181 | 345 | 45 |
| 2009 | 16,400 | 7,802 | 11,575 | 7,696 | 347 | 44 |
| 2010 | 16,970 | 7,154 | 11,120 | 7,194 | 349 | 43 |
| 2011 | 14,960 | 6,539 | 11,675 | 6,693 | 351 | 42 |
| 2012-2016 | 76,195 | 23,051 | 64,550 | 24,860 | 1,799 | 193 |
| 2017-2021 | 47,760 | 8,412 | 59,290 | 8,054 | 1,893 | 160 |
| 2022-2026 | 14,870 | 1,883 | 2,575 | 133 | 1,995 | 121 |
| 2027-2031 | 1,930 | 45 | - | - | 2,127 | 72 |
| 2032-2036 | - | - | - | - | 1,970 | 14 |
| 2037-2041 | - | - | - | - | 580 | - |
| Total | $230,065 | $72,094 | $181,770 | $71,380 | $12,099 | $780 |

**Business-type Activities**

| Year Ended June 30 | Economic Development Bonds | | MUS Workers Compensation Bonds | |
|---|---|---|---|---|
| | Principal | Interest | Principal | Interest |
| 2007 | $ 938 | $197 | $420 | $24 |
| 2008 | 977 | 138 | 430 | 12 |
| 2009 | 533 | 76 | - | - |
| 2010 | 280 | 42 | - | - |
| 2011 | 163 | 24 | - | - |
| 2012-2016 | 195 | 24 | - | - |
| Total | $3,086 | $501 | $850 | $36 |

Debt service requirements of discretely presented component units at June 30, 2006, were as follows (in thousands):

| Year Ended June 30 | Housing Authority | | Montana State University | | University of Montana | |
|---|---|---|---|---|---|---|
| | Principal | Interest | Principal | Interest | Principal | Interest |
| 2007 | $ 10,650 | $ 39,975 | $ 4,292 | $ 4,895 | $ 5,492 | $ 7,038 |
| 2008 | 12,430 | 39,620 | 3,793 | 5,959 | 6,033 | 7,082 |
| 2009 | 13,725 | 39,094 | 3,542 | 6,133 | 5,919 | 6,884 |
| 2010 | 14,020 | 38,510 | 3,788 | 6,121 | 5,790 | 6,667 |
| 2011 | 14,765 | 37,883 | 3,669 | 6,097 | 5,619 | 6,431 |
| 2011-2016 | 89,108 | 178,175 | 27,047 | 21,438 | 31,873 | 28,263 |
| 2017-2021 | 112,175 | 154,295 | 34,650 | 13,148 | 39,715 | 19,901 |
| 2022-2026 | 151,155 | 121,333 | 19,235 | 6,905 | 40,990 | 8,263 |
| 2027-2031 | 189,185 | 76,593 | 11,245 | 3,918 | 10,690 | 1,829 |
| 2032-2036 | 154,075 | 29,019 | 12,600 | 1,460 | 2,140 | 150 |
| 2037-2041 | 29,900 | 4,644 | - | - | - | - |
| 2042-2046 | 6,665 | 419 | - | - | - | - |
| Total | $797,853 | $759,560 | $123,861 | $76,074 | $154,261 | $92,508 |

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

Primary government long-term liability activity for the year ended June 30, 2006, was as follows (in thousands):

| | Beginning Balance | Additions | Reductions | Ending Balance | Amounts Due Within One Year | Amounts Due In More Than One Year |
|---|---|---|---|---|---|---|
| **Governmental activities** | | | | | | |
| Bonds/notes payable | | | | | | |
| General obligation bonds | $213,195 | $ 37,050 | $ 20,180 | $230,065 | $20,695 | $209,370 |
| Special revenue bonds | 192,775 | - | 11,005 | 181,770 | 10,485 | 171,285 |
| Notes payable | 12,439 | - | 340 | 12,099 | 343 | 11,756 |
| | 418,409 | 37,050 | 31,525 | 423,934 | 31,523 | 392,411 |
| Deferred amount on refunding | (6,322) | - | (613) | (5,709) | - | (5,709) |
| Unamortized discount | (158) | - | (13) | (145) | - | (145) |
| Unamortized premium | 9,680 | 1,126 | 348 | 10,458 | - | 10,458 |
| Total bonds/notes payable | 421,609 | 38,176 | 31,247 | 428,538 | 31,523 | 397,015 |
| Other liabilities | | | | | | |
| Lease/installment purchase payable | 2,705 | 881 | 1,127 | 2,459 | 879 | 1,580 |
| Compensated absences payable (1) | 73,403 | 48,619 | 42,897 | 79,125 | 42,891 | 36,234 |
| Early retirement benefits payable (1) | 54 | - | 5 | 49 | 6 | 43 |
| Arbitrage rebate tax payable (1) | 53 | 21 | - | 74 | - | 74 |
| Estimated insurance claims (1) | 32,003 | 85,934 | 89,204 | 28,733 | 12,665 | 16,068 |
| Total other liabilities | 108,218 | 135,455 | 133,233 | 110,440 | 56,441 | 53,999 |
| Total governmental activities Long-term liabilities | $529,827 | $173,631 | $164,480 | $538,978 | $87,964 | $451,014 |
| **Business-type activities** | | | | | | |
| Bonds/notes payable | | | | | | |
| Economic Development Bonds | $ 3,908 | $ 1,103 | $ 1,925 | $ 3,086 | $ 938 | $ 2,148 |
| MUS Workers Compensation | 1,260 | - | 410 | 850 | 420 | 430 |
| Total bonds/notes payable | 5,168 | 1,103 | 2,335 | 3,936 | 1,358 | 2,578 |
| Other liabilities | | | | | | |
| Compensated absences payable | 1,145 | 693 | 609 | 1,229 | 607 | 622 |
| Arbitrage rebate tax payable | 114 | 22 | 7 | 129 | 35 | 94 |
| Estimated insurance claims | 10,613 | 54,748 | 51,502 | 13,859 | 7,387 | 6,472 |
| Total other liabilities | 11,872 | 55,463 | 52,118 | 15,217 | 8,029 | 7,188 |
| Total business-type activities Long-term liabilities | $ 17,040 | $ 56,566 | $ 54,453 | $ 19,153 | $ 9,387 | $ 9,766 |

(1) 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, 2006, was as follows (in thousands):

| | Beginning Balance | Additions | Reductions | Ending Balance | Amounts Due Within One Year | Amounts Due In More Than One Year |
|---|---|---|---|---|---|---|
| **Discretely presented component units** | | | | | | |
| Bonds/notes payable | | | | | | |
| Housing Authority | $ 765,214 | $154,450 | $116,529 | $ 803,135 | $ 10,650 | $ 792,485 |
| Montana State University (MSU) | 107,550 | 26,150 | 4,463 | 129,237 | 4,292 | 124,945 |
| University of Montana (UM) | 136,806 | 31,431 | 16,638 | 151,599 | 5,492 | 146,107 |
| Total bonds/notes payable | 1,009,570 | 212,031 | 137,630 | 1,083,971 | 20,434 | 1,063,537 |
| Other liabilities | | | | | | |
| Lease/installment purch pay | 540 | 498 | 342 | 696 | 261 | 435 |
| Compensated absences pay | 44,757 | 24,385 | 22,192 | 46,950 | 21,077 | 25,873 |
| Arbitrage rebate tax payable | 1,262 | 300 | 421 | 1,141 | 314 | 827 |
| Estimated insurance claims | 590,666 | 205,837 | 132,079 | 664,424 | 137,070 | 527,354 |
| Due to federal government | 30,606 | 429 | - | 31,035 | - | 31,035 |
| Total other liabilities | 667,831 | 231,449 | 155,034 | 744,246 | 158,722 | 585,524 |
| | $1,677,401 | $443,480 | $292,664 | $1,828,217 | $179,156 | $1,649,061 |
| Long-term liabilities of MSU component units | | | | | 448 | 1,130 |
| Long-term liabilities of UM component units | | | | | 469 | 245 |
| Total discretely presented component units Long-term liabilities | | | | | $180,073 | $1,650,436 |

### F. Refunded and Early Retired Debt

**Primary Government**

Pre-payments

During fiscal year 2006, the Department of Natural Resources and Conservation (DNRC) used current available resources to make the following pre-payments on general obligation bonds: $440,000 of Series 1997A Renewable Resource Program, $1,045,000 of Series 2003D Water Pollution Control Revolving Fund Program, and $650,000 of Series 2003E Drinking Water Revolving Fund Program.

DNRC also used current available resources to make a $500,000 pre-payment of special revenue bond Series 2004A Renewable Resource Program Refunding.

Defeased Debt Outstanding

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, 2006, $58,245,000 of bonds outstanding are considered defeased.

**Discretely Presented Component Units**

Current Refundings

The Housing Authority, on November 16, 2005, issued Series 2005RA Single Family Mortgage Bonds in the amount of $30,280,000. $29,120,000 of the proceeds were used for a replacement refunding of the Series 1995B Bonds on December 1, 2005. The refunding resulted in a reduction of debt service to maturity of $3,328,826 and an economic gain of $6,274,029.

Defeased Debt Outstanding

Montana State University and the University of Montana have 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, 2006, $3,415,000 and $54,277,074 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.

**Primary Government**

Montana Board of Investments (BOI)

Under the Economic Development Act, 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. At June 30, 2006, industrial revenue bonds outstanding aggregated $200.5 million.

The BOI is also authorized to issue Qualified Zone Academy Bonds (QZAB), under the Municipal Finance Consolidation Act. The revenues, and in some cases, the taxing power of the borrower are pledged to repay the bonds. At June 30, 2006, QZAB debt outstanding aggregated $5.8 million.

Neither the industrial revenue bonds, nor the QZAB debt issued by the BOI constitutes a debt, liability, obligation, or pledge of faith and credit of the State of Montana.

Beginning Farm Loan Program

The Montana Department of Agriculture is authorized to request issuance of bonds by the BOI 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, 2006, was as follows: Hershberger Project – issued $129,412, outstanding $118,844; Young Project – issued $223,300, outstanding $209,051.

**Discretely Presented Component Units**

Facility Finance Authority (FFA)

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 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, 2006, revenue bonds outstanding aggregated $643 million, and notes payable outstanding aggregated $8 million.

The BOI and the FFA have entered into a capital reserve account agreement for certain bond issues. See Note 16.C. (miscellaneous contingencies) for more information.

Housing Authority (HA)

The HA is authorized to issue bonds and make mortgage loans in order to finance housing which will provide decent, safe, and sanitary housing for persons and families of lower income in the State of Montana. The bonds are special, limited obligations, payable solely from pledged revenues and assets, not general obligations of the HA. The bonds issued by the HA do not constitute a debt, liability, obligation, or pledge of faith and credit of the State of Montana. At June 30, 2006, bonds outstanding aggregated $3 million.

## 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 when 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 also includes the current portion of balances related to amounts loaned by the Economic Development Bonds Fund to other funds, under the Board of Investments INTERCAP loan program. 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, 2006, 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 |
| **Due From Other Funds** | | | | | | |
| Economic Development Bonds | $ - | $ - | $ - | $ - | $2,320 | $ - |
| Federal Special Revenue | - | - | - | 137 | 5 | - |
| General Fund | 6,070 | 1 | 1,471 | - | 176 | - |
| Internal Service Funds | 33 | 3 | 1,185 | 1,884 | 667 | - |
| Nonmajor Enterprise Funds | - | - | 55 | 138 | 12 | - |
| Nonmajor Governmental Funds | - | - | 7 | 2 | 9 | - |
| State Special Revenue | 141 | - | 1,053 | 4,799 | 109 | 3,621 |
| Total | $6,244 | $4 | $3,771 | $6,960 | $3,298 | $3,621 |

| | Nonmajor Enterprise Funds | Nonmajor Governmental Funds | State Special Revenue | Total |
|---|---|---|---|---|
| **Due From Other Funds** *(continued)* | | | | |
| Economic Development Bonds | $ - | $ - | $ 1,864 | $4,184 |
| Federal Special Revenue | - | - | 662 | 804 |
| General Fund | 12,627 | 646 | 42,015 | 63,006 |
| Internal Service Funds | 176 | 3 | 2,121 | 6,072 |
| Nonmajor Enterprise Funds | - | - | 34 | 239 |
| Nonmajor Governmental Funds | - | - | 76 | 94 |
| State Special Revenue | 46 | 1,360 | - | 11,129 |
| Total | $12,849 | $2,009 | $46,772 | $85,528 |

### 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, 2006, consisted of the following (in thousands):

| | Interfund Loans Payable | | | | | |
|---|---|---|---|---|---|---|
| | Federal Special Revenue | Internal Service Funds | Nonmajor Enterprise Funds | Nonmajor Governmental Funds | State Special Revenue | Total |
| **Interfund Loans Receivable** | | | | | | |
| Federal Special Revenue | $ - | $ 302 | $ - | $ - | $ 604 | $ 906 |
| General Fund | 18,268 | 3,300 | - | 1,361 | 6,115 | 29,044 |
| Internal Service Funds | 74 | - | 225 | - | 10 | 309 |
| Nonmajor Enterprise Funds | 4 | - | - | - | - | 4 |
| State Special Revenue | 20,889 | 2,000 | 33 | - | - | 22,922 |
| Total | $39,235 | $5,602 | $258 | $1,361 | $6,729 | $53,185 |

### 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 also includes the noncurrent portion of balances related to amounts loaned by the Economic Development Bonds Fund to other funds, under the Board of Investments INTERCAP loan program.

Advances to/from other funds at June 30, 2006, consisted of the following (in thousands):

| | Advances from Other Funds | | | | | |
|---|---|---|---|---|---|---|
| | Federal Special Revenue | Internal Service Funds | Nonmajor Governmental Funds | Pension (And Other Employee Benefit) Trust Funds | State Special Revenue | Total |
| **Advances to Other Funds** | | | | | | |
| Coal Severance Tax Permanent | $ - | $ - | $ - | $- | $33,477 | $33,477 |
| Economic Development Bonds | - | 4,452 | - | - | 11,679 | 16,131 |
| General Fund | 9 | - | - | - | 60 | 69 |
| Nonmajor Enterprise Funds | 75 | - | - | - | - | 75 |
| Nonmajor Governmental Funds | - | - | - | - | 3,110 | 3,110 |
| State Special Revenue | 1,668 | - | 12,701 | - | - | 14,369 |
| Total | $1,752 | $4,452 | $12,701 | $- | $48,326 | $67,231 |

Additional detail for certain advance balances at June 30, 2006, follows (in thousands):

**Advances from the Economic Development Bonds Fund under the INTERCAP Loan Program**

| Department | Balance |
|---|---|
| Environmental Quality | $ 664 |
| Justice | 11,015 |
| Transportation | 4,453 |
| Total | $16,132 |

**Advances from the Coal Severance Tax Permanent Fund**

| Department | Balance |
|---|---|
| Justice | $ 2,112 |
| Natural Resources and Conservation | 31,365 |
| Total | $33,477 |

### 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.

For the fiscal year 2006, there was a transfer transaction where one side was reported on the fund financial statements and the other side was reflected on the entitywide financial statements. This occurred because modified accrual and full accrual funds transferred capital assets or long-term liabilities between each other. This caused the transfers to be unbalanced on the fund financial statements by $25,081 in the nonmajor enterprise fund transfers out category; however, the transfers were balanced on the entitywide statements.

Interfund transfers for the year ended June 30, 2006, consisted of the following (in thousands):

| | Transfers In | | | | | |
|---|---|---|---|---|---|---|
| | Coal Severance Tax Permanent | Federal Special Revenue | General Fund | Internal Service Funds | Nonmajor Enterprise Funds | Nonmajor Governmental Funds |
| **Transfers Out** | | | | | | |
| Coal Severance Tax Permanent | $ - | $ - | $31,106 | $ - | $ - | $ 417 |
| Federal Special Revenue | - | - | - | 28 | - | 14,909 |
| General Fund | - | 3 | - | 824 | 51 | 32,253 |
| Internal Service Funds | - | - | 48 | 382 | - | - |
| Land Grant Permanent | - | - | - | - | - | 1,590 |
| Nonmajor Enterprise Funds | - | - | 29,887 | - | - | - |
| Nonmajor Governmental Funds | 1,150 | - | - | 500 | - | 3,007 |
| State Special Revenue | 2,256 | 1,284 | 6,614 | 596 | 27 | 11,568 |
| Unemployment Insurance | - | 558 | - | - | - | - |
| Total | $3,406 | $1,845 | $67,655 | $2,330 | $78 | $63,744 |

| | Pension (And Other Employee Benefit) Trust Funds | State Special Revenue | Total |
|---|---|---|---|
| **Transfers Out** *(continued)* | | | |
| Coal Severance Tax Permanent | $ - | $ 9,234 | $ 40,757 |
| Federal Special Revenue | - | 15,757 | 30,694 |
| General Fund | - | 17,597 | 50,728 |
| Internal Service Funds | 232 | - | 662 |
| Land Grant Permanent | - | 91,973 | 93,563 |
| Nonmajor Enterprise Funds | - | 4,416 | 34,303 |
| Nonmajor Governmental Funds | - | 16,261 | 20,918 |
| State Special Revenue | - | 242 | 22,587 |
| Unemployment Insurance | - | - | 558 |
| Total | $232 | $155,480 | $294,770 |

## NOTE 13. FUND DEFICITS

The following funds have a deficit fund balance/net assets position at June 30, 2006, (in thousands):

| Fund Type/Fund | Deficit |
|---|---|
| **Enterprise funds** | |
| Subsequent Injury | $(1,442) |
| State Nursery | $ (12) |
| **Internal service funds** | |
| Justice Legal Services | $ (40) |

## NOTE 14. RESERVED FUND BALANCES

Special Revenue Funds – The State and Federal Special Revenue Funds reserved fund balances are for the following purposes (in thousands):

| Fund Type/Purpose | Amount |
|---|---|
| **State Special Revenue funds** | |
| General Government | $ 32,970 |
| Public Safety/Corrections | 184,340 |
| Transportation | 119,235 |
| Health/Social Services | 52,153 |
| Education/Cultural | 5,725 |
| Resource/Recreation/Environment | 289,746 |
| Economic Development/Assistance | 39,992 |
| Total state special revenue funds | $724,161 |
| **Federal Special Revenue funds** | |
| General Government | $ 7,107 |
| Public Safety/Corrections | 292 |
| Health/Social Services | 2,451 |
| Education/Cultural | 14,237 |
| Resource/Recreation/Environment | 3,591 |
| Economic Development/Assistance | 364 |
| Total federal special revenue funds | $28,042 |

Coal Severance Tax Permanent Trust Fund – The reserve for trust principal is comprised of the following (in thousands):

| Purpose | Amount |
|---|---|
| Big Sky Economic Development Fund | $ 22,510 |
| Coal Severance Tax Bond Fund | 10,374 |
| Treasure State Endowment Fund | 143,843 |
| Treasure State Endowment Regional Water System Fund | 29,872 |
| Coal Severance Tax Permanent Fund | 490,220 |
| Coal Severance Tax Income Fund | (711) |
| Total | $696,108 |

## 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 and by the Student Assistance Foundation of Montana (SAF) and subsidiaries. The Board of Regents and MHESAC have three common board members. Approximately 75.74% of the Regents' outstanding loan volume, or $1,241,985,089 is held by either MHESAC or SAF and subsidiaries. During fiscal year 2000, MHESAC undertook a reorganization under which its operating staff and assets were transferred to the Student Assistance Foundation of Montana, and MHESAC entered into agreements with SAF to provide management and loan servicing to MHESAC. The Board of Regents and SAF have three common board members. The Office of Commissioner of Higher Education (OCHE) paid SAF during fiscal year 2006 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 maintenance costs, utilities, and other shared operating expenses. The total amount of these expenses for fiscal year 2006 amounted to $417,406.

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.

In State of Montana v. Philip Morris, Inc., No. CDV 97-306 (Mont. 1st Jud. Dist. Lewis & Clark County), the State of Montana filed various claims against six tobacco manufacturers seeking recovery of an unspecified amount of damages, penalties and attorney's fees. The lawsuit was resolved eventually through two settlements. The State first settled its claims against one of the manufacturers, Liggett & Meyers, Inc., for $1 million to be paid over a 20-year period. It next settled its claims against the remaining manufacturers in November 1998 for a base settlement amount of $832 million payable over 26 years. The base amount was augmented by $90 million in 1999, with the additional amount to be paid in equal installments over a 10-year period beginning in 2007.

The settlement provides that the cigarette manufacturers may offset against their payment in any year certain amounts of money if it is found that the original settling manufacturers (known as OPMs) have lost more than 2% of their market share to non-settling manufacturers (known as NPMs) and that the disadvantages imposed by the settlement were a "significant factor" in the market share loss. The settlement further provides that the offset, known as the "NPM adjustment" may not be taken against the payments to any state that has enacted a "qualifying statute" and diligently enforced the statute during the year in question. Montana enacted such a qualifying statute in 1999, Title 16, Chapter 11, Parts 401 – 404, MCA.

In March 2006, a determination was made pursuant to the settlement that the OPMs had lost sufficient market share in 2003 to trigger an NPM adjustment analysis, and that disadvantages caused by the settlement were a significant factor in the market share loss. The State has filed a motion in the lawsuit seeking a declaration that it diligently enforced its qualifying statute during 2003. The OPMs have moved to compel arbitration of the question, which motion is pending in the court. In the opinion of the counsel good factual arguments exist to show that the State diligently enforced its statute during the year in question. However, legal and procedural uncertainties exist that make an adverse determination reasonably possible. An adverse determination on the diligent enforcement issue could result in the loss of some or all of the State's 2003 payment which would be recouped through an offset of payments due in future years. At present, the NPM case involves roughly $1.8 million that was withheld from the April 2006 payment to the State. At this time, the State of Montana would not have an additional payment in relation to the NPM adjustment case, but more potential NPM adjustment issues may arise.

This settlement has also formed the basis for other lawsuits against the state. On July 1, 2002, a group of cigarette manufacturers and marketers filed suit against the Attorneys General of 31 states, including Montana, in the United States District Court for the Southern District of New York, seeking a declaration that the provisions of Title 16, Chapter 11, Part 4, MCA, violate several provisions of the United States Constitution, and seeking injunctive relief against the enforcement of the statutes. Grand River Enterprises Six Nations, Ltd., v. Pryor et al., Docket No. 02 CV 5068 (U.S. Dist. Ct., S.D.N.Y.). An adverse outcome could threaten the ability of the State to continue to receive payments from the tobacco companies under the settlement of the Mazurek case discussed above. The potential loss to the Treasury could amount to $30-35 million annually. The federal district court had dismissed the complaint, but the United States Court of Appeals for the Second Circuit has reversed the trial court and remanded one of the claims for further proceedings. The United States Supreme Court has denied review, and the case has been remanded for further proceedings. In the opinion of counsel, good defenses exist to the claims, and an adverse result impairing or preventing receipt of the State's payment is possible, but unlikely.

In September 2002, a coalition of school districts, teachers, and parents filed an action, Columbia Falls Elementary School District v. State of Montana, No. BDV-2002-528 (Mont. 1st Jud. Dist. Lewis & Clark County), that alleges that Montana's system for funding public education violates the requirements of the Montana Constitution. The complaint seeks a declaratory judgment that the system violates the Montana Constitution and declaratory and injunctive relief compelling the State to (1) study and determine the components of free quality public elementary and secondary education and the costs of delivering such education; (2) implement a funding system based on educationally relevant factors; (3) fully fund and equitably distribute the State's share of the costs of public elementary and secondary education; (4) include a cost adjustment factoring the funding system; and (5) establish a mechanism for monitoring and adjusting the funding system and an award of attorney's fees. The court denied the State's motion for summary judgment.

The district court sat for the trial in this case from January 20, 2004 through February 4, 2004. Both parties submitted witness, exhibits, and cross-examined witnesses. On April 15, 2004, the court entered its order holding the school funding system unconstitutional. The State appealed the judgment, and the plaintiffs have cross-appealed certain aspects of the judgment as well. The Supreme Court heard oral argument on the appeal and cross-appeal on October 20, 2004, and the Montana Supreme Court has issued an order that the school funding system violates the Montana Constitution, and has upheld the District order that the State had until October 2005 to address this issue. The State and the plaintiffs have settled the plaintiffs' attorney fee in the amount of $499,732. The parties have agreed to submit that claim for funding by the Montana legislature. Significant additional expenditures on K-12 education may be required in future years, and further litigation in this case is possible regarding school funding.

Beginning in February 2001, the Montana Department of Fish Wildlife and Parks became the defendant in a number of lawsuits challenging the constitutionality and enforcement of Initiative Measure 143, which banned the issuance of new licenses for game farms in Montana, prohibiting the transfer of existing licenses, and prohibited game farm licenses from allowing the shooting of game farm animals on a game farm for a fee or other remuneration. Most of these cases sought declaratory and injunctive relief, but several cases are now pending in which game farmers have alleged that I-143 takes their property without just compensation in violation of the state and federal constitutions, and in which they seek damages from the State for the alleged uncompensated taking. The State believes valid defenses exist to the claims asserted in these cases. One of the cases, Spoklie v. State of Montana, U.S. District Ct., D. Mont. Docket No. CV-02-102-GF-SHE, has been dismissed in its entirety, and the dismissal has now been affirmed by the Ninth Circuit of Appeals. In a second case, Kafka v. Montana Department of Fish Wildlife, and Parks, Hill County Docket No. DV-02-059, the state district court has denied the taking claim and entered final judgment in favor of the State. In Buhlmann et al. v. State of Montana et al., Lewis and Clark Docket No. DV-2002-555, the court has entered judgment in favor of the State on the taking claims, and appeal has been taken to the Montana Supreme Court. Both the Kafka and Buhlman decisions are on appeal before the Montana Supreme Court. Royal Tine Ranch v. State, Flathead County Docket No. DV-02-606C, is submitted on cross-motions for summary judgment. Wallace v. State of Montana, Ravalli County Docket No. 02-254, has been dismissed without prejudice, and the Bowman v. Montana Fish, Wildlife and Parks, Fergus County Docket No. DV-2002-02, case has been dismissed without prejudice for failure to prosecute. Spoklie v. Montana Department of Fish, Wildlife and Parks, Sheridan County Docket No. 11013, Mesaros v. Department of Fish, Wildlife and Parks, Cascade County Docket No. BDV 03-0119, are in varying stages of pretrial preparation. Based on the courts' treatment of the cases thus far, in the opinion of counsel, good defenses exist to all of these claims, although adverse decisions remain possible. The amount of loss cannot be estimated at this time.

In Montana Association for Independent Disability Service, Inc., et al., filed in Montana First Judicial Court, Lewis and Clark County, Cause No. BDV 2002-558, (MAIDS) a class action lawsuit was filed on the part of individually-named developmentally disabled persons and the Montana Association for Independent Disability Services, Inc., a consortium of community-based private facilities serving the developmentally disabled population. The plaintiffs allege that the named defendants, Judy Martz, Gail Gray, and Joe Matthews in their official capacities "configure" the wage and benefit structure of employees at community-based facilities serving developmentally disabled persons at a level that is lower than the level established at Eastmont and MDC. It is alleged that this causes employees to leave the community-based facilities at a higher rate, thereby jeopardizing the quality and quantity of the services provided in the community-based facilities. This allegedly has the effect of precluding individuals with developmental disabilities from living in the community in the least restrictive, most independent circumstances possible. The wage configuration by the defendants allegedly constitutes a violation of statutes concerning the objective of placing developmentally disabled individuals in independent living situations, the establishment of uniform reimbursement rates equivalent to Medicare covered services, the right to enjoy life, liberty, safety, health and happiness (Article II Section 3, Montana State Constitution), to dignity and equal protection (Article II Section 4, Montana State Constitution) and of the requirement of Article XII Section 3 that the State and legislature provide assistance to those in need. The plaintiffs seek declaratory and injunctive relief concerning the proper establishment of reimbursement rates, attorney's fees and costs. The Court entered an order on March 30, 2004, granting the motion for Class Certification. The Court has scheduled a five-week bench trial for May 15, 2007. The fiscal impact on the State should the plaintiffs prevail, and the amount of any potential award for attorney fees and costs is not determinable at this time. An adverse determination in this case is reasonably possible.

In Stavenjord v. State Compensation Insurance Fund, the first decision was issued by the Workers Compensation Court on May 22, 2001. It addressed the issue of whether the failure of the Occupational Disease Act (ODA) to provide PPD (permanent partial disability) benefits equivalent to the benefits provided in the Montana WCA (workers compensation act) violates the claimant's right to equal protection of the law. Relying on the Henry case (previous case from the Supreme Court finding that vocational rehabilitation benefits must also be paid under the ODA), the court held that Title 39, Chapter 72, Part 405, MCA, is unconstitutional as applied to Debra Stavenjord. "Where PPD benefits calculated pursuant to the WCA are greater than the benefits available to a claimant under the ODA, constitutional equal protection guarantees require that benefits be computed and paid in accordance with the WCA. The claimant in this case is entitled to $27,027 under the WCA, versus $10,000 under the ODA." The Montana Supreme Court affirmed the case on April 1, 2003. On August 27, 2004, the Workers Compensation Court held that Stavenjord is retroactive to June 3, 1999 (the date of the Henry decision). The court held that a common fund is created for claimants reaching Maximum Medical Improvement on or after June 3, 1999. The cost of retroactively paying benefits for claims in the period of June 3, 1999 through May 21, 2001 was estimated at $2.2 million and was recorded in the loss reserves of the financial statements. There is no impact on the Old Fund liability with this ruling. This decision was appealed to the Montana Supreme Court.

The Montana Supreme Court issued their decision on the appeal on October 6, 2006, holding that a common fund was not created. The court also held that the decision applies retroactively to claims from July 1, 1987. The cost to retroactively pay claims to July 1, 1987, was estimated at $14 to $19 million for the Montana State Fund (New Fund – for claims on or after July 1, 1990). The impact on the Old Fund liability for claims that occurred from July 1, 1987 to June 30, 1990 was estimated at $5 to $7 million. As the Supreme Court held that claims closed by either court order or settlement are excluded, and the cost estimates above included these claims, the estimates will be reduced. Revised cost estimates have not yet been completed. Actual cost impact is unknown.

In Reesor v. Montana State Fund, 2004 MT 370, Reesor was receiving Social Security retirement benefits at the time he suffered an industrial accident. He received an impairment award, but was denied other permanent partial disability (PPD) benefits pursuant to Title 39, Chapter 71, Part 710, MCA, which provides that persons who are receiving Social Security benefits or are eligible for full Social Security retirement benefits are ineligible for PPD benefits other than an impairment award. Reesor challenged the constitutionality of Title 39, Chapter 71, Part 710, MCA, on equal protection grounds and sought full PPD benefits. On July 26, 2003, the Workers Compensation Court found Title 39, Chapter 71, Part 710, MCA, to be constitutional. Reesor appealed to the Montana Supreme Court, where on December 22, 2004, the court held that limiting Reesor's permanent partial benefit pursuant to Title 39, Chapter 71, Part 710, MCA, violated the Equal Protection Clause of the Montana Constitution. Pending before the Workers Compensation Court are the retroactive application of the decision and common fund status. MSF has estimated the cost of benefits associated with a retroactive application of Reesor. MSF's estimate did not include claims with entitlement dates occurring on or after July 1, 1991 through June 30, 1995 because the Russette decision appears to make Reesor inapplicable during that timeframe. Excluding the Russette timeframe, for claims arising on or after July 1, 1990 through December 22, 2004, the increase in benefit costs for MSF is estimated at $2 million. For claims arising on or after July 1, 1987 through June 30, 1990, the retroactive application of Reesor will result in an estimated benefit cost increase of $1 million for the Old Fund. The potential for the litigation to create a liability for MSF and the State of Montana is reasonably possible. Actual cost impact should the decision be applied retroactively is unknown.

Satterlee v. Lumberman's Mutual Casualty Company et al., WCC No. 2003-0840, was filed before the Workers Compensation Court on July 18, 2003. The Satterlee vs. Lumberman's Mutual Casualty Company case challenges the constitutionality of State statute, (Title 39, Chapter 71, Part 710, MCA) passed by the Montana Legislature in 1981. That statute authorizes termination of permanent total disability benefits and rehabilitation benefits when a claimant receives or becomes eligible to receive full Social Security retirement benefits or an alternative to that plan. Should the statute be found to be unconstitutional as applied to permanent total benefits, Satterlee, et al. request payment of lifetime permanent total disability benefits. In addition, the petition requests certification of this case as a class action or the establishment of a common fund for similarly situated claimants. Petitioners filed a motion and brief for summary judgment on the constitutional issue. The Workers Compensation Court provided an opportunity for any workers compensation insurer to intervene until June 6, 2005. The Workers Compensation Court rendered its decision on December 12, 2005, holding that Title 39, Chapter 71, Part 710, MCA, is constitutional as applied on PTD benefits. This case was appealed to the Supreme Court on December 1, 2006. Should Title 39, Chapter 71, Part 710, MCA, ultimately be held to be unconstitutional as applied to permanent total disability benefits by the Workers Compensation Court and/or the Montana Supreme Court, and also found to apply retroactively, the cost impact has been estimated for non-settled claims arising on or after July 1, 1990 through December 22, 2004 at $135 million to $186 million. The estimated cost of retroactively applying the decision to the Old Fund, for non-settled permanent total disability claims that occurred before July 1, 1990, is $93 million to $116 million. The potential for liability for MSF and the

State of Montana is reasonably possible. Actual cost impact is unknown.

### B. Federal Contingencies

USDA Commodities – In fiscal year 2006, the State distributed $4,456,233 in commodities. The value of the commodities stored in the State's warehouses was $1,767,147 at June 30, 2006, for which the State is liable in the event of loss.

### C. Miscellaneous Contingencies

Loan Guarantees – As of June 30, 2006, the Board of Investments (BOI) had provided loan guarantees from the Coal Severance Tax Permanent Trust Fund to the Economic Development Bonds Enterprise Fund and the Facility Finance Authority, (a component unit of the State of Montana), totaling $131,280,309. The BOI's exposure to bond issues of the Economic Development Bonds Enterprise Fund was $84,050,000, while exposure to bond issues, surety bonds and designated loans of the Facility Finance Authority was $47,230,309.

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, 2006, the following assessments (by fund type) were outstanding (in thousands):

| Taxes | General | State Special Revenue | Permanent Trust | Debt Service | Capital Projects |
|---|---|---|---|---|---|
| Coal severance | $ 563 | $ 176 | $1,091 | $20 | $252 |
| Oil & gas | 11,103 | 1,204 | - | - | - |
| Corporation tax | 5,621 | - | - | - | - |
| Total | $17,287 | $1,380 | $1,091 | $20 | $252 |

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, 2006. The corporations have appealed the decision. As of June 30, 2006, these include $20,131,109 of General Fund corporation tax refunds.

Certain companies have protested property taxes that have been included as revenue on the State's financial statements as of June 30, 2006. As of June 30, 2006, these include $4,683,535 of protested General Fund property taxes.

## NOTE 17. SUBSEQUENT EVENTS

**Bond/Loan Issues**

In July 2006, Montana State University issued its Series K refunding debt in the principal amount of $13.71 million. The proceeds were used to refund portions of the Series E 1998 and Series D 1996 debt.

On July 13, 2006, the Montana Facility Finance Authority issued a bond in the amount of $7,920,000 for Alternatives, Inc. Proceeds were used to purchase a Howard Johnson Express Inn and remodel it into a women's prerelease facility plus other program services.

On August 9, 2006, the Montana Facility Finance Authority issued two bonds in the amount of $14,335,000 to finance the construction of methamphetamine treatment facilities

On August 17, 2006, the Montana Facility Finance Authority issued a bond in the amount of $30,410,000 for St. John's Lutheran Ministries.

On September 20, 2006, the Montana Housing Authority issued $70,805,000 of Single Family Mortgage Bonds Series 2006C to finance the purchase of eligible single family mortgage loans.

On September 26, 2006, the Department of Natural Resources and Conservation issued $1,800,000 of General Obligation Taxable Bonds Series 2006E for its private loan program.

A loan in the amount of $6,100,000 was made from the Montana Facility Finance Authority Variable Rate Program to Bozeman Deaconess Health Services on October 5, 2006, to finance the purchase of equipment.

## NOTE 18. MATERIAL VIOLATIONS OF FINANCE-RELATED LEGAL PROVISIONS

**Constitutionality of Retirement Plan Funding**

The Montana Constitution, Article VIII, Section 15 states that public retirement plans shall be funded on an actuarially sound basis. As of June 30, 2006, there were four retirement plans not in compliance: the Teachers Retirement System (TRS), the Public Employees Retirement System (PERS) Defined Benefit Retirement Plan, the Sheriffs Retirement System, and the Game Wardens and Peace Officers Retirement System. Detailed information for each plan can be found in Note 6.