

Yellowstone County, Montana
Comprehensive Annual Financial Report - Transmittal Letter (Unaudited)
June 30, 2006

November 21, 2006

Board of County Commissioners
Citizens of Yellowstone County
Billings, Montana

The Comprehensive Annual Financial Report of Yellowstone County (the County) for the fiscal year ended June 30, 2006 is submitted herewith. State law requires that counties publish within six months of the close of each fiscal year a complete set of financial statements presented in conformity with accounting principles generally accepted in the United States of America (GAAP) and audited in accordance with auditing standards generally accepted in the United States of America by a firm of licensed certified public accountants. This comprehensive annual financial report meets all required criteria specified by the State, to report the Budgetary, Accounting and Financial Reporting System (BARS), prepared in conformance with the principles and standards for financial reporting as promulgated by the Governmental Accounting Standards Board. Pursuant to those requirements, the finance department hereby issues the comprehensive annual financial report of Yellowstone County for the fiscal year ended June 30, 2006.

This report consists of management's representations concerning the finances of Yellowstone County. Consequently, management assumes full responsibility for the completeness and reliability of all of the information presented in this report. To provide a reasonable basis for making these representations, management of Yellowstone County has established a comprehensive internal control framework that is designed both to protect the government's assets from material loss, theft, or misuse and to compile sufficient reliable information for the preparation of Yellowstone County's financial statements in conformity with GAAP. Because the cost of internal controls should not outweigh their benefits, Yellowstone County's comprehensive framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatement. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.

Yellowstone County, Montana
Comprehensive Annual Financial Report - Transmittal Letter (Unaudited)
June 30, 2006

Yellowstone County's financial statements have been audited by Anderson, ZurMuehlen & Co., a firm of licensed certified public accountants. The goal of the independent audit was to provide reasonable assurance that the financial statements of Yellowstone County for the fiscal year ended June 30, 2006, are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts, and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation. The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that Yellowstone County's financial statements of the opinion units for the fiscal year ended June 30, 2006 are fairly presented in conformity with GAAP. The independent auditor's report is presented as the first component of the financial section of this report.

The independent audit of the financial statements of Yellowstone County was part of a broader, federally mandated "Single Audit" designed to meet the special needs of federal grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the basic financial statements of the opinion units, but also on the audited government's internal controls; legal requirements; and compliance and other matters, with special emphasis on internal controls and rendering an opinion on compliance on the government's administration of federal awards. These reports are available in Yellowstone County's separately issued Single Audit Report. GAAP require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement MD&A and should be read in conjunction with it. Yellowstone County's MD&A can be found immediately following the report of the independent auditors.

FINANCIAL STATEMENT PRESENTATION

This Comprehensive Annual Financial Report includes all of the financial statements and reports as required by the Governmental Accounting Standards Board Statement No. 34. Designed to meet the needs of a broad spectrum of financial statement readers, this Comprehensive Annual Financial Report is divided into four major sections.

1. **Introductory Section:** As the title indicates, this section introduces the reader to the report and includes the table of contents, transmittal letter, organization chart, and elected officials.
2. **Financial Section:** Includes the following subsections –
 - Independent Auditor's Report
 - Management's Discussion and Analysis (MD&A) – This report is a narrative providing information and analysis about the County's financial position, results of operations for the audited year, and significant changes from the prior year.
 - Basic Financial Statements – These include government-wide financial statements which report on both governmental and business-type activities on a full accrual (business-like) basis
 - Notes to Basic Financial Statements – Explanatory narratives, details, and reconciliations that are critical to an understanding of the basic financial statements.
 - Required Supplementary Information
 - Fund Financial Statements – These statements provide additional reporting for the major and nonmajor funds.

Yellowstone County, Montana
Comprehensive Annual Financial Report - Transmittal Letter (Unaudited)
June 30, 2006

3. **Statistical Section:** Although this section contains substantial financial information, these tables differ from financial statements in that they present some nonaccounting data and are designed to reflect social and economic data, as well as the fiscal capacity of the County.

4. **Single Audit Section:** Yellowstone County is required to undergo an annual single audit in conformity with the provisions of the Single Audit Act Amendments of 1996 and U.S. Office of Management and Budget Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." Information related to this single audit, including the schedule of expenditures of federal awards, schedule of findings and questioned costs, summary schedule of prior audit findings, and auditors' reports on internal controls and compliance are included in this section.

The diverse nature of governmental operations and the necessity of assuring legal compliance preclude recording and summarizing all governmental financial transactions and balances in a single accounting entity. Therefore, from an accounting and financial management viewpoint, a governmental unit is a combination of several distinctly different fiscal and accounting entities, each having a separate set of accounts and functioning independently of each other. Each accounting entity is accounted for in a separate "fund." A fund is defined as a fiscal accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

PROFILE OF THE COUNTY

Yellowstone County, created by legislative enactment in 1883, is located in the southern central section of Montana and includes the incorporated City of Billings, which is the County seat and most populous city in the state (population 97,000); and also includes the incorporated City of Laurel (population 6300) and Town of Broadview (population 150). The County imposes tax levies for jurisdictions under the authority of the Board of County Commissioners, which includes county funds and some special districts, such as the Big Sky Economic Development Authority (BSEDA). The Board of County Commissioners also approves levies requested by boards of special cemetery and fire districts. The County does bill, collect, and distribute property taxes on behalf of other taxing entities such as the State of Montana, schools and cities, but does not approve their levies.

The Board of County Commissioners is a commission form of government with a three member board comprised of officials elected at-large from three different district boundaries to six year terms on a staggered two year cycle. The County has the authority to cause actions that are statutorily permitted under Montana law. The Board of County Commissioners establishes budget authority and policies for County departments.

Yellowstone County, Montana
Comprehensive Annual Financial Report - Transmittal Letter (Unaudited)
June 30, 2006

Budgetary control is maintained through an annual budget adopted by the County Commissioners. Public hearings are published and generally conducted in June of each year. The final budget must be adopted by the second Monday in August or 45 days after receiving the certified taxable values from the State of Montana. Budgetary authority is flexible in that the Commissioners may make transfers among budget object lines within a fund and make budget amendments with statutory restrictions when considered necessary for proper administration of County government. Budget amendments may be passed by the Board of County Commissioners after conducting two published public hearings. The level of budgetary control is established at the fund level. Budget comparisons for the major governmental funds are presented as part of the basic financial statements. These statements also show the original budget that was adopted for the major funds. Generally the revisions made during the fiscal year are related to grant funding and associated expenditures.

Yellowstone County provides a full range of services as mandated by Montana statutes, including general government, public works, public safety, public health, social and economic, culture and recreation, and community development. Some of the more significant departments and functions within these areas include:

General Government – County Commissioners, Treasurer and Finance, Elections, Records, Auditing, Facility Maintenance, Property and Liability Insurance, Planning, Geographical Information, and Clerk of District Court

Public Safety – Sheriff’s departments including administration, patrol, detectives, civil, records, adult detention, and communications. Other public safety functions include youth detention, county attorney prosecution, public defenders, and traffic safety programs.

Public Works – County road and bridge projects and maintenance, weed control, and RSID construction and maintenance.

Public Health – Funding support for operations of the City/County Health Department (Deering Clinic), mental health treatment and involuntary commitment costs, animal control, and alcohol rehabilitation programs.

Social and Economic Services – Senior citizen program funding, extension & agricultural services, and low income medical and rent assistance programs.

Culture and Recreation – Library and museum funding, and county parks.

Conservation of Natural Resources – Soil Conservation programs and Air Quality Control funding

Community Development – Community Development Block Grant projects

The County also operates the METRA (Montana Exposition, Trade, and Recreation Arena) and adjacent buildings and grounds. This facility includes 3 large multi-purpose event centers, a 4000 seat grandstand and track, and large adjacent parking, grounds, and ancillary buildings.

Yellowstone County, Montana
Comprehensive Annual Financial Report - Transmittal Letter (Unaudited)
June 30, 2006

FACTORS AFFECTING FINANCIAL CONDITION

General Operating Environment

The information presented in the financial statements is perhaps best understood from the broader perspective when it is considered with the specific perspective in which the County operates.

Local business activity includes agricultural, medical, retail, industrial, petroleum refining, banking, and utility enterprises, which contribute substantially to the County's economy and tax base. The County is home to three substantial oil refineries, two major hospitals, and is the major retailer to a large geographical area. Billings also is an important tourism and cultural center to the region. These businesses and industries have historically provided a stable economy for the community and have provided for steady population and economic growth.

Montana's tax structure predominately relies on income, mineral, property, gambling, and motor vehicle taxes. Counties directly levy property taxes and indirectly share in mineral, gambling and motor vehicle taxes. The State has no general sales tax although some communities in the State are permitted to levy a local sales tax (referred to as the resort tax). Yellowstone County is not currently permitted to levy a local sales tax.

Property taxing authority is statutorily determined and taxing authority above the allowed maximum level must be voter approved. The local governing bodies determine the amount of property tax revenue they wish to levy annually up to the maximum allowed. New property revenues are permitted for new construction valuation and a statutorily determined acceptable inflation growth indexed to 50% of the State's economic growth rate (0.968% for fiscal year 2005; 1.251% for fiscal year 2006; and 1.424% for fiscal year 2007).

The Management Discussion and Analysis provides additional discussion of specific pending financial impacts on the County.

Recent Events

Area refineries continue to make significant expansions and improvements to their refining plants to keep them efficient and clean facilities. Refinery capital projects also include proposals for the processing of heavy crude from Canadian tar sands.

Deaconess hospital is currently expanding significantly with completion expected in the spring of 2007. St. Vincent's hospital is proposing a \$200 million hospital expansion as well. Other medical facilities, including research facilities, have acquired contiguous properties in the medical corridor for new buildings and future projects.

Downtown Billings continues to experience strong revitalization with significant private investment in building renovations to upscale apartments, conversions of older buildings into professional office space, and construction of new office space. These projects have all contributed to a renewed community involvement with downtown Billings.

Yellowstone County, Montana
Comprehensive Annual Financial Report - Transmittal Letter (Unaudited)
June 30, 2006

Internal Controls

In developing and evaluating the County's accounting system, consideration is given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute assurance regarding; (1) the safeguarding of assets against loss from unauthorized uses; (2) the reliability of financial records for preparing financial statements and maintaining accountability for assets; and (3) maintaining compliance with laws and regulations. The concept of reasonable assurance recognizes the costs of internal control should not exceed the benefits likely to be derived and the evaluation of costs and benefits requires estimates and judgments by management.

All internal control evaluations occur within the above framework. We believe the County's internal controls adequately safeguard assets, provide reasonable assurance of proper recording of financial transactions, and maintain compliance with laws and regulations.

As a recipient of Federal and State financial assistance, the County also is responsible for ensuring adequate internal control is in place to ensure compliance with applicable laws and regulations related to major programs. This internal control is subject to periodic evaluation by management and the internal audit staff of the County.

Risk Management

The County uses a self-funded Property and Liability Insurance Fund because the County considers it to be cost effective to self-insure for routine claims and reinsure for catastrophic losses. The County carries commercial liability coverage with a current deductible of \$250,000 and an aggregate limit of \$3,000,000 per year. Coverage of \$3 million per year is anticipated to provide a high degree of safety from catastrophic losses. The Property and Liability Insurance Fund has a fund balance of \$2,137,448, which is considered to be a sufficient reserve to fund any incurred claims against the County. See footnote 9 (page 57) for additional discussion on liability reinsurance. The County also carried \$73.5 million of property damage coverage in FY06 with a \$50,000 deductible on buildings and their contents. The County currently has full terrorism coverage with our property insurance policy.

See footnotes 9 and 10 (pages 57-59) for additional description of coverages related to worker's compensation and health insurance.

Yellowstone County, Montana
Comprehensive Annual Financial Report - Transmittal Letter (Unaudited)
June 30, 2006

Cash Management

The County currently has an investment program agreement with the local schools, irrigation, cemetery, rural fire and other special districts to invest their funds as part of an investment pool. The County invests the funds at a fee of 1% of the interest proceeds received for the month. Currently the County invests in repurchase agreements; U.S. government securities; agencies of the U.S. government; and the State of Montana's Short Term Investment Pool (STIP). The rate of return for the investment pool is net of bank service fees incurred for the operational costs of the participating pool members. Investments are limited to a 5 year maturity. A comparison of previous years' investment results are as follows:

	<u>Total Interest Earned</u>	<u>Average Investment Balance</u>	<u>Rate of Return</u>
F.Y. 96-97	3,229,540	52,136,907	6.19%
F.Y. 97-98	3,277,678	58,027,544	5.65%
F.Y. 98-99	3,254,907	60,896,852	5.34%
F.Y. 99-00	3,744,825	65,516,970	5.70%
F.Y. 00-01	3,893,699	65,881,851	5.91%
F.Y. 01-02	2,236,596	66,354,790	3.37%
F.Y. 02-03	1,491,820	67,602,801	2.21%
F.Y. 03-04	1,217,285	69,836,318	1.74%
F.Y. 04-05	1,785,141	73,877,037	2.42%
F.Y. 05-06	2,693,838	73,462,474	3.67%

The rate of return for FY07 is expected to increase above FY06's rate of return.

See footnote 4 for additional information on cash and cash investments.

Debt

At June 30, 2006 Yellowstone County has a number of debt issues outstanding. These issues included \$5,355,000 of general obligation bonds; \$1,308,225 of rural special improvement district bonds for which the County has limited secondary responsibility; METRA notes payable to the State's Intercap loan program of \$386,487; \$7,500 owed on a noninterest bearing note for METRA; and \$24,809 owed on a note financing new election ballot counters.

See footnote 8 (pages 53-56) and the MD&A (pages 3-19) for additional information on long-term county debt.

Yellowstone County, Montana
Comprehensive Annual Financial Report - Transmittal Letter (Unaudited)
June 30, 2006

Pension and Other Post-Retirement Benefits and Obligations

All county employees may elect participation in the Public Employees Retirement System (PERS) or Sheriff Retirement System (SRS) if they meet eligibility criteria. Employees exceeding 960 hours of work in a year must participate in PERS if they're in a covered position. Current employer contribution rates are 6.8% of covered payroll for PERS and 9.535% for SRS. New employees have the option to elect membership in either a defined benefit (DB) plan or defined contribution (DC) plan. Employees hired before July 1, 2002 have had the opportunity to select their retirement option (DB or DC). Employees hired after July 1, 2002 have 12 months to select an irrevocable retirement option. Funding requirements and plan administration is the responsibility of the State of Montana.

The County allows retiring employees selecting a State pension the option to retain health insurance benefits on the County's plan. Retirees and their dependents may maintain County coverage if they continue to pay a premium. Retirees and their dependents under 65 years old pay the same premium as active employees, except that retiree pays the coverage cost for themselves in addition to their dependents. Retirees and their spouses over 65 pay a reduced premium, since the County becomes a secondary payer after Medicare.

Terminating employees that do not elect or are not eligible for a pension may elect to retain County health coverage under the provisions of the Consolidated Omnibus Budget Reconciliation Act (COBRA). This coverage may be elected and paid for by the terminating employee for up to 18 months.

See footnotes 10B (page 59) and 11 (page 60) for additional information on pension and other post-retirement benefits and obligations.

ACKNOWLEDGEMENTS

This financial report is the financial summation of a great deal of work of all those who serve County government. Without the citizens and businesses that provide the funding and direction for needed services and programs, the government cannot function and the need for financial reporting would not exist. I appreciate and applaud the efforts of all community members who endeavor to improve the community and its governments. Hopefully, this report includes useful information regarding the use of the resources provided to this local government.

I would like to express my appreciation to the finance department staff and the staffs of all the County offices for providing excellent work and cooperation during the year. Although the finance department takes on the task of preparing the financial report, all county departments contribute to the cooperative effort required to maintain the financial system. A special thanks is extended to Dexter Sherman and Lisa Sticka with their assistance in the preparation of the financial report and assistance with the audit. I would also like to thank Anderson ZurMuehlen & Company for their work auditing this report.

Respectfully submitted,

Scott Turner
Finance Director