Statutory Financial Statements
June 30, 2015 and 2014

MONTANA STATEFUND

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Statutory Financial Statements

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CPAs & BUSINESS ADVISORS

Independent Auditor's Report

To the Board of Directors
Montana State Fund
Helena, Montana

Report on the Financial Statements
We have audited the accompanying statutory financial statements of Montana State Fund (MSF), a component unit of the State of Montana, which comprise the statutory statements of admitted assets, liabilities, and policyholders' equity as of June 30, 2015 and 2014, and the related statutory statements of operations, changes in policyholders' equity, and cash flows for the years then ended, and the related notes to the statutory 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 the accounting practices prescribed or permitted by the Insurance Department of the Montana State Auditor's Office. Management is also responsible for 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.

Auditor's Responsibility
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 the audits 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 opinions.

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles
As described in Note 1 to the financial statements, the financial statements are prepared using accounting practices prescribed or permitted by the Insurance Department of the Montana State Auditor's Office, which is a basis of accounting other than accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between the statutory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

1850 N. Central Ave., Ste. 400 | Phoenix, AZ 85004-4624 | T 602.264.5844 | F 602.277.4845 | EOE

Adverse Opinion on U.S. Generally Accepted Accounting Principles
In our opinion, because of the significance of the matter described in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of Montana State Fund as of June 30, 2015 and 2014, or the results of its operations or its cash flows for the years then ended.

Opinion on Regulatory Basis of Accounting
In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and policyholders' equity of Montana State Fund as of June 30, 2015 and 2014, and the results of its operations, changes in policyholders' equity and its cash flows for the years then ended, on the basis of accounting described in Note 1.

Eide Bailly LLP

Fargo, North Dakota
November 02, 2015

	2015	2014
Admitted Assets		
Cash and Invested Assets		
Bonds	$ 1,132,699,368	$ 1,083,973,027
Equity securities	165,361,933	167,515,006
Real estate		
Properties occupied by the Company	26,375,740	26,908,775
Cash and short-term investments	34,182,977	38,011,790
Other invested assets	85,920,568	74,841,190
Securities lending collateral	90,946,591	166,416,008
Total cash and invested assets	1,535,487,177	1,557,665,796
Other Admitted Assets		
Premiums receivable, net	57,742,894	56,180,284
Equipment, net	1,213,938	914,638
Accrued investment income	9,667,349	10,092,205
Reinsurance funds withheld net of reinsurance losses recoverable of $22,308,234 and $20,631,234	54,681,758	45,911,683
Other assets	308,861	345,640
Total other admitted assets	123,614,800	113,444,450
Total admitted assets	$ 1,659,101,977	$ 1,671,110,246
Liabilities and Policyholders' Equity		
Liabilities		
Liability for unpaid losses	$ 780,908,940	$ 805,717,546
Liability for unpaid loss adjustment expenses	114,634,303	118,880,034
Securities lending liability	90,946,591	166,416,008
Unearned premium	50,735,660	48,080,932
Reinsurance funds withheld	76,989,992	66,542,918
Reinsurance reinstatement premium accrual	730,000	160,000
Other liabilities payable	27,251,631	21,460,214
Total liabilities	1,142,197,117	1,227,257,652
Commitments and Contingencies		
Policyholders' Equity		
Policyholders' equity	516,904,860	443,852,594
Total liabilities and policyholders' equity	$ 1,659,101,977	$ 1,671,110,246

	2015	2014
Net Premium Earned	$ 164,556,709	$ 165,271,880
Operating Expenses		
Losses incurred	89,543,987	127,812,156
Loss expenses incurred	12,374,856	15,538,264
Underwriting expenses incurred	34,611,975	33,291,300
Contingent commission income	(8,770,075)	(12,753,215)
Net underwriting gain	36,795,966	1,383,375
Net investment income earned	41,398,973	42,457,728
Net realized capital gains	9,309,050	14,279,687
Receivable balances charged off, net of recoveries of $2,093,350 and $1,183,073	(290,035)	(380,511)
Other expenses	(3,774,084)	(3,994,562)
Net Income Before Dividends	83,439,870	53,745,717
Policyholder Dividends	(20,004,917)	(12,003,138)
Net Income After Dividends	$ 63,434,953	$ 41,742,579
Changes in Policyholders' Equity		
Balance, Beginning of Year	$ 443,852,594	$ 372,277,435
Net income	63,434,953	41,742,579
Net unrealized gain on investments	9,016,970	28,036,023
Change in non-admitted assets	600,343	646,364
Other changes in policyholders' equity	-	1,150,193
Balance, End of Year	$ 516,904,860	$ 443,852,594

	2015	2014
Cash from Operations		
Premiums collected, net of reinsurance	$ 170,072,134	$ 168,246,564
Net investment income	42,739,555	43,680,614
Miscellaneous income	2,202,279	1,299,204
	215,013,968	213,226,382
Benefit and loss related payments	(114,315,814)	(105,678,089)
Loss adjustments and underwriting expenses paid	(45,253,465)	(48,007,033)
Dividends paid to policyholders	(20,004,917)	(12,003,138)
	(179,574,196)	(165,688,260)
Net Cash from Operations	35,439,772	47,538,122
Cash from Investments		
Proceeds from investments sold, matured, or repaid		
Bonds	155,329,314	168,738,186
Equity securities	12,000,000	22,000,000
Total investment proceeds	167,329,314	190,738,186
Cost of investments acquired		
Bonds	(202,028,837)	(218,722,671)
Equity securities	(571)	-
Other invested assets	(5,000,000)	(34,250,000)
Total investments acquired	(207,029,408)	(252,972,671)
Net Cash used for Investments	(39,700,094)	(62,234,485)
Cash from Financing and Other Sources		
Cash provided or (applied)		
Other sources	431,509	(766,108)
Net Cash from (used for) Financing and Other Sources	431,509	(766,108)
Net Increase (Decrease) in Cash and Short-Term Investments	(3,828,813)	(15,462,471)
Cash and Short-Term Investments - Beginning of Year	38,011,790	53,474,261
Cash and Short-Term Investments - End of Year	$ 34,182,977	$ 38,011,790

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 allocated 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 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). MSF governs, operates and completes its financial reporting as an insurance company domiciled in the State of Montana. However, MSF is not currently required to file its annual statement and audited financial reports with the Department of Insurance of the Montana State Auditor's Office (SAO).

The 2015 legislature passed SB 123 which significantly changed the regulatory oversight of MSF beginning January 1, 2016. MSF will be issued a Certificate of Authority, will become an authorized insurer regulated by the Department of Insurance of the Montana State Auditor's Office (SAO) and will be subject to the provisions of Title 33, Montana Insurance Code. MSF financial reporting will convert from a fiscal year ending June 30 to a calendar year of January 1 to December 31. The first calendar year period will begin on January 1, 2016 and quarterly and annual regulatory filings will be submitted to the insurance department as required under the law change.

During the 1990 Montana Special Legislative Session, legislation passed establishing separate liabilities, 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 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 SAO (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 policyholders' 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 SAO 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.

Differences of NAIC SAP from Generally Accepted Accounting Principles

Statutory accounting practices vary in some respects from U.S. generally accepted accounting principles (GAAP). Such significant differences include the following:

a. Investments in equity securities are carried at current market values as determined by the NAIC;

b. Investments in bonds are generally carried at amortized cost, while under GAAP, they are carried at either amortized cost or estimated fair value based on their classification according to the Company's ability and intent to hold or trade the securities;

c. Assets having economic value other than those that can be used to fulfill policyholder obligations are categorized as "nonadmitted assets" and are not permitted to be included in the statutory financial statements of admitted assets, liabilities and capital and policyholders' equity, whereas for GAAP, these assets are recognized in the balance sheet, subject to any valuation allowances. Assets reported under NAIC SAP as "non-admitted" are excluded through a charge against unassigned policyholders' equity. Included with non-admitted assets are furniture, certain equipment and software, prepaid expenses and certain receivables that do not meet statutory criteria for admitted assets.

d. Receivables over 90 days outstanding are not admitted to the statutory financial statements and charged against statutory policyholders' equity, whereas, for GAAP, the Company assesses the collectability of premiums receivable and any charge for uncertain collection is made to the income statement.

e. Cash, cash equivalents, and short-term investments in the statements of cash flows represent cash balances and investments with initial maturities of one year or less. Under GAAP, the corresponding caption of cash and cash equivalents include cash balances and investments with initial maturities of three months or less.

f. Commissions allowed by reinsurers on business ceded are reported as income when received rather than being deferred and, to the extent recoverable, amortized over the life of the policy, as required under GAAP.

g. Governmental pension accounting standards (GASB 68) require recognition of an allocation of the state's unfunded retirement plan liability at the agency level. Under SAP, the recording of a portion of the unfunded liability is not required for a reporting entity who participates in a plan sponsored by another entity but is not directly liable for the obligations under the plan (SSAP No. 102 paragraph 81); however, the amounts contributed to the plan by MSF are recorded as expense in the current year.

h. The statutory statement of cash flows differs in certain respects from the presentation required within GAAP literature, including presentation of changes of cash and short investments instead of cash and cash equivalents. In addition, GAAP requires a reconciliation of net income to net cash from operating activities. Short term investments include securities with a maturity of one year or less and are included in the cash balance, whereas GAAP excludes short term investments from cash. Both statutory and GAAP include cash equivalents in the cash balance. Cash equivalents are defined as highly liquid investments with a maturity of three months or less at acquisition.

i. The statutory financial statements are prepared in conformity with the Annual Financial Reporting Model Regulation # 205, which requires the audited financial statements to conform to the language and groupings used to prepare the Annual Statements filing as set out by the NAIC.

Management has not determined the impact of the differences between statutory accounting practices and GAAP, however the differences are presumed to be material.

MSF's financial statements are stated on a NAIC SAP basis except where certain differences are set out in the Montana Code Annotated (MCA). MCA 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.

For the years ended June 30, 2015 and 2014, there was no difference of MSF's net income and policyholder's equity between NAIC SAP and practices prescribed and permitted by the State of Montana.

Correction of an Error

During the course of the State of Montana's statewide 2014 audit, an error was identified in the other post-employment benefit plan's (OPEB) valuation that resulted in an overstated liability. Under the Regulatory Basis of Accounting described in Note 1, Statement of Statutory Accounting Principle (SSAP) No. 3, *Accounting Changes and Corrections of Errors*, paragraph 10, states: "Corrections of errors in previously issued financial statements shall be reported as adjustments to unassigned funds (Policyholders' Equity) in the period an error is detected." In accordance with SSAP No. 3, MSF recorded its allocated amount of the correction in 2014. The related liability balance was reduced by $1.5M and Policyholders' Equity was increased by $1.2M to reflect the portion of the change related to prior years.

Significant Statutory 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. Savings accounts, certificates of deposits with maturity dates of one year or less, and cash equivalents are also classified as cash. 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. At times during the year, MSF's cash balances are in excess of federally insured limits. The Company does not consider this a material risk.

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, investments in partnerships and limited liability companies, 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 maintain the allocation to public equities at 10% of total portfolio market value. The allocation range is set at +/-2%, or 8% to 12%. Investments in common stock are carried at current fair market value as determined by the Securities Valuation Office (SVO), and the related unrealized capital gains (losses) are reported in policyholders' 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.

Investments in partnerships and limited liability companies are valued based on the underlying audited U.S. GAAP equity of the investee in accordance with SSAP No. 48 and/or SSAP No. 97. The related unrealized capital gains (losses) are reported in policyholders' equity.

MSF has no derivative investments.

Investments in Real Estate are comprised of property occupied by the Company. These investments are recorded at depreciable cost net of related debt obligation, which was zero as of June 30, 2015 and 2014. Depreciation is calculated on a straight-line basis over the estimated useful life of the property. Land is valued at historical cost.

Investment income consists of interest and dividends, net of related investment expenses. 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.

MSF's fund manager uses the scientific (constant yield) interest method of amortization in accordance with SSAP No. 26. Securities transactions are recorded on the trade date.

Fair Values of Financial Instruments

Statement of Statutory Accounting Principles (SSAP) No. 100, "Fair Value Measurements" defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of nonperformance.

The Company classified its investments based upon an established fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. SSAP No. 100 describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value, which are the following:

- Level 1—Quoted prices in active markets for *identical* assets or liabilities.
- Level 2—Inputs other than Level 1 that are observable, either directly or indirectly; such as quoted prices for *similar* assets or liabilities, quoted prices in markets that are not active; or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The asset 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.

Following is a description of the valuation methodologies used for assets measured at fair value or for those assets not stated at fair value in the financial statements but whose estimated fair values are disclosed.

Bonds – Issuer Obligations, including Industrial and Miscellaneous: Valued based on NAIC market values. For those securities not actively traded, quoted market prices of comparable instruments or discounted cash flow analysis are used based upon inputs that are observable in the markets for similar securities. Inputs include benchmark yields, credit spreads, default rates, prepayments and non-bonding broker quotes.

Bonds – Mortgage and Other Asset-Backed Bonds: Valued based on Commercial and Residential Mortgage Backed Securities modeling file provided by the NAIC. The prepayment assumptions used for single class and multi-class mortgage-backed/asset-backed securities were obtained from broker/dealer survey values. These assumptions are consistent with the current interest rate and economic environment.

Common Stock Unaffiliated and Mutual Funds: Valued based on NAIC quoted market values. If NAIC market values are unavailable, value is determined based on the underlying equity.

Other Invested Assets: Value is based on the underlying equity of the related entity.

Cash and Cash Equivalents: The carrying amounts approximate fair value.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of the future fair values. Furthermore, although 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.

Other-Than-Temporary Declines in Fair Value

The Company regularly reviews its investment portfolio for factors that may indicate that a decline in fair value of an investment is other-than-temporary. Some factors considered in evaluating whether or not a decline in fair value is other-than-temporary include: the Company's ability and intent to retain the investment for a period of time sufficient to allow for a recovery in value; the duration and extent to which fair value has been less than cost; and the financial condition and prospects of the issuer. When an other-than-temporary impairment is recognized, the security is written down to estimated fair value and the amount of the write-down is recorded as a realized loss.

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 of at least 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, 2015 and 2014, BOI had no credit risk exposure to borrowers.

Premium Receivable

Premium receivable balances with an amount due over 90 days are non-admitted assets. 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 is capitalized if the actual or estimated historical cost exceeds $5,000. Software is capitalized if the actual or estimated historical cost exceeds $100,000. 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, or less, for application software. In accordance with statutory accounting principles, computer equipment and operating software are admitted assets, although Montana §33-2-501(1) limits admission of EDP equipment to a maximum of 1% of admitted assets. Application software is a non-admitted asset.

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:

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 company 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, 2015 and 2014, 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 company'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. The MSF Investment Policy sets an average portfolio duration range of 2-5 years for fixed income securities except in extraordinary circumstances where a shorter duration may be advisable. BOI uses the effective duration method to calculate interest rate risk. The Board's analytics software uses an option-adjusted measure of a bond's (or portfolio's) sensitivity to changes in interest rates.

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, 2015 and 2014.

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, 2015 and 2014, 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 policyholders' 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, 2015, about 71% of total premium was written through appointed agency producers, and about 29% was written directly through MSF. PayneWest Insurance is one of the largest insurance brokerages in the United States, and as of June 30, 2015, this agency represented about 41% of MSF's total premium.

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. Material estimates susceptible to significant change include loss and loss adjustment expense reserves, the fair value of investments, investment impairments, and cost allocation processes.

Reinsurance Risk – Reinsurance contracts do not relieve the Company from its obligations to insureds. Failure of reinsures to honor their obligations could result in losses to the Company. The Company evaluates the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. Management believes that any liability arising from this contingency would not be material to the Company's financial position.

Risk-Based Capital – Risk-based capital (RBC) is a method developed by the NAIC to measure the minimum amount of capital appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. The formulas for determining the amount of RBC specify various weighting factors that are applied to financial balances or various levels of activity based on the perceived degree of risk of such activities. The adequacy of the company's actual capital is measured by the RBC results as determined by the formulas. Companies below minimum RBC requirements are subject to specified corrective action. MSF was not required to report its RBC as of June 30, 2015 but will begin reporting and being regulated based on its RBC for the year ended December 31, 2016.

Administrative Cost Allocation

State law (Section 39-71-2352, MCA) requires MSF to separately determine and account for administrative expenses and benefit payments on 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 $815K and $820K from the State of Montana for the administration of the Old Fund in fiscal years 2015 and 2014, 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. 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.

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. For further discussion, refer to Note 8.

Reinsurance Recoverable 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.

Unearned Premiums

Unearned premium reflects premium that has been written but not yet earned. Premiums are earned and thereby recognized as revenue on a pro-rata basis over the policy period, beginning on the effective date of the policy. The unearned premium was $51M and $48M at June 30, 2015 and 2014, respectively.

Premium Deficiency Reserve

Premium deficiency reserves and the related expense are recognized when it is probable that losses, loss adjustment expense and policy maintenance costs under a group of existing contracts will exceed net earned premium, reinsurance recoveries and anticipated investment income. No such reserves were required at either December 31, 2015 or 2014.

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 Traditional 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 and banked holiday leave upon termination but extended leave has no cash value at the time of termination.

- Other Postemployment Benefits - Postemployment benefit obligations are administered by the State of Montana. The liability and expense are recorded, and are amortized on a GAAP basis as provided by the State 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. During the course of the State of Montana's statewide audit, an error was identified in the other post-employment benefit plan's valuation that resulted in an overstated liability. Accordingly, MSF recorded a correction of the error in its 2014 results. Refer to Note 18 for more detailed explanation.

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, with the exception of State of Montana agencies, 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. State agency premium is estimated and payments are received quarterly in arrears based on the actual reported payroll.

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, 2015 and 2014. 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.

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 $703K and $473K for the years ended June 30, 2015 and 2014, 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 at June 30, 2015 and 2014 are as follows:

June 30, 2015	Total Investment Holdings	Percentage
Bonds:		
U.S. Government obligations	$ 188,427,758	12.27%
All other government obligations	25,996,769	1.69%
U.S. Special revenue	252,736,003	16.46%
Industrial and miscellaneous	612,906,680	39.92%
Mortgage and other loan-backed securities	52,632,158	3.43%
Total bonds	1,132,699,368	73.77%
Equity securities	165,361,933	10.77%
Cash and short-term investments	34,182,977	2.23%
Other invested assets	85,920,568	5.60%
Securities lending collateral	90,946,591	5.92%
Real Estate - Property occupied by the Company	26,375,740	1.72%
Total invested assets	$ 1,535,487,177	100.00%

June 30, 2014	Total Investment Holdings	Percentage
Bonds:		
U.S. Government obligations	$ 168,923,301	10.85%
All other government obligations	20,969,876	1.35%
U.S. Special revenue	244,520,312	15.70%
Industrial and miscellaneous	589,312,193	37.83%
Mortgage and other loan-backed securities	60,247,345	3.87%
Total bonds	1,083,973,027	69.60%
Equity securities	167,515,006	10.75%
Cash and short-term investments	38,011,790	2.44%
Other invested assets	74,841,190	4.80%
Securities lending collateral	166,416,008	10.68%
Real Estate - Property occupied by the Company	26,908,775	1.73%
Total invested assets	$ 1,557,665,796	100.00%

MSF has investments in two companies – TIAA CREF Asset Management Core Property Fund LP and American Core Realty Fund LLC – which have underlying characteristics of real estate and are classified as other invested assets. The total acquisition cost for each investment was $35M and $40M, respectively.

The cost or amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of invested assets are as follows at June 30:

June 30, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Statutory Fair Value
U.S. Government obligations	$ 188,427,758	$ 8,715,844	$ (504,167)	$ 196,639,435
All other government obligations	25,996,769	277,473	(12,368)	26,261,874
U.S. Special revenue	252,736,003	8,489,648	(104,432)	261,121,219
Industrial and miscellaneous	612,906,680	22,650,400	(1,582,842)	633,974,238
Mortgage and other loan-backed securities	52,632,158	671,931	(134,345)	53,169,744
Total bonds valued at amortized cost	$ 1,132,699,368	$ 40,805,296	$ (2,338,154)	$ 1,171,166,510

	Actual Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Statutory Fair Value
Equity securities	$ 75,261,419	$ 90,100,514	$ -	$ 165,361,933
Other invested assets	75,000,000	10,920,568	-	85,920,568
Total securities valued at fair value	$ 150,261,419	$ 101,021,082	$ -	$ 251,282,501

June 30, 2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Statutory Fair Value
U.S. Government obligations	$ 168,923,301	$ 9,629,156	$ (701,948)	$ 177,850,509
All other government obligations	20,969,876	57,294	(170,950)	20,856,220
U.S. Special revenue	244,520,312	10,220,779	(367,317)	254,373,774
Industrial and miscellaneous	589,312,193	35,491,502	(288,684)	624,515,011
Mortgage and other loan-backed securities	60,247,345	528,464	(97,462)	60,678,347
Total bonds valued at amortized cost	$ 1,083,973,027	$ 55,927,195	$ (1,626,361)	$ 1,138,273,861

	Actual Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Statutory Fair Value
Equity securities	$ 80,352,084	$ 87,162,922	$ -	$ 167,515,006
Other invested assets	70,000,000	4,841,190	-	74,841,190
Total securities valued at fair value	$ 150,352,084	$ 92,004,112	$ -	$ 242,356,196

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, 2015 and 2014, were as follows:

June 30, 2015	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government obligations	$ 4,857,810	$ (166,724)	$ 19,387,500	$ (337,443)	$ 24,245,310	$ (504,167)
All other government obligations	-	-	4,984,940	(12,368)	4,984,940	(12,368)
U.S. Special revenue	15,153,685	(33,296)	8,656,345	(71,136)	23,810,030	(104,432)
Industrial and miscellaneous	113,664,693	(1,424,879)	20,938,234	(157,963)	134,602,927	(1,582,842)
Mortgage and other loan-backed securities	-	-	17,569,386	(134,345)	17,569,386	(134,345)
	$ 133,676,188	$ (1,624,899)	$ 71,536,405	$ (713,255)	$ 205,212,593	$ (2,338,154)

June 30, 2014	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government obligations	$ -	$ -	$ 18,987,199	$ (701,948)	$ 18,987,199	$ (701,948)
All other government obligations	-	-	15,805,653	(170,950)	15,805,653	(170,950)
U.S. Special revenue	-	-	23,332,042	(367,317)	23,332,042	(367,317)
Industrial and miscellaneous	-	-	39,735,952	(288,684)	39,735,952	(288,684)
Mortgage and other loan-backed securities	13,252,045	(14,997)	14,914,458	(82,465)	28,166,503	(97,462)
	$ 13,252,045	$ (14,997)	$ 112,775,304	$ (1,611,364)	$ 126,027,349	$ (1,626,361)

MSF closely monitors its investment portfolio and 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.

The amortized cost and estimated statutory fair value of MSF's fixed maturity securities as of June 30, 2015 and 2014 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.

June 30, 2015	Amortized Cost	Estimated Statutory Fair Value
Due one year or less (excludes STIP)	$ 91,277,097	$ 93,080,935
Due after one year through five years	618,988,566	642,760,274
Due after five years through ten years	415,434,382	427,697,892
Due after ten years through twenty years	2,999,322	3,037,107
Due after twenty years	4,000,001	4,590,302
	$ 1,132,699,368	$ 1,171,166,510

June 30, 2014	Amortized Cost	Estimated Statutory Fair Value
Due one year or less (excludes STIP)	$ 82,073,191	$ 83,730,911
Due after one year through five years	594,164,941	629,268,286
Due after five years through ten years	400,735,635	417,192,855
Due after ten years through twenty years	2,999,259	3,036,644
Due after twenty years	4,000,001	5,045,165
	$ 1,083,973,027	$ 1,138,273,861

Proceeds from sales of invested assets and gross realized gains and gross realized losses on the sales of invested assets were as follows for the years ended June 30:

	2015	2014
Proceeds from sales of debt securities	$ 155,329,314	$ 168,738,186
Proceeds from sales of common stock	12,000,000	22,000,000
Total proceeds from sales of invested assets	$ 167,329,314	$ 190,738,186
Gross realized gains of debt securities	$ 2,556,737	$ 3,514,738
Gross realized losses of debt securities	(156,451)	(146,087)
Gross realized gains of common stock	6,908,764	10,911,036
Gross realized losses common stock	-	-
Net realized capital gains of invested assets	$ 9,309,050	$ 14,279,687

Investment income and related expenses were as follows for the years ended June 30:

	2015	2014
Investment income		
Interest		
Bonds	$ 37,506,245	$ 38,422,743
Cash and short-term investments	48,079	51,652
Real estate	1,643,010	1,643,010
Other invested assets	3,396,382	3,237,558
Securities lending income	563,466	757,879
Total investment income	43,157,182	44,112,842
Investment expenses		
Investment expenses	1,225,174	1,122,079
Depreciation on real estate	533,035	533,035
Total investment expenses	1,758,209	1,655,114
Net investment income	$ 41,398,973	$ 42,457,728

MSF's investment in property occupied by the Company is as follows at June 30:

	2015	2014
Land	$ 1,139,460	$ 1,139,460
Properties occupied by the Company, net	25,236,280	25,769,315
Total real estate	$ 26,375,740	$ 26,908,775

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:

	2015	2014
Securities on loan - carrying value	$ 158,544,722	$ 195,125,895
Securities on loan - market value	164,289,753	206,786,455
Total cash collateral held	90,946,591	166,416,008
Total non-cash collateral held	76,802,930	44,281,936

Note 4 - Fair Value of Financial Instruments

Certain financial instruments are reported at fair value and others are stated at cost or amortized cost, as shown below. For those assets carried at fair value in the financial statements and for those assets not stated at fair value in the financial statements but whose estimated fair values are disclosed, the following table indicated the inputs used to estimate fair value measurements.

The statement values, fair values and related inputs for financial instruments at June 30 are:

2015	Statement Value	Fair Value	(Level 1)	(Level 2)	(Level 3)
Assets reported at amortized cost:					
Bonds	$1,132,699,368	$1,171,166,510	$ -	$1,171,166,510	$ -
Assets reported at fair value:					
Equity securities	$ 165,361,933	$ 165,361,933	$ 146,276,741	$ 19,085,192	$ -
Other invested assets	85,920,568	85,920,568	-	-	**(A)**
Total assets reported at fair value	$ 251,282,501	$ 251,282,501	$ 146,276,741	$ 19,085,192	$ -

2014	Statement Value	Fair Value	(Level 1)	(Level 2)	(Level 3)
Assets reported at amortized cost:					
Bonds	$1,083,973,027	$1,138,273,861	$ -	$1,138,273,861	$ -
Assets reported at fair value:					
Equity securities	$ 167,515,006	$ 167,515,006	$ 147,383,391	$ 20,131,615	$ -
Other invested assets	74,841,190	74,841,190	-	-	**(A)**
Total assets reported at fair value	$ 242,356,196	$ 242,356,196	$ 147,383,391	$ 20,131,615	$ -

(A) – These investments are accounted for using the equity method. For purposes of this disclosure, the equity method is presumed to approximate fair value. If management were to determine fair value for its equity method investments, it would use level 3 inputs.

There were no liabilities reported at fair value as of June 30, 2015 and 2014.

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, 2015 and 2014 consist of:

	2015	2014
Cash in bank	$ 6,184,314	$ 7,019,465
STIP investment	27,998,663	30,992,325
	$ 34,182,977	$ 38,011,790

Note 6 - Receivables, Net

Net receivables consist of the following at June 30:

	2015	2014
Uncollected premiums	$ 10,018,605	$ 10,484,325
Unbilled premiums and installments including earned but unbilled premiums of $4,755,497 and $4,924,023, respectively	48,183,312	46,442,230
Accrued retrospective premiums	78,315	138,744
Other receivables	1,992,409	2,060,610
	60,272,641	59,125,909
Less: nonadmitted receivables	(2,529,747)	(2,945,625)
Total receivables, net	$ 57,742,894	$ 56,180,284

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, 2015	Computer Equipment and Operating Software	Vehicles, Furniture and Office Equipment	Application Software	Total
Assets	$ 5,359,700	$ 2,267,493	$ 15,040,889	$ 22,668,082
Accumulated depreciation	(4,145,762)	(1,057,214)	(14,512,962)	(19,715,938)
Subtotal	1,213,938	1,210,279	527,927	2,952,144
Less: Net assets non-admitted	-	(1,210,279)	(527,927)	(1,738,206)
Net assets admitted	$ 1,213,938	$ -	$ -	$ 1,213,938
Depreciation expense	$ 203,007	$ 193,289	$ 278,716	$ 675,012

June 30, 2014	Computer Equipment and Operating Software	Vehicles, Furniture and Office Equipment	Application Software	Total
Assets	$ 5,305,455	$ 2,199,290	$ 16,760,501	$ 24,265,246
Accumulated depreciation	(4,390,817)	(931,956)	(16,086,977)	(21,409,750)
Subtotal	914,638	1,267,334	673,524	2,855,496
Less: Net assets non-admitted	-	(1,267,334)	(673,524)	(1,940,858)
Net assets admitted	$ 914,638	$ -	$ -	$ 914,638
Depreciation expense	$ 139,888	$ 183,265	$ 354,285	$ 677,438

Note 8 - Loss and Loss Adjustment Expense Reserves

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. The reserves are reported on an undiscounted basis.

Towers Watson, an external independent 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, 2015 and 2014. The study provides a range of potential costs associated with the reported claims, the future development of those claims and IBNR. MSF management has recorded an 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.

The following analysis provides a reconciliation of the activity in the reserve for losses and loss adjustment expenses for the years ended June 30:

	2015 (in 000's)	2014 (in 000's)
At beginning of year:		
Gross liability for unpaid losses and loss adjustment expenses	$ 957,559	$ 938,617
Less reinsurance recoverables	(32,961)	(35,769)
Net liability for unpaid losses and loss adjustment expenses	924,598	902,848
Losses and loss expenses incurred during the year related to:		
Current year	137,627	153,408
Prior years	(35,708)	(9,951)
Total losses and loss adjustment expenses incurred	101,919	143,457
Losses and loss expenses paid during year related to:		
Current year	(26,666)	(29,310)
Prior years	(104,308)	(92,397)
Total losses and loss adjustment expenses paid	(130,974)	(121,707)
At end of year:		
Gross liability for unpaid losses and loss adjustment expenses	931,149	957,559
Less reinsurance recoverables	(35,606)	(32,961)
Net liability for unpaid losses and loss adjustment expenses	$ 895,543	$ 924,598

Changes in the reserve for loss and loss adjustment expenses related to prior years are due to ongoing analysis of loss development trends, re-estimation of unpaid claims, and reinsurance recovery adjustments. Over the past several years, MSF has accumulated a reserve amount specifically to address uncertainty surrounding legislation that put into place significant changes to temporary partial disability benefits in the workers' compensation system in Montana. During the year ended June 30, 2015, MSF decreased this additional reserve amount by ($36.7M), which is the primary cause of the decrease of ($35.7M) shown above.

Included in the amounts above are reserves for asbestos exposure. MSF's exposure to asbestos claims arose from the direct sale of workers' compensation policies to companies with incidental exposure to asbestos. Case reserves related to these claims are as follows as of June 30:

	2015	2014
Beginning case reserves (including LAE)	$ 2,742,674	$ 747,023
Losses and LAE incurred	3,897,149	2,967,997
Payments for losses and LAE	(1,381,250)	(972,346)
Ending case reserves (including LAE)	$ 5,258,573	$ 2,742,674

Note 9 - Retirement Plans, Deferred Compensation and Postretirement Plans

MSF and its employees contribute to the Montana 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 multiemployer pension plan for the benefit of State employees that provides retirement, disability and death benefits to plan members and their beneficiaries. MSF has no legal obligation for pension liabilities under this plan. However, MSF is required to record an allocated amount of the DBRP's unfunded liability on its GAAP financial statements. The amount of that liability is $16.9M.

The second plan is the Defined Contribution Retirement Plan (DCRP), a multiemployer 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 and the investment earnings less administrative costs.

MSF contributed a total of $1.6M and $1.4M to both plans during fiscal year 2015 and 2014, respectively. The required employer contribution rate for both plans increased from 8.17% in FY14 to 8.27% in FY15. There is no liability for unpaid contributions at June 30, 2015.

MSF's allocated annual OPEB cost (expense) for the years ended June 30, 2015 and 2014 was $572K and $633K, respectively. The liability is reported at the same amount 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.

As described in Note 1 to the financial statements, during the course of the State of Montana's statewide 2014 audit, an error was identified in the other post-employment benefit plan's OPEB valuation that resulted in an overstated liability. Under the Regulatory Basis of Accounting described in Note 1, Statement of Statutory Accounting Principle (SSAP) No. 3, *Accounting Changes and Corrections of Errors*, paragraph 10, states: "Corrections of errors in previously issued financial statements shall be reported as adjustments to unassigned funds (Policyholders' Equity) in the period an error is detected." In accordance with SSAP No. 3, MSF recorded its allocated amount of the correction in 2014. The related liability balance was reduced by $1.5M and Policyholders' Equity was increased by $1.2M as of June 30, 2014, to reflect the portion of the change related to prior years.

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.

Note 10 - Policyholder Dividends

During the fiscal year ended June 30, 2015, the MSF Board of Directors authorized and MSF paid dividends of $20M to eligible policyholders for the policy year 2012. During the fiscal year ended June 30, 2014, MSF paid dividends of $12M to eligible policyholders for the policy year 2011.

Note 11 - Reinsurance Assumed and Ceded

For the fiscal years ended June 30, 2015 and 2014, 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 aggregate stop loss contracts. The excess of loss contracts provide for the following coverage:

Contract Period	Reinsurance Coverage
2015	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.
2014	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 current aggregate stop loss 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.

Direct, assumed and ceded activity included the following for the years ended June 30, 2015 and 2014:

	2015 (in 000's)	2014 (in 000's)
Written premiums:		
Direct	$ 175,774	$ 172,254
Assumed	2,747	2,485
Ceded	(11,310)	(9,460)
Net written premiums	$ 167,211	$ 165,279
Earned premiums:		
Direct	173,233	172,385
Assumed	2,634	2,347
Ceded	(11,310)	(9,460)
Net earned premiums	$ 164,557	$ 165,272
Unearned premiums:		
Direct	49,748	47,205
Assumed	988	876
Ceded	-	-
Net unearned premiums	$ 50,736	$ 48,081
Incurred losses and loss adjustment expenses		
Direct	103,267	140,094
Assumed	1,373	(741)
Ceded	(2,721)	3,997
Net incurred losses and loss adjustment expenses	$ 101,919	$ 143,350

MSF commuted two of its outstanding reinsurance contracts during fiscal year 2014. Commutation of the ceded aggregate stop loss contract for the period July 1, 2005 to July 1, 2008 resulted in a reduction in the funds withheld balance of $19.9M and a reduction in the reinsurance receivables balance of $19.9M. No funds were exchanged between MSF and the reinsurers, XL Re Ltd. and Imagine International Reinsurance Co., as part of this commutation and it had no impact on incurred losses or reserves for unpaid losses or LAE. Commutation of assumed reinsurance contracts with Legion Insurance Company for the period January 1, 1999 to July 1, 2001 resulted in a reduction of reserves for unpaid losses and LAE of $1.4M.

The following information provides the name and aggregate recoverable from individual reinsurers that have unsecured aggregate recoverables as of June 30, 2015 and 2014:

Reinsurer Name	AM Best Rating	2015	2014
Hannover Reins (Ireland) Ltd	A+	$ 28,861,899	$ 22,449,157
Xl Re Ltd	A	21,420,363	19,011,753
Imagine Intl Reins Ltd	N/A	16,705,067	15,661,955
Axis Specialty Ltd.	A+	10,603,272	10,027,848
Reliastar Life Ins Co	A	6,280,834	5,532,422
Us Business Of Canada Life Assur Co	A+	1,225,000	914,338
Odyssey Amer Reins Co	A	1,100,621	1,107,808
Hannover Ruckversicherungs Ag	A+	1,050,323	1,053,917
Arch Reins Co	A+	550,311	553,904
Montpelier Reins Ltd	A	550,298	553,892
Lloyd's Syndicate Number 1400	A	412,734	415,430
Federal Ins Co	A++	289,099	344,104
Lloyd's Syndicate Number 570	A	272,640	274,257
Aspen Ins Uk Ltd	A	272,640	274,257
Lloyd's Syndicate Number 435	A	272,640	274,257
Lloyd's Syndicate Number 2000	A	147,634	149,251
Brit Ins Ltd	Not Rated	137,574	138,473
Lloyd's Syndicate Number 2003	A	135,062	135,781
Other	various	1,940,061	2,005,849
Total		$ 92,228,072	$ 80,878,653

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 2015 and 2014 was $439K and $343K, 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 $290K 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
2016	$ 345,599
2017	329,543
2018	318,443
2019	306,995
2020	289,800
Thereafter	5,796,000
	$ 7,386,380

Note 13 - Subsequent Events

Subsequent events were evaluated through November 02, 2015, which is the same date the audited financial statements were available to issue.

Note 14 - Contingencies and Uncertainties

Susan Hensley v. Montana State Fund - Montana State Fund received a Petition for Hearing that was filed before the Workers' Compensation Court in October, 2013. The matter is Susan Hensley vs. Montana State Fund, WCC No. 2013-3235. The matter is fully briefed and is submitted for a decision. Under HB 334, as passed by the legislature in 2011 and codified in 39-71-703 (2), MCA, when a claimant receives a Class I impairment, it is not payable unless the claimant has an actual wage loss as a result of the compensable injury or occupational disease. The law was effective July 1, 2011 and applicable to claims that occurred on or after that date. The petitioner in this matter is challenging the constitutionality of 39-71-703 (2), MCA. State Fund anticipates the chances are remote, but as with any litigated matter there is the possibility of an adverse decision. Should the statute be held unconstitutional, determined to be applicable to other claims and also determined to be retroactively applicable, potential liability is estimated to be at least $2.2 million per year, as based on NCCI initial pricing, and current estimated business volumes. However, based on experience, costs may be substantially higher than the estimate of $2.2 million per year.

Montana State Fund also is involved in other 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 State of Montana agencies. The following significant transactions occurred with state agencies during the year ended June 30:

	2015	2014
Income:		
State of Montana agencies		
Premium	$ 15,086,763	$ 15,523,004
Volume discount/employee return to work	(1,796,564)	(1,819,786)
Retrospective premium	(1,143,221)	(466,658)
Dividends	(660,719)	(652,347)
Net premium income from State of Montana agencies	$ 11,486,259	$ 12,584,213
Expenses:		
Montana Department of Administration		
Support services costs	$ 1,310,536	$ 1,465,174
Benefits Bureau: group insurance	2,905,385	2,551,812
PERS retirement contributions	1,575,564	1,357,403
Montana Department of Labor & Industry - unemployment insurance	84,037	63,809
Montana Board of Investments - transaction fees	383,303	383,940
Montana Department of Justice - Fraud investigation services	327,031	351,151
Montana - various other	24,807	52,045
Expenses paid to State of Montana agencies	$ 6,610,663	$ 6,225,334

MSF writes policies for which the premiums vary based on loss experience. Future premium adjustments for these retrospective policies are estimated and accrued at year-end, and are determined through a review comparing actual losses with projected future losses, to arrive at the estimate of return premium. The State of Montana agencies are considered a retrospective rated group and the estimated accrual at June 30, 2015 was $2.7M for the policy periods July 1, 2013 to June 30, 2014 and July 1, 2014 to June 30, 2015 combined. At June 30, 2014, the estimated accrual for the policy periods July 1, 2012 to June 30, 2013 and July 1, 2013 to June 30, 2014 was $2.6M combined.

Volume discounts payable to state agencies were approximately $502K and $501K at June 30, 2015 and 2014, respectively.

Other amounts due to and from other State of Montana agencies are settled regularly and are not material as of June 30, 2015 and 2014.

Note 16 - Policyholders' Equity – Change in Non-Admitted Assets

The following is an accounting of the changes in non-admitted assets included in the Statement of Changes in Policyholders' Equity for the years ended June 30:

	2015	2014
Balance of non-admitted assets, beginning of year	$ 5,770,526	$ 6,416,890
Increase (decrease) in non-admitted assets:		
Change in premiums receivable	(120,849)	(593,523)
Change in short-term notes and loans receivable	(295,029)	81,999
Change in net tangible assets	(57,055)	(127,988)
Change in intangible assets	(145,597)	(75,637)
Change in property held in trust	(15,033)	3,885
Change in other assets	33,220	64,900
Net increase (decrease) in non-admitted assets	(600,343)	(646,364)
Balance of non-admitted assets, end of year	$ 5,170,183	$ 5,770,526

Note 17 - Policyholders' Equity –Reconciliation of Statutory Equity to GASB Net Position

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

	2015	2014
Statutory policyholders' equity (NAIC)	$ 516,904,860	$ 443,852,594
Add:		
Non-admitted assets as shown above	5,170,183	5,770,526
Change in investment value of bonds to fair market value	38,467,142	54,300,834
Change in investment value of other invested assets to equity method	(1,909,059)	(1,306,687)
Change in allowance for doubtful accounts	(2,046,366)	(2,509,688)
Change in net income between NAIC SAP and GAAP for: Pension accounting	(19,606,350)	-
GASB net position	$ 536,980,410	$ 500,107,579

Note 18 - Policyholders' Equity –Other Changes in Policyholders' Equity

During the course of the State of Montana's statewide 2014 audit, an error was identified in the other post-employment benefit plan's valuation that resulted in an overstated liability. Under the Regulatory Basis of Accounting described in Note 1, Statement of Statutory Accounting Principle (SSAP) No. 3, *Accounting Changes and Corrections of Errors*, paragraph 10, states: "Corrections of errors in previously issued financial statements shall be reported as adjustments to unassigned funds (Policyholders' Equity) in the period an error is detected." In accordance with SSAP No. 3, MSF recorded its allocated amount of the correction in 2014. The Policyholders' Equity was increased by $1.2M to reflect the portion of the change related to prior years.

Supplementary Information
June 30, 2015 and 2014

MONTANA STATEFUND

EideBailly

CPAs & BUSINESS ADVISORS

Independent Auditor's Report on Supplementary Information

To the Board of Directors
Montana State Fund
Helena, Montana

We have audited the statutory financial statements of Montana State Fund as of and for the year ended June 30, 2015, and our report thereon dated November 02, 2015, which expressed an unmodified opinion on those financial statements, appears on page 1. Our audit was conducted for the purpose of forming an opinion on the basic 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 33 through 38 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 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 statutory-basis financial statements taken as a whole.

Eide Bailly LLP

Fargo, North Dakota
November 02, 2015

Basis of Presentation

The following supplemental disclosures present selected statutory-basis financial data as of June 30, 2015, 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 2015 Statutory Annual Statement.

Supplemental Investment Risk Interrogatories

1. The Company's total admitted assets as of June 30, 2015 are $1.7B.

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

	Amount	Percentage of Total Admitted Assets
American Core Realty Fund LLC	$ 45,772,328	2.759%
TIAA-CREF	40,148,241	2.420%
General Electric Co.	24,490,613	1.476%
JPMorgan Chase & Co.	23,952,712	1.444%
Morgan Stanley	19,904,051	1.200%
Citigroup Inc.	17,012,915	1.025%
Ontario (Province of)	17,012,340	1.025%
AT&T Inc.	15,305,878	0.923%
Bunge Limited Finance Co.	14,994,789	0.904%
Aflac Inc.	13,077,994	0.788%

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	$ 903,570,694	54.461%
NAIC-2	226,129,693	13.630%
NAIC-3	2,998,981	0.181%
NAIC-6	-	0.000%
Total Bonds	$ 1,132,699,368	68.272%

4. The amount of assets held in foreign investments is $40M, which is 2.44% of the Company's total admitted assets. None of that amount is denominated in a foreign currency.

(continued on next page)

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, 2015		Amount	Percentage of Total Admitted Assets
Blackrock Equity Index Fund	$	146,276,741	8.817%
Blackrock ACWI Ex-US Superfund		19,085,192	1.150%

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	$	158,544,722	9.556%

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.

	Gross investment holdings		Admitted Assets as Reported in the Annual Statement	
	Amount	%	Amount	%
Bonds:				
U.S. Treasury securities	$ 188,427,758	12.27%	$ 188,427,758	12.27%
U.S. government agency obligations (excluding mortgage-backed securities):				
Issued by U.S. government agencies	-	0.00%	-	0.00%
Issued by U.S. government sponsored agencies	247,852,044	16.14%	247,852,044	16.14%
Non-U.S. government (including Canada, excluding mortgage-backed securities)	25,996,769	1.69%	25,996,769	1.69%
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	4,883,959	0.32%	4,883,959	0.32%
All other	-	0.00%	-	0.00%
CMOs and REMICs:				
All other	-	0.00%	-	0.00%
Other debt and other fixed income securities (excluding short-term):				
Unaffiliated domestic securities (includes credit tenant loans and hybrid securities)	625,616,635	40.74%	625,616,635	40.74%
Unaffiliated non-U.S. securities (including Canada)	39,922,203	2.60%	39,922,203	2.60%
Affiliated securities	-	0.00%	-	0.00%
Equity interests:				
Investments in mutual funds	165,361,933	10.77%	165,361,933	10.77%
Real estate investments:				
Properties occupied by the company	26,375,740	1.72%	26,375,740	1.72%
Securities lending	90,946,591	5.92%	90,946,591	5.92%
Cash, cash equivalents and short-term investments	34,182,977	2.23%	34,182,977	2.23%
Other invested assets	85,920,568	5.60%	85,920,568	5.60%
Total invested assets	$ 1,535,487,177	100.0%	$ 1,535,487,177	100.0%

The following interrogatories are included in accordance with SSAP No. 62R:

7.1 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 ☒

8.1 Has the reporting entity reinsured any risk with any other entity and agreed to release such entity from liability, in whole or in part, from any loss that may occur on this risk, or portion thereof, reinsured?

Yes ☐ No ☒

9.1 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 5% 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 5% 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 ☒

9.2 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 retroceded back to the reporting entity or its affiliates.

Yes ☐ No ☒

9.4 Except for transactions meeting the requirements of paragraph 30 of SSAP No. 62R, 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 ☒

The accompanying schedules and interrogatories present selected statutory-basis financial data as June 30, 2015 and for the year then ended for the purpose of complying with paragraph 9 of the Annual Audited Financial Reports in the Annual Audited Report section of the National Association of Insurance Commissioners' Annual Statement Instructions and 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 fiscal year 2015 Statutory Annual Statement.