A Report
to the
Montana
Legislature

Financial-Compliance Audit

# Montana State Fund

## For the Fiscal Year Ended June 30, 2013

October 2013

Legislative Audit
Division

**12-05B**

## Legislative Audit Committee

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§5-13-202(2), MCA

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## Financial-Compliance Audits

Financial-compliance audits are conducted by the Legislative Audit Division to determine whether an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. 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-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) licenses.

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 reporting 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, 2011, was issued March 29, 2012. The Single Audit Report for the two fiscal years ended June 30, 2013, will be issued by March 31, 2014. 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
Helena, MT 59620-0802

Legislative Audit Division
Room 160, State Capitol
P.O. Box 201705
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# LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Deborah F. Butler, Legal Counsel

Deputy Legislative Auditors
Cindy Jorgenson
Angus Maciver

October 2013

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report of the Montana State Fund, a component unit of the state of Montana, for the fiscal year ended June 30, 2013. The financial statements include comparative information for the fiscal year ended June 30, 2012. This report contains no recommendations. On page A-1, you will find the Independent Auditor's Report. We issued an unmodified opinion on the financial statements, which means the reader can rely on the information presented.

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

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Phone (406) 444-3122 • FAX (406) 444-9784 • E-Mail lad@mt.gov

# Table of Contents

# 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 | |
| | | Term Expires |
| **State Fund Board of Directors** | Elizabeth Best, Chair | 2015 |
| | Joe Brenneman | 2015 |
| | Wayne Dykstra | 2015 |
| | Bruce Mihelish | 2017 |
| | Richard Miltenberger | 2017 |
| | Lynda Moss | 2017 |
| | Lance Zanto | 2017 |

For additional information concerning the Montana State Fund, contact:

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855 Front Street
Helena, MT 59604
(406) 495-5015
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Montana Legislative Audit Division

# Financial-Compliance Audit
# Montana State Fund
## For the Fiscal Year Ended June 30, 2013

October 2013 12-05B Report Summary

In spite of a decrease in the number of active policies from approximately 24,700 in fiscal year 2011-12 to under 24,400 in 2012-13, Montana State Fund (MSF) has experienced an increase in Net Earned Premium of 3.7 percent. The premiums increased from approximately $150.5 million in 2011-12 to $156.0 million in 2012-13. This increase in premiums is attributed to increased payrolls reported by the policyholders. In fiscal year 2011-12, MSF implemented a 20 percent reduction in premium rates as a result of workers' compensation legislation passed in 2011. In the year of implementation, Net Earned Premium decreased by approximately 13.3 percent.

## Context

The MSF board is allocated to the Department of Administration for administrative purposes only. MSF is governed by a seven member board of directors appointed by the Governor. The MSF is a nonprofit, independent public corporation established under Title 39, chapter 71 of the Montana Code Annotated, and provides Montana employers with an option for workers' compensation and occupational disease insurance guaranteeing available coverage for all employers in Montana.

By fiscal year-end 2010-11, the Old Fund (claims incurred prior to July 1, 1990) exhausted all of its resources and by state law, the General Fund became responsible for paying the claims. The General Fund transferred approximately $10.6 and $10.0 million in fiscal years 2012-13 and 2011-12, respectively, for payment of the Old Fund claims and operating costs.

## Results

This report contains no recommendations. The previous audit included one recommendation. We found this prior audit recommendation to be fully implemented.

| Recommendation Concurrence | |
|---|---|
| Concur | 0 |
| Partially Concur | 0 |
| Do Not Concur | 0 |
| **Source: Agency audit response included in final report.** | |

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# Chapter I – Introduction

## Introduction

We performed a financial-compliance audit of the Montana State Fund (MSF) for the fiscal year ended June 30, 2013.

The objectives of this audit were to:

1. Determine whether MSF complied with selected applicable laws and regulations.
2. Obtain an understanding of the MSF's control systems to the extent necessary to support our audit of MSF's financial statements, and if appropriate, make recommendations for improvement in management and internal controls of MSF.
3. Determine whether the MSF's financial statements present fairly the financial position, results of operations, and cash flows for the fiscal year ended June 30, 2013, with comparative financial amounts for the fiscal year ended June 30, 2012.

MSF personnel prepared the financial statements based on accounting information from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) with adjustments. Adjustments are made to present financial activity in accordance with generally accepted accounting principles. This report contains no recommendations.

## Background

MSF is a nonprofit, independent public corporation that 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.

MSF management must set premium rates for the New Fund (claims incurred after July 1, 1990) at amounts sufficient, when invested, to carry the estimated cost of all claims to maturity, to meet the reasonable expenses of conducting the business of the New Fund, 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 investments of the MSF, per state law, are managed by the Montana Board of Investments and invested in accordance with the prudent expert principle.

By fiscal year-end 2010-11, the Old Fund (claims incurred prior to July 1, 1990) exhausted all of its resources and by state law, the General Fund became responsible for paying the claims. The General Fund transferred approximately $10.6 and $10.0 million in fiscal years 2012-13 and 2011-12, respectively, for payment of the Old Fund claims and operating costs.

## Prior Audit Recommendations

Our office performed the financial-compliance audit of MSF for the two fiscal years ended June 30, 2012. The report contained one recommendation. MSF fully implemented this recommendation.

# Independent Auditor's Report and Montana State Fund Financial Statements

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Deborah F. Butler, Legal Counsel

Deputy Legislative Auditors
Cindy Jorgenson
Angus Maciver

# Independent Auditor's Report

The Legislative Audit Committee
of the Montana State Legislature:

***Introduction***

We have audited the accompanying Statement of Fund Net Position of the Montana State Fund as of June 30, 2013, and 2012, the related Statement of Revenues, Expenses and Changes in Fund Net Position, and the Statement of Cash Flows for each of the fiscal years then ended, and the related notes which collectively comprise the Montana State Fund's basic financial statements.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this responsibility includes designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to Montana State Fund's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Montana State Fund's internal control, and accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana State Fund as of June 30, 2013, and 2012, and the changes in net position and cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on page A-5 and the Required Supplementary Information on pages A-35 and A-36 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Respectfully submitted,

*/s/ Cindy Jorgenson*

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

October 8, 2013

# Montana State Fund
# Management's Discussion and Analysis, Financial Statements, Notes, and Required Supplementary Information

**Montana State Fund**
(A Component Unit of the State of Montana)
Management Discussion and Analysis
June 30, 2013, 2012 and 2011

Montana State Fund (MSF) is a self-supporting, not-for-profit workers' compensation insurance carrier. Our statutory purpose is to act as a competitive insurance carrier, providing an available market and thereby guaranteeing coverage to all employers in Montana. Operating on the premium dollars paid by the insured employers and the net proceeds from our investments, we are not funded by the state general fund for primary business operations. We function like a private insurance carrier in a competitive marketplace and, as provided by law, perform all the functions and exercise all the powers of a private insurance carrier that are necessary, appropriate or convenient for the administration of the Montana State Fund.

MSF has undergone a number of changes since our creation in 1990. We have transitioned from a traditional organizational structure to one that is more adapted to the demands of the information age. A comprehensive corporate redesign in 2000 enhanced our operational flexibility with the addition of multifunctional teams that are aligned with specific groups of employers. This change increased employee empowerment and allows us to work more closely with our policyholders and their injured employees. We continue to strive to improve efficiencies in all operational areas and have made a major investment in our safety management services as we work diligently with Montana employers in developing accident prevention programs. MSF has invested more resources for medical management and provider relations to improve our focus on managing medical costs as medical benefit costs are about 65% of total claim costs. As our state's economic structure continues to evolve, we stand ready to fulfill our critical role as the guaranteed workers' compensation market for all Montana employers.

The assets of the Old Fund were completely liquidated in 2011 and it is now fully supported by General Fund resources as required under state law (Section 39-71-2352, MCA). Therefore, the Old Fund is considered to be part of the Primary Government for financial reporting purposes and is not included in the accompanying financial statements.

***Overview of the Financial Statements***

This overview is an introduction to Montana State 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 Position presents information regarding all of MSF's assets and liabilities, with the difference between the two being reported as total net position.

The Statement of Revenues, Expenses, and Changes in Fund Net Position present the financial results of operations for MSF for the two most recent fiscal years. All changes in net position 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 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.

### *Financial Highlights*

While many challenges remain for MSF, the economy and our business are seeing improvements. MSF continues to deliver high quality products to Montana businesses at the lowest possible cost consistent with sound insurance principles. MSF fosters and supports a competitive insurance market in Montana, offering a competitively priced product based upon actuarially sound rates while still fulfilling our role as the guaranteed market. Although we did not see a rate change in fiscal year 2013, The Board of Directors approved a 6% rate decrease effective July 1, 2013.

MSF continues to monitor the impact of House Bill (HB) 334, a state law that put into place historic changes to the workers' compensation system in Montana. Medical staff were added to improve our claim handling and ensure that the appropriate medical treatment protocols are applied. MSF also added a provider relations resource to facilitate more timely scheduling of doctor appointments and medical treatment for our injured employees. MSF looks forward to realizing the improvements intended by HB 334 and the positive benefit it can bring to workers' compensation. We are committed to maintaining a strong, stable and dependable insurer for Montana's businesses and their employees.

***Analysis of Financial Position and Results of Operations***

The following analysis presents three years of comparative condensed financial data for MSF.

**Statement of Net Position (In thousands)**
**For the periods ending June 30, 2013, 2012 and 2011 (restated)**

| | 6/30/2013 | 6/30/2012 | 6/30/2011 (Restated) |
|---|---|---|---|
| Assets: | | | |
| Cash and STIP | $ 52,837 | $ 26,137 | $ 19,715 |
| Investments | 1,278,671 | 1,263,070 | 1,203,149 |
| Security Lending Collateral | 141,152 | 149,465 | 89,190 |
| Receivables (Net) | 67,142 | 62,230 | 58,105 |
| Capital Assets (Net) | 30,391 | 32,351 | 34,720 |
| Other Assets | 59,526 | 49,906 | 42,089 |
| Total Assets | $ 1,629,719 | $ 1,583,159 | $ 1,446,968 |
| Current Liabilities: | | | |
| Estimated Claims Payable | $ 118,467 | $ 114,004 | $ 109,287 |
| Securities Lending Liability | 141,152 | 149,465 | 89,190 |
| Payables | 13,676 | 10,885 | 15,282 |
| Other Current Liabilities | 52,360 | 46,840 | 41,373 |
| Total Current Liabilities | 325,655 | 321,194 | 255,132 |
| Noncurrent Liabilities: | | | |
| Estimated Claims Payable | $ 784,381 | $ 775,936 | $ 765,515 |
| Other Noncurrent Liabilities | 82,961 | 74,096 | 62,762 |
| Total Noncurrent Liabilities | 867,342 | 850,032 | 828,277 |
| Total Liabilities | 1,192,997 | 1,171,226 | 1,083,409 |
| Net Position: | | | |
| Beginning Net Position | 411,933 | 363,559 | 316,876 |
| Adjust to Beginning Net Position (Restated) | - | - | (4,998) |
| Change in Net Position | 24,789 | 48,374 | 51,681 |
| Total Net Position (As Restated) | 436,722 | 411,933 | 363,559 |
| Total Liabilities and Net Position | $ 1,629,719 | $ 1,583,159 | $ 1,446,968 |

MSF has seen a continual increase in Net Position the past three years. Net Position increased 6.02% or $24.8M (million) from $411.9M in fiscal year 2012 to $436.7M in fiscal year 2013. Net Position increased by $48.4M in fiscal year 2012 and $46.7M in fiscal year 2011 which includes a $5.0M reduction in net position related to the 2011 restatement and contingent commission adjustment.

MSF restated fiscal year 2011 to correct the reinsurance funds withheld asset balance in the Statement of Net Position and the contingent commission (contractual services expense) in the Statement of Revenues, Expenses, and Changes in Fund Net Position. There was also a contingent commission expense adjustment that increased Operating Expenses by $2.0M.

MSF investments include bond and equity holdings and the combined value as of June 30, 2013 was $1.3B, this was an increase of $15.6M or 1.24% in fiscal year 2013. Investments increased 4.98% or $59.9M in fiscal year 2012, and 9.14% or $100.7M in fiscal year 2011 compared to the previous year. The changes in market value of MSF's investment portfolio of fixed and equity securities in fiscal years 2013, 2012 and 2011 are as follows (In thousands):

| | 2013 | 2012 | 2011 |
|---|---|---|---|
| Prior Year Market Value | $1,263,070 | $1,203,149 | $1,102,416 |
| Purchases at Cost | 197,389 | 226,513 | 217,506 |
| Sales | (185,115) | (196,328) | (154,964) |
| Net Realized Gains | 11,033 | 4,888 | 6,425 |
| Net Accretion of Bonds | (139) | 25 | 9 |
| Unrealized Gain (Loss) | (7,569) | 24,824 | 31,758 |
| Current Year Market Value | $1,278,670 | $1,263,070 | $1,203,149 |

MSF financial statements include $1.14M in land for fiscal years 2013, 2012, and 2011. Buildings (net of depreciation) is $26.3M, $26.8M, and $27.4M, at June 30, 2013, 2012 and 2011, respectively. (Note 1- Other Assets in the Notes to the Financial Statements provides additional information.)

Liabilities are presented as current and noncurrent. Total liabilities increased by $21.8M in fiscal year 2013 primarily due to an increase in the total estimated claims payable of $12.9M, an increase in unearned premium of $5.4M and an increase of $8.0M in other liabilities which includes the reinsurance funds withheld liability. Total liabilities increased by $87.8M in fiscal year 2012 primarily due to the recording an additional $60.3M for Securities on Loan, compared to a decrease in liabilities of $62.1M in fiscal year 2011. This decrease is also primarily due to recording less Securities on Loan of $78.3M. As part of the Board of Investment (BOI) securities lending program, MSF records both an asset and liability in the amount of the cash collateral received. Since an asset and liability are recorded for the same amount, there is no net impact to Net Position. Fluctuations in this amount are frequent, as the amount recorded depends directly on the amount of securities on loan.

Estimated claims payable include both Loss and Loss Adjustment Expense (LAE) reserves. Loss reserves are the actuarially determined estimate of the cost of claims that have already been incurred, and are the most significant liability on MSF's statement of net position. Reserves are decreased as claims are paid and are increased as new losses are incurred. LAE reserves represent the loss adjustment, or claim management expenses related to the unpaid losses. Since these amounts are a percentage of unpaid losses, fluctuations are typically similar to fluctuations in unpaid losses.

The current portion of the Loss and LAE Reserves liability is presented undiscounted at $118.5M and $114.0M, as of June 30, 2013, and 2012, respectively. The noncurrent portion of the Loss and LAE Reserves liability is $784.4M and $775.9M, as of June 30, 2013, and 2012, respectively. This is a total increase in both the current and noncurrent liability of $12.9M compared to fiscal year 2012, and is

primarily due to changes in the reserves for the new accident year of \$14.3M. Also the LAE rate was increased on prior years from 12.9% to 14.4%. The net impact of the LAE rate change offset by payments from older years is (\$2.2M).

The current portion of the Loss and LAE Reserves liability was presented undiscounted at \$114.0M and \$109.3M, as of June 30, 2012, and 2011, respectively. The noncurrent portion of the Loss and LAE Reserves liability was \$775.9M and \$765.5M, as of June 30, 2012, and 2011, respectively. This is a total increase in both the current and noncurrent liability of \$15.1M compared to fiscal year 2011, and is mostly the result of recording another accident year of losses, prior year development, and \$12.4M of reserve strengthening. Management recommended additional reserve strengthening because of the uncertainty of savings anticipated from HB 334 legislative changes.

Towers Watson, an independent actuarial firm, prepares an annual 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. Towers Watson provides a range of potential costs associated with reported claims, the future development of those claims and IBNR. MSF management has selected a central estimate within that range as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses.

**Statement of Revenues, Expenses, and Changes in Fund Net Position (In thousands)**
**for the fiscal years ending June 30, 2013, 2012, and 2011 (restated)**

| | 6/30/2013 | 6/30/2012 | 6/30/2011 (Restated) |
|---|---|---|---|
| Operating Revenues: | | | |
| Net Premium Earned | \$ 156,062 | \$ 150,482 | \$ 173,605 |
| Total Operating Revenue | 156,062 | 150,482 | 173,605 |
| Operating Expenses: | | | |
| Benefits and Claims | 127,168 | 129,664 | 150,680 |
| Personal Services | 25,316 | 25,245 | 24,454 |
| Other Operating Expense | 15,235 | 15,821 | 25,718 |
| Total Operating Expense | 167,719 | 170,730 | 200,852 |
| Net Operating Income (Loss) | (11,657) | (20,248) | (27,247) |
| Nonoperating Revenue (Expense): | | | |
| Investment Income | 44,573 | 72,831 | 81,074 |
| Other Nonoperating Revenue | 1,878 | 1,792 | 1,859 |
| Dividend Expense | (10,005) | (6,001) | (4,005) |
| Total Nonoperating Revenue (Expense) | 36,446 | 68,622 | 78,928 |
| Change in Net Position | \$ 24,789 | \$ 48,374 | \$ 51,681 |

MSF's book of business increased approximately 3.7% from \$150.5M of net earned premium in fiscal year 2012 to \$156.1M in fiscal year 2013. This increase is a result of increased payroll being reported by policyholders and an increase in new business. MSF's premium retention was approximately 90% in fiscal year 2013.

MSF's Net Earned Premium decreased approximately 13.3% from $173.6M in fiscal year 2011 to $150.5M in fiscal year 2012 as a result of a 20% premium rate reduction to policyholders as a result of HB 334.

Benefits and Claim expenses remained at 76% of total Operating Expenses for fiscal years 2013 and 2012, compared to 75% in fiscal year 2011. Total Operating expenses decreased $3.0M from $170.7M in fiscal year 2012 to $167.7M in fiscal year 2013. Total operating expenses decreased from $200.9M in fiscal year 2011 to $170.7M in fiscal year 2012. In fiscal year 2011, the LAE rate had increased from 10.8% to 12.4% causing a significant increase in the loss expenses incurred in fiscal year 2011. In fiscal year 2012, the LAE rate applied was 12.9%.

Investment income decreased $28.3M or 38.8% from $72.8M in fiscal year 2012 to $44.6M in fiscal year 2013. Net unrealized gains decreased by $32.5M due to the market fluctuation of bonds. There is an increase of $6.1M of net realized gains and a decrease in bond income in the amount of $1.8M.

Investment income decreased from $81.1M in fiscal year 2011 to $72.8M in fiscal year 2012 as a result of a reduction of $7.0M in net unrealized gains, a decrease of $1.5M of net realized gains and an increase in bond income in the amount of $500K.

MSF dividends return to employers a portion of premiums paid to MSF. It is a way for MSF to share our strong financial results with those employers who help make it possible by lowering workplace injuries. MSF paid dividends to policyholders of $10.0M, $6.0M and $4.0M in fiscal years 2013, 2012 and 2011, respectively. The Board of Directors, at its discretion, recommends the amount of dividends to be declared. MSF has declared and paid dividends for fourteen consecutive years.

**Montana State Fund**
**Statement of Net Position**
*Montana State Fund is a component unit of the State of Montana*

| June 30, | 2013 | 2012 |
|---|---|---|
| **ASSETS** | | |
| **Current Assets** | | |
| Cash and Cash Equivalents | $ 52,837,260 | $ 26,136,607 |
| Receivables, Net | 67,142,140 | 62,229,980 |
| Securities Lending Collateral | 141,152,406 | 149,464,962 |
| Other Assets | 6,424,847 | 5,383,285 |
| Total Current Assets | 267,556,653 | 243,214,834 |
| **Noncurrent Assets** | | |
| Investments | 1,278,670,677 | 1,263,070,316 |
| Reinsurance Receivables | 53,100,879 | 44,523,008 |
| Equipment, Net | 2,199,824 | 2,569,015 |
| Land | 1,139,460 | 1,139,460 |
| Buildings, Net | 26,302,350 | 26,835,385 |
| Intangible Assets | 749,161 | 1,807,101 |
| Total Noncurrent Assets | 1,362,162,351 | 1,339,944,285 |
| **Total Assets** | $ 1,629,719,004 | $ 1,583,159,119 |
| **LIABILITIES** | | |
| **Current Liabilities** | | |
| Accounts Payable | $ 13,676,307 | $ 10,885,437 |
| Estimated Claims Payable | 118,466,946 | 114,004,107 |
| Compensated Absences | 1,831,535 | 1,780,343 |
| Securities Lending Liability | 141,152,406 | 149,464,962 |
| Unearned Premium | 48,073,611 | 42,468,980 |
| Policyholder Deposits | 2,454,435 | 2,590,408 |
| Total Current Liabilities | 325,655,240 | 321,194,237 |
| **Noncurrent Liabilities** | | |
| Estimated Claims Payable | 784,380,983 | 775,936,467 |
| Reinsurance Funds Withheld | 76,971,113 | 68,972,283 |
| Compensated Absences | 908,811 | 897,650 |
| Other Post Employment Benefits | 5,080,905 | 4,225,492 |
| Total Noncurrent Liabilities | 867,341,812 | 850,031,892 |
| **Total Liabilities** | 1,192,997,052 | 1,171,226,129 |
| **NET POSITION** | | |
| Net Investment in Capital Assets | 30,390,795 | 32,350,962 |
| Unrestricted | 406,331,157 | 379,582,028 |
| **Total Net Position** | 436,721,952 | 411,932,990 |
| **Total Liabilities and Net Position** | $ 1,629,719,004 | $ 1,583,159,119 |

The notes to the financial statements are an integral part of this statement.

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

| YEAR ENDED JUNE 30, | 2013 | 2012 |
|---|---|---|
| Net Premiums Earned | $ 156,062,480 | $ 150,482,457 |
| Operating Expenses | | |
| Benefits and Claims | 127,168,485 | 129,664,181 |
| Personal Services | 25,316,257 | 25,245,373 |
| Contractual Services | 5,017,254 | 4,210,844 |
| Supplies and Materials | 570,151 | 575,923 |
| Depreciation | 1,445,445 | 1,475,623 |
| Amortization | 1,057,941 | 1,514,338 |
| Rent and Utilities | 530,523 | 512,427 |
| Communications | 1,285,841 | 1,264,377 |
| Travel | 187,262 | 152,584 |
| Repair and Maintenance | 1,366,097 | 1,355,040 |
| Other Operating Expenses | 3,773,765 | 4,759,833 |
| Total Operating Expenses | 167,719,021 | 170,730,543 |
| Operating Income (Loss) | (11,656,541) | (20,248,086) |
| Nonoperating Revenue(Expenses) | | |
| Investment Income | 44,572,556 | 72,830,911 |
| Securities Lending Income | 931,880 | 1,139,151 |
| Securities Lending Expenses | (245,679) | (251,894) |
| Penalties and Interest | 84,361 | 48,767 |
| Loss on Retirement of Assets | (9,692) | 952 |
| Dividend Expense | (10,005,214) | (6,001,168) |
| Other Income | 247,556 | 12,518 |
| Payment From State of Montana | 869,735 | 842,385 |
| Total Nonoperating Revenue(Expenses) | 36,445,503 | 68,621,622 |
| Change in Net Position | 24,788,962 | 48,373,536 |
| Total Net Position - Beginning | 411,932,990 | 363,559,454 |
| Total Net Position - Ending | $ 436,721,952 | $ 411,932,990 |

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

| YEAR ENDED JUNE 30, | 2013 | 2012 |
|---|---|---|
| **Cash Flows from Operating Activities** | | |
| Receipts for Premiums | 156,387,524 | 150,936,447 |
| Payments to Suppliers for Goods and Services | (13,114,915) | (13,398,945) |
| Payments to Employees | (24,168,004) | (24,084,934) |
| Payments for Claims | (114,259,655) | (114,452,759) |
| Other Operating Receipts | 1,201,653 | 903,668 |
| Net Cash Provided by (Used for) Operating Activities | 6,046,603 | (96,523) |
| **Cash Flows from Noncapital Financial Activities** | | |
| Payment of Dividends to Policyholders | (10,005,214) | (6,001,168) |
| Net Cash Provided by (Used for) Noncapital Financing Activities | (10,005,214) | (6,001,168) |
| **Cash Flows from Capital and Related Financing Activities** | | |
| Acquisition of Fixed Assets | (581,549) | (621,055) |
| Proceeds from Sale of Fixed Assets | 28,638 | 952 |
| Net Cash Used for Capital and Related Financing Activities | (552,911) | (620,103) |
| **Cash Flows from Investing Activities** | | |
| Purchase of Investments | (197,388,779) | (229,638,613) |
| Proceeds from Sales or Maturities of Investments | 185,114,870 | 199,454,070 |
| Proceeds from Securities Lending Transactions | 931,880 | 1,139,151 |
| Payments of Security Lending Costs | (254,164) | (246,810) |
| Interest and Dividends on Investments | 42,808,368 | 42,431,387 |
| Net Cash Provided by (Used For) Investing Activities | 31,212,175 | 13,139,185 |
| **Net Increase (Decrease) in Cash and Cash Equivalents** | 26,700,653 | 6,421,391 |
| **Cash and Cash Equivalents - July 1** | 26,136,607 | 19,715,216 |
| **Cash and Cash Equivalents - June 30** | 52,837,260 | 26,136,607 |

The notes to the financial statements are an integral part of this statement.

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

| YEAR ENDED JUNE 30, | 2013 | 2012 |
|---|---|---|
| **Reconciliation of Change in Net Position to Net Cash Provided by (Used for) Operating Activities** | | |
| Change in Net Position | 24,788,962 | 48,373,536 |
| **Adjustments to Reconcile Change in Net Position to Net Cash Provided by (Used for) Operating Activities** | | |
| Depreciation | 1,445,445 | 1,475,623 |
| Amortization | 1,057,941 | 1,514,338 |
| Security Lending Costs | 245,679 | 251,894 |
| Security Lending Income | (931,880) | (1,139,151) |
| Income on Investments | (44,572,556) | (72,830,911) |
| Payments of Dividends to Policyholders | 10,005,214 | 6,001,168 |
| Decrease (Increase) in | | |
| Accounts Receivable | (6,474,424) | (3,462,239) |
| Other Assets | (1,031,871) | 151,851 |
| Increase (Decrease) in | | |
| Accounts Payable | 2,799,354 | (4,401,306) |
| Unearned Premium | 5,604,631 | 5,099,846 |
| Property Held in Trust | (135,974) | (184,863) |
| Funds Withheld | (579,040) | 3,115,306 |
| Estimated Claims Payable | 12,907,355 | 15,137,690 |
| OPEB Liability | 855,412 | 820,539 |
| Compensated Absences | 62,355 | (19,846) |
| Total Adjustments | (18,742,359) | (48,470,059) |
| **Net Cash Provided by (Used for) Operating Activities** | 6,046,603 | (96,523) |

The notes to the financial statements are an integral part of this statement.

**Montana State Fund**
(A Component Unit of the State of Montana)
Notes to Financial Statements
June 30, 2013 and 2012

## 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. MSF Board is allocated to the State of Montana, Department of Administration for administrative purposes only.

During the 1990 Montana Special Legislative Session, legislation passed separating the liability, 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 the New Fund. 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. 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). 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. Other than the administrative fees paid for the management of the Old Fund claims, no State of Montana General Fund money is used for MSF operations.

The assets of the Old Fund were completely liquidated in 2011 and it is now fully supported by General Fund resources as required under state law (Section 39-71-2352, MCA). Therefore, the Old Fund is considered to be part of the Primary Government for financial reporting purposes and is not included in the accompanying financial statements.

### Basis of Accounting

MSF uses 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.

**Montana State Fund**
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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. MSF participates 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 balances as of June 30, 2013 and June 30, 2012 were $48.4M (million) and $21.8M, respectively.

The STIP investments' credit risk is measured by investment grade ratings given individual securities. The Montana Board of Investment's (BOI) policy requires that STIP investments have the highest rating in the short-term category by one of any Nationally Recognized Statistical Rating Organizations (NRSRO).

Investments

In addition to STIP investments, the BOI invests in long-term securities. Under the provisions of the state constitution, MSF invested assets are managed by the BOI. Securities are stated at fair value as defined and required by 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.

The BOI follows the provisions of 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 Montana State Fund 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 Montana State Fund 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 investment policy, revised in February 2013, states "the maximum fixed income credit risk will be limited to 2% of the total securities portfolio in any one name". 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.

**Montana State Fund**
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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, 2013 and 2012, 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 and Core Real Estate investments were purchased in the State of Montana Board of Investments name.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Montana State Fund Investment Policy requires credit risk to be limited to 2 percent in any one corporate name with "no limitation on U.S. government/agency securities". Investments issued or explicitly guaranteed by the U.S. government are excluded from the concentration of credit risk requirement.

In October 2008, the U.S. government extended the explicit guarantee to certain government agencies such as Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (FHLMC-Freddie Mac). Given the explicit guarantee extension, Montana State Fund had no concentration of credit risk exposure to Fannie Mae and Freddie Mac.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Montana State Fund policy sets an average duration range of 2-5 years for fixed income securities except in extraordinary circumstances where a shorter duration may be advisable. 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 analytics software, is "An option-adjusted measure of a bond's (or portfolio's) sensitivity to changes in interest rates. Duration is defined 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, 2013, the Montana State Fund does not hold any synthetic Collateralized Debt Obligations (CDO). A CDO is a security backed by a pool of bonds, loans or other assets. CDOs do not specialize in one type of debt but are often non-mortgage loans or bonds. The Montana State Fund portfolio does 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.

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Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, or 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, 2013, the Montana State Fund portfolio held one variable rate corporate bond with $7 million par with a maturity date of April 29, 2016. Also, as of June 30, 2012, the Montana State Fund portfolio held one variable rate corporate bond with $10 million par. This variable rate security matured in fiscal year 2013. Variable rates are set to float with the six month LIBOR (London Interbank Offered Rate) and a variable spread on a notional amount percent.

Montana State Fund investments are categorized below to disclose credit and interest rate risk as of June 30, 2013. 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. The credit quality ratings have been calculated excluding cash equivalents.

**State Fund - MU26**
**Credit Quality Rating and Effective Duration as of June 30, 2013**

| Security Investment Type | | Fair Value | Credit Quality Rating | Effective Duration |
|---|---|---|---|---|
| Corporate Bonds (Rated) | $ | 652,247,116 | A- | 3.54 |
| Corporate Bonds (Unrated) | | 1,212,500 | NR | NA |
| U.S. Government Direct Obligations | | 180,818,558 | AA+ | 4.86 |
| U.S. Government Agency | | 253,031,739 | AA+ | 3.84 |
| STIP (Unrated) | | 49,043,563 | NR | 0.12 |
| Total Fixed Income Investments | | 1,136,353,476 | A+ | 3.67 |
| Direct Investments | | | | |
| Equity Index Fund-Domestic | | 138,103,728 | | |
| Equity Index Fund-International | | 16,524,550 | | |
| Total Equity Index Funds | | 154,628,278 | | |
| Core Real Estate | | 36,095,610 | | |
| Total Direct Investments | $ | 190,723,888 | | |
| Total Investments | $ | 1,327,077,364 | | |

**Montana State Fund**
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Legal and Credit Risk

As of June 30, 2013 and 2012, the Federal National Mortgage Association and Federal Home Loan Mortgage Corp. remain in conservatorship from September 7, 2008.

On September 15, 2008, Lehman Brothers filed for bankruptcy protection. Montana State Fund held two positions of Lehman Brothers Holdings, Inc., $5 million par, 0.0%, 05/25/2010 and $4 million par, 5%, 01/14/2011. Lehman Brothers filed for Chapter 11 bankruptcy on September 15, 2008. During fiscal year 2009, the Board wrote down the par value of these bonds. As of June 30, 2011, these securities, due to write downs, reported a book value of 20% of their original par value. The Board sold the $4 million position in Lehman Brothers Holdings, Inc. 5% rate, January 14, 2011 maturity at a price of $26 on December 6, 2011. Because the bonds were previously written down to a price of $20, this sale generated a gain of $257,840. For the remaining $5 million position in Lehman Brothers Holdings, Inc. the Board received two bankruptcy principal payments for $191,035 and $249,071 on October 1, 2012 and April 4, 2013 respectively. The security carries a book value of $259,561 as of June 30, 2013.

In August 2011, S&P downgraded the U.S. AAA bond rating to AA+.

The following table presents the market values of the securities on loan and the total collateral held for fiscal years ended June 30, 2013 and 2012:

| | **2013** | **2012** |
|---|---|---|
| Securities on Loan - Market Value | 253,069,509 | 201,687,361 |
| Total Collateral Held | 258,260,798 | 206,240,094 |

Income earned related to securities on loan for MSF for the fiscal years ended June 30, 2013 and 2012 was $932K (thousand) and $1.1M, respectively. Expenses related to securities on loan for MSF for the fiscal years ended June 30, 2013 and 2012 were $246K and $252K, respectively.

MSF is allowed by Montana Constitution to invest in equity securities, with the restriction that equity securities cannot exceed 25% of total investment book value. The BOI policy for MSF maintains equities in the 8% to 12% range. As of June 30, 2013, equity securities in MSF include $127.2M at cost, increased by $63.5M in market value appreciation. As of June 30, 2012, equity securities in MSF include $100.0M at cost, increased by $41.8M in market value appreciation. Additional investment information can be found in Note 2.

Receivables

At June 30, 2013, MSF had a net receivable balance of $67.1M. The gross receivables for billed premium and claim benefits overpayments is $9.1M, which is then reduced by the estimated uncollectible receivables reported as an allowance for doubtful accounts of $3.0M. Other receivables include $45.5M in unbilled premium, $10.3M in investment income due, $150K in

retrospective premium and $194K in notes receivable, all of which are short term. Accounts receivable also includes $4.8M at June 30, 2013 for premium that has been earned but unbilled (EBUB).

At June 30, 2012, MSF had a net receivable balance of $62.2M. The gross receivables for billed premium and claim benefits overpayments is $8.3M, which is then reduced by the estimated uncollectible receivables reported as an allowance for doubtful accounts of $2.9M. Other receivables include $40.2M in unbilled premium, $11.9M in investment income due, $313K in retrospective premium and $359K in notes and loans receivable, all of which are short term. Accounts receivable also includes $4.0M at June 30, 2012 for EBUB.

Reinsurance Receivables

As part of the aggregate stop loss reinsurance program, MSF records a receivable for each contract year's funds withheld amount until the loss performance for that contract year is known. The receivable is increased as interest accrues and decreased with the development of recoverable or in the event of a commutation. The reinsurance receivables were $53.1M at June 30, 2013 and $44.5M at June 30, 2012.

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 recorded directly to the asset balance. All fixed assets are recorded in the MSF Statement of Net Position and shown net of depreciation.

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.

Land and Buildings

For the fiscal year ended June 30, 2013, MSF financial statements include $1.14M in land and $26.3M in buildings, net of depreciation. For the fiscal year ended June 30, 2012, MSF financial statements include $1.14M in land and $26.8M in buildings, net of depreciation.

Accounts Payable

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

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Estimated Claims Payable

The estimated claims payable, also called loss reserves, 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 Watson, 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 central estimates within that range as the estimated claims payable for MSF. For additional disclosure related to the estimated claims payable, refer to Note 4.

Unearned Premium

Unearned premium reflects premium that has been written but not yet earned. The unearned premium was $48.1M and $42.5M at June 30, 2013 and 2012, respectively.

Policyholder Deposits

Policyholder deposits consist of security deposits that are required to have a deposit policy and secure the policy with cash, letter of credit or certificate of deposit.

Reinsurance Funds Withheld

Reinsurance funds withheld represents the reinsurance funds held on behalf of the reinsurer, a requirement of MSF's aggregate stop loss reinsurance contract. Additional information regarding the funds withheld account can be found in Note 3.

Net Position

Net Position consists of the net excess or deficit of assets over liabilities. Net Position increased from $411.9M in FY12 to $436.7M in FY13.

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.

**Montana State Fund**
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Basis of Presentation

The financial statements are presented in accordance with generally accepted accounting principles as prescribed by the GASB. MSF insurance operations are classified as an enterprise fund, proprietary fund type. MSF 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.

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; or (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 operates 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 position 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.

**2. Investments**

The amortized cost and market value of MSF's fixed maturity and equity securities as of June 30, 2013, and 2012, is as follows:

**Montana State Fund**
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| **June 30, 2013** | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Market Value |
|---|---|---|---|---|
| Government Direct-Indirect | $ 400,749,366 | $ 25,039,872 | $ 2,572,138 | $ 423,217,100 |
| Government Mortgage-Backed | 9,995,423 | 637,774 | - | 10,633,197 |
| Corporate Securities Asset-Backed | 38,159,061 | 888,759 | 91,596 | 38,956,224 |
| Other Corporate Securities | 582,085,632 | 34,689,464 | 2,271,705 | 614,503,391 |
| Other Securities | 636,877 | - | - | 636,877 |
| Equity Securities | 91,441,172 | 63,187,105 | - | 154,628,277 |
| Core Real Estate | 35,750,000 | 345,610 | - | 36,095,610 |
| STIP | 48,406,686 | - | - | 48,406,686 |
| Total | $ 1,207,224,217 | $ 124,788,584 | $ 4,935,439 | $ 1,327,077,362 |

| **June 30, 2012** | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Market Value |
|---|---|---|---|---|
| Government Direct-Indirect | $ 345,334,682 | $ 38,330,810 | $ - | $ 383,665,492 |
| Government Mortgage-Backed | 49,253,084 | 3,883,516 | - | 53,136,600 |
| Corporate Securities Asset-Backed | 39,090,242 | 1,217,741 | 500,000 | 39,807,983 |
| Other Corporate Securities | 601,548,372 | 43,089,376 | 376,715 | 644,261,033 |
| Other Securities | 359,511 | - | - | 359,511 |
| Equity Securities | 100,063,227 | 41,776,471 | - | 141,839,698 |
| STIP | 21,811,149 | - | - | 21,811,149 |
| Total | $ 1,157,460,266 | $ 128,297,914 | $ 876,715 | $ 1,284,881,466 |

MSF added an allocation of real estate equity investments to its portfolio during fiscal year 2013.

The amortized cost and estimated market value of MSF's fixed maturity securities as of June 30, 2013 and 2012 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**
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**June 30, 2013**

| | Amortized Cost | Market Value |
|---|---|---|
| Due one year or less | $ 145,165,397 | $ 147,211,356 |
| Due after one year through five years | 556,292,747 | 594,569,403 |
| Due after five years through ten years | 373,807,216 | 388,818,418 |
| Due after ten years | 4,767,685 | 5,754,299 |
| Equity Securities | 91,441,172 | 154,628,277 |
| Core Real Estate | 35,750,000 | 36,095,610 |
| Total | $ 1,207,224,217 | $ 1,327,077,363 |

**June 30, 2012**

| | Amortized Cost | Market Value |
|---|---|---|
| Due one year or less | $ 115,204,259 | $ 115,862,339 |
| Due after one year through five years | 520,577,272 | 561,457,310 |
| Due after five years through ten years | 398,481,913 | 440,864,563 |
| Due after ten years | 23,133,595 | 24,857,556 |
| Equity Securities | 100,063,227 | 141,839,697 |
| Total | $ 1,157,460,266 | $ 1,284,881,465 |

During the fiscal year ending June 30, 2013, MSF realized gross gains from sales of securities of $11.1M and gross realized losses of ($26K). During the fiscal year ending June 30, 2012, MSF realized gross gains from sales of securities of $4.9M and gross realized losses of ($30K).

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 2013, investment income for MSF was $44.6M which includes an unrealized loss on investments in the amount of $7.6M. Investment income for fiscal year 2012 was $72.8M which includes an unrealized gain on investments of $24.8M.

## 3. Reinsurance

For the fiscal years ended June 30, 2013 and 2012, 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.

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The excess of loss contract provides coverage up to $100 million in which MSF retains the first $5 million for the first layer of reinsurance coverage. The excess of loss protection applies to an individual occurrence with the maximum of $5 million on any one life. The excess of loss contracts coverage for fiscal years 2013 and 2012 is as follows:

| Contract Period | Reinsurance Coverage |
| --- | --- |
| 2013 | 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. |
| 2012 | 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. |

The term of the current aggregate stop loss contract is July 1, 2012 through June 30, 2013. The contract provides coverage based on MSF's premium levels, not to exceed 15% of the subject net earned premium. 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 $8.5M and $11.5M in fiscal years 2013 and 2012, respectively. The aggregate stop loss contract requires that MSF maintain a funds withheld liability account which represents the basic premium portion of the total premium paid for aggregate stop loss coverage. The funds withheld liability account at June 30, 2013 is $77.0M for contracts in place from July 1, 2002 to June 30, 2013. The funds withheld liability account at June 30, 2012 was $69.0M for contracts in place from July 1, 2002 to June 30, 2012. Interest must be accrued on the funds withheld account which resulted in accrued interest of $3.7M for fiscal year 2013 and $3.5M for fiscal year 2012.

Estimated claim reserves were reduced by $12.1M and $12.8M for fiscal years 2013 and 2012, 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 2013 the estimated claim reserves were reduced by an additional $23.7M and in fiscal year 2012 an additional $24.3M for

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the amount of reinsurance estimated to be ultimately recoverable on incurred losses due to the aggregate stop loss contract.

As part of the aggregate stop loss reinsurance program, MSF records a reinsurance receivable for each contract year's funds withheld amount until the loss performance for that contract year is known. The receivable is increased as interest accrues and decreased with the development of the recoverable or in the event of a commutation. The reinsurance receivables were $53.1M at June 30, 2013 and $44.5M at June 30, 2012.

MSF also has assumed reinsurance relationships with Zurich American Insurance Company, 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 is $2.0M and $1.5M for fiscal years 2013 and 2012, respectively. The incurred losses from OSC benefits were $1.7M and $859K for fiscal years 2013 and 2012, respectively. The assumed liability for OSC claims is $4.2M and $3.7M for fiscal years 2013 and 2012, 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 financials. At June 30, 2013, approximately 24,400 active policies were insured by MSF. At June 30, 2012, approximately 24,700 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.

Unpaid claims and claim adjustment expenses are estimated based on the ultimate cost of settling the claims including the effects of inflation and other social and economic factors. Towers Watson, 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, 2013 and 2012. 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.

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Towers Watson provides a range of potential costs associated with reported claims, the future development of those claims and IBNR. MSF management has selected a central estimate within that range as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for fiscal years 2013 and 2012. The MSF estimated unpaid claims and claims adjustment expenses payable is presented at face value, net of estimated reinsurance recoverable were $902.8M and $889.9M, as of June 30, 2013 and 2012, respectively. The estimated claims payable increased $12.9M from 2012 to 2013 primarily due to the addition of the new accident year and the increase in the loss adjustment expense rate on prior years from 12.9% to 14.4%. The Statement of Net Position displays this total separated as current and noncurrent estimated claims payable. This rate change was a recommendation by our external actuaries, Towers Watson.

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, 2013 and 2012 are $5.2M and $4.1M, respectively.

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Changes in Claims Liabilities for the Past Two Years

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

| | 2013 | 2012 |
|---|---|---|
| Unpaid claims and claim adjustment expenses at beginning of year | $ 889,940,574 | $ 874,802,884 |
| Incurred claims and claim adjustment expenses: | | |
| Provision for insured events of the current year | 139,204,766 | 125,474,449 |
| Increase(Decrease) in provision for events in prior years | (12,036,281) | 4,189,732 |
| Total incurred claims and claim adjustment expenses | 127,168,485 | 129,664,181 |
| Payments: | | |
| Claims and claim adjustment expenses attributable to insured events of CY | (25,706,480) | (24,729,053) |
| Claims and claim adjustment expenses attributable to insured events of PY | (88,554,650) | (89,797,438) |
| Total payment | (114,261,130) | (114,526,491) |
| Total unpaid claims and claim adjustment expenses at end of the year | $ 902,847,929 | $ 889,940,574 |

## 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 $870K and $842K in administration costs to the Old Fund in fiscal years 2013 and 2012, respectively. Beginning in June 2011, the State of Montana General Fund began making transfers to cover the cost of administering the Old Fund claims. These transfers are recorded as non-operating revenue as a payment from the State of Montana.

## 6. MSF Distributions

During the fiscal year ended June 30, 2013, the MSF Board of Directors authorized a dividend to policyholders. MSF paid dividends to eligible policyholders in the amount of $10.0M for the policy year 2010. The MSF Board of Directors authorized and MSF paid a dividend of $6.0M in fiscal year 2012 for the policy year 2009.

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## 7. 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. The 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.

The total compensated absences liability for MSF is $2.7M for both years ending at June 30, 2013 and 2012.

## 8. 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 employees hired prior to July 1, 2011 are required to contribute 6.9% of annual compensation in fiscal years 2013 and 2012. Employee's hired on or after July 1, 2011 are required to contribute 7.9%. The employer (MSF) is required to contribute 7.17% of annual compensation in fiscal years 2013 and 2012 regardless of the hire date of the employee.  MSF's contributions amounted to $1.4M for both fiscal years 2013 and 2012. MSF and its employees paid one hundred percent of required contributions to PERS and there is no unpaid liability as of June 30, 2013. The PERS financial information is reported in the Public Employees' Retirement Board *Comprehensive Annual Financial Report* for the fiscal year-end.

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This information 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 457(b) Deferred Compensation Plan administered by the PERB. The Deferred Compensation plan is a voluntary, tax-deferred supplemental retirement plan sponsored by the Montana Public Employee Retirement Board and held in trust for the exclusive benefit of public employees and their beneficiaries. The Plan is authorized by IRC Section 457(b) and is subject to specific Internal Revenue Service's laws and requirements. It allows employees to voluntarily contribute a portion of their compensation on a pre-tax basis. The amount invested, plus interest credited on any fixed options and any gain on the variable options, is not taxable until withdrawn at a future date. MSF incurs no costs for this plan.

GASB recently issued standards 67 and 68, Accounting and Financial Reporting for Pensions. These standards will require MSF to record pension accounting entries as well as financial statement disclosures. The requirements of these Standards are effective for financial statements for fiscal years beginning after June 15, 2014. The State of Montana is in the process of determining the effect of the change in accounting and obtaining an estimate of the amount of the unfunded liability, however, an estimate of the amount has not been available. Management believes the amount attributable to MSF will be significant, once the State of Montana completes its valuation.

## 9. Leases and Commitments

MSF leases office facilities outside of Helena under various operating leases that expire through August 2016.

MSF leases 350 parking spaces in a parking garage that was built by the City of Helena adjacent to the MSF facility that expires June 30, 2040. The cost of the parking spaces will be the same monthly rate as equivalent parking passes sold by the city. The parking facility opened in conjunction with the move to the new building in June 2010. The annual subsequent parking cost is estimated to be $279K with potential to change based on parking rates assigned by Helena Parking Commission.

Rental expenses for FY13 of $331K include $265K for the parking garage lease, $52K for office facility leases and $14K for minor office equipment. Rental expenses for FY12 of $314K include $251K for the parking garage lease, $51K for office facility leases and $12K for minor office equipment.

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The future minimum rental payments for office and parking space are as follows:

| Fiscal Year | Amount |
|---|---|
| 2014 | $ 323,808 |
| 2015 | 299,367 |
| 2016 | 297,906 |
| 2017 | 281,850 |
| 2018 | 279,300 |
| Thereafter | 6,144,600 |
| | $ 7,626,831 |

## 10. 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 was $5.1M and $4.2M at June 30, 2013 and 2012, 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 8 Retirement Plans, the following post-employment benefits are provided. Montana Department of Administration established retiree medical premiums vary between $299 and $1,061 per month depending on the medical plan selected, family coverage, and Medicare eligibility. Retirees pay 100 percent of the premiums for medical, dental, and vision. Administratively established monthly dental premiums vary between $35.00 and $60.00; monthly 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. 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 Actuarial Valuation:

The dental and vision benefits are fully-insured and retirees pay 100 percent of the cost for both dental and vision, therefore, no liability for these benefits is calculated in the actuarial valuation. Continuation of the life insurance benefit is not available as an employer-provided group insurance benefit for retirees, therefore, no liability for life insurance is calculated in this valuation.

Funding Policy:

The following estimates were prepared based on an actuarial evaluation prepared as of the year ending December 31, 2011 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 2011 ARC is calculated for all the State plan's participants and then individually allocated to individual participants. The MSF 2013 allocated portion of the ARC is estimated at $855K and is based on the plan's current ARC rate of 6.32% percent of participants' annual covered payroll. The MSF 2013 ARC is equal to an annual amount required each year to fully fund the liability over thirty years.

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 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 January 1, 2011, actuarial valuation date, 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 10 percent were used for both medical and prescription claims. The unfunded actuarial accrued liability is amortized following a 30-year level percent of pay amortization on an open basis, using a 4.25 percent discount rate and a 2.50 percent payroll growth rate assumption.

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 value for Plan Assets made by MSF.

Annual Other Post Employment Benefits (OPEB) Cost:

MSF's allocated annual OPEB cost (expense) was $855K and $821K for the years ending June 30, 2013 and 2012, respectively.

The MSF annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2013 and prior 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 |
| 6/30/2010 | 808,837 | 0.00% | 2,561,741 |
| 6/30/2011 | 843,212 | 0.00% | 3,404,953 |
| 6/30/2012 | 820,539 | 0.00% | 4,225,492 |
| 6/30/2013 | 855,412 | 0.00% | 5,080,904 |

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Funded Status and Funding Progress:

The most recent actuarial valuation available that was completed by the State of Montana was as of January 1, 2011 for the year ending December 31, 2011. This actuarial evaluation is completed every two years with the next valuation to be completed as of January 1, 2013 for the year ending December 31, 2013.

The MSF allocation of the plan as of the year ending December 31, 2011 was as follows:

| | |
|---|---|
| Actuarial Accrued Liability (AAL) | $6,355,058 |
| Actuarial Value of Plan Assets | $0 |
| Unfunded Actuarial Accrued Liability (UAAL) | $6,355,058 |
| Funded Ratio (Actuarial Value of Plan Assets/AAL) | $0 |
| Covered Payroll (Active Plan Members) | $19,544,196 |
| UAAL as a Percentage of Covered Payroll | 32.52% |

## 11. Contingencies

***Victory Insurance Company, Inc. v. Montana State Fund et al.*** Victory filed its Amended Complaint in this action on March 29, 2011, in which it asserts various tort claims against Montana State Fund. No specific amount of damages was stated in the complaint. In October 2012, the district court granted Montana State Fund's motion for summary judgment, and dismissed State Fund from the case. However, the plaintiff refiled the suit against Montana State Fund. Montana State Fund has filed a second motion for summary judgment, which is pending. The actual potential cost impact of this case to State Fund is not known at this time. Montana State Fund does not have sufficient information to determine potential liability or cost impact.

Montana State Fund also is involved in a great deal of litigation in the areas of workers' compensation and disputes with policyholders. These are of a generally routine nature and there are no known matters at this time that will have a large and widespread financial impact.

## 12. Subsequent Events

The Board of Investments adopted a change to require the custodial bank, State Street, to convert to the effective interest rate method of amortizing bond premium/discount as of July 1, 2013. The values as of June 30, 2013 and 2012 were determined on a straight line method of amortization. The cumulative effect of the change resulted in a net decrease of ($182,165) to the Montana State Fund value and amortization/accretion income as of July 1, 2013.

## REQUIRED SUPPLEMENTARY INFORMATION

Other Post-Employment Benefits (Financial Statement Note 10)

As of June 30, 2013, the most recent actuarial valuation available that was completed by the State of Montana was as of January 1, 2011 for the year ending December 31, 2011. This actuarial evaluation is completed every two years with the next valuation to be completed as of January 1, 2013 for the year ending December 31, 2013.

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, 2013.

## 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) |
|---|---|---|---|---|---|---|
| 1/1/2007 | $0 | $8,079,405 | $8,079,405 | 0.00% | $16,805,676 | 48.08% |
| 1/1/2009 | $0 | $6,985,326 | $6,985,326 | 0.00% | $16,766,753 | 41.66% |
| 1/1/2011 | $0 | $6,355,058 | $6,355,058 | 0.00% | $19,544,196 | 32.52% |

Risk Management

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 2004 through 2013. 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.

**Risk Management Trend Information**

| (In Thousands) | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|---|---|---|
| 1. Premiums and Investment Revenue | | | | | | | | | | |
| Earned | 180,754 | 241,663 | 265,626 | 305,151 | 289,223 | 254,395 | 215,261 | 209,177 | 175,254 | 171,206 |
| Ceded | 6,563 | 6,788 | 13,618 | 14,856 | 14,676 | 13,702 | 13,224 | 11,286 | 11,501 | 8,459 |
| Net Earned | 174,191 | 234,875 | 252,009 | 290,295 | 274,546 | 240,693 | 202,036 | 197,891 | 163,753 | 162,747 |
| 2. Unallocated expenses including overhead | 37,569 | 39,078 | 40,548 | 41,947 | 47,778 | 49,215 | 44,188 | 57,282 | 49,557 | 49,515 |
| 3. Estimated losses and expenses, end of accident year | | | | | | | | | | |
| Incurred | 120,705 | 134,290 | 155,057 | 170,652 | 177,100 | 159,229 | 137,507 | 142,989 | 118,066 | 128,522 |
| Ceded | - | - | - | - | - | - | - | 9,769 | 1,099 | - |
| Net Incurred | 120,705 | 134,290 | 155,057 | 170,652 | 177,100 | 159,229 | 137,507 | 133,220 | 116,967 | 128,522 |
| 4. Net paid (cumulative) as of: | | | | | | | | | | |
| End of policy year | 26,123 | 25,721 | 30,977 | 32,708 | 31,002 | 29,009 | 25,475 | 27,902 | 24,729 | 25,706 |
| One year later | 50,888 | 57,239 | 66,063 | 67,928 | 67,034 | 60,009 | 52,701 | 56,502 | 54,982 | |
| Two years later | 66,140 | 72,229 | 84,014 | 85,646 | 86,268 | 74,132 | 66,235 | 69,918 | | |
| Three years later | 74,697 | 82,647 | 94,091 | 98,427 | 95,612 | 83,737 | 74,028 | | | |
| Four years later | 80,233 | 88,236 | 100,189 | 104,967 | 103,337 | 89,431 | | | | |
| Five years later | 83,788 | 93,682 | 105,815 | 109,569 | 109,144 | | | | | |
| Six years later | 86,707 | 96,539 | 109,993 | 112,562 | | | | | | |
| Seven years later | 89,038 | 98,621 | 113,366 | | | | | | | |
| Eight years later | 91,975 | 101,327 | | | | | | | | |
| Nine years later | 93,553 | | | | | | | | | |
| 5. Re-estimated ceded losses and expenses | 1,973 | - | - | - | 5,140 | - | - | 10,441 | 2,697 | - |
| 6. Re-Estimated net incurred losses and expense: | | | | | | | | | | |
| End of policy year | 120,705 | 134,290 | 155,057 | 170,652 | 177,100 | 159,229 | 137,507 | 133,220 | 116,967 | 128,522 |
| One year later | 112,609 | 136,235 | 157,711 | 171,783 | 174,279 | 152,886 | 139,554 | 134,175 | 130,507 | |
| Two years later | 124,413 | 138,447 | 163,433 | 170,786 | 173,808 | 151,738 | 135,833 | 133,652 | | |
| Three years later | 127,827 | 144,484 | 164,358 | 172,038 | 172,888 | 151,303 | 135,253 | | | |
| Four years later | 129,051 | 143,820 | 165,313 | 171,987 | 172,570 | 150,212 | | | | |
| Five years later | 127,702 | 145,839 | 164,613 | 170,997 | 167,166 | | | | | |
| Six years later | 127,054 | 145,031 | 164,248 | 169,555 | | | | | | |
| Seven years later | 126,979 | 142,443 | 163,824 | | | | | | | |
| Eight years later | 126,781 | 142,420 | | | | | | | | |
| Nine years later | 127,057 | | | | | | | | | |
| 7. Increase (decrease) in estimated net incurred losses and expenses from end of policy year | 6,351 | 8,130 | 8,768 | (1,097) | (9,934) | (9,017) | (2,254) | 432 | 13,541 | - |

Montana State Fund

# State Fund Response

MONTANA STATEFUND

P.O. Box 4759 • Helena, MT 59604-4759
Customer Service 1-800-332-6102
Fraud Hotline 1-888-682-7463 (888-MT-CRIME)

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LEGISLATIVE AUDIT DIV.

October 18, 2013

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

Dear Ms. Hunthausen:

Montana State Fund (MSF) appreciates the professionalism of the Legislative Audit Division staff in completing the financial-compliance audit of our governmental financial statements. We are pleased with your issuance of an unmodified (formerly referred to as "unqualified") opinion with no recommendations.

The management and staff of MSF are very proud of our accomplishments and on-going service to Montana businesses and employees. We continually strive to improve our operations to ensure Montanans will benefit from a strong Montana State Fund many years into the future. Thank you for your assistance and assurance.

Sincerely,

Laurence A. Hubbard
President/CEO