Statutory Financial Statements
June 30, 2012 and 2011

MONTANA STATEFUND

MONTANA STATE FUND

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INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Montana State Fund
Helena, Montana

We have audited the accompanying statutory statements of admitted assets, liabilities and equity of Montana State Fund, a component unit of the State of Montana, at June 30, 2012 and 2011 and the related statutory statements of operations, changes in equity and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we do not express such an opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in Note 1 to the financial statements, Montana State Fund prepared these financial statements in conformity with accounting practices prescribed or permitted by the Montana State Auditor, Commissioner of Securities and Insurance, which practices differ from accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between statutory accounting practices and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of Montana State Fund for the years ended June 30, 2012 and 2011 or the results of its operations, changes in equity and cash flows for the years then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and equity of Montana State Fund for the years ended June 30, 2012 and 2011, and results of its operations, changes in equity and cash flows for the years then ended on the basis of accounting described in Note 1.

Eide Bailly LLP

Fargo, North Dakota
November 20, 2012

MONTANA STATE FUND
STATUTORY STATEMENTS OF ADMITTED ASSETS, LIABILITIES AND EQUITY
JUNE 30, 2012 AND 2011

	2012	2011
ADMITTED ASSETS		
INVESTMENTS AND CASH		
Bonds	$ 1,035,226,381	$ 1,001,286,534
Equity securities	141,839,698	137,532,240
Real estate		
Properties occupied by the Company	27,974,845	28,507,880
Cash and short-term investments	26,496,118	19,972,374
Securities lending collateral	149,464,962	89,189,742
Total cash and invested assets	1,381,002,004	1,276,488,770
OTHER ADMITTED ASSETS		
Receivables, net	52,718,641	51,353,320
Equipment, net	1,184,917	1,830,674
Accrued investment income	11,901,108	11,238,630
Reinsurance receivables	44,523,008	43,523,117
Other assets	471,440	471,440
Total other admitted assets	110,799,114	108,417,181
Total admitted assets	$ 1,491,801,118	$ 1,384,905,951

	2012	2011
LIABILITIES AND EQUITY		
LIABILITIES		
Reserve for unpaid losses	$ 784,233,347	$ 775,389,747
Reserve for unpaid loss adjustment expenses	105,707,227	99,413,137
Securities lending liability	149,464,962	89,189,742
Unearned premium	42,468,980	37,369,134
Reinsurance funds withheld	68,972,283	57,887,750
Other expenses payable	23,286,571	29,313,900
Total liabilities	1,174,133,370	1,088,563,410
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Policyholders' equity	317,667,748	296,342,541
Total liabilities and equity	$ 1,491,801,118	$ 1,384,905,951

MONTANA STATE FUND
STATUTORY STATEMENTS OF OPERATIONS AND CHANGES IN EQUITY
YEARS ENDED JUNE 30, 2012 AND 2011

	2012	2011
NET PREMIUM EARNED	$ 150,482,457	$ 173,605,441
Losses incurred	119,493,828	130,505,434
Loss expenses incurred	23,370,622	32,871,562
Underwriting expenses incurred	31,487,030	33,346,355
Contingent commission income	(7,969,224)	(2,865,905)
Net underwriting loss	(15,899,799)	(20,252,005)
Net investment income earned	44,544,238	44,070,315
Net realized capital gains	4,888,091	6,424,612
Receivable balances charged off, net of recoveries of $1,275,212 and $3,273,446	(294,191)	(1,034,688)
Other expense	(3,435,086)	(2,836,313)
NET INCOME BEFORE DIVIDENDS	29,803,253	26,371,921
POLICYHOLDER DIVIDENDS	(6,001,168)	(4,004,521)
NET INCOME AFTER DIVIDENDS	$ 23,802,085	$ 22,367,400
CHANGES IN EQUITY		
BALANCE, BEGINNING OF YEAR	$ 296,342,541	$ 241,545,529
Net income	23,802,085	22,367,400
Net unrealized gain on investments	3,251,769	30,412,063
Change in non-admitted assets	1,295,951	2,017,549
Change in provision for reinsurance	(55,265)	-
Other changes in equity	(6,969,333)	-
BALANCE, END OF YEAR	$ 317,667,748	$ 296,342,541

MONTANA STATE FUND
STATUTORY STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2012 AND 2011

	2012	2011
CASH FROM OPERATIONS		
Premiums collected, net of reinsurance	$ 160,246,406	$ 172,168,444
Net investment income	44,389,541	44,020,649
Miscellaneous income	1,337,449	3,331,458
Total	205,973,396	219,520,551
Benefit and loss related payments	(110,650,229)	(110,761,165)
Loss adjustments and underwriting expenses paid	(48,763,776)	(48,868,014)
Dividends paid to policyholders	(6,001,168)	(4,004,521)
Total	(165,415,173)	(163,633,700)
NET CASH FROM OPERATIONS	40,558,223	55,886,851
CASH FROM INVESTMENTS		
Proceeds from investments sold, matured, or repaid		
Bonds	190,071,230	134,503,904
Equity securities	6,000,000	19,000,000
Total investment proceeds	196,071,230	153,503,904
Cost of investments acquired		
Bonds	(221,153,421)	(205,247,825)
Equity securities	(5,000,000)	(12,000,530)
Real estate	-	(106,155)
Total investments acquired	(226,153,421)	(217,354,510)
NET CASH FROM INVESTMENTS	(30,082,191)	(63,850,606)
CASH FROM FINANCING AND OTHER SOURCES		
Cash provided or (applied)		
Other sources	(3,952,288)	(1,672,572)
NET CASH FROM FINANCING AND OTHER SOURCES	(3,952,288)	(1,672,572)
NET INCREASE (DECREASE) IN CASH AND SHORT-TERM INVESTMENTS	6,523,744	(9,636,327)
CASH AND SHORT-TERM INVESTMENTS - BEGINNING OF YEAR	19,972,374	29,608,701
CASH AND SHORT-TERM INVESTMENTS - END OF YEAR	$ 26,496,118	$ 19,972,374

NOTE 1 - NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The Montana State Fund (MSF) is a nonprofit, independent public corporation established under Title 39, Chapter 71 of the Montana Code Annotated (MCA). MSF provides Montana employers with an option for workers' compensation and occupational disease insurance and guarantees available coverage for all employers in Montana. MSF is governed by a seven member Board of Directors appointed by the Governor. The Board has full power, authority, and jurisdiction in the administration of MSF as fully and completely as the governing body of a private mutual insurance carrier. MSF is attached to the State of Montana, Department of Administration for administrative purposes only, and is reported as a component unit in the State's Comprehensive Annual Financial Reports. MSF is exempt from Federal or State income and premium taxes. MSF governs, operates and completes its financial reporting as an insurance company domiciled in the State of Montana.

MSF functions as an autonomous insurance entity supported solely from its own revenues. All assets, debts, and obligations of MSF are separate and distinct from assets, debts, and obligations of the State of Montana. State law requires MSF to set premiums at least annually at a level sufficient to ensure adequate funding of the insurance program during the period the rates will be in effect. If MSF is dissolved by an act of law, the money in MSF is subject to the disposition provided by the legislature enacting the dissolution with due regard given to obligations incurred and existing (Section 39-71-2322, MCA).

During the 1990 Montana Special Legislative Session, legislation passed establishing separate funding and accounts for claims of injuries resulting from accidents occurring before July 1, 1990, referred to as the Old Fund, and claims occurring on or after July 1, 1990, referred to as MSF. This report reflects only the operations of the Montana State Fund. MSF administers and manages the remaining claims of the Old Fund. The State of Montana pays MSF an administrative fee and provides the funding for the Old Fund benefit payments.

Basis of Presentation

The accompanying financial statements of MSF have been prepared in conformity with accounting practices prescribed and permitted by the State Auditor, Commissioner of Securities and Insurance (Statutory Accounting Principles or SAP). Such practices vary from accounting principles generally accepted in the United States of America (GAAP) principally in that certain assets reportable under GAAP are "non-admitted" under SAP and have been excluded from the accompanying statutory statements of admitted assets, liabilities and equity and charged directly against equity. In addition, certain investments which would be carried at estimated fair value under GAAP are carried at amortized cost or the lower of amortized cost or fair market value for SAP.

The State Auditor, Commissioner of Securities and Insurance recognizes only statutory accounting practices prescribed or permitted by the State of Montana for determining and reporting the financial condition and results of operations of an insurance company. The National Association of Insurance Commissioners' (NAIC) *Accounting Practices and Procedures* manual (NAIC SAP) has been adopted as a component of prescribed or permitted practices by the State of Montana.

MSF's financial statements are stated on a NAIC SAP basis. There are no differences between NAIC SAP basis and the basis of practices prescribed or permitted by the State of Montana for the years ended June 30, 2012 and 2011.

The Montana Code Annotated references conformity with the Accounting Practices and Procedures Manual within section 33-2-701(1) and therefore concludes that no legislation is necessary to adopt its use.

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Significant Accounting Policies

Cash and Cash Equivalents

Cash constitutes a medium of exchange that a bank or other similar financial institution will accept for deposit and allow an immediate credit to the depositor's account. Also classified as cash are savings accounts, certificates of deposits with maturity dates of one year or less, and cash equivalents. Cash equivalents are investments with original maturities of three months or less; are readily convertible to known amounts of cash; and, present insignificant risk of change in value due to changes in interest rates. The Montana State Treasury and the Montana Board of Investments (BOI) hold MSF's cash and cash equivalent balances.

Short-term Investments

Short-term investments are those investments with remaining maturities of one year or less at the time of acquisition, excluding those investments classified as cash equivalents. Short-term investments include but are not limited to bonds, commercial paper, money market instruments, repurchase agreements, and collateral and mortgage loans that meet the above criteria. MSF participates in the Short Term Investment Pool (STIP), maintained by the BOI. STIP balances are highly liquid investments. The market value of investments held in the STIP approximates cost.

Investments

Equity securities, bonds and certificates of deposit with original maturities greater than one year are long-term investment securities. Long-term securities are held by BOI. State Street Bank is the custodial bank for BOI.

Equity securities are valued at fair market value. The Montana Constitution allows investing in equity securities, with the restriction that equity securities cannot exceed 25% of total investment book value. The BOI approved a policy statement to keep equities in the 8% to 12% range. Investments in common stock are carried at current fair value as determined by the Securities Valuation Office (SVO), and the related unrealized capital gains (losses) are reported in equity.

Bonds are rated and valued in accordance with the NAIC Securities Valuation Office (SVO) rating guidelines. Bonds with a SVO rating of 1 and 2 are valued at amortized cost. Bonds with a SVO rating of 3 or higher are valued at the lower of amortized cost or market.

MSF has no derivative investments.

Land is reported at cost. Real estate occupied by the Company is recorded at depreciable cost net of related debt obligation, which was zero as of June 30, 2012 and 2011. Depreciation is calculated on a straight-line basis over the estimated useful life of the property.

Investment income consists of interest and dividends. Interest is recognized on an accrual basis and dividends are recorded as earned at the ex-dividend date. Realized capital gains and losses are determined using the first-in first-out method at the time of disposition. Premiums and discounts are amortized or accreted over the estimated lives of the underlying securities using the straight line method. In accordance with SSAP 26, bond amortization shall be calculated using the scientific (constant yield) interest method. MSF is not able to obtain this information from its fund manager at this time. Management believes the difference between the straight-line method and the scientific method is immaterial to the current year Statutory Statements of Operations and is not able to determine the cumulative impact to the Statutory Statements of Admitted Assets, Liabilities and Equity. Securities transactions are recorded on the trade date.

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Fair Values of Financial Instruments

The following methods and assumptions were used by the Company in estimating the fair value of financial instruments:

Cash and Short-Term Investments – The carrying amounts for cash and short-term investments approximate their fair values due to the short-term nature of these instruments.

Debt Securities – The fair values for debt securities are based on quoted market prices, where available. For debt securities not actively traded, fair values are estimated using values obtained from independent pricing services and based on expected future cash flow using a current market rate applicable to the yield, credit quality, and maturity of investments.

Equity Investments in Common Stocks – The fair values for common stocks are based on quoted market prices as approved by the SVO of the NAIC.

Fair Value Measurements

Some of the MSF's investments are stated at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See Note 4 for discussion of fair value measurements.

Cash Collateral and Liability for Securities on Loan

Under the provisions of state statutes, the Montana Board of Investments (BOI) has, by a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank, to lend BOI's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, BOI receives a fee and the bank must initially receive collateral equal to 102% of the market value of the securities on loan and must maintain collateral equal to not less than 100% of the market value of the loaned security. BOI retains all rights of ownership during the loan period.

The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust. The relationship between the average maturities of the investment pool and BOI's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which BOI could not determine. On June 30, 2012 and June 30, 2011, BOI had no credit risk exposure to borrowers.

Premium Receivable

Premium receivable balances with an amount due over 90 days are non-admitted assets. The MSF evaluates the remaining admitted accounts receivable asset for impairment. If it is probable that any amounts are not collectible, the uncollectible receivable is written off and charged to income in the period the determination is made.

Computer Equipment and Software

Computer equipment and software are capitalized if the actual or estimated historical cost exceeds $5,000. Computer equipment is depreciated on a straight-line basis over an estimated useful life of three years. Software is amortized on a straight-line basis using a three-year life for operating software and a five year life for application software. In accordance with statutory accounting principles, computer equipment and operating software are admitted assets. Application software is a non-admitted asset.

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Furniture, Equipment and Leasehold Improvements

Furniture and equipment are capitalized if the cost exceeds $5,000, and are recorded at cost and depreciated on a straight-line basis using estimated useful lives, which range from five to ten years. There are no leasehold improvements. Statutory accounting principles require that furniture, equipment and leasehold improvements be capitalized, depreciated and non-admitted.

Other Assets

Other assets include advances for the Other States Coverage reinsurance contracts.

Risks and Uncertainties

Risks and uncertainties existing as of the date of the financial statements are as follows:

Use of Estimates – The preparation of financial statements in conformity with Statutory Accounting Principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Credit Risk – Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its obligation. With the exception of the U.S. Government securities, fixed income instruments have credit risk as measured by major credit rating services. This risk is that the issuer of a fixed income security may default in making timely principal and interest payments. The Board of Investment's policy requires MSF fixed income investments, at the time of purchase, to be rated an investment grade as defined by Moody's and/or Standard & Poor's (S&P) rating services. The U.S. Government securities are guaranteed directly or indirectly by the U.S. Government. Obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk.

Custodial Credit Risk – Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. As of June 30, 2012 and 2011, all the fixed income and other equity securities were registered in the nominee name of BOI and held in the possession of BOI's custodial bank, State Street Bank.

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The MSF Investment Policy requires credit risk to be limited to 2% of the total securities portfolio in any one name. The MSF Investment Policy provides for "no limitation on U.S. government/agency securities." Investments issued or explicitly guaranteed by the U.S. Government are excluded from the concentration of credit risk requirement.

Interest Rate Risk –Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. MSF investment policies do not formally address interest rate risk; however, BOI has selected the effective duration method to calculate interest rate risk. This information is provided by the custodial bank.

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying auto loan receivables, credit card receivables, and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets.

MSF investments are categorized in Note 2 to disclose credit and interest rate risk as of June 30, 2012 and 2011.

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Losses Incurred and LAE Reserves – Losses incurred and loss adjustment expense (LAE) reserves are established to provide for the estimated ultimate settlement cost of all claims incurred. Management believes that the reserves for unpaid losses and loss adjustment expenses are adequate; however, there can be no assurance that the ultimate settlement of losses may not vary materially from the estimate recorded. Since liabilities are based on estimates, the ultimate liability may be in excess of, or less than, the amounts provided. Adjustments to these estimates of reserves will be reflected in the Statutory Statement of Operations in future years.

Uncertainty Due to Litigation – In the ordinary course of business, MSF is a defendant in various litigation matters. Although there can be no assurances, as of June 30, 2012 and 2011, in the opinion of MSF's Management based on information currently available, the ultimate resolution of these legal proceedings would not be likely to have a material adverse effect on its statutory results of revenue and expenses, admitted assets, liabilities and equity or liquidity. For further discussion, refer to Note 14 (Contingencies and Uncertainties).

Vulnerability Due to Certain Concentrations – MSF conducts its business primarily within the State of Montana and is susceptible to risk based on the economy of the geographic territory it serves. As of June 30, 2012, about 69% of total premium was written through appointed agency producers, and about 31% was written directly through MSF. In September 2012, a merger of Payne Financial Group and Western States Insurance was announced which will create one of the largest private insurance brokerages in the United States. The producer appointment agreement will be reissued as a combined agency under the new entity effective January 1, 2013; it is estimated that this agency will represent about 37% of MSF's total premium.

Administrative Cost Allocation

State law (Section 39-71-2352, MCA) requires MSF to separately determine and account for administrative expenses and benefit payments for claims for injuries resulting from accidents occurring before July 1, 1990 (Old Fund) from those occurring on or after July 1, 1990 (MSF). The law also limits annual administrative costs of claims associated with the Old Fund to $1.25M. MSF received $842K and $941K from the State of Montana for the administration of the Old Fund in fiscal years 2012 and 2011, respectively.

Losses Incurred and Loss Adjustment Expense Estimates

Loss and loss adjustment expense (LAE) reserves are established to provide for the estimated ultimate settlement cost of all claims incurred. Loss reserves are based on reported aggregate claim cost estimates combined with estimates for future development of such claim costs and estimates of incurred but not reported (IBNR) claims. Because actual claim costs depend on such complex factors as inflation and changes in the law, claim liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors.

A provision for inflation and the calculation of estimated future claim costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. Losses and loss adjustment expenses are presented at face value net of estimated reinsurance recoverable.

Reinsurance Recoverables on Paid and Unpaid Losses

Reinsurance recoverables are estimates of paid and unpaid losses collectible from MSF's reinsurers. The amounts ultimately collected may be more or less than these estimates. Any adjustments of these estimates are reflected in revenues and expenses as they are determined.

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Unearned Premiums

Unearned premium reflects premium that has been written but not yet earned. The unearned premium was $42M and $37M at June 30, 2012 and 2011, respectively.

Other Liabilities

- Security Deposits - Security deposits are monies held on behalf of certain policyholders based on arranged payment terms or account history.

- Funds Withheld - Funds withheld are premiums due to reinsurers on a contingent basis in accordance with the reinsurance contracts in place.

- Accounts Payable - Accounts payable includes liabilities incurred on behalf of claimants, refunds due to policyholders and amounts due to vendors.

- Compensated Absences - MSF supports two leave programs, the State of Montana Leave Program, (Traditional Plan) and the MSF Personal Leave Program. Employees covered in the Tradition Plan accumulate both annual leave and sick leave and MSF pays employees 100% of unused annual leave and 25% of unused sick leave upon termination. MSF also pays 100% of unused compensatory leave credits upon termination to employees in the Traditional Plan. Employees in the Personal Leave Program accumulate personal leave and extended leave. MSF pays employees for 100% of unused personal leave upon termination but extended leave has no cash value at the time of termination.

- Postretirement Benefits - Postretirement benefit obligations are administered by the State of Montana. The liability and expense are included, and are amortized on a GAAP basis because a statutory valuation is not available. Management believes the difference between the GAAP valuation and the SAP valuation is not material to these financial statements. For further discussion, refer to Note 9.

Income and Premium Taxes Payable

MSF is a component unit of the State of Montana and is not subject to Federal or State premium or income tax.

Premium Revenue

Premiums are recognized as revenue on a pro-rata basis over the policy period, beginning on the effective date of the policy. MSF's Board of Directors approves premium rates annually.

Policyholders are contractually obligated to pay certain premiums to MSF in advance of the period in which the premiums are earned. Advance premiums are deferred until the effective date of the policy at which time they are recognized as revenue on a pro-rata basis over the term of the policy. Premium advances are refundable when the policyholder's coverage is canceled and MSF has credited all earned premiums.

Retrospectively Rated Policies

MSF writes policies for which the premiums vary based on loss experience. Future premium adjustments for these retrospective policies are estimated and accrued at June 30, 2012 and 2011. The premium adjustments are determined through the review of each individual retrospective rated policy, comparing actual losses with projected future losses, to arrive at the best estimates of return or additional retrospective premiums. MSF records retrospective premium accruals and receivables as adjustments to earned premium. Return premiums are recorded as liabilities and additional premiums are recorded as assets.

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Policy Acquisition Costs

Expenses incurred in connection with acquiring new insurance business, including such acquisition costs as sales commissions, are charged to operations as incurred.

Advertising Costs

All advertising costs are expensed when incurred. Advertising expense was $658K and $668K for the years ended June 30, 2012 and 2011, respectively.

Policyholder Dividends

Dividends are discretionary and are accrued and expensed when declared and approved by the MSF Board of Directors. The aggregate amount of policyholders' dividends is based on the analysis of policyholder equity balances and the financial results for the year. For further discussion, refer to Note 10.

NOTE 2 - INVESTMENTS

The investments of MSF as of June 30, 2012 and 2011 are as follows:

June 30, 2012	Total Investment Holdings	Percentage
Bonds:		
Government obligations	$ 378,848,651	27.4%
Special revenue	15,739,116	1.1%
Industrial and miscellaneous	601,548,372	43.6%
Mortgage-backed securities	39,090,242	2.8%
Total bonds	1,035,226,381	75.0%
Equity securities	141,839,698	10.3%
Cash and short-term investments	26,496,118	1.9%
Other investments - collateral securities on loan	149,464,962	10.8%
Real Estate - Property occupied by the Company	27,974,845	2.0%
Total invested assets	$ 1,381,002,004	100.0%

June 30, 2011	Total Investment Holdings	Percentage
Bonds:		
Government obligations	$ 365,213,388	28.6%
Special revenue	25,304,778	2.0%
Industrial and miscellaneous	571,993,354	44.8%
Mortgage-backed securities	38,775,014	3.0%
Total bonds	1,001,286,534	78.4%
Equity securities	137,532,240	10.8%
Cash and short-term investments	19,972,374	1.6%
Other investments - collateral securities on loan	89,189,742	7.0%
Real Estate - Property occupied by the Company	28,507,880	2.2%
Total invested assets	$ 1,276,488,770	100.0%

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The amortized cost and market value of securities as of June 30, 2012 are as follows:

June 30, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Government obligations	$ 378,848,651	$ 40,984,483	$ -	$ 419,833,134
Special revenue	15,739,116	1,229,844	-	16,968,960
Industrial and miscellaneous	601,548,372	43,089,376	(376,715)	644,261,033
Mortgage-backed securities	39,090,242	1,217,741	(500,000)	39,807,983
	$ 1,035,226,381	$ 86,521,444	$ (876,715)	$ 1,120,871,110

	Actual Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Equity securities	$ 100,063,227	$ 41,776,471	$ -	$ 141,839,698

The amortized cost and market value of securities as of June 30, 2011 are as follows:

June 30, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Government obligations	$ 365,213,388	$ 27,810,308	$ (91,941)	$ 392,931,755
Special revenue	25,304,778	1,928,853	-	27,233,631
Industrial and miscellaneous	571,993,354	35,479,956	(173,137)	607,300,173
Mortgage-backed securities	38,775,014	1,618,879	(2,500,121)	37,893,772
	$ 1,001,286,534	$ 66,837,996	$ (2,765,199)	$ 1,065,359,331

	Actual Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
Equity securities	$ 99,007,538	$ 38,524,702	$ -	$ 137,532,240

The amortized cost and estimated market value of MSF's fixed maturity securities as of June 30, 2012 and 2011 are shown below at contractual maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Maturities of mortgage-backed securities depend on the repayment characteristics and experience of the underlying mortgage loans.

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June 30, 2012	Carrying Value	Estimated Fair Value
Due one year or less (excludes STIP)	$ 93,033,600	$ 93,691,679
Due after one year through five years	520,577,272	561,457,311
Due after five years through ten years	398,481,913	440,864,564
Due after ten years	23,133,596	24,857,556
	$ 1,035,226,381	$ 1,120,871,110

June 30, 2011	Carrying Value	Estimated Fair Value
Due one year or less (excludes STIP)	$ 110,453,186	$ 112,308,121
Due after one year through five years	502,780,375	528,684,139
Due after five years through ten years	358,522,151	392,569,767
Due after ten years	29,530,822	31,797,304
	$ 1,001,286,534	$ 1,065,359,331

During fiscal year ending June 30, 2012, MSF realized gross gains from sales of securities of $4.9M and gross realized losses of ($30K). During fiscal year ending June 30, 2011, MSF realized gross gains from sales of securities of $6.5M and gross realized losses of ($55K).

The gross unrealized losses and fair value of the Company's investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2012 and 2011, were as follows:

June 30, 2012	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Industrial and miscellaneous	$ 34,691,078	$ (376,715)	$ -	$ -	$ 34,691,078	$ (376,715)
Mortgage-backed securities	-	-	9,500,000	(500,000)	9,500,000	(500,000)
Total	$ 34,691,078	$ (376,715)	$ 9,500,000	$ (500,000)	$ 44,191,078	$ (876,715)

June 30, 2011	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government obligations	$ 4,839,800	$ (91,941)	$ -	$ -	$ 4,839,800	$ (91,941)
Industrial and miscellaneous	19,705,031	(173,137)	-	-	19,705,031	(173,137)
Mortgage-backed securities	30,320	(121)	7,500,000	(2,500,000)	7,530,320	(2,500,121)
Total	$ 24,575,151	$ (265,199)	$ 7,500,000	$ (2,500,000)	$ 32,075,151	$ (2,765,199)

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MSF closely monitors its investment portfolio, in particular, issuers where there are concerns. MSF considers relevant facts and circumstances in evaluating whether the impairment of a security is other than temporary. Relevant facts and circumstances that are considered include: (1) the length of time the fair value has been below cost; (2) the financial position and access to capital of the issuer, including the current and future impact of any specific events; and (3) MSF's ability and intent to hold the security to maturity or until it recovers in value. To the extent the Company determines that a security is deemed other-than-temporarily impaired, the difference between amortized cost and fair value is charged to earnings. Based on the Company's evaluation and ability and intent to hold these securities to maturity or market value recovery, the impairment of the securities identified above is deemed to be temporary.

During June of 2010, MSF completed construction of an office building that it now occupies. The construction was funded by MSF invested assets and is classified as *"Property Occupied by the Company"* in accordance with SSAP 40. MSF's investment in property occupied by the Company is as follows:

	2012	2011
Land	$ 1,139,460	$ 1,139,460
Properties occupied by the Company	26,835,385	27,368,420
Total real estate	$ 27,974,845	$ 28,507,880

NOTE 3 - CASH COLLATERAL AND LIABILITY FOR SECURITIES ON LOAN

The following table presents the carrying and market values of the securities on loan and the total collateral held as of June 30, 2012 and 2011:

	2012	2011
Securities on loan - carrying value	$ 184,015,466	$ 279,181,367
Securities on loan - market value	201,687,361	299,574,784
Total cash collateral held	149,464,962	89,189,742
Total non-cash collateral held	56,775,133	217,226,134

NOTE 4 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by MSF using available market information and appropriate valuation methodologies. However, considerable judgment is necessary to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts MSF could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The carrying values reported in the balance sheets for cash and cash equivalents approximate fair market values due to the relatively short-term nature of the respective instruments.

Fair value for debt securities are based on estimated market prices published from third-party organizations or values established by management if third party published prices are not available.

For equity securities, the carrying amounts represent fair value. Fair values are based on quoted market prices where available. If quoted market prices are not available, fair values are estimated using quoted market prices for similar instruments.

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The following is a summary of the carrying value and fair value of the Company's financial instruments at June 30, 2012 and 2011:

	2012		2011	
	Carrying value	Fair value	Carrying value	Fair value
Assets:				
Bonds	$ 1,035,226,381	$ 1,120,871,110	$ 1,001,286,534	$ 1,065,359,331
Equity securities	141,839,698	141,839,698	137,532,240	137,532,240

Fair Value Measurements

The Company adopted SSAP 100, "Fair Value Measurements and Disclosures", as of June 30, 2011, which establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under the authoritative guidance are described below:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Company has the ability to access.

Level 2 - Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at June 30, 2012 and 2011.

Mutual funds: Valued at the publicly quoted net asset value (NAV) of shares held at year end.
Bonds: Valued at the quoted market prices at year end.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

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The following table sets forth by level, within the fair value hierarchy, the Company's assets that are included in these financial statements at fair value as of June 30, 2012 and 2011. There were no liabilities reported at fair value as of June 30, 2012 and 2011.

Assets reported at fair value:	2012		
Mutual funds:	(Level 1)	(Level 2)	(Level 3)
Equity Index Fund	$ 127,308,260	$ -	$ -
Equity Index Fund Foreign	-	14,531,438	-
Total mutual funds	127,308,260	14,531,438	-
Total assets reported at fair value	$ 127,308,260	$ 14,531,438	$ -

Assets reported at fair value:	2011		
Mutual funds:	(Level 1)	(Level 2)	(Level 3)
Equity Index Fund	$ 120,542,240	$ -	$ -
Equity Index Fund Foreign	-	16,990,000	-
Total mutual funds	120,542,240	16,990,000	-
Total assets reported at fair value	$ 120,542,240	$ 16,990,000	$ -

NOTE 5 - CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

MSF participates in the Short-Term Investment Pool (STIP) maintained by BOI. STIP balances are highly liquid investments. The market value of STIP approximates cost. The STIP investments' credit risk is measured by investment grade ratings given individual securities. BOI's policy requires that STIP investments have the highest rating in the short-term category by one and/or any Nationally Recognized Statistical Rating Organizations (NRSRO). The three NRSRO's include Standard and Poor's, Moody's Investors Service, and Fitch, Inc.

Cash, cash equivalents and short-term investments at June 30, 2012 and 2011 consist of:

	2012	2011
Cash in bank	$ 4,325,459	$ 4,826,177
STIP investment	22,170,659	15,146,197
	$ 26,496,118	$ 19,972,374

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NOTE 6 - RECEIVABLES, NET

Receivables, net, consist of the following at June 30:

	2012	2011
Uncollected premiums	$ 9,070,444	$ 9,006,555
Unbilled premiums and installments including earned but unbilled premiums of $3,989,276 and $3,361,450, respectively	44,202,728	42,360,597
Accrued retrospective premiums	313,312	740,286
Other receivables	2,462,012	2,642,423
	56,048,496	54,749,861
Less: nonadmitted receivables	(3,329,855)	(3,396,541)
	$ 52,718,641	$ 51,353,320

NOTE 7 - EQUIPMENT, NET

Equipment and software are recorded at cost net of accumulated depreciation and admitted or non-admitted in accordance with statutory accounting principles as follows:

June 30, 2012	Computer Equipment and Operating Software	Vehicles, Furniture and Office Equipment	Application Software	Total
Assets	$ 5,078,556	$ 2,016,577	$ 20,506,731	$ 27,601,864
Accumulated depreciation	(3,893,639)	(632,479)	(18,699,630)	(23,225,748)
Subtotal	1,184,917	1,384,098	1,807,101	4,376,116
Less: Net assets non-admitted	-	(1,384,098)	(1,807,101)	(3,191,199)
Net assets admitted	$ 1,184,917	$ -	$ -	$ 1,184,917
Depreciation expense	$ 684,694	$ 183,231	$ 1,437,715	$ 2,305,640

June 30, 2011	Computer Equipment and Operating Software	Vehicles, Furniture and Office Equipment	Application Software	Total
Assets	$ 5,006,926	$ 2,177,744	$ 19,532,199	$ 26,716,869
Accumulated depreciation	(3,176,251)	(643,339)	(17,185,292)	(21,004,882)
Subtotal	1,830,675	1,534,405	2,346,907	5,711,987
Less: Net assets non-admitted	-	(1,534,405)	(2,346,907)	(3,881,312)
Net assets admitted	$ 1,830,675	$ -	$ -	$ 1,830,675
Depreciation expense	$ 719,255	$ 184,678	$ 2,063,890	$ 2,967,823

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NOTE 8 - LOSSES INCURRED AND LOSS ADJUSTMENT EXPENSE RESERVES

Losses incurred and loss adjustment expense (LAE) reserves are established to provide for the estimated ultimate settlement cost of all claims incurred. Losses incurred reserves are based on reported aggregate claim cost estimates combined with estimates for future development of such claim costs and estimates of incurred but not reported (IBNR) claims. The reserves are reported on an undiscounted basis.

Towers Watson, an external actuarial firm, prepares an actuarial study used to estimate liabilities and the ultimate cost of settling claims reported but not settled and IBNR as of June 30, 2012 and 2011. The study provides a range of potential costs associated with the reported claims, the future development of those claims and IBNR. MSF management has selected a central estimate within that range as the estimated loss reserves. Because actual claim costs depend on such complex factors as inflation and changes in the law, claim liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors.

Management believes that the reserves for unpaid losses and loss adjustment expenses are adequate; however, there can be no assurance that the ultimate settlement of losses may not vary materially from the estimate recorded. Since liabilities are based on estimates, the ultimate liability may be in excess of, or less than, the amounts provided. Adjustment to these estimates of reserves will be reflected in the Statutory Statement of Operations in future years.

The MSF estimated unpaid claims and claims adjustment expenses payable is presented at face value, net of the estimated reinsurance recoverable, at $889.9M and $874.8M, as of June 30, 2012 and 2011, respectively.

The following analysis provides a reconciliation of the activity in the reserve for losses and loss adjustment expenses:

	2012 (in 000's)	2011 (in 000's)
At beginning of year:		
Net reserves for losses and loss expenses	$ 874,803	$ 838,765
Losses and loss expenses incurred during the year related to:		
Current year	114,946	130,173
Prior years	27,918	33,204
Total losses incurred	142,864	163,377
Losses and loss expenses paid during year related to:		
Current year	(25,791)	(27,924)
Prior years	(101,935)	(99,415)
Total losses paid	(127,726)	(127,339)
Total losses and loss adjustment expenses at end of year	$ 889,941	$ 874,803

The increase in the provision for insured events of $27.9M related to loss and loss adjustment expenses of prior years' incurred during the period ended June 30, 2012 is a result of ongoing analysis of loss development trends, re-estimation of unpaid claims, reinsurance recovery adjustments, and reserve strengthening. An additional $12.4M was recorded for reserve strengthening. This increase is due to the uncertainty from anticipated savings resulting from House Bill 334 and the consequences of the 20% premium reduction that was executed in fiscal year 2011.

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NOTE 9 - RETIREMENT PLANS, DEFERRED COMPENSATION AND POSTRETIREMENT PLANS

MSF and its employees contribute to the Public Employees Retirement System (PERS), which offers two types of retirement plans administered by the Public Employees' Retirement Board (PERB). The first plan is the Defined Benefit Retirement Plan (DBRP), a multiple-employer, cost-sharing plan that provides retirement, disability and death benefits to plan members and their beneficiaries. Benefits are based on eligibility, years of service and highest average compensation. Vesting occurs once membership service totals five years. Benefits are established by state law and can only be amended by the legislature.

The Government Accounting Standards Board (GASB) recently issued standards 67 and 68, Accounting and Financial Reporting for Pensions. These standards will require MSF to record pension accounting entries as well as financial statement disclosures. The requirements of these Standards are effective for financial statements for fiscal years beginning after June 15, 2014. The State of Montana is in the process of determining the effect of the change in accounting and obtaining an estimate of the amount of the unfunded liability, however, an estimate of the amount has not been available. Management believes the amount attributable to MSF will be significant, once the State of Montana completes its valuation. Once the estimate is available, MSF will be required to record the unfunded pension liability and related pension disclosures in the statutory basis financial statements.

The second plan is the Defined Contribution Retirement Plan (DCRP), created by the 1999 legislature and available to all active PERS members effective July 1, 2002. This plan is a multiple-employer, cost-sharing plan that also provides retirement, disability and death benefits to plan members and their beneficiaries. Benefits are based on the balance in the member's account, which includes the total contributions made, the length of time the funds have remained in the plan and the investment earnings less administrative costs.

Eligible PERS members choose to participate in either the DBRP or DCRP but may not be active members of both plans. MSF employees hired prior to July 1, 2011 are required to contribute 6.9% of annual compensation in fiscal years 2012 and 2011. Employees hired on or after July 1, 2011 are required to contribute 7.9%. The employer (MSF) is required to contribute 7.17% of annual compensation in fiscal years 2012 and 2011 regardless of the hire date of the employee. MSF's contributions amounted to $1.4M and $1.3M for fiscal years 2012 and 2011, respectively. MSF and its employees paid one hundred percent of required contributions to PERS and there is no unpaid liability as of June 30, 2012.

MSF and its employees are eligible to participate in the State of Montana Deferred Compensation Plan (457 plan) administered by the PERB. The Deferred Compensation plan is a voluntary, tax-deferred retirement plan designed as a supplement to other retirement plans. Under the plan, eligible employees elect to defer a portion of their salary until future time periods. MSF incurs no costs for this plan.

MSF employees and dependents are eligible to receive health care through the State Employee Group Benefits Plan administered by the State of Montana Department of Administration. The State of Montana provides optional post-employment medical, vision and dental health care benefits to qualified employees and dependents that elect to continue coverage and pay administratively established premiums.

MSF's allocated annual OPEB cost (expense) for the years ended June 30, 2012 and 2011 was $821K and $812K, respectively. The liability and expense recorded are the same since the liability is unfunded and is reported at the same amounts determined on a GAAP basis for financial reporting required as a component unit of the State of Montana. While this liability is disclosed for financial statement purposes it does not represent a legal liability of MSF, and MSF does not complete a separate actuarial analysis for Statutory reporting purposes.

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NOTE 10 - POLICYHOLDER DIVIDENDS

During the fiscal year ended June 30, 2012, the MSF Board of Directors authorized and MSF paid dividends of $6.0M to eligible policyholders for the policy year 2009. During the fiscal year ended June 30, 2011, MSF paid dividends of $4.0M to eligible policyholders for the policy year 2008.

NOTE 11 - REINSURANCE ASSUMED AND CEDED

For the fiscal years ended June 30, 2012 and 2011, MSF ceded reinsurance to other reinsurance companies to limit the exposure arising from large losses. These arrangements consist of excess of loss contracts that protect against occurrences over stipulated amounts and an aggregate stop loss contract. The excess of loss contracts provide for the following coverage:

Contract Period	Reinsurance Coverage
2012	Workers' compensation accidents of up to $5M in excess of $5M, maximum of $5M per any one claimant.
	Workers' compensation accidents of up to $20M in excess of $10M, maximum of $5M per any one claimant.
	Workers' compensation accidents of up to $70M in excess of $30M, maximum of $5M per any one claimant.
2011	Workers' compensation accidents of up to $5M in excess of $5M, maximum of $5M per any one claimant.
	Workers' compensation accidents of up to $20M in excess of $10M, maximum of $5M per any one claimant.
	Workers' compensation accidents of up to $70M in excess of $30M, maximum of $5M per any one claimant.

The term of the current aggregate stop loss contract is July 1, 2008 through June 30, 2012. The contract provides coverage based on MSF's premium levels not to exceed 15% of subject net earned premium. In the event reinsurers are unable to meet their obligations under either the excess of loss contracts or aggregate stop loss contract, MSF would remain liable for all losses, as the reinsurance agreements do not discharge MSF from its primary liability to the policyholders.

Premium revenue is reduced by premiums paid for reinsurance coverage of $11.5M and $11.3M in fiscal years 2012 and 2011, respectively. The aggregate stop loss contract requires that MSF maintain a funds-withheld account which represents the basic premium portion of the total premium paid for aggregate stop loss coverage. The total funds withheld account at June 30, 2012 is $69.0M for contracts in place from July 1, 2002 to June 30, 2012. The funds withheld account at June 30, 2011 was $57.9M for contracts in place from July 1, 2002 to June 30, 2011. Interest must be accrued on the funds withheld account which resulted in accrued interest of $3.5M for fiscal year 2012 and $2.9M for fiscal year 2011.

During fiscal years 2012 and 2011, estimated claim reserves were reduced $12.8M and $8.0M respectively, for the amount of reinsurance estimated to be ultimately recoverable on incurred losses due to the Excess of Loss Reinsurance contract. In fiscal years 2012 and 2011, estimated claim reserves were reduced by an additional $24.3M and $21.2M, respectively, for the amount of reinsurance estimated to be ultimately recoverable on incurred losses due to the Aggregate Stop Loss contract.

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MSF recorded an adjustment to equity for fiscal year 2012 in the amount of ($7.0M) for the correction of an accounting error that occurred in previous years. MSF was accounting for the funds withheld asset based on a per accident year basis for the reinsurance program. The asset should have been recorded based on the aggregate results from a multi-year contract perspective. Since MSF determined the balance on a year by year basis and did not carry a cumulative impact for the multi-year contract periods of 2003-2005 and 2009-2012, the reinsurance funds withheld asset was overstated by $7.0M.

MSF also has assumed reinsurance relationships with Zurich American Insurance Company, Argonaut Insurance Company and Legion Insurance Company related to Other States Coverage (OSC). MSF assumes risk for OSC claims, which are then covered under MSF's ceded reinsurance contract. Assumed premium for fiscal years 2012 and 2011 is $1.5M and $1.8M, respectively. The assumed liability for OSC claims is $3.7M and $4.8M for fiscal years 2012 and 2011, respectively.

NOTE 12 - LEASES AND COMMITMENTS

MSF leases office facilities and equipment under various operating leases that expire through December 2015. Rental expense for fiscal years 2012 and 2011 was $302K and $304K, respectively.

MSF leases 350 parking spaces in a parking garage that was built by the City of Helena adjacent to the MSF facility that expire June 30, 2040. The cost of the parking spaces will be the same monthly rate as equivalent parking passes sold by the City. The annual subsequent parking cost is estimated to be $248K with potential to change based on parking rates assigned by Helena Parking Commission.

Future minimum rental payments are as follows for the years ending June 30:

Fiscal Year	Amount
2013	$ 297,252
2014	288,294
2015	263,853
2016	263,100
2017	250,350
Thereafter	5,699,400
	$ 7,062,249

NOTE 13 - SUBSEQUENT EVENTS

Subsequent events were evaluated through November 20, 2012, which is the same date the audited financial statements were available to issue.

Policyholder Dividend Authorized

Subsequent to year end, on November 16, 2012, the Board of Directors authorized a dividend of $10M to eligible policyholders for the policy year 2010. The liability and expense for this dividend will be reported in the financial statements for the year ending June 30, 2013.

NOTE 14 - CONTINGENCIES AND UNCERTAINTIES

Lester Roberts v. G & C Industries. Montana State Fund is defending this litigation against a State Fund policyholder that may be covered by the employer's liability coverage of the State Fund's insurance policy. State Fund has an accepted workers' compensation claim based on the injury incurred in this case. The exclusive remedy provisions of MCA Section 39-71-411 should bar this type of tort claim against the policy holder. However, if the plaintiffs are successful in convincing the court that MCA Section 39-71-411 does not provide a defense, then the employer-policyholder may be legally responsible for causing the injuries to its employee. It is reasonably possible that Montana State Fund may be called upon to indemnify the employer-policyholder, up to the policy limits of $1,000,000. The potential cost impact to the State Fund is not known at this time.

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

NOTE 15 - RELATED PARTY TRANSACTIONS

In the ordinary course of business, Montana State Fund conducts many of its transactions through other State of Montana agencies. The following significant transactions occurred with other state agencies during the year ended June 30:

	2012	2011
INCOME:		
State of Montana agencies		
Premium	$ 15,749,928	$ 19,417,359
Volume discount/employee return to work	(1,863,245)	(2,283,751)
Retrospective premium	(302,164)	(984,714)
Dividends	(251,486)	(151,942)
Net premium income from State of Montana agencies	$ 13,333,033	$ 15,996,952
EXPENSES:		
Montana Department of Administration		
Support services costs	$ 1,467,757	$ 1,742,525
Benefits Bureau: group insurance	2,411,937	2,344,593
PERS-retirement contributions	1,365,154	1,299,671
Montana Department of Labor & Industry - unemployment insurance	28,680	27,969
Montana Board of Investments - transaction fees	400,779	390,930
Montana Department of Justice - Fraud investigation services	289,132	283,313
Montana - various other	58,483	29,029
Expenses paid to State of Montana agencies	$ 6,021,922	$ 6,118,030

Amounts due to and from other State of Montana agencies are settled regularly and are not material as of June 30, 2012 and 2011.

NOTE 16 - EQUITY – NON-ADMITTED ASSETS AND RECONCILIATION TO GAAP

The following is an accounting of non-admitted assets for the years ended June 30:

	2012	2011
Balance of non-admitted assets, beginning of year	$ 8,657,716	$ 7,268,470
Change related to prior year restatement of premiums	-	3,406,795
	8,657,716	10,675,265
Increase (decrease) in non-admitted assets:		
Change in premiums receivable	(224,863)	(228,484)
Change in short-term notes and loans receivable	158,177	201,220
Change in net tangible assets	(150,308)	(126,892)
Change in intangible assets	(1,039,806)	(1,676,315)
Change in property held in trust	(33,967)	(182,352)
Change in other assets	(5,184)	(4,726)
Net increase (decrease) in non-admitted assets	(1,295,951)	(2,017,549)
Balance of non-admitted assets, end of year	$ 7,361,765	$ 8,657,716

A one-time increase in non-admitted assets in the amount of $3,406,795 was necessary in fiscal year 2011 due to the prior year restatement of equity, all of which related to non-admitted assets.

The following schedule reconciles statutory equity calculated in accordance with NAIC SAP to Net Assets as determined by governmental accounting principles generally accepted in the United States of America (GASB) at June 30:

	2012	2011
Statutory equity (NAIC)	$ 317,667,748	296,342,541
Add:		
Non-admitted assets as shown above	7,361,765	8,657,716
Change in investment value of bonds to fair market value	85,644,729	64,072,796
Change in allowance for doubtful accounts	(2,867,648)	(2,729,053)
Provision for Reinsurance recorded for statutory	55,265	-
Change in net income between NAIC SAP and GAAP for:		
Deferred acquisition costs	4,071,134	4,184,787
Restatement for GASB purposes		(6,969,333)
Rounding differences	(3)	-
GASB net assets	$ 411,932,990	$ 363,559,454

EideBailly

CPAs & BUSINESS ADVISORS

INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTARY INFORMATION

The Board of Directors
Montana State Fund
Helena, Montana

Our audit was conducted for the purpose of forming an opinion on the statutory-basis financial statements taken as a whole. The accompanying supplementary information included in the *Supplemental Schedule of Investment Risk Interrogatories*, *Summary Investment Schedule, and Supplemental Reinsurance Interrogatories* on pages 25 through 28 are required to be presented to comply with the National Association of Insurance Commissioners' *Annual Statement Instructions* and the National Association of Insurance Commissioners' *Accounting Practices and Procedures Manual* and are not a required part of the basic statutory-basis financial statements. Such information included in the three schedules referred to above is the responsibility of management, is presented for purposes of additional analysis and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other procedures in accordance with the auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Eide Bailly LLP

Fargo, North Dakota
November 20, 2012

Basis of Presentation

The following supplemental disclosures present selected statutory-basis financial data as of June 30, 2012, and for the year then ended for purposes of complying with the National Association of Insurance Commissioners' *Accounting Practices and Procedures Manual* and agree to or are included in the amounts reported in the Company's 2012 Statutory Annual Statement.

Supplemental Investment Risk Interrogatories

1. The Company's total admitted assets as of June 30, 2012 are $1.5B.

2. The Company's ten largest exposures to a single issuer/borrower/investment are as follows:

	Amount	Percentage of Total Admitted Assets
Bank of America	$ 22,473,440	1.506%
General Elec Co.	19,484,423	1.306%
JP Morgan Chase & Co	15,981,445	1.071%
Goldman Sachs Group Inc	15,006,121	1.006%
Bunge Limited Finance Co	14,987,452	1.005%
Citigroup Inc	14,978,257	1.004%
Morgan Stanley	14,486,727	0.971%
Berkshire Hathaway Inc	12,988,734	0.871%
American Express Cr Corp	12,983,497	0.870%
Wal Mart Stores Inc	12,537,063	0.840%

3. The amounts and percentages of the Company's total admitted assets held in bonds by NAIC rating are as follows:

	Amount	Percentage of Total Admitted Assets
NAIC-1	$ 767,721,027	51.463%
NAIC-2	263,806,416	17.684%
NAIC-3	2,999,272	0.201%
NAIC-6	699,666	0.047%
Total Bonds	$ 1,035,226,381	69.394%

4. The amount of assets held in foreign investments is $37M, which is 2.48% of the Company's total admitted assets. None of that amount is denominated in a foreign currency.

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5. The amount of assets held in Canadian investments is less than 2.5% of the Company's total admitted assets.

6. The Company does not hold any assets with contractual sales restrictions.

7. The amounts and percentages of the Company's total admitted assets held in equity interests are as follows:

June 30, 2012	Amount	Percentage of Total Admitted Assets
Blackrock Equity Index Fund	$ 127,308,260	8.534%
Blackrock ACWI Ex-US Superfund	14,531,438	0.974%

8. The Company does not hold any privately placed equities.

9. The Company does not hold any general partnership interests.

10. The Company does not hold any mortgage loans.

11. The amount of assets held in real estate is less than 2.5% of the Company's total admitted assets.

12. The Company does not hold any mezzanine real estate loans.

13. The amounts and percentages of the Company's total admitted assets subject to securities lending agreements are as follows:

	Amount	Percentage of Total Admitted Assets
Securities lending agreements	$ 184,015,466	12.335%

14. The Company does not hold any warrants.

15. The Company does not have any exposure for collars, swaps, or forwards.

16. The Company does not have any exposure for futures contracts.

MONTANA STATE FUND
SUMMARY INVESTMENT SCHEDULE
JUNE 30, 2012

	Gross investment holdings		Admitted Assets as Reported in the Annual Statement	
	Amount	%	Amount	%
Bonds:				
U.S. Treasury securities	$ 148,231,174	10.73%	$ 148,231,174	10.73%
U.S. government agency obligations (excluding) mortgage-backed securities):				
Issued by U.S. government agencies	3,766,869	0.27%	3,766,869	0.27%
Issued by U.S. government sponsored agencies	226,850,608	16.43%	226,850,608	16.43%
Mortgage-backed securities) (includes residential and commercial MBS):				
Pass-through securities:				
Issued or guaranteed by GNMA	-	0.00%	-	0.00%
Issued or guaranteed by FNMA and FHLMC	15,739,116	1.14%	15,739,116	1.14%
All other	20,597,606	1.49%	20,597,606	1.49%
CMOs and REMICs:				
All other	18,492,636	1.34%	18,492,636	1.34%
Other debt and other fixed income securities (excluding short-term):				
Unaffiliated domestic securities (includes credit tenant loans and hybrid securities)	543,365,278	39.35%	543,365,278	39.35%
Unaffiliated non-U.S. securities (including Canada)	58,183,095	4.21%	58,183,095	4.21%
Affiliated securities	-	0.00%	-	0.00%
Equity interests:				
Investments in mutual funds	141,839,697	10.27%	141,839,697	10.27%
Real estate investments:				
Properties occupied by the company	27,974,845	2.03%	27,974,845	2.03%
Cash, cash equivalents and short-term investments	26,496,118	1.92%	26,496,118	1.92%
Other invested assets	149,464,962	10.82%	149,464,962	10.82%
Total invested assets	$ 1,381,002,004	100.0%	$ 1,381,002,004	100.0%

The following interrogatories are included in accordance with SSAP 62:

Has the reporting entity reinsured any risks under a quota share reinsurance contract with any other entity that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g. deductible, a loss ratio corridor, loss cap)? If yes, indicate the number of reinsurance contracts containing such provision and if the amount of reinsurance credit taken reflects the reduction in quota share coverage caused by any applicable limiting provision(s).

Yes ☐ No ☒

Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative UW result greater than 3% of prior year-end surplus as regards to policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded great than 3% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

a. A contract term longer than two years and the contract is non-cancellable by the reporting entity during the contract term;
b. A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
c. Aggregate stop loss reinsurance coverage;
d. An unconditional or unilateral right by either party to commute the reinsurance contract, except for such provisions which are only triggered by a decline in the credit status of the other party;
e. A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
f. Payment schedule, accumulating retention from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

Yes ☒ No ☐

Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or affiliates), excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under commune control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders or the reporting entity is a member, where:

a. The written premium ceded to the reinsurer by the reporting entity or its affiliates represents 50% or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
b. 25% or more of the written premium ceded to the reinsurer has been retro-ceded back to the reporting entity or its affiliates.

Yes ☐ No ☒

Except for transactions meeting the requirements of paragraph 30 of SSAP No. 62, has the reporting entity ceded any risk under any reinsurance contract during the period covered by the financial statements, and either:

a. Accounted for that contract as reinsurance (either prospective or retroactive) under SAP and as a deposit under GAAP; or
b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

Yes ☐ No ☒