



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL AUDIT

Montana Board of Investments

*For the Fiscal Year Ended
June 30, 2017*

FEBRUARY 2018

LEGISLATIVE AUDIT
DIVISION

16-04B

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FINANCIAL AUDITS

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

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.

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LEGISLATIVE AUDIT DIVISION

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Deputy Legislative Auditors
Cindy Jorgenson
Joe Murray

February 2018

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial audit report of the Montana Board of Investments for the fiscal year ended June 30, 2017. We performed this audit of the board in compliance with the Montana Constitution and state law. Our audit work included analyzing the financial statements and note disclosures, examining the underlying financial activity, and testing selected control systems. The report contains one recommendation related to internal controls over financial reporting.

Included in this report are financial statements of the board's Consolidated Unified Investment Program and Enterprise Fund Program. We issued unmodified opinions on the financial statements for these programs.

We thank the members of the board and their staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

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APPOINTED AND ADMINISTRATIVE OFFICIALS

			<u>Term Expires</u> <u>January 1</u>
Montana Board of Investments	Mark Noennig, Chairman	Billings	2021
	Karl Englund, Vice Chair	Missoula	2019
	Teresa Olcott Cohea	Helena	2019
	Quinton Nyman	Helena	2019
	Jack Prothero	Great Falls	2021
	Jeff Greenfield	Shepherd	2021
	Jon Satre	Helena	2019
	Maggie Peterson	Ananconda	2021
	Scott Sales	Senate Liaison	
	Kelly McCarthy	House of Representatives Liaison	

Administrative Officials David Ewer, Executive Director
 Geri Burton, Deputy Director
 Joe Cullen, Chief Investment Officer
 Julie Feldman, Financial Manager

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MONTANA LEGISLATIVE AUDIT DIVISION

FINANCIAL AUDIT

Montana Board of Investments

For the Fiscal Year Ended June 30, 2017

FEBRUARY 2018

16-04B

REPORT SUMMARY

The Montana Board of Investments managed a combined \$17.7 billion of investments for state entities and local governments as of June 30, 2017. Additionally, the board had approximately \$107.9 million in bonds payable and \$94.8 million in loans receivable as of June 30, 2017, associated with the Intermediate Term Capital Program. Our audit work over the board's financial statements identified errors in the presentation and disclosure of financial statement information, including misclassification of assets, overstatements of participant purchase and sale activity, overstatement of realized gains, and misclassification of cash flows. These errors, when considered in the aggregate, indicate a material weakness in internal controls over financial reporting at the board. This report contains a recommendation related to this control deficiency.

Context

Article VIII, Section 13 of the Montana Constitution requires the Legislature to provide for a Unified Investment Program (UIP) for public funds, and §17-6-201, MCA, requires the Montana Board of Investments (board) to administer the program. The board has sole authority to invest public retirement system funds and state compensation insurance fund assets, in accordance with state law and the Montana Constitution. In addition, the board manages the investments of state agencies and certain investments of local governments, such as cities, counties, and school districts.

To manage the UIP, the board has created three investment pools that operate similar to mutual funds. State agencies and local governments may participate in two of the pools, provided they meet the requirements for participation. The state's retirement systems are the only eligible participants for the third pool. The board also manages direct investments for eligible state agencies, including the investments of the Montana State Fund.

During fiscal year 2017, the board changed its internal pool structure for the state's retirement system investments. The board consolidated investments from five pools into a single pool, to align the accounting and investment performance structure with the asset allocations established by the board. The new pool is titled the Consolidated Asset Pension Pool (CAPP).

As of, and for the fiscal year ended, June 30, 2017, the board managed approximately \$17.7 billion of investments in the UIP and distributed approximately \$255.8 million in income to participants.

The board also administers the state's Municipal Finance Consolidation Act (MFC) and Economic Development Bond Act (EDB) programs, known as the Enterprise Fund Program. Under the MFC, the board is authorized to issue up to \$190 million in bonds. The proceeds of the Intermediate Term Capital Program (INTERCAP) bonds issued under the MFC are loaned to eligible Montana

(continued on back)

state and local governments to finance capital improvements or other needs as authorized by law. The board makes firm commitments to fund loans through the INTERCAP program. At June 30, 2017, the board had approximately \$107.9 million in bonds payable \$94.8 million in loans receivable for the INTERCAP program. Additionally, the board had \$30 million in outstanding INTERCAP loan commitments.

In addition to the INTERCAP program, under both the MFC and EDB programs, the board is authorized to provide governments with access to financing through the issuance of conduit (no-commitment) debt. Assets and revenues of the borrower are pledged to repay the debt. Because the board has no obligation for this debt, these bonds are not reflected on the Enterprise Fund Program financial statements. They are, however, disclosed in the notes. At June 30, 2017, the total conduit debt outstanding under the MFC program was \$12.0 million, and there was no debt outstanding under the EDB program.

Results

The Montana Constitution and state law require the board to be audited annually. The board issues separate financial statements for the UIP and Enterprise Fund Program. Our audit work included: reviewing the board's transition to CAPP; analyzing the financial statements and note disclosures; examining the underlying financial activity and tying it to support from external parties, as applicable; and reviewing and testing selected control systems. We also tested the board's compliance with selected state laws and regulations recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements.

Our work identified errors in the presentation and disclosure of information in the UIP and Enterprise Fund Program financial statements. For the UIP, errors in financial reporting included a \$1.7 billion misclassification of assets between cash equivalents and investments, a \$326.1 million overstatement of participant purchase and sale activity, a \$362.3 million overstatement of realized gains, and incorrectly placing supplementary information within the financial statements. For the Enterprise Fund Program, errors included misclassification of cash flows and incomplete note disclosures associated with an approximate \$8.5 million bond anticipation note.

We communicated these errors to the board as part of the audit, and the board made the necessary adjustments to the financial statements and notes to correct the errors. However, these errors, when considered in the aggregate, indicate a material weakness in internal controls over financial reporting at the board. This report contains a recommendation to the board related to this control deficiency.

Recommendation Concurrence	
Concur	1
Partially Concur	0
Do Not Concur	0
Source: Agency audit response included in final report.	

For a complete copy of the report (16-04B) 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>
Report Fraud, Waste, and Abuse to the Legislative Auditor's FRAUD HOTLINE
Call toll-free 1-800-222-4446, or e-mail lad@mt.gov.

Chapter I – Introduction

Introduction

We performed a financial audit of the Montana Board of Investments (board) for the fiscal year ended June 30, 2017. The audit was performed to comply with Article VIII, Section 13 of the Montana Constitution and §§17-6-321, 17-5-1529, and 17-5-1649, MCA. The objectives of the audit were to:

1. Obtain an understanding of the board's control systems to the extent necessary to support an audit of the board's financial statements, and, if appropriate, make recommendations for improvement in management and the internal controls of the board.
2. Determine whether the board's Consolidated Unified Investment Program financial statements present fairly the fiduciary net position and the changes in fiduciary net position of the program for the fiscal year ended June 30, 2017.
3. Determine whether the board's Enterprise Fund Program financial statements present fairly the net position, changes in net position, and cash flows of the program for the fiscal year ended June 30, 2017.
4. Determine compliance with selected state laws and regulations recognized to have a direct effect on the determination on material amounts and disclosures in the financial statements.

Our audit efforts over the board's Consolidated Unified Investment Program (UIP) focused primarily on cash and cash equivalent and investment balances, as well as purchases and sales by participants, net investment income, and income distributions to participants. We compared investment-related transactions recorded by the board to the reports of its custodial bank, which is charged with the safekeeping of the investment assets. In this role, the bank settles purchases and sales of securities, collects information regarding the assets and related income, and provides information and support to the board for its administration of the UIP. We also tested selected control systems related to the program.

During fiscal year 2017, the board made changes to the structure and financial reporting for the UIP. Specifically, the board transitioned pension investments from five investment pools to one, and adopted fiduciary fund financial reporting as the basis for the UIP financial statements. As a result of these changes, the UIP financial statements and related note disclosures presented in this report are different from what has been presented in prior years. As part of the audit, we reviewed the consolidation of the pension investments and evaluated the appropriateness of the board's financial statement format based on generally accepted accounting principles. See the Change in

Financial Reporting Format for the Consolidated Unified Investment Program section on page 4 for more information on the change in financial reporting.

Our audit efforts over the board's Enterprise Fund Program focused primarily on balances of cash and cash equivalents, investments, notes and loans receivable, and bonds payable, as well as financing income revenue. We analyzed the financial statements, examined the underlying transactions, and tested certain control systems and compliance with selected state laws related to the program.

Background

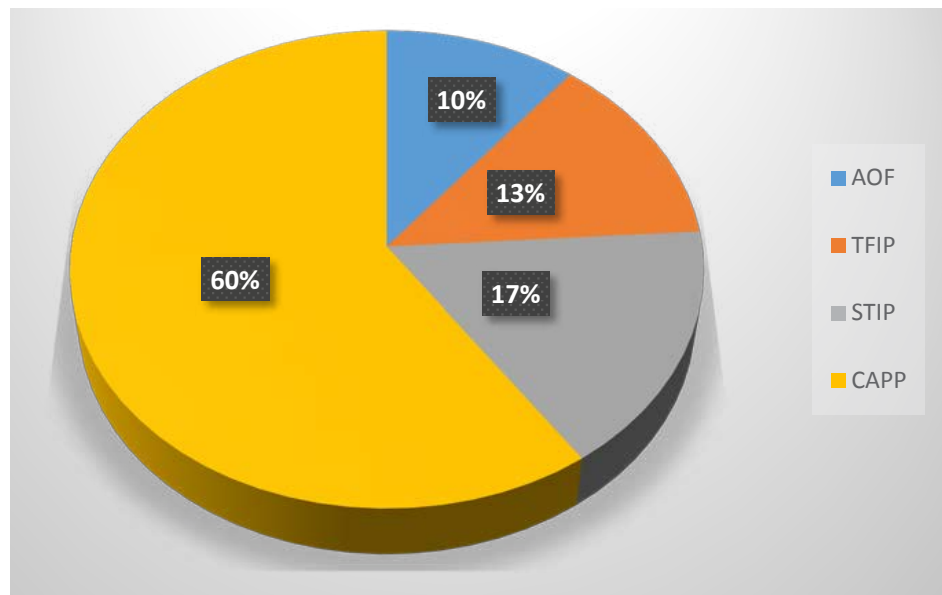
The board is allocated to the Department of Commerce for administrative purposes. The board employs an executive director and chief investment officer who in turn hire and manage staff. The staff members advise the board, implement board decisions, and perform daily investment, economic development, and record keeping functions.

To manage the UIP, the board has created investment pools that operate similar to mutual funds. The board establishes investment policies for these pools, that outline the investment strategy for the pools. The board's objectives for each of the pools, as well as information on pool participants, are presented below.

- ♦ **Short-Term Investment Pool (STIP):** The pool is designed to achieve a high level of investment income that is compatible with the preservation of principal, providing participants with liquidity with one-day notification. State agencies, the state's retirement systems, and local governments are eligible to participate in STIP.
- ♦ **Trust Fund Investment Pool (TFIP):** The pool is designed to provide participants exposure to a portfolio of diversified income-producing assets. State agencies and local governments meeting eligibility criteria may participate in TFIP.
- ♦ **Consolidated Asset Pension Pool (CAPP):** The pool is designed to achieve a high level of investment performance that is compatible with its risk tolerance and prudent investment practices. The board maintains a long-term perspective in formulating and implementing investment policies for the pool, and in evaluating investment performance within the pool. CAPP participants are limited to the state's retirement systems. CAPP was established in fiscal year 2017, by consolidating the five pools previously used to manage pension investments into a single pool.

In addition to these pools, the board manages direct investments in fixed income securities, equity index funds, and commercial loans for approximately 20 state agencies. These investments are reported collectively in the board's UIP financial statements as All Other Funds (AOF). Figure 1 and Table 1 (see page 3) present information on the investments managed in the pools and AOF at June 30, 2017.

Figure 1
Percent of Investments Managed by Pool and All Other Funds - June 30, 2017



Source: Compiled by the Legislative Audit Division based on board accounting records.

Table 1
Pool Investments by Type - June 30, 2017
 (in thousands)

	STIP*	TFIP*	CAPP	AOF
Cash and Cash Equivalents		\$ 814	\$ 241,709	
STIP		\$ 40,549	\$ 116,583	
Fixed Income Investments	\$2,814,397	\$2,084,984	\$ 2,545,529	\$1,404,906
Money Market Funds	\$ 172,219			
Domestic Equity Investments			\$ 3,873,072	
International Equity Investments			\$ 806,131	
Comingled Equity Index Funds			\$ 1,009,736	\$ 185,615
Direct Real Estate Holdings			\$ 18,723	
Mortgages and Loans			\$ 4,935	\$ 160,623
Private Equity Partnerships			\$ 1,209,376	
Core Real Estate Partnerships		\$ 200,691	\$ 341,077	\$ 107,000
Value Added and Opportunistic Real Estate Partnerships			\$ 395,511	
Timber Partnerships			\$ 104,714	
Total	\$2,986,616	\$2,327,038	\$10,667,096	\$ 1,858,144

Source: Compiled by the Legislative Audit Division based on board records.

*Some investments in STIP and TFIP meet the definition of cash and cash equivalents, but are presented by type of investment for greater detail.

The board also administers the state's Economic Development Bond Act (EDB) and Municipal Finance Consolidation Act (MFC) programs, which comprise the Enterprise Fund Program. Under the MFC Act, the board is authorized to issue up to \$190 million in bonds. The board's Intermediate Term Capital Program bonds, issued under the MFC, are used to provide loans to eligible Montana governments to finance capital expenditures for up to 15 years.

Under both the MFC and EDB Programs, the board also provides access to financing through issuance of conduit (no-commitment) debt. Assets and revenues of the borrower are pledged to repay the debt. Because the board has no obligation for this debt, these bond issues are not reflected on the board's Enterprise Fund Program financial statements but are disclosed in the notes.

The board publishes annual reports detailing UIP and Enterprise Fund Program activity for the year. These reports are available on the board's website or by contacting the board. Additionally, the board has made a portfolio listing for each of the UIP pools and AOF, as of June 30, 2017, available on its website. This listing is unaudited.

Change in Financial Reporting Format for the Consolidated Unified Investment Program

The Governmental Accounting Standards Board (GASB) defines generally accepted accounting principles (GAAP) for government financial reporting. This includes a framework, referred to as a hierarchy, which guides financial statement preparers in identifying accounting principles to use. The hierarchy identifies authoritative sources of accounting principles and provides parameters for use of nonauthoritative sources.

As allowed by the hierarchy, the board used guidance in the American Institute of Certified Public Accountants Investment Company Audit Guide (AICPA Audit Guide) as a basis for the type and content of the financial statements prepared for the Consolidated Unified Investment Program (UIP). In June 2016, the GASB modified the hierarchy by issuing Statement Number 76. The statement reduced the sources of authoritative GAAP, and provided greater guidance for governments to consider when an accounting treatment for specific transactions or events is not contained in an authoritative source. Under the new hierarchy, the AICPA Audit Guide was not classified as authoritative.

In response to this change, we revisited the appropriateness of using the AICPA Audit Guide as a basis for the board's UIP financial statements. Beginning with the fiscal year 2016 audit and continuing into the fiscal year 2017 audit, we performed research on which accounting principles constituted a GAAP presentation for the board's

UIP. Our research included reviewing authoritative sources of GAAP, performing a technical inquiry with staff of the GASB, and reviewing financial reporting of similar programs by other states.

Under GAAP, the board's TFIP and STIP are classified as external investment pools, given local governments are allowed to participate in the pools. The CAPP is classified as an internal investment pool, given only state agencies can participate in the pool. Based on our research, there is no authoritative source that directly prescribes a financial reporting format for presenting consolidated activity of internal and external investment pools in a stand-alone set of financial statements. In these situations, the hierarchy directs us to consider authoritative requirements for like situations or events before considering nonauthoritative sources.

Based on our research, there is authoritative guidance establishing a financial reporting format for internal investment pools, as well as guidance for presenting stand-alone financial statements for external investment pools. Under the hierarchy, this guidance has to be considered before the nonauthoritative guidance in the AICPA Audit guide is used. Because of this, we communicated to the board the need to consider authoritative guidance as a basis for the UIP financial statement presentation.

In response to this communication, board staff completed separate research and determined it was appropriate to adopt fiduciary fund financial reporting, as established in authoritative guidance, as the basis for the UIP financial statements. Fiduciary funds are used to report assets held in a trustee or agency capacity for others. Given the board has a trustee relationship with the state agencies and local governments for which it invests, we considered the board's position to be reasonable and supported.

Chapter II – Findings and Recommendations

Internal Controls Over Financial Reporting

The Board of Investment's internal controls were not effective in ensuring complete and accurate financial reporting for the Unified Investment and Enterprise Fund Programs, in accordance with generally accepted accounting principles, for fiscal year 2017.

The Montana Board of Investments (board) administers the state's Unified Investment Program (UIP), as well as the state's Economic Development Bonds Act (EDB) and Municipal Finance Consolidation Act (MFC) programs. The EDB and MFC programs are collectively referred to by the board, and throughout this report section, as the Enterprise Fund Program. The board is required to prepare separate financial statements and related note disclosures for the UIP and Enterprise Fund Program, in accordance with generally accepted accounting principles (GAAP).

As part of our audit, we reviewed the board's financial statements and note disclosures for the UIP and Enterprise Fund Program for fiscal year 2017, for completeness and accuracy. Our audit work identified multiple errors in the financial statements and notes, indicating internal controls were not effective in ensuring complete and accurate financial reporting in accordance with GAAP. We present more detail on some of the significant errors in the following sections.

UIP Financial Statement Presentation Errors

Our audit work over the financial statements for the UIP identified several errors in the board's compilation and presentation of data on the financial statements, including those outlined below.

- ♦ **Misclassification of Cash and Cash Equivalents**

Under GAAP, short-term, highly-liquid investments that are both readily convertible to known amounts of cash and so near their maturity they present insignificant risk of changes in value because of changes in interest rates, should be reported as a cash equivalent for financial reporting purposes. Several investments managed as part of the UIP met this definition of cash equivalents, but were instead reported as investments at fair value on the Statement of Fiduciary Net Position provided as part of the audit. In total, approximately \$1.68 billion of investments were misclassified.

- ◆ **Placement of Combining Statements**

Under GAAP, combining financial statements are considered to be Supplementary Information. This type of information is intended to provide additional information beyond what is in the financial statements and notes, and is not required to be included in financial reporting. If an entity chooses to present Supplementary Information, GAAP requires it to be placed after all required GAAP reporting elements, including the financial statements and note disclosures. The board incorrectly placed the combining financial statements before the note disclosures, instead of after, in the document provided as part of the audit.

- ◆ **Misstatements of Reported Amounts**

The board reports purchases and sales by participants on the Statement of Changes in Fiduciary Net Position. The reported amounts were determined, in part, by analysis of transactions recorded on the state's accounting system. The board's analysis did not consider some intricacies of the transactions recorded throughout the year, including transactions that recorded activity in less detail than was necessary to prepare the financial statements and transactions recorded to correct prior errors. As a result, the reported participant purchases and sales were overstated by approximately \$326.1 million. In addition to the errors on the board's financial statements, the board incorrectly recorded local government participant purchases and sales activity on the accounting records for the investment trust fund at Department of Commerce, overstating contribution and premium revenues and investment distribution expenditures by approximately \$48.6 million. We have referred this error to the Department of Commerce financial-compliance audit team, for their consideration of its impact on that audit (#17-16).

Additionally, the board reports the net increase (decrease) in fair value of investments on the Statement of Changes in Fiduciary Net Position. Actual realized gains or losses, based on investment sales throughout the year, are a component of this activity. The board's analysis of actual realized gains and losses counted the gains at both the pool and participant level, when only the pool gains should have been reported. As a result, the reported net increase in fair value of investments was overstated by approximately \$362.3 million. There was a corresponding overstatement in the distributions to participants reported on the financial statements.

We communicated these errors to the board as part of the audit, and the board made the necessary adjustments to the UIP financial statements to correct the errors. However, the \$48.6 million error on the Department of Commerce accounting records could

not be corrected, given the fiscal year 2017 accounting records were closed at the time the error was discovered.

Enterprise Fund Program Financial Statement Presentation Errors

In fiscal year 2016, the board authorized an approximate \$8.5 million Bond Anticipation Note (BAN) between the Enterprise Fund Program and the Coal Tax Trust Fund, to fund the Enterprise Fund Program's loan commitments in advance of a 2017 bond issuance for the program. During fiscal years 2016 and 2017, the Enterprise Fund Program received approximately \$1.2 million and \$7.3 million, respectively, in proceeds from the BAN. The program also repaid the Coal Tax Trust fund the entire \$8.5 million in BAN proceeds after it issued bonds in fiscal year 2017.

As part of the audit, we reviewed the financial statement presentation and disclosure of the BAN activity for fiscal year 2017, and identified the errors outlined below.

- ♦ **Errors on the Statement of Cash Flows**

Under GAAP, the cash inflows of \$7.3 million and outflows of \$8.5 million associated with the BAN should have been reported as two separate line items within the Non-capital Financing Activities section of the Statement of Cash Flows. Instead, the board reported the cash flows as a net outflow of \$1.2 million in the Investing Activities section.

- ♦ **Missing Note Disclosure**

Under GAAP, the notes to the financial statements should have disclosed information about the BAN debt activity during the year, including a schedule outlining the beginning balance, increases, decreases, and ending balance of the debt. This note disclosure was not included in the notes provided as part of the audit.

We communicated these errors to the board as part of the audit, and the board made the necessary financial statement and note disclosure adjustments to correct the errors.

Summary

State accounting policy requires management to establish internal control policies and procedures designed to ensure the accuracy and reliability of financial data, such as the financial statements and note disclosures. Board staff made the errors previously described during the financial statement preparation process, and the board's review procedures did not identify the errors. For the Enterprise Fund Program, established financial reporting processes did not direct staff to consider GAAP requirements for new or unusual activity for the program.

For the UIP, as outlined in Chapter I of this report, during fiscal year 2017, the board transitioned the state's pension assets from five investment pools to one. The board invested significant staff resources into this transition, given the nature of the transition and the magnitude of the assets involved. This pool transition, along with the adoption of fiduciary fund financial reporting outlined on page 4 of this report, occurred within the span of a few months and resulted in significant changes to the UIP financial statements. Due to these changes, the accounting staff who would normally perform an overall reasonableness and accuracy review of the financial statements were directly involved preparing the statements for fiscal year 2017. Had a separate review been performed by accounting staff not involved in preparing the statements, these errors could have been detected. To ensure the reasonableness of the financial statements in future years, the board should: update CUI financial statement preparation procedures to reflect the new pool structure and reporting format; and ensure the financial statements and notes are reviewed by staff knowledgeable with GAAP requirements and board operations, who were not directly involved in their preparation.

While the board adjusted its financial presentations for the errors and omissions identified, the board's internal control procedures should be enhanced to allow management to prevent, or detect and correct, such errors, ensuring accurate and complete financial reporting. Based on the nature and size of the errors identified, we consider there to be a material weakness in the board's internal controls over financial reporting.

RECOMMENDATION #1

We recommend the Montana Board of Investments:

- A. *Update the procedures for preparing and reviewing the Unified Investment Program financial statements, to reflect the current pool structure and reporting format, and to include an independent review by staff knowledgeable with program operations and generally accepted accounting principles.*
 - B. *Update the procedures for preparing the Enterprise Fund Program financial statements, to include review of requirements in generally accepted accounting principles for new program activity.*
-

**Independent Auditor's Report and
Consolidated Unified Investment
Program Financial Statements**

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors
Cindy Jorgenson
Joe Murray

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

Introduction

We have audited the accompanying Statement of Fiduciary Net Position of the Montana Board of Investment's (board) Unified Investment Program as of June 30, 2017, the related Statement of Changes in Fiduciary Net Position for the fiscal year then ended, and the related notes to the 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 board'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 board's internal control, and accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of

significant accounting estimates made by management, as well as the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana Board of Investment's Unified Investment Program as of June 30, 2017, and the changes in net fiduciary position for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As disclosed in Note 1 to the financial statements, the board changed the presentation format of the financial statements, to align with fiduciary fund reporting. As a result, the names and contents of the financial statements presented in this report are different than what has previously been presented. Our opinion is not modified with respect to this matter.

As disclosed in Note 1, the Montana Board of Investment's Unified Investment Program financial statements are intended to present the financial position and changes in financial position of only the portion of the financial reporting entity of the state of Montana that are attributed to the transactions of the Unified Investment Program. They do not purport to, and do not, present fairly the financial position of the state of Montana as of June 30, 2107, or the changes in its financial position for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As disclosed in Note 13 to the financial statements, in fiscal year 2017, the board transitioned its internal pool structure for pension investments from five individual investment pools to a single investment pool. Our opinion is not modified with respect to this matter.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Combining Statement of Fiduciary Net Position on Pages A-35 and A-36 and the Combining Statement of Changes in Fiduciary Net Position on Pages A-37 and A-38 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and

other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated January 8, 2018, on our consideration of the Montana Board of Investment'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 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 board's internal control over financial reporting and compliance.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

January 8, 2018

STATE OF MONTANA BOARD OF INVESTMENTS
UNIFIED INVESTMENT PROGRAM FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

STATEMENT OF FIDUCIARY NET POSITION	
AS OF JUNE 30, 2017	
(in thousands)	
Assets	
Cash/Cash equivalent - held within pools	\$ 2,079,932
Receivables	
Security lending income receivable	203
Broker receivable for securities sold but not settled	52,791
Dividend and interest receivable	44,563
Total receivables	97,557
Investments at fair value	15,601,831
Security lending cash collateral	119,811
Total assets	17,899,131
Liabilities	
Payables	
Broker payable for securities purchased but not settled	96,500
Income due participants	18,144
Other payable	2,290
Security lending expense payable	83
Administrative fee payable	3,661
Security lending obligations	119,811
STIP reserve	24,235
Total liabilities	264,724
Net position held in trust for pool/AOF participants	\$ 17,634,407
The accompanying notes are an integral part of these financial statements.	

STATE OF MONTANA BOARD OF INVESTMENTS
UNIFIED INVESTMENT PROGRAM FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

STATEMENT OF CHANGES IN FIDUCIARY NET POSITION FOR FISCAL YEAR ENDING JUNE 30, 2017 (in thousands)	
Additions	
Purchases by participants	\$ 7,170,844
Net investment earnings	
Investment earnings:	
Net increase (decrease) on fair value of investments	993,590
Dividend/interest income	331,508
Other investment income	7,794
STIP reserve expense	<u>(11,092)</u>
Investment earnings	<u>1,321,800</u>
Administrative expenses	(52,007)
Other investment expenses	<u>(7,835)</u>
Net investment earnings	<u>1,261,958</u>
Security lending income	4,604
Security lending expense	<u>(1,830)</u>
Total additions	<u>8,435,576</u>
Deductions	
Sales by participants	7,283,888
Income distributions to participants	<u>255,771</u>
Total deductions	<u>7,539,659</u>
Change in net position	<u>895,917</u>
Net position held in trust for pool/AOF participants - beginning of year	<u>16,738,490</u>
Net position held in trust for pool/AOF participants - end of year	<u><u>\$ 17,634,407</u></u>
The accompanying notes are an integral part of these financial statements.	

STATE OF MONTANA BOARD OF INVESTMENTS
UNIFIED INVESTMENT PROGRAM FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

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NOTES TO FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

1. HISTORY AND ORGANIZATION

The Board was created by the Legislature to manage the Unified Investment Program established by the State Constitution. The Investment Program is comprised of state funds, including pensions, trusts, insurance, and cash. Local government entities can, by statute, only voluntarily invest in the Short-Term Investment Pool. With a qualifying event, local government entities may also by statute invest in the long-term investment portion of the Program. The Board manages the Investment Program pursuant to the "Prudent Expert Principle" mandated by State law, which requires an investment manager to:

- (a) discharge the duties with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent person acting in a like capacity with the same resources and familiar with like matters exercises in the conduct of an enterprise of a like character with like aims;
- (b) diversify the holdings of each fund within the unified investment program to minimize the risk of loss and to maximize the rate of return unless, under the circumstances, it is clearly prudent not to do so; and
- (c) discharge the duties solely in the interest of and for the benefit of the funds forming the unified investment program.

The Board is not registered with the US Securities and Exchange Commission as an investment company. The Board's Investment Program is governed by Investment Policy Statements (IPS) approved by the Board.

To facilitate management of the Investment program, the Board uses a combination of investment pools and specific accounts to meet the financial goals and expectations of the agencies and entities which entrust these funds to the Board. The investment activity reported within these financial statements become part of the governmental, proprietary and fiduciary fund categories of the State of Montana's Comprehensive Annual Financial Report.

The Pools, AOF Investments Managed, Pool creation date and eligible state participants are shown in the following table as of June 30, 2017.

Pool / Investments Managed Name	Creation Date	Eligible Participants
Consolidated Asset Pension Pool (CAPP)	03/31/2017	Nine Retirement Funds Only
Trust Funds Investment Pool (TFIP)	10/01/1995	Various State Trust Funds
Short-Term Investment Pool (STIP)	07/01/1974	All State Funds/Local Governments
All Other Funds (AOF) Investments Managed	N/A	Non-Pool State Agency Investments

Prior to November 2016, the asset allocation for the pension-only funds focused on five pools: the Montana Domestic Equity Pool, Montana International Equity Pool, Retirement Funds Bonds Pool, Montana Private Equity Pool, and the Montana Real Estate Pool. The only participants within these pools were the pension systems. In November 2016, upon recommendation from the Chief Investment Officer, the Board approved that the pension asset allocation was to focus on 13 asset classes versus the five pension only pools. On March 31, 2017, the Board converted the five pension only pools into a single "Consolidated Asset Pension Pool", with 13 underlying asset classes, to align the Board's accounting and performance structure with the more detailed asset allocation as formally approved in November 2016 by the Board. CAPP's underlying asset classes are as follows:

STATE OF MONTANA BOARD OF INVESTMENTS
UNIFIED INVESTMENT PROGRAM FINANCIAL STATEMENT
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Domestic Equity	Broad Fixed Income
International Equity	US Treasury / Agency
Private Equity	Investment Grade
Natural Resources	Mortgage Backed Securities
Real Estate	High Yield
TIPS (US Treasury Inflation-Protected Securities)	Cash
Diversified Strategies (not funded as of June 30, 2017)	

These financial statements present only the activity of the Unified Investment Program as managed by the Board. The financial statements do not present the financial position or the results of operations of the Board. The financial information pertaining to the operations of the Board can be found in the Investment Division internal service fund contained within the State of Montana's Comprehensive Annual Financial Report (CAFR) and in the Enterprise fund financial statements contained within this report. The State of Montana's CAFR is available from the Montana Department of Administration's State Financial Services Division website <http://sfsd.mt.gov/SAB/cafr>; at Room 255 Mitchell Building, 125 North Roberts Street, PO Box 200102, Helena, MT 59620-0102 or at 406-444-3092.

These financial statements include the activity for State Fund within AOF on a June 30th basis. State Fund, a discretely presented component unit of the State of Montana, by statute prepares separately issued financial statements on a calendar year basis.

Beginning with the period ending June 30, 2017, single-year financial statements were prepared. In past years, comparative financial statements were prepared. GASB does not require comparative statements and thus the Board changed to a single-year presentation as part of the Board's continual effort to look at ways to increase the efficiency of financial statement preparation. The presentation format of the financial statements was changed to align with a Fiduciary Investment Trust presentation. These changes do not result in a restatement of beginning net position for the period ending June 30, 2017.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

New Accounting Guidance Implemented -

GASB Statement 77 – Tax Abatement Disclosures establishes financial reporting disclosure standards for tax abatement agreements entered into by state and local governments.

A. Basis of Accounting

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting.

B. Valuation and Timing

Investments are reported at fair value on a trade date basis. Quoted market prices, when available, have been used to value investments. The fair values for securities that have no quoted market prices represent estimated fair value. Alternative investment securities are valued using the most recent estimates of fair value from the investment manager.

The net change in fair value of investments consists of the realized gains or losses and the unrealized increase or decrease in fair value of investments during the year. Realized gains and losses on sales of investments are computed based on the difference between the sales price and the original cost of the investment sold. Unrealized gains and losses are computed based on changes in the fair value of investments between years. Interest income is recognized

STATE OF MONTANA BOARD OF INVESTMENTS
UNIFIED INVESTMENT PROGRAM FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

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when earned. Dividend income is recorded on the ex-dividend date. Income due participants is recorded on the date due to participants.

Included in the Pool and Investments Managed assets are the value of the investment portfolios, cash, receivables for securities sold but not yet settled, and dividend/interest receivables. Included in the liabilities are payables for securities purchased but not yet settled, income due participants, and other miscellaneous payables.

Currency exposures may be hedged, in a defensive manner, at the discretion of the active managers to preserve the US dollar value of investments made. The managers are not allowed to engage in currency speculation.

C. Investment Portfolio Value

The portfolios are shown in the Statement of Net Position at fair value. CAPP and TFIP also participate in STIP. For consolidation purposes, CAPP's and TFIP's participation in STIP is eliminated. The All Other Funds (AOF) Investments Managed represent direct investments by approximately 20 state agencies in a combination of either fixed income securities, equity index funds, residential mortgages or commercial loans. The book value and fair value and AOF Investments managed are shown in the following table as of June 30th:

Investment Portfolio Value (in thousands)				
<u>Pool</u>	<u>Book Value*</u>	<u>Fair Value*</u>	<u>Units Outstanding</u>	<u>Unit Value**</u>
Consolidated Pension Asset Pool (CAPP)	\$ 9,665,249	\$ 10,667,096	\$ 103,214	\$ 103.058787
Trust Funds Investment Pool (TFIP)	2,217,207	2,327,039	21,812	107.016814
All Other Funds (AOF) Investments Managed	1,718,111	1,858,144	n/a	n/a
STIP included in investment pools	(157,105)	(157,132)	n/a	n/a
Total	<u>13,443,462</u>	<u>14,695,147</u>		
Short Term Investment Pool (STIP)	<u>2,986,127</u>	<u>2,986,616</u>	<u>2,961,499</u>	<u>1.000165</u>
Total investments managed	<u>\$ 16,429,589</u>	<u>\$ 17,681,763</u>		
* Includes cash/cash equivalents and investments.				
**Not in thousands				

For further detail for each individual Pool and AOF statements, see the Supplementary Information Section. Both TFIP and STIP have local government participants (external) and state agency participants (internal).

D. Income Distributions to Participants

TFIP and AOF distributable income reported in the Statement of Changes in Fiduciary Net Position includes accrued interest, miscellaneous income, and amortization/accretion of discount/premium. STIP income is comprised of accrued interest and amortization of discount. On the first working day of each month, the TFIP and STIP income due participants balance is distributed. On settlement date, AOF portfolio receives gains/losses. The CAPP pool retains all income, including interest, dividend and realized gains/losses on the sale of pool securities. Since March 31st, the cashflow needs for CAPP participants was met through the sale of CAPP participant units. Though February, income

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was distributed to the pension participants for the pension only pools. This distributed income included interest, amortization/accretion of discount/premium, dividends and other income.

E. Investment Expenses

The Legislature sets the maximum management fee the Board may charge the accounts it manages. The maximum fee is set at the aggregate level at the beginning of each fiscal year. The Board allocates the aggregate fees across the Pools and AOF investments managed outside the Pools. Custodial bank fees are paid by a statutory appropriation from the state general fund. The Board allocates custodial bank fees across the Pools and accounts invested outside the Pools and deposits the funds required to pay the fee in the general fund. The State Treasurer then pays the monthly custodial bank fees from the general fund. External manager fees are paid directly from the accounts they manage. Investment expenses charged to each Pool and the AOF investments are shown in the following table:

Total Fiscal Year 2017 Investment Expenses (in thousands)					
<u>Pool</u>	<u>Board</u>	<u>Custodial Bank</u>	<u>External Managers</u>	<u>Total</u>	<u>Investment Expense Ratio</u>
Consolidated Pension Asset Pool (CAPP)	\$ 4,094	\$ 1,239	\$ 41,665	\$ 46,998	0.44%
Trust Funds Investment Pool (TFIP)	545	121	1,846	2,512	0.11%
Short Term Investment Pool (STIP)	667	247	-	914	0.05%
All Other Funds (AOF) Investments Managed	<u>782</u>	<u>130</u>	<u>671</u>	<u>1,583</u>	<u>0.09%</u>
Total	<u>\$ 6,088</u>	<u>\$ 1,737</u>	<u>\$ 44,182</u>	<u>\$ 52,007</u>	<u>0.29%</u>

F. Cash/Cash Equivalents

Cash/cash equivalents generally, are short-term, highly liquid investments with maturities of three months or less at time of purchase. CAPP, TFIP and STIP hold cash/cash equivalents that are measured at cost. STIP also holds cash/cash equivalents at fair value.

G. Investment Earnings

Investment earnings items are recognized when earned. Net increase (decrease) on fair value of investments includes net realized and unrealized gain (loss) on investments and amortization/accretion. The net realized gain/(loss) is based on the sale of investments managed as compared to the reported cost of the investment. The net unrealized gain/(loss) is the change in market value on investments held at fiscal year-end.

STATE OF MONTANA BOARD OF INVESTMENTS
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Total Fiscal Year 2017 Net Increase (Decrease) on Fair Value of Investments (in thousands)				
<u>Pool</u>	<u>Net realized gain (loss)</u>	<u>Net unrealized gain (loss)</u>	<u>Amortization- accretion</u>	<u>Total</u>
Consolidated Pension Asset Pool (CAPP)	1,728,601	(683,372)	(825)	1,044,404
Trust Funds Investment Pool (TFIP)	15,213	(73,393)	(256)	(58,436)
Short Term Investment Pool (STIP)	-	(93)	10,721	10,628
All Other Funds (AOF) Investments Managed	12,889	(17,107)	1,220	(2,998)
STIP included in investment pools*	-	(8)	-	(8)
Total	<u>\$ 1,756,703</u>	<u>\$ (773,973)</u>	<u>\$ 10,860</u>	<u>\$ 993,590</u>

3. INVESTMENT COMMITMENTS

Investments in alternative equity are usually made via Limited Partnership Agreements that involve many limited partners and a General Partner who is responsible for all investment decisions. The Limited Partners make an original commitment, after which capital is called as needed by the General Partner to make investments. These Agreements will usually last for a minimum of 10 years. The following table shows the remaining Board commitments to CAPP alternative equity managers by pension asset class.

Commitments to Fund Managers as of June 30, 2017 (in thousands)				
<u>Pension Asset Class</u>	<u>Original Commitment</u>	<u>Commitment Remaining</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Private Equity PAC	\$ 2,185,722	\$ 671,170	\$ 891,879	\$ 986,638
Real Estate PAC	668,666	157,235	290,610	309,092
Natural Resource PAC	325,000	94,780	180,098	213,117
Total	<u>\$ 3,179,388</u>	<u>\$ 923,185</u>	<u>\$ 1,362,587</u>	<u>\$ 1,508,847</u>

4. TYPES OF INVESTMENTS

A. Pool Participant Units

Pool units are purchased and sold similar to individuals investing in mutual funds. The STIP participants purchase and sell units, at \$1 per unit, at the participant discretion. CAPP and TFIP units and AOF direct investments are purchased and sold at the discretion of Board investment staff based on asset allocations and Investment Policy Statements (IPS) approved by the Board. Individual investments in the pools are not specifically identified to the respective participants. Gains/losses on the sale of CAPP and TFIP participant units are reflected at the participant level. AOF Investments Managed is not an investment Pool, therefore there is no Units Outstanding or a Unit Value calculated.

STATE OF MONTANA BOARD OF INVESTMENTS
UNIFIED INVESTMENT PROGRAM FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

B. Allowed Investments

State agencies and local government entities may participate in one or more Pools. By investing in Pools, participants are provided broad diversification. State agencies may also have direct fixed income, equity or loan investments. These investments are combined and reported as All Other Funds (AOF). Currently, only the nine retirement funds through participation in CAPP and the Montana State Fund (Workers' Compensation) may invest in public corporate capital stock. Neither State law nor the State Constitution place restrictions on retirement fund investments. The Board approves a separate IPS for each pool and AOF participant, which provides board staff a broad strategic framework under which the investments are managed. The IPS's also reflect Board approved asset allocation ranges.

C. CAPP

Invests directly in the underlying Pension Asset Classes (PAC) on behalf of the nine retirement systems within the Board-approved asset allocation ranges. Each PAC has an underlying set of investment objectives and investment guidelines. For liquidity purposes, each PAC and external manager has a limited amount of cash/cash equivalents. With the PAC, it is invested in the State Street Short Term Investment Fund (STIF), which invests in high quality short-term securities. For external managers, it is invested per Board established guidelines.

Domestic Equity PAC – Invests primarily in US traded equity securities such as common stock. The type of portfolio structures utilized are separately managed accounts, commingled accounts, and exchange traded funds.

International Equity PAC - Invests primarily in international equity securities that trade on foreign exchanges in developed and emerging markets. The type of portfolio structures utilized are separately managed accounts, commingled accounts, and exchange traded funds.

Private Equity PAC - Invests in the entire capital structure of private companies. Investments are made via Limited Partnerships managed by a General Partner. The Limited Partnerships typically have well-defined strategies such as buyout, venture, or distressed debt. Private Equity investments are less liquid than other Asset Classes because the funds require a long holding period. Exchange traded funds are utilized to minimize the cash position.

Real Estate PAC - Invests primarily in real estate properties. Transactions are privately negotiated by a General Partner via a Limited Partnership or an open-end fund. The funds typically have well-defined strategies such as core, value-add, or opportunistic. Private Real Estate investments are less liquid than other Asset Classes because the funds require a long holding period. Exchange traded funds are utilized to minimize the cash position.

Natural Resource PAC - Invests primarily in energy and timber investments, but could include agriculture, water or commodity related funds. The investments are made via Limited Partnerships managed by a General Partner, and the funds are less liquid than other Asset Classes because they require a long holding period. Potential investment vehicles could include open-end funds, master limited partnerships and exchange traded funds.

Intermediate Treasury Inflation Protected Securities (TIPS) PAC - Invests primarily in intermediate U.S. TIPS or Treasury securities that are indexed to inflation.

Intermediate U.S. Treasury/Agency PAC - Invests primarily in debt obligations of the U.S. government including its agencies and instrumentalities.

STATE OF MONTANA BOARD OF INVESTMENTS
UNIFIED INVESTMENT PROGRAM FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

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Broad Fixed Income PAC - Invests primarily in core fixed income securities as represented in the Bloomberg Barclays U.S. Aggregate Bond Index. The type of portfolio structures utilized are separately managed accounts, commingled accounts, and potentially exchange traded funds.

Intermediate Investment Grade PAC - Invests primarily in intermediate investment grade corporate bonds typically found in the Bloomberg Barclays U.S. Corporate Bond Index. It includes U.S. dollar denominated securities publicly issued by U.S. and non-U.S. industrial, utility, and financial issuers.

Mortgage Backed Securities PAC - Invests primarily in agency mortgage backed securities, asset backed securities and commercial mortgage backed securities.

High Yield PAC - Invests primarily in U.S. dollar denominated corporate bonds that are classified as high yield according to the major ratings agencies such as S&P, Moody's or Fitch. The type of portfolio structures utilized are separately managed accounts and potentially commingled accounts or exchange traded funds.

Cash PAC - Invests primarily in highly liquid, money-market type securities via STIP.

Diversified Strategies PAC – This asset class was approved by the Board in regard to asset allocation in November 2016. This asset class was not funded as of June 30, 2017. Prior to funding, the Chief Investment Officer will propose the PAC Investment Objectives and Guidelines for approval by the Board.

D. TFIP

Invests primarily in investment grade, U.S. dollar denominated fixed income securities. The portfolio has high yield and core real estate exposure.

E. AOF

Invests primarily in investment grade, US dollar denominated fixed income securities. The portfolio has exposure to core real estate. The AOF portfolio includes Veteran's Home Loan residential mortgages and commercial loans.

The AOF Montana loans receivable represent commercial loans funded from the Coal Severance Tax Trust Fund by the Board and Montana Facility Finance Authority. The Veteran's Home Loan residential mortgages are also funded from the Coal Severance Tax Trust Fund. The Coal Severance Tax Trust loan portfolio also includes loans made by the Montana Science and Technology Alliance (MSTA) Board. The MSTTA Board was abolished on July 1, 1999 and the MSTTA portfolio was assigned to the Board. There are no uncollectible account balances for Montana mortgages and loans receivable as of June 30, 2017. Refer to Note 10 – AOF Montana Mortgages and Loans footnote for further detail.

F. STIP

Invests primarily in short-term, high quality, fixed income securities with a maximum maturity of 397 or less. Variable securities shall have a maximum maturity of 2 years. STIP shall maintain a dollar-weighted average portfolio maturity of 60 days or less. This Pool is managed to preserve principal while providing 24-hour liquidity for state agency and local government participants.

5. SECURITIES LENDING

As of October 2016, STIP was no longer participating in the security lending program. STIP did not have securities on loan as of June 30th. Security lending income and expense entries were recorded through October 2016.

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The Board 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 Board'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 June 30th, 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 Board and the Bank split the earnings, 80/20% respectively, on security lending activities. The Board retains all rights and risks of ownership during the loan period. State Street Indemnifies the Board's credit risk exposure to the borrowers.

During fiscal year 2017, the Bank loaned the Board'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 Board imposed no restrictions on the amount of securities available to lend during fiscal year 2017. 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 fiscal year 2017 resulting from a borrower default. As of June 30th, no securities were recalled and not yet returned.

The cash collateral received for each loan was invested, together with the cash collateral of other qualified plan lenders, in two investment funds, the Quality D Short Term Investment Fund and the Security Lending Quality Trust. Pension funds participated in the Quality D Short Term Investment Fund and non-pension entities participated in the Security Lending Quality Trust. During March 2017, participation in both funds was transitioned into the Navigator Securities Lending Government Money Market portfolio.

The Board and the borrowers maintain the right to terminate all securities lending transactions on notice. Because the securities lending transactions were terminable at will, their duration did not generally match the duration of the investments made with the cash collateral received from the borrower. The average duration was 8 days and the average weighted final maturity was 49 days within the Navigator portfolio.

<u>Pool/AOF</u>	Securities on Loan and Pledged Collateral (in thousands) June 30, 2017				
	Fair Value	Collateral	Collateral	Collateral	% of
	<u>On Loan</u>	<u>Cash</u>	<u>Securities</u>	<u>Total</u>	<u>Fair Value</u>
Consolidated Asset Pension Pool (CAPP)					
Domestic	\$ 343,419	\$ 46,726	\$ 303,253	\$ 349,979	102%
International	38,339	15,509	24,813	40,322	105%
Trust Funds Investment Pool (TFIP)	233,645	18,320	220,117	238,437	102%
Short Term Investment Pool (STIP)	-	-	-	-	0%
AOF Investments Managed	<u>143,297</u>	<u>39,256</u>	<u>107,007</u>	<u>146,263</u>	<u>102%</u>
Total	<u>\$ 758,700</u>	<u>\$ 119,811</u>	<u>\$ 655,190</u>	<u>\$ 775,001</u>	

STATE OF MONTANA BOARD OF INVESTMENTS
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Security Lending Income and Expenses Fiscal Year 2017 (in thousands)				
<u>Pool/AOF</u>	<u>Gross Income</u>	<u>Other Income</u>	<u>Expenses</u>	<u>Net Income</u>
Consolidated Asset Pension Pool (CAPP)	\$ 3,131	\$ -	\$ (1,232)	\$ 1,899
Trust Funds Investment Pool (TFIP)	746	9	(284)	471
Short Term Investment Pool (STIP)	70	-	(32)	38
AOF Investments Managed	639	9	(282)	366
Total	<u>\$ 4,586</u>	<u>\$ 18</u>	<u>\$ (1,830)</u>	<u>\$ 2,774</u>

6. INVESTMENT RISK DISCLOSURES AND DERIVATIVES

A. Custodial Credit Risk

Custodial credit risk is the risk that, in the event of the failure of the counterparty to a transaction, the Board will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. Per policy, the Board'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).

Cash— 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 Board or its accounts. As of June 30th, the Board recorded cash of \$2.0 million.

Investments - As of June 30th, 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 Board's custodial bank, State Street Bank. The Equity Index funds, securities held at the State's Depository bank real estate, mortgage and loan investments were purchased and recorded in the Board's name. Commingled fund investments are registered in the name of the Montana Board of Investments.

B. 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. Concentration risk was within the policies as set by the board.

CAPP – The CAPP IPS contains prescribed asset allocation ranges among the allowable asset classes and is subject to change as modifications are adopted by the Board. The Board will formally affirm or revise the asset allocation ranges for the Retirement Plans annually. The CAPP IPS contains investment objectives and guidelines for each underlying asset class, with a purpose of providing diversified exposure within the asset class in a prudent and cost-effective manner. Within the objective and guidelines for each underlying asset class, limits are placed on the allowable types of investments and the allowable ranges.

TFIP - The TFIP IPS provides for 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.

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STIP – The STIP IPS limits concentration of credit risk exposure by limiting portfolio investment types to 3% in any issuer with the exception of US Treasury and US Agency securities as well as any repurchase agreements with a financial institution.

AOF – Concentration of credit risk is contemplated by investment staff for each portfolio. Exposure to individual securities are limited with the exception of debt obligations of the US Government, including its agencies and instrumentalities.

C. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. Except for U.S. Government securities, the pools' fixed income instruments have credit risk as measured by Nationally Recognized Statistical Rating Organizations (NRSRO). Credit risk is contemplated for each individual portfolio in the IPS. Credit risk is managed by constraining portfolio purchases around investment grade NRSRO ratings as appropriate.

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 and do not require disclosure of credit quality per GASB Statement No. 40.

D. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Board uses effective duration as a measure of interest rate risk for all fixed income portfolios. The Board approves both the IPS and benchmark used for each portfolio. Per the CAPP IPS, the TIPS PAC, US Treasury/Agency PAC, Investment Grade Credit PAC and Agency Mortgage-Backed PAC average duration will be maintained in a range within 20% of the benchmark duration. The Broad Fixed Income PAC and High Yield PAC average duration will be maintained in a range within 25% of the index duration. Per the TFIP IPS, the average duration will be maintained in a range within 20% of the benchmark duration. Interest rate risk for AOF is contemplated in each individual IPS and is managed by limiting the maturity of individual securities and/or matching liabilities to maturities per estimated cash flows.

Per the STIP IPS "the STIP portfolio will minimize interest rate risk by:

- 1) structuring the investment portfolio so securities mature to meet cash requirements for ongoing operations thereby normally avoiding the need to sell securities on the open market prior to maturity;
- 2) maintaining a dollar-weighted average portfolio maturity (WAM) of 60 days or less (for this purpose, the date to the next coupon reset date will be used for all floating or variable rate securities; and
- 3) STIP will maintain a reserve account."

CAPP, TFIP, AOF, and STIP may hold fixed and variable rate securities. Interest payments on variable securities are based on an underlying reference rate, e.g., LIBOR.

CAPP, TFIP and AOF investments are categorized to disclose credit and interest rate risk on the following tables. Credit risk is disclosed using the weighted credit quality rating by investment type. Interest rate risk is disclosed using weighted 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. The S&P rating service provide the credit ratings presented in the following tables. If an S&P rating is not available, an equivalent NRSRO rating is used.

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CAPP Credit Quality Rating and Effective Duration as of June 30, 2017 (in thousands)			
<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating (1)</u>	<u>Effective Duration (1)</u>
Treasuries	\$ 1,060,925	AA+	4.55
Agency/Government Related	125,562	AAA	5.01
Asset Backed Securities	41,968	AA+	2.20
Mortgage Backed Securities	458,851	AAA	4.09
Commercial Mortgage Backed Securities	87,168	AAA	3.76
Financial-Corporate	271,663	BBB+	3.71
Industrial-Corporate	478,729	BBB	4.45
Utility-Corporate	20,663	BBB	3.43
Short Term Investment Pool (STIP)	116,583	NR	0.11
State Street Short Term Investment Fund (STIF)	<u>239,879</u>	<u>NR</u>	<u>0.07</u>
Total Fixed Income Investments at Fair Value	<u>\$ 2,901,991</u>	AA-	3.99
<u>Other investments not requiring credit quality ratings</u>			
Montana Mortgages	4,935		
Domestic Equity Asset Class	3,884,160		
International Equity Asset Class	1,844,346		
Private Equity Asset Class	1,140,205		
Natural Resources Asset Class	221,211		
Real Estate Asset Class	823,538		
Other-cash in portfolios	68		
Less STIF in above Asset Classes	<u>(153,358)</u>		
Total investments not requiring credit quality ratings	<u>7,765,105</u>		
Total investments managed (2)	<u>\$ 10,667,096</u>		
Securities Lending Collateral Investment Pool	<u>\$ 62,235</u>	NR	0.02
1) Credit Quality Rating and Effective Duration are weighted.			
2) Includes \$241,709 of Cash and Cash Equivalents at cost.			

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TFIP Credit Quality Rating and Effective Duration as of June 30, 2017 (in thousands)			
<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating (1)</u>	<u>Effective Duration (1)</u>
Treasuries	\$ 526,628	AA+	7.74
Agency/Government Related	153,351	AA+	6.24
Asset Backed Securities	76,743	AAA	1.88
Mortgage Backed Securities	439,241	AAA	4.45
Commercial Mortgage Backed Securities	130,417	AAA	4.95
Financial-Corporate	205,010	BBB+	4.54
Industrial-Corporate	419,642	A	6.25
Utility-Corporate	28,313	BBB	6.99
Short Term Investment Pool (STIP)	40,549	NR	0.11
High Yield Bond Fund	<u>105,639</u>	<u>B+</u>	<u>3.69</u>
Total fixed income investments	<u>2,125,533</u>	AA-	5.82
<u>Other investments not requiring credit quality ratings.</u>			
Core Real Estate	200,691		
Cash/Cash Equivalent (2)	<u>814</u>		
Total investments not requiring credit quality ratings	<u>201,505</u>		
Total investments managed	<u>\$ 2,327,038</u>		
Securities Lending Collateral Investment Pool	<u>\$ 18,321</u>	NR	0.02
1) Credit Quality Rating and Effective Duration are weighted.			
2) Reported at cost			

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AOF Credit Quality Rating and Effective Duration as of June 30, 2017 (in thousands)				
<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating (1)</u>	<u>Effective Duration (1)</u>	
Treasuries	\$ 322,615	AA+	3.72	
Agency/Government Related	335,978	AAA	3.21	
Asset Backed Securities	54,962	AAA	1.87	
Mortgage Backed Securities	15,900	AAA	6.62	
Commercial Mortgage Backed Securities	15,204	AAA	5.11	
Financial-Corporate	307,928	A-	2.80	
Industrial-Corporate	319,692	A	4.47	
Utility-Corporate	<u>32,625</u>	BBB+	2.90	
Total Fixed Income Investments	<u>\$ 1,404,904</u>	AA-	3.52	
<u>Direct Investments</u>				
Equity Index Fund-Domestic	\$ 146,666			
Equity Index Fund-International	37,766			
Equity Index Fund-US Debt	<u>1,183</u>			
Total Equity Index Funds	185,615			
Core Real Estate	107,001			
MT Mortgages and Loans (2)	<u>160,624</u>			
Total Direct Investments	<u>\$ 453,240</u>			
Total Investment Managed	<u>\$ 1,858,144</u>			
Securities Lending Collateral Investment Pool	<u>\$ 39,256</u>	NR	0.02	
1) Credit Quality Rating and Effective Duration are weighted.				
2) Reported at cost				

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STIP investments are categorized to disclose credit risk and weighted average maturity (WAM). Credit risk reflects the weighted security quality rating by investment type as of the June 30 report date. If a security investment type is unrated, the quality type is indicated by NR (not rated). Although the STIP investments have been rated by investment security type, STIP, as an external investment pool, has not been rated. The short-term credit ratings as provided by S&P's rating services. An A1+ rating is the highest short-term rating by the S&P rating service. STIP interest rate risk is determined using the WAM method. The WAM measure expresses investment time horizons – the time when investments are due or reset and payable in days, months or years – weighted to reflect the dollar size of the individual investments within an investment type. The WAM, calculated in days, for the STIP portfolio is shown on the following table.

STIP Credit Quality Ratings and Weighted Average Maturity as of June 30, 2017 (in thousands)			
<u>Security Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating (1)</u>	<u>WAM in Days</u>
Treasuries	\$ 124,774	A-1+	80
Asset Backed Commercial Paper	1,089,830	A-1	25
Corporate Commercial Paper	356,122	A-1	63
Corporate Notes	369,751	A-1+	78
Certificates of Deposit	484,113	A-1+	35
U.S. Government Agency	389,807	A-1+	24
Money Market Funds (Unrated) (2)	24,219	NR	1
Money Market Funds (Rated) (2)	<u>148,000</u>	<u>A-1+</u>	<u>1</u>
Total Investments Managed	<u>\$ 2,986,616</u>	A-1	39
1) Credit Quality Rating is weighted.			
2) Reported at cost			

E. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates that will adversely affect the fair value of an investment. CAPP is the only IPS that allows for investments that can be held in non-US securities in a foreign currency. Per the CAPP IPS, the Investment Grade Credit Asset Class, Agency Mortgage Backed Securities Asset Class, and High Yield Asset Class sections have maximum restrictions that can be held. As of June 30, 2017, there was no receivable or payable balances pertaining to foreign currency forward contracts.

The Boards' foreign currency exposure by deposits and investment type are reported, in U. S. dollars, at fair value in the following tables excluding the foreign investments denominated in U. S. dollars for the American Depositary Receipts (ADRs), sovereign debt and commingled index funds.

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Foreign Currency Exposure by Country Investment Type in U.S. Dollar Equivalent (in thousands) June 30, 2017				
Foreign Currency Denomination	Currency	Equities	Private Equity	Real Estate
Australian Dollar	\$ 1	\$ 18,122	\$ -	\$ -
Brazilian Real	39	14,682	-	-
Canadian Dollar	54	38,382	-	-
Danish Krone	1	11,684	-	-
EMU-Euro	37	117,307	26,700	4,513
Hong Kong Dollar	6	23,646	-	-
Indonesian Rupiah	2	551	-	-
Japanese Yen	289	81,919	-	-
Malaysian Ringgit	28	1,720	-	-
Mexican Peso	-	1,256	-	-
New Zealand Dollar	2	831	-	-
New Israeli Sheqel	19	3,896	-	-
Norwegian Krone	7	7,503	-	-
Philippine Peso	12	1,504	-	-
Polish Zloty	21	2,625	-	-
Singapore Dollar	21	8,014	-	-
South African Rand	30	10,892	-	-
South Korean Won	69	21,941	-	-
Swedish Krona	5	21,275	-	-
Swiss Franc	1	27,137	-	-
New Taiwan Dollar	0	12,359	-	-
Thailand Baht	3	5,168	-	-
Turkish Lira	14	8,632	-	-
UK Pound Sterling	134	75,014	-	-
Yuan Renminbi	-	2,508	-	-
Total	\$ 795	\$ 518,568	\$ 26,700	\$ 4,513

F. Other

The Federal National Mortgage Association and Federal Home Loan Mortgage Corp. remain in conservatorship from September 7, 2008.

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

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G. Derivatives

The fair value balances and notional amounts of CAPP derivative instruments outstanding as of June 30th, classified by type, are as follows:

List of Derivatives Aggregated by Investment Type (in thousands)		June 30, 2017	
<u>Investment Derivatives</u>	<u>Classification</u>	<u>Fair Value Amount</u>	<u>Notional</u>
Credit default swaps	Swaps	\$ -	\$ -
Currency forward contracts	Long term debt/equity	-	-
Index futures long	Futures	-	3
Rights	Equity	31	39
Warrants	Equity	-	-
Total derivatives		<u>\$ 31</u>	
<u>Investment Derivatives</u>	<u>Classification</u>	<u>Changes in Fair Value</u>	
Credit default swaps	Investment revenue	\$ 198	
Currency forward contracts	Investment revenue	7	
Index futures long	Investment revenue	892	
Rights	Investment revenue	62	
Warrants	Investment revenue	-	
Total derivatives		<u>\$ 1,159</u>	

A credit default swap is a contract to transfer credit exposure of fixed income products between parties. A foreign currency forward is a contract to purchase one currency and sell another at an agreed upon exchange rate. Fair value represents the unrealized appreciation/depreciation on foreign currency forward transactions pending as of yearend and is the difference between the execution exchange rate and the prevailing exchange rate as of the report date. Index futures long are an agreement to buy, on a stipulated future date, a specific amount of an indexed financial instrument. Rights represent a privilege granted to existing shareholders to subscribe to shares of a certain security at a specified price.

H. Counterparty Credit Risk

Counterparty Credit risk is the risk that the counterparty will not fulfill its obligations. The Board was not subject to counterparty credit risk as of June 30th.

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7. FAIR VALUE MEASUREMENT

The Board 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 are determined using unobservable inputs.

Valuations not classified within these levels are further explained in Section B.

A. Fair Value Level

CAPP, STIP and AOF - Fixed income and equity investments classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Fixed income investments 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.

CAPP – Montana Mortgages classified in Level 3 of the fair value hierarchy are present value adjusted. Direct real estate classified in Level 3 of the fair value hierarchy are based on latest appraised value.

Pools and AOF – Investments measured at cost are included to account for all investments within each pool and AOF. These assets represent cash equivalents and Montana mortgages.

For each of the pools and AOF the Board has the following fair value measurements as of June 30th:

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CAPP Investments Measured at Fair Value (in thousands)		Fair Value Measurements Using		
	June 30, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable (Level 3)
<u>Investments by fair value level</u>				
Fixed income investments:				
Treasuries	\$ 1,060,925	\$ 1,060,925	\$ -	\$ -
Agency/Government Related	125,562	-	125,562	-
Asset Backed Securities	41,968	-	41,968	-
Mortgage Backed Securities	458,851	-	458,851	-
Commercial Mortgage Backed Securities	87,168	-	87,168	-
Financial-Corporate	271,663	-	271,663	-
Industrial-Corporate	478,729	-	478,729	-
Utility-Corporate	20,663	-	20,663	-
Equity investments:				
Consumer discretionary	195,457	195,457	-	-
Consumer staples	78,128	78,128	-	-
Energy	82,867	82,867	-	-
Financials	225,847	225,847	-	-
Health care	184,845	184,845	-	-
Industrials	193,938	193,938	-	-
Information technology	318,511	318,511	-	-
Materials	82,833	82,833	-	-
Mutual funds	2,436,876	2,436,876	-	-
Real Estate	37,882	37,882	-	-
Telecommunication services	13,736	13,736	-	-
Utilities	22,152	22,152	-	-
International Equity investments:				
Consumer discretionary	87,888	87,888	-	-
Consumer staples	59,542	59,542	-	-
Energy	33,460	33,460	-	-
Financials	115,773	115,773	-	-
Health care	48,134	48,134	-	-
Industrials	85,118	85,118	-	-
Information technology	91,345	91,345	-	-
Materials	26,821	26,821	-	-
Mutual funds	229,551	229,551	-	-
Private Placement	1,722	1,722	-	-
Real Estate	11,923	11,923	-	-
Rights/Warrants	31	31	-	-
Telecommunication services	10,695	10,695	-	-
Utilities	4,128	4,128	-	-
Direct Real Estate	18,723	-	-	18,723
Montana Mortgages	4,935	-	-	4,935
Total equity investments by fair value level	7,248,390	\$ 5,740,128	\$ 1,484,604	\$ 23,658
<u>Investments measured at the net asset value (NAV)</u>				
Commingled equity index funds	1,009,736			
Private equity - private equity partnerships	1,209,376			
Core Real Estate	341,077			
Opportunistic	92,882			
Timber	104,714			
Value Added	302,629			
Short Term Investment Pool (STIP)	116,583			
Total investments measured at the NAV	3,176,997			
Total investments measured at fair value	10,425,387			
<u>Investments measured at cost</u>				
Cash/cash equivalents	241,709			
Total investments managed	\$ 10,667,096			

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TFIP Investments Measured at Fair Value (in thousands)		Fair Value Measurements Using		
	June 30, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable (Level 3)
<u>Investments by fair value level</u>				
Fixed income investments				
Treasuries	\$ 526,628	\$ 526,628	\$ -	\$ -
Agency/Government Related	153,351	-	153,351	-
Asset Backed Securities	76,743	-	76,743	-
Mortgage Backed Securities	439,241	-	439,241	-
Commercial Mortgage Backed Securities	130,417	-	130,417	-
Financial-Corporate	205,010	-	205,010	-
Industrial-Corporate	419,642	-	419,642	-
Utility-Corporate	28,313	-	28,313	-
Total fixed income investments by fair value level	1,979,345	\$ 526,628	\$ 1,452,717	\$ -
<u>Investments measured at the net asset value (NAV)</u>				
Core Real Estate	200,691			
High Yield Bond Fund	105,639			
Short Term Investment Pool (STIP)	40,549			
Total investments measured at the NAV	346,879			
Total investments at fair value	2,326,224			
<u>Investments measured at cost</u>				
Cash/cash equivalents	814			
Total investments managed	\$ 2,327,038			

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AOF Investments Measured at Fair Value (in thousands)		Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable (Level 3)
	June 30, 2017			
<u>Investments by fair value level</u>				
Fixed income investments				
Treasuries	\$ 322,615	\$ 322,615	\$ -	\$ -
Agency/Government Related	335,978	-	335,978	-
Asset Backed Securities	54,962	-	54,962	-
Mortgage Backed Securities	15,900	-	15,900	-
Commercial Mortgage Backed Securities	15,204	-	15,204	-
Financial-Corporate	307,928	-	307,928	-
Industrial-Corporate	319,693	-	319,693	-
Utility-Corporate	32,626	-	32,626	-
Total fixed income investments by fair value level	<u>1,404,906</u>	<u>\$ 322,615</u>	<u>\$ 1,082,291</u>	<u>\$ -</u>
Equity index Funds				
<u>Investments measured at the net asset value (NAV)</u>				
Core Real Estate	107,000			
Commingled equity index funds	<u>185,615</u>			
Total investments measured at NAV	<u>292,615</u>			
Total investments at fair value	<u>1,697,521</u>			
<u>Investments measured at cost</u>				
Direct investments				
MT Mortgages and Loans	<u>160,623</u>			
Total investments managed	<u>\$ 1,858,144</u>			

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STIP Investments Measured at Fair Value (in thousands)		Fair Value Measurements Using		
	June 30, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable (Level 3)
<u>Investments by fair value level</u>				
Fixed income investments				
Treasuries	\$ 124,774	\$ 124,774	\$ -	\$ -
Asset Backed Commercial Paper	1,089,830	-	1,089,830	-
Corporate Commercial Paper	356,122	-	356,122	-
Corporate Notes	369,751	-	369,751	-
Certificates of Deposit	484,113	-	484,113	-
U.S. Government Agency	389,807	-	389,807	-
Total investments by fair value level	2,814,397	\$ 124,774	\$ 2,689,623	\$ -
<u>Investments measured at cost</u>				
Money Market Funds (Unrated)	24,219			
Money Market Funds (Rated)	148,000			
Total investments measured at cost	172,219			
Total investments managed	<u>\$ 2,986,616</u>			

B. Investments at NAV

The investments measured at NAV for the year ended 2017 are further detailed below:

Investments Measured at NAV* (in thousands)		June 30, 2017		
	Fair Value	Unfunded Commitments	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
CAPP				
Commingled equity index funds	\$ 1,009,736	\$ -	Daily	1 day
Private equity - private equity partnerships	1,209,376	735,280		
Core Real Estate	341,077	-	Monthly, quarterly	45-90 days
Opportunistic	92,882	54,963		
Timber	104,714	30,670		
Value Added	302,629	102,272		
Short Term Investment Pool (STIP)	116,583	-	Daily	1 day
Total investments measured at the NAV	<u>\$ 3,176,997</u>	<u>\$ 923,185</u>		
TFIP				
Core Real Estate	\$ 200,691		Monthly, quarterly	45-90 days
High Yield Bond Fund	105,639		Monthly	30 days
Short Term Investment Pool (STIP)	40,549		Daily	1 day
Total investments measured at the NAV	<u>\$ 346,879</u>			
AOF				
Core Real Estate	\$ 107,000		Monthly, quarterly	45-90 days
Commingled equity index funds	185,615		Daily	1 day
Total investments measured at NAV	<u>\$ 292,615</u>			

*Fair value as contained within section A tables.

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STIP – This investment program is managed and administered under the direction of the Board as authorized by the Unified Investment Program. It is a commingled pool for investment purposes and requested redemptions from the pool are redeemed the next business day. The fair values of the investments in this category have been determined using the NAV per share (or its equivalent) of the investment. STIP as presented in this table, represents a direct holding for CAPP and TFIP. Also, refer to the STIP table included in Section A – Investments Measured at Fair Value for the underlying investments within the fair value hierarchy.

Commingled equity index funds - This type consists of institutional investment funds that invest in domestic equities and funds that invest in international equities. The fair values of the investments of this type have been determined using the NAV per share (or its equivalent) of the investments.

High Yield Bond Fund - This type consists of predominantly U.S. corporate credits, whether in the form of bonds or loans that are rated below investment grade. These assets carry a higher risk of default than investment grade securities and accordingly provide a higher level of income or yield commensurate with that risk. The fair values of the investments of this type have been determined using the NAV per share (or its equivalent) of the investments.

Core Real Estate - This type includes funds that invest primarily in core real estate, which makes equity investments in operating and substantially-leased institutional quality real estate in traditional property types (apartments, office, retail, industrial and hotel) via commingled funds. The primary investment objectives of these core real estate funds are to invest in real estate that will generate income from predictable sources of revenue and not to realize gains on the underlying assets. This investment type receives distributions of generated income and occasionally through the liquidation of the underlying assets of the fund. The fair values of the investments in this category have been determined using the NAV per share (or its equivalent) of the Board's ownership interest in the partners' capital. Redemption of these investments is restricted based on the availability of cash flow arising from investment transactions, sales, and other fund operations occurring in the ordinary course of business. Therefore, requested redemptions from a fund will be redeemed as funds become available.

Value Added and Opportunistic - This type includes private partnership funds that primarily invest in value added and opportunistic real estate funds. These funds assume more risk than the core real estate funds to achieve a greater return on investment. Returns are driven both by current income and by expected capital appreciation. This investment type receives distributions of generated income and occasionally through the liquidation of the underlying assets of the fund. It is expected that the underlying assets of the funds will be liquidated over 7 to 10 years. These investments can never be redeemed with the funds. The fair values of the investments in this category have been determined using the NAV per share (or its equivalent) of the Board's ownership interest in the partners' capital.

Timber - This type includes private partnership funds that primarily invest in timber funds. The underlying assets of these types of funds are typically made of tree farms and managed forest. Returns come from biological growth, upward product class movement, and appreciation in timber and land prices. This investment type receives distributions of generated income and occasionally through the liquidation of the underlying assets of the fund. It is expected that the underlying assets of the funds will be liquidated over 12 to 20 years. These investments can never be redeemed with the funds. The fair values of the investments in this category have been determined using the NAV per share (or its equivalent) of the Board's ownership interest in the partners' capital.

Private Equity Partnerships - This type includes investments in limited partnerships. Generally speaking, the types of partnership strategies included in this portfolio: venture capital, growth equity, buyouts, special situations, mezzanine, and distressed debt. These investments are considered illiquid. Redemptions are restricted over the life of the partnership. During the life of the partnerships, distributions are received as underlying partnership investments are realized. It is expected that the underlying assets of the funds will be liquidated over 10 years. It is probable all of the

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investments in this type will be sold at an amount different from the NAV per share (or its equivalent) of the Board's ownership interest in partners' capital.

8. STIP RESERVE

In November 2007, the STIP Reserve account was established. The STIP reserve account may be used to offset losses within the STIP portfolio. STIP distributes income to STIP participants based on accrued interest and discount amortization, net of fees and STIP reserve expense. The STIP Reserve is detailed as follows for the year ending June 30th:

STIP Reserve (in thousands)	
Beginning STIP Reserve	\$ 13,143
STIP Reserve Expense	
Other Income	
Recovery from SIV related assets	7,774
Realized gains on sale of any STIP asset	19
Accrued interest	15
Daily reserve accrual	3,283
Total reserve expense	11,091
Ending balance	\$ 24,234

In the fiscal year ended June 30, 2007, the Board purchased four Structured Investment Vehicle (SIV) securities held in the STIP portfolio with a combined amortized cost of \$140 million, representing 5.02% of the total portfolio. These securities were purchased from two different issuers. Both issuers received the highest investment grade rating by two rating agencies at the time purchase and as of June 30, 2007. Both issuers of these SIV securities declared insolvency events in fiscal year 2008. In June and December 2009, the Board applied \$21.0 million, in total, from the STIP reserve to the outstanding principal balances. In May 2016, the Board wrote-off the entire remaining outstanding SIV balance of \$23.6 million against the STIP reserve. The Board does not make any assumptions on recovery related to the SIV assets. Any further flows of either principal or interest will be deemed as recovery monies and be applied to the STIP reserve. Refer to Note 14 – Subsequent Events for additional detail.

9. COAL TAX LOAN AND MORTGAGE COMMITMENTS

The Board of Investments (BOI) makes firm commitments to fund commercial loans and Veterans' Home Loan Mortgages (VHLM) from the Coal Severance Tax Permanent Trust Fund. These commitments have expiration dates and may be extended per BOI policies. As of June 30th, the BOI had committed, but not yet purchased, \$33.2 million in loans from Montana lenders. In addition to the above commitments, lenders had reserved \$828 thousand for loans as of June 30th. An additional, \$656 thousand represented lender reservations for the VHLM residential mortgage purchases with no purchase commitments.

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The BOI makes reservations to fund mortgages from the state's pension funds. As of June 30th, there were no mortgage reservations. All BOI residential mortgage purchases are processed by the Montana Board of Housing (MBOH). The MBOH does not differentiate between a mortgage reservation and a funding commitment.

10. AOF MONTANA MORTGAGES AND LOANS

The AOF portfolio includes mortgages and loans, funded by the Permanent Coal Trust as authorized by statute. These mortgages and loans are shown in the following table (in thousands).

<u>Montana Mortgages and Loans</u>	<u>2017 Carrying Value</u>
Science and Technology Alliance ⁽¹⁾	\$ 775
Montana University System	7,904
Montana Facility Finance	3,254
Local Government Infrastructure	23,611
Veterans' Home Loan Mortgages	32,636
Intermediary ReLending Program (IRP) Loans	3,512
Commercial Loans	88,932
	<hr/>
Total Montana Mortgages and Loans	<u>\$ 160,624</u>
 (1) The Montana Science and Technology Alliance (MSTA) loans include funding for research and development, mezzanine and seed capital loans.	

During FY17, the Board wrote-down one commercial loan in the amount of \$171 thousand. The participating bank received a deed-in-lieu-of-foreclosure pertaining to this loan. BOI has an 80% participation in this loan. The property is currently on the market for \$1.2 million.

11. TAX ABATEMENT

Within the Board's Commercial Loan Program within the AOF, by statute the infrastructure loan program is funded by an \$80 million allocation. Eligible local governments request a loan for constructing or purchasing infrastructure to be used by a basic sector business. The basic sector business will pay a user fee to the local government that is pledged to the Board for the loan repayment. The Board reviews each loan and only upon verification that the entities meet the loan requirements is the loan approved by the Board. The Board is part of the primary government of the State of Montana.

To be eligible for the program, the basic sector business must create at least 15 full-time basic sector jobs. The maximum loan size is \$16,666 times the number of full-time jobs created and the minimum loan size is \$250,000. The maximum loan term is 25 years. There is also up to a 2.5% interest rate reduction for job creation. The reduction will be reflected in the user fee rate charged the basic sector business upon Board review and approval. The basic sector business must create the required jobs within four years of the agreement. If the basic sector business does not create the required jobs within the four-year period, then the basic sector business must pay down the loan balance of the local government entity until the loan balance matches the eligible amount per the jobs created. The Board may

STATE OF MONTANA BOARD OF INVESTMENTS
UNIFIED INVESTMENT PROGRAM FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

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increase the interest rate commensurate with the number of jobs eliminated if the borrower eliminates 10 or more qualifying jobs. The basic sector business must annually provide payroll documentation to the Board.

Pursuant to statute, a business that is created or expanded as the result of an Infrastructure Loan is entitled to a credit against either their State of Montana individual income taxes or corporate income taxes for the portion of the fees attributable to the use of the infrastructure. The total amount of tax credit claimed may not exceed the amount of the loan. The credit may be carried forward for seven years or carried back for three years.

During the fiscal year ended June 30, 2017, basic sector business entities made total user fee payments of \$3.2 million, representing \$2.1 million of principal and \$1.1 million in interest. During the fiscal year ended June 30, 2017, a total of \$3.4 million was claimed as a credit against Montana individual and corporation tax. The following table details the credit claimed by tax type and the tax year it was applied against.

Infrastructure Credit Claimed FY17	For TY 2016		For TY 2015	
	Corporate Income Tax	Individual Income Tax	Corporate Income Tax	Individual Income Tax
Amount Claimed (in thousands)	\$ 229	\$ 41	\$ 275	\$ 2,813
Number of Credits	*	13	*	*
* indicates less than 10. Number cannot be reported due to confidentiality concerns.				

The local government entity must pass a resolution authorizing the acceptance of the commitment agreement. The Board indemnifies the local government regarding repayment of the loan.

12. BOND / LOAN GUARANTEES

As of June 30th, the Board had provided loan guarantees from the Coal Severance Tax Permanent Fund to the Enterprise Fund for exposure to INTERCAP bond issues is \$107.9 million. Both the Coal Severance Tax Permanent Fund and the Enterprise Fund are part of the primary government for the State of Montana. The Board has not had to perform on any loan guarantee in the past.

The Board had provided loan guarantees from the Coal Severance Tax Permanent Fund to the Montana Facility Finance Authority (MFFA). Board exposure to bond issues, surety bonds and designated loans of the MFFA totaled \$71.4 million as of June 30th. MFFA is a discretely presented component unit of the State of Montana. MFFA guarantee requests are submitted to the Board for review and approval. The Board's participation, either duration or any other consideration, to either purchase bonds or loans or to lend money for deposit into MFFA's statutorily allowed capital reserve account is explicitly limited by statute which requires the Board to act prudently. The guarantee requests from MFFA pertain to bonds issued by MFFA with a term of up to 40 years. The Board and MFFA have entered into an Agreement detailing repayment to the Board. The Board has not had to perform on any loan guarantee in the past.

The following schedule summarizes the guarantee activity during the fiscal year (in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance
INTERCAP	\$ 97,340	\$ 20,000	\$ 9,460	\$ 107,880
MFFA	79,875	32,905	41,364	71,416

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FISCAL YEAR ENDED JUNE 30, 2017

13. POOL RESTRUCTURE

On March 31, 2017, the Board converted the five pension only pools into a single "Consolidated Asset Pension Pool", with 13 underlying asset classes. Refer to Note 1 – History and Organization and Note 4 – Types of Investments for further detail.

During July 2016, the Board terminated one manager in Montana Domestic Equity Pool (MDEP). A transition manager was hired to liquidate the portfolio and cash was transferred to another fund manager within MDEP. The market value of the transfer was approximately \$63 million.

During October 2016, the Board terminated one manager in MDEP. A transition manager was hired to liquidate the portfolio with cash transferred to another manager within MDEP. The market value of the liquidation was approximately \$27 million.

During March 2017, the Board sold one limited partnership to an outside 3rd party in a secondary market sale. The proceeds of this sale were \$20.4 million.

In April 2017, the Board hired a transition manager to complete the restructuring of several portfolios within the Domestic Equity Asset Class in CAPP to align with the MSCI Indexes. The approximate market value of the transition was \$2.2 billion.

On May 30, 2017, the Board terminated one manager in the Domestic Equity Asset Class in CAPP. A transition manager was hired to transition the assets from the current portfolio to cash with a portion maintained temporarily in large and midcap domestic equity. The approximate market value of the transition was \$154 million.

14. SUBSEQUENT EVENTS

On August 1, 2017, the Board reallocated assets held within a small cap domestic equity fund to four of the Board's existing small cap domestic equity managers. The transfer of securities and cash occurred within the Domestic Equity Asset Class of the CAPP. The approximate market value of the transition was \$120 million.

As of August 22, 2017, the Board had approved an additional loan guarantees from the Coal Severance Tax Permanent Fund to Montana Facility Finance Authority (MFFA) totaling \$15 million. The Board also approved an increase of \$4 million to a previously approved \$10 million commercial loan commitment. Since June 30, 2017, the Board has received an additional \$28.8 million in loan reservations from Montana lenders. Refer to Note 9 – Coal Tax Loan and Mortgage Commitments for further detail.

On August 30, 2017, the Board terminated one manager in the Domestic Equity Asset Class with the CAPP. A transition manager was hired to liquidate the portfolio and cash was transferred to the Board's Cash Asset Class within the CAPP, which in turn purchased STIP. The approximate market value of the transition was \$179 million.

In November 2017, the Board reallocated assets held within an international small cap fund to three of the Board's existing international small cap equity managers. The transfer of securities and cash occurred within the International Equity Pension Asset Class of CAPP. The approximate market value of the transition was \$150 million.

In November 2017, the Governor called the Montana legislature into special session to address a significant budget shortfall in the State's general fund. Senate Bill 4 was passed into law and directs the Board to apply a 3% charge against the average total investments of the State Fund in excess of \$1 billion providing certain conditions are met.

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FISCAL YEAR ENDED JUNE 30, 2017

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The Board is directed to transfer money from this charge on or before April 1, 2018 and 2019 to the State's Fire Suppression Fund. The Board is not providing additional investment services in making the transfer as required by the Act.

In December 2017, two new managers were hired in the High Yield Pension Asset Class. Each manager was funded with \$50 million

Since June 30, 2017, the Board has committed an additional to \$490 million to alternative equity partnerships within CAPP, with allocations of \$145 million within the Private Equity Asset Class, \$145 million within the Natural Resource Asset Class and \$200 million within the Real Estate Asset Class. Refer to Note 3 – Investment Commitments for further detail.

During fiscal year 2017, the Board requested a 100% redemption in the amount of \$174 million from one manager, pertaining to investments from CAPP, TFIP, and AOF. Since June 30, 2017, redemptions in the amount of \$67.6 million have been received. The Board is confident that the full redemption will be received over a reasonable time period.

Since June 30, 2017, the Board has received recovery payments associated with the SIV related assets in the amount of \$1.7 million, representing \$1.1 million of principal and \$0.6 million of interest. Refer to Note 8 – STIP Reserve for further detail.

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SUPPLEMENTARY INFORMATION

STATE OF MONTANA BOARD OF INVESTMENTS
UNIFIED INVESTMENT PROGRAM FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

COMBINING STATEMENT OF FIDUCIARY NET POSITION				
AS OF JUNE 30, 2017				
(in thousands)				
			TFIP	
Assets	Total	CAPP	State Agencies	Local Governments
Cash/cash Equivalents				
Cash equivalent/STIP at fair value - held within pools	\$ -	\$ 116,583	\$ 40,327	\$ 222
Cash/Cash equivalent - held within pools	<u>2,079,932</u>	<u>241,709</u>	<u>810</u>	<u>4</u>
Total cash/equivalents	<u>2,079,932</u>	<u>358,292</u>	<u>41,137</u>	<u>226</u>
Receivables				
Security lending income receivable	203	131	33	-
Broker receivable for securities sold but not settled	52,791	52,791	-	-
Dividend and interest receivable	<u>44,563</u>	<u>19,524</u>	<u>13,017</u>	<u>72</u>
Total receivables	<u>97,557</u>	<u>72,446</u>	<u>13,050</u>	<u>72</u>
Investments at fair value	15,601,831	10,308,804	2,273,171	12,505
Security lending cash collateral	<u>119,811</u>	<u>62,235</u>	<u>18,220</u>	<u>100</u>
Total assets	<u>17,899,131</u>	<u>10,801,777</u>	<u>2,345,578</u>	<u>12,903</u>
Liabilities				
Payables				
Broker payable for securities purchased but not settled	96,500	96,500	-	-
Income due participants	18,144	-	5,755	32
Other payable	2,290	2,290	-	-
Security lending expense payable	83	47	12	-
Administrative fee payable	3,661	3,613	48	-
Security lending obligations	119,811	62,235	18,220	100
STIP reserve	<u>24,235</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total liabilities	<u>264,724</u>	<u>164,685</u>	<u>24,035</u>	<u>132</u>
Net position held in trust for pool/AOF participants	<u>\$ 17,634,407</u>	<u>\$ 10,637,092</u>	<u>\$ 2,321,543</u>	<u>\$ 12,771</u>

STATE OF MONTANA BOARD OF INVESTMENTS
UNIFIED INVESTMENT PROGRAM FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

COMBINING STATEMENT OF FIDUCIARY NET POSITION				
AS OF JUNE 30, 2017				
(in thousands)				
		STIP		STIP included in investment pools*
	AOF	State Agencies	Local Governments	
Assets				
Cash/cash equivalents				
Cash equivalent/STIP at fair value - held within pools	\$ -	\$ -	\$ -	\$ (157,132)
Cash/Cash equivalent - held within pools	14,965	1,186,615	635,829	-
Total cash/equivalents	<u>14,965</u>	<u>1,186,615</u>	<u>635,829</u>	<u>(157,132)</u>
Receivables				
Security lending income receivable	39	-	-	-
Broker receivable for securities sold but not settled	-	-	-	-
Dividend and interest receivable	9,585	1,540	825	-
Total receivables	<u>9,624</u>	<u>1,540</u>	<u>825</u>	<u>-</u>
Investments at fair value	1,843,179	758,006	406,166	-
Security lending cash collateral	39,256	-	-	-
Total assets	<u>1,907,024</u>	<u>1,946,161</u>	<u>1,042,820</u>	<u>(157,132)</u>
Liabilities				
Payables				
Broker payable for securities purchased but not settled	-	-	-	-
Income due participants	9,600	1,795	962	-
Other payable	-	-	-	-
Security lending expense payable	24	-	-	-
Administrative fee payable	-	-	-	-
Security lending obligations	39,256	-	-	-
STIP reserve	-	15,780	8,455	-
Total liabilities	<u>48,880</u>	<u>17,575</u>	<u>9,417</u>	<u>-</u>
Net position held in trust for pool/AOF participants	<u>\$ 1,858,144</u>	<u>\$ 1,928,586</u>	<u>\$ 1,033,403</u>	<u>\$ (157,132)</u>
*STIP holdings, purchases, sales, and investment earnings within investment pools are offset to calculate a combining total.				

STATE OF MONTANA BOARD OF INVESTMENTS
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FISCAL YEAR ENDED JUNE 30, 2017

COMBINING STATEMENT OF CHANGES IN FIDUCIARY NET POSITION FOR FISCAL YEAR ENDING JUNE 30, 2017 (in thousands)				
	Total	CAPP	TFIP	
			State Agencies	Local Governments
Additions				
Purchases by participants	\$ 7,170,844	\$ 450,153	\$ 75,953	\$ -
Net investment earnings				
Investment earnings:				
Net increase (decrease) on fair value of investments	993,590	1,044,404	(58,109)	(327)
Dividend/interest income	331,508	188,278	80,127	450
Other investment income	7,794	-	-	-
STIP reserve expense	(11,092)	-	-	-
Investment earnings	<u>1,321,800</u>	<u>1,232,682</u>	<u>22,018</u>	<u>123</u>
Administrative expenses	(52,007)	(46,998)	(2,498)	(14)
Other investment expenses	<u>(7,835)</u>	<u>(7,835)</u>	<u>-</u>	<u>-</u>
Net investment earnings	<u>1,261,958</u>	<u>1,177,849</u>	<u>19,520</u>	<u>109</u>
Security lending income	4,604	3,131	751	4
Security lending expense	<u>(1,830)</u>	<u>(1,232)</u>	<u>(282)</u>	<u>(2)</u>
Total additions	<u>8,435,576</u>	<u>1,629,901</u>	<u>95,942</u>	<u>111</u>
Deductions				
Sales by participants	7,283,888	633,106	34,847	50
Income distributions to participants	<u>255,771</u>	<u>84,704</u>	<u>77,843</u>	<u>437</u>
Total deductions	<u>7,539,659</u>	<u>717,810</u>	<u>112,690</u>	<u>487</u>
Change in net position	<u>895,917</u>	<u>912,091</u>	<u>(16,748)</u>	<u>(376)</u>
Net position held in trust for pool/AOF participants - beginning of year	<u>16,738,490</u>	<u>9,725,001</u>	<u>2,338,291</u>	<u>13,147</u>
Net position held in trust for pool/AOF participants - end of year	<u>\$ 17,634,407</u>	<u>\$ 10,637,092</u>	<u>\$ 2,321,543</u>	<u>\$ 12,771</u>

STATE OF MONTANA BOARD OF INVESTMENTS
UNIFIED INVESTMENT PROGRAM FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

COMBINING STATEMENT OF CHANGES IN FIDUCIARY NET POSITION FOR FISCAL YEAR ENDING JUNE 30, 2017 (in thousands)				
	AOF	STIP State Agencies	Local Governments	STIP included in investment pools*
Additions				
Purchases by participants	\$ 497,372	\$ 6,161,994	\$ 1,215,468	\$ (1,230,096)
Net investment earnings				
Investment earnings:				
Net increase (decrease) on fair value of investments	(2,998)	7,215	3,413	(8)
Dividend/interest income	46,442	11,693	5,492	(974)
Other investment income	-	5,303	2,491	-
STIP reserve expense	-	(7,547)	(3,545)	-
Investment earnings	43,444	16,664	7,851	(982)
Administrative expenses	(1,583)	(622)	(292)	-
Other investment expenses	-	-	-	-
Net investment earnings	41,861	16,042	7,559	(982)
Security lending income	648	48	22	-
Security lending expense	(282)	(22)	(10)	-
Total additions	539,599	6,178,062	1,223,039	(1,231,078)
Deductions				
Sales by participants	557,186	6,154,126	1,071,810	(1,167,237)
Income distributions to participants	70,028	16,148	7,585	(974)
Total deductions	627,214	6,170,274	1,079,395	(1,168,211)
Change in net position	(87,615)	7,788	143,644	(62,867)
Net position held in trust for pool/AOF participants - beginning of year	1,945,759	1,920,798	889,759	(94,265)
Net position held in trust for pool/AOF participants - end of year	\$ 1,858,144	\$ 1,928,586	\$ 1,033,403	\$ (157,132)
*STIP holdings, purchases, sales, and investment earnings within investment pools are offset to calculate a combining total.				

Independent Auditor's Report and Enterprise Fund Program Financial Statements

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors
Cindy Jorgenson
Joe Murray

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 Board of Investment's (board) Enterprise Fund Program as of June 30, 2017, the related Statement of Revenues, Expenses and Changes in Net Position, and the Statement of Cash Flows for the fiscal year then ended, and the related notes to the 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 board'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 board's internal control, and accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of the Montana Board of Investment's Enterprise Fund Program as of June 30, 2017, and the changes in net position and cash flows for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the Montana Board of Investment's Enterprise Fund Program financial statements are intended to present the financial position, changes in financial position, and cash flows of only the portion of the financial reporting entity of the state of Montana that are attributed to the transactions of the Enterprise Fund Program at the board. They do not purport to, and do not present fairly the financial position of the state of Montana as of June 30, 2017, or the changes in its financial position and cash flows for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America. 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 Schedule of Funding Progress on page A-64, Schedule of Net Pension Liability on page A-64, and Schedule of Contributions on page A-65 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 January 8, 2018, on our consideration of the board'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 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 board's internal control over financial reporting and compliance.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

January 8, 2018

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

STATEMENT OF NET POSITION AS OF JUNE 30, 2017 (in thousands)	
Assets	2017
Current assets:	
Cash and cash equivalents (Note 2)	\$ 6,699
Interest receivable	534
Notes/loans receivable (Note 2)	12,346
Interfund notes/loans (Note 2)	2,400
Interfund interest receivable (Note 2)	118
Component Unit notes/loans (Note 2)	2,680
Component Unit interest receivable (Note 2)	186
Short-term investments at fair value (Notes 2, 3)	9,491
Total current assets	34,454
Noncurrent assets:	
Restricted investments at fair value (Notes 2, 3)	2,137
Notes/loans receivable (Note 2)	44,119
Interfund notes/loans and interest receivable (Note 2)	10,546
Component Unit notes/loans receivable (Note 2)	22,659
Equipment	4
Accumulated depreciation	(3)
Total noncurrent assets	79,462
Total assets	113,916
Pension deferred outflows (Notes 11, 14)	64
Liabilities	
Current liabilities:	
Accounts payable	1
Accrued expenses	23
Accrued interest payable	432
Arbitrage rebate tax payable	3
Compensated absences (Note 10)	33
Current bonds/notes payable (Note 6)	107,880
Total current liabilities	108,372
Noncurrent liabilities	
Compensated absences (Note 10)	30
Arbitrage rebate tax payable	19
OPEB implicit rate subsidy (Note 13)	89
Net pension liability (Notes 11, 14)	385
Total noncurrent liabilities	523
Total liabilities	108,895
Pension deferred inflows (Notes 11, 14)	1
Net position	
Net investment in capital assets	1
Restricted (Note 2)	1,522
Unrestricted	3,561
Total net position (Note 2)	\$ 5,084

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION FOR THE FISCAL YEAR ENDED JUNE 30, 2017 (in thousands)	
Operating revenue	2017
Reimbursements	\$ 37
Investment income	81
Financing income	1,667
Total operating revenue	1,785
Operating expenses	
Personal services (Note 10)	387
Contracted services	32
Supplies and materials	13
Communications	7
Travel	3
Rent	50
Indirect and other costs	62
OPEB (Note 13)	13
Pension expense (Notes 11, 14)	37
Depreciation expense	1
Arbitrage rebate tax expense (Note 9)	6
Debt service	
Interest expense	769
Trustee fee expense	65
Bond issuance cost amortization expense (Note 10)	169
Loan interest	(1)
Other debt service expense	239
Total operating expenses	1,852
Operating income	(67)
Nonoperating revenue	
Pension revenue (Notes 11, 14)	7
Nonoperating income	7
Change in fund net position	(60)
Total fund net position, July 1, as previously reported	5,177
Prior period adjustment (Note 11)	(33)
Total fund net position, July 1, as restated	5,144
Total fund net position, June 30 (Note 2)	\$ 5,084
The accompanying notes are an integral part of these financial statements.	

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2017 (in thousands)	
	2017
Cash flows from operating activities:	
Reimbursements	\$ 37
Payments to suppliers for goods and services	(168)
Payments to employees	(381)
Other revenue	7
	<hr/>
Net cash (used for) operating activities	(505)
	<hr/>
Cash flows from non-capital financing activities:	
Payment of principal and interest on bonds and notes	(10,438)
Proceeds from issuance of bonds and notes	20,000
Payment of bond issue costs	0
Net pension deferred inflows/outflows (Note 14)	(33)
Proceeds from interentity loan	7,272
Payment for interentity loan	(8,479)
	<hr/>
Net cash (used for) provided by non-capital financing activities	8,322
	<hr/>
Net cash (used for) capital and related financing activities	0
	<hr/>
Cash flows from investing activities:	
Collections for principal and interest on loans	33,870
Cash payments for loans	(46,697)
Purchase of deposits/investments	(163,775)
Proceeds from sales or maturities of deposits/investments	161,483
Interest on deposits/investments	114
	<hr/>
Net cash (used for) provided by investing activities	(15,005)
	<hr/>
Net (decrease) increase in cash and cash equivalents	(7,188)
Cash and cash equivalents, July 1	13,887
Cash and cash equivalents, June 30	<u>\$ 6,699</u>

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2017 (in thousands)	
	2017
Reconciliation of net income to net cash (used for) operating activities:	
Net operating income	\$ (67)
Adjustments to reconcile net income to net cash (used for) operating activities	
Depreciation	1
Pension revenue	7
Interest on investments	(81)
Financing income	(1,667)
Interest expense	1,241
Arbitrage rebate tax expense (Note 9)	6
Change in assets and liabilities:	
(Decrease) increase in other payables	2
(Decrease) increase in due to other funds	(1)
(Decrease) increase in compensated absences payable	3
(Decrease) increase in net pension liability (Notes 11, 14)	93
Increase (decrease) in OPEB implicit rate subsidy (Notes 13)	10
Increase (decrease) in pension deferred inflows/outflows (Notes 11, 14)	(52)
Total adjustments	(438)
Net cash (used for) operating activities	(505)
Schedule of noncash transactions:	
Increase/(decrease) in fair value of investments	75
Total noncash transactions	\$ 75
The accompanying notes are an integral part of these financial statements.	

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

1. ORGANIZATION

The Board uses the Enterprise Fund to account for its programs created under the Economic Development Bond Act and the Municipal Finance Consolidation Act.

Economic Development Bond Act programs include:

- The Stand Alone Economic Development Bond Program provides access to limited economic development projects through the issuance of conduit debt.
- The Conservation Reserve Enhancement Program (CRP), created in 1990 by issuing bonds, allows farmers to receive a lump sum payment by assigning their federal CRP contract to the Board. The farmers under contract must comply with seeding and other requirements. The Montana Trust Funds Investment Pool funded the Conservation Reserve Enhancement Program.

Municipal Finance Consolidation Act programs include:

- The INTERCAP loan program provides funds to eligible Montana governments to finance capital expenditures for up to fifteen years.
- The Irrigation District Pooled Loan Program provided funds for the Board to purchase the refunding bonds from participating irrigation districts for the purpose of prepaying the U.S. Department of Interior, Bureau of Reclamation Projects Loans.
- Qualified Zone Academy Bond (QZAB) Program provides a financial instrument that is a different form of subsidy from traditional tax-exempt bonds. The federal government pays the interest on the QZABs in the form of an annual tax credit to a bank (or other eligible financial institution) that holds the QZAB. The Board acts as a legal funding conduit only and is not pecuniary liable for the repayment of the bonds.
- Qualified School Construction Bond (QSCB) Program provides a financial instrument that is a different form of subsidy from traditional tax-exempt bonds. The revenues of the borrower are pledged to repay the bonds. The Board acts as a legal funding conduit only and is not pecuniary liable for the repayment of the bonds.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Beginning with the period ending June 30, 2017, single-year financial statements were prepared. In past years, comparative financial statements were prepared. GASB does not require comparative statements and thus the Board changed to a single-year presentation as part of the Board's continual effort to look at ways to increase the efficiency of financial statement preparation. This change does not result in a restatement of beginning net asset value for the period ending June 30, 2017.

A. Basis of Accounting

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, expenses are recorded when incurred and revenues are recorded when earned. The financial statements are prepared from the Statewide Accounting, Budgeting, and Human Resource System (SABHRS) and information contained in the bond trustee statements. These financial statements

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

are intended to present only the financial position and changes in financial position of the Economic Development Bond and Municipal Finance Consolidation programs, known as the Enterprise Fund administered by the Board. The Board's Enterprise Fund is reported as a proprietary fund within the State of Montana's Comprehensive Annual Financial Report.

B. Fixed Asset Depreciation

The equipment fixed assets recorded in the Enterprise Fund are depreciated on a straight-line basis value, in accordance with state policy.

C. Receivables

The Enterprise Fund notes/loans receivables of \$94.7 million as of June 30th, represent loans made to state agencies, local governments, and the state university system. The Enterprise Fund notes/loans are classified in three categories as follows:

- 1) Notes/loans receivable from local governments and Montana universities.
- 2) Interfund notes/loans receivable from state agency governments.
- 3) Component Unit notes/loans receivable from certain state agencies and university units for which the State is financially accountable.

Interest receivable of \$534 thousand includes \$480 thousand of interest on local government and other notes/loans and \$54 thousand of interest on investments.

D. Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, the Enterprise Fund considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents, as identified in the Statement of Net Position, are as follows:

Cash and Cash Equivalents (in thousands)		June 30, 2017
Cash in treasury	\$	19
Short Term Investment Pool (STIP)*		63
First American Government Obligation Fund		755
US Treasury Bills*		5,862
Total Cash and Cash Equivalents	\$	<u>6,699</u>
* Reported at fair value.		

STIP and US Treasury Bills are presented in the Statement of Net Position at fair value and other cash/cash equivalents are reported at cost. The Enterprise Fund invests its operational cash in the Board's Short-Term Investment Pool (STIP), an external investment pool. STIP is managed to preserve principal while providing 24-hour liquidity for state agency and local government participants. Funds may be invested for one or more days. The STIP investments and the income are owned by the participants and are managed on their behalf by the Board.

E. Net Position

Net Position represents the accumulated net profits of the Enterprise Fund programs. The Statement of Net Position for the Enterprise Fund reports a restricted net position. A net position is reported as restricted when constraints placed on the net position use are either:

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

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- 1) Externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or
- 2) Imposed by law through constitutional provisions or enabling legislation.

The net position of all Enterprise Fund programs except for MEDB (Montana Economic Development Bonds) Guarantee Fund Account, MEDB Guarantee CRP Note Reserve, MEDB Contingency Account, and CRP are restricted under bond indentures governing the use of these funds.

F. Investments

Investments are presented in the Statement of Net Position at fair value. Investment fair values for publicly traded securities are determined primarily by reference to market prices supplied by the Board's trustee. Amortized cost, or carrying value, represents the original cost, adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized/accreted using the straight-line method to the maturity date of the securities. The Net Position as of June 30th included (\$11) thousand in unrealized appreciation (depreciation) in reporting the fair value of the Enterprise Fund investments.

3. INVESTMENT RISK DISCLOSURES

The Enterprise Fund deposits and investments are restricted by the bond trust indentures to the following: government and agency obligations, certificates of deposits, repurchase agreements, and investment agreements. Deposits and investments must be made with Montana banks or in the Short-Term Investment Pool (STIP) administered by the Board.

A. Custodial Credit Risk

Custodial credit risk is the risk that, in the event of the failure of the counterparty to a transaction, the Board will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. Per policy, the Board'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).

Cash

Custodial risk for cash is the risk that, in the event of the failure of the custodial financial institution, the cash or collateral securities may not be recovered from an outside party. The securities used as collateral are held by U.S. Bank's Trust Department in the name of the Board.

Investments

As of June 30th, Enterprise Fund securities were recorded in book entry form in the name of U.S. Bank National Association as Trustee for the Montana Board of Investments by specific account. The Enterprise Fund does not have a policy addressing custodial credit risk for deposits and investments, specifically, uninsured, collateralized deposits.

B. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of any single investment per issuer name. Investments directly issued or explicitly guaranteed by the U.S. government and investments in mutual funds are excluded from the concentration of credit risk requirement. The STIP Investment Policy limits concentration of credit risk by limiting portfolio investment types to 3% in any issuer except for US Treasury and US Agency securities as well as any repurchase agreements with a financial institution. STIP concentration risk was within the policy as set by the board.

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

C. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The Enterprise Fund's U.S. government direct-backed securities, consisting of U.S. Treasury notes and bills, are guaranteed directly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality per GASB Statement No. 40. The Enterprise Fund does not have a formal investment policy addressing credit risk for Permitted Investments as provided in the Indenture or investment in the STIP. Permitted Investments, as described in the Indenture, include "either (i) long term obligations of such bank, trust company or association are rated in one of the three highest investment category of the Standard & Poor's Corporation or Moody's Investor Service Inc., which investment category shall not be less than the prevailing rate on the Bonds or (ii) the deposits are continuously secured as to principal, but only to the extent not insured by the Bank Insurance Fund or the Savings Association Insurance Fund, or any successor to either, of the Federal Deposit Insurance Corporation (FDIC)."

The Board's STIP investment policy statement (IPS) specifies that STIP securities have a minimum of two credit ratings as provided by national recognized statistical rating organizations, to assist in the monitoring and management of credit risk. The purchase of STIP securities other than US government or US Agency obligations are restricted to those which are pre-approved. Although the STIP investments have been rated by investment security type, STIP, as an external investment pool, has not been rated.

D. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Enterprise Fund does not have a formal investment policy addressing interest risk for Permitted Investments as provided in the Indenture or the cash equivalent investment in the STIP. STIP interest rate risk is determined using the WAM method. In accordance with GASB Statement No. 40, the Board has selected the effective duration method to disclose interest rate risk.

According to the STIP IPS "the STIP portfolio will minimize interest rate risk by:

- 1) structuring the investment portfolio so securities mature to meet cash requirements for ongoing operations thereby normally avoiding the need to sell securities on the open market prior to maturity;
- 2) maintaining a dollar-weighted average portfolio maturity (WAM) of 60 days or less (for this purpose, the date to the next coupon reset date will be used for all floating or variable rate securities; and
- 3) STIP will maintain a reserve account."

Enterprise Fund investments are categorized as follows to disclose credit and interest rate risk as of June 30th. Credit risk reflects the weighted credit quality rating by investment type. Interest rate risk is disclosed using weighted effective duration as calculated by Board staff. 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. Both the credit quality ratings and duration have been calculated excluding cash equivalents with credit ratings of NR or NA duration calculations. There were no derivative transactions during the fiscal year for investments held by the trustee.

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

Credit Quality Rating and Effective Duration as of June 30, 2017 (in thousands)			
<u>Security Type</u>	<u>Fair Value</u>	<u>Credit Quality Rating (1)</u>	<u>Effective Duration (1)</u>
First American Government Obligation Fund (2,3)	\$ 755	AAA	0.09
U.S. Treasuries (2)	5,862	AAA	0.07
Short Term Investment Pool (STIP) (2)	63	NR	0.11
U.S. Government Indirect Obligations	<u>11,628</u>	<u>AAA</u>	<u>0.75</u>
Total	\$ <u>18,308</u>	<u>AAA</u>	<u>0.50</u>
1) Credit Quality Rating and Effective Duration are weighted.			
2) Security types are cash equivalents.			
3) Reported at cost.			

4. FAIR VALUE MEASUREMENT

The Board 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 are determined using unobservable inputs.

A. Fair Value Level

US Treasury Obligations classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities.

US Agency Obligations 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.

For the Enterprise Fund, the Board has the following fair value measurements as of June 30th:

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

Enterprise Fund Investments Measured at Fair Value (in thousands)		Fair Value Measurements Using		
	June 30, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable (Level 3)
<u>Investments by fair value level</u>				
Short-term investments at fair value				
US Treasury Obligations	\$ 12,912	\$ 12,912	\$ -	\$ -
US Agency Obligations	2,441	-	2,441	-
Restricted investments at fair value				
US Treasury Obligations	1,050	1,050	-	-
US Agency Obligations	1,087	-	1,087	-
Total investments by fair value level	17,490	\$ 13,962	\$ 3,528	\$ -
<u>Investments measured at the net asset value (NAV)</u>				
Short Term Investment Pool (STIP)	63			
Total investments at fair value	17,553			
<u>Investments measured at cost</u>				
First American Government Obligation Fund	755			
Total investments managed	\$ 18,308			

B. Investments at NAV

The investments measured at NAV for the year ended 2017 are further detailed as follows:

Enterprise Fund Investments Measured at NAV		June 30, 2017		
	Fair Value	Unfunded Commitments	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
Short-Term Investment Pool (STIP)	\$ 63		Daily	1 day

STIP is managed and administered under the direction of the Board as authorized by the Unified Investment Program. It is a commingled external investment pool for investment purposes and requested redemptions from the pool are redeemed the next business day. The fair values of the investments in this category have been determined using the NAV per share (or its equivalent) of the investment. STIP investments are measured at fair value.

5. SECURITY LENDING

The Enterprise Fund is a participant in the Board's Short-Term Investment Pool (STIP). As of October 2016, STIP was no longer participating in the security lending program. STIP did not have securities on loan as of June 30th. Security lending income and expense entries were recorded through October 2016.

The Board 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 Board's securities on a collateralized basis 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. The Bank compensates for market movement by recalculating on the following business day to meet the collateralization requirements. The Board and the Bank split the earnings, 80/20% respectively, on security lending activities. The Board retains all rights and risks of ownership during the loan period. State Street Indemnifies the Board's credit risk exposure to the borrowers.

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
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During fiscal year 2017, the Bank lent Board 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 Board imposed no restrictions on the amount of securities available to lend during fiscal year 2017. 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 fiscal year 2017 resulting from a borrower default.

The cash collateral for STIP was invested in the Security Lending Quality Trust Fund. The securities lending transactions were terminable at will.

6. BONDS PAYABLE

As of June 30th, the Enterprise Fund reported no long-term bonds/notes payable.

Current Bonds Payable

The Enterprise Fund is authorized to issue INTERCAP bonds under the Municipal Finance Consolidation Act. These bonds may not aggregate more than \$190 million as amended by the 2007 Legislature. The INTERCAP bonds provide funds for the Board to make loans to eligible government units. The bonds are not a debt or liability of the State of Montana. The bonds are limited obligations of the Board payable solely from: a) repayments of principal and interest on loans made by the Board to participating eligible Montana governments; b) investment income under the Indenture; and c) an irrevocable pledge by the Board. The Board has no taxing power. These bonds may be redeemed, at the bondholder's option, any March 1, prior to maturity. The Board did not enter into an arms-length financing agreement to convert the bonds "put," or tender, and were not resold into some other form of long-term obligation. Accordingly, these bonds, considered demand bonds, are recorded as current liabilities of the Enterprise Fund.

The INTERCAP obligations at June 30, 2017 (in thousands)				
<u>Series</u>	<u>Amount Issued</u>	<u>Interest Range</u>	<u>Maturity</u>	<u>Balance June 30, 2017</u>
1998	\$ 12,500	Variable	2018	\$ 2,600
2000	15,000	Variable	2025	14,255
2003	15,000	Variable	2028	14,330
2004	18,500	Variable	2029	18,000
2007	15,000	Variable	2032	14,725
2010	12,000	Variable	2035	11,975
2013	12,000	Variable	2038	11,995
2017	20,000	Variable	2042	20,000
Total INTERCAP Debt	<u>\$ 120,000</u>			<u>\$ 107,880</u>
Current Bonds Payable				<u>\$ 107,880</u>

The following schedule summarizes the INTERCAP activity during the fiscal year (in thousands):

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Beginning Balance	Additions	Reductions	Ending Balance
\$ 97,340	\$ 20,000	\$ 9,460	\$ 107,880

Bond Anticipation Note (BAN)

In November 2015, the Board authorized the issuance of up to \$8.5 million BAN in anticipation of a new INTERCAP bond issuance in 2017 to bond liquidity to the program. The BAN was purchased and funded by the Permanent Coal Tax Trust Fund on April 15, 2016 with a state maturity of March 15, 2017. The following table summarizes the BAN activity during the fiscal year (in thousands):

Beginning Balance	Additions	Reductions	Ending Balance
\$ 1,207	\$ 7,272	\$ 8,479	\$ 0

7. OTHER DEBT

QZAB Debt

In this program, the Board is authorized to issue Qualified Zone Academy Bonds (QZAB), under the Municipal Finance Consolidation Act, as conduit (no commitment) debt. The revenues, and in some cases the taxing power, of the borrower are pledged to repay the bonds. Because the Board has no obligation for this debt, these bond issues are not reflected on the Board's financial statements. Bonds issued and outstanding by the Board as QZAB conduit (no-commitment) debt are listed as follows (in thousands):

<u>Project</u>	<u>Issue Date</u>	<u>Maturity Date</u>	<u>Amount Issued</u>	<u>Balance June 30, 2017</u>
Philipsburg Schools	December 2003	12/10/17	\$ 2,000	\$ 2,000
Cut Bank Elementary	August 2005	08/18/21	825	825
Cut Bank High School	August 2005	08/18/21	625	625
Billings School	December 2008	06/15/18	773	773
Kalispell Elementary School	October 2013	06/15/28	620	620
Kalispell High School	October 2013	06/15/28	1,587	1,587
Total QZAB conduit debt			\$ 6,430	\$ 6,430

QSCB Debt

In this program, the Board is authorized to issue Qualified School Construction Bonds (QSCB), under the Municipal Finance Consolidation Act, as conduit (no commitment) debt. The revenues of the borrower are pledged to repay the bonds. Because the Board has no obligation for this debt, these bond issues are not reflected on the Board's financial statements. Bonds issued and outstanding by the Board as QSCB conduit (no-commitment) debt are as follows (in thousands):

<u>Project</u>	<u>Issue Date</u>	<u>Maturity Date</u>	<u>Amount Issued</u>	<u>Balance June 30, 2017</u>
Great Falls High Schools	April 2011	12/15/25	\$ 1,855	\$ 1,244
Great Falls Elementary	April 2011	12/15/25	6,510	4,364
Total QSCB conduit debt			\$ 8,365	\$ 5,608

STATE OF MONTANA BOARD OF INVESTMENTS
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8. INTERCAP PROGRAM COMMITMENTS

The Board makes firm commitments to fund loans from the INTERCAP loan program. The Board's outstanding commitments to eligible Montana governments, as of June 30th, totaled \$30.0 million.

9. ARBITRAGE

The fiscal year-end Arbitrage Rebate Tax Expense represents an over accrual of estimated arbitrage liability as calculated by a contracted vendor.

10. COMPENSATED ABSENCES AND PERSONAL SERVICES

Compensated absences liabilities represent the unpaid leave balances for employees at fiscal yearend. The liability identifies the vacation, sick leave and exempt compensatory time which state employees have earned but not taken. Annually, the compensated absences liabilities balances are adjusted between prior year and current year balances with an offset to personal services expense.

11. PRIOR PERIOD ADJUSTMENT

The prior period adjustment was a decrease to the beginning net position by \$33 thousand, which was the result of an increase of Net Pension Liability of \$30 thousand, an increase of Deferred Pension Inflows of \$4 thousand, and an increase of Pension Deferred Outflows of \$1 thousand.

12. NON-PENSION EMPLOYEE BENEFITS PLANS

Deferred Compensation Plan

The Board's permanent employees are eligible to participate in the State of Montana's deferred compensation plan. The compensation deferred is not available to employees until separation from State service, retirement, death, or upon an unforeseeable emergency, when still employed and meeting IRS specified criteria. The plan is governed by Internal Revenue Service Code (IRC) Section 457 and Title 19, Chapter 50, Montana Code Annotated (MCA). Assets of the deferred compensation plan are required to be held in trust, custodial accounts or insurance company contracts for the exclusive benefit of participants and their beneficiaries.

Health Care

Board staff and dependents are eligible to receive medical and dental health care through the State Group Benefits Plan administered by the Montana Department of Administration (DOA) Health Care & Benefits Division. The State funds claims on a pay-as-you-go basis. Montana DOA established premiums vary depending on family coverage and eligibility. Agencies contribute of \$1,054 per month per eligible State of Montana employee, in addition to the employee's monthly contribution, as shown as follows:

Premiums	CY2017
Medical	\$30.00 - \$327.00
Dental (optional)	\$0.00 - \$28.90
Vision Hardware (optional)	\$7.64 - \$22.26

13. OTHER POST EMPLOYMENT BENEFITS (OPEB)

Post-employment Healthcare Plan Description

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Eligible retirees and dependents can receive health care through the State Group Benefits Plan administered by the DOA. By statute, 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 financial statement reporting purposes, the State Group Benefits Plan is considered an agent multiple-employer plan and the Board is a separate employer participating in the plan. The State Group Benefits Plan allows retirees to participate as a group, at a rate that does not cover all of the related costs. Retiree participation results in the reporting of an "implied rate" subsidy in the Board's financial statements and footnotes as OPEB liability. The OPEB liability is disclosed for financial statement purposes but does not represent a legal liability of the Board.

Montana established retiree medical premiums vary depending on family coverage and eligibility, as shown on the table as follows. Retirees pay 100% of the premiums for medical, dental, and vision. Basic life insurance in the amount of \$14,000 is provided until age 65 at a cost of \$1.90 per month to the retiree. The State reimburses all validated medical claims net of member obligations (annual deductibles and coinsurance of the members' selected medical plan). Dental claims are reimbursed at 50% to 100% of the allowable charges, depending on the services provided. The State acts as secondary payer for retired Medicare-eligible claimants.

Retiree Premiums	CY2017
Non-Medicare Medical	\$1,131 - \$1,633
Medicare Medical	\$439 - \$911
Dental	\$41.10 - \$70.00
Optional Vision Hardware	\$7.64 - \$22.26

Benefits Not Included in the Valuation

Dental and vision benefits are fully-insured and retirees pay 100% of the premiums, therefore no liability is calculated in the OPEB valuation. The basis life insurance benefit is not available as an employer-provided group insurance benefit for retirees; therefore, no liability for life insurance is calculated in the OPEB valuation.

Funding Policy

The following estimates were prepared based on an actuarial valuation prepared as January 1, 2015. The resulting State of Montana Actuarial Valuation of Other Post-Employment Benefits Plan (plan) contains the Board's data and is available from the Montana Department of Administration's State Financial Services Division, Room 255 Mitchell Building, 125 North Roberts Street, PO Box 200102, Helena, MT 59620-0102 or at 406-444-3154.

GASB requires the plan's participants, including the Board, to report each year the actuarially determined annual required contribution (ARC). The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year of retiree health care costs and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

The ARC is calculated for all the State Plan's participants and then allocated to individual participants. The Board's ARC is estimated at \$12 thousand, and is based on the plan's current ARC rate of 4% of participants' annual covered payroll for the year. The Board's ARC is equal to an annual amount required each year to fully fund the liability over 30 years.

The Board's estimated OPEB actuarial accrued liability is \$89 thousand. The actuarial accrued liability is the present value of future retiree benefits and expenses.

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
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Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. The results of the valuation represent reasonable estimates and variation from the estimates is probable. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents information that shows the actuarial value of plan assets and liabilities.

In the January 1, 2015, actuarial valuation, the projected unit cost funding method was used for the State. The actuarial assumptions included a 4.25% discount rate and a 2.50% payroll growth rate. The unfunded actuarial accrued liability is amortized following a 30-year level percentage of payroll amortization schedule on an open basis.

The State finances claims on a pay-as-you-go basis and does not advance-fund the OPEB liability. Therefore, the following cost information shows no plan assets made by the Board.

Annual OPEB Cost:

The Board's allocated annual OPEB cost (expense) was \$13 thousand, adjusted for amortization of the net OPEB obligation plus interest on the prior year obligation amount, less employer contributions. The Board's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation are as follows: (in thousands)

Fiscal Year	Annual OPEB Cost	% of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/2017	\$ 13	25%	\$ 89
6/30/2016	\$ 13	25%	\$ 79
6/30/2015 *	\$ 13	28%	\$ 69
*Cost reflected does not include prior period adjustment of (\$2) thousand			

Funded Status and Funding Progress

The funded status of the Board's allocation of the plan as of June 30th was as follows: (in thousands)

Actuarial Accrued Liability (AAL)	\$ 138
Actuarial Value of Plan Assets	\$ 0
Unfunded Actuarial Accrued Liability (UAAL)	\$ 138
Funded Ratio (Actuarial Value of Plan Assets/AAL)	-
Covered Payroll (Active Plan Members)	\$ 301

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

UAAL as a Percentage of Covered Payroll	46%
ARC as a Percentage of Covered Payroll	4%

14. PENSION FOOTNOTE

Plan Description

The Board and its employees contribute to either the Public Employees' Retirement System (PERS)-Defined Benefit Retirement Plan (DBRP) or the PERS-Defined Contribution Retirement Plan (DCRP). Both the DBRP and the DCRP are administered by the Montana Public Employee Retirement Administration (MPERA). The DBRP is a multiple-employer, cost-sharing plan and the DCRP is a multiple employer plan.

All new members are initially members of the PERS-DBRP and have a 12-month window during which they may choose to remain in the PERS-DBRP or join the PERS-DCRP by filing an irrevocable election. Members may not be members of both the defined contribution and defined benefit retirement plans. DBRP benefits are based on eligibility, years of service and highest average compensation. DCRP benefits are based on the balance in the member's account, which includes the total contributions made, the length of time the funds have remained in the plan and the investment earnings less administrative costs. Both the DBRP and DCRP provides retirement, disability, and death benefits to plan members and their beneficiaries.

Benefits are established by state law and can only be amended by the Legislature. Member rights are immediately vested in their own contributions and attributable income. Members are vested after five years of service for the employer's contributions to individual accounts and the attributable income. Non-vested contributions are forfeited upon termination of employment per statute. Forfeitures are used to cover the administrative expenses of the DCRP. At the plan level, the DCRP employer did not recognize any net pension liability or pension expense. For the year ended June 30, 2016, plan level non-vested forfeitures for the 289 employers that have participants in the PERS-DCRP totaled \$383 thousand.

Employees of the Enterprise Fund may or may not be members of the DCRP. Based on confidentiality requirements, PERS is not able to provide detail on DCRP members. The pension liability, pension deferred inflows and pension deferred outflows as reported within these financial statements related to DBRP members. The pension disclosure as follows applies to both DBRP and DCRP, unless specifically stated otherwise.

The PERS financial information is reported in the MPERA's Comprehensive Annual Financial Report (CAFR). MPERA's CAFR information including MPERA stand-alone financial statements and latest actuarial valuation reports can be found on MPERA's web site at <http://mpera.mt.gov/index.shtml>; at 100 North Park, PO Box 200131, Helena MT 59620-0131; or at 406-444-3154. The information contained within MPERA's CAFR will only display information regarding PERS in total and will not display information specific to the Enterprise Fund as an entity. The Enterprise Fund activity is reported within the Department of Commerce GASB 68 employer report as prepared by MPERA and represents 3% of the agency's liability and .026% of the total liability for all employers for the fiscal year.

Summary of Benefits - DBRP

Member's highest average compensation (HAC)

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

Eligibility for benefit

Service retirement:

Hired prior to July 1, 2011	Age 60, 5 years of membership service;
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STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

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Hired on or after July 1, 2011 Age 65, regardless of membership service; or
Any age, 30 years of membership service.
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.

Second Retirement (requires returning to PERS covered employment or PERS service)

*Retire before January 1, 2016 and accumulate less than 2 years additional service credit, or
Retire on or after January 1, 2016 and accumulate less than 5 years additional service credit:*

- A refund of member's contributions plus regular interest (.25%);
- No service credit for second employment;
- Start the same benefit amount the month following termination; and
- GABA start again in the January immediately following the second retirement.

Retire before January 1, 2016 and accumulate 5 or more years of service credit:

- A recalculated retirement benefit based on provisions in effect after the initial retirement; and
- GABA starts on the recalculated benefit in the January after receiving the new benefit for 12 months.

Retire on or after January 1, 2016 and accumulate 5 or more year of service credit:

- The same retirement as prior to the return to service;
- A second retirement benefit as prior to the second period of service based on laws in effect upon the rehire date; and
- GABA starts on both benefits in the January after receiving the original and the new benefit for 12 months.

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)

- 3% for members hired prior to July 1, 2007
- 1.5% for members hired between July 1, 2007 and June 30, 2013
- Members hired on or after July 1, 2013:
 - 1.5% for each year PERS is funded at or above 90%;
 - 1.5% is reduced by 0.1% for each 2% PERS is funded below 90%; and
 - 0% whenever the amortization period for PERS is 40 years or more

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

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

Overview of Contributions

Rates are specified by state law for periodic employer and employee contributions. The State legislature has the authority to establish and amend the statutory contribution rates to the plan.

Currently, plan members are required to contribute 7.90% of member's compensation. Contributions are deducted from each member's salary and remitted by participating employers. By statute, the 7.90% member contributions are temporary and will be decreased to 6.90% on January 1 following actuary valuation results that show the amortization period has dropped below 25 years and would remain below 25 years following the reduction of both the additional employer and additional member contribution rates.

As the employer, the State of Montana employers was required to contribute 8.47% of members' compensation for fiscal year ended June 30, 2017. Effective July 1, 2014, employer contributions increased 1.0%. Beginning July 1, 2014, employer contributions will increase an additional 0.1% a year over 10 years, through 2024. The employer additional contributions including the 0.27% added in 2007 and 2009, terminates on January 1 following actuary valuation results that show the amortization period of the PERS-DBRP has dropped below 25 years and would remain below 25 years following the reductions of both the additional employer and member contributions rates. The additional contributions were not terminated on January 1, 2017. Effective July 1, 2013, employers are required to make contributions on working retirees' compensation. Member contributions for working retirees are not required. DBRP received non-employer contributions from the Coal Severance Tax income and earnings from the Coal Trust Permanent Trust fund.

PERS received 100% of the required contributions from the Enterprise Fund in the amount of \$51 thousand for the fiscal year.

Actuarial Assumptions - DBRP

The Total Pension Liability as of the fiscal year, is based on the results of an actuarial valuation date of June 30, 2016, with update procedures to roll forward the total pension liability to June 30, 2017. There were several significant assumptions and other inputs used to measure the Total Pension Liability. The actuarial assumptions used in the June 30, 2016 valuation were based on the results of the last actuarial experience study, dated June 2010 for the six-year period July 1, 2003 to June 30, 2009. Among those assumptions were the following:

- General Wage Growth* 4.00%
 - *includes Inflation at 3.00%
- Merit Increases 0% to 6%
- Investment Return (net of admin expense) 7.75%
- Admin Expense as % of Payroll 0.27%
- Mortality assumptions among contributing members, terminated vested members, service retired members and beneficiaries based on RP 2000 Combined Employee and Annuitant Mortality Tables projected to 2015 with scale AA.
- Mortality assumptions among Disabled Retirees are based on RP 2000 Combined Employee and Annuitant Mortality Tables with no projections. No future mortality improvement is assumed.
- Guaranteed Annual Benefit Adjustment (GABA)
 - 3% for members hired prior to July 1, 2007
 - 1.5% for members hired between July 1, 2007 and June 30, 2013
 - Members hired on or after July 1, 2013:
 - 1.5% for each year PERS is funded at or above 90%;

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

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- 1.5% is reduced by 0.1% for each 2 % PERS is funded below 90%; and
- 0% whenever the amortization period for PERS is 40 years or more.

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

Discount Rate - DBRP

The discount rate used to measure the Total Pension Liability was 7.75%. The projection of cash flows used to determine the discount rate assumed that contributions from participating plan members, employers, and non-employer contributing entities will be made based on the Board's funding policy, which establishes the contractually required rates under Montana Code Annotated. The State contributes 0.1% of salaries for local governments and 0.37% for school districts. In addition, the State contributes coal severance tax and interest money from the general fund. The interest is contributed monthly and the severance tax is contributed quarterly.

Based on those assumptions, the System's fiduciary net position was projected to be adequate to make all the projected future benefit payments of current plan members through the year 2117. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the Total Pension Liability. No municipal bond rate was incorporated in the discount rate.

The long-term expected return on pension plan assets is reviewed as part of the regular experience study prepared for the System. The most recent analysis, performed for the period covering fiscal years 2003 through 2009, is outlined in a report dated June 2010, which is located on the MPERA website. The long-term expected rate of return on pension 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 (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the target asset allocation as of June 30, 2016 are summarized as follows:

Asset Class	Target Asset Allocation	Real Rate of Return Arithmetic Basis	Long-Term Expected Real Rate of Return
	(a)	(b)	(a) x (b)
Cash Equivalents	2.6%	4.00%	0.10%
Domestic Equity	36.0%	4.55%	1.64%
Foreign Equity	18.0%	6.35%	1.14%
Fixed Income	23.4%	1.00%	0.23%
Private Equity	12.0%	7.75%	0.93%
Real Estate	<u>8.0%</u>	4.00%	0.32%
Total	100.0%		4.37%
Inflation			3.00%

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

Expected Portfolio Return	7.37%
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The table as follows represents the employer Net Position Liability calculated using the discount rate of 7.75%, as well as what the Net Pension Liability would be if it were calculated using a discount rate that is 1.00% lower (6.75%) or 1.00% higher (8.75%) than the current rate.

Net Pension Liability Sensitivity Analysis (in thousands)	1.0% Decrease (6.75%)	Current Discount Rate (7.75%)	1.0% Increase (8.75)
Enterprise Fund	\$ 559	\$ 385	\$ 235

Summary of Significant Accounting Policies - DBRP

DBRP financial statements are prepared using the accrual basis of accounting. The same accrual basis was used for the purposes of measuring the Net Pension Liability, deferred inflows of resources and deferred outflows of resources related to pensions, pension expense, information about the fiduciary net position and additions to/deductions from fiduciary net position. Member contributions are recognized in the period in which contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Revenues are recognized in the accounting period they are earned and become measurable. Benefit payments and refunds are recognized in the accounting period when due and payable in accordance with the benefit terms. Expenses are recognized in the period incurred. Investments are reported at fair value. MPERA adheres to all applicable Governmental Accounting Standards Board (GASB) statements.

PERS has a special funding situation in which the State of Montana is legally responsible for making contributions directly to PERS on behalf of local government, school district and other governmental agency employers.

The State of Montana also has a funding situation that is not a Special Funding whereby the State General Fund provides contributions from the Coal Severance Tax fund. All employers are required to report the portion of Coal Tax Severance income and earnings attributable to the employer. Contributions provided by the Coal Tax revenue attributable to the Enterprise Fund was \$8 thousand.

At year end, the Enterprise Fund recorded a liability of \$385 thousand for its proportionate share of the DBRP Net Pension Liability and \$37 thousand for its proportionate share of the pension expense. The employer's proportionate share equals the ratio of the employer's contributions to the sum of all employer and non-employer contributions during the measurement period.

There were no changes in assumptions or other inputs that affected the measurement of the Total Pension Liability. There have been no changes in benefit terms since the previous measurement date. There were no changes between the measurement date of the collective Net Pension Liability and the employer's reporting date that are expected to have a significant effect on the employer's proportionate share of the collective NPL.

Deferred pension inflow / outflow - DBRP

At year end, the employer recognized a deferred outflow of resources of \$65 thousand for the employers contributions subsequent to the measurement date. The pension deferred inflows were \$1 thousand, which related to the net difference between projected and actual earning on pension plan investments.

Amounts reported as deferred outflows of resources related to pensions resulting from the employer's contributions subsequent to the measurement date will be recognized as a reduction of the NPL in the year ended June 30, 2018. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in Pension Expense as follows:

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

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Year ended June 30:	Deferred Outflows/Inflows of Resources (in thousands)
2018	\$ 2
2019	2
2020	21
2021	13
2022	n/a
Thereafter	n/a

15. SUBSEQUENT EVENTS

Since June 30, 2017, the Board made additional commitments to fund loans from the INTERCAP loan program in the amount of \$10.0 million.

On August 22, 2017, the Board approved two QZAB loans in the amount of \$1.4 million.

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

REQUIRED SUPPLEMENTARY INFORMATION

RSI – 1 OTHER POST EMPLOYMENT BENEFITS

(See also Note 13 – Other Post-Employment Benefits (OPEB))

As of the fiscal year-end, the most recent actuarial valuation available that was completed by the State of Montana was 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% for the current fiscal year-end.

Schedule of Funding Progress for Montana Board of Investments (in thousands)						
Date	Actuarial Value of Assets	Actuarial Accrued Liability *	Unfunded AAL	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll ((B-A)/(C))
	(A)	(AAL) (B)	(UAAL) (B-A)	(A/B)	(C)	
1/1/2015	\$ 0	\$ 138	\$ 138	\$ 0	\$ 288	48%
1/1/2013	0	123	123	0	249	49%
1/1/2011	0	71	71	0	130	55%

RSI – 2 PENSION LIABILITY AS AN EMPLOYER ENTITY

(See also Note 14 – Pension Footnote)

RSI regarding the pension information is as follows. As additional years of data are available, a total of 10 years will be presented.

Schedule of Required Supplementary Information Schedule of Net Pension Liability (in thousands)			
	June 30, 2017	June 30, 2016	June 30, 2015
Proportion of NPL	.025932%	.020880%	.019702%
Proportionate share of NPL	\$ 385	\$ 291	\$ 245
Pensionable payroll	\$ 307	\$ 241	\$ 220
Proportionate share of NPL as % of pensionable payroll	143.920%	121.237%	111.436%
Plan fiduciary net position as % of total NPL	74.710%	78.400%	79.900%

STATE OF MONTANA BOARD OF INVESTMENTS
ENTERPRISE FUND FINANCIAL STATEMENT
FISCAL YEAR ENDED JUNE 30, 2017

Schedule of Required Supplementary Information Schedule of Contributions (in thousands)			
	June 30, 2017	June 30, 2016	June 30, 2015
Contractually required contribution	\$ 51	\$ 21	\$ 19
Contributions made	<u>(51)</u>	<u>(21)</u>	<u>(19)</u>
Contribution deficiency / (excess)	0	0	0
Share of pensionable payroll	\$ 307	\$ 241	\$ 220
Contributions as a % of pensionable payroll	19.09%	8.77%	8.83%

Changes in Actuarial Assumptions and Methods

Method and assumptions used in calculations of actuarially determined contributions

The following addition to the actuarial assumption was adopted in 2014 based upon implementation of GASB Statement 68:

- Admin Expense as % of Payroll 0.27%

There were no changes following the 2013 Economic Experience study.

The following Actuarial Assumptions were adopted from the June 2010 Experience Study:

- General Wage Growth* 4.25%
- *Includes inflation at 3.00%
- Merit increase 0% to 6.0%
- Investment rate of return 7.75%, net of pension plan investment expense, and including inflation
- Asset valuation method 4-year smoothed market
- Actuarial cost method Entry age
- Amortization method Level percentage of pay, open

Report on Internal Control and Compliance

LEGISLATIVE AUDIT DIVISION

B-1

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors
Cindy Jorgenson
Joe Murray

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 Consolidated Unified Investment Program and the Enterprise Fund Program financial statements of the Montana Board of Investments (board) as listed on the table of contents on page i, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the board's financial statements, and have issued our reports thereon dated January 8, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Montana Board of Investments' 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 the board's internal control. Accordingly, we do not express an opinion on the effectiveness of the board'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 the attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that

were not identified. We did identify a deficiency in internal control over financial statement preparation that we consider to be a material weakness. See the finding and recommendation starting on page 7 for a description of this material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the board'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 of 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*.

Montana Board of Investment's Response to Finding

The Montana Board of Investments' response to the finding identified in our audit is described on page C-1 of this report. The board's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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 the board's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the board'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

January 8, 2018

MONTANA BOARD OF
INVESTMENTS

BOARD RESPONSE

MONTANA BOARD OF INVESTMENTS

C-1

Street Address:
2401 Colonial Drive, 3rd Floor
Helena, MT 59601

Mailing Address:
P.O. Box 200126
Helena, MT 59620-0126

Department of Commerce



Phone: 406/444-0001
Facsimile: 406/449-6579
Website: www.investmentmt.com

February 1, 2018

Mr. Angus Maciver
Legislative Auditor
Room 160, State Capitol
PO Box 201705
Helena, MT 59620-1705

RECEIVED
FEB 02 2018
LEGISLATIVE AUDIT DIV.

Dear Mr. Maciver:

The Board of Investments has received your office's financial audit for the fiscal year ended June 30, 2017. We appreciate the courtesy of allowing our response to be included in the final report.

We want to recognize your staff's proficient work and our need to change how we prepare our financial statements. We are pleased to note that the actual audit letter is "unmodified" or clean: all funds are accounted for, and where they are supposed to be. We acknowledge that the auditors found weaknesses in our internal controls over financial reporting and we will review and revise them as necessary to meet all GASB standards. We understand the need to design and follow stringent internal controls for preparing our financial statements. We will remedy the deficiencies noted and implement the recommendations made.

The Board of Investments is committed to excellence in all its endeavors. Our priority is *always* to deliver financial statements that accurately report our financial information and obtain clean audit opinions.

In Chapter II, the auditor's report identified various deficiencies and makes the following general recommendations:

- A. *Update the procedures for preparing and reviewing the Unified Investment Program financial statements, to reflect the current pool structure and reporting format, and to include an independent review by staff knowledgeable with program operations and generally accepted accounting principles.*
- B. *Update the procedures for preparing the Enterprise Fund Program financial statements, to include a review of requirements in generally accepted account principles for new program activity.*

We concur.

We will do the following:

1. For existing procedures, we will update them to comply with the latest accounting standards as established by GASB where needed;
2. Where we now use a different presentation format from previous years, we will establish and document procedures in preparing and reviewing the Unified Investment Program financial statements;
3. We will adhere to a specific work flow requirement to include an independent review by staff knowledgeable with program operations and generally accepted accounting principles;
4. At least annually, our staff will update the Board on quality control in preparing our financial statements and footnotes; and,
5. No later than June 29, 2018, we will submit a report to the Legislative Auditor addressing this matter.

Chapter II of the report identifies presentation errors, which are listed below along with our response:

- Misclassification of Cash and Cash Equivalents

The report finds that \$1.6 billion in assets that the Board categorized as “investments” should have been categorized as “cash/cash equivalents.” For many years the Board has used the guidance contained in the American Institute of Certified Public Accountants’ (AICPA) publication entitled “Audit and Accounting Guide -- Investment Companies.” We understood that categorizing certain assets as “investments” rather than as “cash equivalents” was the more descriptive and conservative approach. However, as noted in the auditor’s report, the AICPA audit guide is no longer deemed by GASB as authoritative. We will follow the GASB rules.

- Placement of Combining Statements

The report finds that our “Combining Statement of Fiduciary Net Position” properly belonged in the “Supplementary Information” section of the financial statements. We agree and will review overall GASB requirements for the presentation changes that were newly enacted in FY 2017.

- Misstatements of Reported Amounts

The Board’s misstatements are in two areas: STIP purchases and sales and participant gains and losses.

As noted, approximately \$326 million in participants’ purchases and sales in STIP were recorded in the Board’s Statement of Changes in Fiduciary Net Position which should have been backed out by year-end and not included in this statement. The Board has implemented an additional monthly reconciliation step in the STIP program that will address this issue.

As noted, approximately \$362 million in participant gains and losses along with corresponding pool gains and losses were included in our financial statement material. Only the pool gains and losses should have been reported. While the Board has included both participant and pool gains and losses for many years for the sake of transparency, we acknowledge that this practice is not supported under GASB.

While both of these misstatements, if left uncorrected, would not have affected the balance sheet, their absence resulted in the total activity reported to be reduced in the Statement in Fiduciary Net Position.

- Error in the Statement of Cash Flow

As noted, cash inflows of \$7.3 million and outflows of \$8.5 million associated with a bond anticipation note (BAN) should have been reported in two separate line items. The Board reported this matter in a single net outflow of \$1.2 million. We will take steps to report both inflows and outflows separately in the future.

- Missing Note Disclosure

A schedule in the Enterprise footnotes should have included activity regarding BAN activity with respect to beginning balance, increases, decreases and ending balances of the debt. The BAN in question was unusual in that the Board both issued and self-funded it. We will take steps to assure required reporting in the future.

Again, we appreciate your professionalism and look forward to assisting your efforts as the audit authority for all the State of Montana's financial statements. We will be reporting back on our progress.

Sincerely

A handwritten signature in black ink, appearing to read "David Ewer", with a stylized, cursive script.

David Ewer
Executive Director