A Report
to the
Montana
Legislature

Financial-Compliance Audit

Montana State Fund

For the 6-Month Period Ended December 31, 2015

May 2016

Legislative Audit
Division

15-05

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Financial-Compliance Audits

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The Single Audit Act Amendments of 1996 and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards require the auditor to issue certain financial, internal control, and compliance reports in addition to those reports required by Government Auditing Standards. 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, 2015, was issued March 29, 2016. The Single Audit Report for the two fiscal years ended June 30, 2017, will be issued by March 31, 2018. Copies of the Single Audit Report can be obtained by contacting:

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Room 277, State Capitol
P.O. Box 200802
Helena, MT 59620-0802

Legislative Audit Division
Room 160, State Capitol
P.O. Box 201705
Helena, MT 59620-1705

Audit Staff

Jeane Carstensen-Garrett
Aaron Funk
Shandell VanDonsel
Jennifer Erdahl
Shenae Stensaas

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LEGISLATIVE AUDIT DIVISION

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

Deputy Legislative Auditors:
Cindy Jorgenson
Angus Maciver

May 2016

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report of the Montana State Fund (MSF), a component unit of the state of Montana, for the 6-month period ended December 31, 2015. Pursuant to Chapter 320, Session Laws of 2015, MSF is under the regulatory authority of the Insurance Commissioner and operates on a calendar-year basis as of January 1, 2016. This report transitions MSF from a fiscal year ended June 30 to a fiscal year ended December 31 and covers July 1, 2015, to December 31, 2015. This report does not include any audit 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 C-1. We thank the Montana State Fund President/CEO and his staff for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

Room 160 • State Capitol Building • PO Box 201705 • Helena, MT • 59620-1705
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

Julie Jenkinson, Vice President, Insurance Operations

Sam Heigh, Vice President, Insurance Operations Support

Curt Larsen, Interim General Counsel

Al Parisian, Chief Information Officer

State Fund Board of Directors		Term Expires
	Lance Zanto, Chair	2017
	Matthew C. Mohr	2019
	Bruce Mihelish	2017
	Richard Miltenberger	2017
	Lynda Moss	2017
	Jack Edward Owens	2019
	Jan VanRiper	2019

Laurence Hubbard, President/CEO - ex officio nonvoting member

For additional information concerning the Montana State Fund, contact:

Laurence Hubbard, President/CEO
855 Front Street
Helena, MT 59604
(406) 495-5015

e-mail: lhubbard@mt.gov

Montana Legislative Audit Division

Financial-Compliance Audit
Montana State Fund
For the 6-Month Period Ended December 31, 2015

May 2016 15-05 Report Summary

Montana State Fund issued financial statements for the 6-month period ending December 31, 2015, to transition to a calendar fiscal year-end. Pursuant to Chapter 320, Session Laws of 2015, effective January 1, 2016, MSF is under the regulatory authority of the State Auditor's Office Insurance Commissioner and operates on a calendar-year basis. Under this legislative change, MSF is subject to additional reporting requirements and the commissioner is to review the rates set by MSF to determine if they are excessive, inadequate, or unfairly discriminatory.

Context

Montana State Fund (MSF) is established by Title 39, Chapter 71 of the Montana Code Annotated. MSF is governed by a seven-member board of directors appointed by the Governor. The MSF board of directors appoints the President/CEO who oversees MSF's day-to-day operations.

Effective January 1, 2016, MSF is also under the regulatory authority of the Insurance Commissioner (commissioner). However, the commissioner does not have any authority over claims occurring before July 1, 1990, referred to as the old fund claims as they were excluded from Chapter 320, Session Laws of 2015. While these claims are administered by MSF, old fund claims are an obligation of the primary government and are therefore reflected on the state of Montana's financial statements.

Operating as a nonprofit, independent public corporation, MSF provides a system of workers' compensation insurance. MSF functions like a private insurance carrier in a competitive marketplace which guarantees coverage to all employers in Montana.

MSF does not receive funding from the General Fund. Instead, revenue for MSF comes primarily from insurance premiums and investment income. Revenues from insurance premiums and investment income were $88.5 million and $12.5 million, respectively for the 6-month period ended December 31, 2015. Expenses for MSF are primarily for injured workers' claims. Benefits and claims expenses for the same period were $67.4 million.

Results

We performed work over MSF internal controls and business processes related to the payment of claim expenses and the reserves for future claims, the collection of insurance premium revenue, investment activity, reinsurance activity, and compliance with selected laws and regulations. Our audit included an in depth review of fiscal year-end transactions and policies and procedures to determine the completeness and accuracy of closing the books at December 31, 2015, for the first time. We also considered the overall reasonableness of the financial statement presentation.

We issued an unmodified opinion on the financial statements and this report does not contain any recommendations. The prior report also did not contain recommendations to MSF.

For a complete copy of the report (15-05) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to **lad@mt.gov**; or check the web site at **http://leg.mt.gov/audit**
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Call toll-free 1-800-222-4446, or e-mail **ladhotline@mt.gov**.

Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Montana State Fund (MSF) for the 6-month period ended December 31, 2015.

The objectives of this audit were to:

1. Determine whether the MSF's financial statements present fairly the financial position, results of operations, and cash flows for the 6-month period ended December 31, 2015.
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.
3. Determine whether MSF complied with selected applicable laws and regulations.

Our audit work included testing of MSF internal controls and business processes related to:

- Payment of claim expenses and reservations for future claims
- Assessment and collection of policy premiums
- Investment activity
- Reinsurance activity
- The December 31, 2015 fiscal year-end closing process
- Compliance with selected laws and regulations
- Overall reasonableness of the financial statement presentation, including note disclosures

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 (GAAP), such as adjusting the estimated claims liability based on their actuary report and board approval, which occurs subsequent to fiscal year-end.

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 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 MSF, and to maintain a surplus over a calculated amount based on 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.

Pursuant to Chapter 320, Session Laws of 2015, effective January 1, 2016, MSF is under the regulatory authority of the Insurance Commissioner at the State Auditor's Office for claims incurred after July 1, 1990. The MSF reporting period changed to a calendar-year basis requiring a 6-month audit to complete the year from July 1, 2015, to December 31, 2015. Under the new law, by March 1 of each year, MSF is required to submit financial statements in a regulatory format to the Insurance Commissioner. Financial statements, completed in accordance with GAAP, will also continue to be prepared by Montana State Fund. The audit of GAAP financial statements remains a requirement per §39-71-2361, MCA, and will continue to be audited by our office in support of the audit of the state's basic financial statements.

Independent Auditor's Report

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 Net Position of the Montana State Fund as of December 31, 2015, the related Statement of Revenues, Expenses and Changes in Fund Net Position, and the Statement of Cash Flows for the 6-month period 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 the 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 the Montana State Fund's internal control, and accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used

Room 160 • State Capitol Building • PO Box 201705 • Helena, MT • 59620-1705
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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.

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 December 31, 2015, and the changes in net position and cash flows for the 6-month period then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the financial statements, the Statement of Revenues, Expenses, and Changes in Fund Net Position and Statement of Cash flows only present 6 months of activity, rather than a full fiscal year. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Managements' Discussion and Analysis on page A-7 and the risk management, retirement, and other post-employment benefits Required Supplementary Information starting on page A-43 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 4, 2016, on our consideration of the Montana State Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control

over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Montana State Fund's internal control over financial reporting and compliance.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

May 4, 2016

Montana State Fund Financial Statements

Montana State Fund
(A Component Unit of the State of Montana)
Management Discussion and Analysis
December 31, 2015

Montana State Fund (MSF) is a self-sufficient, 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, MSF is 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. Our operational structure includes multifunctional teams that are aligned with specific groups of employers and agents that allow 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 over half of total claim costs. During the 2015 Legislative session, legislation passed (SB123) transferring oversight of MSF to the State Auditor's Office, who is charged with regulating all insurance companies doing business in Montana.

MSF also administers and manages the claims remaining in the Old Fund for the State of Montana. The assets of the Old Fund were completely liquidated in 2011 and benefit payments and administrative costs for claims occurring before July 1st, 1990, are 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, deferred outflows of resources, liabilities, deferred inflows of resources, and total net position.

The Statement of Revenues, Expenses, and Changes in Fund Net Position presents the financial results of operations for MSF for the six-month period ending December 31, 2015. 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 period. However, this statement does not consider unpaid responsibilities which have been established by contract or other underlying events during the period.

Financial Highlights

The 2015 Montana Legislature passed Senate Bill (SB) 123 which moves Montana State Fund under regulation by the State Auditor's Office and Title 33, Montana Insurance Code, effective January 1, 2016. In order for MSF financial reporting to convert from a fiscal year ending June 30th to a calendar year of January 1st to December 31st as required by the law, MSF is issuing the accompanying financial statements as of and for the six-month period ended December 31, 2015. Due to this change, the comparability of the prior-period information presented below is affected. MSF will only issue financial statements for a six-month period one time and will resume issuing 12-month statements, on a calendar-year basis, as of January 1, 2016.

MSF continues to deliver high-quality services 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. The Board of Directors approved a 5% decrease in rates for the policy year covering July 1, 2015 to June 30, 2016.

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. Total dividends of $35M (million), the largest amount ever, were declared to qualifying policyholders during the six-month period ended December 31, 2015. The Board of Directors, based on analysis of policyholder surplus adequacy and financial results, approves the amount of dividends to be declared. MSF has declared and paid dividends for seventeen consecutive years.

Analysis of Financial Position and Results of Operations

The following analysis presents comparative condensed financial data for MSF.

Net Position (in thousands)

	12/31/2015	6/30/2015
Current and Other Assets	$ 242,088	$ 244,722
Capital Assets (Net)	28,843	29,328
Investments	1,405,963	1,421,359
Total Assets	1,676,894	1,695,409
Total Deferred Outflows of Resources	1,187	1,614
Current Liabilities	272,095	284,870
Long-term Liabilities	889,268	870,815
Total Liabilities	1,161,363	1,155,685
Total Deferred Inflows of Resources	1,757	4,357
Net Position:		
Net Investment in Capital Assets	28,843	29,328
Unrestricted	486,118	507,652
Total Net Position	$ 514,961	$ 536,980

MSF's overall net position decreased during the six-month period ended December 31, 2015, largely due to the declaration of the $35M dividend. This large dividend, coupled with only six months of operating income, led to a larger decrease in net position than it would have during a twelve-month reporting period. Despite this decrease, MSF's net position remains strong. With around $1.7B in combined assets and deferred outflows of resources to meet $1.2B of liabilities and deferred inflows of resources, MSF has a net position commensurate with prudent insurance operations.

The largest component of MSF's assets is its investments, which decreased during the six months ended December 31, 2015, due mostly to unrealized losses on the MSF bond portfolio. The change in value is summarized in the following display (in thousands):

	Six Months Ended 12/31/15	Twelve Months Ended 6/30/15
Prior Year Market Value	$ 1,421,359	$ 1,380,202
Purchases at Cost	51,208	222,306
Sales	(58,624)	(182,696)
Net Realized Gains	984	9,310
Net Accretion of Bonds	(101)	(383)
Unrealized Gain (Loss)	(8,863)	(7,379)
Current Year Market Value	$ 1,405,963	$ 1,421,359

The most significant MSF liability is estimated claims payable, which increased slightly during the six months ended December 31, 2015. This liability is increased as new claims for the year are added and decreased as claim payments are made. Additionally, changes to the estimates for prior years can increase or decrease the liability. The changes are summarized in the following display (in thousands):

	Six Months Ended 12/31/15	Twelve Months Ended 6/30/15
Estimated Claims Payable - Beginning	895,543	924,598
Incurred Claims Payable	67,383	89,197
Claim Payments	(62,630)	(118,252)
Estimated Claims Payable - Ending	900,296	895,543

Willis Towers Watson, an independent actuarial firm, prepares an annual actuarial study used to estimate claims liabilities for MSF and provides a range of potential costs associated with claims. MSF management selected an estimate within that range as the estimated claims payable, consisting of unpaid claims, reserve strengthening and claim adjustment expenses.

Changes in Net Position (in thousands)

	Six Months Ended 12/31/2015	Twelve Months Ended 6/30/15
Operating Revenues:		
Net Premium Earned	$ 88,495	$ 164,557
Total Operating Revenue	88,495	164,557
Operating Expenses:		
Benefits and Claims	67,383	89,197
Personal Services	14,448	25,657
Other Operating Expense	7,232	16,695
Total Operating Expense	89,063	131,549
Net Operating Income (Loss)	(568)	33,008
Nonoperating Revenue (Expense):		
Investment Income	12,500	42,487
Other Nonoperating Revenue	1,052	1,731
Dividend Expense	(35,003)	(20,005)
Total Nonoperating Revenue (Expense)	(21,451)	24,213
Change in Net Position	(22,019)	57,221
Prior Period Adjustment	-	(20,349)
Beginning Net Position	536,980	500,108
Total Net Position	$ 514,961	$ 536,980

For the six months ended December 31, 2015, MSF yielded a decrease in net position of ($22.0M) after returning $35.0M in dividends to eligible policyholders. Net premium income for the six-month period was approximately 54% of the amount for the twelve month period ending June 30, 2015, indicating relatively consistent premium levels from period to period. Premium retention, or the amount of premium that was retained from the prior year, was approximately 90% for the six months ended December 31, 2015, which is consistent with MSF's recent history.

The accident year ultimate loss, which is the expected ultimate cost of all claims incurred during the six-month period, was approximately 54% of the prior year twelve-month ultimate loss, indicating relatively stable expected loss experience from period to period. However, the reserve strengthening component of the estimated claims liability was reduced by $32.1M during the twelve months ended June 30, 2015, which caused a substantial decrease in benefits and claims expenses for that period. In comparison , this makes the benefits and claims expenses shown for the six months ended December 31, 2015 to appear high as they are 76% of the prior twelve-month amount, however the six month period benefit expenses trended with what was anticipated and are comparable to other years when reserve reductions were not made.

Personal services and other operating expense levels remained relatively consistent from period to period. The amounts shown for the six months ended December 31, 2015, are therefore roughly half the amounts of the twelve-month period ended June 30, 2015.

The final contributing factor in the ($22.0M) change in net position is MSF's investment income. While the rate of returns from the portfolio remained relatively constant throughout the 18 months shown above, MSF had significantly fewer realized gains during the six months ended December 31, 2015 than it did during the twelve months ended June 30, 2015. Accordingly, the investment income reported is significantly less than half of the prior year amount.

A six-month operating loss of ($568) thousand coupled with lower investment income and a $35M dividend resulted in a change in net position of ($22.0M).

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

	December 31, 2015
ASSETS	
Current Assets	
Cash and Cash Equivalents	$ 63,247,178
Receivables, Net	81,105,652
Securities Lending Collateral	28,299,273
Other Assets	2,304,762
Total Current Assets	174,956,865
Noncurrent Assets	
Investments	1,405,962,782
Reinsurance Receivables	67,131,833
Capital Assets:	
Land	1,139,460
Other Capital Assets, Net of Depreciation	27,703,350
Total Capital Assets	28,842,810
Total Noncurrent Assets	1,501,937,425
Total Assets	1,676,894,290
DEFERRED OUTFLOWS OF RESOURCES	
Deferred Pension Outflows	1,186,782
LIABILITIES	
Current Liabilities	
Accounts Payable	44,618,157
Estimated Claims Payable	126,297,835
Unearned Premium	68,310,184
Securities Lending Liability	28,299,273
Compensated Absences	2,099,081
Policyholder Deposits	2,470,442
Total Current Liabilities	272,094,972
Noncurrent Liabilities	
Estimated Claims Payable	773,998,661
Reinsurance Funds Withheld	89,571,173
Net Pension Liability	19,369,771
Other Post Employment Benefits	5,679,169
Compensated Absences	649,400
Total Noncurrent Liabilities	889,268,174
Total Liabilities	1,161,363,146
DEFERRED INFLOWS OF RESOURCES	
Deferred Pension Inflows	1,757,045
NET POSITION	
Net Investment in Capital Assets	28,842,810
Unrestricted	486,118,071
Total Net Position	$ 514,960,881

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

	For the Six Months Ended December 31, 2015
Net Premiums Earned	$ 88,494,811
Operating Expenses	
Benefits and Claims	67,383,170
Personal Services	14,447,553
Contractual Services	2,306,962
Supplies and Materials	217,990
Communications	547,809
Travel	116,510
Rent and Utilities	127,707
Repair and Maintenance	303,888
Depreciation and Amortization	734,038
Other Operating Expenses	2,877,550
Total Operating Expenses	89,063,177
Operating Income (Loss)	(568,366)
Nonoperating Revenue (Expenses)	
Investment Income	12,500,446
Securities Lending Income	182,002
Securities Lending Expenses	(43,843)
Loss on Retirement of Assets	(20,377)
Dividend Expense	(35,003,064)
Other Income	933,673
Total Nonoperating Revenue (Expenses)	(21,451,163)
Change in Net Position	(22,019,529)
Total Net Position - Beginning	536,980,410
Total Net Position - Ending	$ 514,960,881

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 DECEMBER 31,	2015
Cash Flows from Operating Activities	
Receipts for Premiums	87,997,752
Payments to Suppliers for Goods and Services	(6,617,066)
Payments to Employees	(13,390,494)
Payments for Claims	(62,755,244)
Other Operating Receipts	933,673
Net Cash Provided by (Used for) Operating Activities	6,168,621
Cash Flows from Noncapital Financing Activities	
Payment of Dividends to Policyholders	(1,721,553)
Net Cash Provided by (Used for) Noncapital Financing Activities	(1,721,553)
Cash Flows from Capital and Related Financing Activities	
Acquisition of Fixed Assets	(299,983)
Proceeds from Sale of Fixed Assets	24,705
Net Cash Used for Capital and Related Financing Activities	(275,278)
Cash Flows from Investing Activities	
Purchase of Investments	(54,203,492)
Proceeds from Sales or Maturities of Investments	58,623,961
Proceeds from Securities Lending Transactions	182,002
Payments of Security Lending Costs	(48,394)
Interest and Dividends on Investments	20,578,756
Net Cash Provided by (Used For) Investing Activities	25,132,833
Net Increase (Decrease) in Cash and Cash Equivalents	29,304,623
Cash and Cash Equivalents - July 1	33,942,555
Cash and Cash Equivalents - December 31	63,247,178

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

YEAR ENDED DECEMBER 31,	**2015**
Reconciliation of Change in Net Position to Net Cash Provided by (Used for) Operating Activities	
Change in Net Position	(22,019,529)
Adjustments to Reconcile Change in Net Position to Net Cash Provided by (Used for) Operating Activities	
Depreciation	565,024
Amortization	169,014
Security Lending Costs	43,843
Security Lending Income	(182,002)
Income on Investments	(12,500,446)
Pension Offsets	333,683
Payments of Dividends to Policyholders	1,721,553
Decrease (Increase) in	
Accounts Receivable	(17,263,742)
Other Assets	(1,073,295)
Increase (Decrease) in	
Accounts Payable	34,261,430
Unearned Premium	17,574,524
Property Held in Trust	(86,047)
Reinsurance Funds Withheld	(598,895)
Estimated Claims Payable	4,753,253
OPEB Liability	543,787
Compensated Absences	(73,534)
Total Adjustments	28,188,150
Net Cash Provided by (Used for) Operating Activities	6,168,621

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

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 a discretely presented component unit of the State of Montana and results are included in the State's Comprehensive Annual Financial Report. MSF's results are included in the State of Montana's financial reports because of the significance of MSF's financial relationship with the State. 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's Board is allocated 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 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 2015 legislature passed SB 123, which significantly changed the regulatory oversight of MSF effective January 1, 2016. MSF was issued a Certificate of Authority, became an authorized insurer regulated by the Montana Commission of Securities and Insurance and is subject to the provisions of Title 33, Montana Insurance Code. MSF was required to change its fiscal year end to a calendar year ending December 31. To make this transition, MSF completed a six-month reporting cycle of July 1, 2015 to December 31, 2015. This six-month period and future calendar year reporting periods will be presented in the State of Montana Comprehensive Annual Financial Report (CAFR), which uses a June 30 reporting date. The first calendar year period began on January 1, 2016 and quarterly and annual regulatory filings will be submitted to the insurance department as required under the law change. The accompanying financial statements are as of, and for the six month conversion period ended, December 31, 2015, and therefore do not include a comparable prior period.

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

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.

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 reported at net asset value. MSF had STIP transactions within the six-month period, however the STIP balance as of December 31, 2015 was zero.

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

MSF holds investments in long-term debt securities, mutual funds, and real estate partnerships through the BOI. 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 72, "Fair Value Measurement and Application", which MSF adopted during the six-month period ended December 31, 2015. Premiums and discounts are amortized using the scientific 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 U.S. Government securities, MSF's fixed income instruments have credit risk as measured by major credit rating services.

The U.S. Government guarantees the U.S. Government securities directly or indirectly. Obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk. The S&P rating service provide the credit ratings presented

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

in the following tables. If an S&P rating is not available, a Nationally Recognized Statistical Rating Organization (NRSRO) rating is used.

MSF's investment policy for credit risk requires fixed income investments, at the time of purchase, to be rated investment grade as defined either by Moody's or by a NRSRO.

Asset-backed securities are bonds backed by cash flows from principal and interest payments emanating from a Trust containing a pool of underlying assets. These securities, while sensitive to prepayments due to interest rate changes, generally have less credit risk than unsecured bonds. Their credit risk is based on the structure itself rather than balance sheet risk. This includes such factors as default rates, overcollateralization, and quality of collateral.

Custodial Credit Risk for Deposits

Custodial risk for cash is the risk that, in the event of the failure of the custodial institution, the cash or collateral securities may not be recovered from an outside party. For any cash balances held as deposits of the Custodial bank or sub-custodial bank, they are held in the name of the BOI or its accounts. Per policy, the BOI's custodial institution must hold short-term and long-term credit rating by at least one NRSRO with a minimum requirement of A1/P1 (short-term) and A3/A-1 (long-term).

Custodial Credit Risk for Investments

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the BOI may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. All the public securities as well as securities held by the separate public equity account managers were registered in the nominee name for the Montana Board of Investments and held in the possession of the BOI's custodial bank, State Street Bank. The Equity Index funds were purchased and recorded in the BOI's name. Commingled fund investments are registered in the name of the Montana Board of Investments.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributable to the magnitude of any single investment per issuer name. Investments 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, the BOI had no concentration of credit risk exposure to Fannie Mae and Freddie Mac within the MSF portfolio.

The policy for MSF states, "Fixed income holdings rated lower than A3 or A- are limited to a maximum of 25% of the fixed income portfolio at the time of purchase." MSF is limited to stock investments not to exceed 12% of the book value of its total invested assets. In addition, MSF's

investment policy requires a 2% portfolio limit for dollar-denominated debt obligations of domestic and foreign corporations (Yankee bonds) and a 3% portfolio limit in non-agency Mortgage Pass-through (MBS) securities. The investment policy also states, "The maximum fixed income credit risk will be limited to 2% of the total securities portfolio in any one name." There was no concentration of credit risk exceeding policy guidelines as of December 31, 2015.

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 Board of Investments uses effective duration as a measure of interest rate risk for MSF portfolio. The BOI's analytic software uses "an option-adjusted measure of a bond's (or portfolio's) sensitivity to changes in interest rates. Duration is 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 embedded options for bonds and changes in prepayments for mortgage-backed securities (including pass-through securities, Collateralized Mortgage Obligation (CMO), and Adjustable Rate Mortgage (ARM) securities)".

MSF's investment 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.

The fixed coupon holdings pay a fixed rate of interest until maturity while floating rate securities pay a variable rate of interest until maturity. The portfolio held certain variable rate issues. Interest payments on these securities are based on an underlying reference rate, e.g., LIBOR.

The subsequent table categorized investment in order to disclose credit and interest rate risk as of December 31, 2015. Credit risk reflects the bond quality rating, by investment type, as of the December 31 report date. Interest rate risk is disclosed using effective duration. If a bond investment type is unrated, the quality type is indicated by NR (not rated). The credit quality ratings have been calculated excluding non-rated investment types. NA (not applicable) indicates if duration has not been calculated.

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

State Fund - MU26
Credit Quality Rating and Effective Duration as of December 31, 2015
(in thousands)

Security Investment Type	Fair Value	Credit Quality Rating	Effective Duration
Treasuries	$ 200,117	AA+	4.04
Agency/Government Related	280,178	AA+	3.61
Asset Backed Securities	45,854	AAA	2.01
Mortgage Backed Securities	4,339	AA+	2.18
Financial-Corporate	307,522	A-	3.34
Industrial-Corporate	271,301	A	3.66
Utility-Corporate	44,864	BBB+	4.22
Total Fixed Income Investments	$ 1,154,175	AA-	3.58
Direct Investments			
Equity Index Fund-Domestic	$ 146,506		
Equity Index Fund-International	17,311		
Total Equity Index Funds	$ 163,817		
Core Real Estate	$ 87,971		
Total Direct Investments	$ 251,788		
Total Investments	$ 1,405,963		
Securities Lending Collateral Investment Pool*	$ 28,299	NR	0.09

*Securities Lending Collateral Investment Pool is comprised of the Securities Lending Quality Trust Liquidity

Legal and Credit Risk

As of December 31, 2015, the Federal National Mortgage Association and Federal Home Loan Mortgage Corp. remain in conservatorship from September 7, 2008.

On September 14, 2008, Lehman Brothers filed for Chapter 11 bankruptcy. The MSF portfolio included a $5 million position in Lehman Brothers Holdings, Inc. As of June 30, 2011, this holding was written down to $1 million and the book value of the bond represented 20% of par. All of the remaining $1 million position was received in October 2013 which has resulted in a remaining book value of $1. Therefore, any future payments received will be recorded as gain. For six-month period ending December 31, 2015 the BOI recorded a $119K payment to gain in October 2015.

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

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

Securities Lending

MSF participates in a securities lending program through the BOI. The BOI is authorized by law to lend its securities and has contracted with the custodial bank, State Street Bank and Trust, "the Bank", to lend the BOI's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The Bank is required to maintain collateral equal to 102 percent of the fair value of domestic securities and 105 percent of the fair value of international securities while the securities are on loan. On any day, including December 31, the markets may move in a positive or negative direction resulting in under or over collateralization. The Bank compensates for market movement by recalculating on the following business day to meet the collateralization requirements. The BOI and the Bank split the earnings, 80/20% respectively, on security lending activities. The BOI retains all rights and risks of ownership during the loan period.

During six-month period ended December 31, 2015, the Bank loaned MSF's public securities and received as collateral: U.S. dollar cash; U.S. Government and government-sponsored agency securities; U.S. corporate debt securities and structured securities rated AA-/Aa3 or higher; sovereign debt securities of the G10 nations; and debt securities issued by certain supranational agencies. The Bank does not have the ability to sell collateral securities unless the borrower defaults.

The BOI imposed no restrictions on the amount of securities available to lend during the six-month period ended December 31, 2015. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the period that resulted in a declaration and notice of Default of the Borrower. There were no losses during the six-month period ended December 31, 2015, resulting from a borrower default.

The following table presents the market values of the securities on loan and the total collateral held as of December 31, 2015:

		Amount
Securities on loan - market value	$	67,613,325
Collateral Cash		28,299,273
Collateral Securities		40,659,053
Collateral Total	$	68,958,326
% of Fair Value		102%

During the six-month period ended December 31, 2015, the BOI and the borrowers maintained the right to terminate all securities lending transactions on notice. The cash collateral received for each loan was invested, together with the cash collateral of other qualified plan lenders, in the Security Lending Quality Trust. Because the securities lending transactions were terminable

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

at will, their duration did not generally match the duration of the investments made with the cash collateral received from the borrower. At year-end December 31, 2015, State Street Bank indemnified BOI's credit risk exposure to borrowers.

The average duration and average weighted final maturity for the investment fund is as follows as of December 31, 2015:

	Liquidity Pool
Average Duration	35 days
Average Weighted Final Maturity	90 days

Income earned related to securities on loan for MSF for the six-month period ended December 31, 2015, was $182K. Expenses related to securities on loan for MSF for the six-month period ended December 31, 2015, were $44K.

Receivables

At December 31, 2015, MSF had a net receivable balance of $81.1M. The gross receivables for billed premium and claim benefits overpayments are $5.9M, which are then reduced by the estimated uncollectible receivables reported as an allowance for doubtful accounts of $2.3M. Other receivables include $64.4M in premium deferred but not yet billed, $9.0M in investment income due, $155K in retrospective premium and $258K in notes receivable, all of which are short term. Accounts receivable also includes $3.7M at December 31, 2015 for premium that is earned but unbilled (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 $67.1M at December 31, 2015.

Equipment, Accumulated Depreciation and Intangible Assets

Equipment and intangible assets are capitalized if the actual or estimated historical cost exceeds $5K and $100K, respectively. Depreciation expense is computed on a straight-line basis for equipment over a period of three to ten years and amortization of intangible assets is computed on a straight-line basis over four years. Amortization of intangible assets is recorded directly to the asset balance. All fixed assets are shown net of depreciation.

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

Other Assets

Other assets include advances and prepaid expenses.

Land and Buildings

As of December 31, 2015, MSF financial statements include $1.1M in land and $25.0M in buildings, net of depreciation. Buildings are depreciated on a straight-line basis over a period of 50 years. For additional disclosure related to capital assets, see Note 3.

Accounts Payable

Accounts payable is a short term liability account reflecting amounts owed for goods and services received by MSF. At December 31, 2015, accounts payable includes $33.3M of dividends declared by the MSF Board of Directors in November 2015 but not paid until 2016.

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. Willis 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. The MSF Board of Directors approved estimates within that range as the estimated claims payable for MSF. For additional disclosure related to the estimated claims payable, refer to Note 5.

Unearned Premium

Unearned premium reflects premium that has been written but not yet earned. The unearned premium was $68.3M at December 31, 2015.

Policyholder Deposits

Policyholder deposits consist of security deposits required for deposit-type policies 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 4.

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

Net Position

Net Position consists of the net excess or deficit of assets plus deferred outflows of resources over liabilities plus deferred inflows of resources. Net Position as of December 31, 2015 was $515.0M.

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 policy year 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 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 for the six months ending December 31, 2015.

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.

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

2. Investments

The amortized cost and market value of MSF's fixed maturity and equity securities as of December 31, 2015, is as follows:

December 31, 2015	Amortized Cost	Market Value
Treasuries	$ 193,474,570	$ 200,116,965
Agency/Government related	273,780,272	280,177,774
Asset-backed securities	45,989,148	45,854,028
Mortgage-backed securities	4,064,258	4,339,037
Financial-corporate	299,847,834	307,521,312
Industrial-corporate	265,622,315	271,301,206
Utility-corporate	43,624,005	44,864,280
Equity index fund-domestic	61,260,319	146,505,781
Equity index fund-international	14,004,925	17,311,319
Core real estate	75,000,000	87,971,079
Total	$ 1,276,667,645	$ 1,405,962,782

The amortized cost and estimated market value of MSF's fixed maturity securities as of December 31, 2015 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.

December 31, 2015	Amortized Cost	Market Value
Due one year or less	$ 127,177,284	$ 129,006,154
Due after one year through five years	625,994,235	643,621,697
Due after five years through ten years	359,284,898	367,068,208
Due after ten years	13,945,985	14,478,543
Total	$ 1,126,402,402	$ 1,154,174,602

During the six-month period ended December 31, 2015, MSF realized gross gains from sales of securities of $1.2M and gross realized losses of ($245K).

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

MSF categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles as follows:

- Level 1—Quoted prices for *identical* assets or liabilities in active markets.
- Level 2—Prices determined using inputs, other than quoted prices included within Level 1, that are observable for an asset or liability, either directly or indirectly.
- Level 3—Prices determined using unobservable inputs.

The Company has the following recurring fair value measurements as of December 31, 2015:

		Fair Value Measurements Using		
	12/31/2015	Quoted Prices in Active Markets for Identical Assets **(Level 1)**	Significant Other Observable Inputs **(Level 2)**	Significant Unobservable **(Level 3)**
Investments by fair value level				
Fixed Income Investments				
Treasuries	$ 200,116,965	$ 200,116,965	$ -	
Agency/Government related	280,177,774	-	280,177,774	
Asset-backed securities	45,854,028	-	45,854,028	
Mortgage-backed securities	4,339,037	-	4,339,037	
Financial-corporate	307,521,312	-	307,521,312	
Industrial-corporate	271,301,206	-	271,301,206	
Utility-corporate	44,864,280	-	44,864,280	
Total Fixed Income Investments	1,154,174,602	200,116,965	954,057,637	
Equity Index Funds				
Domestic S&P 500 index fund	146,505,782	146,505,782		
Ex-U.S. ACWI index fund	17,311,318	17,311,318		
Total Equity Index Funds	163,817,100	163,817,100		
Total investments by fair value level	$ 1,317,991,703	$ 363,934,065	$ 954,057,637	
Investments measured at the net asset value (NAV)				
Core Real Estate	$ 87,971,079			

Debt and equity securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Debt securities classified in Level 2 of the fair value hierarchy are valued using a matrix pricing technique. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices. MSF does not classify any holdings within Level 3 of the fair value hierarchy.

MSF holds two core real estate funds which make equity investments in operating and substantially-leased institutional-quality real estate in the traditional property types (apartments, office, retail, industrial and hotel) via commingled funds. As of December 31, 2015, there are no unfunded commitments. The value of these investments was determined using the NAV per share of MSF's ownership interest in the partners' capital. One fund can have requests for redemptions of units at any time and are effective at the end of the calendar quarter in which the fund's manager receives the request. Any requested redemptions from that fund may be redeemed in installments as funds become available. In the other fund held

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

by MSF, holders may elect to have funds redeemed by providing a forty-five (45) day written notice. Any requested redemptions from that fund may be received in monthly installments. For both funds, redemptions are subject to availability of cash flow arising from investment transactions, sales, and other fund operations occurring in the normal course of business. This investment type issues quarterly distributions of generated income and occasionally through the liquidation of the underlying assets of the fund. The primary investment objective of these funds is to invest in real estate which will generate income from predictable income sources and not to realize gains on the underlying assets. Therefore, the underlying assets of the funds will typically be liquidated when the funds need to reposition those assets to better match the investment objectives.

During the six-month period ended December 31, 2015, investment income for MSF was $12.5M, which includes unrealized losses on investments in the amount of ($8.9M).

3. Capital Assets

Capital assets are used for the business activities of MSF. Balances for the six month period ended December 31, 2015 are as follows:

	Beginning Balances	Increases	Decreases	Ending Balances
Capital assets not being depreciated:				
Land	$ 1,139,460	$ -	$ -	$ 1,139,460
Total capital assets not being depreciated	1,139,460	-	-	1,139,460
Capital assets being depreciated:				
Buildings/improvements	27,941,323	-	-	27,941,323
Equipment, furniture, and vehicles	7,627,193	294,046	(416,029)	7,505,209
Total capital assets being depreciated	35,568,516	294,046	(416,029)	35,446,532
Less accumulated depreciation for:				
Buildings/improvements	(2,705,043)	(266,517)	-	(2,971,560)
Equipment, furniture, and vehicles	(5,202,976)	(298,507)	370,947	(5,130,535)
Total accumulated depreciation	(7,908,018)	(565,024)	370,947	(8,102,095)
Total capital assets being depreciated, net	27,660,497	(270,978)	(45,082)	27,344,437
Intangible assets	527,927	-	(169,014)	358,913
Total capital assets, net	$ 29,327,884	$ (270,978)	$ (214,096)	$ 28,842,810

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

4. Reinsurance

For the six-month period ended December 31, 2015, MSF ceded premiums to 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 premiums.

The excess of loss contract provides coverage up to $100 million with an MSF retention of $5 million on the first layer of coverage. The excess of loss protection applies to an individual occurrence with a maximum of $5 million on any one life. The coverage for the six-month period ending December 31, 2015 is as follows:

Contract Period	Reinsurance Coverage
2015	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, 2014 through December 31, 2016. 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 $5.5M for the six-month period ended December 31, 2015. 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 December 31, 2015 is $89.6M for contracts in place from July 1, 2002 to December 31, 2015. Interest must be accrued on the funds withheld account which resulted in accrued interest of $2.2M for the six-month period ended December 31, 2015.

Estimated claim reserves were reduced by $10.8M as of December 31, 2015, for the amount of reinsurance estimated to be ultimately recoverable on incurred losses due to the excess of loss reinsurance contracts. The estimated claim reserves were reduced by an additional $22.4M for 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 $67.1M at December 31, 2015.

MSF also has assumed reinsurance relationships with Zurich American Insurance Company and Argonaut 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. For the six-month period ended December 31, 2015, assumed premium is $1.2M and incurred losses from OSC benefits were $556K. The assumed liability for OSC claims is $2.7M at December 31, 2015.

5. 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 December 31, 2015, approximately 24,400 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. Willis 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 December 31, 2015. 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.

Willis 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 December 31, 2015. The MSF estimated unpaid claims and claims adjustment expenses payable presented at face value, net of estimated reinsurance

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

recoverable were $900.3M, as of December 31, 2015. The Statement of Net Position displays this total separated as current and noncurrent estimated claims payable.

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.

Changes in Claims Liabilities

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

	2015
Unpaid claims and claim adjustment expenses at beginning of period	$ 895,543,243
Incurred claims and claim adjustment expenses:	
Provision for insured events of the current period	72,200,154
Increase(Decrease) in provision for events in prior years	(4,816,985)
Total incurred claims and claim adjustment expenses	67,383,170
Payments:	
Claims and claim adjustment expenses attributable to insured events of CY	(8,090,333)
Claims and claim adjustment expenses attributable to insured events of PY	(54,539,584)
Total payment	(62,629,917)
Total unpaid claims and claim adjustment expenses at end of the period	$ 900,296,496

6. 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 $430K in administration costs to the Old Fund for the six-month period ended

December 31, 2015. The administration costs are recorded in non-operating revenue as other income. Beginning in June 2011, the State of Montana General Fund began making transfers to cover the cost of administering and paying the Old Fund claim benefits.

7. MSF Distributions

During the six-month period ended December 31, 2015, the MSF Board of Directors declared a $35M dividend to eligible policyholders for the 2013 policy year. MSF paid $1.7M of this amount during December 2015 and the remaining $33.3M during January 2016.

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. 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 MSF compensated absences liability is $2.7M as of December 31, 2015.

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), a defined benefit retirement plan (PERS-DBRP) and a defined contribution retirement plan (PERS-DCRP).

Defined Benefit Retirement Plan

Benefits provided. The PERS-DBRP is a multiple-employer, cost-sharing plan that provides retirement, disability and death benefits to plan members and their beneficiaries. Benefits are established in state law and may only be amended by the State of Montana Legislature. Members are vested after five years of membership service, which entitles the member to an accrued normal retirement benefit payable at age 60 (or age 65 if hired after June 30, 2011). A member may receive a refund of accumulated contributions in lieu of a pension, thereby forfeiting the right to a monthly benefit. A description of the benefits and eligibility rules for the plan are shown in the following table:

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

Member's highest average compensation (HAC)

Hired prior to July 1, 2011 - highest average compensation during any consecutive 36 months;
Hired on or after July 1, 2011 - highest average compensation during any consecutive 60 months;
Hired on or after July 1, 2013 - 110% annual cap on compensation considered as part of a member's highest average compensation.

Eligibility for benefit

Service retirement:

Hired prior to July 1, 2011:	Age 60, 5 years of membership service; Age 65, regardless of membership service; or Any age, 30 years of membership service.
Hired on or after July 1, 2011:	Age 65, 5 years of membership service; Age 70, regardless of membership service.

Early retirement, actuarially reduced:

Hired prior to July 1, 2011:	Age 50, 5 years of membership service; or Any age, 25 years of membership service.
Hired on or after July 1, 2011:	Age 55, 5 years of membership service.

Vesting

5 years of membership service

Monthly benefit formula

Members hired prior to July 1, 2011:
Less than 25 years of membership service: 1.785% of HAC per year of service credit;
25 years of membership service or more: 2% of HAC per year of service credit.

Members hired on or after July 1, 2011:
Less than 10 years of membership service: 1.5% of HAC per year of service credit;
10 years or more, but less than 30 years of membership service: 1.785% of HAC per year of service credit;
30 years or more of membership service: 2% of HAC per year of service credit.

Guaranteed Annual Benefit Adjustment (GABA)

After the member has completed 12 full months of retirement, the member's benefit increases by the applicable percentage each January, inclusive of all other adjustments to the member's benefit.

-- 3% for members hired prior to July 1, 2007
-- 1.5% for members hired on or after July 1, 2007 but prior to July 1, 2013
-- For members hired on or after July 1, 2013, 1.5% if the plan is funded at or above 90%; 1.5% less 0.1% for each 2% the plan is funded below 90%; 0% if the plan amortization peri is 40 years or more.

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

Contributions. Contribution requirements for the plan are established in Montana Code Annotated Title 19, Chapter 3, Part 3, and can only be amended by the State of Montana Legislature. All members contribute 7.9% of their compensation. This is a temporary 1% increase for members hired prior to July 1, 2011 and remains the same for members hired on or after July 1, 2011. Interest is credited to member accounts at the rates determined by the PERB. All member contributions will be decreased to 6.9% on January 1 following the actuarial valuation results that project the amortization period to drop below 25 years and remain below following the termination of the 1% additional member contribution rate.

MSF contributes 8.27% of each member's compensation. This was increased from 6.9% to 7.035% on July 1, 2007, 7.17% on July 1, 2009, and to 8.17% on July 1, 2013. The rate will continue to increase .1% each year until 2024. These increased contributions will terminate on January 1 following the actuarial valuation results that project the amortization period to drop below 25 years and remain below following the termination of the additional employer contribution rates. Effective July 1, 2013, contributions are also made to the plan from the Coal Severance Tax Fund. The plan recognized $1,442,885 in MSF (employer) contributions during the plan year ended June 30, 2015.

Further information regarding description of the plan is available Montana Public Employees Retirement Administration website: http://mpera.mt.gov/docs/2015CAFR.pdf

Actuarial assumptions. The plan costs and liabilities in the June 30, 2015 actuarial valuation were determined using the following assumptions:

Rate of Investment Return	7.75% (net of investment expenses)
Rate of Wage Inflation	4.00%
Interest on Member Contributions	3.50%
Rate of Increase in Total Payroll	4.00%

Mortality rates were based on the RP-200 Combined Employee and Annuitant Mortality tables, with adjustments for mortality improvements using scale AA. These actuarial assumptions are based on the most recent experience study of the plan, which was completed in 2010.

Discount rate. The discount rate used to measure the total pension liability was 7.75%, which is the assumed long-term expected rate of return on plan assets. The projection of cash flows used to determine the discount rate assumes contractual contribution rates. Based on those assumptions, the pension plan's fiduciary net position is projected to be sufficient to make all projected future benefit payments of current active and inactive employees. Accordingly, the long-term expected rate of return on pension investments was applied to all periods of projected benefit payments to determine the liability.

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

The 7.75% long-term expected rate of return on plan investments was determined by considering information from various sources, including historical rates of return, rate of return assumptions adopted by similar public sector systems, and by using a building-block method in which best-estimate ranges of expected future real rates of return are developed for each major asset class. The target allocation and best estimates of arithmetic real rate of return for the asset classes are shown in the following table:

Asset Class	Target Allocation	Expected Rate of Return
Cash Equivalents	2.0%	-0.25%
Domestic Equity	36.0%	4.55%
Foreign Equity	18.0%	6.10%
Fixed Income	24.0%	1.25%
Private Equity	12.0%	8.00%
Real Estate	8.0%	4.25%

The following table displays MSF's proportionate share of the net pension liability using the 7.75% discount rate as well as the proportionate share using 6.75% and 8.75%, a decrease of 1% and an increase of 1%, respectively.

	1% Decrease (6.75%)	Discount Rate (7.75%)	1% Increase (8.75%)
MSF's Proportionate Share of the Net Pension Liability	$ 29,863,996	$ 19,369,771	$ 10,507,642

Plan fiduciary net position. Detailed information about the plan's fiduciary net position is available in the separately issued PERB Comprehensive Annual Financial Report available at the following address: http://mpera.mt.gov/docs/2015CAFR.pdf

Pension liabilities, expense, and deferred inflows and outflows of resources. At December 31, 2015 MSF reported a liability for its proportionate share of the plan's total net pension liability in the amount of $19,369,771, representing a 1.385661% share of the total based on amount of contributions by each employer. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2014, with updated procedures used to roll forward the liability to June 30, 2015. There were no significant events between the measurement date and reporting date that are expected to have an impact on MSF's proportionate share of the liability.

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

For the six months ended December 31, 2015, MSF recognized pension expense of $798,537 and revenue of $464,854 for support provided by the Coal Severance Tax. At December 31, 2015 MSF reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Actual vs. Expected Experience	$ -	$ 117,188
Changes of assumptions	-	-
Actual vs. Expected Investment Earnings	-	1,639,857
Changes in Proportionate Shares	379,677	-
Differences Between Actual Contributions and Proportionate Share Contributions	53,001	-
Contributions Subsequent to the Measurement Date	754,104	-
Total	$ 1,186,782	$ 1,757,045

The $754,104 reported as deferred outflows of resources related to pensions resulting from MSF contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended June 30:	
2016	$ (580,044)
2017	(580,044)
2018	(590,776)
2019	426,495
2020	-
Thereafter	-

Defined Contribution Retirement Plan

The PERS-DCRP is a multiple-employer plan that provides retirement, disability and death benefits to plan members and their beneficiaries. Benefit terms are established in state law by the State of Montana Legislature. Those terms are as follows:

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

Eligibility for benefit
Termination of Service

Vesting
Immediate for participant's contributions and attributable income;
5 years of membership service for the employer's contributions to individual accounts and attributable income.

Benefit
Depends upon eligibility and individual account balance;
Various payout options are available, including: taxable lump sums, periodic payments per participant direction and IRS permitted rollovers.

Member and employer contribution rates are established in state law by the State of Montana Legislature. The member contribution rate for the six months ended December 31, 2015 was 7.9% of member compensation, while the MSF contribution rate was 8.37% of member compensation. Both the member and employer rates have been temporarily increased by the Legislature and will decrease to 6.9% on January 1 following actuarial valuation results that show the amortization period of the PERS-DBRP has dropped below 25 years and will remain below 25 years following the reduction of both the additional employer and additional member contribution rates.

For the six months ended December 31, 2015, MSF contributed $615,164 to the defined benefit and defined contribution plans combined. MSF cannot determine the portion of that total that relates to the defined contribution plan. Of that amount, $89K remains outstanding at December 31, 2015.

Deferred Compensation Plan

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. A summary of eligibility and benefits is shown in the following table:

Contribution

Voluntary, pre-tax deferral or designated Roth contribution.

Eligibility for benefit

Not available to participant until separation from service, retirement, death, or upon an unforeseeable emergency, while still employed, provided IRS-specified criteria are met.

Vesting

Participants are fully vested in their accounts immediately.

Benefit

Lump sum or periodic benefit payment, at the option of the participant. Based on individual account balances and plan provisions. IRS permitted rollovers are also possible.

10. Leases and Commitments

MSF leases office facilities outside of Helena under various operating leases that expire through February 2019.

MSF leases 350 parking spaces from the City of Helena in a parking garage adjacent to the MSF facility. The cost of the parking spaces is the same monthly rate as equivalent parking passes sold by the City and has the potential to change based on parking rates assigned by the Helena Parking Commission until the lease expires on June 30, 2040.

Rental expenses for the six-month period ending December 31, 2015, were $25K, which includes a credit of ($11K) for the parking garage lease, $28K for office facility leases and $8K for minor office equipment.

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

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

	Amount
2016	$ 348,662
2017	334,666
2018	326,116
2019	304,623
2020	300,324
Thereafter	5,815,254
	$ 7,429,645

11. 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.

OPEB 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.

The OPEB plan allows retirees to participate, as a group, at a rate that does not cover all of the related costs. This results in the reporting of an “implied rate subsidy” in the related financial statement and footnotes. While this liability is disclosed for financial statement purposes, it does not represent a legal liability of the State or MSF. Accordingly, reported contributions are not a result of direct funding to the plan or for associated liabilities, but are a measure of the difference in retiree payments into the plan and actual medical costs associated with those individuals paid for by the plan.

The OPEB plan does not issue a standalone financial report.

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

Funding Policy

The State of Montana pays for postemployment healthcare benefits on a pay-as-you-go basis. Section 2-18-8, MCA gives authority for establishing and amending the funding policy to the Department of Administration.

As of December 2015, the OPEB plan's administratively established retiree medical contributions vary between $371 and $1,345 per month depending on the medical plan selected, family coverage, and Medicare eligibility. Administratively established dental contributions vary between $22 and $68.50 and vision hardware contributions vary between $5.76 and $16.76 depending on the coverage selected.

OPEB Costs and Contributions

The annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45, 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 ARC is calculated for all the State plan's participants and then allocated to individual participants. The MSF allocated portion of the ARC for the six-month period ended December 31, 2015 is estimated at $753K and is based on the plan's current ARC rate of 5.69% percent of participants' annual covered payroll.

The following table presents the OPEB cost, amount contributed, and changes is the OPEB liability for the six-month period ended December 31, 2015:

Annual required contribution	$ 753,590
Interest on net OPEB obligation	223,741
Amortization factor	(175,483)
Annual OPEB cost	801,848
Contributions made	(258,061)
Increase in net OPEB obligation	543,787
Net OPEB obligation - beginning of year	5,135,382
Net OPEB obligation - end of year	$ 5,679,169

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

The MSF annual OPEB cost, percentage of OPEB cost contributed, and OPEB liability for the current and two prior reporting periods are as follows:

Fiscal Period Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
12/31/2015	801,848	32.18%	5,679,169
6/30/2015	796,772	28.19%	5,135,382
6/30/2014	783,312	19.25%	4,563,229

The most recent actuarial valuation available as of the reporting date was as of January 1, 2013 for the year ending December 31, 2013. The valuation occurs every other year. MSF's allocation of the plan as of the most recent valuation is as follows:

Actuarial Accrued Liability (AAL)	$9,062,629
Actuarial Value of Plan Assets	$0
Unfunded Actuarial Accrued Liability (UAAL)	$9,062,629
Funded Ratio (Actuarial Value of Plan Assets/AAL)	0%
Covered Payroll (Active Plan Members)	$20,491,842
UAAL as a Percentage of Covered Payroll	44.23%

Actuarial Methods and Assumptions

Actuarial valuations of an OPEB plan involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, including future employment, mortality, and health care trends. The actuarially-determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Actuarial calculations reflect a long-term perspective and are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, provides information regarding the multi-year trend of the actuarial value of plan assets and liabilities.

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. As of the January 1, 2013, actuarial valuation date, the projected unit cost 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 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 interest/discount rate and a 2.50 percent payroll growth rate assumption.

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2015

12. Contingencies

Susan Hensley v. Montana State Fund Montana State Fund received a Petition for Hearing that was filed before the Workers' Compensation Court in October, 2013. The matter is Susan Hensley vs. Montana State Fund, WCC No. 2013-3235. The matter is fully briefed and is submitted for a decision. Under HB 334, as passed by the legislature in 2011 and codified in 39-71-703 (2), MCA, when a claimant receives a Class I impairment, it is not payable unless the claimant has an actual wage loss as a result of the compensable injury or occupational disease. The law was effective July 1, 2011 and applicable to claims that occurred on or after that date. The petitioner in this matter is challenging the constitutionality of 39-71-703 (2), MCA. State Fund anticipates the chances are remote, but as with any litigated matter there is the possibility of an adverse decision. Should the statute be held unconstitutional, determined to be applicable to other claims and also determined to be retroactively applicable, potential liability is estimated to be at least $2.2 million per year, as based on NCCI initial pricing, and current estimated business volumes. However, based on experience, costs may be substantially higher than the estimate of $2.2 million per year.

Montana State Fund also is involved in 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.

REQUIRED SUPPLEMENTARY INFORMATION

Risk Management (Financial Statement Note 5)

The following table illustrates how the earned revenues of MSF plus investment income compare to related costs of loss and other expenses incurred by MSF for fiscal years 2007 through 2015 as well as the six-month period ended December 31, 2015 (shown as 2015.5). 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 trends. 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)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2015.5*
1. Premiums and Investment Revenue										
Earned	313,220	298,114	262,822	223,616	218,952	184,640	181,826	191,194	183,805	95,851
Ceded	14,856	14,676	13,702	13,224	11,286	11,501	8,459	9,460	11,310	5,545
Net Earned	298,364	283,438	249,120	210,392	207,665	173,139	173,367	181,734	172,495	90,306
2. Unallocated expenses including overhead	41,947	47,778	49,215	44,188	57,282	49,557	49,515	46,206	52,570	27,822
3. Estimated losses and expenses, end of accident year										
Incurred	170,652	177,100	159,229	137,507	142,989	118,066	128,522	139,145	124,831	66,142
Ceded	-	-	-	-	9,769	1,099	-	-	-	-
Net Incurred	170,652	177,100	159,229	137,507	133,220	116,967	128,522	139,145	124,831	66,142
4. Net paid (cumulative) as of:										
End of policy year	32,708	31,002	29,009	25,475	27,902	24,729	25,706	26,808	24,150	8,090
One year later	67,928	67,034	60,009	52,701	56,502	54,982	50,574	55,957	41,969	
Two years later	85,646	86,268	74,132	66,235	69,918	70,487	64,327	65,058		
Three years later	98,427	95,612	83,737	74,028	76,385	80,144	69,066			
Four years later	104,967	103,337	89,431	78,884	81,578	82,902				
Five years later	109,569	109,144	93,622	82,764	83,427					
Six years later	112,562	113,630	96,935	84,368						
Seven years later	115,195	118,024	98,651							
Eight years later	118,476	121,076								
Nine years later	120,529									
5. Re-estimated ceded losses and expenses	-	4,463	-	-	4,363	8,873	-	-	-	-
6. Re-Estimated net incurred losses and expense:										
End of policy year	170,652	177,100	159,229	137,507	133,220	116,967	128,522	139,145	124,831	66,142
One year later	171,783	174,279	152,886	139,554	134,175	130,507	123,912	134,698	122,779	
Two years later	170,786	173,808	151,738	135,833	133,652	130,281	119,972	127,156		
Three years later	172,038	172,888	151,303	135,253	133,796	119,821	115,676			
Four years later	171,987	172,570	150,212	134,681	135,734	116,555				
Five years later	170,997	167,166	149,230	133,836	133,047					
Six years later	169,555	166,367	149,291	131,359						
Seven years later	168,400	169,470	147,199							
Eight years later	168,641	167,101								
Nine years later	166,530									
7. Increase (decrease) in estimated net incurred losses and expenses from end of policy year	(4,122)	(9,998)	(12,029)	(6,148)	(173)	(412)	(12,846)	(11,989)	(2,052)	-

* Column represents the six-month period ended December 31, 2015.

Retirement Plans (Financial Statement Note 9)

Schedule of MSF's Proportionate Share of the Net Pension Liability*

June 30:	2015	2014
Proportionate Share of the Net Pension Liability	1.39%	1.35%
Proportionate Share of the Net Pension Liability	$ 19,369,771	$ 16,863,200
Defined Benefit Pensionable Payroll	15,976,817	15,132,665
Proportionate Share as % of Pensionable Payroll	121.24%	111.44%
Plan Fiduciary Net Position as a % of Total Pension Liability	78.40%	79.90%

Schedule of MSF Contributions*

June 30:	2015	2014
Contractually Required Contributions	$ 1,332,551	$ 1,351,735
Contributions in Relation to the Contractually Required Contributions	1,442,885	1,351,735
Contribution Deficiency (Excess)	(110,334)	-
Defined Benefit Pensionable Payroll	15,976,817	15,132,665
Proportionate Share as % of Pensionable Payroll	8.34%	8.93%

*This schedule is intended to show ten years of data. Additional years will be presented as they become available.

Other Post-Employment Benefits (Financial Statement Note 11)

As of December 31, 2015, the most recent actuarial valuation available that was completed by the State of Montana was as of January 1, 2013 for the year ending December 31, 2013. This actuarial evaluation is completed every two years with the next valuation to be completed as of January 1, 2015 for the year ending December 31, 2015.

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 December 31, 2015.

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)
1/1/2013	$0	$7,288,059	$7,288,059	0.00%	$18,899,275	38.56%
1/1/2011	$0	$6,355,058	$6,355,058	0.00%	$19,544,196	32.52%
1/1/2009	$0	$6,985,326	$6,985,326	0.00%	$16,766,753	41.66%
1/1/2007	$0	$8,079,405	$8,079,405	0.00%	$16,805,676	48.08%

Report on Internal Control and Compliance

LEGISLATIVE AUDIT DIVISION

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

Deputy Legislative Auditors:
Cindy Jorgenson
Angus Maciver

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Legislative Audit Committee
of the Montana State Legislature:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Montana State Fund, as of and for the 6 months ended December 31, 2015, and the related notes to the financial statements, which collectively comprise Montana State Fund's basic financial statements, and have issued our report thereon dated May 4, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Montana State Fund's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Montana State Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of Montana State Fund's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal controls was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify

any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Montana State Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination on financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Montana State Fund's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Montana State Fund's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

May 4, 2016

Montana State Fund

State Fund Response

P.O. Box 4759 • Helena, MT 59604-4759
Customer Service 1-800-332-6102
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May 17, 2015

Ms. Tori Hunthausen
Legislative Auditor
Legislative Audit Division
State Capitol Building, Room 106
Helena, Montana 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 opinion with no recommendations.

The management and staff of MSF are very proud of our accomplishments and prioritize high-level service to Montana employers 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