

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

ANNUAL FINANCIAL REPORT

FOR THE YEAR ENDED JUNE 30, 2008



CERTIFIED PUBLIC ACCOUNTANTS
MEMBERS OF CPA ASSOCIATES INTERNATIONAL, INC.

1283 NORTH 14TH STREET, SUITE 201
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FILE COPY

December 29, 2008

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

We have audited the financial statements of the business-type activities and the major fund of Big Sky County Water & Sewer District No. 363 for the year ended June 30, 2008, and have issued our report thereon dated December 29, 2008. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated July 12, 2006, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter dated July 12, 2006.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by Big Sky County Water & Sewer District No. 363 are described in Note One to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during fiscal year ended June 30, 2008. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The attached journal entry number three shows the material misstatement detected as a result of audit procedures; this misstatement was corrected by management. Journal entries one and two were immaterial; the first entry was posted to reconcile the beginning balance; the second entry was not posted.

Disagreements with Management

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

Management Representations

We have requested certain representations from management that are included in the management representation letter dated December 29, 2008.

Management Consultations with Other Independent Accountants

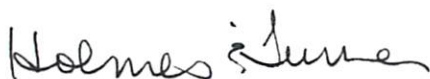
In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination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

Other Audit Findings or Issues

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

This information is intended solely for the use of the Board and is not intended to be and should not be used by anyone other than this specified party.

Very truly yours,



HOLMES & TURNER

HOLMES & TURNER
CERTIFIED PUBLIC ACCOUNTANTS

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363

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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, 2008, 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.

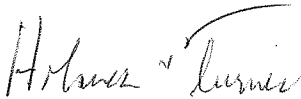
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and 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, 2008, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 29, 2008, on our consideration of the Big Sky County Water and 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 grant 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 the 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 read in conjunction with this report in considering the results of our audit.

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.

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.



December 29, 2008



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Management Discussion and Analysis Fiscal Year 7/1/2007 - 6/30/2008

The Big Sky County Water & Sewer District No. 363 is accounted for as a governmental 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 assets and end of year net assets 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 \$30,997,411 to \$31,382,471. The water capital assets increased from \$13,369,703 to \$16,690,274. The District's other asset category decreased from \$597,800 to \$347,800 as a result of the payment received 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 associated with the existing State Revolving Fund Loans of both systems increased from \$15,476,064 to \$17,302,779 (excluding current portion of debt). The District uses low interest rate loans from the State Revolving Loan Fund Program to finance both water and sewer projects. The sewer projects were substantially completed in 2004. The water system improvements are continuing with the latest State Revolving Loan of \$5,000,000. The current liabilities of the District decreased from \$2,930,841 to \$2,684,318. The decrease is due to accounts payable on 6/30/2007; a contractor had a payment of approximately \$223,000 dollars pending.

Year	Total Assets	Growth Rate	Total Liabilities	Growth Rate
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%	\$18,212,904	-4.08%
2006-2007	\$47,593,123	5.70%	\$18,406,905	1.07%
2007-2008	\$51,395,601	7.99%	\$19,987,097	8.58%

Operating Revenue/Non-Operating Revenue

The total operating revenues of the District decreased to \$2,031,491 from \$2,042,536. The total sewer operating revenue was up \$11,051 to \$1,085,035. The total water operating revenue was down \$22,096 to \$946,456. Water revenues were down despite an increase in customer base as a result of lower usage by District customers. The Sewer revenue increase is a result of a larger customer base and additional other income from compost sales and rock sales. The District has a plant investment charge on the sewer plant but no plant investment charge on the water system. The total non-operating revenue which includes plant



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investment charges, interest income, tax receipts for bond payments, resort tax revenue, net of interest expenses of the District decreased to \$1,633,248 from \$2,235,148. The District's collection of plant investment charges decreased from \$1,165,075 to \$446,463. 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 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 Hidden Village 1 Million Gallon Water Tank, Meadow Village Booster Station and install the initial phase of the water meters. The Resort Tax also provided funding of \$8,425 (total rollover award \$38,920) for the pond liner rock cover project. The District received \$250,000 from Boyne on their annual payment agreement. The District also collected \$802,616 in tax receipts for payments on the State Revolving Fund Loans used to finance the water tank, water meters, the new water projects and sewer treatment plant.

Operating Expenses

The total operating expense for the District increased to \$2,246,848 from \$2,042,785. The total general and administrative expense increased to \$376,794 from \$367,760. The total sewer general and administrative expense increased to \$186,465 from \$175,254. Total sewer operation expense increased to \$933,995 from \$839,623. The total water general and administrative expense increased to \$182,899 from \$175,416. The total water operating expense increased to \$566,695 from \$484,732. The total operating expense increase of 9.98% was primarily due to unexpected sewer and water main repairs and the increased cost of energy related products.

Year	Total Revenues	Growth Rate	Total Expenses	Growth Rate
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%	\$2,899,112	14.63%
2006-2007	\$4,924,499	3.56%	\$2,689,600	-7.23%
2007-2008	\$4,316,041	-12.36%	\$2,898,150	7.20%

Capital Assets

The District received \$804,395 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 are 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% of asset cost deposit made by the developer. The contributed assets are then recorded as either water or sewer assets on the books of the District and depreciated accordingly. The recorded value of the asset is recognized as income in the year of acceptance.

The District's total net assets at June 30, 2008 were \$31,408,504. The total amount includes \$22,795,812 invested in capital assets, net of related debt, \$6,783,776 in unrestricted assets, and \$1,828,916 restricted for debt service. The total represents an increase of \$2,222,286 over the prior fiscal year total. The invested in capital assets, net of related debt increased by \$1,048,739 due to asset additions, contributions and debt reduction. The unrestricted decreased by \$1,172,056 due to plant investment funds expended for sewer projects and debt service. The restricted for debt service increased to \$1,828,916 from \$1,827,425.



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Summary

The Districts overall financial position remains stable with sufficient reserves and financing sources available to fund both the operating and non-operating activities of the District. However, the District's sewer operating revenue was again insufficient to cover all the sewer operating expenses in fiscal 2007-2008. The District's water department operating revenue was sufficient to cover operating expenses; however, future expected outlays for the water department operations as well as inflation fears initiated a review of the rate structure for both water and sewer. As a result, the District held hearings on the rate structure in the spring of 2008. The District adopted new rates effective July 1, 2008 and July 1, 2009. The District believes the new rate structure will enable the sewer department to break even by the 2009-2010 fiscal year end and the water department to remain fiscally sound.

The budget for fiscal 2007-2008 at year-end had several significant variances. The overall operating loss of \$215,357 was primarily the sewer department's loss. The District expected to use \$123,767 of sewer reserves to balance the sewer budget; however, \$223,822 was needed to balance the sewer budget. The water department remained in positive operating position. The budget estimated a \$57,000 net income for the water department but the actual was only \$8,465. The sewer operating revenue was 6.02% below budget estimates. The water operating revenue was 4.35% below budget estimates. Administrative expenses for general administration, water administration and sewer administration all came in under budget. However, the sewer operations expense and water operations expense were both over budget. Sewer operations exceeded budget estimates by 7.65% and water operations exceeded budget estimates by 4.66%.

Non-operating revenue was down 18.69% primarily due to the slow-down in new construction development. Plant investment income derived from new construction development was less than half of the budgeted \$400,000. In the category of donated capital assets (sewer and water extensions) the District estimated donations of \$500,000; however, donations totaled \$804,395. Overall, the slower construction growth, the water conservation of customers of the District, as well as the increase in inflation and energy related costs put pressure on the 2007-2008 budgets.

The District has a total of seven State Revolving Fund Loans with an outstanding balance at fiscal year-end of \$18,027,431 including the current portion of the long-term debt. The District services the debt through bi-annual payments funded through several sources. The three main sources are the Big Sky Area Resort Tax, Plant Investment Fees (sewer only) and ad-velorem tax. The District currently has a commitment from the Big Sky Area Resort Tax for two of the seven loans. For the other five loans the District applies annually for funding of the State Revolving Fund Loans to the Big Sky Area Resort Tax. For fiscal 2008-2009 the District secured \$100,000 for sewer debt service and \$200,000 for the water debt service from the Resort Tax. As a result, the District was able to reduce the mill levy for water debt service from 24.74 mills to 16.17 mills and slightly increase the sewer mill from 20.30 mills to 21.52 mills.



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The District made no additional draws on the existing sewer State Revolving Fund loan. The open loan has a remaining commitment of approximately \$775,000 to expand the sewer system. The District intends on using these funds for the pond liner rock cover project. The District continues to make bi-annual payments on the open sewer loan. As a result, the District paid down the principal on this particular loan by \$254,000. The District obtained approval for a State Revolving Fund Loan for water system upgrades in the amount of \$5,000,000. The District drew a total of \$3,172,277 for water system projects during fiscal 2007-2008. The balance on the water State Revolving Fund loan was \$3,087,277 at fiscal year end. The District intends on using the remaining funds to complete the water system upgrades. Based on the current funding and expected future funding sources, the existing State Revolving Fund Loans will not impact planned future capital outlays.

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
FOR THE YEAR ENDED JUNE 30, 2008

ASSETS

Current assets:

Cash and cash equivalents	\$ 8,353,055
Investments	1,601
Accounts receivable	481,677
Prepaid expenses	4,770
Water meter inventory	29,191
Boyne settlement - current portion	<u>250,000</u>

Total current assets	<u>9,120,294</u>
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Restricted cash and cash equivalents:

Debt service fund	<u>1,828,916</u>
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Property and equipment, at cost:

Fixed assets - sewer	31,382,471
Fixed assets - water	<u>16,690,274</u>
	48,072,745
Less accumulated depreciation	<u>(7,974,154)</u>

Total property and equipment	<u>40,098,591</u>
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Other assets:

Notes receivable	97,800
Boyne settlement receivable	500,000
Less: current portion	<u>(250,000)</u>

Total other assets	<u>347,800</u>
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Total assets	<u><u>\$ 51,395,601</u></u>
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LIABILITIES AND FUND EQUITY

Current liabilities:

Accounts payable and accrued expenses	\$ 478,834
Performance bonds and retainage payable	663,484
Current portion of long-term debt	<u>1,210,000</u>

Total current liabilities	<u>2,352,318</u>
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Long-term liabilities:

Deferred revenue	597,800
Compensated absences payable	63,011
General obligation bonds	18,027,431
Office building loan	156,537
Less: current portion of long-term debt	<u>(1,210,000)</u>

Total long-term liabilities	<u>17,634,779</u>
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Total liabilities	<u>19,987,097</u>
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Net assets:

Invested in capital assets, net of related debt	22,463,812
Unrestricted	7,115,776
Restricted for debt service	<u>1,828,916</u>

Total fund equity	<u>31,408,504</u>
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Total liabilities and fund equity	<u><u>\$ 51,395,601</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, 2008

Operating revenues:	
Sewer services	\$ 1,085,035
Water services	946,456
	<hr/>
Total operating revenue	2,031,491
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Operating expenses:	
General and administrative:	
Meetings	2,703
Directors' expense	4,089
Salaries	192,232
Payroll taxes and benefits	28,163
Utilities	5,693
Janitorial and carpet services	6,765
Office supplies and expense	11,124
Telephone	5,822
Printing	35
Postage and shipping	8,404
Advertising	973
Insurance	75,360
Dues and subscriptions	1,020
Vehicle expense	4,735
Legal fees	4,194
Computer maintenance	4,859
Audit expense	8,273
Bank service charges	46
State annual filing fee	890
Miscellaneous	1,507
Office building repair & maintenance	5,562
Education expenses	3,798
Election fees	547
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Total general and administrative	376,794
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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, 2008

Operating expenses (Continued):

Sewer general and administrative:

Salaries and wages	126,345
Workers' compensation insurance	31,135
Payroll taxes and benefits	21,071
Dues and subscriptions	344
Telephone	5,272
Office supplies	963
Education expense	1,335
	<hr/>
Total sewer general and administrative	186,465
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Sewer plant expense:

Fuel - equipment and vehicles	16,316
Vehicle repair and maintenance	8,129
Vehicle insurance	1,508
Utilities	181,778
Chemicals	43,630
Stream water quality monitoring	938
Waste water monitoring	19,421
Lab testing equipment	504
Compost supplies	8,209
Safety equipment	1,017
Operating supplies	501
Discharge permit fees	750
Welding & welding supplies	175
Sewer repairs and maintenance	35,591
Treatment plant repairs and maintenance	11,213
Maintenance and repairs - building and grounds	11,047
Tools	4,304
Equipment rental	15
Jetting - sewer lines	22,076
Safety training	114
Engineering	1,780
Miscellaneous	1,232
Depreciation expense	563,747
Total sewer plant expense	<hr/> 933,995 <hr/>

(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, 2008

Operating expenses (Continued):

Water general and administrative:

Salaries and wages	124,992
Workers' compensation insurance	29,703
Payroll taxes and benefits	16,548
Dues and subscriptions	868
Telephone	6,062
Publications	570
Education expense	622
Public water supply fees	<u>3,534</u>

Total water general and administrative	<u>182,899</u>
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Water plant expense:

Fuel - equipment and vehicles	12,300
Vehicle repair and maintenance	13,082
Vehicle insurance	1,508
Utilities	133,365
Chemicals	1,852
Lab fees	8,614
Lab testing equipment	643
Safety equipment	145
Repairs and maintenance	80,567
Tools	4,540
Equipment rental	1,070
Special projects	14,227
Professional services	5,920
Miscellaneous	22,432
Depreciation expense	<u>266,430</u>

Total water plant expense	<u>566,695</u>
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Total operating expenses	<u>2,246,848</u>
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Operating (loss)	<u>(215,357)</u>
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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, 2008

Nonoperating revenues (expenses):	
Other nonoperating expenses	(42,961)
Other nonoperating revenue	19,001
Interest income	318,045
Tax receipts for bond payments	772,616
Plant investment charges	446,463
Resort tax revenue	728,425
Interest expense	<u>(608,341)</u>
Total nonoperating revenues (expenses)	<u>1,633,248</u>
Income before contributions	1,417,891
Contributed capital	<u>804,395</u>
Increase in net assets	2,222,286
Net assets, beginning of year	<u>29,186,218</u>
Net assets, end of year	<u><u>\$ 31,408,504</u></u>

See accompanying notes to financial statements

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2008

Increase in cash and cash equivalents:

Cash flows from operating activities

Receipts from customers	\$ 2,234,598
Payments to suppliers	(1,170,448)
Payments to employees	(443,569)
Other receipts (payments)	<u>1,727,081</u>
Net cash provided (used) by operating activities	<u>2,347,662</u>

Cash flows from capital and related financing activities

Proceeds from capital debt	3,172,277
Principal paid on capital debt	(1,104,162)
Purchases of capital assets	(2,813,323)
Interest paid on capital debt	<u>(608,341)</u>
Net cash (used) by capital and related financing activities	<u>(1,353,549)</u>

Cash flows from investing activities:

Interest	310,635
Proceeds from sale of investments	326,500
Interest capitalized	<u>(108,028)</u>
Net cash provided by investing activities	<u>529,107</u>

Net increase in cash and cash equivalents	1,523,220
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Cash and cash equivalents - beginning of the year	<u>8,658,751</u>
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Cash and cash equivalents - end of the year	<u><u>\$ 10,181,971</u></u>
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Cash and cash equivalents as presented on the statement of net assets:

Cash and cash equivalents	\$ 8,353,055
Restricted cash and cash equivalents	<u>1,828,916</u>
	<u><u>\$ 10,181,971</u></u>

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

Operating (loss)	\$ (215,357)
Adjustments to reconcile operating (loss) to net cash provided by operating activities:	
Depreciation	830,177
Nonoperating income	1,923,544
(Increase) decrease in current assets:	
Accounts receivable	6,644
Prepaid expenses	2,013
Inventory	18,449
Notes receivable	250,000
(Increase) decrease in current liabilities:	
Accounts payable and accrued expenses	(226,408)
Compensated absences payable	8,600
Deferred revenue	(250,000)
	<u>2,563,019</u>
Net cash provided by operating activities	<u>\$ 2,347,662</u>

Supplemental Schedule of Non-cash Investing and Financing Activities:

During the fiscal year ended June 30, 2008, developers contributed water and sewer extensions valued at \$804,395 to the District.

During the fiscal year ended June 30, 2008, developers purchased water meters from the District and contributed these back to the District; these meters were recorded as fixed assets in the amount of \$56,948.

See accompanying notes to financial statements

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008

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 No. 363 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, 2008

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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 custodial 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 \$782,842 is restricted; this is the amount that has accumulated in the Debt Service Fund. Cash in the amount of \$1,046,074 is restricted as the result of a legally binding agreement. Both of these restrictions are for debt repayment.

(continued)

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

G. Inventory

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

H. Internal Balances

Internal receivable and payable balances have been eliminated in the Statement of Net Assets.

I. 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.

J. 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.

K. Net Assets

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.

(continued)

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

K. Net Assets (continued)

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.”

L. 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.

M. 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.

N. 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).

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008

2. CASH AND INVESTMENTS

As of June 30, 2008, the carrying amount of the District's deposits (cash and interest-bearing money market accounts) at local banks was \$10,181,766 and the bank balance was \$10,186,362. Of the bank balance, \$300,000 was covered by federal depository insurance, \$9,700,982 was covered by collateral held by the pledging bank's agent in the District's name and the remaining \$185,380 was uncollateralized.

At June 30, 2008, 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, 2008 was \$1,601.

At the time that this report was issued, the following information was available regarding this investment as of June 30, 2008:

GASB 31

According to GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment 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 a 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 and to compute unit values. The Board of Investments has adopted a policy to treat STIP as a 2a7-like pool.

GASB 40

Effective June 30, 2005, the Board implemented the provisions of GASB Statement No. 40 – *Deposit and Investment Risk Disclosures*. The unaudited financial statements as of June 30, 2008 and 2007 have disclosures pertaining to STIP's exposure to credit risk, custodial credit risk, concentration of credit risk, interest rate risk, and legal and credit risk.

Although the STIP investments have been rated by investment security type, STIP, as an external investment pool, has not been rated.

Security Lending

STIP is eligible to participate in securities lending. Securities lending transactions for fiscal year 2008 are disclosed in STIP's financial statements.

An unaudited copy of the STIP fiscal year 2008 financial statements is available online at www.investmentmt.com/Programs/STIP Program.

(continued)

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008

3. CHANGES IN CAPITAL ASSETS

	Balance <u>7/1/07</u>	<u>Additions</u>	<u>Retirements</u>	Balance <u>6/30/08</u>
Capital assets not being depreciated:				
Land	\$ 1,063,038	\$ -	\$ -	\$ 1,063,038
Land easements	58,117	-	-	58,117
Sewer construction in progress	2,390,183	-	(2,339,343)	50,840
Water construction in progress	<u>1,614,667</u>	<u>2,610,618</u>	<u>-</u>	<u>4,225,285</u>
Total capital assets not being depreciated	<u>5,126,005</u>	<u>2,610,618</u>	<u>(2,339,343)</u>	<u>5,397,280</u>
Capital assets being depreciated:				
Office building	463,738	-	-	463,738
Sewer infrastructure	27,157,743	385,060	-	27,542,803
Water infrastructure	<u>11,619,628</u>	<u>3,049,296</u>	<u>-</u>	<u>14,668,924</u>
Total capital assets being depreciated	39,241,109	3,434,356	-	42,675,465
Accumulated depreciation	<u>(7,143,977)</u>	<u>(830,177)</u>	<u>-</u>	<u>(7,974,154)</u>
Net depreciable capital assets	<u>32,097,132</u>	<u>2,604,179</u>	<u>-</u>	<u>34,701,311</u>
Total capital assets	<u>\$ 37,223,137</u>	<u>\$ 5,214,797</u>	<u>\$ (2,339,343)</u>	<u>\$ 40,098,591</u>

As of June 30, 2008, approximately \$2,187,601 of interest has been capitalized as capital assets.

4. OUTSTANDING DEBT

The following is a summary of long-term debt at June 30, 2008:

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, 2008 was 7%.

\$ 156,537

(continued)

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008

4. OUTSTANDING DEBT (Continued)

General obligation bonds

4% State Revolving Loan #1 dated May 28, 1996 for \$5,513,000 with the Department of Natural Resources and Conservation of the State of Montana under the Wastewater Treatment Works Revolving Fund Program, for the design, construction, and installation of mandated improvements to the District's wastewater treatment system, satisfying the Interim Action Work Plan mandated by the Montana Water Quality Bureau, Payable in 33 semi-annual installments of approximately \$232,000 until January 1, 2013. 2,081,000

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. 168,000

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, 2008 totaled \$6,766,000. Payable in 40 semi-annual installments of approximately \$260,000 until July 1, 2023. 5,869,000

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. 448,000

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, 2008 was \$5,725,154. 4,651,154

(continued)

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008

4. OUTSTANDING DEBT (Continued)

4% State Revolving Fund (DNRC Drinking Water Revolving Loan Program) Series 2003 dated May 20, 2003 for the construction of a water tank. Total loan commitment of \$1,966,000. Payable in 42 semi-annual installments of approximately \$72,000 until July 1, 2024. 1,723,000

3.75% State Revolving Fund (DNRC Drinking Water Revolving Loan Program) Series 2007 dated August 17, 2007 for improvements to the District's water system. Total possible loan commitment of \$5,000,000; amount advanced as of June 30, 2008 was \$3,172,277. Payable in 40 semi-annual installments of approximately \$132,000 until July 1, 2027. 3,087,277

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.

	Balance 6/30/07	Additions	Reductions	Balance 6/30/08	Amounts Due within One Year
Bonds and notes payable:					
State Revolving Loan #1	\$ 2,450,000	\$ -	\$ (369,000)	\$ 2,081,000	\$ 384,000
State Revolving Loan #2	198,000	-	(30,000)	168,000	31,000
SRF Treatment Plant	6,138,000	-	(269,000)	5,869,000	279,000
SRF Water Meters	468,000	-	(20,000)	448,000	22,000
SRF Water Tank	1,796,000	-	(73,000)	1,723,000	75,000
GO Bonds Treatment Plant	4,905,154	-	(254,000)	4,651,154	263,000
SRF Water System Improvements	-	3,172,277	(85,000)	3,087,277	149,808
American Bank Off. Bldg	<u>160,699</u>	<u>-</u>	<u>(6,561)</u>	<u>156,537</u>	<u>6,561</u>
Total bonds and notes payable	16,115,853	3,172,277	(1,106,561)	18,183,968	1,210,369
Compensated absences	<u>54,411</u>	<u>8,600</u>	<u>-</u>	<u>63,011</u>	<u>-</u>
Total long-term liabilities	<u>\$ 16,170,264</u>	<u>\$ 3,180,877</u>	<u>\$ (1,106,561)</u>	<u>\$ 18,246,979</u>	<u>\$ 1,210,369</u>

(continued)

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008

4. OUTSTANDING DEBT (Continued)

Debt service requirements at June 30, 2008, were as follows:

Year Ended June 30,	Principal	Interest
2009	\$ 1,210,369	\$ 695,416
2010	1,262,423	647,513
2011	1,308,519	597,631
2012	1,362,657	545,901
2013	1,414,839	492,029
2014-2018	5,217,579	1,813,293
2019-2023	5,904,139	711,214
2024-2025	503,443	14,631
Total	<u>\$ 18,183,968</u>	<u>\$ 5,517,629</u>

Sewer System General Obligation Bonds – Debt Restrictions

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

The District was in compliance with the bond covenants at June 30, 2008.

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 \$500,000 at June 30, 2008 is offset by deferred revenue of \$500,000.

Changes in deferred revenue were as follows:

	Balance 6/30/07	Additions	Revenue Recognized	Balance 6/30/08
Boyne settlement	\$ 750,000	\$ -	\$ (250,000)	\$ 500,000
Farmhouse	97,800	-	-	97,800
	<u>\$ 847,800</u>	<u>\$ -</u>	<u>\$ (250,000)</u>	<u>\$ 597,800</u>

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008

6. NET ASSETS – RESTRICTED

Net assets are restricted as follows:

Restricted for debt service	<u>\$ 1,828,916</u>
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7. 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 2008 total payroll and covered payroll for both retirement plans was \$441,378. 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. As of July 1, 2007, the District is required to contribute 6.935% of members' compensation, which was \$30,610 for the year ended June 30, 2008. Prior to July 1, 2007, the District was required to contribute 6.8% of members' compensation, which was \$28,140 and \$26,665 for the years ended June 30, 2007 and 2006, respectively. Plan members are required to contribute 6.9% of their compensation, which was \$30,455, \$28,554, and \$27,058 for the years ended June 30, 2008, 2007, and 2006, respectively. The State is required to contribute .1% of members' compensation, which was \$441, \$414, and \$392 for the years ended June 30, 2008, 2007, and 2006, 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. Employees become vested in the employer's contributions after 5 years of service and become vested in the employee's contributions immediately.

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008

8. COMMITMENTS AND CONTINGENCIES

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, 2008

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 Wastewater Revolving Loan Program Series 2003) - Wastewater Treatment Plant				
	66.458	SRF C-301184-04	\$6,500,000	\$ 4,651,154

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, 2007 and 2008. This loan balance outstanding is also included in the federal expenditures presented in this schedule.

Program Title	Federal CFDA Number	Outstanding Amount at 6/30/07	Outstanding Amount at 6/30/08
Office of Water, Environmental Protection Agency Passed through Montana Department of Natural Resources and Conservation:			
State Revolving Fund (DNRC Wastewater Revolving Loan Program Series 2003) - Wastewater Treatment Plant			
	66.458	\$4,905,154	\$ 4,651,154

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 financial statements of Big Sky County Water and Sewer District No. 363 as of and for the year ended June 30, 2008, and have issued our report thereon dated December 29, 2008. 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 & Sewer District No. 363's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Big Sky County Water & Sewer District No. 363's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Big Sky County Water & Sewer District No. 363's internal control over financial reporting.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

December 29, 2008

Board of Directors

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether Big Sky County Water & 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 grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the Board of Directors, others within the entity, 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.

A handwritten signature in cursive script, appearing to read "Holmes & Turner", with a long horizontal flourish extending to the right.

December 29, 2008

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 (a nonprofit organization) 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, 2008. Big Sky County Water & 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 & Sewer District No. 363's management. Our responsibility is to express an opinion on Big Sky County Water & 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 & 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 & 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 its major federal program for the year ended June 30, 2008.

Internal Control over Compliance

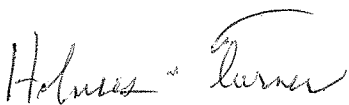
The management of the Big Sky County Water & Sewer District No. 363 is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered 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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Big Sky County Water & Sewer District No. 363's internal control over compliance.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, the Board of Directors, others within the entity, 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.



December 29, 2008

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Summary of auditor's results

1. The auditor's report expresses an unqualified opinion on the financial statements of Big Sky County Water and Sewer District No. 363
2. No instances of noncompliance material to the financial statements of Big Sky County Water and Sewer District No. 363 were disclosed during the audit.
3. The auditor's report on compliance for the major federal award programs for Big Sky County Water and Sewer District No. 363 expresses an unqualified opinion on all major federal programs.
5. There were no audit findings relating to major programs that are required to be reported in accordance with Section 510(a) of OMB Circular A-133.
6. The auditee's major program is follows:

Office of Water, Environmental Protection Agency
Passed-through Montana Department of Natural Resources and Conservation
State Revolving Fund (DNRC Wastewater Revolving Loan Program Series 2003)
– Wastewater Treatment Plan
CFDA #66.458
7. The \$300,000 threshold was used in distinguishing between Type A and Type B programs.
8. Big Sky County Water and Sewer District No. 363 was determined to be a low-risk auditee.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
CURRENT STATUS OF PRIOR YEAR RECOMMENDATIONS
FOR THE YEAR ENDED JUNE 30, 2008

There were no findings, questioned costs, or reportable conditions for the year ended June 30, 2007.