

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

ANNUAL FINANCIAL REPORT

FOR THE YEAR ENDED JUNE 30, 2006

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

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CERTIFIED PUBLIC ACCOUNTANTS

MEMBERS OF CPA ASSOCIATES INTERNATIONAL, INC.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Big Sky County Water and Sewer District No. 363
Big Sky, Montana

We have audited the accompanying financial statements of the business-type activities of Big Sky County Water and Sewer District No. 363 as of and for the year ended June 30, 2006, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Big Sky County Water and Sewer District No. 363's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Big Sky County Water and Sewer District No. 363 as of June 30, 2006, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 6 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the required 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 September 18, 2006, on our consideration of the Big Sky County Water and Sewer District No. 363 internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That 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 audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Big Sky County Water and Sewer District No. 363 basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements of Big Sky County Water and Sewer District No. 363. The schedule of expenditures of federal awards has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Holmes & Turner

September 18, 2006



BIG SKY COUNTY WATER & SEWER DISTRICT No. 363

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Management's Discussion and Analysis Fiscal Year 7/1/2005 -6/30/2006

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 Statement of Net Assets, Statement of Revenue, Expenses, and Changes in Fund Net Assets and Statement of Cash Flows. Each statement contains vital financial information regarding the District's financial position and overall financial stability. The statement of net assets contains the assets, liabilities, and fund equity. The statement of revenue, expenses, and changes in fund net assets 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 as well as the beginning net asset and end of year net asset total. The statement of cash flows provides the detail of cash sources and uses for operating activities, capital and related 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 \$30,642,676 to \$30,877,505. The water capital assets increased from \$10,535,374 to \$11,530,099. The District's other assets decreased from \$1,103,800 to \$847,800 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 decreased from \$18,727,643 to \$16,746,731. The District used low interest rate loans from the State Revolving Loan Fund to finance both the water and sewer projects. The State Revolving Loans decreased from \$17,052,711 to \$16,429,514. The current liabilities of the District increased from \$260,784 to \$1,466,174. This is primarily the current portion of the long term debt \$1,002,057.

Year	Total Assets	Growth Rate	Total Liabilities	Growth Rate
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%
2005-2006	\$45,022,077	4.20%	\$18,212,905	-4.08%

The total operating revenues of the District increased to \$1,843,098 from \$1,722,804. The total sewer operating revenue was \$979,987. The total water operating revenue was \$863,111. The District has a plant investment charge on the sewer side but no plant investment charge on the water side. The total non-operating revenue (net expenses) of the District increased to \$2,228,523 from \$1,711,383. This was primarily due to the District's collection of additional plant investment charges, which increased from \$897,989 to \$1,357,528. 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 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 Resort Tax



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also provided funding of \$50,000 for the pond liner project. The District received \$250,000 from Boyne on their annual payment agreement. The District also collected \$540,294 in tax receipts for payments on the new State Revolving Loans used to finance the new water tank and sewer treatment plant.

The total operating expense for the District increased to \$2,215,545 from \$1,838,606. This was primarily a result of the write-off of the snowmaking project capital costs of \$290,450. The District invested in the snowmaking process for wastewater disposal prior to executing agreements with the Yellowstone Club in 2001, which among other terms, provides for wastewater disposal on their golf course property. The subsequent agreement, as well as other future disposal sites, has rendered this disposal method for the District obsolete. The total general and administrative expense increased to \$341,853 from \$333,696. The total sewer general and administrative increased to \$175,366 from \$145,381 due primarily to an additional sewer operator for a full fiscal year. Total sewer operation expense increased to \$1,101,657 from \$800,271 as a result of the snowmaking project write-off. The total water general and administrative expense increased to \$160,671 from \$158,198. The total water operation expense increased to \$435,998 from \$401,060. Both the water and sewer operating expense increases are due primarily to the increase in depreciation expense of the long-lived assets and the snowmaking project write-off.

Year	Total Revenues	Growth Rate	Total Expenses	Growth Rate
2002-2003	\$3,091,031	-4.24%	\$1,619,308	4.22%
2003-2004	\$2,608,068	-15.62%	\$1,900,410	17.36%
2004-2005	\$3,434,187	31.68%	\$2,529,075	33.08%
2005-2006	\$4,755,185	38.47%	\$2,899,109	14.63%

The District received \$734,772 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 is also 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 recognized as income in the year of acceptance.

The District's total net assets at June 30, 2006 were \$26,809,172. The total amount includes \$19,233,701 in invested in capital assets, net of related debt, \$6,596,964 in unrestricted assets, and \$988,507 restricted for debt service. The total represents an increase of \$2,590,813 over the prior fiscal year total. The amount invested in capital assets, net of related debt increased by \$1,055,491 due to asset additions and contributions. The unrestricted net assets increased by \$781,215 due to additional plant investment income. The net assets restricted for debt service was not shown as an individual line item in last years' financial statements but is approximately the same as the prior year's debt service.

The District's 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 District's operating revenue was insufficient to cover all operating expenses in fiscal 2005-2006 which were covered by reserves.



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The District is also expecting to use reserves for the fiscal year 2006-2007 in an effort to continue the policy of rate stability. The District had an extended period of positive operating results through fiscal year 2003 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 decrease was 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. The District's loans are low interest rate loans between 3.75% and 4.00% resulting in significant principal reductions each year. The District's draws on the open Sewer State Revolving Loan did not exceed the principal payoff on the existing loans resulting in an overall decrease in the outstanding principal on all the loans. As a result, the District's financial position was not adversely affected by the new debt. The District is also attempting to minimize the tax born 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 for sewer projects 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 should continue to be used to pay the State Revolving Fund loan payments.

The budget for fiscal 2005-2006 at year-end did not have any significant negative variations with the exception of the snowmaking project write-off and 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 were budgeted for. This variance will have a positive impact on the District's financial position. The write-off of the snowmaking project was a non-cash event in this fiscal year and will not have any adverse effect in the future. The operating loss was a result of approximately 101.85% of budgeted revenues being collected and approximately 115.60% of budgeted expenses paid. This resulted in an operating loss of \$372,447. Since the majority of this loss was a result of the \$290,450 write-off of the snowmaking project, the impact will not jeopardize the District's ongoing ability to meet its financial obligations. Generally, the budget for 2005-2006 was met with the revenue and expense projections within a tolerable range from the actual expenses incurred to those budgeted.

The District drew an additional \$334,803 in State Revolving Fund loan obligations to expand the sewer systems. Even though this loan is not closed out, bi-annual payments must be made. As a result, the District paid down the principal on this particular loan by \$236,000 for a net increase of \$98,803 for this particular State Revolving Fund Loan. The District has a total of six State Revolving Fund Loans with an outstanding balance at fiscal year-end of \$17,431,571, including the current portion of the long-term debt. As mentioned earlier, these loans are secured by general obligation bonds. The District intends on maintaining a stable mill levy on property in the District and will utilize the available other resources to pay the principal and interest on these new loans. These loans will not impact planned future capital outlays.



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The District, and the District's engineer have started the new water supply projects to connect existing water supply systems for system redundancy. The District is using an inter-fund loan of \$2,500,000 from the sewer plant investment fund. These funds will finance the first phase of the project anticipating the funds loaned to the water system will be repaid by another State Revolving Fund Loan which will be applied for in fiscal 2006-2007. The District applied for Resort Tax Funding for the debt service on the new water system redundancy project for the 2006-2007 fiscal year, but the application was denied. The District will reapply for Resort Tax Funding in the 2007-2008 fiscal year. The District will be sending out information on the project in the Fall of 2006. The District property owners will be voting on the bonding issue in December of 2006.

The District's 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.

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363

STATEMENT OF NET ASSETS

JUNE 30, 2006

ASSETS

Current assets:

Cash and cash equivalents	\$ 6,068,897
Investments	304,088
Accounts receivable	486,625
Prepaid expenses	37,952
Water meter inventory	67,776
Boyne settlement - current portion	<u>250,000</u>

Total current assets 7,215,338

Restricted cash and cash equivalents:

Debt service fund	<u>988,507</u>
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Property and equipment, at cost:

Fixed assets - sewer	30,877,505
Fixed assets - water	<u>11,530,099</u>
	42,407,604
Less accumulated depreciation	<u>(6,437,172)</u>

Total property and equipment 35,970,432

Other assets:

Notes receivable	97,800
Boyne settlement receivable	1,000,000
Less: current portion	<u>(250,000)</u>

Total other assets 847,800

Total assets \$ 45,022,077

LIABILITIES AND FUND EQUITY

Current liabilities:

Accounts payable and accrued expenses	\$ 115,324
Performance bonds and retainage payable	348,793
Accrued health insurance claims payable	-
Current portion of long-term debt	<u>1,002,057</u>

Total current liabilities	<u>1,466,174</u>
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Long-term liabilities:

Deferred revenue	1,097,800
Compensated absences payable	54,602
General obligation bonds	16,429,514
Office building loan	166,872
Less: current portion of long-term debt	<u>(1,002,057)</u>

Total long-term liabilities	<u>16,746,731</u>
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Total liabilities	<u>18,212,905</u>
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Net assets:

Invested in capital assets, net of related debt	19,223,701
Unrestricted	6,596,964
Restricted for debt service	<u>988,507</u>

Total fund equity	<u>26,809,172</u>
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Total liabilities and fund equity	<u><u>\$ 45,022,077</u></u>
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See accompanying notes to financial statements

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2006

Operating revenues:

Sewer services	\$ 979,987
Water services	<u>863,111</u>

Total operating revenue	<u>1,843,098</u>
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Operating expenses:

General and administrative:

Meetings	1,651
Directors' expense	2,776
Salaries	166,966
Payroll taxes and benefits	24,696
Utilities	3,725
Janitorial and carpet services	7,725
Computer software	-
Office supplies and expense	11,746
Telephone	4,131
Postage and shipping	7,616
Advertising	585
Insurance	63,913
Dues and subscriptions	1,135
Vehicle expense	4,416
Legal fees	14,811
Computer maintenance	6,419
Audit expense	9,500
Bank service charges	235
State annual filing fee	675
Miscellaneous	874
GIS mapping and other consulting fees	630
Office building repair & maintenance	3,823
Education expenses	1,925
Election fees	<u>1,880</u>

Total general and administrative	<u>341,853</u>
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Operating expenses (Continued):

Sewer general and administrative:

Salaries and wages	116,200
Workers' compensation	33,663
Payroll taxes and benefits	18,614
Dues and subscriptions	252
Telephone	4,261
Office supplies	319
Education expense	2,057

Total sewer general and administrative	175,366
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Sewer plant expense:

Fuel - equipment and vehicles	12,288
Vehicle repair and maintenance	5,357
Vehicle insurance	1,518
Utilities	128,003
Chemicals	61,305
Stream water quality monitoring	882
Waste water monitoring	16,066
Lab testing equipment	440
Lab fees	1,478
Compost supplies	14,859
Safety equipment	2,501
Operating supplies	489
Discharge permit fees	1,425
Sewer repairs and maintenance	4,786
Treatment plant repairs and maintenance	3,146
Maintenance and repairs - building and grounds	6,930
Tools	4,938
Equipment rental	148
Jetting - sewer lines	12,795
Engineering	5,735
Miscellaneous	714
Impairment loss	290,450
Depreciation expense	525,404

Total sewer plant expense	1,101,657
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(continued)

See accompanying notes to financial statements

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS (Continued)
FOR THE YEAR ENDED JUNE 30, 2006

Operating expenses (Continued):

Water general and administrative:

Salaries and wages	113,141
Workers' compensation	24,231
Payroll taxes and benefits	14,742
Dues and subscriptions	832
Telephone	2,990
Office supplies	33
Education expense	684
Public water supply fees	4,018

Total water general and administrative	<u>160,671</u>
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Water plant expense:

Fuel - equipment and vehicles	7,343
Vehicle repair and maintenance	5,463
Vehicle insurance	1,508
Utilities	92,219
Chemicals	1,069
Lab testing equipment	7
Lab fees	2,286
Safety equipment	180
Repairs and maintenance	78,648
Tools	3,969
Equipment rental	69
Small equipment	3,459
Special projects	14,195
Professional services	6,080
Miscellaneous	824
Depreciation expense	<u>218,679</u>

Total water plant expense	<u>435,998</u>
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Total operating expenses	<u>2,215,545</u>
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Operating (loss)	(372,447)
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Nonoperating revenues (expenses):

Other nonoperating revenue	50
Interest income	264,215
Tax receipts for bond payments	540,294
Plant investment charges	1,357,528
Resort tax revenue	750,000
Interest expense	(676,064)
Loss on disposal of assets	<u>(7,500)</u>

Total nonoperating revenues (expenses)	<u>2,228,523</u>
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Income before contributions	1,856,076
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Contributed capital	<u>734,772</u>
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Increase in net assets	2,590,848
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Net assets, beginning of year	<u>24,218,324</u>
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Net assets, end of year	<u><u>\$ 26,809,172</u></u>
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See accompanying notes to financial statements

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2006

Increase in cash and cash equivalents:

Cash flows from operating activities

Receipts from customers	\$ 2,925,336
Payments to suppliers	(589,056)
Payments to employees	(396,307)
Other receipts (payments)	<u>1,549,344</u>
Net cash provided (used) by operating activities	<u>3,489,317</u>

Cash flows from capital and related financing activities

Proceeds from capital debt	334,803
Principal paid on capital debt	(1,002,668)
Purchases of capital assets	(943,162)
Interest paid on capital debt	(676,064)
Other receipts (payments)	<u>3,500</u>
Net cash (used) by capital and related financing activities	<u>(2,283,591)</u>

Cash flows from investing activities:

Interest	<u>251,609</u>
Net cash provided by investing activities	<u>251,609</u>

Net increase in cash and cash equivalents	1,457,335
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Cash and cash equivalents - beginning of the year	<u>5,600,069</u>
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Cash and cash equivalents - end of the year	<u><u>\$ 7,057,404</u></u>
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Cash and cash equivalents as presented on the statement of net assets:

Cash and cash equivalents	\$ 6,068,897
Restricted cash and cash equivalents	<u>988,507</u>
	<u><u>\$ 7,057,404</u></u>

Reconciliation of operating (loss) to net cash provided by operating activities:

Operating (loss)	<u>\$ (372,447)</u>
Adjustments to reconcile operating (loss) to net cash provided by operating activities:	
Depreciation	744,083
Loss on impairment	290,450
Nonoperating income	2,647,872
(Increase) decrease in current assets:	
Accounts receivable	(13,290)
Prepaid expenses	(31,362)
Inventory	(31,759)
Notes receivable	259,000
(Increase) decrease in current liabilities:	
Accounts payable and accrued expenses	253,409
Compensated absences payable	2,389
Accrued health insurance claims payable	2,972
Deferred revenue	<u>(262,000)</u>
	<u>3,861,764</u>
Net cash provided by operating activities	<u><u>\$ 3,489,317</u></u>

Supplemental Schedule of Non-cash Investing and Financing Activities:

During the fiscal year ended June 30, 2006, developers contributed \$734,772 in capital assets to the District.

See accompanying notes to financial statements

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Big Sky County Water & Sewer District No. 363 (District) have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the District's accounting policies are described below.

A. Reporting Entity

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.

B. Measurement Focus and Basis of Accounting

The term measurement focus is used to denote what is being measured and reported in the District's operating statements. The District is accounted for on the flow of "economic resources" measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets (or cost recovery), financial position and cash flows. All assets and liabilities (whether current or noncurrent) associated with their activities are reported and equity is reported as net assets.

The term basis of accounting is used to determine when a transaction or event is recognized on the District's financial statements. The District uses the full accrual basis of accounting, with revenues recorded when earned and expenses recorded when incurred, even though actual payment or receipt may not occur until after the period ends.

Big Sky County Water and Sewer District has elected, as allowed in paragraph 7 of Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*, not to follow Financial Accounting Standards Board (FASB) pronouncements issued subsequent to November 30, 1989. Therefore, the District follows all GASB pronouncements and FASB pronouncements issued on or before November 30, 1989, unless those pronouncements conflict or contradict GASB pronouncements.

(continued)

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Measurement Focus and Basis of Accounting (continued)

For the fiscal year ended June 30, 2004, the District adopted the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. Statement 34 established standards for external financial reporting for all states and local governmental entities, which includes a statement of net assets, a statement of revenues, expenses, and changes in fund net assets and a statement of cash flows.

It requires the classification of net assets into three components as described below:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- Restricted – This component of net assets consists of restrictions placed on net assets as a result of external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted net assets – This component of net assets consist of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

For the fiscal year ended June 30, 2006, the District adopted the provisions of GASB Statement No. 40, *Deposit and Investment Risk Disclosures* to amend GASB Statement No. 3. This new Statement updates the custodial credit risk disclosure requirements of Statement 3 and establishes a more comprehensive disclosure requirement. It also addresses other common risks of the deposits and investments of state and local governments. Statement 40 eliminates Category 1 and 2 custodial credit risk and disclosures are now limited to the following:

- Deposits that are not covered by depository insurance and are (a) uncollateralized, (b) collateralized with securities held by the pledging financial institution, or (c) collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name.
- Investment securities that are uninsured, are not registered in the name of the government, and are held by either (a) the counterparty or (b) the counterparty's trust department or agent but not in the government's name.

C. Revenues and Expenses

Revenues and expenses are distinguished between operating and nonoperating items. Operating revenues generally result from providing services in connection with the District's principal ongoing operations. The principal operating revenues of the District are water and wastewater user charges. Revenue from user charges and sales of services is recognized as the related service is provided. Refunds to customers are charged to income in the period in which those refunds are paid. Operating expenses include the costs associated with the conveyance of water and wastewater, treatment of wastewater, administrative expenses, and depreciation of capital assets.

(continued)

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. Revenues and Expenses (continued)

All revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses.

D. Water and Wastewater User Charges

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 submits any delinquent accounts to the County Treasurer for collection.

E. Cash and Investments

The District is authorized by statute to invest in time and savings deposits with a bank, savings and loan association, or credit union in the state. In addition, it may also invest in obligations of the United States Government, securities issued by agencies of the United States, repurchase agreements, and the State Short-Term Investment Pool (STIP).

To minimize credit risk in relation to the District's deposits, it is the District's policy to have uninsured deposits covered by collateral held by the pledging bank's agent in the District's name.

The District does not have a policy regarding concentration of credit risk in relation to its investments.

For the purpose of the cash flow statement, cash and cash equivalents are considered to be cash on hand, deposits in demand accounts and money market accounts.

F. Restricted Cash

According to a bond resolution, cash in the amount of \$68,571 is restricted; this is the amount that has accumulated in the Debt Service Fund. Cash in the amount of \$919,936 is restricted as the result of a legally binding agreement. Both of these restrictions are for debt repayment.

G. Inventory

Inventory is recorded at lower of cost or market and consists primarily of operating materials.

(continued)

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

H. Capital Assets

The District's capital assets are capitalized at historical cost or estimated historical cost. Contributions of capital assets are recorded at fair market value when received. Depreciation of capital 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 life of a fixed asset, 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.

I. 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.

J. Tax Revenue

Property tax levies are set by the Counties according to the rates approved by the voters and are based on taxable values listed as of January 1 for all real property located in the District. Taxable values are established by the Montana Department of Revenue based on market values. A revaluation of all property is required to be completed on a periodic basis. Taxable value is defined by Montana statute as a fixed percentage of market value.

Real property taxes and special assessments are generally billed in October and are payable one half by November 30 and one half by May 31. After these dates, taxes and assessments become delinquent and become a lien on the property. Personal property is assessed and personal property taxes are billed throughout the year, with a significant portion generally billed in May, June, and July. Personal property taxes are based on levies set during the prior August. These taxes become delinquent 30 days after billing.

Taxes and assessments that become delinquent are charged interest at the rate of 5/6 of 1% per month from the time of delinquency until paid plus a penalty of 2%. Real property on which taxes and assessments remain delinquent and unpaid may be sold at tax sales. In the case of personal property, the property is seized and sold after the taxes become delinquent.

(continued)

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

K. Use of Estimates

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

L. 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).

2. CASH AND INVESTMENTS

As of June 30, 2006, the carrying amount of the District's deposits (cash and interest-bearing money market accounts) at local banks was \$7,057,404 and the bank balance was \$7,062,295. Of the bank balance, \$300,000 was covered by federal depository insurance and the remaining balance was covered by collateral held by the pledging bank's agent in the District's name.

At June 30, 2006, the District's only investment was in the Montana Short-Term Investment Pool (STIP). STIP was created by the State of Montana Board of Investments to allow qualifying funds, per sections 17-6-201, 202 and 204, MCA, to participate in a diversified pool. The carrying amount of this investment as of June 30, 2006 was \$304,088.

STIP has not been rated by the Nationally Recognized Statistical Rating Organizations (NRSRO).

The STIP portfolio includes Variable Rate (Floating-Rate) Securities to provide diversification and a competitive rate of return. These securities offer many advantages of short-term bonds because they are designed to minimize the investor's interest rate risk. As with variable rate loans issued by banks, the interest rate paid by the issuer of these securities is reset periodically depending on the market conditions. The value of these securities will usually remain at or near par because their interest rates are reset to maintain a current market yield. STIP's variable rate securities float to the London Interbank Offering Rate (LIBOR), which is similar to the European federal funds rate. The STIP investment portfolio consists of securities with maximum maturity of 397 days or less.

According to GASB Statement No. 31, Accounting and Financial Reporting for Certain Investments and External Investments Pools, STIP is considered an external investment pool. An external investment pool is defined as an arrangement that pools the monies of more than one legally separate entity and invests, on the participant's behalf, in an investment portfolio. STIP is also classified as a "2a7-like" pool. A 2a7-like pool is an external investment pool that is not registered with the Security and Exchange Commission (SEC) as an investment company, but has policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. If certain conditions are met, 2a7-like pools are allowed to use amortized cost rather than fair market value to report net assets to compute unit values. The Board of Investments has adopted a policy to treat STIP as a 2a7-like pool. Accordingly, the investment in STIP is valued at amortized cost as of June 30, 2006.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

3. CHANGES IN CAPITAL ASSETS

	Balance 7/1/05	Additions	Retirements	Balance 6/30/06
Capital assets not being depreciated:				
Land	\$ 1,063,038	\$ -	\$ -	\$ 1,063,038
Land easements	58,117	-	-	58,117
Sewer construction in process	14,714,571	259,701	(12,634,929)	2,339,343
Water construction in progress	2,986,900	-	(2,986,900)	-
Total capital assets not being depreciated	<u>18,822,626</u>	<u>259,701</u>	<u>(15,621,829)</u>	<u>3,460,498</u>
Capital assets being depreciated:				
Office building	458,653	5,085	-	463,738
Sewer infrastructure	14,406,413	12,604,973	-	27,011,386
Water infrastructure	7,490,358	4,035,124	(53,500)	11,471,982
Total capital assets being depreciated	22,355,424	16,645,182	(53,500)	38,947,106
Accumulated depreciation	(5,735,589)	(744,083)	42,500	(6,437,172)
Net depreciable capital assets	<u>16,619,835</u>	<u>15,901,099</u>	<u>(11,000)</u>	<u>32,509,934</u>
Total capital assets	<u>\$ 35,442,461</u>	<u>\$ 16,160,800</u>	<u>\$ (15,632,829)</u>	<u>\$ 35,970,432</u>

As of June 30, 2006, approximately \$99,820 of interest has been capitalized as capital assets.

4. OUTSTANDING DEBT

The following is a summary of long-term debt at June 30, 2006:

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, 2006 was 7%.

\$ 166,872

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.

2,629,000

(continued)

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

4. OUTSTANDING DEBT (Continued)

4% State Revolving 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. 212,000

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, 2006 totaled \$6,766,000. Payable in 40 semi-annual installments of approximately \$260,000 until July 1, 2023. 6,269,000

4% State Revolving Fund (DNRC Drinking Water Revolving Loan Program) Series 2002 dated September 24, 2002 for \$534,000 for the purchase and installation of water meters. Payable in 42 semi-annual installments of approximately \$39,000 until July 1, 2023. 478,000

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, 2006 was \$5,706,515. 5,010,514

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 of \$1,966,000. Payable in 42 semi-annual installments of approximately \$72,000 until July 1, 2024. 1,831,000

The general obligation bonds are to be repaid semi-annually through 2024 with resort tax revenue appropriated to the District, a mill levy approved in 2004, District plant investment charges, and operating revenue and reserves. 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.

(continued)

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

4. OUTSTANDING DEBT (Continued)

	<u>Balance</u> <u>6/30/05</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>6/30/06</u>	<u>Amounts</u> <u>Due within</u> <u>One Year</u>
Bonds and notes payable:					
State Revolving Loan #1	\$ 2,977,000	\$ -	\$ (348,000)	\$ 2,629,000	\$ 362,000
State Revolving Loan #2	240,000	-	(28,000)	212,000	29,000
SRF Treatment Plant	6,522,000	-	(253,000)	6,269,000	264,000
SRF Water Meters	498,000	-	(20,000)	478,000	20,000
SRF Water Tank	1,900,000	-	(69,000)	1,831,000	71,000
SRF Treatment Plant	4,915,711	334,803	(240,000)	5,010,514	250,000
Backhoe	39,772	-	(39,772)	-	-
American Bank Off. Bldg	<u>171,768</u>	<u>-</u>	<u>(4,896)</u>	<u>166,872</u>	<u>6,057</u>
Total bonds and notes payable	17,264,251	334,803	(1,002,668)	16,596,386	1,002,057
Compensated absences	<u>52,213</u>	<u>2,389</u>	<u>-</u>	<u>54,602</u>	<u>-</u>
Total long-term liabilities	<u>\$ 17,316,464</u>	<u>\$ 337,192</u>	<u>\$ (1,002,668)</u>	<u>\$ 16,650,988</u>	<u>\$ 1,002,057</u>

Debt service requirements at June 30, 2006, were as follows:

<u>Year Ended</u> <u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 1,002,057	\$ 641,668
2008	1,039,304	601,631
2009	1,083,561	560,285
2010	1,126,828	517,178
2011	1,169,106	472,405
2012-2016	4,725,116	1,734,516
2017-2021	4,858,982	852,711
2022-2026	<u>1,646,034</u>	<u>85,202</u>
Total	<u>\$ 16,650,988</u>	<u>\$ 5,465,596</u>

(continued)

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

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.
- 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 2006.

5. DEFERRED REVENUE

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 \$1,000,000 at June 30, 2006 is offset by deferred revenue of \$1,000,000.

Changes in deferred revenue were as follows:

	Balance <u>6/30/05</u>	<u>Additions</u>	Revenue <u>Recognized</u>	Balance <u>6/30/06</u>
Boyne settlement	\$ 1,250,000	\$ -	\$ (250,000)	\$ 1,000,000
Big Sky Chapel	12,000	-	(12,000)	-
Farmhouse	<u>97,800</u>	-	-	<u>97,800</u>
	<u>\$ 1,359,800</u>	<u>\$ -</u>	<u>\$ (262,000)</u>	<u>\$ 1,097,800</u>

6. NET ASSETS – RESTRICTED

Net assets are restricted as follows:

Restricted for debt service	<u>\$ 988,507</u>
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(continued)

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

7. IMPAIRMENT LOSS

Sewer plant expenses include an impairment loss of \$290,450 due to stopping construction on the snowmaking project.

8. EMPLOYEE BENEFIT PLANS

Plan Description and Provisions – All full-time District employees participate in one of two statewide cost-sharing multiple-employer retirement benefit plans administered by the Public Employees Retirement Division (PERD). Contributions to the two plans are as required by State statute. Fiscal year 2006 total payroll and covered payroll for both retirement plans was \$393,918 and \$392,138, respectively. Financial information for the two plans is reported in the Public Employees' Retirement Board's published Comprehensive Annual Financial Report for the fiscal year end. It is available from PERD at 100 North Park Avenue, Suite 220, P.O. Box 200131, Helena, MT 59620-0131. The authority to establish, amend and provide cost of living adjustments to the plans is assigned to the State legislature. The authority to establish and amend contribution rates to the plans is also assigned to the State legislature.

Public Employees' Retirement System (PERS)

All District employees are provided pension benefits by this multi-employer plan. Funding is provided by participating units of government and their covered employees. The District is required to contribute 6.8% of members' compensation, which was \$26,665, \$24,433, and \$20,093 for the years ended June 30, 2006, 2005, and 2004, respectively. Plan members are required to contribute 6.9% of their compensation, which was \$27,058, \$24,792, and \$20,388 for the years ended June 30, 2006, 2005, and 2004, respectively. The State is required to contribute .1% of members' compensation, which was \$392, \$329, and \$296 for the years ended June 30, 2006, 2005, and 2004, respectively. One hundred percent of required contributions were made for all three years.

Defined Benefit Retirement Plan (DBRP) – Participants become eligible for benefits after age 60 and 5 years of service, after age 65 regardless of service, or 30 years of service regardless of age. The benefit is 1/56 of the final compensation for each year of credited service, paid as a modified cash refund annuity. A participant is eligible for early retirement benefits after age 50 and 5 years of service or after 25 year of service regardless of age. Rights become vested after 5 years of service.

Defined Contribution Retirement Plan (DCRP) – Participants may elect the defined contribution plan, in which the contributions into the plan are known, but the benefit is not. The retirement benefit received is based upon account balance, which is determined by contributions made plus investment earnings, or losses, less administrative costs.

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006

9. COMMITMENTS AND CONTINGENCIES

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, 2006.

Risk Management

The District faces a considerable number of risks of loss, including a) damage to and loss of property and contents, b) employee torts, c) professional liability (i.e. errors and omissions), d) environmental damage, and e) workers' compensation (i.e., employee injuries).

The District participates in a risk pool, which provides general liability insurance, auto liability insurance, crime/bond coverage, errors and omissions insurance, and property insurance. This pool purchases commercial insurance to cover the members' risks; the District does not assume the liabilities of other entities.

Workers' compensation insurance coverage is provided through a commercial policy.

Yellowstone Mountain Club Agreement

On March 28, 2001, the District signed an agreement with the Yellowstone Mountain Club and other related entities owned by a 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 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.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2006

Federal grantor/Program title	Federal CFDA Number	Pass-through Entity Identifying Number	Total Loan Amount	Federal Expenditures
Office of Water, Environmental Protection Agency Passed through Montana Department of Natural Resources and Conservation:				
State Revolving Fund (DNRC Drinking Water Revolving Loan Program Series 2003) -				
Wastewater Treatment Plant	66.458	SRF C-301184-04	\$ 6,500,000	\$ 5,706,514

NOTE 1. BASIS OF PRESENTATION

The schedule of expenditures of federal awards includes the federal grant activity of the Big Sky County Water and 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*.

NOTE 2. LOANS OUTSTANDING

The District had the following loan balance outstanding at June 30, 2006. This loan balance outstanding is also included in the federal expenditures presented in this schedule.

Program Title	Federal CFDA Number	Outstanding Amount at 6/30/05	Outstanding Amount at 6/30/06
Office of Water, Environmental Protection Agency Passed through Montana Department of Natural Resources and Conservation:			
State Revolving Fund (DNRC Drinking Water Revolving Loan Program Series 2003) -			
Wastewater Treatment Plant	66.458	\$ 4,915,711	\$ 5,010,514



CERTIFIED PUBLIC ACCOUNTANTS
MEMBERS OF CPA ASSOCIATES INTERNATIONAL, INC.

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

To the Board of Directors
Big Sky County Water and Sewer District No. 363
Big Sky, Montana

We have audited the accompanying financial statements of the business-type activities of Big Sky County Water and Sewer District No. 363 as of and for the year ended June 30, 2006, which collectively comprise the Big Sky County Water and Sewer District No. 363's basic financial statements and have issued our report thereon dated September 18, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Big Sky County Water and Sewer District No. 363'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 an opinion 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 controls 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 misstatements caused by error or fraud 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 operations that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Big Sky County Water and Sewer District No. 363'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*.

September 18, 2006
Board of Directors
Page two

This report is intended solely for the information and use of management, the Board of Directors, federal and state awarding agencies, and the Montana Department of Administration and is not intended to be and should not be used by anyone other than these specified parties.

Holmes & Turner

September 18, 2006



CERTIFIED PUBLIC ACCOUNTANTS
MEMBERS OF CPA ASSOCIATES INTERNATIONAL, INC.

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

To the Board of Directors
Big Sky County Water and Sewer District No. 363
Big Sky, Montana

Compliance

We have audited the compliance of Big Sky County Water and Sewer District No. 363 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 its major federal program for the year ended June 30, 2006. Big Sky County Water and Sewer District No. 363's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of Big Sky County Water and Sewer District No. 363's management. Our responsibility is to express an opinion on Big Sky County Water and Sewer District No. 363'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 the major federal program occurred. An audit includes examining, on a test basis, evidence about Big Sky County Water and 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 of Big Sky County Water and Sewer District No. 363's compliance with those requirements.

In our opinion, Big Sky County Water and Sewer District No. 363 complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2006.

Internal Control over Compliance

The management of the Big Sky County Water and Sewer District No. 363 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 Big Sky County Water and 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 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 Board of Directors and federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Holmes & Turner

September 18, 2006

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2006

SUMMARY OF AUDIT RESULTS

- The auditor's report expresses an unqualified opinion on the financial statements.
- No reportable conditions disclosed during the audit of the financial statements are reported in the report on compliance and on internal control over financial reporting based on an audit of financial statements performed in accordance with Government Auditing Standards.
- No instances of noncompliance material to the financial statements of Big Sky County Water and Sewer District No. 363 were disclosed during the audit.
- No reportable conditions relating to the audit of the major federal awards program are reported in the report on compliance with requirements applicable to its major program and internal control over compliance in accordance with OMB Circular A-133.
- The auditor's report on compliance for the major federal awards program for the Big Sky County Water and Sewer District No. 363 expresses an unqualified opinion on the major program.
- The audit did not disclose any audit findings, which the auditor is required to report under OMB Circular A-133.
- The auditee's major program is as follows:

Office of Water, Environmental Protection Agency
Passed-through Montana Department of Natural Resources and Conservation
State Revolving Fund (DNRC Drinking Water Revolving Loan Program Series
2003) – Wastewater Treatment Plan

CFDA Number: 66.458

- The \$300,000 threshold was used in distinguishing between Type A and Type B programs.
- The auditee did not qualify as a low-risk auditee under the provisions of OMB Circular A-133.

FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARD PROGRAM AUDIT

None reported.

FINDINGS AND REPORTABLE CONDITIONS – FINANCIAL STATEMENT AUDIT

None reported.

**BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
CURRENT STATUS OF PRIOR YEAR RECOMMENDATIONS
FOR THE YEAR ENDED JUNE 30, 2006**

There were no findings, questioned costs, or reportable conditions for the year ended June 30, 2006.