

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

FINANCIAL STATEMENTS

JUNE 30, 2005 and 2004

Knaub & Company, P.C.
Certified Public Accountants

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

JUNE 30, 2005

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BIG SKY COUNTY WATER & SEWER DISTRICT No. 363

PO BOX 160670 • 561 LITTLE COYOTE RD • BIG SKY, MT 59716 • 406-995-2660 • FAX 406-995-3053 • Email - WSD363@GOMONTANA.COM

Management Discussion and Analysis Fiscal Year 7/1/2004 -6/30/2005

The District is accounted for as an enterprise. As a result, the accounting is much the same as a for profit organization with the exception of state and federal income tax. The District is tax exempt. The basic financial statements produced by the District include the Balance Sheet, Statement of Revenue and Expenses, Statement of Changes in Fund Equity and Statement of Cash Flows. Each statement contains vital financial information regarding the District's financial position and overall financial stability. The balance sheet contains the assets, liabilities, and fund equity. The statement of revenue and expenses contain the detail of revenue sources and the detail of where the revenue was expended to provide the water and sewer services to the District. The statement of changes in fund equity shows the restricted and unrestricted portion of retained earnings and contributed capital and the net income for the current period and the previous period. The statement of cash flows provides the detail of cash sources and uses for Operating Activities, Non-capital Financing Activities, Capital Financing Activities and Investing Activities.

The total assets and total liabilities of the District increased as a result of the expansion of both the sewer system and water system. The sewer capital assets of the district increased from \$29,340,658 to \$30,642,676. The water capital assets increased from \$10,328,510 to \$10,535,374. The District's other assets decreased from \$1,370,483 to \$1,103,800 primarily as a result of the payment made for the Boyne Annual Settlement Agreement. This agreement stipulates among other things that Boyne will make a \$250,000 payment each April 1, through the year 2010.

The total long-term liabilities of both systems increased from \$17,098,528 to \$18,727,643. The District used low interest rate loans from State Revolving Loan Fund to finance both the water and sewer projects. The State Revolving Loans increased from \$16,182,740 to \$17,052,711. The current liabilities of the District decreased from \$1,837,024 to \$1,367,968. This is a result of the decrease in the performance bonds and retainage payable to the contractors who worked on both the water and sewer projects.

Year	Total Assets	Growth Rate	Total Liabilities	Growth Rate
2001-2002	\$22,713,732	14.16%	\$6,960,839	-4.37%
2002-2003	\$31,078,296	36.83%	\$10,814,644	55.36%
2003-2004	\$41,378,423	33.14%	\$18,935,606	75.09%
2004-2005	\$43,206,751	4.42%	\$18,988,427	0.28%

The total operating revenues of the District increased to \$1,722,804 from \$1,438,382. The total sewer operating revenue was \$927,847. The total water operating revenue was \$794,957. The District has a plant investment charges on the sewer side but no plant investment charge on the water side.. The total nonoperating revenue (net expenses) of the District increased to \$1,711,383 from \$1,169,686. This was primarily due to the District's collection of additional plant investment charges, which increased from \$264,468 to \$897,989. The District received \$500,000 from the Big Sky Resort Tax Board for paying interest and principal on two of the State Revolving Fund loans for the sewer filter building and another \$170,000 for the State Revolving Fund loans for the new sewer treatment plant. The Big Sky Resort Tax



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Board also provided an additional \$30,000 for the water project State Revolving Fund loans used to build the new tank by Hidden Village and install the initial phase of the water meters. The District received \$250,000 from Boyne on their annual payment agreement. The District also collected \$454,888 in tax receipts for payments on the new State Revolving Loans used to finance the new water tank and sewer treatment plant. The total revenue of the District including non-operating revenues (net) was \$3,434,187.

The total operating expense for the District increased to \$1,838,606 from \$1,334,325. This was primarily a result of the depreciation of plant assets which increased from \$390,730 to \$669,098. The total general and administrative expense decreased to \$333,696 from \$336,372. The total sewer general and administrative increased to \$145,381 from \$115,234 due primarily to an additional sewer operator. Total sewer operation expense increased to \$800,271 from \$445,876. The total water general and administrative expense increased to \$158,198 from \$124,139 due primarily to additional staffing resources dedicated to the water system. The total water operation expense increased to \$401,060 from \$312,504. Both the water and sewer operating expense increases are due primarily to the increase in depreciation expense of the long-lived assets.

Year	Total Revenues	Growth Rate	Total Expenses	Growth Rate
2001-2002	\$3,228,054	31.49%	\$1,286,095	-8.05%
2002-2003	\$3,091,031	-4.24%	\$1,441,194	12.06%
2003-2004	\$2,608,068	-15.62%	\$1,334,325	-7.42%
2004-2005	\$3,434,187	31.68%	\$1,838,606	37.79%

The District received \$179,926 in donated capital assets. The donated capital assets are the water and sewer extensions as well as other infrastructure required to install and complete new construction projects and subdivisions within the District. All these assets were acquired by the District through formal transfer agreements recorded at the appropriate county office. The District also is given a one year warranty on these assets in most cases with a 10% deposit made by the developer. These assets are then recorded as either water or sewer assets on the books of the District and depreciated accordingly. The recorded value of these assets is then recognized as income in the year of acceptance.

The Districts overall financial position is stable with sufficient reserves and financing sources available to fund both the operating and non-operating activities of the District. The Districts operating revenue was insufficient to cover all operating expenses in fiscal 2004-2005 which were covered by reserves. The District is also expecting to use reserves for the fiscal year 2005-2006 in an effort to maintain rate stability. The District has had an extended period of positive operating results and will use these reserves to cover the current operating expenses that exceed revenues. The Board will continue to monitor the revenues and expenses on a monthly basis and will take appropriate action if warranted. The District has rate setting authority, so if the Board believes the current status will not change as expected, both water and sewer rates can be changed subsequent to a public hearing to insure sufficient operating revenue to cover operating expenses associated with both water and sewer operations.

In the non-operating category the increase has been in the State Revolving Fund Loans which are backed by general obligation bonds paid through a mill levy on the District property owners each year. As a



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result, the District's financial position is not adversely effected by the new debt. However, the District is attempting to minimize the tax borne by the District property owners by using other sources to fund the new State Revolving Fund loans. The two main other sources include plant investment fees paid by new construction within the District and Resort Tax Funds which are sales tax receipts collected by the Resort Tax Board and used for community projects. The growth in the District seems to be continuing at a healthy pace and both of these sources of revenue used to pay the State Revolving Fund loan payments should continue.

The budget for fiscal 2004-2005 at year-end did not have any significant negative variations with the exception of non-operating revenues. In the case of the non-operating revenues there was an increase in building projects causing a greater amount of plant investment fees collected than budgeted. This variance will have a positive impact on the Districts financial position. The operating loss was a result of approximately 98.21% of budgeted revenues being collected and approximately 106.40% of budgeted expenses paid. This resulted in an operating loss of \$115,802. As was stated earlier this will not cause any significant impact on the Districts ongoing financial ability to meet its financial obligations. Generally, the budget for 2004-2005 was met with the revenue and expense projections within a tolerable range from the actual expenses incurred to those budgeted. The new treatment plant which came on line in May 2004 will continue to be monitored closely to evaluate the expenses estimated by the District engineers and the actual expense incurred.

The District has incurred an additional \$1,791,971 in State Revolving Fund loan obligations to expand both the water and sewer systems. As mentioned earlier, these loans are secured by general obligation bonds. The District intends on maintaining a stable mill levy on the property in the District and utilize the available other resources to pay the principle and interest on these new loans. These loans will not impact planned future capital outlays. The District, and the District's engineers are working on new water supply projects to connect existing water supply systems for system redundancy. The District will consider all available financing sources. The financing options include, but are not limited to; additional low interest rate State Revolving Fund loans as well as current reserve funds. The District will communicate with the District property owners in 2006 with an update on the water project plan status.

The Districts current financial position is stable. There are no significant facts, decisions or conditions that are expected to have a significant effect on the financial position of the District or results of operations.

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, 2005 and 2004, 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, 2005 and 2004, and the results of its operations and cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on page 1 through 3 are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 21, 2005 on our consideration of the Big Sky County Water & Sewer District No. 363's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in

conjunction with this report in considering the results of our audits.

The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of Big Sky County Water & Sewer District No. 363. The schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Knaub & Company, P.C.

November 21, 2005

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

BALANCE SHEETS

JUNE 30, 2005 AND 2004

ASSETS

	<u>6-30-05</u>	<u>6-30-04</u>
Current assets:		
Cash and investments	\$ 3,290,690	2,970,381
Accounts receivable	473,335	384,918
Prepaid expenses	6,590	21,323
Water meter inventory	36,017	33,695
Boyne settlement - current portion	250,000	250,000
Notes receivable - current portion	3,000	6,081
Total current assets	<u>4,059,632</u>	<u>3,666,398</u>
Restricted cash and cash equivalents:		
Debt service fund	196	5,838
Restricted for future capital improvements	2,380,284	1,110,539
Retainage accounts	220,378	622,488
Total restricted cash and cash equivalents	<u>2,600,858</u>	<u>1,738,865</u>
Property and equipment, at cost:		
Fixed assets - sewer	30,642,676	29,340,658
Fixed assets - water	10,535,374	10,328,510
	41,178,050	39,669,168
Less: accumulated depreciation	(5,735,589)	(5,066,491)
Total property and equipment	<u>35,442,461</u>	<u>34,602,677</u>
Other assets:		
Notes receivable	106,800	126,564
Less: current portion	(3,000)	(6,081)
Boyne settlement receivable	1,250,000	1,500,000
Less: current portion	(250,000)	(250,000)
Total other assets	<u>1,103,800</u>	<u>1,370,483</u>
TOTAL ASSETS	<u>\$ 43,206,751</u>	<u>41,378,423</u>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

BALANCE SHEETS (Continued)

JUNE 30, 2005 AND 2004

LIABILITIES AND FUND EQUITY

	<u>6-30-05</u>	<u>6-30-04</u>
Current liabilities:		
Accounts payable and accrued expenses	\$ 66,298	160,868
Performance bonds and retainage payable	224,364	672,680
Compensated absences payable	52,213	44,177
Accrued health insurance claims payable	21,501	16,796
Current portion of long-term debt	<u>1,003,592</u>	<u>942,503</u>
Total current liabilities	<u>1,367,968</u>	<u>1,837,024</u>
Long-term liabilities:		
Deferred revenue	1,359,800	1,626,564
State revolving fund loans	17,052,711	16,182,740
Office building loan	171,768	177,143
Backhoe loan	39,772	54,638
Less: current portion of long-term debt	<u>(1,003,592)</u>	<u>(942,503)</u>
Total long-term liabilities	<u>17,620,459</u>	<u>17,098,582</u>
Net assets:		
Invested in capital assets, net of related debt	18,178,210	18,188,156
Unrestricted	3,435,466	2,471,442
Restricted for capital outlay	2,380,284	1,110,539
Restricted for retainage payable	<u>224,364</u>	<u>672,680</u>
Total fund equity	<u>24,218,324</u>	<u>22,442,817</u>
TOTAL LIABILITIES AND FUND EQUITY	<u>\$ 43,206,751</u>	<u>41,378,423</u>

(Concluded)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	<u>6-30-05</u>	<u>6-30-04</u>
OPERATING REVENUE:		
Sewer services	\$ 927,847	852,282
Water services	794,957	586,100
Gross operating revenue	<u>1,722,804</u>	<u>1,438,382</u>
OPERATING EXPENSES:		
General and administrative:		
Meetings	1,016	1,481
Directors' expense	2,656	4,908
Salaries	164,603	153,643
Payroll taxes and benefits	65,721	59,027
Utilities	3,331	4,018
Janitorial and carpet service	6,895	3,523
Computer software	7,316	5,498
Office supplies and expense	6,219	4,777
Telephone	5,377	5,235
Postage and shipping	8,643	8,134
Advertising	886	2,456
Insurance	35,746	51,534
Dues and subscriptions	1,018	655
Vehicle expenses	4,048	3,465
Legal fees	4,398	11,842
Computer maintenance	4,231	3,017
Audit expense	7,500	5,915
Bank service charges	207	703
State annual filing fee	675	675
Miscellaneous	1,267	1,331
GIS Mapping and other consulting fees	260	4,184
Office building repair & maintenance	1,683	551
Total general and administrative	<u>333,696</u>	<u>336,572</u>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

OPERATING EXPENSES (Continued):

	<u>6-30-05</u>	<u>6-30-04</u>
Sewer general and administrative:		
Salaries and wages	90,810	83,547
Payroll taxes and employee benefits	47,679	28,365
Dues and subscriptions	250	210
Telephone	4,244	2,692
Office supplies	2,117	420
Publications	281	-
	<hr/>	<hr/>
Total sewer general and administrative	145,381	115,234
	<hr/>	<hr/>
Sewer Plant Expense:		
Fuel - equipment & vehicles	11,094	3,920
Vehicle repair and maintenance	4,423	5,880
Vehicle insurance	1,508	1,422
Utilities	153,048	82,518
Chemicals	51,475	38,313
Stream water quality monitoring	2,998	1,383
Waste water monitoring	17,939	13,484
Lab testing equipment	-	421
Compost supplies	4,581	-
Safety equipment	3,960	1,829
Operating supplies	6,201	840
Discharge permit fees	750	750
Sewer repairs and maintenance	17,427	10,032
Treatment plant repairs and maintenance	12,276	-
Maintenance and repairs - building and grounds	22,934	21,852
Tools	5,472	1,393
Equipment rental	1,808	-
Jetting - sewer lines	14,369	15,073
Video taping	-	3,547
Engineering	5,027	5,902
Miscellaneous	714	699
Depreciation expense	462,267	236,618
	<hr/>	<hr/>
Total sewer plant expense	800,271	445,876
	<hr/>	<hr/>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

OPERATING EXPENSES (Continued)

	<u>6-30-05</u>	<u>6-30-04</u>
Water general and administrative:		
Salaries and wages	114,255	85,097
Payroll taxes and employee benefits	33,587	32,070
Dues and subscriptions	832	927
Telephone	3,057	1,941
Publications	-	344
Office supplies	1,000	158
Public water supply fees	<u>5,467</u>	<u>3,602</u>
Total water general and administrative	<u>158,198</u>	<u>124,139</u>
Water plant expense:		
Vehicle expenses	8,705	6,398
Fuel - equipment	484	1,661
Utilities and garbage	87,350	83,478
Lab fees	6,098	2,158
Equipment rental	705	675
Small equipment	31	2,388
Tools	-	1,705
Repairs and maintenance	56,377	48,716
Miscellaneous	2,576	699
Special projects	26,930	4,560
Depreciation	206,831	154,112
Professional services	<u>4,973</u>	<u>5,954</u>
Total water plant expense	<u>401,060</u>	<u>312,504</u>
Total expenses	<u>1,838,606</u>	<u>1,334,325</u>
Operating income (loss)	<u>(115,802)</u>	<u>104,057</u>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	<u>6-30-05</u>	<u>6-30-04</u>
NONOPERATING REVENUE (EXPENSES):		
Other nonoperating revenue	355	54,275
Rental income	600	600
Interest income - restricted	28,855	29,638
Interest income - unrestricted	60,338	38,126
Interest expense	(686,601)	(548,551)
Source water protection project	(3,868)	(4,959)
Restricted for bond payments	670,000	500,000
Tax receipts for bond payments	454,888	515,264
Restricted for capital improvements	1,147,989	514,468
Other restricted resort tax funds	38,827	83,400
Loss on disposition of assets	-	(12,575)
Total nonoperating revenue (expenses)	<u>1,711,383</u>	<u>1,169,686</u>
 Donated capital assets	 <u>179,926</u>	 <u>905,422</u>
 CHANGE IN NET ASSETS	 1,775,507	 2,179,165
 NET ASSETS, beginning of year	 <u>22,442,817</u>	 <u>20,263,652</u>
 NET ASSETS, end of year	 \$ <u>24,218,324</u>	 <u>22,442,817</u>

(Concluded)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	<u>6-30-05</u>	<u>6-30-04</u>
Increase (Decrease) in Cash and Cash Equivalents:		
CASH FLOWS FROM OPERATIONS:		
Receipts from customers	\$ 1,634,387	1,787,537
Payments to suppliers	(1,200,092)	(229,940)
Payments to employees	<u>(503,914)</u>	<u>(440,634)</u>
Net cash provided (used) by operating activities	<u>(69,619)</u>	<u>1,116,963</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Other sewer non-operating revenue	355	54,275
Source water protection project	(3,868)	(4,959)
Rental income - lower office	<u>600</u>	<u>600</u>
Net cash provided (used) by noncapital financing activities	<u>(2,913)</u>	<u>49,916</u>
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:		
Principal paid on long-term debt	(942,241)	(842,625)
Proceeds from long-term debt (SRF)	1,791,971	8,901,386
Interest paid	(686,601)	(548,551)
Resort tax revenue	708,827	583,400
Sewer plant investment fees	897,989	264,468
Boyne payment restricted for capital improvements	250,000	250,000
Tax receipts for bond payments	454,888	515,264
Proceeds from disposal of fixed assets	0	12,575
Acquisition of fixed assets	(1,328,956)	(10,402,927)
Payment received on notes receivable	<u>19,764</u>	<u>5,518</u>
Net cash flows provided by (used) in capital financing activities	<u>1,165,641</u>	<u>(1,261,492)</u>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENTS OF CASH FLOWS (Continued)

FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	<u>6-30-05</u>	<u>6-30-04</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest income	89,193	67,764
Net cash provided by investing activities	89,193	67,764
Net increase (decrease) in cash	1,182,302	(26,849)
Cash and cash equivalents, beginning of year	4,709,246	4,736,095
Cash and cash equivalents, end of year	\$ <u>5,891,548</u>	<u>4,709,246</u>
As reported in the accompanying balance sheet:		
Unrestricted cash and cash equivalents	\$ 3,290,690	2,970,381
Restricted cash and cash equivalents	<u>2,600,858</u>	<u>1,738,865</u>
	\$ <u>5,891,548</u>	<u>4,709,246</u>
Noncash transactions consist of the following:		
Contributed capital from developers	\$ <u>179,926</u>	\$ <u>905,422</u>

(Continued)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363
STATEMENTS OF CASH FLOWS - INDIRECT WORKSHEET
FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

	<u>6-30-05</u>	<u>6-30-04</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income (loss)	\$ (115,802)	104,057
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation	669,098	390,730
Interest expense	-	0
Gain (loss) on disposal of fixed assets	0	(12,575)
(Increase) decrease in current assets:		
Accounts receivable	(88,417)	111,730
Prepaid expenses	14,733	(5,485)
Water meter inventory	(2,322)	(33,695)
Other receivables	0	250,000
Increase (decrease) in current liabilities:		
Accounts payable	(94,570)	2,765
Retainages payable	(448,316)	313,839
Compensated absences payable	8,036	7,170
Accrued health insurance claims payable	4,705	(6,055)
Deferred revenue collected	(16,764)	(5,518)
	<u>46,183</u>	<u>1,012,906</u>
Net cash provided by operating activities	\$ <u>(69,619)</u>	\$ <u>1,116,963</u>

(Concluded)

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005 and 2004

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 2,400 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.

GASB 34 was implemented for the year ended June 30, 2004.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2005 and 2004

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 - 75 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, 2005 and 2004

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. Most of the accounts have been converted 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, 2005 and 2004

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 years 2005 and 2004, \$500,000, each year, 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, 2005 and 2004

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, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Unrestricted	\$ 2,999,211	2,685,450
Debt service fund	196	5,838
Restricted for capital improvements	2,380,284	1,110,539
Restricted - Retainage and construction performance bonds	<u>220,378</u>	<u>622,488</u>
	5,600,069	4,424,315
Investment in STIP - unrestricted	<u>291,479</u>	<u>284,931</u>
Total cash and investments	\$ <u>5,891,548</u>	<u>4,709,246</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>
2005 - Cash and cash equivalents \$	<u>205</u>	<u>-</u>	<u>5,599,864</u>	<u>5,600,069</u>
2004 - Cash and cash equivalents \$	<u>205</u>	<u>-</u>	<u>4,424,110</u>	<u>4,424,315</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363**NOTES TO FINANCIAL STATEMENTS (Continued)****JUNE 30, 2005 and 2004****3. CHANGES IN CAPITAL ASSETS**

	<u>Balance</u> <u>7/1/04</u>	<u>Additions</u>	<u>Retirements</u>	<u>Transfers</u>	<u>Balance</u> <u>6/30/05</u>
Land	\$ 1,063,038	-	-	-	1,063,038
Land easements	58,117	-	-	-	58,117
Office building	458,653	-	-	-	458,653
Sewer infrastructure	14,228,996	177,417	-	-	14,406,413
Sewer construction in progress	13,589,971	1,124,600	-	-	14,714,571
Water infrastructure	7,377,858	112,500	-	-	7,490,358
Water construction in progress	<u>2,892,535</u>	<u>94,365</u>	<u>-</u>	<u>-</u>	<u>2,986,900</u>
Total	39,669,168	1,508,882	-	-	41,178,050
Accumulated depreciation	<u>(5,066,491)</u>	<u>669,098</u>	<u>-</u>	<u>-</u>	<u>(5,735,589)</u>
Net capital assets	<u>34,602,677</u>	<u>839,784</u>	<u>-</u>	<u>-</u>	<u>35,442,461</u>

4. OUTSTANDING DEBT

The following is a summary of long-term debt at June 30, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
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 \$1,048 over 25 years. The rate at June 30, 2004 was 4.0%.	\$ 171,768	177,143
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, with a final balloon payment of \$39,772 due in July, 2005.	39,772	54,638
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.	2,977,000	3,312,000

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2005 and 2004

4. OUTSTANDING DEBT (Continued)

<u>General Obligation Bonds</u>	<u>2005</u>	<u>2004</u>
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.	240,000	267,000
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, 2005 totaled \$6,766,000. Payable in 40 semi-annual installments of approximately \$260,000 until July 1, 2023.	6,522,000	6,766,000
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.	498,000	516,000
3.75% State of Montana General Obligation Bonds, Wastewater Revolving Fund Program totaling \$6,500,000, dated October 1, 2003 to finance construction of the water treatment plant. Payable in 40 installments of approximately \$232,000 until July 1, 2023. Amount advanced at June 30, 2005 was \$5,371,711.	4,915,711	3,443,374

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363**NOTES TO FINANCIAL STATEMENTS (Continued)****JUNE 30, 2005 and 2004****4. OUTSTANDING DEBT (Continued)**

	<u>2005</u>	<u>2004</u>
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, 2005 totaled \$1,966,000. Payable in 42 semi-annual installments of approximately \$72,000 until July 1, 2024.	<u>1,900,000</u> 17,264,251	<u>1,878,366</u> 16,414,521
Less: current portion	<u>(1,003,592)</u>	<u>(942,503)</u>
	<u>\$ 16,260,659</u>	<u>15,472,018</u>

The general obligation bonds are to be repaid semi-annually through 2013 with resort tax revenue appropriated to the District by the counties as well as the mill levy approved in 2004. 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, 2005

	<u>Balance</u> <u>6/30/2004</u>	<u>Additions</u>	<u>Repayment</u>	<u>Balance</u> <u>6/30/2005</u>	<u>Current</u> <u>Portion</u>
State Revolving Loan #1 \$	3,312,000	-	(335,000)	2,977,000	348,000
State Revolving Loan #2	267,000	-	(27,000)	240,000	28,000
SRF Treatment Plant	6,766,000	-	(244,000)	6,522,000	253,000
SRF Water Meters	516,000	-	(18,000)	498,000	20,000
SRF Water Tank	1,878,366	87,634	(66,000)	1,900,000	69,000
SRF Treatment Plant	- 3,443,374	1,704,337	(232,000)	4,915,711	240,000
Backhoe	54,638	-	(14,866)	39,772	39,772
American Bank Off. Bldg.	<u>177,143</u>	<u>-</u>	<u>(5,375)</u>	<u>171,768</u>	<u>5,820</u>
	<u>\$ 16,414,521</u>	<u>1,791,971</u>	<u>(942,241)</u>	<u>17,264,251</u>	<u>1,003,592</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2005 and 2004

4. OUTSTANDING DEBT (Continued)

June 30, 2004

	<u>Balance</u> <u>6/30/2003</u>	<u>Additions</u>	<u>Repayment</u>	<u>Balance</u> <u>6/30/2004</u>	<u>Current</u> <u>Portion</u>
State Revolving Loan #1 \$	3,633,000	-	(321,000)	3,312,000	335,000
State Revolving Loan #2	293,000	-	(26,000)	267,000	27,000
SRF Treatment Plant	3,593,390	3,406,610	(234,000)	6,766,000	244,000
SRF Water Meters	534,000	-	(18,000)	516,000	18,000
SRF Water Tank	50,964	1,827,402	-	1,878,366	66,000
SRF Treatment Plant	-	3,667,374	(224,000)	3,443,374	232,000
Backhoe	68,821	-	(14,183)	54,638	14,911
American Bank Off. Bldg.	<u>182,585</u>	<u>-</u>	<u>(5,442)</u>	<u>177,143</u>	<u>5,592</u>
	\$ <u>8,355,760</u>	<u>8,901,386</u>	<u>(842,625)</u>	<u>16,414,521</u>	<u>942,503</u>

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

	<u>Principal</u>	<u>Interest</u>
2006	\$ 1,003,592	709,753
2007	1,002,057	671,224
2008	1,039,304	631,387
2009	1,083,561	588,951
2010	1,126,828	493,747
2011-2015	5,030,546	2,130,759
2016-2020	4,674,064	1,186,545
2021-2025	<u>2,304,299</u>	<u>251,035</u>
Total	\$ <u>17,264,251</u>	<u>6,663,401</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2005 and 2004

4. 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, 2005 and 2004.

5. DEFERRED REVENUE

Changes in deferred revenue were as follows:

	<u>Balance</u> <u>6/30/04</u>	<u>Additions</u>	<u>Revenue</u> <u>Recognized</u>	<u>Balance</u> <u>6/30/05</u>
Boyne settlement	\$ 1,500,000	-	(250,000)	1,250,000
Big Sky Chapel	12,000	-	-	12,000
Farmhouse	<u>114,564</u>	<u>-</u>	<u>(16,764)</u>	<u>97,800</u>
	\$ <u>1,626,564</u>	<u>-</u>	<u>(266,764)</u>	<u>1,359,800</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2005 and 2004

5. DEFERRED REVENUE (Continued)

	<u>Balance</u> <u>6/30/03</u>	<u>Additions</u>	<u>Revenue</u> <u>Recognized</u>	<u>Balance</u> <u>6/30/04</u>
Boyne settlement	\$ 1,750,000	-	(250,000)	1,500,000
Big Sky Chapel	15,000	-	(3,000)	12,000
Farmhouse	<u>117,082</u>	<u>-</u>	<u>(2,518)</u>	<u>114,564</u>
	\$ <u>1,882,082</u>	<u>-</u>	<u>(255,518)</u>	<u>1,626,564</u>

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 before 2002. 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.

7. NET ASSETS - RESTRICTED

Retained earnings are restricted as follows:

	<u>2005</u>	<u>2004</u>
Restricted for retainage payable	\$ 224,364	672,680
Restricted for capital outlay	<u>2,380,284</u>	<u>1,110,539</u>
	<u>\$ 2,604,648</u>	<u>1,783,219</u>

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2005 and 2004

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 - 2005	6.8%	6.9%	.1%	13.8%
PERS - 2004	6.8%	6.9%	.1%	13.8%
PERS - 2003	6.8%	6.9%	.1%	13.8%

The amounts contributed to the plan during the year ended June 30, 2005 and 2004, 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>
2005	\$ 359,301	24,433	24,792	49,225
2004	295,484	20,093	20,388	40,481
2003	269,426	18,321	18,590	36,911

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2005 and 2004

9. COMMITMENTS AND CONTINGENCIES

Employee Health Insurance

The District carries outside health insurance for its employees which pays 60% of covered medical expenses. The District pays an additional \$2,500 of covered expenses for each employee. The maximum risk the District faces is \$2,500 per employee, for a total of \$17,500. The claims payable had the following activity:

	<u>Beginning Liability</u>	<u>Estimated Accrual</u>	<u>Claims Paid</u>	<u>Ending Liability</u>
2005	\$ 16,796	25,603	20,898	21,501
2004	22,851	15,606	21,661	16,796

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.

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, 2004 and 2005.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2005 and 2004

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 \$1,250,000 at June 30, 2005 and \$1,500,000 at June 30, 2004 is offset by deferred revenue of \$1,250,000 at June 30, 2005 and \$1,500,000 at June 30, 2004.

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.

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.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2005 and 2004

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.) (Continued)

Legal counsel for WSD No. 363 thinks that this case is ready to be dismissed. The contracts for the construction of the water and sewer improvements were awarded and the construction has been completed. It is unclear whether the Plaintiffs will make other requests before they will agree to dismiss this action. At this point, however, the District's liability exposure under the Plaintiffs' claims has generally been resolved.

Westland Enterprises, Inc. and Simkins Holdings, LLC v. Big Sky County Water & Sewer District No. 363 (Montana Eighteenth Judicial District Court, Gallatin County, Cause No. DV-04-331)

This declaratory judgment action was brought by the Plaintiffs to dispute certain vacant lot fees assessed by the District against real property owned by the Plaintiffs. The disputed fees total approximately \$18,000.00. The District has instructed this firm to vigorously defend the District from the claims made by the Plaintiffs. The District believes its vacant lot fees are legal and valid under the applicable Montana statutes. The District's liability exposure in this law suit could exceed \$18,000.00 if the Plaintiffs are successful with their declaratory judgment claim, and the Court consequently orders the District to reimburse the Plaintiffs for their reasonable attorney's fees and costs.

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

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

NOTES TO FINANCIAL STATEMENTS (Continued)

JUNE 30, 2005 and 2004

9. COMMITMENTS AND CONTINGENCIES (Continued)

Obligation to Provide Future Sewer and Water Services (Continued)

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 Contracts

As of June 30, 2005, the District is obligated to pay the following balances on contracts not yet completed:

Bodell Construction Co.	\$ 59,943
HKM Engineering	<u>11,455</u>
Total	\$ <u>71,398</u>

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. Gary McRae is employed by Spanish Peaks Development, LLC.

**INDEPENDENT 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 County Water & Sewer District No. 363, with 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, 2005. Big Sky County Water & Sewer District No. 363's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of law, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Big Sky County Water & Sewer District No. 363 management. Our responsibility is to express an opinion on Big Sky County Water & Sewer District No. 363 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 Big Sky County Water & Sewer District No. 363'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 Big Sky County Water & Sewer District No. 363'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, 2005.

Internal Control Over Compliance

The management of Big Sky County Water & Sewer District No. 363, is responsible for establishing and maintaining effective internal control over compliance with requirements of law, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Big Sky County Water & Sewer District No. 363'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 reportable 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 caused by error or fraud that would be material in relation to a major federal program 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 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, 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.

November 21, 2005

BIG SKY COUNTY WATER & SEWER DISTRICT #363

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE YEAR ENDED JUNE 30, 2005

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Total Loan Award Amount</u>	<u>Federal Expenditures</u>
<u>Office of Water, Environmental Protection Agency</u>				
Passed-through Montana Department of Natural Resources and Conservation:				
State Revolving Fund (DNRC Water Revolving Loan Program - Water tank	66.458	SRF WRF-03050	1,966,000	1,966,000
State Revolving Fund (DNRC Drinking Water Revolving Loan Program Series 2003 - Wastewater Treatment Plant	66.458	SRF C-301184-04	6,500,000	5,147,711
Total Federal Awards			\$ 8,466,000	7,113,711

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 the 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, 2005

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	\$ 1,704,337
66.458 Water Tank	\$ 87,634

Dollar threshold used to distinguish between Type A and Type B programs	\$ 300,000
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Auditee qualified as low-risk auditee?	yes
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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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