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ORIGINAL

**BIG SKY COUNTY WATER &
SEWER DISTRICT NO. 363**

FINANCIAL STATEMENTS

JUNE 30, 2001 and 2000

Knaub & Company, P.C.

Certified Public Accountants

985 Technology Blvd. #102
Bozeman, Montana 59718

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

JUNE 30, 2001

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Big Sky County Water & Sewer
District No. 363

We have audited the accompanying financial statements of Big Sky County Water & Sewer District No. 363 as of and for the years ended June 30, 2001 and 2000, as listed in the table of contents. 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 audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *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 audits provide 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 No. 363, as of June 30, 2001 and 2000, and the results of its operations and cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 17, 2001 on our consideration of the Big Sky County Water & Sewer District NO. 363's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

Knaub & Company, P.C.

August 17, 2001

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363**BALANCE SHEETS****JUNE 30, 2001 AND 2000****ASSETS**

	<u>6-30-01</u>	<u>6-30-00</u>
Current assets:		
Cash and investments	\$ 1,292,393	1,346,695
Accounts receivable	512,681	417,944
Prepaid expenses	15,700	14,994
Boyne settlement - current portion	505,177	250,000
Notes receivable - current portion	1,653	1,136
Total current assets	<u>2,327,604</u>	<u>2,030,769</u>
Restricted cash and cash equivalents:		
Restricted for bond payments	350,155	337,154
Restricted for future capital improvements	3,228,909	2,520,130
Retainage accounts	19,681	84,853
Total restricted cash and cash equivalents	<u>3,598,745</u>	<u>2,942,137</u>
Property and equipment, at cost:		
Land	616,604	616,604
Vehicles	114,965	92,293
Water meters	109,612	-
Furniture and equipment	36,913	32,081
Computer equipment and software	40,564	38,164
Water and sewer system equipment and infrastructure	14,611,791	14,691,361
	<u>15,530,449</u>	<u>15,470,503</u>
Less: accumulated depreciation	<u>(3,697,364)</u>	<u>(3,149,357)</u>
Total property and equipment	<u>11,833,085</u>	<u>12,321,146</u>
Other assets:		
Lease deposits	494	494
Notes receivable	138,010	138,125
Less: current portion	(1,653)	(1,136)
Boyne settlement receivable	2,505,177	2,500,000
Less: current portion	<u>(505,177)</u>	<u>(250,000)</u>
Total other assets	<u>2,136,851</u>	<u>2,387,483</u>
TOTAL ASSETS	<u>\$ 19,896,285</u>	<u>19,681,535</u>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363**BALANCE SHEETS (Continued)****JUNE 30, 2001 AND 2000****LIABILITIES AND FUND EQUITY**

	<u>6-30-01</u>	<u>6-30-00</u>
Current liabilities:		
Accounts payable	\$ 27,601	155,126
Retainages payable	2,585	84,858
Private contractor bonds	16,595	-
Payroll taxes payable	3,120	6,275
Compensated absences payable	23,218	25,718
Accrued health insurance claims payable	30,810	18,512
Current portion of long-term debt	329,873	339,402
Total current liabilities	<u>433,802</u>	<u>629,891</u>
Long-term liabilities:		
Deferred revenue	2,389,125	2,639,438
Intercap loan	7,487	10,997
State revolving fund loans	4,579,500	4,887,000
Computer leases	2,658	7,668
Office building loan	196,397	199,832
Telemetry equipment	-	158,565
Less: current portion of long-term debt	(329,873)	(339,402)
Total long-term liabilities	<u>6,845,293</u>	<u>7,564,098</u>
Fund equity:		
Contributed capital - unrestricted	3,436,356	3,363,110
Contributed capital - RID assets	885,272	885,272
Retained earnings - unrestricted	8,295,562	7,239,164
Total fund equity	<u>12,617,190</u>	<u>11,487,546</u>
TOTAL LIABILITIES AND FUND EQUITY	<u>\$ 19,896,285</u>	<u>19,681,535</u>

(Concluded)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUE AND EXPENSES

FOR THE YEARS ENDED JUNE 30, 2001 AND 2000

	<u>6-30-01</u>	<u>6-30-00</u>
OPERATING REVENUE:		
Sewer services	\$ 972,287	885,127
Sewer plant investment fees	323,789	1,177,130
Water services	<u>721,566</u>	<u>660,166</u>
Gross operating revenue	<u>2,017,642</u>	<u>2,722,423</u>
OPERATING EXPENSES:		
General and administrative:		
Meetings	779	580
Salaries	127,599	128,059
Payroll taxes and benefits	38,627	37,248
Rent	-	11,129
Condo assoc. dues and property taxes	-	2,750
Utilities	3,622	2,555
Janitorial	3,383	2,209
Computer software	2,192	2,180
Office supplies and expense	9,502	8,066
Telephone	9,968	6,498
Postage and shipping	4,992	5,265
Printing	255	1,156
Advertising	1,944	759
Insurance	36,903	19,727
Dues and subscriptions	227	372
Election expenses	-	511
Vehicle expenses	5,164	4,102
Interest expense	1,056	2,274
Legal fees	42,043	25,092
Computer maintenance	1,747	1,151
Audit expense	4,736	4,700
Bank service charges	337	384
State annual filing fee	675	675
Miscellaneous	5,149	2,753
GIS mapping	3,600	4,664
Other consulting fees	1,131	-
Office building repair & maintenance	<u>987</u>	<u>-</u>
Total general and administrative	<u>306,617</u>	<u>274,859</u>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUE AND EXPENSES

FOR THE YEARS ENDED JUNE 30, 2001 AND 2000

OPERATING EXPENSES (Continued):

	<u>6-30-01</u>	<u>6-30-00</u>
Sewer general and administrative:		
Salaries	54,396	55,706
Payroll taxes and employee benefits	17,519	16,856
Dues and subscriptions	148	306
Telephone	2,348	2,972
Office supplies	201	382
Publications	61	-
	<hr/>	<hr/>
Total sewer general and administrative	74,673	76,222
	<hr/>	<hr/>
Sewer Plant Expense:		
Gas and oil	3,807	3,242
Vehicle repair and maintenance	2,177	967
Insurance	876	615
Utilities	40,215	46,489
Chemicals	33,491	29,997
Lab fees	-	11,292
Stream water quality monitoring	3,004	890
Waste water monitoring	12,985	-
Equipment rental	157	-
Safety equipment	1,085	191
Operating supplies	711	-
Sewer repairs and maintenance	2,975	7,298
Backhoe rent	7,024	7,293
Maintenance	10,052	22,507
Tools	1,579	943
Jetting	8,134	7,335
Video taping	564	-
Engineering	5,473	5,184
Miscellaneous	39	193
Depreciation expense	381,299	354,184
Long-term compliance work plan	21,418	24,781
	<hr/>	<hr/>
Total sewer plant expense	537,064	523,401
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(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUE AND EXPENSES

FOR THE YEARS ENDED JUNE 30, 2001 AND 2000

OPERATING EXPENSES (Continued)

	<u>6-30-01</u>	<u>6-30-00</u>
Water general and administrative:		
Salaries	51,836	57,040
Wages	4,495	4,325
Payroll taxes and employee benefits	20,191	18,147
Dues and subscriptions	947	519
Communications and telemetry equipment	2,079	2,418
Publications	331	136
Office supplies	524	503
Public water supply fees	2,540	2,308
Total water general and administrative	<u>82,942</u>	<u>85,396</u>
Water plant expense:		
Vehicle expenses	8,711	4,375
Utilities	54,053	54,719
Lab fees	2,172	2,947
Equipment rental	1,333	1,105
New water services	107	2,134
Safety equipment	348	265
Tools	2,552	-
Interest expense	9,729	9,759
Repairs and maintenance	56,425	41,713
Backhoe rent	7,024	7,068
Leak detection and engineering	11,906	4,285
Water rights	-	1,395
Miscellaneous	33	1,686
Depreciation	166,709	135,941
DEQ Water quality study	-	9,028
Water well testing	-	7,198
Well metering	1,150	-
Water facilities plan	58,518	18,777
Water metering project	16,556	-
Total water plant expense	<u>397,324</u>	<u>302,395</u>
Total expenses	<u>1,398,620</u>	<u>1,262,273</u>
Operating income	<u>619,022</u>	<u>1,460,150</u>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUE AND EXPENSES

FOR THE YEARS ENDED JUNE 30, 2001 AND 2000

NONOPERATING REVENUE (EXPENSES):

Resort tax revenue - bond payment	500,000	500,000
Resort tax revenue - other	-	17,198
Other sewer non-operating revenue	-	5,000
Rental income	400	-
Interest income	239,286	132,731
Interest expense	(207,157)	(207,754)
Boyne settlement payment	250,000	250,000
Write down of obsolete assets	(346,711)	-
Gain on disposition of assets	1,559	-
Loss on disposition of assets	-	(3,502)

Total nonoperating revenue (expenses)

437,376	693,673
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NET INCOME

\$ 1,056,398	2,153,823
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(Concluded)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363**STATEMENTS OF CHANGES IN FUND EQUITY****FOR THE YEARS ENDED JUNE 30, 2001 AND 2000**

	<u>Contributed Capital</u>		<u>Retained Earnings</u>	
	<u>Unrestricted</u>	<u>RID Assets</u>	<u>Unrestricted</u>	<u>Total</u>
Beginning balances, July 1, 1999	\$ 2,552,379	885,272	5,085,341	8,522,992
Net income			2,153,823	2,153,823
Contributed capital	<u>810,731</u>			<u>810,731</u>
Ending balances, June 30, 2000	\$ 3,363,110	885,272	7,239,164	11,487,546
Net income			1,056,398	1,056,398
Contributed capital	<u>73,246</u>			<u>73,246</u>
Ending balances, June 30, 2001	\$ <u>3,436,356</u>	<u>885,272</u>	<u>8,295,562</u>	<u>12,617,190</u>

See accompanying notes to financial statements.

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363**STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED JUNE 30, 2001 AND 2000****CASH FLOWS FROM OPERATING ACTIVITIES:**

	<u>6-30-01</u>	<u>6-30-00</u>
Operating income	\$ 619,022	1,460,150
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation	548,008	490,125
Interest expense	10,785	12,033
(Increase) decrease in current assets:		
Accounts receivable	155,262	(45,224)
Prepaid expenses	(706)	(115)
Accrued interest receivable	-	1,100
Other receivables	(255,177)	-
Increase (decrease) in current liabilities:		
Accounts payable	(127,525)	18,610
Retainages payable	(82,273)	121
Private contractor bonds	16,595	(23,261)
Payroll taxes payable	(3,155)	(1,606)
Compensated absences payable	(2,500)	6,871
Accrued health insurance claims payable	12,298	8,325
Deferred revenue	(313)	313
Accrued interest payable	-	(175)
	<u>271,299</u>	<u>467,117</u>
Net cash provided by operating activities	<u>890,321</u>	<u>1,927,267</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:

Interest paid	(10,785)	(12,033)
Rental income - lower level office	400	-
Lease deposits refunded	-	1,118
	<u>-</u>	<u>1,118</u>
Net cash provided (used) from noncapital financial activities	<u>(10,385)</u>	<u>(10,915)</u>

CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:

Principal paid on long-term debt	(478,022)	(328,672)
Interest paid	(207,157)	(207,754)
Resort tax revenue	500,000	517,198
Landscaping reimbursement	-	5,000
Proceeds from sale of computer equipment	-	1,543
Proceeds from sale of spring gauging equipment	1,559	-
Acquisition of fixed assets	(333,411)	(1,277,657)
Payment received on notes receivable	115	1,000
Boyne settlement payment	-	250,000
Proceeds from long-term debt	-	221,752
	<u>(516,916)</u>	<u>(817,590)</u>
Net cash flows provided (used) from capital financing activities	<u>(516,916)</u>	<u>(817,590)</u>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF CASH FLOWS (Continued)

FOR THE YEARS ENDED JUNE 30, 2001 AND 2000

	<u>6-30-01</u>	<u>6-30-00</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest income	<u>239,286</u>	<u>132,731</u>
Net cash provided by investing activities	<u>239,286</u>	<u>132,731</u>
Net increase in cash	602,306	1,231,493
Cash and cash equivalents, beginning of year	<u>4,288,832</u>	<u>3,057,339</u>
Cash and cash equivalents, end of year	\$ <u><u>4,891,138</u></u>	<u><u>4,288,832</u></u>
 Per balance sheet:		
Unrestricted cash and cash equivalents	\$ 1,292,393	1,346,695
Restricted cash and cash equivalents	<u>3,598,745</u>	<u>2,942,137</u>
	\$ <u><u>4,891,138</u></u>	<u><u>4,288,832</u></u>
 Non-cash transactions consist of the following:		
Contributed capital from developers	\$ <u><u>73,246</u></u>	\$ <u><u>810,731</u></u>
Write off snowmaking project engineering fees	\$ <u><u>346,711</u></u>	<u><u>-</u></u>

See accompanying notes to financial statements.

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2001 and 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Big Sky County Water & Sewer District No. 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 acquired Lone Mountain Springs, water district, as part of a settlement agreement reached with Boyne USA on July 25, 1997. The District is governed by a Board of Directors elected by members of the District and establishes its own budget independent of any other government entity so it is therefore considered to be a primary government. The daily affairs of the District are conducted under the supervision of the District's general manager. The District serves approximately 2,100 customers.

Basis of Accounting

The District is considered a proprietary governmental unit. As such, its activities are similar to those found in the private sector where determination of net income is necessary or useful to sound financial administration. Goods and services are provided to outside parties therefore making it an enterprise activity. As a proprietary/enterprise entity, the activities are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation are included on the balance sheet. Fund equity is segregated into contributed capital and retained earnings components. Proprietary/enterprise operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets. The accrual basis of accounting is utilized by the District. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Pursuant to GASB Statement 20 "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting", the District follows GASB guidance as applicable to proprietary funds and FASB Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989 that do not conflict with or contradict GASB pronouncements.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Investments

Under the District's investment policy, the District is restricted to investing funds in specific types of deposit and investment instruments. All cash and investments held by the District that have a maturity of one year or less are presented as cash equivalents in the Statement of Cash Flows. Management considers all cash and certificates of deposit to be cash and cash equivalents. This differs from generally accepted accounting principles which requires a three-month maturity; however, the difference is not material. 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. Deposits in excess of the FDIC insurance limits were collateralized by pledged securities. Restricted amounts are detailed in Note 2. Investments are stated at the lower of aggregate cost or market value.

Investments in the State Short-Term Investment Pool (STIP) are carried at amortized cost. STIP is a 2a-7 like pool that is managed by the State of Montana and is not registered with the Securities and Exchange Commission (SEC) as an investment company, but nevertheless operates in a manner consistent with the SEC's Rule 2a-7 of the Investment Company Act of 1940. GASB Statement No. 31 allows reporting of investments in such pools at amortized cost.

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:

Water and 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. All interest costs associated with new construction are capitalized.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

User Fees and Accounts Receivable

Property owners are assessed sewer and water fees annually based on the number of single family equivalent units. On January 1, 1998, the District began billing for water fees after acquiring Lone Mountain Springs. No allowance has been made for uncollectible accounts because the District believes that all accounts will be collected. The District may turn over any delinquent accounts to the County Treasurer for collection.

Resort Taxes

Applications requesting budget funds from resort taxes are reviewed by the Big Sky Resort Tax Advisory Board. Expenses paid from the resort tax proceeds are included in operating expenses in the Statement of Revenue and Expenses.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

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

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Risk Management (Continued)

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.

The District has limited insurance 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.

The District has the following coverage under its insurance policies:

General liability	\$ 2,000,000
Personal injury	1,000,000
Employer benefits liability	1,000,000
Failure to supply	1,000,000
Limited pollution	1,000,000
Umbrella liability	4,000,000
Building and contents	3,276,000
Public officials liability	5,000,000
Earthquake	15,000,000

Economic Dependency

Big Sky County Water & Sewer District receives a vast majority of its revenue from resort tax revenue collected by the Resort Tax District, and the user fees charged to the property owners. During fiscal year 2001 and 2000, \$500,000 of the resort tax revenue was used to pay principal and interest on the general obligation bonds.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

2. CASH AND INVESTMENTS

The District began investing in the state short-term investment pool (STIP) in 2000. The following is a summary of cash and cash equivalents as of June 30, 2001 and 2000:

	<u>2001</u>	<u>2000</u>
Unrestricted	\$ 540,045	639,810
Restricted for bond payments	350,155	337,154
Restricted for capital improvements	3,228,909	2,520,130
Restricted - Retainage and construction performance bonds	<u>19,681</u>	<u>84,853</u>
	4,138,790	3,581,947
Investment in STIP	<u>752,348</u>	<u>706,885</u>
Total cash and investments	\$ <u>4,891,138</u>	<u>4,288,832</u>

The District's deposits are categorized below by the level of credit risk. Category 1 includes deposits insured or collateralized with securities held by the District. Category 2 includes deposits collateralized with securities held by the financial institution's trust department or agency in the District's name. Category 3 are deposits that are collateralized with securities held by the pledging financial institution or its trust department or agent, but not in the District's name.

	<u>Category</u>			
	<u>1</u>	<u>2</u>	<u>3</u>	<u>Total</u>
2001 - Cash and cash equivalents \$	<u>91,451</u>	<u>-</u>	<u>4,047,339</u>	\$ <u>4,138,790</u>
2000 - Cash and cash equivalents \$	<u>204,773</u>	<u>-</u>	<u>3,377,174</u>	\$ <u>3,581,947</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

3. CHANGES IN FIXED ASSETS

	Balance			Balance
	<u>7/1/00</u>	<u>Additions</u>	<u>Deletions</u>	<u>6/30/01</u>
Land	\$ 616,604	-	-	616,604
Sewer plant assets	2,683,466	2,391	-	2,685,857
Sewer systems/extensions	899,909	36,623	-	936,532
Sewer outfall line	917,092	23,211	-	940,303
Storage ponds	2,413,374	-	-	2,413,374
Storage maintenance building	151,279	16,632	-	167,911
Irrigation system	1,742,431	-	-	1,742,431
Treatment plant	1,871,972	615	-	1,872,587
Snowmaking project	694,994	6,717	(346,711)	355,000
New office building	338,370	119,829	-	458,199
Vehicles	92,293	22,672	-	114,965
Furniture and fixtures	32,081	4,832	-	36,913
Computer equipment and software	38,164	2,400	-	40,564
Water plant contributions	125,522	-	-	125,522
Water plant structures and improvements	83,093	-	-	83,093
Wells and springs	754,817	-	-	754,817
Supply mains	52,997	-	-	52,997
Pumping equipment	64,090	-	-	64,090
Distribution reservoirs	126,775	-	-	126,775
Transmission and distribution	572,412	-	-	572,412
Meters and hydrants	39,344	-	-	39,344
Generator	38,326	-	-	38,326
Westfork water system	25,846	-	-	25,846
Telemetry equipment	204,110	-	-	204,110
Blue Grouse well	103,565	-	-	103,565
Yellowstone Condos water line	129,064	-	-	129,064
Water systems/extensions	658,513	61,123	-	719,636
Water meters	<u>-</u>	<u>109,612</u>	<u>-</u>	<u>109,612</u>
 Total	 \$ <u>15,470,503</u>	 <u>406,657</u>	 <u>(346,711)</u>	 <u>15,530,449</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

4. LEASE AGREEMENTS

- a. The District leases a backhoe for \$600 per month from Tractor & Equipment Company. This is a month-to-month lease.
- b. The District entered into a three-year lease agreement for six computers from Green Tree Corporation for \$15,934 on July 23, 1997. The lease calls for payment of \$554 per month. The lease qualified as a capital lease. This lease was replaced in 2000 by a lease to Conseco. This lease will be paid in 24 payments of \$368 each.
- d. The District acquired two capital leases for \$204,110 for telemetry equipment with the acquisition of Lone Mountain Springs. The leases are for a period of ten (10) years, expiring in 2004 and 2007. The leases call for payment of \$1,857 and \$6,212 per month. These leases were paid off in December of 2000 and June of 2001.
- e. The District is leasing a computer server with an original cost of \$3,358 from Dell Financial Services. This is recorded as a capital lease dated November 25, 1999. Payments are \$127 per month for 36 months at an interest rate of 21%.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

4. LEASE AGREEMENTS (Continued)

The following is a summary of the future minimum lease payments under capital leases to be paid during the succeeding fiscal years:

	Net Future Minimum <u>Lease Payment</u>	Total Future Minimum <u>Lease Payments</u>	Less - Amount Representing <u>Interest</u>
2002	\$ 2,303	2,576	273
2003	452	471	19
2004	-	-	-
2005	-	-	-
2006	-	-	-
Thereafter	<u>-</u>	<u>-</u>	<u>-</u>
	\$ <u>2,755</u>	<u>3,047</u>	<u>292</u>

5. OUTSTANDING DEBT

The following is a summary of long-term debt at June 30, 2001 and 2000:

	<u>2001</u>	<u>2000</u>
Variable rate InterCap loan dated October 29, 1999, payable to the Board of Investments of the State of Montana for the purchase of a generator; payable in semi-annual payments of approximately \$3,800 depending on the interest rate. Rate at June 30, 2001 was 5.6%.	\$ 7,487	10,997
Variable rate note payable to American Bank of Montana dated April 7, 2000 to finance the new office building, secured by the property. Payable in monthly installments of \$1,397 over 25 years. The rate at June 30, 2001 was 6.75%	\$ 196,397	199,832

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

5. OUTSTANDING DEBT (Continued)

<u>General Obligation Bonds</u>	<u>2001</u>	<u>2000</u>
4% State Revolving Loan #1 dated May 28, 1996 for \$5,513,000 with the Department of Natural Resources and Conservation of the State of Montana under the Wastewater Treatment Works Revolving Fund Program; 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. Payable in 33 semi-annual installments of approximately \$232,000 until January 1, 2013.	\$ 4,239,000	4,524,000
4% State Resolving Loan #2 dated December 11, 1997 for \$417,000 with the Department of Natural Resources and Conservation of the State of Montana under the Wastewater Treatment Works Revolving Fund Program; for wastewater treatment system; payable in 30 semi-annual installments of approximately \$19,000 until January 1, 2013	<u>340,500</u>	<u>363,000</u>
Less: current portion	<u>(327,570)</u>	<u>(313,691)</u>
	<u>\$ 4,455,814</u>	<u>4,784,138</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

5. OUTSTANDING DEBT (Continued)

The general obligation bonds are to be repaid semi-annually through 2013 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.

June 30, 2001

	Beginning Of Year	Additions	Reductions	End of Year
State Revolving Loan #1	\$ 4,524,000	-	141,000	4,239,000
State Revolving Loan #2	<u>363,000</u>	<u>-</u>	<u>11,260</u>	<u>340,500</u>
	\$ <u>4,887,000</u>	<u>-</u>	<u>152,260</u>	<u>4,579,500</u>

June 30, 2000

State Revolving Loan #1	\$ 4,799,000	-	275,000	4,524,000
State Revolving Loan #2	<u>385,000</u>	<u>-</u>	<u>22,000</u>	<u>363,000</u>
	\$ <u>5,184,000</u>	<u>-</u>	<u>297,000</u>	<u>4,887,000</u>

Annual principal payments on all long-term debt required until maturity are as follows:

2002	\$ 327,570
2003	340,657
2004	351,101
2005	366,386
2006	380,692
Thereafter	<u>3,016,978</u>
Total	\$ <u>4,783,384</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

5. OUTSTANDING DEBT (Continued)

Sewer System General Obligation Bonds - Debt Restrictions

- a. The District must establish a debt service fund for money to be set aside to pay the debt of the SRF loan.
- b. Liability insurance must be carried.
- c. All fund properties, buildings, equipment, and fixtures must be adequately insured with a reputable carrier.
- d. The District must maintain adequate accounting records.
- e. The District may invest money in securities which are fully and unconditionally guaranteed by the U.S. Government.
- f. The Sewer Fund must be audited on an annual basis.
- g. The District was in compliance with the bond covenants at June 30, 2001 and 2000.

6. FUND EQUITY

Contributed capital consists of \$885,272 transferred from the RID, which operated before the District was formed in September of 1993, plus additional contributions by developers for new hook-ups. All assets are currently owned and depreciated by the District.

7. RETIREMENT PLANS

The District participates in a state-wide, cost-sharing multiple employer defined benefit retirement plan (Public Employees Retirement System (PERS)), which covers all employees, except certain part-time employees. The plan is established under State law and is administered by the State of Montana. The plan provides retirement, disability, and death benefits to plan members and beneficiaries.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

7. RETIREMENT PLANS (Continued)

The plan issues publicly available annual reports which include financial statements and required supplemental information for the plan. Those reports may be obtained from the following:

Public Employees Retirement System
PO Box 200131
1712 Ninth Avenue
Helena, MT 59620-0131
(406) 444-3154

Contribution rates for the plan are required and determined by State law. The PERS rates for employees and employers expressed as a percentage of covered payroll, were as follows:

	<u>Employer</u>	<u>Employee</u>	<u>State of Montana</u>	<u>Total</u>
PERS - 2001	6.8%	6.9%	.1%	13.8%
PERS - 2000	6.8%	6.9%	.1%	13.8%

The amounts contributed to the plan during the year ended June 30, 2001, were equal to the required contribution. The amounts contributed by both the District and its employees (including additional voluntary contributions by employees as permitted by State law) were as follows:

	<u>Covered Wages</u>	<u>Employer</u>	<u>Employee</u>	<u>Total</u>
2001	236,407	16,076	16,312	32,388
2000	234,171	15,924	16,158	32,082
1999	227,403	15,236	15,463	30,699

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

8. COMMITMENTS AND CONTINGENCIES

Employee Health Insurance

The District carries outside health insurance for its employees which pays 50% of covered medical expenses effective January 1, 2000 (60% prior). The District pays an additional 30% of covered expenses for each employee effective January 1, 2000. The maximum risk the District faces is \$4,000 per employee, for a total of \$24,000. The District recorded estimated claims payable of \$30,810 for the year ended June 30, 2001. The claims payable had the following activity:

	<u>Beginning Liability</u>	<u>Estimated Accrual</u>	<u>Claims Paid</u>	<u>Ending Liability</u>
2000	10,187	8,672	347	18,512
2001	18,512	13,353	1,055	30,810

Compensated Absences

Employees accrue vacation time at 10 hours per moth (increasing to 12 hours after 10 years up to 16 hours after 21 years) and sick leave at 8 hours per month. Upon termination, unused sick time is paid at 25%. Unused vacation may not be accrued beyond two times the annual amount. Excess time must be used within 90 days of the next calender year or be forfeited.

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 13, 1999, required tasks of the amended compliance order must be completed by December 1, 2002. The District has met the State's compliance requirements through June 30, 2001.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

8. COMMITMENTS AND CONTINGENCIES (Continued)

Boyne Litigation and Related Complaint Action

The District entered into a Settlement Agreement, dated July 25, 1997, with Boyne USA (Boyne), owner of the Big Sky Ski & Summer Resort and the Big Sky Owner's Association (BSOA). They agreed to settle the litigation regarding the actions of the parties related to the short- and long-term development of the sewer system for the Big Sky area. This case had been pending since 1991 in the Eighteenth Judicial District, Gallatin County, Montana. The District Court signed an order to dismiss the case on November 18, 1997. Boyne agreed to pay the District \$250,000 per year for a period of 13 years beginning April 1, 1998. The remaining amount due of \$2,505,177 at June 30, 2001 and \$2,500,000 at June 30, 2000 is offset by deferred revenue of \$2,250,000 at June 30, 2001 and \$2,500,000 at June 30, 2000. \$255,177 due June 30, 2001 was paid in July, 2001.

Acquisition of Lone Mountain Springs (LMS)

Part of the Settlement Agreement between the District and Boyne USA, Inc. was the transfer of the assets and certain liabilities of LMS to the District in 1998. The District's water operation is the former Lone Mountain Springs.

Cronin Litigation

A landowner with the District, Paul and Janet Cronin, together with Log Condominiums, Inc. (Paul and Janet Cronin), filed a suit seeking to declare one of the District's ordinances invalid and unconstitutional because it imposes impact fees and grants certain exemptions to those impact fees. The Plaintiffs were attempting to certify this case as a class action; however, in April, 2000, the judge refused to certify the case as a class action. Plant investment fees paid were approximately \$21,000. Plaintiffs are also asking for reimbursement of attorney's fees of approximately \$60,000. The lawsuits are being defended by Interstate Insurance on behalf of the District. However, the extent of indemnity coverage has yet to be determined. The cases had been set for trial beginning July 23, 2001, but were postponed indefinitely at the request of the Plaintiffs.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

Greater Yellowstone Coalition, et al. v. Montana Department of Environmental Quality, Mark Simonich, Big Sky Water & Sewer District No. 363

This action was brought by the Plaintiffs challenging the approval process of the permit allowing WSD No. 363 to discharge treated wastewater into the Gallatin River and to enjoin WSD No. 363 from discharging treated wastewater into the Gallatin River. This case is currently on hold. On March 28, 2001, the District entered into an agreement with the Yellowstone Mountain Club that will, in part, allow the District to dispose of treated wastewater through irrigation on real property owned by the Yellowstone Mountain Club. This agreement is contingent upon voter approval to annex the Yellowstone Mountain Club property into the District and approval of bond financing. The election will take place in January, 2002. WSD No. 363 is currently working on the engineering to design a new treatment plant and force main pipe to Yellowstone Club with the intention of starting construction in the spring of 2002. The WSD No. 363 intends to withdraw its discharge permit after contracts have been awarded which lead to the termination of this pending litigation. If either the annexation or the bond requests fail during the January, 2002 election, the District will vigorously defend the Plaintiff's claims.

Hall v. John Kircher, Boyne USA, Inc. and Big Sky County Water and Sewer District No. 363

This declaratory judgment action was brought by the Plaintiff to dispute the imposition by WSD No. 363 of a surcharge of \$3,500 per SFE on Tract 4 pursuant to the July 25, 1997 Settlement Agreement signed by Boyne USA and WSD No. 363. The Complaint also alleges the following counts against Defendants Kircher and Boyne USA: breach of contract, negligent misrepresentation, fraud, unjust enrichment, punitive damages. Defendant WSD No. 363 filed a counterclaim for declaratory judgement against Plaintiff Sarah Hall and Defendant Boyne USA, Inc. Discovery is in its initial stages. WSD No. 363 vigorously contests Plaintiff Halls's claims.

West Berlin Developers, LLC and Big Sky County Water and Sewer District No. 363

The District entered into an easement and water use agreement with West Berlin Developers, LLC on October 14, 1999. The agreement provides a permanent easement to the District for a water main that crosses through a commercial tract of land in Phase IV of the Summit View Subdivision, located in the SW ¼ of Section 20, Township 6 South, Range 3 East in Madison County. In exchange for the easement, the District agrees to sell surplus water to West Berlin Developers for a maximum of 15.53 Single Family Equivalents.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2001 and 2000

8. COMMITMENTS AND CONTINGENCIES (Continued)

Yellowstone Mountain Club Agreement

On March 28, 2001, the District signed an agreement with the Yellowstone Mountain Club and other related entities owned by Tim Blixeth (Developer) for the sale of water, treatment of wastewater, and right to use land for the storage and disposal of treated wastewater. The District shall have the right to dispose of up to 160,000,000 gallons of treated wastewater per year on land owned by the Developer in exchange for a capital asset commitment of approximately \$18 million. The Developer will construct storage ponds and a golf course irrigation system totaling approximately \$6.6 million.

Obligation to Provide Future Sewer and Water Services

The District is obligated to provide water, 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.

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

To the Board of Directors
Big Sky County Water & Sewer District NO. 363

We have audited the financial statements of Big Sky County Water & Sewer District NO. 363 as of and for the year ended June 30, 2001, and have issued our report thereon dated August 17, 2001. We conducted our audit in accordance with U.S. generally accepted auditing standards, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, 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*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Directors of Big Sky County Water & Sewer District NO. 363, management, the Montana Department of Commerce, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Knaub & Company, P.C.

August 17, 2001

INDEPENDENT AUDITORS' REPORT ON
SUMMARY OF PRIOR AUDIT FINDINGS

NONE