MONTANA UNIVERSITY SYSTEM -WORKERS' COMPENSATION PROGRAM

AUDITED FINANCIAL STATEMENTS
With Supplemental Information

June 30, 2018

JCCS

**MONTANA UNIVERSITY SYSTEM -
WORKERS' COMPENSATION PROGRAM**

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INDEPENDENT AUDITORS' REPORT

Board of Regents - Montana University System Self-Funded
Workers' Compensation Management Committee
Helena, Montana

Report on the Financial Statements
We have audited the accompanying financial statements of the Montana University System - Workers' Compensation Program, an enterprise fund of the State of Montana, which comprise the statement of net position as of June 30, 2018, and the related statement of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements.

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

Auditors' 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 auditors' 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 control relevant to the entity'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 entity's internal control. 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 evaluating the overall presentation of the financial statements.

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

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Opinion
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montana University System - Workers' Compensation Program (an enterprise fund of the State of Montana) as of June 30, 2018, and the changes in its financial position, and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter
As discussed in Note 1 to the financial statements, the financial statements present only the Montana University System - Workers' Compensation Program and do not purport to, and do not, present fairly the financial position of the State of Montana as of June 30, 2018, and the changes in its financial position, or, where applicable, its cash flows for the 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 the management's discussion and analysis on pages 4 through 6 and the schedule of claims development information on pages 19 and 20 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 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.

Report Issued in Accordance with *Government Auditing Standards*
In accordance with *Government Auditing Standards*, we have also issued our report dated October 10, 2018, on our consideration of Montana University System - Workers' Compensation Program's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 the internal control over financial reporting or on compliance. The report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Montana University System - Workers' Compensation Program's internal control over financial reporting and compliance.

Junkermier, Clark, Campanella, Stevens, P.C.

Helena, Montana
October 10, 2018

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the Montana University System Workers' Compensation Program (Program) provides this *Management's Discussion and Analysis* of the Program's financial statements. This narrative overview and analysis of the financial activities of the Program should be read in conjunction with the Program's financial statements and accompanying notes for the fiscal year ended June 30, 2018.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial statements provide a broad view of the Program's short-term and long-term operations and financial position. These statements were prepared using the accrual basis of accounting with revenues recognized when earned and expenses recognized when incurred, regardless of the related cash flow timing. The financial statements include:

- *Statement of Net Position* - presents the Program's assets and liabilities, with the difference between the two reported as "net position."
- *Statement of Revenues, Expenses and Changes in Net Position* - presents changes to the Program's net position during the fiscal year.
- *Statement of Cash Flows* - shows how changes in balance sheet accounts and income affect cash and cash equivalents, and breaks the analysis down to operating, investing, and financing activities. The cash flow statement reflects the flow of cash in and cash out of the Program.
- *Notes to the Financial Statements* - provide additional information that is essential to a full understanding of the data provided in the financial statements.

Financial Position and Results of Operation

Revenue
Due to a premium holiday, fiscal year (FY) 2018 revenues consisted entirely of interest on funds deposited with the Montana Board of Investments' (MBOI) Short Term Investment Pool (STIP) and Trust Fund Investment Pool (TFIP) and from interest bearing bank accounts used to pay claim costs. Total interest revenue was $215,220 for the fiscal year ending June 30, 2018, an approximate 37% increase over FY17 interest earnings. Total FY18 revenue however was a mere 5% of FY17 total revenue.

Expenses
Total Program expenses for FY18 were $2,737,609. Claim payments, ceded insurance premiums, $afety$mart awards and claims administration costs combine for approximately 91% of the Program's expenditures. By declaring a premium holiday, it was the WC Committee's intent to use excess reserves to fund FY18 expenses.

- The Program made claim payments of $1,513,273 during FY18 which was down approximately 13% from FY17.
- FY18 ceded insurance premiums totaling $323,486 were up 3% from the prior fiscal year. The Department of Labor and Industry (DLI) mandates all self-insured workers' compensation programs carry excess insurance. Additionally, the Program purchases an "other states" workers' compensation policy to ensure coverage for MUS employees who are living and working outside Montana on a more than temporary basis.
- The Committee authorized $500,000 in $afety$mart awards during FY18 with $446,970 of the awarded funds spent within the fiscal year. $afety$mart was initiated in FY12 as a mechanism for reducing Program net position in a controlled manner consistent with its mission and goals. When authorized, $afety$mart funds are awarded to campuses specifically to enhance workers' safety and to reduce claim frequency and claim severity.
- The Program utilizes a Third Party Administrator (TPA) to managing the Program's claims. The claim administration expense in FY18 was $194,650, an approximate 4% increase over FY17. FY18 is the first year of a new TPA contract. No cost adjustments are allowed during the initial term of the TPA

contract term FY18–FY20, with annual pricing adjustments thereafter based on a Consumer Price Index (CPI).

Net Position

Net position at fiscal year-end was $11,543,683; an 18% decrease in net position from the end of the preceding fiscal year. The decrease was intentional and predicated by the decision to forego premium revenue during FY18. Insurance programs acknowledge that it is entirely possible for a given year's losses to exceed premium revenues collected in that year and that equity built through positive results achieved most years can offset larger than expected losses in exceptional years.

Investments

The Program's FY18 total assets (primarily cash and investments) were $17,597,884 a decrease of 18% from prior year. The Program's assets are managed by the MBOI as required by state statute. At FY18 close, approximately 73% of the Program's assets were invested in STIP and 27% in TFIP. The Committee's Investment Policy Statement allows up to 35% of Program assets to be invested in TFIP, though the Committee's currently approved maximum TFIP investment is capped at $5 million. TFIP is expected to earn higher yields than STIP, though this higher yield bears higher risks, including loss of principal potential and duration risk. Loss of principal can occur when interest rates go up and duration risk is the loss of immediate access to invested funds. TFIP invested funds are expected to be committed for 3-5 years; however, in the event of need, access to the funds is approximately 60-90 days. STIP funds are typically available within 3 days.

Claim Liabilities

The Program carried total liabilities of $6,054,201 at the close of FY18, a reduction of nearly 19% compared to FY17. Estimated claim liabilities account for 96% of the total liabilities and were comprised of $2,188,742 current claim liability and $3,640,921 non-current claim liability, also known as Incurred but not Reported (IBNR).

The MUS Program utilizes a TPA with experienced, senior staff to manage claims and an actuary experienced in workers' compensation to calculate its claim liability and to ensure adequate rate setting and reserving for the liability.

The Program and its actuary will continue to incorporate Montana University System claim data, trends and experience into the estimate of current and non-current claim liability and make adjustments accordingly.

Current Year Financial and Budget Results

	2018 Budget FY	2018 Actual	Variance
REVENUE Premiums + Non-Op. income	200,000	215,220	-15,220
OPERATING EXPENSES			
Personal services	96,500	99,870	-3,370
Operational expenses	730,500	677,496	53,004
Benefits & Claims	3,000,000	1,513,273	1,486,727
OPERATING EXPENSE SUBTOTAL	**3,827,000**	**2,290,639**	**1,536,361**
OTHER EXPENSE - $afety $mart Awards	500,000	446,970	53,030
TOTAL EXPENSES	**4,327,000**	**2,737,609**	**1,589,391**
CHANGE IN NET POSITION	**-4,127,000**	**-2,522,389**	**2,109,689**

Budget Variance FY18

Typically, variations between budget and actual amounts are principally due to the necessary reliance on estimates of system payroll for revenue and estimates of claim costs for expenses prior to the start of the fiscal year. Due to premium holiday, the FY18 budget was reliant on estimated interest revenue, rather than estimated premiums.

The most significant line-item variance between budget and actual is with claims and benefits expense. The budgeted benefits and claims expense is an estimate of *ultimate losses* for claims occurring during the policy year, including IBNR, whereas the benefit and claims amount recorded for the fiscal year reflects only those payments made *within* the fiscal year (per accounting rules), so the potential for significant variance is well-recognized.

The Committee authorized $500,000 in FY18 $afety$mart funds but not all authorized funds were spent within the fiscal year.

DLI Benchmarks

Annually, the DLI Self-Insurers' Regulatory Department conducts an analysis and determination of the Program's financial ability to meet its obligations. In January 2018, DLI finalized a new financial adequacy benchmark requiring financial statements of public entities self-insuring workers' compensation to substantiate Available Funds (AF) to pay undiscounted claim obligations at 85% or greater actuary confidence level as provided by the actuary where AF=Total Assets less (-) Property & Equipment Assets less (-) Accounts Payable. DLI also established a requirement for a written Improvement Plan if AF falls below 85% confidence level and a security deposit if AF falls to or below an 80% confidence level. The Program's AF for FY18 is $17,457,103, which is anticipated to exceed the 85% confidence threshold. Since the confidence level is determined by an actuary, that data element will not be finalized until the FY18 actuarial review is complete.

In prior years DLI utilized a 25% equity benchmark or an Equity:SIR benchmark of 10:1, where the SIR is the Self-Insured Retention ($750,000) on the Program's excess insurance policy. The Program's net position exceeds each of these benchmarks.

Currently Known Facts, Decisions or Conditions

Currently known facts, decisions, or conditions that are expected to have an impact on the Program's financial position or on the results of operations are summarized below:

- The Committee elected to extend the premium holiday through FY19. The Program intends to access its net position to meet operational costs during the holiday and thereby reduce its net position and its AF. The Program anticipates that it will continue to meet or exceed all financial benchmarks.
- $500,000 in $afety $mart funds were authorized for distribution to campuses during FY19.
- The Program will continue to receive reimbursements on a FY09 claim that has pierced the SIR and is expected to remain open for the foreseeable future. The Program will begin receiving reimbursements early in FY19, for a FY17 excess claim. The FY17 claim is expected to be fully closed with no further payments beyond FY19. Statutory survivor benefits continue to be paid on an FY13 claim that is expected to pierce the SIR approximately 2028. (Note: SIR was raised from $500,000 to $750,000 starting in FY14).
- The Program intends to have an independent claims audit performed prior to the end of FY19.
- Several of the MUS campuses continue to experience declining enrollments that have led to reductions in personnel which may impact premium beginning in FY20. The Program is monitoring the situation to ensure it is planning appropriately for both workers' compensation claim exposures and revenue adequacy.

CONCLUSION

The Montana University System Workers' Compensation Program has a strong financial position with good liquidity. After acting conservatively to slow the net position growth over several years, the Program implemented more aggressive steps in FY18 to better align its net position with adequacy measures for meeting its obligations. The Program and its actuary will continue to monitor the fiscal health of the Program and refine revenues to align with its specific experience as a self-insured entity.

MONTANA UNIVERSITY SYSTEM -
WORKERS' COMPENSATION PROGRAM
STATEMENT OF NET POSITION
AS OF JUNE 30, 2018

ASSETS	
Current Assets	
Cash and cash equivalents	$ 12,713,985
Interest receivable	33,395
Reinsurance receivable	13,919
Short-term securities lending collateral	66,416
Total current assets	12,827,715
Noncurrent Assets	
Long-term investments	4,770,169
Total assets	$ 17,597,884
LIABILITIES	
Current Liabilities	
Vouchers payable	$ 140,781
Current portion of compensated absences liability	6,812
Current securities lending liability	66,416
Current portion of estimated claims liability	2,188,742
Total current liabilities	2,402,751
Noncurrent Liabilities	
Compensated absences liability - net of current portion	1,581
Estimated claims liability - net of current portion	3,640,921
Estimated liability - OPEB	8,948
Total noncurrent liabilities	3,651,450
Total liabilities	$ 6,054,201
NET POSITION	
Unrestricted	$ 11,543,683

See the notes to financial statements.

MONTANA UNIVERSITY SYSTEM -
WORKERS' COMPENSATION PROGRAM
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2018

OPERATING REVENUES	
Premiums	$ -
OPERATING EXPENSES	
Claims administration	194,650
Actuary fees	16,126
Consulting & Professional Services	783
Insurance and reinsurance expense	323,486
Audit fees	12,485
Department of Labor assessment	81,385
Rent	7,778
Travel	634
Supplies and materials	470
Personal services	99,870
Communications	467
Other operating expenses	39,232
Safety Smart awards	446,970
Benefits and claims	1,513,273
Total operating expenses	2,737,609
OPERATING INCOME	(2,737,609)
NONOPERATING REVENUES (EXPENSES)	
Interest and investment earnings	214,681
STIP security lending income	1,063
STIP security lending expenses	(524)
Total nonoperating revenues	215,220
CHANGE IN NET POSITION	(2,522,389)
NET POSITION BEGINNING OF YEAR	14,055,937
PRIOR PERIOD ADJUSTMENT (NOTE 8)	10,135
NET POSITION BEGINNING OF YEAR - AS RESTATED	14,066,072
NET POSITION END OF YEAR	$ 11,543,683

See the notes to financial statements.

MONTANA UNIVERSITY SYSTEM -
WORKERS' COMPENSATION PROGRAM
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2018

CASH FLOWS FROM OPERATING ACTIVITIES	
Benefits and claims	(2,991,803)
Cash payments for insurance and reinsurance expense	(323,486)
Cash payments for employees	(99,715)
Cash payments for administrative expenses	(244,544)
Cash payments for other operating expenses	(494,344)
Net cash used by operating activities	(4,153,892)
CASH FLOWS FROM INVESTING ACTIVITIES	
TFIP net sales	144,929
STIP security lending income received	1,063
STIP security lending expenses paid	(524)
Interest received	207,015
Net cash provided by investing activities	352,483
Net change in cash	(3,801,409)
CASH AND CASH EQUIVALENTS BEGINNING OF YEAR	16,515,394
CASH AND CASH EQUIVALENTS END OF YEAR	$ 12,713,985

RECONCILIATION OF OPERATING INCOME TO NET CASH
FROM OPERATING ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2018

Operating income	$ (2,737,609)
Adjustments to reconcile operating income to net cash from operating activities:	
Increase in reinsurance receivables	(11,134)
Increase in vouchers payable	60,923
Increase in compensated absences liability	155
Increase in estimated liability - OPEB	1,169
Decrease in estimated claims liability	(1,467,396)
	(1,416,283)
Net cash used by operating activities	$ (4,153,892)

See the notes to financial statements.

NOTE 1 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Description of Program:

The Montana University System - Workers' Compensation Program (the Program) was organized to provide self-insured workers' compensation coverage for employees of the Montana University System. The Montana University System Board of Regents elected to provide workers' compensation coverage under the Compensation Plan Number One (39-71-2101, MCA) as of July 1, 2003. Prior to that date, the Montana University System obtained its workers' compensation coverage through participation in the Montana State Fund. Each member of the Program is jointly and severally liable for the full amount of any and all known or unknown claims of each member arising during the member's participation in the program.

Basis of Accounting:

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental units, specifically standards applicable to public entity risk pools. The Governmental Accounting Standards Board is the accepted standard setting body for establishing governmental accounting and reporting principles.

Professional standards require resources to be classified for accounting and reporting purposes into the following three net position categories:

- *Net investment in capital assets:* Capital assets, net of accumulated depreciation, reduced by the outstanding balances of debt and deferred inflows of resources related to the acquisition, construction, or improvement of those assets.
- *Restricted:* Restricted assets reduced by liabilities and deferred inflows of resources related to those assets.
- *Unrestricted:* Amounts not required to be reported in the other components of net position.

When both restricted and unrestricted resources are available for use, it is the Program's policy to use restricted first, then unrestricted resources as they are needed.

Reporting Entity:

In accordance with governmental accounting and financial reporting standards, there are no component units to be included with the Montana University System - Workers' Compensation Program as a reporting agency.

Fund Accounting:

The Program is considered a public entity risk pool and is classified as an enterprise fund of the State of Montana; that is, a fund that is financed and operated in a manner similar to private business enterprises, where the intent of the Program is that the expenses of meeting its organizational purpose be financed or recovered primarily through user charges and investment earnings, and the periodic determination of revenue earned and expense incurred as appropriate for capital maintenance, public policy, management control, accountability and other purposes. The Program maintains its records on the accrual basis of accounting with revenues recorded when earned and expenses recorded when the obligation is incurred. Operating revenues and expenses generally arise from providing insurance coverage. All other revenues and expenses are classified as non-operating.

NOTE 1 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Administration of Claim Payments:

The Program contracts directly with Intermountain Claims, Inc. for claims administration services.

Allowance for Doubtful Accounts:

Management of the Program considers all premium receivables to be fully collectible, therefore, an allowance for uncollectible premiums is not deemed necessary.

Cash and Cash Equivalents:

Cash and cash equivalents consist of cash in checking and savings accounts and specific investments held on behalf of the Program in pooled accounts with the Montana Board of Investments Short-Term Investment Program (STIP). The Program considers all highly-liquid investments with maturity of three months or less when purchased to be cash equivalents.

Estimates:

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities, and the reported amounts of revenue and expenses. The major estimates are unpaid claims liabilities, and due to their prospective nature, actual results may differ from those estimates.

Premium Revenue:

Premium rates for all members are established by the Program's Committee based on anticipated premiums needed as determined by the actuary. Premium rates are adjusted annually based on inflation, claims experience, and other factors. Premiums are recorded as revenue in the period for which coverage is provided. Members may be subject to supplemental assessments in the event of deficiencies and in the event of increased costs due to changes in law or excessive claims costs. The Program considers anticipated investment income in determining if a premium deficiency exists.

The Program initiated a "premium holiday" for the fiscal year ended June 30, 2018, in which no premium payments were owed to the Program.

Unpaid Claims Liabilities and Expenses:

The Program establishes claim liabilities (loss reserves) for unpaid claims liabilities based on actuarial estimates of the ultimate cost of claims (including future allocated claim adjustment expenses) that have been reported but not paid or settled and that have been incurred but not reported. The liability includes the unallocated claims adjustment expense. The liabilities are based on the estimated ultimate cost of settling the reported and unreported claims, and claims reserve development including the effects of inflation and other societal and economic factors. Estimated amounts of subrogation and reinsurance recoverable on unpaid claims are deducted from the liability for unpaid claims. Estimated claims liabilities are recomputed periodically based on current reviews of claims information, experience with similar claims and other factors. Adjustments to estimated claims liabilities are charged or credited to expense in the periods in which they are made.

The Program is self-insured for workers' compensation claims to a maximum of $750,000 per occurrence after July 1, 2013. Prior to July 1, 2013, the Program was self-insured for workers' compensation claims to a maximum of $500,000 per occurrence. Losses in excess of those limits or $1,000,000 for an aircraft-related claim, are covered by reinsurance with a commercial carrier. Employer's liability claims are covered to a maximum of $1,000,000 above the self-insured amount. During the fiscal year ended June 30, 2018, the Program ceded $323,486 in premiums to reinsurers.

NOTE 2 -- CASH, CASH EQUIVALENT, AND INVESTMENTS

Cash and cash equivalents at June 30, 2018 consist of the following:

Cash with fiscal agent	$ 327,160
Cash in bank	502,610
Short Term Investment Program (STIP)	11,884,215
Total	$ 12,713,985

All of the cash on deposit in operating, savings and claims accounts at June 30, 2018 are held at US Bank which is covered up to the limits imposed by Federal Depository Insurance Corporation (FDIC). Cash in bank represents the cash held in the State of Montana Treasury and STIP is invested and managed by the Montana Board of Investments (MBOI).

Short Term Investment Pool (STIP) – This investment program is managed and administered under the direction of the MBOI as authorized by the Unified Investment Program. Funds may be invested for one or more days and provides a 24-hour liquidity for state agency participants. 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 Net Asset Value (NAV) per share (or its equivalent) of the investment.

The STIP portfolio may include asset-backed securities, commercial paper, corporate, U.S. Government direct obligations, U.S. Government agency securities, repurchase agreements, institutional money market funds, certificates of deposit, and variable-rate (floating-rate) instruments. Investments must have a maximum maturity of 397 days or less unless they are a variable rate security.

Trust Fund Investment Pool (TFIP) – TFIP is an external investment pool managed and administered under the direction of the MBOI as statutorily authorized by the Unified Investment Program. It is a commingled external investment pool and participants may request for redemption on a monthly basis. The fair values of the investments in this category have been determined using the NAV per share (or its equivalent) of the investment.

The TFIP fixed income portfolio includes U.S. Treasury securities, U.S. agency and government-related securities, asset-backed securities, mortgage-backed securities, commercial mortgage-backed securities, and corporate securities categorized as financial, industrial or utility. This portfolio may include variable-rate (floating rate) instruments with the interest rate tied to a specific rate such as LIBOR (London Interbank Offered Rate). Variable rate securities pay a variable rate of interest until maturity.

As of June 30, 2018 the fair value of the TFIP investment was $4,770,169.

Fair Value Measurement:
The MBOI categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles as follows:

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

NOTE 2 -- CASH, CASH EQUIVALENT, AND INVESTMENTS (Continued)

Refer to the fair value measurement note disclosures within the MBOI's annual financial statements for the underlying investments within the fair value hierarchy.

The MBOI annual financial information is available from the MBOI at 2401 Colonial Drive 3rd Floor, PO Box 200126, Helena, MT 59620-0126 or by calling 406-444-0001. The annual financial statements are located on the MBOI's website, www.investmentmt.com.

The investment risk disclosures are described in the following paragraphs.

***Credit Risk*:**
Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of U.S. Government securities, the pools' fixed income instruments have credit risk as measured by major credit rating services. For all retirement Pools, only approved cash investment vehicles are permitted. These include the custodian's STIF vehicle, STIP, or any SEC-registered money market fund, all of which specifically address credit risk in their respective investment guidelines. The MBOI's policy requires TFIP fixed income investments to be invested in investment grade securities (Baa3/BBB- or higher) with the exception of non-rated securities issued or guaranteed by agencies or instrumentalities of the US Government. The MBOI's STIP investment policy specifies that STIP securities have a minimum of two separate credit ratings as provided by Standard and Poor's, Moody's, or Fitch that meet the minimum as stated in the STIP investment policy depending on the type of investment. The U.S. Government guarantees the U.S. Government securities directly or indirectly. Obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk and do not require disclosure of credit quality per GASB Statement No. 40.

Custodial Credit Risk:
Custodial credit risk is the risk that, in the event of the failure of the counterparty to a transaction, the MBOI will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. Per policy, the MBOI's custodial institution must hold short-term and long-term credit rating by at least one Nationally Recognized Statistical Rating Organization with a minimum requirement of A1/P1 (short term) and A3/A-1 (long-term).

Concentration of Credit Risk:
Concentration of credit risk is the risk of loss attributable to the magnitude of any single investment per issuer name. Investments explicitly guaranteed by the U.S. Government are excluded from the concentration of credit risk requirement. The U.S. government extended the explicit guarantee to certain government agencies such as Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (FHLMC-Freddie Mac). Given the explicit guarantee extension, the MBOI had no concentration of credit risk exposure to Fannie Mae and Freddie Mac in either the TFIP or STIP.

The TFIP Investment Policy Statements provide for a 2% portfolio limit for dollar denominated debt obligations of domestic and foreign corporations (Yankee bonds) and a 3% portfolio limit in non-agency Mortgage Pass-through (MBS) securities. The four RFBP external managers are limited to debt obligations of domestic and foreign corporations up to 3% of portfolio assets per issuer.

NOTE 2 -- CASH, CASH EQUIVALENT, AND INVESTMENTS (Continued)

The STIP Investment Policy limits concentration of credit risk exposure by limiting portfolio investment types to 3% in any issuer with the exception of US Treasury and US Agency securities as well as any repurchase agreements with a financial institution. Concentration risk was within the policy as set by the MBOI.

Interest Rate Risk:
Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with GASB Statement No. 40, the MBOI uses effective duration as a measure of interest rate risk for the Bond Pool portfolio. Duration is the average percentage change in a bond's price for a given change in interest rates. Prices move inversely to interest rates. Per policy, the TFIP's duration is to remain within 20% of the established Index duration.

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

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

Although the STIP investments have been rated by investment security type, STIP, as an external investment pool, has not been rated.

NOTE 3 -- SECURITIES LENDING

The MBOI has authorized the use of securities lending transactions - loans of debt or equity securities to broker-dealer and other entities for collateral with a corresponding agreement for the MBOI to return the collateral for the same securities in the future. The MBOI has contracted with the custodial bank, State Street Bank and Trust (the Bank). The Bank is required to maintain collateral equal to 102 percent of the fair value of domestic securities while the securities are on loan. The MBOI and the Bank split the earnings on security lending activities. The MBOI retains all rights and risks of ownership during the loan period. Information regarding the STIP securities lending transactions is available in the MBOI's comprehensive annual financial report.

NOTE 4 -- RELATED PARTIES

Certain employees of the campuses of the university system provide services to the Program at no charge. The value of such services has not been determined.

NOTE 5 -- PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Funding Policy

The State of Montana's Public Employees' Retirement Board (Retirement Board) was authorized by 19-3-2102, MCA, to establish with the Public Employees' Retirement System (PERS) a defined contribution plan (Plan) in accordance with Montana law in July 2002. The Plan was established as a pension plan for the exclusive benefit of members and their beneficiaries and as a "qualified plan" pursuant to section 401(a) of the Internal Revenue Code and its implementing regulations. The assets of the Plan are held in a trust, with the Retirement Board acting as a trustee. The Retirement Board has the powers and shall perform the duties regarding the Plan as provided in 19-3-2104, and 19-2-403, MCA as applicable and may also exercise the powers and shall perform the duties provided in Title 19, Chapter 3, MCA. A Plan participant is vested in 100% of the participant's employee contribution account at all times and is vested 100% in the participant's employer contribution account upon completion of five years of membership service. Normal retirement age under the Plan is age 65. Upon a participant's attainment of normal retirement age and completion of five years of membership service, the participant has a nonforfeitable right to the employer contribution account. Any non-vested amounts shall be forfeited upon termination of service. Any amount forfeited will be held in a separate plan account and used to pay administrative expenses of the Plan.

The employer contribution rate per 19-3-316, MCA is calculated as follows: 6.9% and an additional contribution of 1.27% beginning on July 1, 2013, increasing .10% each fiscal year and continuing until the additional contributions terminate pursuant to 19-3-316, MCA; less the plan choice rate determined under 19-3-2117 and 19-3-212, MCA; less the education fund rate and less the long term disability fund rate under 19-3-2117, MCA. Employee plan contributions per 19-3-315(2), MCA are 7.9% of compensation. The total contribution to the participant's individual account is 16.47%.

	*Employer	Employee	Total
2018	8.23%	7.9%	16.13%
2017	8.13%	7.9%	16.03%
2016	4.19%	7.9%	12.09%

*In 2018, total Employer Contributions (8.57%) less required disbursements (0.34%) = Allocation to Employee Account (8.23%). In 2017, total Employer Contributions (8.47%) less required disbursements (0.34%) = Allocation to Employee Account (8.13%).

The amount contributed by the Program to the Plan during the year ended June 30, 2018 was $6,405.

Further information regarding the plan may be obtained by contacting:

Public Employees' Retirement System
100 N Park Avenue, Suite 200
P.O. Box 200131
Helena, MT 59620-0131
(406) 444-3154

NOTE 6 -- LEASE AND RENT EXPENSE

The Program as part of the Office of the Commissioner of Higher Education entered into a ten year lease agreement to lease a portion of office space within a building located on 560 N Park Avenue, Helena, Montana. The commencement date of the lease was January 15, 2018. During the year ended June 30, 2018, the Program paid rent of $7,778.

The following is a schedule by year of minimum future lease payments for the years ended June 30:

2019	$	8,677
2020		8,677
2021		8,677
2022		8,677
2023		8,677
Thereafter		36,878
Total minimum future lease payments	$	80,263

NOTE 7 -- UNPAID CLAIMS LIABILITIES

As discussed in Note 1, the Program establishes actuarial estimated unpaid claims liabilities (undiscounted basis). The estimated unpaid claims incurred but not reported and loss development liability have been adjusted to reflect the actuarial best estimates of the ultimate costs of claims for 2018.

The following represents changes in the aggregate unpaid claims liabilities for the Program for 2018:

Total present value of estimated unpaid claim losses at beginning of year	$ 7,297,059
Changes in the estimated unpaid claim losses:	
Provision for insured events of the current year	2,794,000
Decrease in provision for insured events of prior years	(1,273,305)
Total incurred claims	1,520,695
Payments (including claims legal defense):	
Claims paid attributable to insured events of current year	605,258
Claims paid attributable to insured events of prior years	2,382,833
Total payments	2,988,091
Total present value of estimated unpaid claim losses at end of year	$ 5,829,663

The estimated liability for workers' compensation claims as of June 30, 2018, consist of the following:

Estimated claims reported but unpaid	$ 2,188,742
Estimated claims incurred but not reported and loss development	3,640,921
	$ 5,829,663

NOTE 8 -- CHANGE IN ACCOUNTING PRINCIPLES AND PRIOR PERIOD ADJUSTMENT

In fiscal year 2018, the provisions for GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* were implemented. The beginning OPEB liability has been restated in accordance with the standard. As a result, change in net position for the year ended June 30, 2018 has increased $8,878.

The extensive disclosures relating to the change are not material to the Program and thus, have not been included within the notes to the financial statements.

In addition, there is a change in net position for the year ended June 30, 2018 for the inclusion of excess premium received of $1,257.

NOTE 9 -- SUBSEQUENT EVENTS

Management has evaluated subsequent events through October 10, 2018, the date on which the financial statements were available to be issued.

The Program anticipates receiving approximately $142,803 in excess reimbursement funds from claims that pierced the SIR threshold in July 2018.

The Program initiated a second "premium holiday" for the fiscal year ended June 30, 2019, in which no premium payments will be owed to the Program.

REQUIRED SUPPLEMENTARY INFORMATION

MONTANA UNIVERSITY SYSTEM -
WORKERS' COMPENSATION PROGRAM
CLAIMS DEVELOPMENT INFORMATION

The table on the following pages illustrates how the Program's earned revenues (net of excess loss coverage) and investment income compare to related costs of loss (net of loss assumed by excess loss coverage insurers) and other expenses assumed by the Program as of the end of each of the previous ten years. The rows of the table are defined as follows:

1. This line shows the total of each fiscal year's gross earned contribution revenue and investment revenue.

2. This line shows each fiscal year's other operating costs of the Program including overhead and claims expense not allocable to individual claims.

3. This line shows the Program's gross incurred claims and allocated claim adjustment expenses and net incurred claims and allocated adjustment expense (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called *policy* year).

4. This section of rows shows the cumulative net amounts paid as of the end of successive years for each policy year.

5. This line shows the latest reestimated amount of claims assumed by reinsurers as of the end of the current year for each accident year.

6. This section of rows shows how each policy year's net incurred claims increased or decreased as of the end of successive years. This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, and emergence of new claims not previously known.

7. This line compares the latest reestimated net incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of net claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and reestimated amounts commonly is used to evaluate the accuracy of net incurred claims currently recognized in less mature policy years. The columns of the table show data for successive policy years.

See the accompanying independent auditors' report.

	Fiscal and Policy Year Ended										
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
1. Net earned (required contribution and investment revenues)	$ 4,777,099	$ 4,930,524	$ 4,758,849	$ 4,515,064	$ 3,968,546	$ 4,052,736	$ 1,930,189	$ 4,316,704	$ 4,088,926	$ 3,679,810	$ (108,805)
2. Unallocated expenses	386,512	460,508	441,977	426,068	883,006	701,688	1,002,129	985,418	739,829	735,938	900,851
3. Estimated incurred claims and expenses, end of policy year	2,693,000	2,922,000	2,959,000	3,115,000	3,158,000	3,399,000	3,329,000	3,417,000	3,157,000	3,096,000	2,794,000
4. Gross paid (cumulative) as of:											
End of policy year	469,399	640,717	572,486	742,041	709,651	891,252	1,010,989	701,427	597,999	940,066	605,312
One year later	1,099,932	1,764,405	1,446,724	1,608,465	1,185,473	1,803,450	1,647,393	1,440,073	1,366,109	2,910,281	
Two years later	1,286,205	2,997,006	1,835,851	1,900,333	1,277,606	2,282,882	1,870,557	1,767,555	1,517,317		
Three years later	1,440,632	3,275,598	2,071,374	1,961,168	1,317,629	2,536,294	1,887,113	1,811,206			
Four years later	1,497,940	3,450,482	2,190,713	2,078,996	1,322,131	2,644,417	1,942,446				
Five years later	1,563,146	3,630,194	2,354,356	2,086,650	1,322,350	2,684,764					
Six years later	1,571,929	3,672,828	2,393,894	2,097,773	1,330,688						
Seven years later	1,574,542	3,765,763	2,408,683	2,113,862							
Eight years later	1,574,542	3,785,533	2,463,456								
Nine years later	1,574,829	3,847,710									
Ten years later	1,576,171										
5. Reestimated ceded claims and expenses	-	-	-	-	-	-	-	-	-	-	-
6. Reestimated net incurred claims and expenses											
End of policy year	2,693,000	2,922,000	2,959,000	3,115,000	3,158,000	3,399,000	3,329,000	3,417,000	3,157,000	3,096,000	2,794,000
One year later	2,686,541	3,046,000	3,017,000	3,428,000	3,364,000	3,693,000	3,317,000	2,999,000	3,048,000	3,252,000	
Two years later	2,630,000	3,977,000	3,000,000	3,396,000	2,650,000	3,712,000	2,979,000	2,636,000	2,436,000		
Three years later	2,391,000	4,199,000	3,078,000	3,032,000	2,140,000	3,729,000	2,596,000	2,310,000			
Four years later	2,335,000	3,987,000	2,923,000	2,725,000	1,598,000	3,558,000	2,198,000				
Five years later	1,754,000	3,657,000	2,926,000	2,367,000	1,502,000	3,402,000					
Six years later	1,769,000	3,318,000	2,691,000	2,325,000	1,454,000						
Seven years later	1,661,000	3,312,000	2,680,000	2,302,000							
Eight years later	1,638,000	3,319,000	2,711,000								
Nine years later	1,571,000	3,339,000									
Ten years later	1,571,000										
7. Increase (decrease) in estimated net incurred claims and expenses from end of policy year	(1,122,000)	417,000	(248,000)	(813,000)	(1,704,000)	3,000	(1,131,000)	(1,107,000)	(721,000)	156,000	-

See the accompanying independent auditors' report.

INDEPENDENT AUDITORS' 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*

Board of Regents - Montana University System Self-Funded
Workers' Compensation Management Committee
Helena, Montana

We have audited, 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, the financial statements of the Montana University System - Workers' Compensation Program, (an enterprise fund of the State of Montana) which comprise the statement of net position as of June 30, 2018, and the related statement of revenue, expense and changes in net position and cash flows for the year then ended and the related notes to the financial statements, and have issued our report thereon dated October 10, 2018.

Internal Control Over Financial Reporting
In planning and performing our audit of the financial statements, we considered the Montana University System - Workers' Compensation Program's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Montana University System - Workers' Compensation Program's internal control. Accordingly, we do not express an opinion on the effectiveness of the Montana University System - Workers' Compensation Program'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 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 control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting 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 University System - Workers' Compensation Program's financial statements are free of 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*.

We noted certain other matters that we reported to management of the Montana University System - Workers' Compensation Program in a separate letter dated October 10, 2018.

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 entity'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Junkermier, Clark, Campanella, Stevens, P.C.

Helena, Montana
October 10, 2018

**MONTANA UNIVERSITY SYSTEM -
WORKERS' COMPENSATION PROGRAM
SCHEDULE OF FINDINGS AND RESPONSES**

The results of our tests disclosed no instances of noncompliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters or any internal control deficiencies considered to be significant deficiencies or material weaknesses, which were required to be reported under *Government Auditing Standards* as of June 30, 2018.