

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

**AUDITED FINANCIAL STATEMENTS  
With Supplemental Information**

**June 30, 2016**





**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, 2016, 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 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 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.

## **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, 2016, 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, 2016, 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 8 and the schedule of claims development information on pages 23 and 24 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 18, 2016, 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 18, 2016

## 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, 2016.

### **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 are prepared using the accrual basis of accounting with revenues recognized as soon as they are earned and expenses recognized as soon as the related liability is 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**

Fiscal year (FY) 2016 total revenues were \$4.40 million with premiums paid by campuses contributing \$4.26 million and interest earnings contributing the balance of \$138 thousand. The Program utilizes an actuarial analysis to establish annual premium needs and corresponding composite premium rate to meet this need when applied to campus payroll. The MUS Work Comp Committee (Committee), then divides the composite rate into two separate rates that correspond to the National Council on Compensation Insurance (NCCI) risk classes for higher education.

The FY16 rates applied to payroll were approximately 7% less than the FY15 rates, while Montana University System (MUS) payroll increased approximately 3% during that same period. The result was approximately \$340 thousand less in premium revenue for FY16 than in FY15.

The Program earns modest 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 nearly \$138 thousand for the fiscal year ending June 30, 2016 a significant increase over FY15 interest earnings of \$23 thousand. The increased interest revenue is attributable to three factors 1) improved returns from STIP investments 2) transferring a portion of Program funds to the higher yielding TFIP 3) final settlement of the Structured Investment Vehicle (SIV) securities.

#### **Expenses**

Total Program expenses for FY16 were \$2.43 million. Claim payments, ceded insurance premiums, SafetySmart awards and claims administration costs combine for more than 90% of the Program's expenditures.

- The Program made claim payments of \$1.38 million during FY16 which is the lowest the claim expense has been the since the Program was initiated in FY04.
- Ceded insurance premiums totaled nearly \$312 thousand during the 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 \$300 thousand in SafetySmart awards during FY16 with \$285 thousand of the awarded funds spent within the fiscal year. SafetySmart was initiated in FY12 as a mechanism for reducing Program equity in a controlled manner consistent with its mission and goals. When authorized, SafetySmart 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 FY16 was \$200 thousand. The current TPA contract limits annual claims administration cost adjustments to a Consumer Price Index (CPI), but in no event more than 4% per year. No cost adjustment was made between FY15 and FY16.

### **Net Position**

Net position at fiscal year-end was \$12.85 million; an increase of approximately \$1.97 million over net position at the end of the preceding fiscal year. 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.

The Program tracks numerous benchmarks to evaluate adequacy of its equity or net position. In the Program's experience, the least restrictive benchmark is Risk Based Capital--an insurance industry measure; the most restrictive has been DLI's Equity:SIR ratio of 10:1 where the SIR is the Self-Insured Retention (\$750,000) on the Program's excess insurance policy. In FY16, DLI informed the Program that while the Equity:SIR ratio remains an informative benchmark, DLI is not applying this benchmark in its annual financial analysis of the Program.

The Program's net position exceeds the conservative Equity:SIR benchmark of \$7.5 million. Starting in FY12 and continuing through the present, the Program has taken actions to stem the Program's net position growth. Efforts to reduce its net position have been counteracted by a significant reduction in the actuarial estimates of prior-year claim liabilities and a trend toward reduced claim frequency and reduced claim severity over the same time period.

### **Investments**

The Program's total assets (primarily cash and investments) as of June 30, 2016, totaled \$20.81 million; a \$1.53 million (8%) increase compared to invested assets at close of FY15. The Program's assets are managed by the MBOI as required by state statute. During FY16, the Program worked with MBOI to evaluate and adjust its asset investment allocation. Subsequently, the Committee approved a new Investment Policy Statement allowing up to 35% of Program assets to be invested in TFIP, and provided the MBOI with authority to transfer up to \$5 million of the Program's assets to TFIP. By fiscal year end, the MBOI had transferred \$3 million of the Program's assets from STIP to TFIP. The primary benefit of this change is the potential for increased returns on the Program's invested assets; TFIP is currently earning approximately 2.0% interest whereas STIP had been generating returns of less than .02% in recent years. 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 \$7.97 million at the close of FY16, a reduction of \$436 thousand compared to FY15. Estimated claim liabilities account for \$7.76 million (97%) of the total liabilities and are comprised of \$2.04 million current claim liability and \$5.72 million non-current claim liability, also known as Incurred but not Reported (IBNR).

The MUS Program utilizes a Third Party Administrator (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 Program's actuary will continue to incorporate Montana University System claim data, trends and experience into its estimate of current and non-current claim liability and make adjustments accordingly.

### Current Year Financial and Budget Results

	FY 2016 Actual	2016 Budget	Variance
<b>REVENUE</b> Premiums + Non-Op. income	4,401,762	4,359,000	(42,762)
<b>OPERATING EXPENSES</b>			
Personal services	97,446	96,000	(1,446)
Operational expenses	669,217	684,300	15,083
Benefits & Claims	1,378,496	3,500,000	2,121,504
<b>OPERATING EXPENSE SUBTOTAL</b>	<b>2,145,159</b>	<b>4,280,300</b>	<b>2,135,141</b>
<b>OTHER EXPENSE - Safety Smart Awards</b>	<b>285,000</b>	<b>300,000</b>	<b>15,000</b>
<b>TOTAL EXPENSES</b>	<b>2,430,159</b>	<b>4,580,300</b>	<b>2,150,141</b>
<b>CHANGE IN NET POSITION</b>	<b>1,971,602</b>	<b>-221,300</b>	<b>2,192,902</b>

### Budget Variance FY16

The 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.

The Committee adopted a FY16 budget of \$4.36 million. The Program received approximately \$4.40 million in revenue through premiums earned. Because premiums are based on a rate applied to payroll, some variation between anticipated/budgeted revenues and actual revenue is expected.

The most significant line-item variance between budget and actual is with claims and benefits paid. The budgeted benefits and claims expense is an estimate of ultimate losses for the fiscal 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 variance is significant. Even with that consideration, at \$1.38 million, the benefit and claims expense for FY16 was exceptionally low. The low fiscal year claim payments can be attributed in part to the fortunate trend of fewer claims and reduced claim losses over the past several years, but also to the happenstance of billing and payment timing. The result is a large variance between the budgeted change in net position and the actual change in net position at the close of FY16.

While the Committee authorized \$300,000 in SafetySmart funds, not all funds were spent within the fiscal year.

### DLI Benchmarks

Annually, the Program undergoes an analysis and determination of financial ability to meet its obligations by the DLI Self-Insurers' Regulatory Department. The Program is meeting all DLI 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 combined premium rate adopted for FY17, \$0.88/\$100 payroll, is a reduction of approximately 10% compared to the FY16 combined rate of \$0.98/\$100 payroll. Anticipated FY17 premium resulting from this combined rate is \$4.0 million.
- \$300,000 in Safety Smart funds were authorized for distribution to campuses during FY17.
- 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 was reimbursed approximately \$66 thousand by its excess insurance policy in FY16. A second claim was reported to the excess carrier in FY13; however, those costs are limited to statutory survivor benefits and are not expected to exceed the excess \$500,000 SIR until 2028. (Note: SIR was raised from \$500,000 to \$750,000 starting in FY14).
- The Committee's decision to invest a portion of its assets in TFIP is expected to result in increased interest revenue in future years.
- The Program has reported cash generated by SIV securities as revenue since FY08. MBOI wrote off the remaining balance of these downgraded investments during FY16 so no future SIV allocation is expected.
- The 2011 Montana Legislature implemented a statutory 5-year medical benefit termination provision, with few exceptions and limited opportunity for reopening, will begin impacting claims in FY17. Though the Program has very few claims remain open five or more years, the claim closure law may have an impact on claim liability estimates and loss costs. A court challenge to the constitutionality of this claim closure provision is expected.
- Several of the MUS campuses have experienced declining enrollments that have led to reductions in personnel; however, potential impacts on premium revenue have been neutralized by growth on several different campuses. The Program is monitoring the situation to ensure it is planning appropriately for both work comp claim exposures and revenue adequacy.

#### CONCLUSION

The Montana University System Workers' Compensation Program has a strong financial position with good liquidity. The Program is working to carefully reduce its net position to better align 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, 2016**

**ASSETS**

**Current Assets**

Cash and cash equivalents	\$ 17,585,753
Interest receivable	15,262
Reinsurance receivable	61,987
Short-term securities lending collateral	<u>104,730</u>

Total current assets	<u>17,767,732</u>
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**Noncurrent Assets**

Long-term investments	<u>3,044,523</u>
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Total assets	<u><u>\$ 20,812,255</u></u>
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**LIABILITIES**

**Current Liabilities**

Vouchers payable	\$ 73,562
Current portion of compensated absences liability	5,879
Current securities lending liability	104,730
Current portion of estimated claims liability	<u>2,041,436</u>

Total current liabilities	<u>2,225,607</u>
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**Noncurrent Liabilities**

Compensated absences liability - net of current portion	2,294
Estimated claims liability - net of current portion	5,721,795
Estimated liability - OPEB	<u>16,730</u>

Total noncurrent liabilities	<u>5,740,819</u>
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Total liabilities	<u><u>\$ 7,966,426</u></u>
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**NET POSITION**

Unrestricted	<u><u>\$ 12,845,829</u></u>
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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, 2016**

<b>OPERATING REVENUES</b>	
Premiums	<u>\$ 4,264,187</u>
<b>OPERATING EXPENSES</b>	
Claims administration	200,063
Actuary fees	15,671
Insurance and reinsurance expense	311,836
Audit fees	12,120
Dues	2,940
Department of Labor assessment	84,152
Rent	7,122
Travel	617
Supplies and materials	1,641
Personal services	97,446
Communications	549
Other operating expenses	32,506
Safety Smart awards	285,000
Benefits and claims	<u>1,378,496</u>
Total operating expenses	<u>2,430,159</u>
<b>OPERATING INCOME</b>	<u>1,834,028</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>	
Interest and investment earnings	137,290
STIP security lending income	452
STIP security lending expenses	<u>(168)</u>
Total nonoperating revenues	<u>137,574</u>
<b>CHANGE IN NET POSITION</b>	1,971,602
<b>NET POSITION BEGINNING OF YEAR</b>	<u>10,874,227</u>
<b>NET POSITION END OF YEAR</b>	<u><u>\$ 12,845,829</u></u>

See the notes to financial statements.

**MONTANA UNIVERSITY SYSTEM -  
WORKERS' COMPENSATION PROGRAM  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED JUNE 30, 2016**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Cash received from premiums	\$ 4,264,187
Benefits and claims	(1,959,029)
Cash payments for insurance and reinsurance expense	(201,055)
Cash payments for employees	(96,366)
Cash payments for administrative expenses	(291,368)
Cash payments for other operating expenses	<u>(326,140)</u>

Net cash provided by operating activities 1,390,229

**CASH FLOWS FROM INVESTING ACTIVITIES**

Reclassification from STIP to long-term investments (TFIP)	(2,889,737)
STIP security lending income received	452
STIP security lending expenses paid	(168)
Interest received	<u>124,943</u>

Net cash used by investing activities (2,764,510)

Net change in cash (1,374,281)

**CASH AND CASH EQUIVALENTS BEGINNING OF YEAR** 18,960,034

**CASH AND CASH EQUIVALENTS END OF YEAR** \$ 17,585,753

**RECONCILIATION OF OPERATING INCOME TO NET CASH  
PROVIDED BY OPERATING ACTIVITIES  
FOR THE YEAR ENDED JUNE 30, 2016**

Operating income \$ 1,834,028

Adjustments to reconcile operating income to net cash provided by operating activities:

Increase in reinsurance receivables	(55,424)
Decrease in prepaid expense	110,781
Increase in vouchers payable	23,578
Increase in compensated absences liability	1,080
Increase in estimated liability - OPEB	1,295
Decrease in estimated claims liability	<u>(525,109)</u>

(443,799)

Net cash provided by operating activities \$ 1,390,229

See the notes to financial statements.

**MONTANA UNIVERSITY SYSTEM -  
WORKERS' COMPENSATION PROGRAM  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2016**

**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.

**MONTANA UNIVERSITY SYSTEM -  
WORKERS' COMPENSATION PROGRAM  
NOTES TO FINANCIAL STATEMENTS (Continued)  
June 30, 2016**

**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.

***Premium Receivable:***

These amounts represent premium receivable from a component unit (Montana University System) of the State of Montana.

***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.

***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.

**MONTANA UNIVERSITY SYSTEM -  
WORKERS' COMPENSATION PROGRAM  
NOTES TO FINANCIAL STATEMENTS (Continued)  
June 30, 2016**

**NOTE 2 -- CASH, CASH EQUIVALENT, AND INVESTMENTS**

Cash and cash equivalents at June 30, 2016 consist of the following:

Cash with fiscal agent	\$ 252,103
Cash in bank	1,027,592
Short Term Investment Program (STIP)	<u>16,306,058</u>
Total	<u>\$ 17,585,753</u>

All of the cash on deposit in operating, savings and claims accounts at June 30, 2016 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, 2016 the fair value of the TFIP investment was \$3,044,523.

***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.

**MONTANA UNIVERSITY SYSTEM -  
WORKERS' COMPENSATION PROGRAM  
NOTES TO FINANCIAL STATEMENTS (Continued)  
June 30, 2016**

**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 3<sup>rd</sup> 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](http://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.



**MONTANA UNIVERSITY SYSTEM -  
WORKERS' COMPENSATION PROGRAM  
NOTES TO FINANCIAL STATEMENTS (Continued)  
June 30, 2016**

**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.

**MONTANA UNIVERSITY SYSTEM -  
WORKERS' COMPENSATION PROGRAM  
NOTES TO FINANCIAL STATEMENTS (Continued)  
June 30, 2016**

**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 12.09%.

	<u>*Employer</u>	<u>Employee</u>	<u>Total</u>
2016	4.19%	7.9%	12.09%
2015	4.19%	7.9%	12.09%
2014	4.19%	7.9%	12.09%

\*Total Employer Contributions (8.17%) less required disbursements (3.98%) = Allocation to Employee Account (4.19%) starting in 2013.

The amount contributed by the Program to the Plan during the year ended June 30, 2016 was \$6,143.

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

**MONTANA UNIVERSITY SYSTEM -  
WORKERS' COMPENSATION PROGRAM  
NOTES TO FINANCIAL STATEMENTS (Continued)  
June 30, 2016**

**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 with Student Assistance Foundation of Montana to lease a portion of office space at the building located on 2500 Broadway, Helena, Montana. The commencement date of the lease was January 1, 2009. During the year ended June 30, 2016, the Program paid rent of \$7,122.

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

2017	\$ 5,049
2018	5,094
2019	<u>2,547</u>
 Total minimum future lease payments	 <u>\$ 12,690</u>

**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 2016.

The following represents changes in the aggregate unpaid claims liabilities for the Program for 2016:

Total present value of estimated unpaid claim losses at beginning of year	<u>\$ 8,288,340</u>
Changes in the estimated unpaid claim losses:	
Provision for insured events of the current year	3,157,000
Decrease in provision for insured events of prior years	<u>(1,716,517)</u>
Total incurred claims	<u>1,440,483</u>
Payments (including claims legal defense):	
Claims paid attributable to insured events of current year	597,999
Claims paid attributable to insured events of prior years	<u>1,367,593</u>
Total payments	<u>1,965,592</u>
Total present value of estimated unpaid claim losses at end of year	<u>\$ 7,763,231</u>

The estimated liability for workers' compensation claims as of June 30, 2016, consist of the following:

Estimated claims reported but unpaid	\$ 2,041,436
Estimated claims incurred but not reported and loss development	<u>5,721,795</u>
	<u>\$ 7,763,231</u>

**MONTANA UNIVERSITY SYSTEM -  
WORKERS' COMPENSATION PROGRAM  
NOTES TO FINANCIAL STATEMENTS (Continued)  
June 30, 2016**

**NOTE 8 -- OTHER POST-EMPLOYMENT BENEFITS**

A retiree may continue coverage with the Montana University System Employee Group Benefits Plan (Benefits Plan) if the retiree is eligible to receive a State Retirement Benefit from Teacher Retirement System (TRS) or the Public Employee Retirement System (PERS) at the time they leave their employment with the Montana University System.

An eligible retiree must make arrangements with the Human Resources/Benefits Office to continue coverage as a retiree on a self-pay basis within 63 days of retirement.

Plan Description

The Benefits Plan is considered a multiple employer agent plan. The Benefits Plan allows retirees to participate, as a group, at a rate that does not cover all of the related costs. This results in the reporting of an "implied rate" subsidy in the related financial statements and footnotes. While this liability is disclosed for financial statement purposes, it does not represent a legal liability of the Program. The Benefits Plan is reported as an agency fund. There are no assets or liabilities as only contributions collected and distributions made are reflected in the fund. See the funding policy that follows.

The Benefits Plan does not issue a standalone financial report, but is subject to audit as part of the State of Montana's Comprehensive Annual Financial Report (CAFR). A copy of the most recent CAFR can be obtained online at <http://accounting.mt.gov/cafr/default.mcp> or by contacting the Montana Department of Administration, P.O. Box 200102, Helena, MT 59620-0102.

As of June 30, 2016, the number of Montana University System - Workers' Compensation Program active participants in the Benefits Plan was 1.

Funding Policy

The Benefits Plan funds the post employment benefits on a pay-as-you-go basis from premiums from campuses, which are paid by retirees. Montana Code Annotated, Title 20, Chapter 25, Part 13 gives authority for establishing the group benefits plans.

The Benefits Plan's administratively established self-insured retiree medical premiums vary between \$278 and \$970 per month and are revised annually. The Benefits Plan provides different coinsurance amounts depending on whether members use in-network or out-of-network providers. After an annual \$500 in-network deductible for most non-Medicare-eligible retirees, the Benefits Plan reimburses 75% in medical claims until the in-network out of pocket maximum of \$3,500 has been reached. After the in-network out of pocket maximum is reached, the Benefits Plan reimburses covered medical claims at 100% for the remainder of the Benefits Plan year. For out-of-network services, after an annual \$750 deductible (which is separate from the in-network deductible), the Benefits Plan reimburses 65% in allowed medical claim charges until the out-of-network out of pocket maximum is reached. The Benefits Plan automatically reduces claim reimbursement for members eligible for Medicare, even if the member is not enrolled in Medicare.

Annual Other Post-employment Benefit Cost and Contributions

The Program's annual other post-employment benefit (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with GASB Statement No. 45. The calculated ARC represents an amount that, if funded, would cover normal cost each year and amortize any unfunded actuarial liability over a period not to exceed 30 years. For the fiscal year ended June 30, 2016, the Program's annual OPEB cost (expense) of \$1,703 was equal to the ARC. The actuarial determination was based on plan information as of July 1, 2013.

There are no long-term contracts for contributions to the OPEB plan. Contributions refer to contributions made in relation to ARC.

**MONTANA UNIVERSITY SYSTEM -  
WORKERS' COMPENSATION PROGRAM  
NOTES TO FINANCIAL STATEMENTS (Continued)  
June 30, 2016**

**NOTE 8 -- OTHER POST-EMPLOYMENT BENEFITS (Continued)**

The following table presents the Workers' Compensation Program OPEB cost for the fiscal year ended June 30, 2016, the amount contributed, and changes in the Workers' Compensation Program OPEB plan for fiscal year 2016:

Annual required contribution/OPEB cost	\$ 1,546
Interest on net OPEB obligation	730
Amortization	<u>(573)</u>
Annual OPEB cost	1,703
Contributions made	<u>(408)</u>
Increase in net OPEB obligation	1,295
Net OPEB obligation - beginning of year	<u>15,435</u>
 Net OPEB obligation - end of year	 <u><u>\$ 16,730</u></u>

Actuarial Methods and Assumptions

The projected unit credit funding method was used to determine the cost of the Benefits Plan. This method's objective is to fund each participant's benefits under the Benefits Plan as they accrue. The total benefit to which each participant is expected to become entitled at retirement is categorized into units, each associated with a year of past or future credited service.

The actuarial assumptions included, in addition to marital status at retirement, mortality rates and retirement age:

Interest/Discount Rate	4.25%
Payroll Growth Rate	2.50%
Participation	50% of future retirees are assumed to elect medical coverage, 60% of the future retirees who elect coverage and are married are assumed to elect spousal coverage as well
Healthcare Cost Trend Rate-Medical	7.50%
Healthcare Cost Trend Rate-Prescription drugs	7.50%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual review and revision as actual results are compared with past expectations, and new estimates are made about the future.

**NOTE 9 -- SUBSEQUENT EVENTS**

Management has evaluated subsequent events through October 18, 2016, the date on which the financial statements were available to be issued.

## **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 twelve 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.

MONTANA UNIVERSITY SYSTEM - WORKERS' COMPENSATION PROGRAM  
CLAIMS DEVELOPMENT INFORMATION

	Fiscal and Policy Year Ended												
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
1. Net earned (required contribution and investment revenues)	\$ 2,273,944	\$ 2,850,849	\$ 3,510,259	\$ 4,153,570	\$ 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
2. Unallocated expenses	227,267	279,716	263,904	259,412	386,512	460,508	441,977	426,068	883,006	701,688	1,002,129	985,418	739,829
3. Estimated incurred claims and expenses, end of policy year	2,174,000	2,366,000	2,453,000	2,600,000	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
4. Gross paid (cumulative) as of:													
End of policy year	551,749	382,154	390,972	367,913	469,399	640,717	572,486	742,041	709,651	891,252	1,010,989	701,427	597,999
One year later	1,019,751	1,001,996	910,335	932,787	1,099,932	1,764,405	1,446,724	1,608,465	1,185,473	1,803,450	1,647,393	1,440,073	
Two years later	1,123,504	1,227,600	1,254,242	1,092,644	1,286,205	2,997,006	1,835,851	1,900,333	1,277,606	2,282,882	1,870,557		
Three years later	1,147,508	1,526,088	1,351,046	1,157,520	1,440,632	3,275,598	2,071,374	1,961,168	1,317,629	2,536,294			
Four years later	1,165,362	1,554,903	1,386,285	1,203,059	1,497,940	3,450,482	2,190,713	2,078,996	1,322,131				
Five years later	1,210,361	1,660,121	1,393,297	1,227,284	1,563,146	3,630,194	2,354,356	2,086,650					
Six years later	1,251,309	1,691,861	1,401,236	1,238,378	1,571,929	3,672,828	2,393,894						
Seven years later	1,253,722	1,759,234	1,408,799	1,238,514	1,574,542	3,765,763							
Eight years later	1,257,246	1,769,993	1,410,797	1,238,514	1,574,542								
Nine years later	1,259,246	1,785,717	1,410,797	1,238,901									
Ten years later	1,261,093	1,793,068	1,410,756										
Eleven years later	1,263,925	1,800,068											
Twelve years later	1,266,174												
5. Reestimated ceded claims and expenses	-	-	-	-	-	-	-	-	-	-	-	-	-
6. Reestimated net incurred claims and expenses													
End of policy year	2,174,000	2,366,000	2,453,000	2,600,000	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
One year later	2,174,000	2,565,000	2,267,356	2,293,413	2,686,541	3,046,000	3,017,000	3,428,000	3,364,000	3,693,000	3,317,000	2,999,000	
Two years later	2,037,000	2,459,000	2,510,000	2,412,000	2,630,000	3,977,000	3,000,000	3,396,000	2,650,000	3,712,000	2,979,000		
Three years later	1,830,000	2,602,000	2,471,000	2,131,000	2,391,000	4,199,000	3,078,000	3,032,000	2,140,000	3,729,000			
Four years later	1,570,000	2,622,000	2,069,000	1,804,000	2,335,000	3,987,000	2,923,000	2,725,000	1,598,000				
Five years later	1,499,000	2,312,000	1,512,000	1,779,000	1,754,000	3,657,000	2,926,000	2,367,000					
Six years later	1,327,000	1,965,000	1,511,000	1,412,000	1,769,000	3,318,000	2,691,000						
Seven years later	1,284,000	1,825,000	1,422,000	1,231,000	1,661,000	3,312,000							
Eight years later	1,288,000	1,825,000	1,388,000	1,232,000	1,638,000								
Nine years later	1,244,000	1,785,000	1,390,000	1,232,000									
Ten years later	1,246,000	1,805,000	1,390,000										
Eleven years later	1,248,000	1,914,000											
Twelve years later	1,334,000												
7. Increase (decrease) in estimated net incurred claims and expenses from end of policy year	(840,000)	(452,000)	(1,063,000)	(1,368,000)	(1,055,000)	390,000	(268,000)	(748,000)	(1,560,000)	330,000	(350,000)	(418,000)	-

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, 2016, 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 18, 2016.

**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 18, 2016.

**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 18, 2016

**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, 2016.