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BIG SKY COUNTY WATER & SEWER DISTRICT #363

FINANCIAL STATEMENTS

JUNE 30, 1995

Knaub & Company, P.C.

Certified Public Accountants

P.O. Box 3454 • Bozeman, Montana 59772

BIG SKY COUNTY WATER & SEWER DISTRICT #363

JUNE 30, 1995

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
of Big Sky County Water & Sewer District #363

We have audited the accompanying financial statements of **BIG SKY COUNTY WATER & SEWER DISTRICT #363** as of and for the year ended June 30, 1995. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **BIG SKY COUNTY WATER & SEWER DISTRICT #363**, as of June 30, 1995, and the results of its operations and cash flows for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note 5 to the financial statements, the District changed its method of accounting for user fees receivable. This resulted in an increase of \$211,123 in prior years' contributed capital.

Knaub & Company, P.C.

October 27, 1995

BIG SKY COUNTY SEWER & WATER DISTRICT #363**BALANCE SHEET****JUNE 30, 1995****ASSETS****CURRENT ASSETS:**

Cash and cash equivalents	\$	349,725	
Accounts receivable		222,219	
Less allowance for bad debts		(11,000)	
Resort tax receivable		40,252	
Inventory		2,000	
Prepaid expenses		<u>166</u>	
Total current assets			\$ 603,362

RESTRICTED CASH AND CASH EQUIVALENTS:

Proceeds restricted for construction:			
RID		371,357	
Boyne		370,267	
Hookup/inspection - Seypar		35,227	
Restricted for replacement		<u>53,739</u>	830,590

PROPERTY AND EQUIPMENT, at cost:

Land		611,604	
Vehicle		15,407	
Furniture and equipment		45,814	
Sewer system equipment		<u>2,119,943</u>	
		2,792,768	
Less - accumulated depreciation		<u>(773,865)</u>	2,018,903

OTHER ASSETS:

Rent deposit		<u>1,057</u>	
			\$ <u>3,453,912</u>

LIABILITIES AND FUND EQUITY**CURRENT LIABILITIES:**

Accounts payable	\$	158,553	
Payroll taxes payable		3,056	
Compensated absences payable		<u>4,675</u>	
Total current liabilities			\$ 166,284

DEFERRED LIABILITY - Boyne**370,255****FUND EQUITY:**

Contributed capital - unrestricted		2,372,571	
Contributed capital - restricted		372,957	
Retained earnings - unrestricted		118,106	
Retained earnings - restricted		<u>53,739</u>	2,917,373
			\$ <u>3,453,912</u>

See accompanying notes to financial statements.

BIG SKY COUNTY WATER & SEWER DISTRICT #363**STATEMENT OF REVENUES AND EXPENSES****FOR THE YEAR ENDED JUNE 30, 1995****OPERATING REVENUE:**

Sewer services	\$	430,851	
Hook-up fees		<u>11,000</u>	\$ 441,851

OPERATING EXPENSES:

Rental and miscellaneous	7,689 ✓	
Travel and expenses	6,162 ✓	
Bank charges	2,223 ✓	
Dues	3,342	
Office administration	36,346 ✓	
Utilities	27,842	
Maintenance and general repairs	49,830	
Project manager	78,200 ✓	
Well samples and chemical analysis	39,965	
Office supplies	9,859 ✓	
Chlorine and operating supplies	13,042	
Vehicle repair and maintenance	3,822	
Salaries	50,177 - 20,177 ✓	
Employee benefits	8,906 - 5,000 ✓	
Payroll taxes	8,281 - 5,122 ✓	
Directors' compensation	170 ✓	
Insurance	6,900 ✓	
Rent	12,356 ✓	
Data base setup	21,078 ✓	
Audit expense	9,703 ✓	
Accounting	2,300 ✓	
Legal - general	30,667 ✓	
Legal - Boyne et al	25,006 ✓	
Legal - Water Quality Bureau	56,712	
Infiltration and inflow repairs	245,765	
Engineering - general	4,697	
Contingency	20,014 ✓	
Bad debt allowance	11,000 ✓	
Depreciation	<u>73,474</u>	

Total operating expenses 865,528

DEFICIENCY OF OPERATING REVENUE OVER OPERATING EXPENSES (423,677)

NONOPERATING REVENUE:

Resort tax revenue	400,000	
Lone Mountain Springs reimbursement	19,822	
Interest income	25,343	
Miscellaneous revenue	<u>1,141</u>	<u>446,306</u>

NET REVENUE OVER EXPENSES \$ 22,629

See accompanying notes to financial statements.

BIG SKY COUNTY WATER & SEWER DISTRICT #363**STATEMENT OF CHANGES IN FUND EQUITY****FOR THE YEAR ENDED JUNE 30, 1995**

	<u>Contributed Capital Unrestricted</u>	<u>Contributed Capital Restricted</u>	<u>Retained Earnings Unrestricted</u>	<u>Retained Earnings Restricted</u>	<u>Total</u>
Beginning balance, July 1, 1994	\$ 2,208,132	372,957	102,532	-	2,683,621
Excess of revenues over expenses	-	-	22,629		22,629
Depreciation restricted for replacement	(46,684)	-	(7,055)	53,739	-
Prior period adjustment (Note 5)	211,123	-	-	-	211,123
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Balance, June 30, 1995	\$ <u>2,372,571</u>	<u>372,957</u>	<u>118,106</u>	<u>53,739</u>	<u>2,917,373</u>

See accompanying notes to financial statements.

BIG SKY COUNTY WATER & SEWER DISTRICT #363**STATEMENT OF CASH FLOWS****FOR THE YEAR ENDED JUNE 30, 1995****CASH FLOWS FROM OPERATING ACTIVITIES:**

Deficiency of operating revenues over operating expenses \$ (423,677)

Adjustments to reconcile operating income to

net cash provided:

Depreciation 73,474

Bad debt allowance 11,000

Prior period adjustment 211,123

Write-off of delinquent property taxes receivable 16,742

(Increase) decrease in current assets:

Accounts receivable (222,219)

Resort tax receivable (40,252)

Accrued interest receivable 1,800

Prepaid expenses 9,834

Increase (decrease) in current liabilities:

Accounts payable 143,931

Payroll taxes payable 3,056

Construction and retainage payable (48,930)

Compensated absences payable 4,675

Total adjustments 164,234**Net cash (used) by
operating activities** (259,443)**CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:**

Resort tax revenue 400,000

Lone Mountain Springs reimbursement 19,822

Miscellaneous revenue 1,141**Net cash provided by
non-capital financing activities** 420,963**CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:**

Purchase of office furniture, equipment and computers (45,814)

Sewer system equipment purchases (119,201)**Net cash (used) by
capital financing activities** (165,015)**CASH FLOWS FROM INVESTING ACTIVITIES:**

Workers' compensation deposit refund 335

Certificates of deposit matured 104,000

Interest income 25,343

Additions to deferred liability to Boyne 6,889**Net cash provided by
investing activities** 136,567**NET INCREASE IN CASH** 133,072**CASH AND CASH EQUIVALENTS, beginning of year** 1,047,243**CASH AND CASH EQUIVALENTS, end of year** \$ 1,180,315

See accompanying notes to financial statements.

BIG SKY COUNTY WATER & SEWER DISTRICT #363

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1995

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Big Sky County Water & Sewer District #363 (the District) was created by resolution by the Board of County Commissioners of Gallatin County, Montana and Madison County, Montana on August 3, 1993 and August 4, 1993, respectively. The District was created for the purpose of constructing, repairing, operating, managing, maintaining and acquiring a sanitary sewer facility on the West Fork of the West Gallatin River, Gallatin County, Montana. The District is governed by a Board of Directors. The daily affairs of the District are conducted under the supervision of the District's project manager.

Fund Accounting

The activities of the District are reported as an enterprise fund. An enterprise fund is operated in a manner similar to private business enterprises, where (a) the intent of the governing body is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; and (b) the governing body has decided that periodic determination of revenues earned, expenses incurred and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

Basis of Accounting

Property owners are assessed sewer fees annually based on the number of single family equivalents. On June 30, 1995, owners were billed for the six months ended June 30, 1995. Beginning July 1, 1995, owners are billed quarterly in arrears by the district. Prior to that, annual sewer fees were billed by Gallatin and Madison counties along with the first half of the property tax assessment. The counties then remitted the collected sewer fees to the District. The fees were billed by the county on a calendar year basis, but recorded as revenue in the fiscal year received by the district. In prior years, the difference between the calendar year and fiscal year was not material. However since the district is now billing on a fiscal year basis, the accrual for prior years was recorded in these statements as a prior period adjustment. See Note 5.

The fund is accounted for using the accrual basis of accounting. Revenues are recognized when they are earned and expenses are recognized when they are incurred. Governmental grants are recognized when qualified expenditures are incurred.

BIG SKY COUNTY WATER & SEWER DISTRICT #363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 1995

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

Management considers all short-term high liquid investments with an original maturity of three months or less to be cash and cash equivalents. The following is a summary of cash and cash equivalents as of June 30, 1995:

Unrestricted	\$ 349,725
Restricted - RID	371,357
Restricted - Boyne	370,267
Restricted - Seypar	35,227
Restricted for replacement	<u>53,739</u>
Total	\$ <u>1,180,315</u>

See Note 3 for additional information regarding the restricted amounts.

Investments

Investments are stated at the lower of aggregate cost or market value.

Fixed Assets

Capital outlays for property, plant and equipment are recorded as capital assets when incurred. All purchased fixed assets are valued at historical cost. Fixed assets contributed are recorded at their estimated fair market values or historical cost if fair market value is not reasonably determinable. Depreciation of fixed assets is calculated using the straight-line method with estimated useful lives as follows:

Sewer system and equipment	7 - 40 years
Vehicle	5 years

Maintenance and repair costs are expensed as incurred. Replacements which improve or extend the lives of fixed assets are capitalized. Proceeds received from government or other grantors, for the purchase or construction of fixed assets, are credited to contributed capital.

User Fees and Accounts Receivable

Beginning June 30, 1995, an allowance for uncollectible accounts receivable was recorded. There was no allowance in prior years because Management of the District was of the opinion

BIG SKY COUNTY WATER & SEWER DISTRICT #363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 1995

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

User Fees and Accounts Receivable (Continued)

that all receivables are collectible. However, since the counties are no longer collecting the fees, it was determined an allowance for bad debts should be recorded.

Application of FASB Documents Issued After 11/30/89 to Proprietary Funds

In September, 1993, GASB issued Statement No. 20 which requires proprietary activities to apply all applicable GASB pronouncements as well as FASB pronouncements, APB opinions and Accounting Research Bulletins on or before 11/30/89, unless these conflict with or contradict GASB pronouncements. Governments have an option of whether or not to apply FASB pronouncements issued after that date to their proprietary activities. In accordance with GASB No. 20, management has elected not to apply FASB pronouncements issued after 11/30/89.

Contributed Capital

The amount of depreciation applicable to assets acquired through contributions and grants is closed to the related contributed capital account instead of retained earnings.

Resort Taxes

Applications requesting budget funds from resort taxes are reviewed by Big Sky Resort Tax Advisory Board of Trustees who in turn make recommendations to the county commissions of both Gallatin and Madison counties. Final approval rests with the county commissioners after all budget requirements have been met.

Tax Exempt Status

The District is a municipal corporation and, therefore, is not liable for federal and state income taxes pursuant to Internal Revenue Code 501(c)(1).

2. CASH AND INVESTMENTS

Under the District's investment policy, the District is restricted to investing funds in specific types of deposit and investment instruments.

The following is the type of permitted deposits and investments: Interest bearing savings accounts, certificates of deposits and time deposits insured by the Federal Deposit Insurance Corporation or which are fully collateralized.

BIG SKY COUNTY WATER & SEWER DISTRICT #363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 1995

2. CASH AND INVESTMENTS (Continued)

The District's deposits and investments are categorized to give an indication of the level of risk assumed by the District. Category 1 includes deposits and investments which are insured, registered or held by the District or its agent in the District's name. Investments maintained by the District consist of certificates of deposits and interest bearing money market and savings accounts, and are all included in category 1. Cost and market value are the same. There were no Category 2 or 3 investments.

Deposits in excess of the FDIC insurance limits were collateralized by pledged securities. Restricted amounts are detailed in Note 1 and discussed in Note 3.

3. COMMITMENTS AND CONTINGENCIES

LMS Memo of Understanding

The District had an agreement with Lone Mountain Springs, Inc. (LMS), a water company, and Big Sky Owners Association (BSOA), a homeowner association, for funding the employment and administration of a joint LMS and District water/sewer system operator at Big Sky, Montana. The District was required to pay \$42,000 per annum to fund the joint employer costs for supervision of the joint employee. The LMS and District Accountant was related to a director of the District. The contract was terminated during fiscal year 1995 at which time the district hired their own full-time staff.

Effective July 1, 1995, under a contract signed November 22, 1994, the District assumed the management duties of Lone Mountain Springs. Pursuant to the management agreement, the District will provide the operational, maintenance and repair services for the company.

Service Contract with BSOA

The District entered into a service contract with BSOA to fund the costs necessary to employ and administer working activities for the District in the amount of \$20,000 per annum. This agreement was terminated effective September 26, 1994. See Note 4.

Boyne Memo of Understanding

The District has an agreement, dated January 7, 1993, with Boyne USA, Inc. (Boyne), BSOA and the District for the purpose of establishing funds necessary to design and construct a sewage treatment facility. Under this agreement, the District and Boyne deposited \$350,000 each into

BIG SKY COUNTY WATER & SEWER DISTRICT #363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 1995

3. COMMITMENTS AND CONTINGENCIES (Continued)

Boyne Memo of Understanding (Continued)

a special suspense fund to be used for the design and construction of the sewage treatment facility. At such time as a judgment or settlement is reached, the party determined to be financially responsible must reimburse the other party their proportionate share of cash in the suspense fund, together with interest at the rate of New York Prime.

Boyne Litigation and Related Complaint Action

Boyne USA, Inc. has filed a declaratory action suit to determine if the District rather than Boyne is responsible for costs associated with constructing a sewer system that complies with State regulations. The District has been unsuccessful in settlement negotiations and management intends to defend and prosecute its claims to a verdict if required. The District has also filed a related claim against the State of Montana asserting that as a result of State action the expansion of the sewage treatment facilities has been wrongfully delayed, thereby exposing the State to liability for a share of the cost of the expansion.

Seypar, Inc. Litigation

A landowner within the District, Seypar, Inc., filed a declaratory judgement asking the Court for an order invalidating certain sewer hook-up fees it paid under protest and for reimbursement of fees. The risk to the District is the Court could order partial reimbursement of fees paid under protest by Seypar, Inc. and prohibit imposition of fees in the future. The suit is being vigorously defended by counsel.

Compliance Order

On July 13, 1993, the Montana Department of Health and Environmental Sciences issued a compliance order to the District imposing a moratorium restricting new hook-ups to the sewer system and requires the District to upgrade the sewer facility to prevent seepage of sewage from the Big Sky sewer system treatment and disposal facility and resultant contamination of State ground waters. The District is required to comply with the requirements of the order or face penalties of up to \$25,000 for each day in which a violation occurs or a failure or refusal to comply continues. Under an amendment dated August 31, 1995, required tasks of the amended compliance order must be completed by September 1, 2000. The District has met the State's compliance requirements through June 30, 1995.

BIG SKY COUNTY WATER & SEWER DISTRICT #363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 1995

3. COMMITMENTS AND CONTINGENCIES (Continued)

Obligation to Provide Future Sewer Services

The District is obligated to provide sewage collection and treatment services to existing property owners presently connected to the system. Additionally, the District has incurred certain obligations to provide future wastewater collection and treatment services to certain of the original subdivisions as well as other commitments either by agreement or legally mandated.

Engineering Service Contract

The District entered into professional service agreements with two engineering firms for the planning, design and construction oversight of improvements to the District. The remaining commitment at June 30, 1995 was approximately \$120,000.

4. RELATED PARTIES

The District has two contracts with related parties in the normal course of business.

- 1) The District had a memorandum of understanding with Big Sky Owners' Association, Inc. (BSOA) for administration of the District's contract labor personnel. Dee Rothschilder is an employee of BSOA and serves on the District's Board of Directors.
- 2) The LMS (Lone Mountain Springs) and District consortium operations were administered by Bill Murdock in his capacity as executive administrator of BSOA. The District paid the consortium \$42,000 to fund the wages and benefits of a joint employee of LMS and the District (see Note 3). This agreement was terminated during fiscal year 1995.

5. PRIOR PERIOD ADJUSTMENT

Effective June 30, 1995, the District began billing user fees to customers directly instead of collecting through property tax assessment. The billing dated June 30, 1995 was for the six month period of January, 1995 through June, 1995. In prior years, the counties billed the fees in November of each year and the District recorded revenue as collected which was not materially different than accruing the revenue on an estimated basis. Because of this change, the District received an annual billing from each county as well as six months of revenue from its own billing. Therefore one-half of the amount received from the counties (\$211,123) is shown as a prior period adjustment in these statements.

BIG SKY COUNTY WATER & SEWER DISTRICT #363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 1995

6. LEASE AGREEMENT

The District entered into a five year lease agreement for office space effective May 24, 1994 commencing upon substantial completion of the premises and terminating five years thereafter. The District moved into the new space in September, 1994, and pays \$1,057 monthly to be adjusted annually by the previous calendar year Consumer Price Index, or 3%, whichever is greater. The District has the option to extend the lease for a second five year term.

The following is a summary of lease commitments to be paid during the succeeding fiscal years:

1996	\$ 13,065
1997	13,456
1998	13,860
1999	14,276

7. CONTRACT LABOR AGREEMENT

During fiscal year 1994, the District entered into a management agreement with H & H Resources. The contract requires monthly payments of \$6,800. This agreement terminates effective December 15, 1995.

8. RISK MANAGEMENT

The District faces a considerable number of risks of loss, including:

- a) damage to and loss of property and contents
- b) employee torts
- c) professional liability, i.e., errors and omissions
- d) environmental damage
- e) workers' compensation, i.e. employee injuries
- f) medical insurance costs of employees
- g) potential liability created under the Memorandum Understanding with Boyne, USA, Inc.

A variety of methods is used to provide insurance for these risks. Commercial insurance policies, transferring all risks of loss, except for relatively small deductible amounts, are purchased for property and content damage, employee medical costs, and professional liabilities.

BIG SKY COUNTY WATER & SEWER DISTRICT #363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 1995

8. RISK MANAGEMENT (Continued)

Workers' compensation insurance coverage is provided through the State fund. Given the lack of coverage available, the District has no coverage for potential losses due to environmental damages. The amounts of any potential losses are unknown.

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE
BASED ON AN AUDIT OF GENERAL PURPOSE OR BASIC
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

To the Board of Directors
of Big Sky County Water & Sewer District #363

We have audited the general purpose financial statements of **BIG SKY COUNTY WATER & SEWER DISTRICT #363** as of and for the year ended June 30, 1995, and have issued our report thereon dated October 27, 1995.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to **BIG SKY COUNTY WATER & SEWER DISTRICT #363**, is the responsibility of the District's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the District's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the general purpose financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

We noted certain immaterial instances of noncompliance that we have reported to the management of the District in the Independent Auditors' Report on Internal Control Structure on page 14.

This report is intended for the information of the audit committee, management, and the State of Montana. However, this report is a matter of public record and its distribution is not limited.

Knaub & Company, P.C.

October 27, 1995

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL
STRUCTURE BASED ON AN AUDIT OF GENERAL PURPOSE OR
BASIC FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors
of Big Sky County Water & Sewer District #363

We have audited the general purpose financial statements of **BIG SKY COUNTY WATER & SEWER DISTRICT #363** as of and for the year ended June 30, 1995, and have issued our report thereon dated October 27, 1995.

We have conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement.

The management of **BIG SKY COUNTY WATER & SEWER DISTRICT #363** is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the general purpose financial statements of **BIG SKY COUNTY WATER & SEWER DISTRICT #363** for the year ended June 30, 1995, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures

for the purpose of expressing our opinion on the general purpose financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements.

Reportable Conditions

1. Contractor's Gross Receipts Tax Withholding

Finding

The District has not been withholding the required 1% contractor's gross receipts tax for public contracts over \$5,000 as required by MCA 15-50-206 (2).

Recommendation

The District should withhold 1% of payments to contractors when the contract amount exceeds \$5,000. This amount should then be remitted to the Department of Revenue.

2. Manager Contract

Finding

The contract with the District manager has some stipulations included in the contract that could cause the IRS to question whether the manager meets the requirements to be considered an independent contractor.

Recommendation

The District should consider hiring the new manager as an employee rather than an independent contractor to eliminate the possibility of unrecorded payroll tax liabilities.

3. Final Budget Approval

The final budget as adjusted by the board was not officially approved in the minutes.

Recommendation

Budget revisions should be clearly documented and approved in the minutes.

4. General Ledger Account Reconcilements

Numerous audit adjustments were required to close and adjust the year-end records. This was mainly because of personnel turnover. The bank account did not balance to the general ledger by \$1,443. The payroll expense did not reconcile to the quarterly 941 reports. Capital expenditures were not recorded as assets. Compensated absences were not recorded, and the resort tax receivable was not recorded. All material differences were investigated and adjusted as necessary.

Recommendation

The District should attempt to keep all accounts reconciled on a monthly basis. In addition, now that the District is doing their own billing, controls for follow-up on past due accounts will need to be implemented.

5. Segregation of Duties

Finding

Small organizations often have internal control weaknesses in the area of segregation of duties because of limited personnel. Also, the District is in a state of change because of turnover in key management positions.

Recommendation

As policies and procedures are developed, the following control procedures should be considered to strengthen internal accounting controls:

● **Cash Receipts**

Incoming mail should be opened by a person having no other cash receipt posting duties in order to establish initial control over cash receipts. The initial listing of cash receipts should later be compared to cash receipt records and deposit slips by an employee having no access to cash.

Complaints on customer statements should be investigated by an employee who is independent of the preparer of the daily cash receipts list and the accounts receivable records.

● **Cash Disbursements**

Blank checks should be stored in a locked, fire-proof cabinet.

Voided checks should be properly defaced and retained.

Supporting documentation should accompany the check when presented for signature.

Bank reconciliations should be performed by someone other than the person responsible for preparing cash disbursement checks and reconciling accounts payable.

Completed bank reconciliations should be reviewed by a responsible official on a monthly basis.

Adjustments of cash accounts should be approved by an appropriate person.

The District should consider implementing a purchase order system.

Extensions and footings should be checked when processing invoices, with an initial to indicate who performed the procedure.

- **Petty Cash**

Responsibility for petty cash should be assigned to one person. The fund should be maintained on an imprest basis with monthly reconciliations of the activity.

- **Certificates of Deposit**

Certificates of deposit should be adequately protected, preferably in a safe deposit box or on deposit with a corporate trustee.

- **Payroll**

Personnel records should be maintained in a fire-proof, locked cabinet.

- **Property and Equipment**

Written policies should document the District's capitalization policy, in order for accounting personnel to consistently differentiate between capital and expense items.

- **Computer Controls**

Passwords used to control terminal access should be changed at regular intervals. Passwords for terminated employees should be promptly cancelled.

Off-premises storage should be maintained for back-up files so that records can be recreated in the case of fire or theft.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

This report is intended for the information of the audit committee, management, and the State of Montana. However, this report is a matter of public record, and its distribution is not limited.

Knaub & Company, P.C.

October 27, 1995

COMMUNICATION WITH AUDIT COMMITTEE

To the Board of Directors
of Big Sky County Water & Sewer District #363

We have audited the financial statements of **BIG SKY COUNTY WATER & SEWER DISTRICT #363** for the year ended June 30, 1995, and have issued our report thereon dated October 27, 1995. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Generally Accepted Auditing Standards

As stated in our engagement letter dated June 30, 1995, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with generally accepted accounting principles. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is a risk that material errors, irregularities, or illegal acts, including fraud and defalcations, may exist and not be detected by us.

As part of our audit, we considered the internal control structure of **BIG SKY COUNTY WATER & SEWER DISTRICT #363**. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control structure.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by **BIG SKY COUNTY WATER & SEWER DISTRICT #363** are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 1995. We noted no transactions entered into by the Organization during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Significant Audit Adjustments

For purposes of this letter, professional standards define a significant audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. These adjustments may include those proposed by us but not recorded by the Organization that could potentially cause future financial statements to be materially misstated, even though we have concluded that such adjustments are not material to the current financial statements.

Numerous audit adjustments were made in order to properly close the books at year-end. All significant adjustments were recorded in the financial statements.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Organization's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Organization's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

This information is intended solely for the use of the Audit Committee, Board of Directors, and management of Big Sky County Water & Sewer District #363 and should not be used for any other purpose.

Knaub & Company, P.C.

October 27, 1995

