A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

Montana State Fund

For the Calendar Year Ended December 31, 2018

AUGUST 2019

LEGISLATIVE AUDIT
DIVISION

19-05A

Financial-Compliance Audits

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) 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, 2017, was issued March 23, 2018. The Single Audit Report for the two fiscal years ended June 30, 2019, will be issued by March 31, 2020.

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LEGISLATIVE AUDIT DIVISION

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

Deputy Legislative Auditors:
Cindy Jorgenson
Joe Murray

August 2019

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report of the Montana State Fund, a component unit of the state of Montana, for the calendar year ended December 31, 2018. This report does not contain any recommendations, and we issued an unmodified opinion on the financial statements, which means the reader can rely on the information presented.

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

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

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

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Appointed and Administrative Officials

Montana State Fund

Laurence Hubbard, President/CEO

Mark Burzynski, Vice President, Corporate Support (from March 2019)

Mark Barry, Vice President, Corporate Support (to March 2019)

Richard Duane, Vice President, Human Resources

Julie Jenkinson, Vice President, Insurance Operations

Denise Heigh, Vice President, Insurance Operations Support

Kevin Braun, Vice President, General Counsel

Al Parisian, Vice President, Chief Information Officer

State Fund Board of Directors

	Qualifications	Location	Term Expires
Lance Zanto, Chair	Policyholder	Helena	2021
Matthew C. Mohr	Policyholder–Private Enterprise	Bozeman	2019
Lynda Moss	Public Representative	Billings	2021
Jack Edward Owens	Private Enterprise	Missoula	2023
Jan VanRiper	Policyholder–Private Enterprise	Helena	2023
Cliff Larsen	Policyholder–Private Enterprise	Missoula	2021
Jim Molloy	Private Enterprise	Helena	2021

Laurence Hubbard, President/CEO–ex officio nonvoting member

For additional information concerning the Montana State Fund, contact:

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

e-mail: lhubbard@mt.gov

Montana Legislative Audit Division

Financial-Compliance Audit
Montana State Fund
For the Calendar Year Ended December 31, 2018

August 2019 | 19-05A | Report Summary

In calendar year 2018, the Montana State Fund (MSF) Board of Directors declared a dividend of approximately $40 million, similar to the dividend declared in calendar year 2017. MSF reported $161 million in earned premium revenue, and ending net position was approximately $483 million. Rates for the policy year beginning July 1, 2019, are set to decrease by 8.6 percent, following an 8 percent rate level decrease the previous year.

Context

MSF is supported by revenue from insurance premiums and investments. In calendar year 2018 insurance premium revenue and investment income totaled $161 million and $4.1 million, respectively. Total operating expenses were $228.2 million, which includes $121.9 million of benefit and claims payments to injured workers, $40 million in dividend expense, and $30.4 million in personal services.

MSF is established by Title 39, Chapter 71, Part 23 of the Montana Code Annotated. Operating as a nonprofit, independent public corporation, MSF functions like a private insurance carrier in a competitive marketplace. Under state law, MSF functions as the "guaranteed market," and is required to insure any employer in this state who requests coverage unless the employer or the employer's principals have defaulted on an obligation to MSF and the obligation remains unsatisfied. MSF is governed by a seven-member board of directors appointed by the Governor. The MSF Board of Directors appoints the President/CEO who oversees MSF's day-to-day operations.

In accordance with state law, MSF is under the regulatory authority of the Insurance Commissioner at the State Auditor's Office.

Claims occurring before July 1, 1990, referred to as the old fund claims, are an obligation of the primary government and are reflected on the state of Montana's financial statements.

Results

We performed audit work over MSF internal controls and business processes related to the payment of claims expenses, reserves for future claims payments, collection of insurance premium revenue, investment activity, reinsurance activity, and compliance with selected laws and regulations. We also considered the overall reasonableness of the financial statement presentation.

We issued an unmodified opinion on the financial statements, meaning the reader can rely on the information presented. This report does not contain any recommendations. The prior report also did not contain recommendations to MSF.

For a complete copy of the report (19-05A) 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 **https://leg.mt.gov/lad/audit-reports**
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Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Montana State Fund (MSF) for the calendar year ended December 31, 2018. MSF is the only state entity operating on a calendar year.

The objectives of this audit were to:

1. Determine whether the MSF's financial statements present fairly the financial position, results of operations, and cash flows for the calendar year ended December 31, 2018.
2. Obtain an understanding of the MSF's control systems to the extent necessary to support our audit of MSF's financial statements, and if appropriate, make recommendations for improvement in MSF management and internal controls.
3. Determine whether MSF complied with selected applicable laws and regulations.

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

- Payment of claim expenses
- Reserves for future claim payments
- Assessment and collection of policy premiums
- Investment activity
- Reinsurance activity
- Transactions and activities at calendar year-end
- Compliance with selected laws and regulations
- Overall reasonableness of the financial statement presentations

Other operating expenses on the Statement of Revenues, Expenses, and Changes in Net Position includes an approximately $13.6 million accrual related to the legislatively-required transfer to the Department of Natural Resources and Conservation's Fire Suppression Fund. MSF recorded this accrual as an expense in calendar year 2018 and paid the expense in calendar year 2019. The law requiring the transfer expires June 30, 2019, so no further transfers will occur under its provisions.

MSF personnel prepared the management discussion and analysis, financial statements and notes, and the required supplementary information, beginning on page A-5, based on accounting information from the Statewide Accounting, Budgeting, and Human

Resources System (SABHRS) with adjustments. Adjustments are made to present financial activity in accordance with Generally Accepted Accounting Principles (GAAP). We issued an unmodified opinion on the financial statements, meaning the reader can rely on the information presented.

Background

MSF is a state entity operating as a nonprofit, independent public corporation that provides Montana employers with an option for workers' compensation and occupational disease insurance, and guarantees available coverage for all employers in Montana. MSF is governed by a seven-member board of directors appointed by the governor.

MSF's Board of Directors must set premium rates at amounts sufficient, when invested, to carry the estimated cost of all claims to maturity, to meet the reasonable expenses of conducting the business of MSF, and to maintain a surplus over a calculated amount based on the National Association of Insurance Commissioners' risk-based capital requirements for a casualty insurer. The investments of the MSF, per state law, are managed by the Montana Board of Investments.

MSF is under the regulatory authority of the Insurance Commissioner at the State Auditor's Office, pursuant to §39-71-2375, MCA. MSF reports on a calendar-year basis. State laws requires MSF to submit financial statements in a regulatory format to the Insurance Commissioner by March 1 of each year. MSF also prepares annual financial statements in accordance with GAAP. This audit of GAAP financial statements remains a requirement per §39-71-2361, MCA, and continues to be necessary to support our audit of the state's basic financial statements.

Claims occurring before July 1, 1990, referred to as the old fund claims, are an obligation of the primary government and are reflected on the state of Montana's financial statements. MSF administers claims of the old fund, and received $595,684 from the general fund in calendar year 2018 for these services.

Independent Auditor's Report

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 Net Position of the Montana State Fund, a component unit of the state of Montana, as of December 31, 2018, the related Statement of Revenues, Expenses and Changes in Fund Net Position and the Statement of Cash Flows for the calendar year then ended, and the related notes which collectively comprise the Montana State Fund's basic financial statements.

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

Auditor's Responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana State Fund as of December 31, 2018, and the changes in net position and cash flows for the calendar year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis and the Risk Management, Retirement, and Other Post-employment benefits Required Supplementary Information 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 June 3, 2019, on our consideration of the Montana State Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Montana State Fund's internal control over financial reporting and compliance.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

June 3, 2019

Montana State Fund Financial Statements

Montana State Fund
(A Component Unit of the State of Montana)
Management Discussion and Analysis
December 31, 2018

Montana State Fund (MSF) is a non-profit, independent public corporation that provides workers' compensation insurance. Its statutory purpose is to act as a competitive insurance carrier, providing an available market and thereby guaranteeing coverage to all employers in Montana. Operating on the premium dollars paid by its insured employers and the net proceeds from its investments, MSF is not funded by the State General Fund for primary business operations. MSF functions like a private insurance carrier in a competitive marketplace and, as provided by law, perform all the functions and exercise all the powers of a private insurance carrier that are necessary, appropriate or convenient for the administration of the Montana State Fund.

MSF has undergone a number of changes since its creation in 1990. MSF continues to strive to improve efficiencies in all operational areas and has made major investments in safety management services as it works diligently with Montana employers in developing accident prevention programs. MSF is in the software development phase of a multi-year project to transition from its legacy policy management system to a more customer-interactive policy and billing system. Effective January 1, 2016, the State Auditor's Office, which regulates all insurance companies doing business in Montana, became responsible for oversight of MSF. External independent audits are completed annually of financial statements based on standards set by the National Association of Insurance Commissioners (NAIC). The State Auditor's Office requires specific information and filings throughout the year and reviews and approves premium rates.

MSF also administers and manages the claims remaining in the Old Fund for the State of Montana. The assets of the Old Fund were completely liquidated in 2011 and benefit payments and administrative costs for claims occurring before July 1, 1990, are supported by General Fund resources as required under state law (Section 39-71-2352, MCA). Therefore, the Old Fund is considered to be part of the Primary Government for financial reporting purposes and is not included in the accompanying financial statements.

Overview of the Financial Statements

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

The Statement of Net Position presents information regarding all of MSF's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and total net position.

The Statement of Revenues, Expenses, and Changes in Fund Net Position presents the financial results of operations for MSF for the year ending December 31, 2018. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods.

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

Financial Highlights

MSF continues to deliver high-quality services to Montana businesses while making continued rate reductions. MSF supports a competitive insurance market in Montana, offering a competitively priced product based upon actuarially sound rates while still fulfilling its role as the carrier for the guaranteed market. The Board of Directors continued its trend of decreasing rates during 2018, approving a rate reduction of 8% effective July 1, 2018, and recently approved a rate reduction of 8.6% effective July 1, 2019.

The Board of Directors, based on analysis of policyholder equity adequacy and financial results, approves the amount of dividends to be declared. MSF has declared and paid dividends to policyholders for 20 consecutive years. It is a way for MSF to share strong financial results by returning premium to those employers who help make it possible by lowering workplace injuries. A dividend of $40M (million) was declared in 2018 to qualifying policyholders.

Legislators passed Senate Bill 4 (SB 4) during the November 2017 special session, which required the Montana Board of Investments to transfer $14.7 million from MSF's portfolio to the Department of Natural Resources and Conservation's Fire Suppression Fund before April 1, 2018, and another $13.6M before April 1, 2019. The actual transfer dates were March 30, 2018 and February 14, 2019.

Analysis of Financial Position and Results of Operations

The following analysis presents comparative condensed financial data for MSF.

Net Position (in thousands)

	12/31/2018	12/31/2017
Current and Other Assets	$ 150,271	$ 227,746
Capital Assets (Net)	34,806	28,219
Investments	1,410,418	1,437,222
Total Assets	1,595,495	1,693,187
Total Deferred Outflows of Resources	6,965	6,114
Current Liabilities	208,822	242,865
Long-term Liabilities	909,637	917,115
Total Liabilities	1,118,459	1,159,980
Total Deferred Inflows of Resources	814	229
Net Position:		
Net Investment in Capital Assets	34,806	28,219
Unrestricted	448,380	510,872
Total Net Position	$ 483,186	$ 539,091

MSF's overall net position decreased during the year ended December 31, 2018, largely due to unrealized losses on MSF's investment portfolio. Despite those losses, with around $1.6B in combined assets and deferred outflows of resources to meet $1.1B of liabilities and deferred inflows of resources, MSF is well-positioned to meet the commitments to policyholders that it has incurred, which is the hallmark of prudent insurance planning and operations.

The largest component of MSF assets is investments, which decreased during the year ended December 31, 2018. The change in value is summarized in the following display (in thousands):

	Year Ended 12/31/18	Year Ended 12/31/17
Prior Year Market Value	$ 1,437,222	$ 1,423,772
Purchases at Cost	290,394	376,450
Sales	(284,471)	(398,194)
Net Realized Gains	18,823	26,064
Net Accretion (Amortization) of Bonds	66	(220)
Unrealized Gain (Loss)	(51,616)	9,350
Current Year Market Value	$ 1,410,418	$ 1,437,222

The most significant MSF liability is estimated claims payable, which increased slightly during the year ended December 31, 2018. This liability is increased as new claims for the year are added and decreased as claim payments are made. Additionally, changes to the estimates for prior years can increase or decrease the liability. The changes are summarized in the following display (in thousands):

	Year Ended 12/31/18	Year Ended 12/31/17
Estimated Claims Payable - Beginning	$ 919,689	$ 921,531
Incurred Claims Payable	121,925	123,028
Claim Payments	(99,976)	(124,870)
Estimated Claims Payable - Ending	$ 941,638	$ 919,689

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

Changes in Net Position (in thousands)

	Year Ended 12/31/2018	Year Ended 12/31/2017
Operating Revenues:		
Net Premium Earned	$ 161,259	$ 166,768
Total Operating Revenue	161,259	166,768
Operating Expenses:		
Benefits and Claims	121,925	123,028
Personal Services	30,417	31,387
Dividend Expense	39,998	40,002
Other Operating Expense	35,834	32,470
Total Operating Expense	228,174	226,887
Net Operating Income (Loss)	(66,915)	(60,119)
Nonoperating Revenue (Expense):		
Investment Income	4,144	72,617
Other Nonoperating Revenue	635	1,299
Total Nonoperating Revenue (Expense)	4,779	73,916
Change in Net Position	(62,136)	13,798
Prior Period Adjustment	6,231	(11)
Beginning Net Position	539,091	525,304
Total Net Position	$ 483,186	$ 539,091

For the year ended December 31, 2018, MSF produced a decrease in net position of $(62.1)M after returning $40.0M in dividends to eligible policyholders. Net premium income for the year was relatively consistent when compared to the prior year, despite an 8% rate reduction taking effect mid-way through the year. Premium retention, or the amount of premium that was retained from the prior year, was approximately 91% for the year ended December 31, 2018, which is consistent with MSF's recent history.

The accident year ultimate loss, which is the expected ultimate cost of all claims incurred during the year, was approximately 100.3% of the prior year ultimate loss, indicating relatively stable expected loss experience from period to period.

Personal services and other operating expense levels increased slightly in 2018 as compared to the prior year. As noted above, MSF in the process of replacing its policy management software and is therefore incurring costs that were not present in the prior year.

The final contributing factor in the $(62.1)M change in net position is MSF's investment income. While the rates of return from the portfolio remained relatively constant throughout the two years shown above, MSF had significantly more unrealized losses during 2018 than it did during 2017 due to market volatility. In addition, the amount of realized gains on the portfolio were larger during 2017 than 2018. A combination of these factors resulted in investment income being roughly $(68.5)M less in 2018 than in 2017.

An operating loss of ($66.9)M that includes a $40M dividend, offset by lower than expected investment income resulted in a change in net position of $(62.1)M.

Statement of Net Position

Montana State Fund is a component unit of the State of Montana

		December 31, 2018
ASSETS		
Current Assets		
Cash and Cash Equivalents	$	22,693,381
Receivables, Net		75,979,949
Securities Lending Collateral		102,000
Other Assets		3,109,782
Total Current Assets		101,885,112
Noncurrent Assets		
Investments		1,410,418,477
Reinsurance Receivables		48,385,574
Capital Assets:		
Land		1,139,460
Other Capital Assets, Net of Depreciation		33,666,350
Total Capital Assets		34,805,810
Total Noncurrent Assets		1,493,609,861
Total Assets		1,595,494,973
DEFERRED OUTFLOWS OF RESOURCES		6,964,502
LIABILITIES		
Current Liabilities		
Accounts Payable		26,916,657
Estimated Claims Payable		113,205,490
Unearned Premium		63,931,327
Securities Lending Liability		102,000
Other Current Liabilities		4,666,878
Total Current Liabilities		208,822,352
Noncurrent Liabilities		
Estimated Claims Payable		828,432,205
Reinsurance Funds Withheld		48,385,574
Net Pension Liability		31,263,987
Other Noncurrent Liabilities		1,555,494
Total Noncurrent Liabilities		909,637,260
Total Liabilities		1,118,459,612
DEFERRED INFLOWS OF RESOURCES		813,609
NET POSITION		
Net Investment in Capital Assets		34,805,810
Unrestricted		448,380,444
Total Net Position	$	483,186,254

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

Statement of Revenues, Expenses, and Changes in Fund Net Position

Montana State Fund is a component unit of the State of Montana

	For the Year Ended December 31, 2018
Net Premiums Earned	$ 161,258,975
Operating Expenses	
Benefits and Claims	121,924,898
Personal Services	30,417,498
Contractual Services	9,621,869
Supplies and Materials	1,805,069
Communications	1,132,388
Travel	256,948
Rent and Utilities	608,151
Repair and Maintenance	2,019,961
Depreciation and Amortization	1,203,154
Dividend Expense	39,997,664
Other Operating Expenses	19,186,820
Total Operating Expenses	228,174,420
Operating Income (Loss)	(66,915,445)
Nonoperating Revenue (Expenses)	
Investment Income	4,144,375
Securities Lending Income	411,341
Securities Lending Expenses	(224,721)
Loss on Retirement of Assets	(29,804)
Other Income	478,632
Total Nonoperating Revenue (Expenses)	4,779,823
Change in Net Position	(62,135,622)
Total Net Position - Beginning (As Previously Reported)	539,090,932
Prior Period Adjustment	6,230,944
Total Net Position - Beginning (As Restated)	545,321,876
Total Net Position - Ending	$ 483,186,254

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

Statement of Cash Flows

Montana State Fund is a component unit of the State of Montana

YEAR ENDED DECEMBER 31,	2018
Cash Flows from Operating Activities	
Receipts for Premiums	$ 162,563,768
Payments for Claims	(112,515,188)
Payments to Employees	(27,411,247)
Payments to Suppliers for Goods and Services	(32,956,299)
Payments for Dividends	(41,253,490)
Other Operating Receipts	703,467
Net Cash Provided by (Used for) Operating Activities	(50,868,989)
Cash Flows from Capital and Related Financing Activities	
Acquisition of Fixed Assets	(7,857,492)
Proceeds from Disposal of Fixed Assets	37,716
Net Cash Used for Capital and Related Financing Activities	(7,819,776)
Cash Flows from Investing Activities	
Purchase of Investments	(290,394,477)
Proceeds from Sales or Maturities of Investments	284,471,295
Interest and Dividends on Investments	36,907,038
Net Cash Provided by (Used For) Investing Activities	30,983,856
Net Increase (Decrease) in Cash and Cash Equivalents	(27,704,909)
Cash and Cash Equivalents - January 1	50,398,290
Cash and Cash Equivalents - December 31	$ 22,693,381

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

Statement of Cash Flows

Montana State Fund is a component unit of the State of Montana

YEAR ENDED DECEMBER 31,		2018
Reconciliation of Change in Net Position to Net Cash Provided by (Used for) Operating Activities		
Change in Net Position	$	(62,135,622)
Adjustments to Reconcile Change in Net Position to Net Cash Provided by (Used for) Operating Activities		
Depreciation		1,092,692
Amortization		110,462
Loss on Sale of Fixed Assets		48,041
Gain on Sale of Fixed Assets		(18,237)
Income on Investments		(4,330,995)
Decrease (Increase) in		
Accounts Receivable		3,493,503
Reinsurance Receivables		25,448,727
Deferred Outflows of Resources		(850,396)
Other Assets		81,940
Increase (Decrease) in		
Accounts Payable		1,125,839
Unearned Premium		(3,032,109)
Property Held in Trust		(222,912)
Reinsurance Funds Withheld		(37,484,569)
Estimated Claims Payable		21,948,000
Deferred Inflows of Resources		584,145
Pension Liabilities		3,155,876
OPEB Liability		38,530
Compensated Absences		78,096
Total Adjustments		11,266,633
Net Cash Provided by (Used for) Operating Activities	$	(50,868,989)

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

Montana State Fund
(A Component Unit of the State of Montana)
Notes to Financial Statements
December 31, 2018

1. Summary of Significant Accounting Policies

Description of Business

The Montana State Fund (MSF) is a nonprofit, independent public corporation established under Title 39, chapter 71 of the Montana Code Annotated (MCA). MSF provides Montana employers with an option for workers' compensation and occupational disease insurance and guarantees available coverage for all employers in Montana. MSF is a discretely presented component unit of the State of Montana and results are included in the State's Comprehensive Annual Financial Report because of the significance of MSF's financial relationship with the State. MSF is governed by a seven member Board of Directors appointed by the Governor. The Board has full power, authority, and jurisdiction in the administration of MSF. MSF's Board is allocated to the State of Montana, Department of Administration for administrative purposes only.

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

MSF functions as an autonomous insurance entity supported solely from its own revenues. All assets, debts, and obligations of MSF are separate and distinct from assets, debts, and obligations of the State of Montana. MSF administers and manages the claims remaining in the Old Fund for the State of Montana and is the administering entity for recording the financial activity related to receipt and disbursement of funds and assets held by the Old Fund. Other than the administrative fees paid for the management of the Old Fund claims, no State of Montana General Fund money is used for MSF operations.

The 2015 Legislature passed SB 123, which significantly changed the regulatory oversight of MSF effective January 1, 2016. MSF was issued a Certificate of Authority, became an authorized insurer regulated by the Montana State Auditor's Office and became subject to the provisions of Title 33, Montana Insurance Code. As a result, MSF reports financial results on a calendar year basis instead of using the State's fiscal year ending June 30th.

Prior Period Adjustment

During the year ended December 31, 2018, MSF implemented GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which requires a restatement of beginning net position for the cumulative effect of the initial statement application. Accordingly, MSF recorded an adjustment to its beginning net position of $6.2M.

In addition, the State of Montana received a revised pension actuarial valuation subsequent to the issuance of MSF's December 31, 2017 financial statements that changed MSF's allocated share of the recorded pension liability. Accordingly, MSF restated its beginning net position to reflect this change. The net impact of the adjustment was less than $1K (thousand).

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Basis of Presentation

The financial statements are presented in accordance with generally accepted accounting principles (GAAP) as prescribed by the GASB. MSF insurance operations are classified as an enterprise fund, in the proprietary fund category. MSF comprises only one of the State of Montana's enterprise funds. The financial statements in this report reflect the financial position and results of operations and cash flows of MSF for the year ending December 31, 2018.

An enterprise fund is used to account for operations: (a) financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity; (b) where laws or regulations require that the activity's costs of providing services be recovered with fees and charges, rather than with taxes or similar revenues; or (c) where the pricing policies of the activity establish fees and charges designed to recover its costs, where the primary focus of these criteria is on fees charged to external users.

Basis of Accounting

MSF uses the accrual basis of accounting, as defined by GAAP, for its workers' compensation insurance operations. Under the accrual basis, revenues are recorded in the accounting period earned, if measurable, and expenses are recorded in the period incurred, if measurable.

Cash and Cash Equivalents

Cash balances include demand deposits with the State Treasury. Cash equivalents are short-term, highly-liquid investments that are both readily-convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value. MSF participates in the Montana Board of Investments' Short Term Investment Pool (STIP), an external investment pool. STIP is managed and administered under the direction of the Montana Board of Investments (BOI) as authorized by the Unified Investment Program. STIP is a commingled pool for investment purposes and requested redemptions from the pool are redeemed the next business day. The STIP portfolio is reported at net asset value. STIP balance as of December 31, 2018, was $17.8M.

Investments

MSF holds investments in long-term debt securities, mutual funds, and real estate partnerships through the BOI. Under the provisions of the state constitution, MSF's invested assets are managed by the BOI. Securities are stated at fair value. Premiums and discounts are amortized using the scientific method over the life of the securities.

The investment risk disclosures are described in the following paragraphs.

Credit Risk

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

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The U.S. Government guarantees its 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 risk.

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

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

The BOI's STIP investment policy specifies that STIP securities have a minimum of two credit ratings as provided by Standard and Poor's, Moody's, or Fitch that meet the minimum as stated in the STIP policy on the type of investment.

Custodial Credit Risk (Cash and Cash Equivalents and Investments)

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

As of December 31st, all of the public securities, core real estate, and commingled equity index funds were registered in the nominee name for the Montana Board of Investments and held in possession of BOI's custodial bank.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributable to the magnitude of any single investment per issuer name. Excluded from the concentration of credit risk requirement are investments explicitly guaranteed by the U.S. Government. Concentration of credit risk is addressed within all Investment Policy Statements as set by BOI.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. BOI uses effective duration as a measure of interest rate risk for the MSF portfolio.

MSF's investment policy states the duration is to remain within 20% of the established benchmark in duration.

According to the STIP Investment Policy, "the STIP portfolio will minimize interest rate risk by:

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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) for 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."

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

Investments at fair value are categorized to disclose credit risk and interest rate risk on the following table for fixed income securities. Credit risk is disclosed using the weighted credit quality rating by investment type. Interest rate risk is disclosed using weighted effective duration. The credit quality ratings have been calculated excluding non-rated investment types. NRSRO provides the credit ratings presented in the following tables.

Security Investment Type	Fair Value	Credit Quality Rating	Effective Duration
Treasuries	$ 279,122,465	AAA	3.76
Agency/Government Related	166,060,283	AA+	3.70
Asset Backed Securities	47,741,027	AAA	2.18
Mortgage Back Securities - Noncommercial	38,554,563	AA+	5.46
Mortgage Back Securities - Commercial	16,125,944	AAA	7.16
Financial-Corporate	275,339,321	A-	3.00
Industrial Corporate	308,629,589	A	4.28
Utility-Corporate	21,193,280	BBB+	2.32
Short Term Investment Pool (STIP)	17,805,151	NR	0.08
Total Fixed Income Investments	$ 1,170,571,623		

Securities Lending

MSF participates in a securities lending program through the BOI. The BOI is authorized by law to lend its securities and has contracted with the custodial bank, State Street Bank and Trust, "the Bank," to lend 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% of the fair value of domestic securities and 105% of the fair value of international securities while the securities are on loan. On any day, including December 31st, 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. BOI and the Bank split the earnings, 80/20% respectively, on security lending activities. BOI retains all rights and risks of ownership during the loan period. The Bank indemnifies BOI's credit risk exposure to borrowers.

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During the year, the Bank loaned MSF's public securities and received as collateral: U.S. dollar cash; U.S. Government and government-sponsored agency securities; U.S. corporate debt securities and structured securities rated AA-/Aa3 or higher; sovereign debt securities of the G10 nations; and debt securities issued by certain supranational agencies. The Bank cannot sell collateral securities unless the borrower defaults.

BOI imposed no restrictions on the number of securities available to lend during the year ended December 31, 2018. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the period that resulted in a declaration and notice of default of the borrower. There were no losses during the year ended December 31, 2018, resulting from a borrower default. As of December 31, no securities were recalled and not yet returned.

The cash collateral received for each loan was invested, together with other qualified plan lenders cash collateral, in an investment fund named the Navigator Securities Lending Government Money Market (Navigator) portfolio.

The following table presents the market values of the securities on loan and the total collateral held as of December 31, 2018:

	Amount
Fair Value On Loan	$ 112,770,787
Collateral Cash	102,000
Collateral Securities	114,763,180
Collateral Total	$ 114,865,180
% of Fair Value	102%

BOI 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. As of December 31, 2018, the Navigator portfolio's average duration was .03 days, and its average weighted final maturity was 10 days.

Income earned related to securities lending for the year ended December 31, 2018, was $411K. Expenses related to securities lending for the year ended December 31, 2018, were $225K.

Receivables

At December 31, 2018, MSF had a net receivable balance of $76.0M. The gross receivables for billed premium and claim benefits overpayments are $5.3M, which are then reduced by the estimated uncollectible receivables reported as an allowance for doubtful accounts of $2.7M. Other receivables include $59.2M in unbilled premium, $8.3M in investment income due, $39K in retrospective premium and $279K in notes receivable, all of which are short term. Accounts receivable also includes $3.5M at December 31, 2018, for premium that is earned but unbilled (EBUB).

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Reinsurance Receivables

As part of the aggregate stop-loss reinsurance program, MSF records a receivable for each contract year's funds withheld amount until the loss performance for that contract year is known. The receivable is increased as interest accrues and decreased with the development of recoverable or in the event of a commutation. The reinsurance receivables were $48.4M at December 31, 2018.

Equipment, Accumulated Depreciation and Intangible Assets

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

Construction Work in Process

Costs for internally-generated intangible assets exceeding $500K are capitalized once activities in the preliminary project stage are completed and management authorizes and commits to funding the project. Costs incurred during the design of the chosen path, including software configuration and interfaces, coding, installation to hardware, and testing are capitalized. Amortization begins once the asset is placed in service on a straight-line basis over four years.

Other Assets

Other assets include advances and prepaid expenses.

Land and Buildings

As of December 31, 2018, MSF financial statements include $1.1M in land and $23.4M in buildings, net of depreciation. Buildings are depreciated on a straight-line basis over a period of 50 years. For additional disclosure related to capital assets, see Note 3.

Accounts Payable

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

Estimated Claims Payable

The estimated claims payable, also called loss reserves, is established to provide for the estimated ultimate settlement cost of all claims incurred. Estimated claims payable is based on reported aggregate claim cost estimates combined with estimates for future development of such claim costs and estimates of incurred but not reported (IBNR) claims. Willis Towers Watson, an external actuarial firm, prepares an actuarial study that provides a range of potential costs associated with reported claims, the future development of those claims and IBNR. The MSF Board of Directors approved estimates within that range as the estimated claims payable for MSF. The claim costs estimated to be paid in the next year are displayed in Current Liabilities as Estimated Claims Payable and the remainder of the total is shown in Noncurrent Liabilities. For additional disclosure related to the estimated claims payable, refer to Note 5.

Unearned Premium

Unearned premium reflects premium that has been written but not yet earned. The unearned premium was $63.9M at December 31, 2018.

Policyholder Deposits

Policyholder deposits consist of security deposits required for deposit-type policies and secure the policy with cash, letter of credit or certificate of deposit.

Reinsurance Funds Withheld

Reinsurance funds withheld represents the reinsurance funds held on behalf of the reinsurer, a requirement of MSF's aggregate stop-loss reinsurance contract. Additional information regarding the funds withheld account can be found in Note 4.

Net Position

Net Position consists of the net excess or deficit of assets plus deferred outflows of resources over liabilities plus deferred inflows of resources. Net Position as of December 31, 2018, was $483.2M.

Premiums

The MSF Board of Directors approves premium rates annually. These rates are then filed with the Montana State Auditor's Office for approval in accordance with MCA, Title 33. Generally, policies are effective for the term of the policy period not to exceed 12 months. Premium revenue is recognized over the term of the policy year as it is earned or when MSF is liable for coverage.

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

2. Investments

MSF has the following recurring fair value measurements as of December 31, 2018:

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		Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable (Level 3)
Investments by fair value level				
Fixed Income Investments				
Treasuries	$ 279,122,465	$ 279,122,465		
Agency/Government related	166,060,283		166,060,283	
Asset-backed securities	47,741,027		47,741,027	
Mortgage-backed securities-noncommercial	38,554,563		38,554,563	
Mortgage-backed securities-commercial	16,125,944		16,125,944	
Financial-corporate	275,339,321		275,339,321	
Industrial-corporate	308,629,589		308,629,589	
Utility-corporate	21,193,280		21,193,280	
Total Fixed Income Investments by fair value level	1,152,766,472	279,122,465	873,644,007	

	Fair Value	Unfunded Commitments	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
Investments measured at the net asset value (NAV)				
Core Real Estate	104,049,435		Monthly, Quarterly	45-90 days
Commingled Equity Index Funds	153,602,571		Daily	1 day
Short Term Investment Pool (STIP)	17,805,151		Daily	1 day
Total Investments at NAV	275,457,157			
Total investments at fair value	$ 1,428,223,629			

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

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

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. MSF does not classify any holdings within Level 3 of the fair value hierarchy.

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MSF holds five core real estate funds which make equity investments in operating and substantially-leased institutional-quality real estate in the traditional property types (i.e. 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 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 MSF'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. As of December 31, 2018, there are no unfunded commitments.

MSF holds two commingled equity index funds which 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.

The Short Term Investment Program (STIP) is managed and administered under the direction of the Board of Investments 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.

The amortized cost and estimated market value of MSF's fixed maturity securities as of December 31, 2018, are shown below at contractual maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Market Value
Due one year or less	$ 79,142,968	$ 78,901,957
Due after one year through five years	792,353,145	786,633,925
Due after five years through ten years	295,285,891	287,230,590
Total	$ 1,166,782,004	$ 1,152,766,472

During the year ended December 31, 2018, MSF realized gross gains from sales of securities of $21.7M and gross realized losses of ($2.8M). During the year ended December 31, 2018, net investment income for MSF was $4.1M, which is comprised of investment income of $55.7M and unrealized losses on investments in the amount of ($51.6M).

3. Capital Assets

Capital assets are used for the business activities of MSF. Balances for the year ended December 31, 2018 are as follows:

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	Beginning Balances	Increases	Decreases	Ending Balances
Capital assets not being depreciated:				
Land	$ 1,139,460	$ —	$ —	$ 1,139,460
Construction Work in Process	1,384,541	6,907,586	—	8,292,127
Total capital assets not being depreciated	2,524,001	6,907,586	—	9,431,587
Capital assets being depreciated:				
Buildings/improvements	27,941,323	—	—	27,941,323
Equipment, furniture, and vehicles	7,257,230	949,906	(471,425)	7,735,711
Total capital assets being depreciated	35,198,553	949,906	(471,425)	35,677,034
Less accumulated depreciation for:				
Buildings/improvements	(4,025,879)	(530,885)	—	(4,556,764)
Equipment, furniture, and vehicles	(5,597,351)	(561,807)	403,906	(5,755,252)
Total accumulated depreciation	(9,623,230)	(1,092,692)	403,906	(10,312,016)
Total capital assets being depreciated, net	25,575,323	(142,786)	(67,519)	25,365,018
Intangible assets	119,668	—	(110,463)	9,205
Total capital assets, net	$ 28,218,992	$ 6,764,800	$ (177,982)	$ 34,805,810

4. Reinsurance

For the year ended December 31, 2018, MSF ceded premiums to reinsurance companies to limit the exposure arising from large losses. These arrangements consist of excess of loss contracts that protect against individual occurrences over stipulated amounts and an aggregate stop-loss contract which protects MSF against the potential that aggregate losses will exceed expected levels expressed as a percentage of premiums.

The excess of loss contract provides coverage up to $100 million with an MSF retention of $5 million on the first layer of coverage. The excess of loss protection applies to an individual occurrence with a maximum of $5 million on any one life.

The term of the current aggregate stop-loss contract is January 1, 2017, through January 1, 2020. The contract provides coverage based on MSF's premium levels, not to exceed 15% of the subject net earned premium. In the event reinsurers are unable to meet their obligations under either the excess of loss contracts or aggregate stop-loss contract, MSF would remain liable for all losses, as the reinsurance agreements do not discharge MSF from its primary liability to the policyholders.

Premium revenue is reduced by premiums paid for reinsurance coverage of $10.0M for the year ended December 31, 2018. The aggregate stop-loss contract requires that MSF maintain a funds withheld liability account which represents the basic premium portion of the total premium paid for aggregate stop-loss coverage. The funds withheld liability account at December 31, 2018, is $48.4M for contracts in place from July 1, 2012, to December 31, 2018. Interest must be accrued on the funds withheld account which resulted

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in accrued interest of $3.3M for the year ended December 31, 2018.

Estimated claim reserves were reduced by $1.3M as of December 31, 2018, for the amount of reinsurance estimated to be ultimately recoverable on incurred losses due to the excess of loss reinsurance contracts. The estimated claim reserves were not reduced due to the aggregate stop-loss contract, as no recoverable amounts are expected at the end of 2018.

As part of the aggregate stop-loss reinsurance program, MSF records a reinsurance receivable for each contract year's funds withheld amount until the loss performance for that contract year is known. The receivable is increased as interest accrues and decreased with the development of the recoverable or in the event of a commutation. The reinsurance receivables were $48.4M at December 31, 2018.

MSF also has assumed reinsurance relationships with Zurich American Insurance Company and Argonaut Insurance Company related to Other States' Coverage (OSC). MSF assumes risk related to Montana domiciled businesses with operations in other states, which are then covered under MSF's ceded reinsurance contract. For the year ended December 31, 2018, assumed premium is $2.8M and incurred losses from OSC benefits were $3.1M. The assumed liability for OSC claims is $4.8M at December 31, 2018.

5. Risk Management

MSF provides liability coverage to employers for injured employees that are insured under the Workers' Compensation and Occupational Disease Acts of Montana. Workers' compensation claims occurring on or after July 1, 1990 are reported in the MSF financials. At December 31, 2018, approximately 23,800 active policies were insured by MSF.

MSF is a self-supporting, competitive state fund and functions as the guaranteed market insurer for employers since workers' compensation coverage is mandated in Montana. Employers may obtain coverage through private carriers, through MSF, or through self-insurance if they meet certain criteria. State of Montana agencies are required by law to insure through MSF.

Unpaid claims and claim adjustment expenses are estimated based on the ultimate cost of settling the claims including the effects of inflation and other social and economic factors. Willis Towers Watson, an external actuarial firm, prepares an actuarial study used to estimate liabilities and the ultimate cost of settling claims reported but not settled and claims incurred but not reported (IBNR) for MSF as of December 31, 2018. Because actual claim costs depend on such complex factors such as inflation, duration, and changes in the law, claim liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. A provision for inflation is implicit in the calculation of estimated future claim costs because reliance is placed both on actual historical data that reflects past inflation and on other factors that are considered to be appropriate modifiers of past experience.

Willis Towers Watson provides a range of potential costs associated with reported claims, the future development of those claims, and IBNR. MSF management has selected a central estimate within that range as the estimated claims payable, consisting of unpaid claims and claim adjustment expenses, for December 31, 2018. The MSF estimated unpaid claims and claims adjustment expenses payable presented at face value,

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net of estimated reinsurance recoverable were $941.6M, as of December 31, 2018. The Statement of Net Position displays this total separated as current and noncurrent estimated claims payable.

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

Changes in Claims Liabilities

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

		2018
Unpaid claims and claim adjustment expenses at beginning of period	$	919,689,695
Incurred claims and claim adjustment expenses:		
Provision for insured events of the current year		137,066,019
Increase(Decrease) in provision for events in prior years		(15,141,122)
Total incurred claims and claim adjustment expenses		121,924,897
Payments:		
Claims and claim adjustment expenses attributable to insured events of the current year		(22,902,550)
Claims and claim adjustment expenses attributable to insured events of prior years		(77,074,347)
Total payment		(99,976,897)
Total unpaid claims and claim adjustment expenses at the end of the period	$	941,637,695

6. Administrative Cost Allocation

State law (Section 39-71-2352, MCA) requires MSF to separately determine and account for administrative expenses and benefit payments for claims for injuries resulting from accidents occurring before July 1, 1990 (Old Fund) from those occurring on or after July 1, 1990 (MSF). The law limits annual administrative costs of claims associated with the Old Fund to $1.25M for periods prior to July 1, 2017 and $625K for periods through July 1, 2019. MSF allocated $596K in administration costs to the Old Fund for the year ended December 31, 2018. The administration costs are recorded in non-operating revenue as other income. The State of Montana General Fund is responsible for the cost of administering and paying the Old Fund claim benefits.

7. MSF Distributions

The MSF Board of Directors declared a $40M dividend in September 2018, of which $39.9M was paid in 2018. The remaining amount was paid in 2019.

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8. Compensated Absences

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

The total MSF compensated absences liability is $3.2M as of December 31, 2018.

9. Retirement Plans

MSF and its employees contribute to the Public Employees' Retirement System (PERS), which offers two types of retirement plans administered by the Public Employees' Retirement Board (PERB), a defined benefit retirement plan (PERS-DBRP) and a defined contribution retirement plan (PERS-DCRP).

<u>Defined Benefit Retirement Plan</u>

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

Eligibility for benefit	
Service retirement:	
• Hired prior to July 1, 2011:	Age 60, 5 years of membership service; Age 65, regardless of membership service; or Any age, 30 years of membership service.
• Hired on or after July 1, 2011:	Age 65, 5 years of membership service; Age 70, regardless of membership service.
Early Retirement	
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.

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- Hired on or after July 1, 2011: Age 55, 5 years of membership service.

Second Retirement (requires returning to PERS-covered employer 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 return interest (currently .77% effective July 1, 2017).
- No service credit for second employment;
- Start the same benefit amount the month following termination; and
- Guaranteed Annual Benefit Adjustment (GABA) starts again in the January immediately following the second retirement.

Retire before January 1, 2016 and accumulate at least 2 years of additional 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 years 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.

Member's highest average compensation (HAC)

- Hired prior to July 1, 2011 - highest average compensation during any consecutive 36 months;
- Hired on or after July 1, 2011 – highest average compensation during any consecutive 60 months;

Compensation Cap

- Hired on or after July 1, 2013 – 110% annual cap on compensation considered as a part of a member's highest average compensation.

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;

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- 10 years or more, but less than 30 years of membership service: 1.785% of HAC per year of service credit;
- 30 years or more of membership service: 2% of HAC per year of service credit.

Guaranteed Annual Benefit Adjustment (GABA)
After the member has completed 12 full months of retirement, the member's benefit increases by the applicable percentage (provided below) each January, inclusive of all other adjustments to the member's benefit.

- 3.0% 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:
  a. 1.5% for each year PERS is funded at or above 90%;
  b. 1.5% reduced by 0.1% for each 2.0% PERS is funded below 90%; and
  c. 0% whenever the amortization period for PERS is 40 years or more.

There have been no changes to benefit terms since the prior measurement date.

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

MSF contributes 8.57% of each member's compensation. This was increased from 6.9% to 7.035% on July 1, 2007, 7.17% on July 1, 2009, and to 8.17% on July 1, 2013. The rate will continue to increase .1% each year until 2024. These increased contributions will terminate on January 1 following the actuarial valuation results that project the amortization period to drop below 25 years and remain below following the termination of the additional employer contribution rates. Effective July 1, 2013, contributions are also made to the plan from the Coal Severance Tax Fund. The plan recognized $1,582,700 in MSF (employer) contributions during the plan year ended June 30, 2018.

Actuarial assumptions. The TPL used to calculate the NPL was determined by taking the results of the June 30, 2017, actuarial valuation and applying standard roll forward procedures to update the TPL to June 30, 2018. There were several significant assumptions and other inputs used to measure the TPL. The actuarial assumptions used in the June 30, 2018, valuation were based on the results of the last actuarial experience study, dated May 2017, for the six- year period July 1, 2010 to June 30, 2016. Among those assumptions were the following:

• Investment Return (net of admin expense)	7.65%
• Admin Expense as % of Payroll	0.26%
• General Wage Growth (includes inflation at 2.75%)	3.50%
• Merit Increases	0% to 6.3%
• Postretirement Benefit Increases:	
Guaranteed Annual Benefit Adjustment (GABA)	

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

- ◦ 3.0% 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:
  - (a) 1.5% for each year PERS is funded at or above 90%;
  - (b) 1.5% reduced by 0.1% for each 2.0% PERS is funded below 90%; and
  - (c) 0% whenever the amortization period for PERS is 40 years or more.
- Mortality assumptions among contributing members, terminated vested members, service retired members and beneficiaries were based on RP 2000 Combined Employee and Annuitant Mortality Tables projected to 2020 with scale BB, males set back 1 year.
- Mortality assumptions among disabled members were based on RP 2000 Combined Health Mortality Tables with no projections.

There were no changes in actuarial assumptions and methods since the last actuarial valuation.

Discount rate. The discount rate used to measure the TPL was 7.65%. The projection of cash flows used to determine the discount rate assumed that contributions from participating plan members, employers, and non-employer contributing entities would be made based on the Board's funding policy, which established the contractually required rates under the Montana Code Annotated. The state contributed 0.10% of the salaries paid by local governments and 0.37% paid by school districts. In addition, the state contributed coal severance tax and interest money from the general fund. The interest was contributed monthly and the severance tax was contributed quarterly. Based on those assumptions, the Plan's fiduciary net position was projected to be adequate to make all the projected future benefit payments of current plan members through the year 2121. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the TPL. A municipal bond rate was not incorporated in the discount rate.

The long-term expected return on pension plan assets was reviewed as part of the regular experience study prepared for the Plan. The most recent analysis, performed for the period of July 1, 2010 to June 30, 2016, was outlined in a report dated May 2017 and can be 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, 2018, are summarized below.

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Asset Class	Target Allocation	Expected Rate of Return
Cash Equivalents	2.6%	4.00%
Domestic Equity	36.0%	4.55%
Foreign Equity	18.0%	6.35%
Fixed Income	23.4%	1.00%
Private Equity	12.0%	7.75%
Real Estate	8.0%	4.00%
Total	100.0%	

The following table displays MSF’s proportionate share of the net pension liability using the 7.65% discount rate as well as the proportionate share using 6.65% and 8.55%, a decrease of 1% and an increase of 1%, respectively.

	1% Decrease (6.65%)	Discount Rate (7.65%)	1% Increase (8.65%)
MSF's Proportionate Share of the Net Pension Liability	$45,214,966	$31,263,987	$19,808,010

Plan fiduciary net position. The financial statements of the Montana Public Employees Retirement Board (PERB) Comprehensive Annual Financial Report (CAFR) and the GASB 67 Report disclose the Plan’s fiduciary net position. The reports are available from the PERB at PO Box 200131, Helena MT 59620-0131, (406) 444-3154 or both are available on the MPERA website at http://mpera.mt.gov

Pension liabilities, expense, and deferred inflows and outflows of resources. At December 31, 2018, MSF reported a liability for its proportionate share of the plan’s total net pension liability in the amount of $31,263,987, representing a 1.497933% share of the total based on amount of contributions by each employer. The net pension liability was measured as of June 30, 2018, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2017, with updated procedures used to roll forward the liability to June 30, 2018. There were no significant events between the measurement date and reporting date that are expected to have an impact on MSF’s proportionate share of the liability.

For the year ended December 31, 2018, MSF recognized pension expense of $4,180,721. At December 31, 2018, MSF reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

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	Deferred Outflows of Resources	Deferred Inflows of Resources
Actual vs. Expected Experiences	$ 2,377,416	$ —
Changes of assumptions	2,658,533	—
Actual vs. Expected Investment Earnings	—	485,529
Changes in Proportion and Differences Between Actual Contributions and Proportionate Share Contributions	1,109,544	—
Contributions Subsequent to the Measurement Date	808,302	—
Total	$ 6,953,795	$ 485,529

The $808,302 reported as deferred outflows of resources related to pensions resulting from MSF contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

State of Montana's year ended June 30:	
2019	$ 3,173,160
2020	2,642,849
2021	43,455
2022	(199,500)
2023	—
Thereafter	—

Defined Contribution Retirement Plan

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

Eligibility for benefit

Termination of service

Vesting

Immediate for participant's contributions and attributable income;

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

Benefit

Depends upon eligibility and individual account balance;

various payout options are available, including: taxable lump sums, periodic payments per participant direction and IRS permitted rollovers.

Member and employer contribution rates are established in state law by the State of Montana Legislature. The member contribution rate for the year ended December 31, 2018, was 7.9% of member compensation, while the MSF contribution rate was 8.57% of member compensation for the first half of the year and 8.67% for the second half. Both the member and employer rates have been temporarily increased by the Legislature and will decrease to 6.9% on January 1 following actuarial valuation results that show the amortization period of the PERS-DBRP has dropped below 25 years and will remain below 25 years following the reduction of both the additional employer and additional member contribution rates.

For the year ended December 31, 2018, MSF contributed $1.9M to the defined benefit and defined contribution plans combined. MSF cannot determine the portion of that total that relates to the defined contribution plan. Of that amount, $44K remains outstanding at December 31, 2018.

Deferred Compensation Plan

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

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Contribution

Voluntary, pre-tax deferral or designated Roth contribution.

Eligibility for benefit

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

Vesting

Participants are fully vested in their accounts immediately.

Benefit

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

10. Leases and Commitments

MSF leases office facilities outside of Helena under various operating leases that expire through September 2022.

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

Rental expenses for the year ended December 31, 2018, were $396K, which includes $298K for the parking garage lease, $58K for office space leases, and $40K for minor office equipment.

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

	Amount
2019	$ 397,349
2020	370,153
2021	331,910
2022	323,550
2023	315,000
Thereafter	5,197,500
	$ 6,935,462

During a 2017 special session of the Montana Legislature, Legislators passed Senate Bill 4 (SB 4) which required the Montana Board of Investments to make a transfer of MSF assets to the Fire Suppression Fund within the Montana Department of Natural Resources and Conservation. The amount transferred was based on 3% of MSF's average invested asset balance in excess of $1 billion. One transfer was made

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March 30, 2018 based on the results of 2017 and the second was made February 14, 2019 based on the results of 2018. The expense recorded in 2017 was $14.7M and the expense recorded in 2018 is $13.6M.

MSF is in a multi-year project to replace its legacy policy management system. The first phase to select vendors, coordinate change management processes and develop and implement core policy management and billing transaction systems is expected to be completed by December 2019 and require total expenditures estimated at $21M. The total project cost from January 1, 2017 to December 31, 2018 was $12.7M. The last phase to develop remaining enhancement features will be planned and arranged with consulting services towards the end of 2019. Costs during the application development phase will be capitalized and recorded as construction work in process until the system is deployed.

11. Other Post-Employment Benefits (OPEB)

MSF participates in a single-employer, defined-benefit post-employment healthcare plan administered by the State of Montana. In accordance with Section 2-18-704, MCA, the plan provides optional post-employment medical, dental, and vision benefits to eligible MSF retirees and their dependents, as well as surviving dependents of deceased employees. In accordance with GASB Statement 75, MSF is required to report in its financial statements its proportionate share of the collective total OPEB liability, OPEB expense, and deferred inflows and outflows of resources related to OPEB.

OPEB Plan Description

The plan allows retirees to participate in the State health insurance plan, as a group, at a rate that does not cover all the related costs. Retirees pay their entire administratively-determined premium. Accordingly, reported contributions are not a result of direct funding to the plan or for associated liabilities, but are a measure of the difference in retiree payments into the plan and actual medical costs associated with those individuals paid for by the plan.

The plan is not administered through a trust and therefore there are no accumulated plan assets to offset the total OPEB liability. The plan is funded on a pay-as-you-go-basis, and Section 2-18-8, MCA, gives authority for establishing and amending the funding policy of the State group health insurance plan to the Montana Department of Administration.

As of December 31, 2018, the OPEB plan's administratively established retiree medical premiums vary between $439.00 and $1,633.00 per month, depending on the medical plan selected, family coverage, and Medicare eligibility. Administratively established dental premiums vary between $41.10 and $70.00 and vision hardware premiums vary between $7.64 and $22.26, depending on the coverage selected. The plan provides different coinsurance amounts and deductibles depending on whether members use in-network or out-of-network providers. The plan automatically reduces claim reimbursement for members eligible for Medicare, even if the member is not enrolled in Medicare.

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Schedule of Changes in OPEB Liability

The following schedule presents the change in MSF's proportionate share of the total OPEB liability (TOL). As of the measurement date, MSF's share of the TOL is 1.41%, based on the number of total plan participants. MSF's share of the TOL increased .06% since the prior measurement date.

December 31, 2017 Balance (Restated)	$	675,246
Changes for the year:		
Service cost		123,509
Interest		131,642
OPEB expense		255,151
Contributions		111,459
Difference between expected and actual experience		(308,760)
Changes of assumptions or other inputs		(19,320)
December 31, 2018 Balance	$	713,776

Actuarial Assumptions

The plan's TOL was determined using the following actuarial assumptions and other inputs, applied to all periods included in the measurement, unless otherwise specified:

Valuation date	December 31, 2017
Measurement date	March 31, 2018
Cost method	Entry age normal funding method
Amortization method	Open basis
Remaining amortization period	20 years
Asset valuation method	N/A - no plan assets
Discount rate	3.89%
Projected payroll increases	4.00%
Participation:	
Future retirees	55.00%
Future eligible spouses	60.00%

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Health Care Cost Trend Rate: The following health care cost trend rates were used:

Plan Year	Medical	Prescription Drug
2018	7.5%	7.5%
2019	7.0%	7.0%
2020	6.5%	6.5%
2021	6.0%	6.0%
2022	5.9%	5.9%
2023	5.7%	5.7%
2024	5.6%	5.6%
2025	5.5%	5.5%
2026	5.3%	5.3%
2027-2043	5.2%	5.2%

Marital Status: Actual spouse information is used for current retirees. Future retired members who elect to participate in the plan are assumed to be marries at a rate of 70%. Males are assumed to be 3 years older than females.

Mortality - Healthy: Healthy mortality is assumed to follow the RP2000 Combined Mortality Table with improvements projected to Scale BB to 2020, set back one year for males.

Mortality - Disabled: Disabled mortality is assumed to follow the RP2000 Combined Mortality Table with no projections.

Changes in actuarial assumptions and methods since last measurement date: Changes in actuarial methods include adjustments to the amortization period and actuarial cost method to conform with GASB 75 requirements. Changes in actuarial assumptions include revised rates per the retirement system pension valuations as of July 1, 2017 and interest rate based upon the March 31, 2018, 20-year municipal bond index per GASB 75 requirements. Other changes include revised rates based on actual data and projected trend and updated projected health care trend rates to follow the Getzen model.

Changes in benefit terms since last measurement date: Medical plans moved from Cigna to Allegiance as of January 1, 2016, the State implemented reference-based pricing hospital contracts effective July 1, 2016, and pharmacy moved from URx to Navitus as of January 1, 2017. The State implemented an Employer Group Waiver Program for Medicare retirees effective January 1, 2017.

Rate Sensitivity

The following tables present MSF's proportionate share of the TOL calculated using a healthcare cost trend and discount rate that are 1% higher and 1% lower than the assumed rates:

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	Health Care Cost Trend Rate		
	1% Decrease 6.5%	Assumed rate 7.5%	1% Increase 8.5%
Proportionate share of OPEB liability (in thousands)	$ 553,275	$ 713,775	$ 936,531

	Discount Rate		
	1% Decrease 2.89%	Assumed rate 3.89%	1% Increase 4.89%
Proportionate share of OPEB liability (in thousands)	$ 922,868	$ 713,775	$ 557,414

Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

At December 31, 2018, MSF's proportionate share of the plan's deferred outflows and inflows of resources are as follows:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ —	$ 308,760
Changes of assumptions or other inputs	—	19,320
Transactions subsequent to the measurement date	10,707	—
Total	$ 10,707	$ 328,080

Net deferred outflows and inflows of resources will be recognized as OPEB expense as follows:

State of Montana's year ended June 30:		
2019	$	(27,067)
2020	$	(27,067)
2021	$	(27,067)
2022	$	(27,067)
2023	$	(27,067)
Thereafter	$	(192,746)

12. Contingencies

Susan Hensley v. Montana State Fund Montana State Fund received a Petition for Hearing that was filed before the Workers' Compensation Court in October 2013. The matter is Susan Hensley vs. Montana State Fund, WCC No. 2013-3235. The matter is fully briefed and is submitted for a decision. Under HB 334, as passed by the legislature in 2011 and codified in 39-71-703 (2), MCA, when a claimant receives a Class I impairment, it is not payable unless the claimant has an actual wage loss as a result of the compensable injury or occupational disease. The law was effective July 1, 2011 and applicable to claims that occurred on or

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after that date. The petitioner in this matter is challenging the constitutionality of 39-71-703 (2), MCA. State Fund anticipates the chances are remote, but as with any litigated matter there is the possibility of an adverse decision. Should the statute be held unconstitutional, determined to be applicable to other claims and also determined to be retroactively applicable, potential liability is estimated to be at least $2.2 million per year, as based on NCCI initial pricing, and current estimated business volumes. However, based on experience, costs may be substantially higher than the estimate of $2.2 million per year.

Montana State Fund received another Petition for Hearing that was filed before the Workers' Compensation Court. The matter is Steven Hanson vs. Montana State Fund, WCC No. 2014-3398. This is a companion case to Susan Hensley v. Montana State Fund and has been held in abeyance pending a decision in Hensley.

Mak and Sons Concrete Construction Service v. Montana State Fund This case involves a lawsuit by a policyholder over cancellation of its workers' compensation insurance policy. The matter is filed in the First Judicial District Court in Helena. The Montana State Fund canceled Mak and Sons' policy of insurance due to not receiving timely payment of premium. During the uninsured period, several employees of Mak and Sons were involved in a motor vehicle accident. As a result, Mak and Sons was sued for the injuries sustained by its employees. Mak and Sons then sued the Montana State Fund seeking to have coverage for the injuries as well as for breach of the contract of insurance and breach of the covenant of good faith and fair dealing. Should Mak and Sons prevail, MSF estimates the loss may approach $1.0M. The matter is in its preliminary stages and MSF intends to vigorously defend.

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

13. Related Party Transactions

Montana State Fund's administrative attachment to the State of Montana requires that certain processes and transactions be conducted with various state agencies. The Constitution of the State of Montana, Part VIII, Article 13, requires that the Montana Board of Investments invest the assets of MSF. Under Montana statute, state agencies are required to purchase workers' compensation insurance from MSF and the laws define other administrative relationships that require MSF to pay specific service charges.

The following significant transactions occurred with state agencies during the year ended December 31, 2018:

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Income:		
Premium	$	12,073,032
Retrospective premium		(235,000)
Dividends		(1,793,984)
Old Fund adminstrative cost allocation		595,684
Net income from State of Montana agencies	$	10,639,732
Expenses:		
Montana Department of Administration		
Support services cost	$	1,968,065
Benefits bureau: group insurance		3,152,408
PERS retirement contributions		1,895,736
Montana Department of Labor & Industry - unemployment insurance		69,495
Montana Board of Investments - transaction fees		294,438
Montana Department of Justice - worker's comp fraud investigation services		342,677
Montana Commissioner of Securities & Insurance - regulation fees		223,008
Montana Fire Suppression Fund - SB 4 mgmt. fee		13,552,282
Other		21,078
Expenses paid to State of Montana agencies	$	21,519,187

MSF, under a group plan agreement with state agencies, writes policies for which the premiums vary based on loss experience. Future premium adjustments for these retrospective policies are estimated and accrued through a review comparing actual losses with projected future losses, to arrive at the estimate of return premium.

REQUIRED SUPPLEMENTARY INFORMATION

Risk Management (Financial Statement Note 5)

The following table illustrates how MSF's earned revenues plus investment income compare to related costs of loss and other expenses incurred for fiscal years 2010 through 2015, the six-month period ended December 31, 2015 (shown as 2015.5), and calendar years 2016 through 2018. In addition, cumulative amounts related to estimated and actual paid claims are presented. The information allows for comparison of actual and estimated claims and is a basis for developing revenue and claims trends. As data for individual policy years mature, the correlation between original estimates and re-estimated amounts is used to evaluate the accuracy of incurred claims currently recognized for less mature policy years.

Risk Management Trend Information

(In Thousands)	2010	2011	2012	2013	2014	2015	2015.5*	2016	2017	2018
1. Premiums and Investment Revenue										
Earned	229,879	226,151	189,764	187,360	198,124	191,693	101,090	194,401	186,929	172,507
Ceded	13,224	11,286	11,501	8,459	9,460	11,310	5,545	10,447	9,841	10,007
Net Earned	216,655	214,865	178,263	178,901	188,664	180,383	95,545	183,954	177,088	162,499
2. Unallocated expenses including overhead	44,188	57,282	49,557	49,515	46,206	52,570	27,822	55,392	74,235	77,032
3. Estimated losses and expenses, end of accident year										
Incurred	137,507	142,989	118,066	128,522	139,145	124,831	66,142	128,147	126,403	126,243
Ceded	—	9,769	1,099	—	—	—	—	—	—	—
Net Incurred	137,507	133,220	116,967	128,522	139,145	124,831	66,142	128,147	126,403	126,243
4. Net paid (cumulative) as of:										
End of policy year	25,475	27,902	24,729	25,706	26,808	24,150	16,181	23,086	24,597	22,903
One year later	52,701	56,502	54,982	50,574	55,957	59,787	27,202	50,862	56,481	
Two years later	66,235	69,918	70,487	64,327	74,159	60,844	35,629	64,022		
Three years later	74,028	76,385	80,144	73,805	75,811	70,093	39,857			
Four years later	78,884	81,578	85,661	74,955	81,706	75,235				
Five years later	82,764	85,276	88,453	78,447	85,888					
Six years later	85,972	87,238	92,201	80,123						
Seven years later	87,220	89,050	93,719							
Eight years later	89,584	90,500								
Nine years later	90,962									
5. Re-estimated ceded losses and expenses	—	2,268	9,639	—	—	—	—	—	—	—
6. Re-Estimated net incurred losses and expense:										
End of policy year	137,507	133,220	116,967	128,522	139,145	124,831	74,233	128,147	126,403	126,243
One year later	139,554	134,175	130,507	123,912	134,698	140,598	69,180	124,616	125,061	
Two years later	135,833	133,652	130,281	119,972	136,257	120,835	66,085	124,219		
Three years later	135,253	133,796	119,821	120,415	126,431	118,624	67,545			
Four years later	134,681	135,734	119,313	115,453	125,011	117,441				
Five years later	133,836	134,896	115,802	113,205	124,616					
Six years later	132,963	133,600	115,694	112,263						
Seven years later	131,396	132,922	114,818							
Eight years later	129,612	132,486								
Nine years later	128,994									
7. Increase (decrease) in estimated net incurred losses and expenses from end of policy year	(8,513)	(735)	(2,149)	(16,259)	(14,528)	(7,390)	1,403	(3,928)	(1,342)	—

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

Retirement Plans (Financial Statement Note 9)

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

June 30:	2018	2017	2016	2015	2014
Proportion of the Net Pension Liability	1.50%	1.44%	1.39%	1.39%	1.35%
Proportionate Share of the Net Pension Liability	$31,263,987	$28,106,689	$23,678,261	$19,369,771	$16,863,200
Defined Benefit Pensionable Payroll	$18,494,222	$17,690,906	$16,452,061	$15,976,817	$15,340,151
Proportionate Share as % of Pensionable Payroll	169.05%	158.88%	143.92%	121.24%	111.22%
Plan Fiduciary Net Position as a % of Total Pension Liability	73.47%	73.75%	74.71%	78.40%	79.87%

June 30:	2018	2017	2016	2015	2014
Contractually Required Contributions	$1,582,700	$1,498,428	$1,391,782	$1,332,551	$1,351,735
Plan Choice Rate Required Contributions	—	—	69,744	110,334	—
Contributions in Relation to the Contractually Req. Contributions	1,582,700	1,498,428	1,461,526	1,442,885	1,351,735
Contribution Deficiency (Excess)	—	—	—	—	—
Defined Benefit Pensionable Payroll	18,494,222	17,690,906	16,452,061	15,976,817	15,132,665
Proportionate Share as % of Pensionable Payroll	8.56%	8.47%	8.88%	9.03%	8.93%

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

Other Post-Employment Benefits (Financial Statement Note 11)

In accordance with GASB 75, the following information is presented to reflect the funding progress of the OPEB plan. There are no assets accumulated in a trust that meets the criteria of GASB 75 paragraph 4 with which to pay benefits.

Schedule of Funding Progress*

	2018
Proportion of TOL	1.41%
Proportionate share of TOL	$ 713,776
Covered-employee payroll	$ 22,248,980
Proportionate share of TOL as % of covered-employee payroll	3.21%

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

Report on Internal Control and Compliance

LEGISLATIVE AUDIT DIVISION

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 financial statements as of and for the calendar year ended December 31, 2018, and the related notes to the financial statements, which collectively comprise the Montana State Fund's basic financial statements, and have issued our report thereon dated June 3, 2019.

Internal Control Over Financial Reporting

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

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Montana State Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination 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*.

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 Montana State Fund's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Montana State Fund's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

June 3, 2019

Montana State Fund

State Fund Response

Montana State Fund

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

August 2, 2019

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LEGISLATIVE AUDIT DIV.

Mr. Angus Maciver
Legislative Auditor
Legislative Audit Division
State Capitol Building, Room 160
Helena, MT 59620-1705

Dear Mr. Maciver:

Montana State Fund (MSF) appreciates the professionalism of the Legislative Audit Division staff in completing the financial-compliance audit of our calendar year 2018 governmental financial statements. We are pleased with your issuance of an unmodified opinion with no recommendations.

The management and staff of MSF continually strive to improve our operation and prioritize high-level service to Montana employers and employees. We thank the Legislative Audit Division for its assurance and assistance in achieving our vision to be an indispensable partner in achieving a safer, healthier and more prosperous Montana.

Sincerely,

Laurence A. Hubbard
President/CEO