



ORIGINAL

AUDITED FINANCIAL STATEMENTS

JUNE 30, 1996

**Joseph Eve & Company
Certified Public Accountants**

Big Sky County Water & Sewer District #363
Big Sky, Montana

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**Joseph Eve & Company
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INDEPENDENT AUDITORS' REPORT

**To the Board of Directors
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, 1996. 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 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. 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, 1996, and the results of its operations and cash flows for the year then ended in conformity with generally accepted accounting principles.

*Joseph Eve & Company
Certified Public Accountants*

**Billings, Montana
October 18, 1996**

BIG SKY COUNTY WATER & SEWER DISTRICT #363**BALANCE SHEET
JUNE 30, 1996****ASSETS****Current Assets:**

Cash and cash equivalents	\$85,098
Accounts receivable	155,980
Resort tax receivable	183,416
Total Current Assets	424,494

Restricted Cash and Cash Equivalents:**Proceeds restricted for construction:**

RID	304,888
Boyne	303,744
Hookup/inspection - Seypar	35,739
Total Restricted Cash and Cash Equivalents	644,371

Property and Equipment, at cost:

Land	611,604
Vehicle	41,917
Furniture and equipment	120,077
Sewer system equipment	2,551,239
	3,324,837
Less: Accumulated depreciation	(868,637)
Total Property and Equipment	2,456,200

Other Assets:

Lease deposits	1,407
Total Other Assets	1,407
Total Assets	\$3,526,472

LIABILITIES AND FUND EQUITY**Current Liabilities:**

Cash overdraft	\$71,366
Accounts payable	118,099
Payroll taxes payable	6,973
Compensated absences payable	10,549
Total Current Liabilities	206,987

Long-term Liabilities:

Intercap Loan	26,861
Deferred Liability - Boyne	444,290
Total Long-term Liabilities	471,151

Fund Equity:

Contributed capital - unrestricted	1,342,825
Contributed capital - restricted - Boyne	444,290
Contributed capital - restricted - RID assets	973,078
Retained earnings - unrestricted	88,141
Total Fund Equity	2,848,334
Total Liabilities and Fund Equity	\$3,526,472

See Independent Auditors' Report and Notes to the Financial Statements.

BIG SKY COUNTY WATER & SEWER DISTRICT #363

**STATEMENT OF REVENUE AND EXPENSES
FOR THE YEAR ENDED JUNE 30, 1996**

OPERATING REVENUE:

Sewer services	<u>\$542,349</u>
Total Operating Revenue	<u>542,349</u>

OPERATING EXPENSES:

Accounting and audit fees	19,548
Bank charges	24
Chlorine and operating supplies	13,969
Contract labor (LMS)	45,398
Depreciation	94,772
Dues	3,556
Engineering:	
General	2,694
IAWP (Interim Action Work Plan)	8,547
WWTP (Waste Water Treatment Plan)	80,700
Infiltration and in-flow repairs	217,864
Insurance	7,639
Interest expense	74,230
Lease payments	3,886
Legal - Boyne, et. al.	26,449
Legal - general	82,315
Legal - Water Quality Bureau	50,000
Maintenance and general repairs	47,335
Office supplies	12,110
Payroll taxes and benefits	18,849
Postage and miscellaneous	3,743
Rent	15,996
Salaries and wages:	
Directors' compensation	33,344
Office administration	35,876
Salaries - other	99,357
Travel and expenses	11,984
Utilities	25,757
Well samples and chemical analysis	48,590
Total Operating Expenses	<u>1,084,532</u>
Operating Income (Loss)	<u>(542,183)</u>

NON-OPERATING REVENUE:

Resort tax revenue	375,000
Lone Mountain Springs reimbursement	28,321
Interest income	48,789
Miscellaneous revenue	9,461
Total Non-Operating Revenue	<u>461,571</u>
Net Loss	<u><u>(\$80,612)</u></u>

See Independent Auditors' Report and Notes to the Financial Statements.

BIG SKY COUNTY WATER & SEWER DISTRICT #363
STATEMENT OF CHANGES IN FUND EQUITY
FOR THE YEAR ENDED JUNE 30, 1996

	<u>Contributed Capital</u>			<u>Retained Earnings</u>		<u>Total</u>
	<u>Unrestricted</u>	<u>Restricted Boyne</u>	<u>Restricted RID Assets</u>	<u>Unrestricted</u>	<u>Restricted</u>	
Beginning balances, July 1, 1995	\$2,372,571	\$372,957		\$118,106	\$53,739	\$2,917,373
Transfer net assets contributed to contributed capital account	(967,413)		\$1,021,152		(53,739)	0
Beginning balances, July 1, 1995, as restated	1,405,158	372,957	1,021,152	118,106	0	2,917,373
Net loss				(80,612)		(80,612)
Transfer depreciation on on contributed assets			(48,074)	48,074		0
Boyne - deferred liability	(71,333)	71,333				0
Prior period adjustment (see Note 10)	9,000			2,573		11,573
Ending balances, June 30, 1996	<u>\$1,342,825</u>	<u>\$444,290</u>	<u>\$973,078</u>	<u>\$88,141</u>	<u>\$0</u>	<u>\$2,848,334</u>

See Independent Auditors' Report and Notes to the Financial Statements.

BIG SKY COUNTY WATER & SEWER DISTRICT #363

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 1996**

CASH FLOWS FROM OPERATING ACTIVITIES:

Excess of operating expense over operating revenue	(\$542,183)
Adjustments to reconcile operating loss to net cash provided:	
Depreciation	94,772
Prior period adjustment	11,573
(Increase) decrease in current assets:	
Accounts receivable	66,239
Allowance for bad debts	(11,000)
Resort tax receivable	(143,164)
Prepaid expenses	(184)
Inventory	2,000
Increase (decrease) in current liabilities:	
Accounts payable	(40,454)
Payroll taxes payable	3,917
Compensated absences payable	5,874
Net cash (used) by operating activities	<u>(552,610)</u>

CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:

Resort tax revenue	375,000
Lone Mountain Springs reimbursement	28,321
Miscellaneous revenue	9,461
Net cash provided by non-operating financing activities	<u>412,782</u>

CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:

Purchase of office furniture, equipment, computers and perimeter fence	(74,263)
Sewer system equipment purchases	(431,296)
Vehicle purchases	(26,510)
Net cash (used) by capital financing activities	<u>(532,069)</u>

CASH FLOWS FROM INVESTING ACTIVITIES:

Intercap loan	26,861
Interest income	48,789
Additions to deferred liability to Boyne	74,035
Net cash provided by investing activities	<u>149,685</u>
Net decrease in cash	(522,212)
Cash and cash equivalents, beginning of year	<u>1,180,315</u>
Cash and cash equivalents, end of year	<u><u>\$658,103</u></u>

See Independent Auditors' Report and Notes to the Financial Statements.

BIG SKY COUNTY WATER & SEWER DISTRICT #363
Big Sky, Montana

Notes to the Financial Statements
For the Year Ended June 30, 1996

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 general 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 revenue earned, expenses incurred and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

Basis of Accounting

The fund is accounted for using the accrual basis of accounting. Revenue is recognized when it is earned and expenses are recognized when they are incurred.

Property owners are assessed sewer fees annually based on the number of single family equivalent units. 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.

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 are the types of permitted deposits and investments: Interest bearing savings accounts, certificates of deposit and time deposits insured by the Federal Deposit Insurance Corporation or which are fully collateralized. Investments are stated at the lower of aggregate cost or market value. Deposits in excess of the FDIC insurance limits were collateralized by pledged securities. Restricted amounts are detailed in Note 2.

BIG SKY COUNTY WATER & SEWER DISTRICT #363
Big Sky, Montana

Notes to the Financial Statements
For the Year Ended June 30, 1996

1. Summary of Significant Accounting Policies - (Cont'd)

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
Vehicles	5 years
Computer equipment and software	3-5 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. This amount was removed in the current year. (See Note 10). There was no allowance in prior years because management of the District was of the opinion that all receivables are collectible. Even though the District took over the billing of accounts receivable, they may still turn over any delinquent accounts to the County for collection.

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.

Resort Taxes

Applications requesting budget funds from resort taxes are reviewed by the 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.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

BIG SKY COUNTY WATER & SEWER DISTRICT #363
Big Sky, Montana

Notes to the Financial Statements
For the Year Ended June 30, 1996

1. Summary of Significant Accounting Policies - (Cont'd)

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).

Risk Management

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

- a. damage to and loss of property and contents
- b. environmental damage
- c. workers' compensation; i.e., employee injuries
- d. potential liability created under the Memorandum of 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.

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 future losses are unknown. At the present time, the District is unaware of any potential future loss due to environmental damages.

Economic Dependency

Big Sky County Water and Sewer District receives a vast majority of its revenue from resort tax revenue collected by Gallatin County, Montana, and the user fees charged to the property owners. During fiscal year 1997, \$250,000 of the resort tax revenue is designated for project construction debt service and \$216,291 is designated for infiltration and in-flow repairs to system and water sampling and testing. In the following years, resort tax has committed revenue to the District which is to be used to pay principal and interest on the general obligation bonds. (See Note 8).

2. Cash and Cash Equivalents

Management considers all short-term, highly 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, 1996:

Unrestricted	\$ 13,732
Restricted - RID	304,888
Restricted - Boyne	303,744
Restricted - Seypar	<u>35,739</u>
Total	<u>\$658,103</u>

BIG SKY COUNTY WATER & SEWER DISTRICT #363
Big Sky, Montana

Notes to the Financial Statements
For the Year Ended June 30, 1996

3. Contract Labor Agreement

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

4. Construction and Other Significant Commitments

On June 28, 1996, the District entered into three construction contracts:

- * Construction of a waste water treatment plant with Williams Brothers for \$1,436,000.
- * Expansion of storage ponds with Van Dyke Construction for \$1,128,291.
- * Construction of a golf course irrigation system with Huppert Brothers for \$1,232,300.

5. Subsequent Event - Settlement

In October of 1996, the District settled a potential lawsuit with landowners that claimed their land had been damaged because of contamination of the ground water located in, under and flowing through their real property allegedly caused by leakage from the District's wastewater storage ponds. Total damages paid to the claimants was \$10,000. This amount has been accrued and expensed appropriately in the current year's financial statements.

6. Lease Agreements

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 \$1,125 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 based on the minimum annual 3% increase:

1997	\$14,078
1998	14,500
1999	14,935

The District entered into an agreement to lease a storage trailer from Montana Ready Mix, Ltd. The lease commenced on June 10, 1996, and has no specified expiration date. The lease calls for payments of \$60 per month. Payments made pursuant to the lease during 1996 were \$60.

The District entered into an operating lease agreement to lease a 1995 Ford Ranger from Ford Motor Credit Company on July 11, 1995. The lease called for a refundable deposit of \$350.00 and monthly payments of \$349.15 for 24 months. Payments made pursuant to the lease during 1996 were \$3,840.65. Future minimum lease payments will be:

1997	\$4,189.80
1998	349.15

The lease qualifies as an operating lease.

BIG SKY COUNTY WATER & SEWER DISTRICT #363
Big Sky, Montana

Notes to the Financial Statements
For the Year Ended June 30, 1996

7. Intercap Loan

On May 31, 1996, the District borrowed \$26,754.11 from the Montana Department of Commerce Board of Investments for the purchase of a 1995 GMC Suburban. Note payments are due on August 15th and February 15th. The first principal payment will be for \$2,390.94 on August 15, 1996, and that amount will increase with each payment until the final payment of \$2,976.79 on August 15, 2001. The interest rate shall equal the interest rate on the Board's bonds plus up to 1½% per annum as is necessary to pay the borrower's share of program expenses. The original interest rate was 4.85%. The note is collateralized by the Suburban.

8. General Obligation Bonds

On May 28, 1996, the District entered into an agreement with the Department of Natural Resources and Conservation of the State of Montana under the Wastewater Treatment Works Revolving Fund Program. The bond agreement calls for loaning \$5,513,000 to the District. The loan will be paid out as progress is made on the District's project to acquire land for the design, construction, and installation of mandated improvements to the District's wastewater treatment system, satisfying the Interim Action Work Plan mandated by the Montana Water Quality Bureau. The District received their first installment of \$366,340 on July 19, 1996. The maximum interest and carrying charge on the loan is 4% per annum. Total up-front program costs were \$86,830 consisting of an origination fee of \$55,130 and an administrative fee of \$31,700.

Per the bond agreement, the District will make semi-annual installments, commencing January 1, 1997, paying interest and loan administration expenses. Upon completion of the project, the payments will also apply to principal. The general obligation bonds are to be repaid over the next 16 years with resort tax revenue appropriated to the District by the counties. The appropriation will not exceed the lesser of \$500,000, or 50% of the total amount of the annual resort tax revenue collected in any fiscal year.

9. Fund Equity

Contributed capital consists of all capital that existed before the District was formed in September of 1993. The \$444,290 restricted portion of contributed capital is for amounts relating to the Memorandum of Understanding with Boyne. (See Note 12). The \$973,078 restricted amount of contributed capital is related to the RID assets currently owned and depreciated by the District.

10. Prior Period Adjustments

In the current year, the District made three adjustments relating to prior period audits. One entry was made to reconcile cash to the June 30, 1994, audit balance. The second entry was to reconcile accounts payable to the June 30, 1995, audit balance. The third entry was to reverse an entry made in the June 30, 1994, audit. The net effect of these adjustments was a \$573 increase to retained earnings.

Also during the audit, a prior period adjustment was made to remove the allowance for uncollectible accounts, as it was deemed unnecessary. Delinquent accounts may still be turned over to the County for collection. The effect of this adjustment was an \$11,000 increase to retained earnings.

BIG SKY COUNTY WATER & SEWER DISTRICT #363
Big Sky, Montana

Notes to the Financial Statements
For the Year Ended June 30, 1996

11. Related Parties

The District had two contracts with related parties in the normal course of business:

- a. The District had a memorandum of understanding with Big Sky Owner's 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. These designated funds have all been used up.
- b. 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 \$45,398 to fund the wages and benefits of a joint employee of LMS and the District (see Note 3). This agreement was terminated in December, 1995.

12. 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 contract was terminated in December, 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.

Compliance Order

On July 13, 1993, the Montana Water Quality Bureau issued a compliance order to the District imposing a moratorium restricting new hook-ups to the sewer system and requiring 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, 1996.

BIG SKY COUNTY WATER & SEWER DISTRICT #363
Big Sky, Montana

Notes to the Financial Statements
For the Year Ended June 30, 1996

12. Commitments and Contingencies - (Cont'd)

Boyne Memo of Understanding

The District has an agreement, dated March 18, 1993, with Boyne USA, Inc. (Boyne), owner of Big Sky Ski & Summer Resort, and BSOA 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 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 in the litigation, 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. The District has recorded a deferred liability of \$444,290, which includes the original deposit amount of \$350,000 plus accrued interest of \$94,290.

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 State regulations. The District is in settlement negotiations and if the negotiations are unsuccessful, 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 with the District, Seypar, Inc., filed a declaratory judgment asking the Court for an order invalidating certain sewer hook-up fees it paid under protest and requesting reimbursement of the fees. The risk to the District is that the Court could order partial reimbursement of fees paid under protest by Seypar, Inc. and prohibit imposition of any such fees in the future. The District has accrued a liability of \$35,000. The court has awarded in favor of the District; however, Seypar has filed an appeal.

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 obligations to provide future wastewater collection and treatment services to certain of the original subdivisions as well as other commitments entered into either by agreement or legally mandated.



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

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

We have audited the financial statements of Big Sky Water & Sewer District #363 as of and for the year ended June 30, 1996, and have issued our report thereon dated October 18, 1996.

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 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 financial statements was not to provide an opinion on the 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 an immaterial instance of noncompliance that we have reported to the management of the District in the Independent Auditors' Report on Internal Control Structure (page 18 - 941 Reports).

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.

*Joseph Eve & Company
Certified Public Accountants*

**Billings, Montana
October 18, 1996**



**Joseph Eve & Company
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**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL
STRUCTURE BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS**

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

We have audited the financial statements of Big Sky Water & Sewer District #363 as of and for the year ended June 30, 1996, and have issued our report thereon dated October 18, 1996.

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 statements are free of material misstatement.

The management of Big Sky 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 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 financial statements of Big Sky Water & Sewer District #363 for the year ended June 30, 1996, 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 financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

**To the Board of Directors
Big Sky Water & Sewer District #363
Independent Auditors' Report on Internal
Control Structure Based on an Audit of
Financial Statements Performed in Accordance
with *Government Auditing Standards*
Page 2**

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 financial statements.

Segregation of Duties

Small organizations often have internal control weaknesses in the area of segregation of duties because of limited personnel. Big Sky Water & Sewer District #363 has only two office employees and, as such, has limitations on improvements that can be made. However, management can weigh the cost/benefit of the following recommendations:

Recommendations

- * Cash Receipts - Incoming mail should be opened by a person having no other cash receipt posting duties in order to establish internal 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 - 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 using pre-numbered purchase orders.
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.

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Recommendations - (Cont'd)

- * 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.

941 Reports

During our testing and review of payroll, we noted that line 6A, taxable social security wages; line 6B, taxable social security tips; and line 7, Medicare wages and tips, were not entered correctly on 2 of the 4 quarterly Form 941 reports filed.

Recommendation

All correspondence to the federal government should be filed completely and correctly. This will eliminate additional circumstances where IRS adjustments may arise.

Disbursement Testing

During our testing of disbursements, we noted that out of a sample of twenty-five, seven disbursements were not properly approved.

Recommendation

We recommend that all disbursements be approved before the disbursement is made.

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 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 are material weaknesses.

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

Joseph Eve & Company
Certified Public Accountants

Billings, Montana
October 18, 1996

