

ORIGINAL

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

FINANCIAL STATEMENTS

JUNE 30, 2002 and 2001

Knaub & Company, P.C.

Certified Public Accountants

2066 Stadium Drive #102

Bozeman, Montana 59715

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

JUNE 30, 2002

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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, 2002 and 2001, 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, 2002 and 2001, 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 8, 2002 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 8, 2002

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

BALANCE SHEETS

JUNE 30, 2002 AND 2001

ASSETS

	<u>6-30-02</u>	<u>6-30-01</u>
Current assets:		
Cash and investments	\$ 3,256,698	2,097,559
Accounts receivable	589,178	512,681
Prepaid expenses	18,473	15,700
Boyne settlement - current portion	250,000	505,177
Notes receivable - current portion	<u>2,178</u>	<u>1,653</u>
Total current assets	<u>4,116,527</u>	<u>3,132,770</u>
Restricted cash and cash equivalents:		
Restricted for future capital improvements	2,862,416	2,773,898
Retainage accounts	<u>14,817</u>	<u>19,681</u>
Total restricted cash and cash equivalents	<u>2,877,233</u>	<u>2,793,579</u>
Property and equipment, at cost:		
Land	616,604	616,604
Office building	458,653	458,198
Vehicles	114,965	114,965
Water meters	393,952	109,612
Furniture and equipment	45,018	36,913
Computer equipment and software	39,933	37,206
Leased computer hardware	3,358	3,358
Water and sewer system equipment and infrastructure	<u>16,296,545</u>	<u>14,153,593</u>
	17,969,028	15,530,449
Less: accumulated depreciation	<u>(4,133,535)</u>	<u>(3,697,364)</u>
Total property and equipment	<u>13,835,493</u>	<u>11,833,085</u>
Other assets:		
Lease deposits	0	494
Notes receivable	136,357	138,010
Less: current portion	(2,178)	(1,653)
Boyne settlement receivable	2,000,000	2,505,177
Less: current portion	<u>(250,000)</u>	<u>(505,177)</u>
Total other assets	<u>1,884,179</u>	<u>2,136,851</u>
TOTAL ASSETS	\$ <u><u>22,713,432</u></u>	<u><u>19,896,285</u></u>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

BALANCE SHEETS (Continued)

JUNE 30, 2002 AND 2001

LIABILITIES AND FUND EQUITY

	<u>6-30-02</u>	<u>6-30-01</u>
Current liabilities:		
Accounts payable	\$ 301,629	27,601
Retainages payable	7,628	2,585
Private contractor bonds	7,689	16,595
Payroll taxes payable	0	3,120
Compensated absences payable	23,218	23,218
Accrued health insurance claims payable	27,707	30,810
Current portion of long-term debt	345,920	329,873
Total current liabilities	<u>713,791</u>	<u>433,802</u>
Long-term liabilities:		
Deferred revenue	2,139,125	2,389,125
Interkap loan	3,823	7,487
State revolving fund loans	4,259,000	4,579,500
Computer leases	333	2,658
Office building loan	190,687	196,397
Less: current portion of long-term debt	(345,920)	(329,873)
Total long-term liabilities	<u>6,247,048</u>	<u>6,845,293</u>
Fund equity:		
Contributed capital - unrestricted	3,363,110	3,363,110
Contributed capital - RID assets	885,272	885,272
Retained earnings - unrestricted	8,626,978	5,575,229
Retained earnings - restricted	2,877,233	2,793,579
Total fund equity	<u>15,752,593</u>	<u>12,617,190</u>
TOTAL LIABILITIES AND FUND EQUITY	<u>\$ 22,713,432</u>	<u>19,896,285</u>

(Concluded)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUE AND EXPENSES

FOR THE YEARS ENDED JUNE 30, 2002 AND 2001

	<u>6-30-02</u>	<u>6-30-01</u>
OPERATING REVENUE:		
Sewer services	\$ 992,178	972,287
Water services	707,872	721,566
Gross operating revenue	<u>1,700,050</u>	<u>1,693,853</u>
OPERATING EXPENSES:		
General and administrative:		
Meetings	3,596	779
Salaries	142,640	127,599
Payroll taxes and benefits	45,683	38,627
Utilities	3,371	3,622
Janitorial	3,211	3,383
Computer software	1,605	2,192
Office supplies and expense	8,127	9,502
Telephone	4,607	9,968
Postage and shipping	6,809	4,992
Printing	670	255
Advertising	76	1,944
Insurance	41,138	36,903
Dues and subscriptions	935	227
Election expenses	164	-
Vehicle expenses	2,454	5,164
Interest expense	381	1,056
Legal fees	18,023	42,043
Computer maintenance	3,825	1,747
Audit expense	4,700	4,736
Bank service charges	525	337
State annual filing fee	675	675
Miscellaneous	1,456	5,149
GIS mapping	-	3,600
Other consulting fees	2,861	1,131
Office building repair & maintenance	1,546	987
Total general and administrative	<u>299,078</u>	<u>306,617</u>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUE AND EXPENSES

FOR THE YEARS ENDED JUNE 30, 2002 AND 2001

OPERATING EXPENSES (Continued):

	<u>6-30-02</u>	<u>6-30-01</u>
Sewer general and administrative:		
Salaries	62,409	54,396
Payroll taxes and employee benefits	18,829	17,519
Dues and subscriptions	148	148
Telephone	2,803	2,348
Office supplies	413	201
Publications	-	61
	<hr/>	<hr/>
Total sewer general and administrative	84,602	74,673
	<hr/>	<hr/>
Sewer Plant Expense:		
Gas and oil	3,512	3,807
Vehicle repair and maintenance	1,766	2,177
Insurance	1,100	876
Fuel - equipment	288	-
Utilities	46,686	40,215
Chemicals	28,172	33,491
Stream water quality monitoring	3,214	3,004
Waste water monitoring	12,755	12,985
Equipment rental	645	157
Safety equipment	418	1,085
Operating supplies	795	711
Sewer repairs and maintenance	3,870	2,975
Backhoe rent	5,406	7,024
Maintenance	15,673	10,052
Tools	1,312	1,579
Jetting	8,833	8,134
Video taping	164	564
Engineering	2,463	5,473
Miscellaneous	118	39
Depreciation expense	348,342	381,299
Long-term compliance work plan	-	21,418
	<hr/>	<hr/>
Total sewer plant expense	485,532	537,064
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BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUE AND EXPENSES

FOR THE YEARS ENDED JUNE 30, 2002 AND 2001

OPERATING EXPENSES (Continued)

	<u>6-30-02</u>	<u>6-30-01</u>
Water general and administrative:		
Salaries	61,606	51,836
Wages	5,771	4,495
Payroll taxes and employee benefits	22,231	20,191
Dues and subscriptions	724	947
Communications and telemetry equipment	2,203	2,079
Publications	216	331
Office supplies	229	524
Public water supply fees	<u>3,232</u>	<u>2,540</u>
Total water general and administrative	<u>96,212</u>	<u>82,942</u>
Water plant expense:		
Vehicle expenses	4,625	8,711
Fuel - equipment	318	-
Utilities	72,882	54,053
Lab fees	7,672	2,172
Equipment rental	222	1,333
New water services	-	107
Safety equipment	233	348
Tools	2,989	2,552
Interest expense	327	9,729
Repairs and maintenance	40,228	56,425
Backhoe rent	5,406	7,024
Leak detection and engineering	5,141	11,906
Miscellaneous	188	33
Source water protection project	16,910	-
Depreciation	162,480	166,709
Well metering	-	1,150
Water facilities plan	1,050	58,518
Water metering project	<u>-</u>	<u>16,556</u>
Total water plant expense	<u>320,671</u>	<u>397,324</u>
Total expenses	<u>1,286,095</u>	<u>1,398,620</u>
Operating income	<u>413,955</u>	<u>295,233</u>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUE AND EXPENSES

FOR THE YEARS ENDED JUNE 30, 2002 AND 2001

NONOPERATING REVENUE (EXPENSES):	<u>6-30-02</u>	<u>6-30-01</u>
Other water nonoperating revenue	10	-
Rental income	650	400
Interest income	63,240	105,010
Interest expense	(189,664)	(207,157)
Write down of obsolete assets	-	(346,711)
Lawsuit settlement	(78,000)	-
Insurance reimbursement for lawsuit	50,000	-
Gain on disposition of assets	<u>1,639</u>	<u>1,559</u>
 Total nonoperating revenue (expenses)	 <u>(152,125)</u>	 <u>(446,900)</u>
 RESTRICTED REVENUE		
Restricted for bond payments	500,000	500,000
Restricted for capital improvements	1,169,129	708,065
Restricted for source water protection project	<u>11,000</u>	<u>-</u>
 Total restricted revenue	 <u>1,680,129</u>	 <u>1,208,065</u>
 Donated capital assets	 <u>1,193,444</u>	 <u>73,246</u>
 NET INCOME	 \$ <u><u>3,135,403</u></u>	 <u><u>1,129,644</u></u>

(Concluded)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363**STATEMENTS OF CHANGES IN FUND EQUITY****FOR THE YEARS ENDED JUNE 30, 2002 AND 2001**

	Contributed Capital		Retained Earnings		Total
	Unrestricted	RID Assets	Unrestricted	Restricted	
Beginning balances, July 1, 2000	\$ 3,363,110	885,272	4,634,181	2,604,983	11,487,546
Net income	0	0	(78,421)	1,208,065	1,129,644
Satisfaction of restrictions	0	0	1,019,469	(1,019,469)	0
Ending balances, June 30, 2001	\$ 3,363,110	885,272	5,575,229	2,793,579	12,617,190
Net income	0	0	1,455,274	1,680,129	3,135,403
Satisfaction of restrictions	0	0	1,596,475	(1,596,475)	0
Ending balances, June 30, 2002	<u>\$ 3,363,110</u>	<u>885,272</u>	<u>8,626,978</u>	<u>2,877,233</u>	<u>15,752,593</u>

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2002 AND 2001

CASH FLOWS FROM OPERATING ACTIVITIES:

	<u>6-30-02</u>	<u>6-30-01</u>
Operating income	\$ 413,955	295,233
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation	436,171	548,008
Interest expense	709	10,785
Disposal of fixed assets	74,348	-
(Increase) decrease in current assets:		
Accounts receivable	173,503	155,262
Prepaid expenses	(2,773)	(706)
Other receivables	255,177	(255,177)
Increase (decrease) in current liabilities:		
Accounts payable	274,027	(127,525)
Retainages payable	5,043	(82,273)
Private contractor bonds	(8,906)	16,595
Payroll taxes payable	(3,120)	(3,155)
Compensated absences payable	-	(2,500)
Accrued health insurance claims payable	(3,103)	12,298
Deferred revenue	-	(313)
	<u>1,201,076</u>	<u>271,299</u>
 Net cash provided by operating activities	 <u>1,615,031</u>	 <u>566,532</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:

Interest paid	(709)	(10,785)
Other sewer nonoperating revenue	10	-
Rental income - lower level office	650	400
Lease deposits refunded	494	-
Lawsuit settlement	(78,000)	-
Insurance reimbursement for lawsuit	<u>50,000</u>	<u>-</u>
 Net cash provided (used) from noncapital financial activities	 <u>(27,555)</u>	 <u>(10,385)</u>

CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:

Principal paid on long-term debt	(332,198)	(478,022)
Interest paid	(189,664)	(207,157)
Resort tax revenue	561,000	500,000
Sewer plant investment fees	781,302	323,789
Proceeds from sale of computer equipment	1,639	-
Proceeds from sale of spring gauging equipment	-	1,559
Acquisition of fixed assets	(1,319,482)	(333,411)
Payment received on notes receivable	<u>1,653</u>	<u>115</u>
 Net cash flows provided (used) from capital financing activities	 <u>(495,750)</u>	 <u>(193,127)</u>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF CASH FLOWS (Continued)

FOR THE YEARS ENDED JUNE 30, 2002 AND 2001

	<u>6-30-02</u>	<u>6-30-01</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest income	<u>151,067</u>	<u>239,286</u>
Net cash provided by investing activities	<u>151,067</u>	<u>239,286</u>
Net increase in cash	1,242,793	602,306
Cash and cash equivalents, beginning of year	<u>4,891,138</u>	<u>4,288,832</u>
Cash and cash equivalents, end of year	<u>\$ 6,133,931</u>	<u>4,891,138</u>
Per balance sheet:		
Unrestricted cash and cash equivalents	\$ 3,256,698	2,097,559
Restricted cash and cash equivalents	<u>2,877,233</u>	<u>2,793,579</u>
	<u>\$ 6,133,931</u>	<u>4,891,138</u>
Noncash transactions consist of the following:		
Contributed capital from developers	\$ <u>1,193,444</u>	\$ <u>73,246</u>
Write off snowmaking project engineering fees	\$ <u>-</u>	<u>346,711</u>

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2002 and 2001

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 2,200 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, 2002 and 2001

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:

Office building	39 years
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, 2002 and 2001

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. The District is currently in the process of converting to a metering system. 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 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.

Use of 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. 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, 2002 and 2001

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	\$ 10,000,000
Personal injury	10,000,000
Employer benefits liability	10,000,000
Failure to supply	10,000,000
Limited pollution	10,000,000
Aggregate coverage	20,000,000
Building and contents	3,792,600
Public officials liability	10,000,000
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 2002 and 2001, \$561,000 and \$500,000, respectively, 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, 2002 and 2001

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, 2002 and 2001:

	<u>2002</u>	<u>2001</u>
Unrestricted	\$ 2,481,976	1,345,211
Restricted for capital improvements	2,862,416	2,773,898
Restricted - Retainage and construction performance bonds	<u>14,817</u>	<u>19,681</u>
	5,359,209	4,138,790
 Investment in STIP	 <u>774,722</u>	 <u>752,348</u>
 Total cash and investments	 \$ <u>6,133,931</u>	 <u>4,891,138</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>
2002 - Cash and cash equivalents \$	<u>69,455</u>	<u>-</u>	<u>5,289,754</u>	\$ <u>5,359,209</u>
2001 - Cash and cash equivalents \$	<u>91,451</u>	<u>-</u>	<u>4,047,339</u>	\$ <u>4,138,790</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2002 and 2001

3. CHANGES IN FIXED ASSETS

	<u>Balance</u> <u>7/1/01</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>6/30/02</u>
Land	\$ 616,604	-	-	616,604
Sewer plant assets	2,685,857	4,292	-	2,690,149
Sewer systems/extensions	936,532	652,633	-	1,589,165
Sewer outfall line	940,303	-	-	940,303
Storage ponds	2,413,374	-	-	2,413,374
Storage maintenance building	167,911	-	-	167,911
Irrigation system	1,742,431	2,709	-	1,745,140
Treatment plant	1,872,587	795,318	-	2,667,905
Snowmaking project	355,000	-	(64,550)	290,450
Office building	458,199	454	-	458,653
Vehicles	114,965	-	-	114,965
Furniture and fixtures	36,913	8,105	-	45,018
Computer equipment and software	40,564	12,524	(9,797)	43,291
Water plant contributions	125,522	-	-	125,522
Water plant structures and improvements	83,093	135,236	-	218,329
Wells and springs	754,817	-	-	754,817
Supply mains	52,997	2,160	-	55,157
Pumping equipment	64,090	8,440	-	72,530
Distribution reservoirs	126,775	-	-	126,775
Transmission and distribution	572,412	-	-	572,412
Meters and hydrants	39,344	65,903	-	105,247
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	719,636	540,812	-	1,260,448
Water meters	<u>109,612</u>	<u>284,340</u>	<u>-</u>	<u>393,952</u>
Total	\$ <u>15,530,449</u>	<u>2,512,926</u>	<u>(74,347)</u>	<u>17,969,028</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2002 and 2001

4. LEASE AGREEMENTS

- a. 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 Conesco calling for 24 payments of \$368 each. This lease was paid off in September, 2001.
- b. 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 2002.
- c. 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%.

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

	Total Future Minimum <u>Lease Payment</u>	Less - Amount Representing <u>Interest</u>	Net Future Minimum <u>Lease Payment</u>
2002	\$ 382	49	333
2003	-	-	-
2004	-	-	-
2005	-	-	-
2006	-	-	-
Thereafter	-	-	-
	\$ <u>382</u>	<u>49</u>	<u>333</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2002 and 2001

5. OUTSTANDING DEBT

The following is a summary of long-term debt at June 30, 2002 and 2001:

	<u>2002</u>	<u>2001</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, 2002 was 4.75%.	\$ 3,823	7,487

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, 2002 was 4.50%	190,687	196,397
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General Obligation Bonds

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.	3,942,000	4,239,000
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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>317,000</u>	<u>340,500</u>
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	4,453,510	4,783,384
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Less: current portion	<u>(345,587)</u>	<u>(327,570)</u>
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	<u>\$ 4,107,923</u>	<u>4,455,814</u>
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BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2002 and 2001

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, 2002

	<u>Beginning Of Year</u>	<u>Additions</u>	<u>Reductions</u>	<u>End of Year</u>
State Revolving Loan #1	\$ 4,239,000	-	297,000	3,942,000
State Revolving Loan #2	<u>340,500</u>	<u>-</u>	<u>23,500</u>	<u>317,000</u>
	<u>\$ 4,579,500</u>	<u>-</u>	<u>320,500</u>	<u>4,259,000</u>

June 30, 2001

State Revolving Loan #1	\$ 4,524,000	-	285,000	4,239,000
State Revolving Loan #2	<u>363,000</u>	<u>-</u>	<u>22,500</u>	<u>340,500</u>
	<u>\$ 4,887,000</u>	<u>-</u>	<u>307,500</u>	<u>4,579,500</u>

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

2003	\$ 345,190
2004	355,730
2005	371,153
2006	385,573
2007	401,013
Thereafter	<u>2,594,851</u>
Total	<u>\$ 4,453,510</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2002 and 2001

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, 2002 and 2001.

6. CONTRIBUTED CAPITAL

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. RETAINED EARNINGS - RESTRICTED

Retained earnings have been restricted/reserved as follows:

	<u>2002</u>	<u>2001</u>
Reserved for retainages payable	\$ 14,817	19,681
Restricted for capital outlay	<u>2,862,416</u>	<u>2,773,898</u>
	\$ <u>2,877,233</u>	<u>2,793,579</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2002 and 2001

8. 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.

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 - 2002	6.8%	6.9%	.1%	13.8%
PERS - 2001	6.8%	6.9%	.1%	13.8%

The amounts contributed to the plan during the year ended June 30, 2002 and 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>
2002	\$ 259,724	17,661	17,921	35,582
2001	236,407	16,076	16,312	32,388
2000	234,171	15,924	16,158	32,082

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2002 and 2001

9. 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, 2002. The claims payable had the following activity:

	<u>Beginning Liability</u>	<u>Estimated Accrual</u>	<u>Claims Paid</u>	<u>Ending Liability</u>
2001	\$ 18,512	13,353	1,055	30,810
2002	30,810	14,759	17,862	27,707

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 met the State's compliance requirements through June 30, 2002.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2002 and 2001

9. 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 \$2,000,000 at June 30, 2002 and \$2,505,177 at June 30, 2001 is offset by deferred revenue of \$2,000,000 at June 30, 2002 and \$2,250,000 at June 30, 2001. \$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. In November, 2001, this case was settled for \$78,000 of which \$50,000 was covered by the District's insurance.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2002 and 2001

9. COMMITMENTS AND CONTINGENCIES (Continued)

Greater Yellowstone Coalition, et al. v. Montana Department of Environmental Quality, Mark Simonich, Big Sky Water & Sewer District No. 363, (Montana Eighteenth Judicial District, Gallatin County, Cause No. DV-99-123.)

This action was brought by the Plaintiffs challenging the approval process of the Department of Environmental Quality in the issuance of a 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. On April 18, 2001, this case was stayed by the Court pending negotiations between WSD No. 363 and the Yellowstone Mountain Club for an agreement that would, in part, allow WSD No. 363 to dispose of treated wastewater through irrigation on real property owned by the Yellowstone Mountain Club and eliminate direct discharge to the Gallatin River. WSD No. 363's right to dispose of treated wastewater on Yellowstone Mountain Club real property was contingent upon voter approval of WSD No. 373's annexation of Yellowstone Mountain Club real property and voter approval of the bond financing necessary for the improvements required by the agreement. In the spring of 2002, the voters approved the annexation and the bond financing. The agreement between WSD No. 363 and Yellowstone Mountain Club has thus become final. This case is ready to be dismissed. At the request of Ron Edwards, General Manager of WSD, counsel for WSD is waiting to sign the Stipulation for Dismissal of this action until the contracts for the construction of the water and sewer improvements have been awarded. Counsel anticipated that the Stipulation for Dismissal and Order of Dismissal will be filed in this matter in approximately one hundred twenty (120) days.

Hall v. John Kircher, Boyne USA, Inc. and Big Sky County Water and Sewer District No. 363, (Montana Eighteenth Judicial District Court, Gallatin County, Cause No. DV-99-420.)

This declaratory judgment action was brought by the Plaintiff to dispute the imposition by WSD No. 363 of a surcharge of \$3,500.00 per SFE on a certain tract of land pursuant to the July 27, 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 filed a counter claim for declaratory judgment against Plaintiff Sarah Hall and Defendant Boyne USA, Inc. This case has been settled, though the parties are still drafting the actual settlement agreement.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2002 and 2001

9. COMMITMENTS AND CONTINGENCIES (Continued)

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. This agreement was still in effect as of June 30, 2002. However, on September 4, 2002, the District notified West Berlin Developers of its intent to cancel the agreement. The Developers have two years to find other means of attaining water and sewer services.

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.

Remaining Balance on Engineering Contract

As of June 30, 2002, the District is obligated to pay the following balances on engineering contracts not yet completed:

Allied Engineering Services, Inc.	\$ 26,804
HKM Engineering	667,914
Morrison-Maierle, Inc.	<u>1,110</u>
Total	\$ <u>695,828</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2002 and 2001

10. RELATED PARTY TRANSACTIONS

Packy Cronin and Skip Radick, Board members, are involved in the South Fork Development and The Pines/Deer Run Development, respectively.

11. 2001 RESTATEMENT

Classification of restricted assets, net assets, and contributed capital were re-stated to comply with current classification criteria.

**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, 2002, and have issued our report thereon dated August 8, 2002. 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 State of Montana, 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 8, 2002

INDEPENDENT AUDITORS' REPORT ON
SUMMARY OF PRIOR AUDIT FINDINGS

NONE