A Report
to the
Montana
Legislature

Financial Audit

Montana State Fund

For the Two Fiscal Years Ended June 30, 2009

December 2009

Legislative Audit
Division

08-05B

Financial Audits

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2007, was issued January 23, 2008. The Single Audit Report for the two fiscal years ended June 30, 2009, will be issued by March 31, 2010. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
Room 277, State Capitol
P.O. Box 200802
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LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors
James Gillett
Angie Grove

December 2009

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the financial audit of the Montana State Fund, a component unit of the state of Montana, for the two fiscal years ended June 30, 2009. The objectives of this audit include determining if the financial statements for fiscal years 2008-09 and 2007-08 present fairly the Montana State Fund's and State of Montana–Old Fund's financial position at June 30 for each fiscal year and the results of its operations for the fiscal years then ended. We also tested compliance with laws that have a direct and material effect on the financial statements. We made no recommendations to the Montana State Fund in either the current or prior audit report.

Montana State Fund is a nonprofit, independent public corporation that provides Montana employers with an option for workers' compensation and occupational disease insurance, and acts as the guaranteed market. Montana State Fund is governed by a seven-member board of directors appointed by the governor. State law separates funding sources for claims related to injuries incurred before July 1, 1990, commonly referred to as Old Fund, and those incurred after July 1, 1990.

Montana State Fund management must set premium rates at amounts sufficient, when invested, to carry the estimated cost of all claims to maturity, to meet the reasonable expenses of conducting business, and to maintain a surplus over the amount produced by the National Association of Insurance Commissioners' risk-based capital requirements for a casualty insurer. The Old Fund costs are currently funded by investment earnings and investment principal. If Old Fund assets are insufficient, then, by law, the state general fund will provide funding for claims. Montana State Fund's investments are managed by the Montana Board of Investments and are invested according to policies established in law.

On page A-1, you will find the Independent Auditor's Report followed by the Management's Discussion and Analysis, the financial statements and accompanying notes, and the Schedule of Funding Progress. The Management's Discussion and Analysis and Schedule of Funding Progress are supplementary information required by the Governmental Accounting Standards Board. As disclosed in the Independent Auditor's Report, we did not audit the information and express no opinion on it. We issued an unqualified opinion on the financial statements, which means the reader can rely on the information presented.

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Montana State Fund's response to our audit is on page B-1. We thank the Montana State Fund staff for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

Appointed and Administrative Officials

Montana State Fund	Laurence Hubbard, President/CEO	
	Mark Barry, Vice President, Corporate Support	
	Richard Duane, Vice President, Human Resources	
	Richard Root, Vice President, Insurance Operations	
	Peter Strauss, Vice President, Insurance Operations Support	
	Nancy Butler, General Counsel	
	Al Parisian, Chief Information Officer	
State Fund Board of Directors		Term Expires
	Joe Dwyer, Chairman	2011
	Jane Debruycker	2013
	Thomas R. Heisler	2013
	Ken Johnson	2013
	James Swanson	2013
	Boyd Taylor	2011
	Wally Yovetich	2011

For additional information concerning the Montana State Fund, contact:

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LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors
James Gillett
Angie Grove

Independent Auditor's Report

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Statements of Net Assets of the Montana State Fund and the State of Montana–Old Fund, which together comprise a component unit of the state of Montana, as of June 30, 2009, and 2008, and the related Statements of Revenues, Expenses, and Changes in Fund Net Assets, Montana State Fund and State of Montana–Old Fund, and Statements of Cash Flows, Montana State Fund and State of Montana–Old Fund, for each of the fiscal years then ended. The information contained in these financial statements is the responsibility of the Montana State Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana State Fund and State of Montana–Old Fund as of June 30, 2009, and 2008, and the respective results of operation and cash flows for each of the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying Management's Discussion and Analysis and Schedule of Funding Progress are not required parts of the financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

November 4, 2009

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Montana State Fund and the State of Montana–Old Fund Management's Discussion and Analysis, Financial Statements, Notes, and Required Supplementary Information

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Management Discussion and Analysis
June 30, 2009 and 2008

Overview of the Financial Statements

This overview is an introduction to Montana State Fund (MSF) and the Old Fund financial statements. The financial statements consist of two components: (1) basic financial statements, and (2) notes to the basic financial statements.

The statement of net assets presents information regarding all of MSF's and Old Fund's assets and liabilities, with the difference between the two being reported as net assets.

The statements of revenue, expenses, and changes in fund net assets present the financial results of operations for MSF and the Old Fund for the two most recent fiscal years. This statement presents information showing how the net assets changed during the two most recent fiscal years. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods.

The statement of cash flows details the cash used and provided by the various activities of MSF and the Old Fund during the fiscal year. However, this statement does not consider unpaid responsibilities which have been established by contract or other underlying events during the fiscal year.

The following analysis presents two years of comparative condensed financial data for MSF and the Old Fund.

Analysis of Financial Position - MSF

The following is a comparison of the financial position of MSF at June 30, 2009 to 2008, (In thousands):

	6/30/2009	6/30/2008	Change
Assets:			
Cash and STIP	$ 31,386	$ 23,286	$ 8,100
Investments	993,222	952,604	40,618
Security Lending Collateral	175,758	143,711	32,047
Receivables (Net)	20,230	30,044	(9,814)
Capital Assets (Net)	19,890	10,049	9,841
Other Assets	50,287	38,168	12,119
Total Assets	$ 1,290,773	$ 1,197,862	$ 92,911
Liabilities:			
Loss and LAE Reserves	$ 813,305	$ 752,253	$ 61,052
Liability for Securities on Loan	175,758	143,711	32,047
Payables	17,825	19,368	(1,543)
Other Liabilities	66,263	57,978	8,285
Total Liabilities	1,073,151	973,310	99,841
Net Assets:			
Investment in Capital Assets	19,890	10,049	9,841
Unrestricted Net Assets	197,732	214,503	(16,771)
Total Net Assets	217,622	224,552	(6,930)
Total Liabilities and Net Assets	$ 1,290,773	$ 1,197,862	$ 92,911

Net Assets decreased approximately $6.9M (million) from the prior year. Loss and LAE Reserves increased by $61M. Cash and Short-term investment pool (STIP) and Investments increased by $48.7M in comparison to a $94M increase in the previous year. Other assets increased $12M and other liabilities increased $8M.

The change in market value of MSF's investment portfolio of fixed and equity securities in fiscal year 2009 was as follows, (In thousands):

Fiscal Year 2008 Market Value	$ 952,604
Purchases at Cost	243,834
Sales	(174,984)
Net Realized Losses	(13,625)
Net Accretion of Bonds	498
Unrealized Gain (Loss)	(15,104)
Fiscal Year 2009 Market Value	$ 993,222

Towers Perrin, an independent actuarial firm, prepares an actuarial study used to estimate liabilities, including claim adjustment expenses and the ultimate cost of settling claims reported but not settled and claims incurred but not reported (IBNR) for MSF as of June 30, 2009 and June 30, 2008. Towers Perrin provides a range of potential costs associated with reported claims, the future development of those claims and IBNR. MSF management has selected a best estimate within that range as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for fiscal years 2009 and 2008. The estimated claims payable is presented undiscounted, net of estimated reinsurance recoverable, at $813.3M and $752.3M, as of June 30, 2009, and June 30, 2008, respectively.

The following is a comparison of the financial position of MSF at June 30, 2008, to June 30, 2007, (In thousands):

	6/30/2008	**6/30/2007**	**Change**
Assets:			
Cash and STIP	$ 23,286	$ 13,744	$ 9,542
Investments	952,604	868,027	84,577
Security Lending Collateral	143,711	146,413	(2,702)
Receivables (Net)	30,044	31,700	(1,656)
Capital Assets (Net)	10,049	6,772	3,277
Other Assets	38,168	25,883	12,285
Total Assets	$ 1,197,862	$ 1,092,539	$ 105,323
Liabilities:			
Loss and LAE Reserves	$ 752,253	$ 679,209	$ 73,044
Liability for Securities on Loan	143,711	146,413	(2,702)
Payables	19,368	18,627	741
Other Liabilities	57,978	46,685	11,293
Total Liabilities	973,310	890,934	82,376
Net Assets:			
Investment in Capital Assets	10,049	6,772	3,277
Unrestricted Net Assets	214,503	194,833	19,670
Total Net Assets	224,552	201,605	22,947
Total Liabilities and Net Assets	$ 1,197,862	$ 1,092,539	$ 105,323

Net Assets increased approximately $22.9M from the prior year. Loss and LAE Reserves increased by $73M and investments increased by $85M. Cash and Short-term investment pool (STIP) also had an increase of $9M and other assets increased $12M. Other liabilities had an increase in the amount of $11M.

The change in market value of MSF's investment portfolio of fixed and equity securities in fiscal year 2008 was as follows, (In thousands):

Fiscal Year 2007 Market Value	$ 868,027
Purchases at Cost	182,426
Sales	(88,072)
Net Realized Losses	(114)
Net Accretion of Bonds	702
Unrealized Gain (Loss)	(10,366)
Fiscal Year 2008 Market Value	$ 952,604

MSF management has selected a best estimate within the range established by Towers Perrin as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for fiscal years 2008 and 2007. The estimated claims payable was presented undiscounted, net of estimated reinsurance recoverable, at $752.3M and $679.2M, as of June 30, 2008, and June 30, 2007, respectively.

Results of Operations – MSF

The following is a comparison of MSF's results of operations for fiscal year 2009 to fiscal year 2008, (In thousands):

	6/30/2009	6/30/2008	Change
Operating Revenues:			
Net Premium Earned	$ 203,976	$ 230,965	$ (26,989)
Total Operating Revenue	203,976	230,965	(26,989)
Operating Expenses:			
Benefits and Claims	185,514	201,333	(15,819)
Personal Services	22,138	22,984	(846)
Other Operating Expense	18,576	17,672	904
Total Operating Expense	226,228	241,989	(15,761)
Net Operating Income (Loss)	(22,252)	(11,024)	(11,228)
Nonoperating Revenue (Expense):			
Investment Income	17,306	32,861	(15,555)
Other Nonoperating Revenue	2,013	1,109	904
Dividend Expense	(3,997)	0	(3,997)
Total Nonoperating Revenue (Expense)	15,322	33,970	(18,648)
Change in Net Assets	$ (6,930)	$ 22,946	$ (29,876)

MSF's book of business decreased 11.7% from $231M of net earned premium in fiscal year 2008 to $204M of net earned premium in fiscal year 2009. The economic conditions caused a decline in the amount of payroll reported by policyholders, and a 3% rate decrease reduced the net premium for 2009. Montana's unemployment rate increased from 4.4% in June 2008 to 6.7% in June 2009.

MSF paid dividends of $4.0M to policyholders in the first half of fiscal year 2009. The Board of Directors, at its discretion, determines the amount of dividends to be declared. MSF did not pay a dividend in fiscal year 2008 due to a change in the annual schedule of when the dividends are considered and declared by the board.

Investment income decreased by ($15.6M) in fiscal year 2009 over investment income earned in fiscal year 2008. This decrease was primarily due to realized losses on bonds due to write-downs and sales. Total net realized losses on investments for fiscal year 2009 were ($13.6M) compared to ($114K) in fiscal year 2008.

MSF experienced an unrealized loss on investments of ($15.1M) in fiscal year 2009, compared to an unrealized loss on investments of ($10.4M) in fiscal year 2008. This was primarily due to the decrease in fair value of equities of ($21.7M) in fiscal year 2009, offset by unrealized gains on investments in bonds of $6.6M.

The following is a comparison of MSF's results of operations for fiscal year 2008 to fiscal year 2007, (In thousands):

	6/30/2008	6/30/2007	Change
Operating Revenues:			
Net Premium Earned	$ 230,965	$ 238,203	$ (7,238)
Total Operating Revenue	230,965	238,203	(7,238)
Operating Expenses:			
Benefits and Claims	201,333	208,627	(7,294)
Personal Services	22,984	19,507	3,477
Other Operating Expense	17,672	18,427	(755)
Total Operating Expense	241,989	246,561	(4,572)
Net Operating Income (Loss)	(11,024)	(8,358)	(2,666)
Nonoperating Revenue (Expense):			
Investment Income	32,861	59,301	(26,440)
Other Nonoperating Revenue	1,109	79	1,030
Dividend Expense	0	(7,001)	7,001
Total Nonoperating Revenue (Expense)	33,970	52,379	(18,409)
Change in Net Assets	$ 22,946	$ 44,021	$ (21,075)

MSF's book of business decreased from $238M in fiscal year 2007 to $231M in fiscal year 2008. Net earned premium decreased by 3% compared to the prior year due to a 1% rate decrease and because MSF wrote fewer policies.

MSF did not pay a dividend in fiscal year 2008. This analysis was moved to later in the calendar year when fiscal year-end financial results are available. MSF paid dividends of $7.0M to policyholders in fiscal year 2007.

Investment income, excluding unrealized gain/loss, increased by $7.0M in fiscal year 2008 over investment income earned in fiscal year 2007. This increase was primarily due to an increase in investment in fixed securities of $94.42M. In fiscal year 2008, MSF had a realized loss on the sales and maturities of investments of ($114K) compared to a realized loss of ($656K) on sales and maturities of investments in fiscal year 2007.

MSF experienced an unrealized loss on investments of ($10.4M) in fiscal year 2008, compared to an unrealized gain on investments of $22.0M in fiscal year 2007. This was primarily due to the decrease in fair value of equities of ($13.1M) in fiscal year 2008.

<u>Effects of Transactions with Other Parties</u>

The State of Montana Board of Investments (BOI) is currently building office space for Montana State Fund (MSF) by utilizing MSF invested assets. BOI purchased and holds title to the land. BOI has entered into a contract with Dick Anderson Construction, Helena, Montana and is coordinating and overseeing the construction of the building. The MSF Board of Directors have committed to occupying the building for MSF office space. Construction of the building began in September 2008 and is expected to be completed in June 2010. The land cost plus interest is $1.14M and the cost of construction and related fees for the building is estimated to be $27M. (Note 10 in the Notes to the Financial Statements provides additional information.)

Analysis of Financial Position – Old Fund

The following is a comparison of the financial position of the Old Fund at June 30, 2009, to June 30, 2008, (In thousands):

	6/30/2009	6/30/2008	Change
Assets:			
Cash and STIP	$ 13,268	$ 12,383	$ 885
Investments	7,374	19,925	(12,551)
Security Lending Collateral	1,569	4,179	(2,610)
Receivables (Net)	161	382	(221)
Total Assets	$ 22,372	$ 36,869	$ (14,497)
Liabilities:			
Loss and LAE Reserves	$ 65,575	$ 68,435	$ (2,860)
Liability for Securities on Loan	1,569	4,179	(2,610)
Payables	723	767	(44)
Total Liabilities	67,867	73,381	(5,514)
Net Assets:			
Unrestricted Net Assets	(45,495)	(36,512)	(8,983)
Total Net Assets	(45,495)	(36,512)	(8,983)
Total Liabilities and Net Assets	$ 22,372	$ 36,869	$ (14,497)

Net Assets decreased ($9.0M) from the prior year. The primary reason for this decrease is the continuing development on remaining loss reserves increasing the estimated amount remaining to be paid on outstanding claims. The decreases in net assets have left a deficit in the net asset account of ($45.5M).

The change in market value of Old Fund's investment portfolio of fixed securities in fiscal year 2009 was as follows, (In thousands):

Fiscal Year 2008 Market Value	$ 19,925
Purchases at Cost	1,133
Sales	(13,476)
Net Realized Losses	(266)
Net Amortization of Bonds	(17)
Par Value Adjustment	(1)
Unrealized Gain (Loss)	75
Fiscal Year 2009 Market Value	$ 7,374

Towers Perrin, an independent actuarial firm, prepares an actuarial study used to estimate liabilities, including claim adjustment expenses and the ultimate cost of settling claims reported but not settled and claims incurred but not reported (IBNR) for the Old Fund as of June 30, 2009, and June 30, 2008. Towers Perrin provides a range of potential costs associated with reported claims, the future development of those claims and IBNR. State Fund management has selected the Towers Perrin estimate within that range as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for fiscal years 2009 and 2008. The estimated claims payable is presented discounted at $65.6M and $68.4M, as of June 30, 2009 and June 30, 2008, respectively. The discount rate used to calculate present value is based on an estimate of expected investment yield and considers the risk of adverse deviation in the future from such yield. The Old Fund discounted its actuarially determined unpaid balances by a factor of 3.5% for the period ended June 30, 2009, and 4.5% for the period June 30, 2008. The estimated claims payable undiscounted for fiscal years 2009 and 2008, respectively, is $79.2M and $86.7M.

The following is a comparison of the financial position of the Old Fund at June 30, 2008 to June 30, 2007, (In thousands):

	6/30/2008	6/30/2007	Change
Assets:			
Cash and STIP	$ 12,383	$ 7,862	$ 4,521
Investments	19,925	34,713	(14,788)
Security Lending Collateral	4,179	13,688	(9,509)
Receivables (Net)	382	574	(192)
Total Assets	$ 36,869	$ 56,837	$ (19,968)
Liabilities:			
Loss and LAE Reserves	$ 68,435	$ 75,063	$ (6,628)
Liability for Securities on Loan	4,179	13,688	(9,509)
Payables	767	720	47
Total Liabilities	73,381	89,471	(16,090)
Net Assets:			
Unrestricted Net Assets	(36,512)	(32,634)	(3,878)
Total Net Assets	(36,512)	(32,634)	(3,878)
Total Liabilities and Net Assets	$ 36,869	$ 56,837	$ (19,968)

Net Assets decreased ($3.9M) from the prior year. The primary reason for this decrease is the continuing development on remaining loss reserves increasing the estimated amount remaining to be paid on outstanding claims. The decreases in net assets left a deficit in the net asset account of ($36.5M) as of June 30, 2008.

The change in market value of Old Fund's investment portfolio of fixed securities in fiscal year 2008 was as follows, (In thousands):

Fiscal Year 2007 Market Value	$ 34,713
Purchases at Cost	3,805
Sales	(19,046)
Net Realized Gains	135
Net Accretion of Bonds	(109)
Par Value Adjustment	86
Unrealized Gain (Loss)	341
Fiscal Year 2008 Market Value	$ 19,925

MSF management has selected the Towers Perrin best estimate as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for fiscal years 2008 and 2007. The estimated claims payable is presented discounted at $68.4M and $75.0M, as of June 30, 2008 and June 30, 2007, respectively. The discount rate used to calculate present value is based on an estimate of expected investment yield and considers the risk of adverse deviation in the future from such yield. The Old Fund discounted its actuarially determined unpaid balances by a factor of 4.5% for the period ended June 30, 2008, and 5% for the period ended June 30, 2007. The estimated claims payable undiscounted for fiscal years 2008 and 2007, respectively, is $86.7M and $98.2M.

Results of Operations – Old Fund

The following is a comparison of Old Fund's results of operations for fiscal year 2009 to fiscal year 2008, (In thousands):

	6/30/2009	6/30/2008	Change
Operating Expenses:			
Benefits and Claims	$ 8,265	$ 4,659	$ 3,606
Personal Services	7	11	(4)
Other Operating Expense	1,282	1,401	(119)
Total Operating Expense	9,554	6,071	3,483
Nonoperating Revenue:			
Investment Income	571	2,193	(1,622)
Total Nonoperating Revenue	571	2,193	(1,622)
Change in Net Assets	$ (8,983)	$ (3,878)	$ (5,105)

Benefits and Claims expense for fiscal year 2009 includes adverse development of $4.3M while the same expense for fiscal year 2008 includes $1.2M in adverse development.

State law (Section 39-71-2352, MCA) requires MSF to separately determine and account for administrative expenses and benefit payments for claims for injuries resulting from accidents occurring before July 1, 1990 (Old Fund) from those occurring on or after July 1, 1990 (MSF). The law also limits annual administrative costs of claims associated with the Old Fund to $1.25M for both fiscal years 2009 and 2008. MSF allocated $1.25M in administration costs to the Old Fund in fiscal years 2009 and 2008. The Old Fund has a $6K obligation to MSF in un-recovered administrative costs incurred in fiscal years 2009 and prior. MSF intends to recover this amount in future years where the cost of administering the Old Fund is less than the statutorily permitted $1.25M.

The following is a comparison of Old Fund's results of operations for fiscal year 2008 to fiscal year 2007, (In thousands):

	6/30/2008	**6/30/2007**	**Change**
Operating Expenses:			
Benefits and Claims	$ 4,659	$ 12,072	$ (7,413)
Personal Services	11	32	(21)
Other Operating Expense	1,401	1,336	65
Total Operating Expense	6,071	13,440	(7,369)
Nonoperating Revenue:			
Investment Income	2,193	2,702	(509)
Other Nonoperating Revenue	0	5	(5)
Total Nonoperating Revenue	2,193	2,707	(514)
Change in Net Assets	$ (3,878)	$ (10,733)	$ 6,855

As allowed under the statute explained above, MSF allocated $1.25M in administration costs to the Old Fund in fiscal years 2008 and 2007. The Old Fund had a $126K obligation to MSF in un-recovered administrative costs incurred in fiscal years 2008 and prior. MSF intends to recover this amount in future years where the cost of administering the Old Fund is less than the statutorily permitted $1.25M.

Montana State Fund
Statement of Net Assets
Montana State Fund is a component unit of the State of Montana

June 30,	2009	2008
ASSETS		
Current Assets		
Cash and Cash Equivalents	$ 31,389,015	$ 23,285,799
Receivables, Net	19,673,528	29,421,393
Due from Primary Government	5,033	8,042
Due from Old Fund	548,648	614,801
Securities Lending Collateral	175,758,454	143,710,845
Other Assets	50,286,653	38,167,896
Total Current Assets	277,661,331	235,208,777
Noncurrent Assets		
Investments	993,222,091	952,603,759
Equipment	4,924,498	4,863,684
Land	1,139,460	1,139,460
Construction Work in Progress	11,790,414	4,376,593
Accumulated Depreciation	(3,982,421)	(3,469,305)
Intangible Assets	6,017,661	3,138,414
Total Noncurrent Assets	1,013,111,704	962,652,605
Total Assets	$ 1,290,773,034	$ 1,197,861,382
LIABILITIES		
Current Liabilities		
Accounts Payable	$ 16,477,927	$ 17,869,533
Due to Primary Government	1,320,579	1,386,975
Due to Old Fund	26,634	111,803
Estimated Claims Payable	137,985,395	140,045,343
Compensated Absences	1,129,304	1,231,568
Securities Lending Liability	175,758,454	143,710,845
Unearned Premium	6,018,437	9,842,296
Property Held in Trust	55,973,044	44,888,624
Total Current Liabilities	394,689,775	359,086,987
Noncurrent Liabilities		
Estimated Claims Payable	675,319,317	612,207,957
Compensated Absences	1,389,308	1,156,747
Other Post Employment Benefits	1,752,904	858,215
Total Noncurrent Liabilities	678,461,529	614,222,919
Total Liabilities	1,073,151,304	973,309,906
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	19,889,612	10,048,847
Unrestricted	197,732,118	214,502,629
Total Net Assets	217,621,730	224,551,476
Total Liabilities and Net Assets	$ 1,290,773,034	$ 1,197,861,382

Montana State Fund
Statement of Revenues, Expenses, and Changes in Fund Net Assets
Montana State Fund is a component unit of the State of Montana

YEAR ENDED JUNE 30,	2009	2008	Variance
Net Premiums Earned	$ 203,976,354	$ 230,965,306	$(26,988,953)
Operating Expenses			
Benefits and Claims	185,513,924	201,333,093	(15,819,169)
Personal Services	22,138,406	22,984,130	(845,724)
Contractual Services	5,282,787	8,943,666	(3,660,880)
Supplies and Materials	462,802	634,314	(171,512)
Depreciation	517,800	668,018	(150,218)
Amortization	1,461,828	1,102,235	359,594
Rent and Utilities	466,325	460,256	6,069
Communications	1,337,269	1,623,405	(286,136)
Travel	219,620	283,431	(63,811)
Repair and Maintenance	1,263,454	928,389	335,065
Other Operating Expenses	7,563,463	3,028,598	4,534,864
Total Operating Expenses	226,227,677	241,989,536	(15,761,859)
Operating Income (Loss)	(22,251,324)	(11,024,230)	(11,227,094)
Nonoperating Revenue(Expenses)			
Investment Income	17,305,580	32,861,208	(15,555,629)
Securities Lending Income	3,420,076	6,841,075	(3,421,000)
Securities Lending Expenses	(1,491,080)	(5,803,640)	4,312,560
Penalties and Interest	71,848	34,576	37,272
Loss on Retirement of Assets	(6,350)	-	(6,350)
Dividend Expense	(3,996,599)	-	(3,996,599)
Other Income	18,104	37,325	(19,221)
Total Nonoperating Revenue(Expenses)	15,321,578	33,970,544	(18,648,966)
Change in Net Assets	(6,929,746)	22,946,314	(29,876,060)
Total Net Assets - Beginning	224,551,476	201,605,162	22,946,314
Total Net Assets - Ending	$ 217,621,730	$ 224,551,476	$(6,929,746)

Montana State Fund
Statement of Cash Flows
Montana State Fund is a component unit of the State of Montana

YEAR ENDED JUNE 30,	2009	2008
Cash Flows from Operating Activities		
Receipts for Premiums	204,050,563	231,697,573
Payments to Suppliers for Goods and Services	(18,455,256)	(15,928,208)
Payments to Employees	(22,206,875)	(21,906,284)
Cash Payments for Claims	(124,716,354)	(128,658,281)
Other Operating Receipts	89,952	71,902
Net Cash Provided by (Used for) Operating Activities	38,762,029	65,276,702
Cash Flows from Noncapital Financial Activities		
Payment of Dividends to Policyholders	(3,996,599)	-
Net Cash Provided by (Used for) Noncapital Financing Activities	(3,996,599)	-
Cash Flows from Capital and Related Financing Activities		
Acquisition of Fixed Assets	(12,267,023)	(2,009,259)
Proceeds from Sale of Fixed Assets	(6,350)	-
Net Cash Used for Capital and Related Financing Activities	(12,273,373)	(2,009,259)
Cash Flows from Investing Activities		
Purchase of Investments	(265,377,998)	(204,419,392)
Proceeds from Sales or Maturities of Investments	203,321,905	107,260,650
Proceeds from Securities Lending Transactions	3,379,067	6,841,075
Payments of Security Lending Costs	(1,450,072)	(5,803,640)
Interest and Dividends on Investments	45,738,257	42,395,527
Net Cash Provided by (Used For) Investing Activities	(14,388,841)	(53,725,780)
Net Increase (Decrease) in Cash and Cash Equivalents	8,103,216	9,541,663
Cash and Cash Equivalents - July 1	23,285,799	13,744,136
Cash and Cash Equivalents - June 30	31,389,015	23,285,799

Montana State Fund
Statement of Cash Flows
Montana State Fund is a component unit of the State of Montana

YEAR ENDED JUNE 30,	**2009**	**2008**
Reconciliation of Change in Net Assets to Net Cash Provided by (Used for) Operating Activities		
Change in Net Assets	(6,929,746)	22,946,313
Adjustments to Reconcile Change in Net Assets to Net Cash Provided by (Used for) Operating Activities		
Depreciation	517,800	668,018
Amortization	1,461,828	1,102,235
Security Lending Costs	1,450,072	5,803,640
Security Lending Income	(3,379,067)	(6,841,075)
Interest on Investments	(17,305,580)	(32,861,207)
Payments of Dividends to Policyholders	3,996,599	-
Decrease (Increase) in		
Accounts Receivable	9,550,208	1,819,347
Due from Old Fund	79,363	(189,292)
Due from Primary Government	3,009	5,369
Notes Receivable	-	33,598
Other Assets	(12,112,407)	(12,284,158)
Increase (Decrease) in		
Accounts Payable	(7,649,738)	664,059
Due to Primary Government	(257,272)	72,892
Deferred Revenue	(3,823,859)	(374,098)
Property Held in Trust	11,084,420	10,614,884
Estimated Claims Payable	61,051,413	73,044,300
OPEB Liability	894,689	858,215
Compensated Absences	130,297	193,662
Total Adjustments	45,691,775	42,330,389
Net Cash Provided by (Used for) Operating Activities	38,762,029	65,276,702

STATE OF MONTANA - OLD FUND
STATEMENT OF NET ASSETS
Montana State Fund is a component unit of the State of Montana

June 30,	2009	2008
ASSETS		
Current Assets		
Cash and Cash Equivalents	$ 13,268,383	$ 12,383,308
Receivables, Net	133,928	269,182
Due from Montana State Fund	26,633	111,803
Securities Lending Collateral	1,568,726	4,179,153
Total Current Assets	14,997,671	16,943,446
Noncurrent Assets		
Investments	7,373,884	19,925,461
Total Noncurrent Assets	7,373,884	19,925,461
Total Assets	$ 22,371,556	$ 36,868,908
LIABILITIES		
Current Liabilities		
Accounts Payable	$ 173,970	$ 151,212
Due to Primary Government	209	-
Due to Montana State Fund	548,649	615,424
Estimated Claims Payable	10,974,661	7,201,713
Securities Lending Liability	1,568,726	4,179,153
Total Current Liabilities	13,266,215	12,147,502
Noncurrent Liabilities		
Estimated Claims Payable	54,599,881	61,233,197
Total Noncurrent Liabilities	54,599,881	61,233,197
Total Liabilities	67,866,096	73,380,699
NET ASSETS		
Unrestricted	(45,494,540)	(36,511,792)
Total Net Assets	(45,494,540)	(36,511,792)
Total Liabilities and Net Assets	$ 22,371,556	$ 36,868,908

STATE OF MONTANA - OLD FUND
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
Montana State Fund is a component unit of the State of Montana

YEAR ENDED JUNE 30,	2009	2008
Operating Expenses		
Benefits and Claims	$ 8,265,086	$ 4,659,487
Personal Services	7,448	11,020
Contractual Services	1,038,661	1,064,611
Depreciation	31,393	40,306
Amortization	88,627	66,505
Other Operating Expenses	122,382	229,052
Total Operating Expenses	9,553,596	6,070,982
Operating Income (Loss)	(9,553,596)	(6,070,982)
Nonoperating Revenue(Expenses)		
Investment Income	529,155	2,150,478
Securities Lending Income	77,421	343,751
Securities Lending Expenses	(35,728)	(300,872)
Total Nonoperating Revenue(Expenses)	570,848	2,193,358
Change in Net Assets	(8,982,748)	(3,877,624)
Total Net Assets - Beginning	(36,511,792)	(32,634,167)
Total Net Assets - Ending	$ (45,494,540)	$ (36,511,792)

State of Montana - Old Fund
Statement of Cash Flows
Montana State Fund is a component unit of the State of Montana

YEAR ENDED JUNE 30,	2009	2008
Cash Flows from Operating Activities		
Payments to Suppliers for Goods and Services	(1,535,149)	(1,567,640)
Payments to Employees	111,427	16,659
Payments for Claims	(10,993,712)	(11,143,411)
Net Cash Used for Operating Activities	(12,417,434)	(12,694,392)
Cash Flows from Investing Activities		
Purchase of Investments	71,128	(3,805,054)
Proceeds from Sales or Maturities of Investments	12,538,565	18,911,122
Proceeds from Securities Lending Transactions	76,907	343,751
Payments of Security Lending Costs	(41,126)	(345,865)
Interest and Dividends on Investments	657,036	2,111,989
Net Cash Provided by Investing Activities	13,302,509	17,215,943
Net Decrease in Cash and Cash Equivalents	885,075	4,521,551
Cash and Cash Equivalents - July 1	12,383,308	7,861,757
Cash and Cash Equivalents - June 30	13,268,383	12,383,308

State of Montana - Old Fund
Statement of Cash Flows
Montana State Fund is a component unit of the State of Montana

YEAR ENDED JUNE 30,	2009	2008
Reconciliation of Change in Net Assets to Net Cash Used for Operating Activities		
Change in Net Assets	(8,982,748)	(3,877,624)
Adjustments to Reconcile Change in Net Assets to Net Cash Used for Operating Activities		
Security Lending Costs	35,213	300,872
Security Lending Income	(76,907)	(343,751)
Interest on Investments	(529,155)	(2,150,479)
Decrease (Increase) in		
Accounts Receivable	(51,156)	25,829
Due from Primary Government	85,170	(111,803)
Other Assets	-	224
Increase (Decrease) in		
Accounts Payable	28,671	88,109
Due to Montana State Fund	(66,154)	3,225
Due to Primary Government	-	(826)
Estimated Claims	(2,860,369)	(6,628,168)
Total Adjustments	(3,434,686)	(8,816,768)
Net Cash Used for Operating Activities	(12,417,434)	(12,694,392)

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

1. Summary of Significant Accounting Policies

Description of Business

The Montana State Fund (MSF) is a nonprofit, independent public corporation established under Title 39, chapter 71 of the Montana Code Annotated (MCA). MSF provides Montana employers with an option for workers' compensation and occupational disease insurance and guarantees available coverage for all employers in Montana. MSF is governed by a seven member Board of Directors appointed by the Governor. The Board has full power, authority, and jurisdiction in the administration of MSF as fully and completely as the governing body of a private mutual insurance carrier. MSF is attached to the State of Montana, Department of Administration for administrative purposes only.

During the 1990 Montana Special Legislative Session, legislation passed establishing separate funding and accounts for claims of injuries resulting from accidents occurring before July 1, 1990, referred to as the Old Fund, and claims occurring on or after July 1, 1990, referred to as MSF. Hereafter, any reference to MSF refers to the New Fund or those claims occurring after July 1, 1990.

MSF functions as an autonomous insurance entity supported solely from its own revenues. All assets, debts, and obligations of MSF are separate and distinct from assets, debts, and obligations of the State of Montana. No State of Montana General Fund money is used for MSF operations.
If MSF is dissolved by an act of law, the assets held by MSF are subject to the disposition provided by the legislature enacting the dissolution with due regard given to obligations incurred and existing (Section 39-71-2322, MCA). Under Section 39-71-2352, the Old Fund is a liability of the State of Montana and if at any time the Old Fund is not adequately funded, amounts necessary to pay claims of the Old Fund must be transferred from the General Fund. MSF administers and manages the claims remaining in the Old Fund for the State of Montana and is the administering entity for recording the financial activity related to receipt and disbursement of funds and assets held by the Old Fund.

MSF and Old Fund financial statements are presented as a component unit in the State of Montana Comprehensive Annual Financial Report. The fiscal year 2009 and 2008 financial statements are presented in conformance with generally accepted accounting principles (GAAP), and Governmental Accounting Standards Board Statement 34 (GASB), which is a comparable format to the State of Montana Comprehensive Annual Financial Report.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

Basis of Accounting

MSF and the Old Fund use the accrual basis of accounting, as defined by generally accepted accounting principles, for their workers' compensation insurance operations. Under the accrual basis, revenues are recorded in the accounting period earned, if measurable, and expenses are recorded in the period incurred, if measurable.

Cash and Cash Equivalents

Cash balances include demand deposits with the State Treasury. Cash equivalents are short-term, highly liquid investments that are both readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. MSF and the Old Fund participate in the Montana Board of Investments Short Term Investment Pool (STIP). STIP balances are highly liquid investments with maturities of 397 days or less with the exception of securities having rate reset dates. The STIP portfolio is carried at amortized cost or book value with market value approximating cost. MSF's STIP balance of \$24.2M as of June 30, 2009, represents 1.05% of the total STIP. The Old Fund STIP balance of \$12.5M as of June 30, 2009, represents 0.54% of the total STIP. MSF's STIP balance of \$17.6M as of June 30, 2008, represents 0.75% of the total STIP. The Old Fund STIP balance of \$12.9M as of June 30, 2008, represents 0.55% of the total STIP.

The STIP investments' credit risk is measured by investment grade ratings given individual securities. The BOI's policy requires that STIP investments have the highest rating in the short-term category by one of any Nationally Recognized Statistical Rating Organizations (NRSRO). The three NRSRO's include Standard and Poor's, Moody's Investors Service, and Fitch, Inc.

Investments

In addition to STIP investments, the BOI invests in long-term securities. Under the provisions of the state constitution, MSF and the Old Fund's invested assets are managed by the BOI. Securities are stated at fair value as defined and required by Governmental Accounting Standards Board (GASB) Statement 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools". Premiums and discounts are amortized using the straight-line method over the life of the securities. Net unrealized gains or losses on securities are included in net income in accordance with GASB 31.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

The BOI follows the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – Deposit and Investment Risk Disclosures. The investment risk disclosures are described in the following paragraphs.

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 MSF 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 Investments' policy requires MSF and Old Fund's fixed income investments, at the time of purchase, to be rated investment grade as defined either 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 following table are provided by S&P's rating services. If an S&P rating is not available, a Moody's rating has been used.

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, 2009 and 2008, 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 investment was 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. The MSF Investment policy requires credit risk to be limited to 3% in any one name except AAA rated issues will be limited to 6% while the Old Fund investment policy statement does not address concentration of credit risk. The MSF Investment policy provides for "no limitation on U.S. government/agency securities". MSF also has specified certain client preferences. Investments issued or explicitly guaranteed by the U.S. government are excluded from the concentration of credit risk requirement.

MSF fiscal year 2009 concentration of credit risk is stated as 7.05% - Federal Home Loan Banks, 10.39% - Federal National Mortgage Association (Fannie Mae) and 8.77% - Federal Home Loan Mortgage Corp. (Freddie Mac). For fiscal year 2008, MSF had concentration of credit risk exposure

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

of 8.81% with Federal Home Loan Banks, 12.47% to the Federal National Mortgage Association (Fannie Mae) and 10.07% with the Federal Home Loan Mortgage Corp. (Freddie Mac).

The Old Fund fiscal year 2009 concentration of credit risk is stated as 7.38% - Commercial Mortgage Trust. For fiscal year 2008, Old Fund had concentration of credit risk exposure to the Federal National Mortgage Association of 10.27%, Commercial Mortgage Trust of 6.96%, and Federal Home Loan Mortgage Corp. (Freddie Mac) of 11.26%.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The MSF and Old Fund investment policies do not formally address interest rate risk. In accordance with GASB Statement No. 40, the Board has selected the effective duration method to disclose interest rate risk. This method, as provided by our custodial bank and analytics software, 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 price for a given change in interest rates. Prices move inversely to interest rates. 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)."

As of June 30, 2009 and 2008, the MSF holds two Collateralized Debt Obligations (CDO). A CDO is a security backed by a pool of bonds, loans and other assets. CDOs do not specialize in one type of debt but are often non-mortgage loans or bonds. These CDO variable rate positions include $10 million par in Aria II, 2.130%, 10/10/2012 and $4 million par in Galena 1, 5.060%, 01/11/2013. The MSF and Old Fund portfolios did not hold any structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). REMICs are pass-through vehicles for multiclass mortgage-backed securities. The REMIC securities are based on separate or combined cash flows from principal and interest payments on underlying mortgages.

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.

As of June 30, 2009 and 2008, the MSF portfolio held three variable rate corporate bonds with a $19 million par. The MSF variable-rate securities float with LIBOR (London Interbank Offered Rate).

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

The MSF and Old Fund investments are categorized below to disclose credit and interest rate risk as of June 30, 2009. Credit risk reflects the bond quality rating, by investment type, as of the June 30 report date. If a bond investment type is unrated, the quality type is indicated by NR (not rated). Interest rate risk is disclosed using effective duration. Both the credit quality ratings and duration have been calculated excluding cash equivalents.

MSF - Credit Quality Rating and Effective Duration as of June 30, 2009

Security Investment Type		Fair Value	Credit Quality Rating	Effective Duration
Corporate Bonds (Rated)	$	493,259,360	A	3.78
Corporate Bonds (Unrated)		3,000,000	NR	(2.26)
U.S. Government Direct Obligations		101,775,104	AAA	6.43
U.S. Government Agency		311,247,987	AAA	3.43
SIVs (Unrated)		2,196,735	NR	0.13
STIP (Unrated)		24,207,449	NR	0.13
Total Fixed Income Investments		935,686,635		
Direct Investments				
Equity Index Fund	$	81,742,905		
Total Direct Investments		81,742,905		
Total Investments	$	1,017,429,540	AA-	3.83

Old Fund - Credit Quality Rating and Effective Duration as of June 30, 2009

Security Investment Type		Fair Value	Credit Quality Rating	Effective Duration
Corporate Bonds (Rated)	$	2,882,976	AA	1.16
U.S. Government Direct Obligations		2,841,610	AAA	2.45
U.S. Government Agency		515,989	AAA	1.30
SIVs (Unrated)		1,133,310	NR	0.13
STIP (Unrated)		12,488,783	NR	0.13
Total Investments	$	19,862,668	AAA	0.64

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

The MSF and Old Fund investments are classified in risk Category 1 or as Not Categorized under State of Montana standards. Risk category 1 includes investments that are insured or registered, or securities held by the BOI or its agent in the BOI's name. Not Categorized includes investments held by broker-dealers under securities loans with cash collateral.

The following table presents the market values of the securities on loan and the total collateral held for fiscal years ended June 30, 2009 and June 30, 2008 for both MSF and the Old Fund:

	MSF		**Old Fund**	
	2009	**2008**	**2009**	**2008**
Securities on Loan - Market Value	329,537,940	318,204,397	1,535,742	8,896,141
Total Collateral Held	338,295,564	329,248,784	1,568,726	10,402,078

Interest income earned related to securities on loan for MSF and the Old Fund for the year ended June 30, 2009 was $3.4M and $77K, respectively. Expenses related to securities on loan for MSF and the Old Fund for the year ended June 30, 2009 was $1.5M and $36K, respectively.

Interest income earned related to securities on loan for MSF and the Old Fund for the year ended June 30, 2008 was $6.8M and $344K, respectively. Expenses related to securities on loan for MSF and the Old Fund for the year ended June 30, 2008 was $5.8M and $301K, respectively.

In November 2000, the Montana Constitution was amended to allow MSF to invest in equity securities, with the restriction that equity securities cannot exceed 25% of total investment book value. In May 2003, the BOI approved a policy statement to keep equities in the 8% to 12% range. As of June 30, 2009, equity securities in MSF include $84.4M at book value, reduced by $2.7M in market value depreciation. As of June 30, 2008, equity securities in MSF include $68.4M at book value, enhanced by $19.0M in market value appreciation.

Additional investment information can be found in Note 2.

<u>Receivables</u>

At June 30, 2009, MSF had a net receivable balance of $19.7M. The premium receivable and claim benefit recoveries balance is $11.7M, which is then reduced by estimated uncollectible receivables reported as an allowance for doubtful accounts of $3.4M. Other receivables include $11.2M in investment income due and $199K in notes and loans receivable, all of which is short term.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

At June 30, 2008, MSF had a net receivable balance of $17.8M. The premium receivable and claim benefit recoveries balance is $20.5M, which is then reduced by estimated uncollectible receivables reported as an allowance for doubtful accounts of $2.7M. Other receivables include $11.4M in investment income due and $225K in notes and loans receivable, all of which is short term.

Accounts receivable includes $6.2M at June 30, 2009 and $8.9M at June 30, 2008 for premium that has been earned but unbilled (EBUB).

Accounts receivable in the Old Fund include medical and indemnity overpayments and interest receivable. Old Fund accounts receivable for year ended June 30, 2009 and June 30, 2008 were $1.2M and $1.5M, respectively. Estimated uncollectible receivables are reported as an allowance for doubtful accounts and are recorded at $1.1M and $1.25M for the years ended June 30, 2009 and June 30, 2008 respectively. Interest receivable of $93K at June 30, 2009 and $279K at June 30, 2008 represent investment income due.

Equipment, Accumulated Depreciation and Intangible Assets

Equipment is capitalized if the actual or estimated historical cost exceeds $5K. Depreciation expense is computed on a straight-line basis for equipment over a period of three to five years and amortization of intangible assets is computed on a straight-line basis over five years. Amortization of intangible assets is applied directly to the asset balance. All fixed assets are recorded in the MSF financials. Because MSF administers the Old Fund, the Old Fund does not carry fixed assets.

Land and Construction Work in Process

The State of Montana Board of Investments (BOI) is currently building office space for Montana State Fund (MSF) by utilizing MSF invested assets. Construction of the building began in September 2008 and is expected to be completed in FY2010. The land is recorded at $1.14M and the cost of construction and related fees for the building is estimated to be $27M. As of June 30, 2009, $11.6M has been recorded as construction work in process for the building, and $197K for software in development. Additional information on the building can be found in Note 10.

Other Assets

Other assets include advances, prepaid expenses and deferred acquisition costs. Deferred acquisition costs are amounts incurred during the policy writing process that are recognized ratably over the related policy term.

Estimated Claims Payable

The estimated claims payable is established to provide for the estimated ultimate settlement cost of all claims incurred. Estimated claims payable is based on reported aggregate claim cost estimates combined with estimates for future development of such claim costs and estimates of incurred but not reported (IBNR) claims. Towers Perrin, an external actuarial firm, prepares an actuarial study that provides a range of potential costs associated with reported claims, the future development of those claims and IBNR. MSF management has selected best estimates within that range as the estimated claims payable for MSF and has used the Towers Perrin best estimate for the estimated claims payable for the Old Fund. For additional disclosure related to the estimated claims payable, refer to Note 4.

Accounts Payable

Accounts payable is a short term liability account reflecting amounts owed for goods and services received by MSF.

Unearned Premium

Unearned premium reflects amounts received or billed in advance, but not yet earned for policies effective July 1, 2009 or July 1, 2008.

Property Held in Trust

Property Held in Trust consists of security deposits owed to certain policyholders and the reinsurance funds withheld account, a requirement of MSF's aggregate stop loss reinsurance contract. Additional information regarding the funds withheld account can be found in Note 3.

Net Assets

Net assets consist of the net excess or deficit of assets over liabilities. For additional information on distributions impacting total net assets see Note 6.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

Premiums

The MSF Board of Directors approves premium rates annually. Generally, policies are effective for the term of the policy period not to exceed 12 months. Premium revenue is recognized over the term of the fiscal year, which runs from July 1 through June 30, as it is earned or when MSF is liable for coverage.

Policyholders are contractually obligated to pay certain premiums to MSF in advance of the period the premiums are earned. Premium advances are refundable when the policyholder's coverage is canceled and all earned premiums have been credited by MSF.

Basis of Presentation

The financial statements are presented in accordance with generally accepted accounting principles as prescribed by the GASB. MSF and Old Fund insurance operations are classified as an enterprise fund, proprietary fund type. MSF and Old Fund comprises only a part of the State of Montana's enterprise funds. The financial statements in this report reflect the financial position and results of operations and cash flows of MSF and the Old Fund.

An enterprise fund is used to account for operations: (a) financed and operated in a manner similar to private business enterprises, where the legislature intends that the entity finance or recover costs primarily through user charges; (b) where the legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate; (c) where the activity is financed solely by a pledge of the net revenues from fees and charges of the activity; (d) when laws or regulations require that the activities' costs of providing services be recovered with fees and charges rather than with taxes or similar revenues.

Investments are presented in accordance to GASB Statement Number 31, "Accounting and Financial Reporting for Certain Investments and External Investment Pools." STIP is considered an external investment pool, which is defined as an arrangement that pools the monies of more than one legally separate entity and invests, on the participant's behalf, in an investment portfolio. STIP is also classified as a "2a7-like" pool. A 2a7-like pool is an external investment pool that is not registered with the Securities and Exchange Commission (SEC) as an investment company, but has a policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. If certain conditions are met, 2a7-like pools are allowed to use amortized cost rather than fair value to report net assets to compute unit values. The BOI has adopted a policy to treat STIP as a 2a7-like pool. See Note 1, Basis of Accounting – Investments and Note 2 for further discussions of the effect of GASB 31.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

2. Investments

The amortized cost and market value of MSF's fixed maturity and equity securities as of June 30, 2009, and June 30, 2008, are as follows:

		Gross Unrealized		
June 30, 2009	Amortized Cost	Gain	Loss	Market Value
Government Direct-Indirect	$ 338,506,185	$ 18,421,356	$ 1,096,593	$ 355,830,948
Government Mortgage-Backed	55,021,462	2,170,681	-	57,192,143
Corporate Securities Asset-Backed	67,844,154	817,761	12,999,051	55,662,864
Other Corporate Securities	448,365,867	9,504,796	17,274,167	440,596,496
Other Securities	2,196,735	-	-	2,196,735
Equity Securities	84,406,677	-	2,663,771	81,742,906
STIP	24,207,449	-	-	24,207,449
Total	$ 1,020,548,529	$ 30,914,595	$ 34,033,583	$ 1,017,429,540

		Gross Unrealized		
June 30, 2008	Amortized Cost	Gain	Loss	Market Value
Government Direct-Indirect	$ 333,382,539	$ 8,771,946	$ 469,919	$ 341,684,566
Government Mortgage-Backed	52,966,201	211,637	787,941	52,389,897
Corporate Securities Asset-Backed	77,834,457	1,117,957	2,979,923	75,972,490
Other Corporate Securities	388,444,247	1,199,719	14,128,127	375,515,839
Other Securities	19,584,192	280,832	267,381	19,597,643
Equity Securities	68,406,677	19,036,648	-	87,443,325
STIP	15,926,865	-	-	15,926,865
Total	$ 956,545,179	$ 30,618,738	$ 18,633,292	$ 968,530,625

The amortized cost and estimated market value of MSF's fixed maturity securities as of June 30, 2009 and June 30, 2008 are shown below at contractual maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

June 30, 2009

	Amortized Cost	Market Value
Due one year or less	$ 50,409,071	$ 49,248,619
Due after one year through five years	385,090,036	382,973,275
Due after five years through ten years	394,248,043	401,097,674
Due after ten years	106,394,702	102,367,067
Equity Securities	84,406,677	81,742,906
Total	$ 1,020,548,529	$ 1,017,429,540

June 30, 2008

	Amortized Cost	Market Value
Due one year or less	$ 98,527,550	$ 98,644,698
Due after one year through five years	306,548,743	304,254,488
Due after five years through ten years	369,966,115	366,451,413
Due after ten years	113,096,093	111,736,701
Equity Securities	68,406,677	87,443,325
Total	$ 956,545,179	$ 968,530,625

During the fiscal year ending June 30, 2009, MSF realized gross gains from sales of securities of $1.57M and gross realized losses of $15.2M. During the fiscal year ending June 30, 2008, MSF realized gross gains from sales of securities of $283K and gross realized losses of $396K.

As discussed in Note 1, GASB 31 requires governmental entities to report their investments at fair value. Fair value is defined as the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The adjustment to fair value is reflected as an increase or decrease in investment income. During fiscal year 2009, investment income for MSF reflects a decrease of ($15.1M) due to the unrealized loss on investments. Investment income for fiscal year 2008 reflects a decrease of ($10.4M) due to the unrealized loss on investments.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

The amortized cost and market value of the Old Fund fixed maturity securities as of June 30, 2009 and June 30, 2008 are as follows:

		Gross Unrealized		
June 30, 2009	Amortized Cost	Gain	Loss	Market Value
Government Direct-Indirect	$ 2,726,000	$ 115,610	$ -	$ 2,841,610
Government Mortgage-Backed	487,945	28,044	-	515,989
Corporate Securities Asset-Backed	1,810,580	10,486	-	1,821,066
Other Corporate Securities	1,013,685	48,224	-	1,061,909
Other Securities	1,133,310	-	-	1,133,310
STIP	12,488,783	-	-	12,488,783
Total	$ 19,660,305	$ 202,364	$ -	$ 19,862,668

		Gross Unrealized		
June 30, 2008	Amortized Cost	Gain	Loss	Market Value
Government Direct-Indirect	$ 12,265,615	$ 270,021	$ -	$ 12,535,636
Government Mortgage-Backed	776,024	17,581	-	793,605
Corporate Securities Asset-Backed	3,533,815	16,194	13,293	3,536,716
Other Corporate Securities	2,019,056	-	163,011	1,856,045
Other Securities	1,203,458	-	-	1,203,458
STIP	11,688,727	-	-	11,688,727
Total	$ 31,486,696	$ 303,796	$ 176,304	$ 31,614,188

The amortized cost and market value of the Old Fund fixed maturity securities as of June 30, 2009 and June 30, 2008 are shown below at contractual maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

June 30, 2009

	Amortized Cost	Market Value
Due one year or less	$ 13,622,093	$ 13,622,093
Due after one year through five years	4,227,631	4,419,508
Due after five years through ten years	-	-
Due after ten years	1,810,580	1,821,066
Total	$ 19,660,305	$ 19,862,668

June 30, 2008

	Amortized Cost	Market Value
Due one year or less	$ 21,548,878	$ 21,637,181
Due after one year through five years	6,404,002	6,440,291
Due after five years through ten years	-	-
Due after ten years	3,533,815	3,536,717
Total	$ 31,486,695	$ 31,614,188

During the fiscal year ended June 30, 2009, the Old Fund realized less than $1K in gross gains from sales of securities and $266K in gross losses from sales of securities. During the fiscal year ended June 30, 2008, the Old Fund realized $140K in gross gains from sales of securities and $5K in gross losses from sales of securities.

During fiscal year 2009, the effect of GASB 31 on Old Fund investment income was an increase of $75K due to unrealized gains on its long-term portfolio. The effect of GASB 31 on Old Fund investment income for fiscal year 2008 was an increase of $341K due to unrealized gains on its long-term portfolio.

3. Reinsurance

For the fiscal years ended June 30, 2009 and June 30, 2008, MSF ceded premiums to other reinsurance companies to limit the exposure arising from large losses. These arrangements consist of excess of loss contracts that protect against individual occurrences over stipulated amounts and an aggregate stop loss contract which protects MSF against the potential that aggregate losses will exceed expected levels expressed as a percentage of premium.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

The excess of loss contracts provide coverage for fiscal years 2009 and 2008, respectively, as follows:

Contract Period	Reinsurance Coverage
2009	Workers' compensation accidents of up to $5M in excess of $5M, maximum of $5M per any one claimant.
	Workers' compensation accidents of up to $20M in excess of $10M, maximum of $5M per any one claimant.
	Workers' compensation accidents of up to $70M in excess of $30M, maximum of $5M per any one claimant.
2008	Workers' compensation accidents of up to $5M in excess of $5M, maximum of $5M per any one claimant.
	Workers' compensation accidents of up to $10M in excess of $10M, maximum of $5M per any one claimant.
	Workers' compensation accidents of up to $30M in excess of $20M, maximum of $5M per any one claimant.
	Workers' compensation accidents of up to $50M in excess of $50M, maximum of $5M per any one claimant.

The term of the current aggregate stop loss contract is July 1, 2008 through June 30, 2011. The contract provides coverage based on MSF's premium levels at a maximum of $45M per year and a minimum of $36.6M, but in aggregate not to exceed 100.0% of the sum of the annual limits for all contract years. In the event reinsurers are unable to meet their obligations under either the excess of loss contracts or aggregate stop loss contract, MSF would remain liable for all losses, as the reinsurance agreements do not discharge MSF from its primary liability to the policyholders.

Premium revenue is reduced by premiums paid for reinsurance coverage of $13.7M and $14.7M in fiscal years 2009 and 2008, respectively. The aggregate stop loss contract requires that MSF maintain a funds-withheld account which represents the basic premium portion of the total premium paid for aggregate stop loss coverage. The total funds withheld account at June 30, 2009 is $51.9M for contracts in place from July 1, 2002 to June 30, 2009. The funds withheld account at June 30, 2008 was $40.9M for contracts in place from July 1, 2002 to June 30, 2008.

Interest must be accrued quarterly at an annual rate of 4.75% for fiscal year 2009 and 5.0% for fiscal year 2008, resulting in accrued interest of $2.6M for fiscal year 2009 and $2.1M for fiscal year 2008.

Estimated claim reserves were reduced by $7.3M and $14.0M for fiscal years 2009 and 2008 respectively for the amount of reinsurance estimated to be ultimately recoverable on incurred losses due to the excess of loss reinsurance contract. In fiscal year 2009 estimated claim reserves were reduced by an additional $10.7M and in fiscal year 2008 an additional $10.8M for the amount of reinsurance estimated to be ultimately recoverable on incurred losses due to the aggregate stop loss contract.

MSF also has assumed reinsurance relationships with Argonaut Insurance Company and Legion Insurance Company related to Other States Coverage (OSC). MSF assumes risk related to Montana domiciled businesses with operations in other states, which are then covered under MSF's ceded reinsurance contract. Assumed premium for fiscal years 2009 and 2008 is $2.7M and $2.3M, respectively. The assumed liability for OSC claims is $4.6M and $3.9M for fiscal years 2009 and 2008, respectively.

4. Risk Management

MSF provides liability coverage to employers for injured employees that are insured under the Workers' Compensation and Occupational Disease Acts of Montana. Workers' compensation claims occurring on or after July 1, 1990, are reported in the MSF. At June 30, 2009, approximately 26,398 active policies were insured by MSF. At June 30, 2008, approximately 27,947 active policies were insured by MSF.

MSF is a self-supporting, competitive state fund and functions as the guaranteed market insurer for employers since workers' compensation insurance is mandatory in Montana. Employers may obtain coverage through private carriers, through MSF or through self-insurance if they meet certain criteria. Public entities may self-insure or insure through MSF.

Montana State Fund serves as claim administrator on claims for injuries that occurred before July 1, 1990, known as the State of Montana (Old Fund). Should the reserves in the Old Fund become inadequate, the State of Montana and General Fund will be obligated to cover benefit payments and administrative costs. Unpaid claims and claims adjustment expenses are estimated based on the ultimate cost of settling the claims including the effects of inflation and other social and economic factors. When MSF purchases annuity contracts, the claim is settled in full and on a final basis, and all liability of MSF is terminated.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

Towers Perrin, an external actuarial firm, prepares an actuarial study used to estimate liabilities and the ultimate cost of settling claims reported but not settled and claims incurred but not reported (IBNR) for MSF as of June 30, 2009 and June 30, 2008. Because actual claim costs depend on such complex factors such 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 social 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 reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience.

Towers Perrin provides a range of potential costs associated with reported claims, the future development of those claims and IBNR. MSF management has selected our best estimate within that range as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for fiscal years 2009 and 2008. The MSF estimated unpaid claims and claims adjustment expenses payable is presented at face value, net of estimated reinsurance recoverable, at $813.3M and $752.3M, as of June 30, 2009 and June 30, 2008, respectively. The estimated claims payable increased $61.0M from 2008 to 2009, which includes adverse development of approximately $18.9M on prior year claims. MSF currently has no knowledge of any significant environmental or asbestos claims that would contribute to this estimate.

State law (Section 39-71-2311, MCA) requires MSF to set premiums at least annually at a level sufficient to ensure adequate funding of the insurance program during the period the rates will be in effect. Anticipated investment income is considered when computing premium rate levels. State law also requires the MSF Board of Directors to establish surplus above risk based capital requirements to secure MSF against risks inherent in the business of insurance.

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. MSF acquisition costs are capitalized and amortized ratably over the subsequent year. Capitalized acquisition costs at June 30, 2009 and June 30, 2008 are $4.6M and $5.1M, respectively. For the years ended June 30, 2009 and June 30, 2008, acquisition costs that were amortized are $5.1M and $3.9M, respectively.

The Old Fund covers the liability and payment of workers' compensation claims for incidents occurring before July 1, 1990. Funding for claims payments in the Old Fund is provided by the assets and investment earnings from those assets. If the assets held by the Old Fund are not adequate to fund claim payments and the administration of the Old Fund, the State of Montana and the state General Fund must fund future claims payments.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

An actuarial study prepared by Towers Perrin for the Old Fund as of June 30, 2009 and June 30, 2008, is used to estimate liabilities and the ultimate cost of settling claims that have been reported, but not settled, and claims that have been incurred, but not reported (IBNR). Towers Perrin provides a range of potential cost associated with reported claims, the future development of those claims and IBNR. MSF management has selected the best estimate within that range as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for fiscal years 2009 and 2008. As of June 30, 2009, the undiscounted estimated claims payable is $79.2M and is presented at net present value of $65.6M discounted at a 3.5% rate. As of June 30, 2008, the undiscounted estimated claims payable was $86.7M and presented at net present value of $68.4M discounted at a 4.5% rate.

Changes in Claims Liabilities for the Past Two Years

The following table presents changes in the aggregate liabilities for MSF and the Old Fund for the past two years, net of estimated reinsurance recoverable. The information presented has not been discounted.

	MSF	
	2009	**2008**
Unpaid claims and claim adjustment expenses at beginning of year	$ 752,253,300	$ 679,209,000
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current year	151,964,493	195,324,877
Increase(Decrease) in provision for events in prior years	30,842,102	17,612,233
Total incurred claims and claim adjustment expenses	182,806,595	212,937,110
Payments:		
Claims and claim adjustment expenses attributable to insured events of CY	(28,062,156)	(35,772,829)
Claims and claim adjustment expenses attributable to insured events of PY	(93,693,027)	(104,119,981)
Total payment	(121,755,183)	(139,892,810)
Total unpaid claims and claim adjustment expenses at end of the year	$ 813,304,712	$ 752,253,300

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

	Old Fund (Undiscounted)	
	2009	2008
Unpaid claims and claim adjustment expenses at beginning of year	$ 86,732,627	$ 98,232,540
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current year	-	-
Increase(Decrease) in provision for events in prior years	3,170,707	(212,258)
Total incurred claims and claim adjustment expenses	3,170,707	(212,258)
Payments:		
Claims and claim adjustment expenses attributable to insured events of CY	-	-
Claims and claim adjustment expenses attributable to insured events of PY	(10,740,637)	(11,287,655)
Total payment	(10,740,637)	(11,287,655)
Total unpaid claims and claim adjustment expenses at end of the year	$ 79,162,697	$ 86,732,627

Risk Management Trend Information

The following table illustrates how the earned revenues of MSF plus investment income compare to related costs of loss and other expenses assumed by MSF for fiscal years 2000 through 2009. In addition, cumulative amounts related to estimated and actual paid claims are presented. The information allows for comparison of actual and estimated claims and is a basis for developing revenue and claims information. As data for individual policy years mature, the correlation between original estimates and re-estimated amounts is used to evaluate the accuracy of incurred claims currently recognized for less mature policy years.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

(In Millions's)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
1. Premiums and Investment Revenue										
Earned	94,625	112,233	119,627	156,955	164,859	222,882	242,394	278,813	258,693	223,420
Ceded	855	2,952	(465)	5,654	6,563	6,788	13,618	14,856	14,676	13,702
Net Earned	93,770	109,282	120,092	151,301	158,297	216,095	228,776	263,957	244,017	209,718
2. Unallocated expenses including overhead	21,649	26,188	28,713	31,548	37,569	39,078	40,548	41,947	47,778	49,215
3. Estimated losses and expenses, end of accident year										
Incurred	65,957	68,267	81,560	110,153	120,705	134,290	155,057	170,652	177,100	159,229
Ceded	-	-	-	-	-	-	-	-	-	-
Net Incurred	65,957	68,267	81,560	110,153	120,705	134,290	155,057	170,652	177,100	159,229
4. Net paid (cumulative) as of:										
End of policy year	13,177	14,140	16,693	22,982	26,123	25,721	30,977	32,708	31,002	29,009
One year later	29,218	32,888	38,185	48,861	50,888	57,239	66,063	67,928	67,034	
Two years later	37,555	45,218	52,359	63,773	66,140	72,229	84,014	85,646		
Three years later	43,649	55,248	60,029	72,957	74,697	82,647	94,091			
Four years later	48,322	61,846	64,922	79,060	80,233	88,236				
Five years later	52,027	66,031	68,343	84,340	83,788					
Six years later	54,473	69,553	71,566	88,645	-					
Seven years later	57,077	72,367	74,253	-	-					
Eight years later	59,228	75,269	-	-	-					
Nine years later	60,690	-	-	-	-					
5. Re-estimated ceded losses and expenses	-	-	-	8,600	2,138	-	-	-	-	-
6. Re-Estimated net incurred losses and expense:										
End of policy year	65,957	68,267	81,560	110,153	120,705	134,290	155,057	170,652	177,100	159,229
One year later	66,421	71,094	86,799	110,532	112,609	136,235	157,711	171,783	174,279	-
Two years later	66,662	81,053	91,241	112,443	124,413	138,447	163,433	170,786	-	-
Three years later	70,302	88,157	94,615	117,245	127,827	144,484	164,358	-	-	-
Four years later	72,492	92,329	99,755	115,414	129,051	143,820	-	-	-	-
Five years later	73,423	95,727	100,925	119,976	127,702	-	-	-	-	-
Six years later	76,048	98,124	105,651	121,686	-	-	-	-	-	-
Seven years later	77,930	102,847	104,874	-	-	-	-	-	-	-
Eight years later	80,680	103,475	-	-	-	-	-	-	-	-
Nine years later	81,400	-	-	-	-	-	-	-	-	-
7. Increase (decrease) in estimated net incurred losses and expenses from end of policy year	15,444	35,208	23,314	11,533	6,997	9,530	9,301	134	(2,821)	(0)

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

5. Administrative Cost Allocation

State law (Section 39-71-2352, MCA) requires MSF to separately determine and account for administrative expenses and benefit payments for claims for injuries resulting from accidents occurring before July 1, 1990 (Old Fund) from those occurring on or after July 1, 1990 (MSF). The law also limits annual administrative costs of claims associated with the Old Fund to $1.25M. MSF allocated $1.25M in administration costs to the Old Fund in each of fiscal years 2009 and 2008. The Old Fund has a $6K obligation to MSF in unrecovered administrative costs incurred in fiscal years 2009 and prior. MSF intends to recover this amount in future years where the cost of administering the Old Fund is less than the statutorily permitted $1.25M.

6. MSF Distributions

During the fiscal year ended June 30, 2009, the MSF Board of Directors authorized and MSF paid dividends to eligible policyholders in the amount of $4.0M for the policy year 2006. The MSF Board of Directors did not authorize and MSF did not pay a dividend in fiscal year 2008.

7. Old Fund Net Asset Position

Net assets consist of the net excess or deficit of assets over liabilities.

Section 39-71-2352 (5), MCA, provides for the payment of excess funds from the Old Fund to the State of Montana General Fund based on adequate funding levels in the Old Fund. This law defined the term "adequately funded" to mean the present value of:

a) the total cost of future benefits remaining to be paid; and,
b) the cost of administering the claims

Section 39-71-2352 (6), MCA, requires the transfer from the State of Montana General Fund any amount necessary to pay claims from the Old Fund.

There were no excess funds to transfer to the General Fund as of June 30, 2009 and June 30, 2008. In order to value liabilities consistently with investments, the estimated claims liability discount rate is 3.5% in fiscal year 2009 and was 4.5% in 2008. The Old Fund net asset level, using a present value discount factor of 3.5%, is ($45.5M) as of June 30, 2009 and ($36.5M) as of June 30, 2008. Applying the current actuarially estimated payout pattern of the Old Fund there are sufficient invested assets to meet its obligations up to the year 2011. State law requires the General Fund to satisfy all outstanding claims when the Old Fund has liquidated all financial resources and cannot meet its obligations.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

8. Compensated Absences

MSF supports two leave programs, the State of Montana Leave Program, (Traditional Plan) and the MSF Personal Leave Program, implemented in January 2002. The State of Montana Leave Program covers union represented employees who have elected to remain in the plan. These employees accumulate both annual leave and sick leave and MSF pays employees 100% of unused annual leave and 25% of unused sick leave upon termination. MSF also pays 100% of unused compensatory leave credits upon termination to non-exempt employees in the Traditional Plan. MSF Personal Leave Program covers all non-union employees, union employees hired before July 26, 2006 who have elected to adopt the plan, and all employees hired after July 25, 2007. Employees in the Personal Leave Program accumulate personal leave and extended leave. MSF pays employees for 100% of unused personal leave upon termination but extended leave has no cash value at the time of termination.

MSF absorbs expenditures for termination pay in its annual operational costs. MSF may allocate some of these costs to the Old Fund as a portion of the Old Fund administrative cost allocation. The total leave liability for MSF is $2.5M for fiscal year 2009. The total leave liability for MSF is $2.4M for fiscal year 2008.

9. Retirement Plans

MSF and its employees contribute to the Public Employees' Retirement System (PERS), which offers two types of retirement plans administered by the Public Employees' Retirement Board (PERB). The first plan is the Defined Benefit Retirement Plan (DBRP), a multiple-employer, cost-sharing plan that provides retirement, disability and death benefits to plan members and their beneficiaries. Benefits are based on eligibility, years of service and highest average compensation. Vesting occurs once membership service totals five years. Benefits are established by state law and can only be amended by the legislature.

The second plan is the Defined Contribution Retirement Plan (DCRP), created by the 1999 legislature and available to all active PERS members effective July 1, 2002. This plan is a multiple-employer, cost-sharing plan that also provides retirement, disability and death benefits to plan members and their beneficiaries. Benefits are based on the balance in the member's account, which includes the total contributions made, the length of time the funds have remained in the plan, the investment earnings less administrative costs.

Eligible PERS members choose to participate in either the DBRP or DCRP but may not be active members of both plans. MSF and its employees were required to contribute 6.9% of annual compensation in fiscal years 2009 and 2008. MSF's contributions amounted to $1.1M for fiscal year 2009 and $1.2M for fiscal year 2008. MSF and its employees paid one hundred percent of required contributions to PERS and there is no unpaid liability as of June 30, 2009.

The PERS financial information is reported in the Public Employees' Retirement Board *Comprehensive Annual Financial Report* for the fiscal year-end. It is available from PERB at 100 North Park Avenue, Suite 220, P. O. Box 200131, Helena, MT 59620-0131, (406) 444-3154.

MSF and its employees are eligible to participate in the State of Montana Deferred Compensation Plan (457 plan) administered by the PERB. The Deferred Compensation plan is a voluntary, tax-deferred retirement plan designed as a supplement to other retirement plans. Under the plan, eligible employees elect to defer a portion of their salary until future time periods. MSF incurs no costs for this plan.

10. Building

MSF currently leases an office building from the State of Montana. Under an agreement with the State of Montana, which expires on July 31, 2010, MSF pays all costs associated with the building, including utilities, property assessments, janitorial services, and maintenance plus an administrative rental fee to the State of Montana, Department of Administration.

Under an agreement with the Board of Investments, BOI is coordinating and managing construction of an office building that MSF will occupy. Montana State Fund will pay all costs of the property including utilities, property assessments, janitorial services, and maintenance. Construction began in August 2008 and is expected to be completed in fiscal year 2010. For the year ended June 30, 2009, MSF financial statements include $1.14M in Land and $11.6M Construction Work in Process (CWIP) related to the building.

11. Commitments

MSF will lease 350 parking spaces in an adjacent parking garage that will be built by the City of Helena. The cost of the parking spaces will be the same monthly rate as equivalent parking passes sold by the city. The parking facility is expected to open in conjunction with the move to the new building in June 2010. The annual subsequent parking cost is estimated to be $231K with potential to change based on parking rates assigned by Helena Parking Commission.

12. Other Post-Employment Benefits (OPEB)

Beginning with the fiscal year ending June 30, 2008, the State of Montana implemented Governmental Accounting Standards Board (GASB) Statement 45, Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions. This statement requires the disclosure of employer liability for retiree medical subsidies and other post-employment benefits. The OPEB liability at June 30, 2009 and June 30, 2008 are $1.8M and $858K respectively.

Post-employment Healthcare Plan Description:

MSF employees and dependents are eligible to receive health care through the State Group Benefits Plan administered by the Montana Department of Administration. In accordance with section 2-18-704, MCA, the State provides optional post-employment medical, vision and dental 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. For GASB 45 reporting, the State Group Benefits Plan is considered an agent multiple-employer plan and MSF is considered to be a separate employer participating in the plan.

In addition to the employee benefits described in Note 9 Retirement Plans, the following post-employment benefits are provided. Montana Department of Administration established retiree medical premiums vary between $182 and $836 per month depending on the medical plan selected, family coverage, and Medicare eligibility. Administratively established dental premiums vary between $34.10 and $58.00; vision premiums vary between $7.64 and $22.26; both premiums vary depending on the coverage selected. Basic life insurance in the amount of $14,000 is provided until age 65 at a cost of $1.90 per month to the retiree. The State Benefit Plans reimburse all validated medical claims net of member obligations (annual deductibles and coinsurance of the members' selected medical plan). Dental claims are reimbursed at 50% to 100% of the allowable charges, depending on the services provided. The State acts as secondary payer for retired Medicare-eligible claimants.

Benefits Not Included in the Valuation:

Retirees pay 100 percent of dental premiums. Thus, there is no liability for dental valued in this valuation. The vision benefit is fully-insured and retirees pay 100 percent of the cost. Thus, there is no liability for vision valued in this valuation. The life insurance benefit is a fully-insured benefit that is payable until age 65 with the retiree required to pay the full premium. There is no liability valued in this valuation for the retirees, though the required premium is an active/retiree blended premium. This liability would be insignificant to the overall results of this valuation.

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

Funding Policy:

The following estimates were prepared based on an actuarial evaluation prepared as of January 1, 2007 for the Department of Administration and the resulting State of Montana Actuarial Valuation of Other Post-Employment Benefits Plan (plan) contains the MSF data and is available through:
Montana Department of Administration,
State Accounting Division
Room 255, Mitchell Bldg,
125 N Roberts St
PO Box 200102,
Helena, MT 59620-0102.

GASB 45 requires the plan's participants, including the MSF, to report each year the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year of retiree health care costs and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The 2008 ARC is calculated for all the State plan's participants and then individually allocated to individual participants. The MSF 2008 ARC is estimated at $858,215 and is based on the plan's current ARC rate of 7.99% percent of participants' annual covered payroll. The MSF 2008 ARC is equal to an annual amount required each year to fully fund the liability over thirty years.

The amount of the estimated OPEB actuarial accrued liability at transition was determined in accordance with the GASB Statement 45, and liability is estimated at $8,079,405 for MSF. The actuarial accrued liability is the present value of future retiree and active employees who will retire and be eligible for benefits and expenses.

Actuarial Methods and Assumptions:

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents information that shows the actuarial value of plan assets and liabilities. In the December 31, 2007, actuarial valuation, the projected unit credit funding method is used. The actuarial assumptions did not include an investment rate of return since no assets meet the definition of plan assets under GASB 43 or 45. Annual healthcare cost trend rates of 8 percent for medical and 15 percent for prescription claims are used. The unfunded actuarial accrued liability is amortized following a 30-year level percentage of payroll amortization schedule on an open basis beginning January 1, 2007.

The State finances claims on a pay-as-you-go basis and does not advance-fund the OPEB liability. While this liability is disclosed for financial statement purposes it does not represent a legal liability of the State of Montana or MSF. Therefore, the following cost information shows no cost contributions or plan assets made by MSF.

Annual Other Post Employment Benefits (OPEB) Cost:

MSF's allocated annual OPEB cost (expense) for year ending June 30, 2009 was $858,215. The interest on the net OPEB obligation for year ending June 30, 2009 was $36,474. For 2008, MSF's allocated annual OPEB cost (expense) of $858,215 was equal to the ARC. The cost that was allocated to the Old Fund for the years ended June 30, 2009 and June 30, 2008 was $51,142 and $48,835, respectively.

The MSF annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2009 and 2008 are as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/2008	858,215	0.00%	858,215
6/30/2009	894,689	0.00%	1,752,904

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

Funded Status and Funding Progress:

As of June 30, 2009, the most recent actuarial valuation available was completed by the State of Montana for the calendar year ending December 31, 2007, the MSF allocation of the plan was as follows:

Actuarial Accrued Liability (AAL)	$8,079,405
Actuarial Value of Plan	$0
Unfunded Actuarial Accrued Liability	$8,079,405
Funded Ratio (Actuarial Value of Plan	$0
Covered Payroll (Active Plan	$16,805,676
UAAL as a Percentage of Covered	48.08%

13. Subsequent Events

On November 3, 2009, the Montana Supreme Court issued its opinion in *Satterlee v. Lumberman's Mutual Casualty Company v. Montana State Fund,* 2009 MT 368, which affirmed the Workers' Compensation Court decision holding §39-71-710, MCA constitutional as not violating Satterlee's right to equal protection and substantive due process. The range of estimated liability was not included in Montana State Fund or Old Fund loss reserves. The contingency disclosure previously included in the notes to the financial statements has been removed.

14. Contingencies

Working Rx, Inc., v. Montana State Fund, Ed Heinrich, (Chairman of the Board of Directors of the Montana State Fund), Laurence Hubbard (President of the Montana State Fund), National Medical Health Card Systems, Inc, and John Does 1-20. This complaint was served in September 2006, but has since been dismissed to provide for the presentation of the claim to the Department of Administration as required in Title 2, Chapter 9, Section 301, MCA. Whether Montana State Fund has any responsibility to Working Rx for payment of pharmacy claims is the basis of the claim. Montana State Fund does not have sufficient information to determine potential liability or cost impact.

Coles, Individually and as Personal Representatives for the Estate of Steven Bearcrane v. Black Ranches, Inc., Crow Tribal Court No. CAV 07-044, is a tort case filed against a policy holder of Montana State Fund. The case involves a wrongful death claim by the estate of an employee of the policyholder. Montana State Fund is providing a defense under a complete reservation of rights to the policy holder under Part Two of the State Fund's insurance policy, also known as employers' liability coverage. The policy limits in this case are $1,000,000. The exclusive remedy provisions of

Montana State Fund and Old Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2009 and 2008

MCA Section 39-71-411 should bar this type of tort claim against the policy holder. However, if the plaintiffs are successful in convincing the court that MCA Section 39-71-411 does not provide a defense, and that the employer-policyholder was at fault in causing the death of its employee the damages may be substantial. Actual potential cost impact to the State Fund is not known at this time. Liability for Montana State Fund, up to its policy limits ($1,000,000), is reasonably possible.

REQUIRED SUPPLEMENTARY INFORMATION

Other Post-Employment Benefits (Financial Statement Note 11)

As of June 30, 2009, the most recent actuarial valuation available was completed by the State of Montana for the calendar year ending December 31, 2007. Since 2008 was the OPEB reporting implementation year and the year of transition, there is not previous years' information available to report as required by Governmental Accounting Standards Board Statement 45. The State of Montana finances claims on a pay-as-you-go basis and does not advance fund the OPEB liability. Therefore, the funded ratio remains at 0% at June 30, 2009.

SCHEDULE OF FUNDING PROGRESS

Date	Actuarial Value of Assets (A)	Actuarial Accrued Liability (AAL) (B)	Unfunded AAL (UAAL) (B-A)	Funded Ratio (A/B)	Covered Payroll (C)	UAAL as a Percentage of Covered Payroll ((B-A)/C)
12/31/07	$0	$8,079,405	$8,079,405	0.00%	$16,805,676	48.08%

Montana State Fund

Fund's Response

MONTANA STATE FUND

5 South Last Chance Gulch • P.O. Box 4759 • Helena, MT 59604-4759
Customer Service 1-800-332-6102 or 406-444-6500
Fraud Hotline 1-800-682-7463 (800-M-CRIME)

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LEGISLATIVE AUDIT DIV.

November 25, 2009

Ms. Tori Hunthausen
Legislative Audit Division
Room 160, State Capitol
Helena, MT 59620-1705

Dear Ms. Hunthausen:

Montana State Fund (MSF) appreciates the efficient and professional approach of the audit staff involved in this audit of our governmental financial statements. Once again, we are pleased with your issuance of an unqualified opinion without any audit recommendations on the financial statements we have presented.

The management and staff of MSF are very proud of our continued accomplishments in serving Montana businesses. Montana State Fund is committed to the health and economic prosperity of Montana through superior service, leadership, and caring individuals working in an environment of teamwork, creativity, and trust. We continually strive to improve all aspects of our operations to ensure Montana businesses and the community will continue to benefit from a strong Montana State Fund many years into the future.

Sincerely,

Laurence A. Hubbard
President/CEO

LAH/sh