

ORIGINAL

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

FINANCIAL STATEMENTS

JUNE 30, 2003 and 2002

Knaub & Company, P.C.

Certified Public Accountants

2066 Stadium Drive #102

Bozeman, Montana 59715

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

JUNE 30, 2003

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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, 2003 and 2002, 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, 2003 and 2002, 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 September 4, 2003 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.

September 4, 2003

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

BALANCE SHEETS

JUNE 30, 2003 AND 2002

ASSETS

	6-30-03	6-30-02
Current assets:		
Cash and investments	\$ 2,758,263	3,256,698
Accounts receivable	496,648	589,178
Prepaid expenses	15,838	18,473
Boyne settlement - current portion	500,000	250,000
Notes receivable - current portion	2,518	2,178
Total current assets	3,773,267	4,116,527
Restricted cash and cash equivalents:		
Restricted for future capital improvements	1,644,893	2,862,416
Retainage accounts	332,939	14,817
Total restricted cash and cash equivalents	1,977,832	2,877,233
Property and equipment, at cost:		
Fixed Assets - Sewer	21,216,034	13,673,957
Fixed Assets - Water	7,176,557	4,295,071
	28,392,591	17,969,028
Less: accumulated depreciation	(4,694,958)	(4,133,535)
Total property and equipment	23,697,633	13,835,493
Other assets:		
Notes receivable	132,082	136,357
Less: current portion	(2,518)	(2,178)
Boyne settlement receivable	2,000,000	2,000,000
Less: current portion	(500,000)	(250,000)
Total other assets	1,629,564	1,884,179
TOTAL ASSETS	\$ 31,078,296	22,713,432

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

BALANCE SHEETS (Continued)

JUNE 30, 2003 AND 2002

LIABILITIES AND FUND EQUITY

	6-30-03	6-30-02
Current liabilities:		
Accounts payable	\$ 158,103	301,629
Retainages payable	46,152	7,628
Performance bonds payable	312,689	7,689
Compensated absences payable	37,007	23,218
Accrued health insurance claims payable	22,851	27,707
Current portion of long-term debt	541,014	345,920
Total current liabilities	1,117,816	713,791
Long-term liabilities:		
Deferred revenue	1,882,082	2,139,125
Interkap loan	0	3,823
State revolving fund loans	8,104,354	4,259,000
Computer leases	0	333
Office building loan	182,585	190,687
Backhoe loan	68,821	0
Less: current portion of long-term debt	(541,014)	(345,920)
Total long-term liabilities	9,696,828	6,247,048
Fund equity:		
Contributed capital - unrestricted	3,363,110	3,363,110
Contributed capital - RID assets	885,272	885,272
Retained earnings - unrestricted	14,037,438	8,626,978
Retained earnings - restricted	1,977,832	2,877,233
Total fund equity	20,263,652	15,752,593
TOTAL LIABILITIES AND FUND EQUITY	\$ 31,078,296	22,713,432

(Concluded)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUE AND EXPENSES

FOR THE YEARS ENDED JUNE 30, 2003 AND 2002

	6-30-03	6-30-02
OPERATING REVENUE:		
Sewer services	\$ 1,036,906	992,178
Water services	640,367	707,872
 Gross operating revenue	 1,677,273	 1,700,050
 OPERATING EXPENSES:		
General and administrative:		
Meetings	1,068	787
Directors' expense	4,450	2,809
Salaries	146,980	142,640
Payroll taxes and benefits	53,892	45,683
Utilities	3,217	3,371
Janitorial	3,436	3,211
Computer software	3,263	1,605
Office supplies and expense	9,486	8,127
Telephone	5,600	4,607
Postage and shipping	7,994	6,809
Printing	-	670
Advertising	673	76
Insurance	45,451	41,138
Dues and subscriptions	948	935
Election expenses	-	164
Vehicle expenses	4,554	2,454
Interest expense	10	381
Legal fees	14,095	18,023
Computer maintenance	3,842	3,825
Audit expense	5,890	4,700
Bank service charges	629	525
State annual filing fee	675	675
Miscellaneous	1,076	1,456
Other consulting fees	559	2,861
Office building repair & maintenance	1,450	1,546
 Total general and administrative	 319,238	 299,078

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUE AND EXPENSES

FOR THE YEARS ENDED JUNE 30, 2003 AND 2002

OPERATING EXPENSES (Continued):

	6-30-03	6-30-02
Sewer general and administrative:		
Salaries	71,772	62,409
Payroll taxes and employee benefits	24,845	18,829
Dues and subscriptions	148	148
Telephone	2,413	2,803
Office supplies	23	413
Publications	50	-
Total sewer general and administrative	99,251	84,602
Sewer Plant Expense:		
Fuel - equipment & vehicles	4,512	3,800
Vehicle repair and maintenance	2,051	1,766
Insurance	1,148	1,100
Utilities	46,712	46,686
Chemicals	35,166	28,172
Stream water quality monitoring	1,955	3,214
Waste water monitoring	13,182	12,755
Equipment rental	120	645
Safety equipment	261	418
Operating supplies	469	795
Sewer repairs and maintenance	9,044	3,870
Backhoe rent	-	5,406
Maintenance	13,326	15,673
Tools	901	1,312
Jetting	14,486	8,833
Video taping	3,869	164
Engineering	2,534	2,463
Miscellaneous	580	118
Depreciation expense	369,344	348,342
Total sewer plant expense	519,660	485,532

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUE AND EXPENSES

FOR THE YEARS ENDED JUNE 30, 2003 AND 2002

OPERATING EXPENSES (Continued)

	6-30-03	6-30-02
Water general and administrative:		
Salaries	67,472	61,606
Wages	7,846	5,771
Payroll taxes and employee benefits	25,324	22,231
Dues and subscriptions	862	724
Communications and telemetry equipment	1,616	2,203
Publications	452	216
Office supplies	-	229
Public water supply fees	3,400	3,232
Total water general and administrative	106,972	96,212
Water plant expense:		
Vehicle expenses	5,269	4,625
Fuel - equipment	414	318
Utilities	74,309	72,882
Lab fees	3,455	7,672
Equipment rental	86	222
Small equipment	982	233
Tools	-	2,989
Interest expense	90	327
Repairs and maintenance	41,062	40,228
Backhoe rent	-	5,406
Leak detection and engineering	7,206	5,141
Miscellaneous	581	188
Source water protection project	8,415	16,910
Depreciation	246,474	162,480
Water facilities plan	7,730	1,050
Total water plant expense	396,073	320,671
Total expenses	1,441,194	1,286,095
Operating income	236,079	413,955

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUE AND EXPENSES

FOR THE YEARS ENDED JUNE 30, 2003 AND 2002

NONOPERATING REVENUE (EXPENSES):	6-30-03	6-30-02
Other nonoperating revenue - Boyne well settlement	18,909	10
Rental income	600	650
Interest income - restricted	53,890	63,240
Interest income - unrestricted	60,021	-
Interest expense	(177,814)	(189,664)
Lawsuit settlement	-	(78,000)
Insurance reimbursement for lawsuit	-	50,000
Gain (loss) on disposition of assets	(300)	1,639
Total nonoperating revenue (expenses)	(44,694)	(152,125)
RESTRICTED REVENUE		
Restricted for bond payments	500,000	500,000
Restricted for capital improvements	950,037	1,169,129
Restricted for source water protection project	8,415	11,000
Total restricted revenue	1,458,452	1,680,129
Donated capital assets	2,861,222	1,193,444
NET INCOME	\$ 4,511,059	3,135,403

(Concluded)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF CHANGES IN FUND EQUITY

FOR THE YEARS ENDED JUNE 30, 2003 AND 2002

		Contributed Capital		Retained Earnings		Total
		Unrestricted	RID Assets	Unrestricted	Restricted	
Beginning balances, July 1, 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	\$	3,363,110	885,272	8,626,978	2,877,233	15,752,593
Net income		0	0	3,052,608	1,458,451	4,511,059
Satisfaction of restrictions		0	0	2,357,852	(2,357,852)	0
Ending balances, June 30, 2003	\$	3,363,110	885,272	14,037,438	1,977,832	20,263,652

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2003 AND 2002

CASH FLOWS FROM OPERATING ACTIVITIES:

	6-30-03	6-30-02
Operating income	\$ 236,079	413,955
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation	615,818	436,171
Interest expense	100	709
Gain (loss) on disposal of fixed assets	(300)	74,348
(Increase) decrease in current assets:		
Accounts receivable	92,530	173,503
Prepaid expenses	2,635	(2,773)
Other receivables	(250,000)	255,177
Increase (decrease) in current liabilities:		
Accounts payable	(143,526)	274,027
Retainages payable	38,524	5,043
Private contractor bonds	305,000	(8,906)
Payroll taxes payable	-	(3,120)
Compensated absences payable	13,789	-
Accrued health insurance claims payable	(4,856)	(3,103)
Deferred revenue collected	(7,043)	-
	662,671	1,201,076
Net cash provided by operating activities	898,750	1,615,031

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:

Interest paid		(709)
Other sewer nonoperating revenue	18,909	10
Rental income - lower level office	600	650
Lease deposits refunded	-	494
Lawsuit settlement	-	(78,000)
Insurance reimbursement for lawsuit	-	50,000
Net cash provided (used) from noncapital financial activities	19,509	(27,555)

CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:

Principal paid on long-term debt	(359,469)	(332,198)
Proceeds from long-term debt (SRF)	4,261,386	-
Interest paid	(177,913)	(189,664)
Resort tax revenue	508,415	561,000
Sewer plant investment fees	700,036	781,302
Boyer payment restricted for capital improvements	250,000	-
Proceeds from disposal of equipment	16,830	1,639
Acquisition of fixed assets	(7,633,566)	(1,319,482)
Payment received on notes receivable	4,275	1,653
Net cash flows provided (used) from capital financing activities	(2,430,006)	(495,750)

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF CASH FLOWS (Continued)

FOR THE YEARS ENDED JUNE 30, 2003 AND 2002

	6-30-03	6-30-02
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest income	113,911	151,067
Net cash provided by investing activities	113,911	151,067
Net increase in cash	(1,397,836)	1,242,793
Cash and cash equivalents, beginning of year	6,133,931	4,891,138
Cash and cash equivalents, end of year	\$ 4,736,095	6,133,931

Per balance sheet:

Unrestricted cash and cash equivalents	\$ 2,758,263	3,256,698
Restricted cash and cash equivalents	1,977,832	2,877,233
	\$ 4,736,095	6,133,931

Noncash transactions consist of the following:

Contributed capital from developers	\$ 2,861,222	\$ 1,193,444
Write off snowmaking project engineering fees	\$ -	346,711

(Concluded)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2003 and 2002

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, 2003 and 2002

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 income. 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, 2003 and 2002

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, 2003 and 2002

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	3,712,600
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 2003 and 2002, \$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, 2003 and 2002

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, 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Unrestricted	\$ 2,476,462	2,481,976
Restricted for capital improvements	1,644,893	2,862,416
Restricted - Retainage and construction performance bonds	<u>332,939</u>	<u>14,817</u>
	4,454,294	5,359,209
 Investment in STIP - unrestricted	<u>281,801</u>	<u>774,722</u>
 Total cash and investments	\$ <u>4,736,095</u>	<u>6,133,931</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>Total</u>
	<u>1</u>	<u>2</u>	<u>3</u>	
2003 - Cash and cash equivalents \$	<u>4,216</u>	<u>-</u>	<u>4,450,078</u>	\$ <u>4,454,294</u>
2002 - Cash and cash equivalents \$	<u>69,455</u>	<u>-</u>	<u>5,289,754</u>	\$ <u>5,359,209</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2003 and 2002

3. CHANGES IN FIXED ASSETS

		<u>Balance</u> <u>7/1/02</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>6/30/03</u>
Land	\$	611,604	451,434	0	1,063,038
Land easements		5,000	52,500	0	57,500
Office building		458,653	0	0	458,653
Sewer assets		12,601,603	4,851,827	(49,513)	17,403,917
Sewer construction in progress		0	2,290,426	0	2,290,426
Water assets		4,292,168	558,176	(21,712)	4,828,631
Water construction in progress		<u>0</u>	<u>2,290,426</u>	<u>0</u>	<u>2,290,426</u>
Total	\$	<u>17,969,028</u>	<u>10,494,789</u>	<u>(71,226)</u>	<u>28,392,591</u>

4. OUTSTANDING DEBT

The following is a summary of long-term debt at June 30, 2003 and 2002:

	<u>2003</u>	<u>2002</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%.	\$ 0	3,823
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%.	182,585	190,687
4.3% note payable to Caterpillar Financial Services Corporation for the purchase of a backhoe for \$83,032. Payable in 37 monthly payments of \$1,414 until July, 2005.	68,821	0

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2003 and 2002

4. OUTSTANDING DEBT (Continued)

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. 3,633,000 3,942,000

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. 293,000 317,000

4% State Revolving Fund (DNRC Revolving Loan Program) Series 2002 dated September 24, 2002 for \$7,000,000 for the purpose of constructing a wastewater treatment plant. Funds advanced as of June 30, 2003 totaled \$3,353,390. Payable in 40 semi-annual installments of approximately \$260,000 until July 1, 2023. 3,593,390 0

4% State Revolving Fund (DNRC Drinking Water Revolving Loan Program) Series 2002 dated September 24, 2002 for the purchase and installation of water meters. Payable in 42 semi-annual installments of approximately \$39,000 until July 1, 2023. 534,000 0

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2003 and 2002

4. OUTSTANDING DEBT (Continued)

4% State Revolving Fund (DNRC Drinking Water Revolving Loan Program) Series 2003 dated May 20, 2003 for the construction of a water tank. Total loan commitment \$1,966,000. Funds advanced as of June 30, 2003 totaled \$50,964. Payable in 42 semi-annual installments of approximately \$72,000 until July 1, 2024.

	<u>50,964</u>	<u>0</u>
	8,355,760	4,453,510
Less: current portion	<u>(541,014)</u>	<u>(345,587)</u>
	\$ <u><u>7,814,746</u></u>	<u><u>4,107,923</u></u>

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, 2003

	Balance <u>6/30/2002</u>	<u>Additions</u>	<u>Repayment</u>	Balance <u>6/30/2003</u>
State Revolving Loan #1	\$ 3,942,000	0	309,000	3,633,000
State Revolving Loan #2	317,000	0	24,000	293,000
SRF Treatment Plant	0	3,593,390	0	3,593,390
SRF Water Meters	0	534,000	0	534,000
SRF Water Tank	<u>0</u>	<u>50,964</u>	<u>0</u>	<u>50,964</u>
	\$ <u><u>4,259,000</u></u>	<u><u>4,178,354</u></u>	<u><u>333,000</u></u>	<u><u>8,104,354</u></u>

June 30, 2002

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><u>4,579,500</u></u>	<u><u>-</u></u>	<u><u>320,500</u></u>	<u><u>4,259,000</u></u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2003 and 2002

4. OUTSTANDING DEBT (Continued)

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

2004	\$	541,014
2005		670,028
2006		703,199
2007		689,013
2008		716,456
Thereafter		<u>5,036,050</u>
Total	\$	<u>8,355,760</u>

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, 2003 and 2002.

5. 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. Beginning in 2002, assets contributed by developers are recorded as income in accordance with GASB 33.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2003 and 2002

6. RETAINED EARNINGS - RESTRICTED

Retained earnings are restricted as follows:

	<u>2003</u>	<u>2002</u>
Restricted for retainages payable	\$ 332,939	14,817
Restricted for capital outlay	<u>1,644,893</u>	<u>2,862,416</u>
	\$ <u>1,977,832</u>	<u>2,877,233</u>

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.

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 - 2003	6.8%	6.9%	.1%	13.8%
PERS - 2002	6.8%	6.9%	.1%	13.8%

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2003 and 2002

8. RETIREMENT PLANS

The amounts contributed to the plan during the year ended June 30, 2003 and 2002, 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>
2003	\$ 269,426	18,321	18,590	36,911
2002	259,724	17,661	17,921	35,582
2001	236,407	16,076	16,312	32,388

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 claims payable had the following activity:

	<u>Beginning Liability</u>	<u>Estimated Accrual</u>	<u>Claims Paid</u>	<u>Ending Liability</u>
2002	\$ 30,810	14,759	17,862	27,707
2003	\$ 27,707	14,717	19,573	22,851

Compensated Absences

Employees accrue vacation time at 10 hours per month (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 calendar year or be forfeited.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2003 and 2002

9. COMMITMENTS AND CONTINGENCIES (Continued)

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 amendment #5 dated November 13, 2002, the wastewater treatment plant must be completed by September 30, 2004. The District met the State's compliance requirements through June 30, 2003.

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 \$1,750,000 at June 30, 2003 and 2002 is offset by deferred revenue of \$1,750,000 at June 30, 2003 and \$2,000,000 at June 30, 2002. The \$250,000 payment due April 1, 2003 has not yet been paid. Interest is accruing at 10% and a demand letter has been sent.

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.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2003 and 2002

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 has not been dismissed but has been inactive for approximately two (2) years. The 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. 363'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. In addition, installation of the physical infrastructure (pipes, pumps, etc.) for transferring the treated wastewater from the treatment facilities to the Yellowstone Mountain Club disposal site has been started and should be completed within a year or two.

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 64.1 SFEs appurtenant to certain tract of land pursuant to the July 27, 1997 Settlement Agreement signed by Boyne USA and WSD No. 363. The total amount at issue is \$224,350.00. 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. An apparent settlement has been reached between the Plaintiff and Defendants Boyne USA and John Kircher. Defendants Boyne USA and John Kircher claim that WSD No. 363 is bound by their settlement with the Plaintiff. WSD No. 363 denies it is bound by the settlement. WSD No. 363's liability exposure in this case, however, is limited to its attorney's fees and costs, because even if the Plaintiff is not required to pay the surcharges, Boyne USA remains contractually obligated under the terms of the July 27, 1997 Settlement Agreement.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2003 and 2002

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, 2003, the District is obligated to pay the following balances on engineering contracts not yet completed:

Allied Engineering Services, Inc.	\$ 48,532
HKM Engineering	<u>465,768</u>
Total	\$ <u>514,300</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2003 and 2002

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.

**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, 2003, and have issued our report thereon dated September 4, 2003. 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.

September 4, 2003

AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL
CONTROL OVER COMPLIANCE IN ACCORDANCE WITH
OMB CIRCULAR A-133

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

Compliance

We have audited the compliance of Big Sky Water & Sewer District No. 363 (the District), with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2003. The District's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the District's management. Our responsibility is to express an opinion on the District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the District's compliance with those requirements.

In our opinion, Big Sky County Water & Sewer District No. 363 complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003.

Internal Control Over Compliance

The management of the District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the District's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control 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 noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected with a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the audit committee, management, others within the organization, City Council, 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.

September 4, 2003

BIG SKY COUNTY WATER & SEWER DISTRICT #363

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE YEAR ENDED JUNE 30, 2003

Federal Grantor/Pass-through Grantor/Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures
<u>Office of Water, Environmental Protection Agency</u>			
Passed-through Montana Department of Natural Resources and Conservation:			
State Revolving Fund (DNRC Revolving Loan Program)			
- Wastewater treatment plant	66.458	SRF C301084-03	\$ 3,593,390
State Revolving Fund (DNRC Drinking Water Revolving Loan Program) - Water meters	66.458	SRF NWRF-03045	534,000
State Revolving Fund (DNRC Water Revolving Loan Program - Water tank	66.458	SRF WRF-03050	50,964
Total Federal Awards			\$ 4,178,354

NOTES TO SCHEDULE OF FEDERAL AWARDS

NOTE 1

The accompanying schedule of federal awards includes the federal grant activity of the Big Sky County Water & Sewer District No. 363 and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in or used in tax preparation of the basic financial statements.

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED JUNE 30, 2003

Section I - Summary of Auditors' Results

Financial Statements

Type of auditors' report issued	unqualified
Internal control over financial reporting:	
Material weakness identified?	no
Reportable conditions identified not considered to be material weaknesses?	none reported
Noncompliance material to financial statements noted?	no

Federal Awards

Internal control over major programs:	
Material weakness identified?	no
Reportable condition identified not considered to be material weaknesses?	none reported
Type of auditors' report issued on compliance for major programs:	unqualified
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a)?	no

Identification of major programs

66.458 Water Treatment Plant	\$ 3,593,390
66.458 Water Meters	\$ 534,000
66.458 Water Tank	\$ 40,964

Dollar threshold used to distinguish between Type A and Type B programs	\$ 300,000
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Auditee qualified as low-risk auditee?	no
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<u>Financial Statement Findings:</u>	none
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<u>Federal Award Findings and Questioned Costs:</u>	none
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COMMUNICATION WITH AUDIT COMMITTEE

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** (The District) for the year ended June 30, 2003, and have issued our report thereon dated September 4, 2003. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards and OMB Circular A-133

As stated in our engagement letter dated August 13, 2003, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting standards. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

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 opinion on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As a 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. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the District's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* applicable to each of its major federal programs for the purpose of expressing an opinion on the District's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the District's compliance with those requirements.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the District are described in Note 1 to the financial statements. The accounting policy for fixed asset capitalization was increased to \$5,000 during 2003. We noted no transactions entered into by the District during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

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

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the District's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the District, either individually or in the aggregate, indicate matters that could have a significant effect on the District's financial reporting process.

One audit adjustment was made to adjust the deferred revenue account for \$257,043.

There were three "passed adjustments" which were considered immaterial individually and in the aggregate and are detailed on the attached schedule.

Disagreements with Management

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

Consultations with Other Independent Accountants

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

Issues Discussed Prior to Retention of Independent Auditors

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

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit. We would like to commend the management of **BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363** for their conscientious effort during the year and throughout the audit.

This information is intended solely for the use of the Board of Directors and the management of **BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363** and is not intended to be and should not be used by anyone other than these specified parties.

Knaub & Company, P.C.

September 4, 2003

WP Ref	Account	A/C #	Debit	Credit	P&L Effect Dr. < Cr.
	P < 1 >				
F	Depn. expense		4882.00		4882.00
	Accum. Depn.			4882.00	
To adjust for error in recording to the schedule, Per Terry he forgot to change the number after he made a change.					
B/1p.2	P < 2 >				
	Water Misc. Income	3046		7058.00	7058
	AIR - water user fees	1222	7058.00		
To record Yellowstone Devel. water usage fees for 4/1/03-6/30/03.					
G-4	P < 3 >				
	Boyer settlement Receivable	1217	6164.10		
	Boyer Interest Income			6164.10	6164
to record interest (late fee) receivable from Boyer for late payment of annual \$250,000					
Immaterial individually & in the aggregate.					