

ORIGINAL

Audit FY 2011-2012

Financials Audit

holmes & turner
Certified Public Accountants

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
ANNUAL FINANCIAL REPORT
FOR THE YEAR ENDED JUNE 30, 2012

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 and major fund of Big Sky County Water and Sewer District No. 363 as of and for the year ended June 30, 2012, 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 opinions 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 the 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and major fund of Big Sky County Water and Sewer District No. 363 as of June 30, 2012, 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 [DATE], 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 considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context.

[DATE]

Big Sky County Water and Sewer District No. 363

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We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

[DATE]



BIG SKY COUNTY WATER & SEWER DISTRICT No. 363

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Management Discussion and Analysis Fiscal Year 7/1/2011 - 6/30/2012

The Big Sky County Water & Sewer District 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.

Assets/Liabilities

The total assets of the District decreased by 0.36% in the fiscal year. This was primarily due to capital assets net of accumulated depreciation decreasing from \$42,866,485 to \$42,324,410. The District added few new capital assets to the asset base due to the continued slowdown in development. The total liabilities of the District decreased 7.60% primarily due to debt service principal payments. The sewer capital assets of the District increased from \$34,979,518 to \$35,222,306. The District added approximately \$8,400 to the Sewer Pond filtration System, \$7,400 to the Treatment Plant, \$4,200 Cascade System, and \$223,000 in Sewer Pond Improvements. The water capital assets increased from \$18,245,604 to \$18,428,071. The District spent \$19,000 to refurbish the Meadow Village 250K Water Tank. The District spent \$57,000 on new variable frequency drives for the booster pumps and telemetry equipment for the Cascade System. The District replaced old fire hydrants and spent approximately \$47,000 on new fire hydrants. The District added a dump truck to the vehicle fleet in the amount of \$6,500. The District installed \$48,000 in water meter equipment and \$2,000 in computer upgrades. There was one outstanding invoice in the amount of \$1,725 for the Silverbow Condominium project. The District's other asset category remained at \$97,800 which is a note receivable from Farmhouse Partners for Plant Investment Fees.

The total long-term liabilities associated with the existing State Revolving Fund Loans of both systems decreased from \$16,377,309 to \$14,994,309. The District used low interest rate (3.75%-4.00%) loans from the State Revolving Loan Fund Program to finance both water and sewer projects. The wastewater treatment plant upgrade project was substantially completed in 2004. The District completed sewer work on the pond liner cover using funds from the Plant Investment Fund. The water system improvements are continuing with the most recent State Revolving Loan in the amount of \$5,000,000. At June 30, 2012 the loan balance available for use on water projects was \$141,521. The current liabilities of the District increased from \$2,582,107 to \$2,673,049 which includes a decrease in accounts payable to \$358,825 from \$374,469 an increase in performance bonds and retainage payable from \$704,679 to \$736,124 an increase in water reserve payable to \$78,857 from \$55,579 and the increase in the current portion of long-term debt from \$1,447,380 to \$1,499,243 at June 30, 2012.

Year	Total Assets	Growth Rate	Total Liabilities	Growth Rate
2007-2008	\$51,395,601	7.99%	\$19,987,097	8.58%
2008-2009	\$51,949,681	1.08%	\$19,193,305	-3.97%
2009-2010	\$55,644,784	7.11%	\$18,950,880	-1.26%
2010-2011	\$55,327,031	-0.57%	\$17,695,607	-6.62%
2011-2012	\$55,125,201	-0.36%	\$16,350,775	-7.60%

Operating Revenue/Non-Operating Revenue

The total operating revenues of the District increased to \$2,338,408 from \$2,319,863. The total sewer operating revenue decreased to \$1,288,657 from \$1,323,696. The total water operating revenue increased to \$1,049,751 from \$996,167. The decrease in sewer operating revenue was due to a decrease in sewer usage of 6.79%. The water operating revenue increase was due to a 5.78% increase in water usage; primarily summer irrigation water, which is not included as a source for sewer operations revenue. 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 includes plant investment charges, interest income, tax receipts for bond payments and Resort Tax allocations. The total non-operating revenue, net of interest expenses and other non-operating expenses of the District increased to \$1,248,654 from \$1,015,754. The increase is primarily due to the additional debt service funding of \$250,000 from the Big Sky Area Resort Tax. The District received \$500,000 from the Big Sky Area Resort Tax Board for paying interest and principal on two of the State Revolving Fund loans for the sewer filter building based on the Inter-local Agreement that the District has with the Big Sky Resort Tax Board. The District also collected \$921,149 in general obligation bond tax receipts for payments on the State Revolving Fund Loans used to finance the water tank, water meters, two water system rehabilitation projects (Hidden Village and Silverbow Condominiums), and the new sewer treatment plant. The decrease in tax receipts is due to the additional funding by the Big Sky Area Resort Tax.

Year	Total Revenues	Growth Rate	Total Expenses	Growth Rate
2007-2008	\$4,316,041	-12.36%	\$2,898,150	7.20%
2008-2009	\$4,338,448	0.52%	\$3,116,370	7.53%
2009-2010	\$4,743,019	9.33%	\$3,095,868	-0.66%
2010-2011	\$3,986,600	-15.95%	\$3,049,081	-1.51%
2011-2012	\$4,201,313	5.39%	\$3,058,311	0.30%

Operating Expenses/Non-Operating Expenses

The total operating expense for the District increased to \$2,444,060 from \$2,398,098. The total general and administrative expense increased to \$429,406 from \$412,798. The total sewer general and administrative expense decreased to \$183,015 from \$186,855. Total sewer operation expense decreased to \$966,477 from \$989,582. The total water general and administrative expense increased to \$241,159 from \$206,908. The total water operating expense increased to \$624,003 from \$601,955. The total operating expense increased from last fiscal year at a rate of 1.92%. In the non-operating expense category the main item is the interest expense on the State Revolving Fund Loans. In fiscal 2011-2012 the District made principal payments in the amount of \$1,383,000 with total payments amounting to \$1,973,272. The District paid \$590,272 in interest on those loans. The other item in the non-operating expense category was the Snowmaking Pilot Project. The expenses associated with that project were off set in their entirety by contributions and grants to pay for the study.

Year	Total Operating Revenues	Growth Rate	Total Operating Expenses	Growth Rate
2007-2008	\$2,031,491	-0.54%	\$2,246,848	9.90%
2008-2009	\$2,330,721	14.73%	\$2,367,521	5.37%
2009-2010	\$2,397,265	2.86%	\$2,378,743	0.47%
2010-2011	\$2,319,863	-3.23%	\$2,398,098	0.81%
2011-2012	\$2,338,408	0.80%	\$2,444,060	1.92%

Capital Assets

The District did not receive any donated capital assets this fiscal year. 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 donated capital assets are acquired by the District through formal transfer agreements, which are recorded at the appropriate county office. The District is also given a one-year warranty on these assets as either cash or a letter of credit in the amount of 10% of the asset cost made by the developer as warranty security. 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, 2012 were \$38,774,426. The total amount includes \$27,330,101 invested in capital assets, net of related debt, \$10,633,352 in unrestricted assets which includes cash, and \$810,973 restricted cash for debt service. The total represents an increase of \$1,143,002 over the prior fiscal year total. The amount invested in capital assets, net of related debt increased by \$840,925 due to asset additions and debt reduction. The unrestricted portion increased by \$232,317 due to an increase in cash position. The restricted for debt service category increased to \$810,973 from \$741,213 due to additional funding by the Big Sky Area Resort Tax.

Summary

The District's 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, both the District's sewer and water operating revenue were insufficient to cover all the operating expenses in fiscal 2011-2012. The total operating loss was \$105,652. The sewer department loss totaled \$71,740 and the water department loss totaled \$33,912. Both the water and sewer departments operate in positive cash flow but used reserve funds to balance their operating budgets. The District is not contemplating rate increases at this time, but will monitor closely the next fiscal year's operating expenditures. The District continues to believe that both regulatory and other operating costs will increase for the District's water and sewer department. The District believes that the water and sewer rates adopted effective July 1, 2008 and July 1, 2009 will be insufficient to cover operating expenses in the next fiscal-year. However, depreciation expense on capital equipment is on a downward trend and should provide some leeway with respect to rate adjustments. The District will keep the District's property owners informed of any planned rate change.

Rates Fiscal Year	Water Base	Growth Rate	Water Usage	Growth Rate	Sewer Base	Growth Rate	Sewer Usage	Growth Rate
2005-2006	\$14.25	0%	\$2.35	0%	\$22.04	0%	\$3.85	0%
2006-2007	\$14.25	0%	\$2.35	0%	\$22.04	0%	\$3.85	0%
2007-2008	\$14.25	0%	\$2.35	0%	\$22.04	0%	\$3.85	0%
2008-2009	\$14.89	4.49%	\$2.42*	2.98%	\$23.03	4.49%	\$4.81	24.94%
2009-2010	\$15.46	3.83%	\$2.49*	2.89%	\$23.91	3.82%	\$5.82	21.00%
2010-2011	\$15.46	0%	\$2.49*	0%	\$23.91	0%	\$5.82	0%
2011-2012	\$15.46	0%	\$2.49*	0%	\$23.91	0%	\$5.82	0%

*Beginning in July of 2008 the water usage rates were tiered, 0-60,000 gallons, 60,000 to 90,000 gallons and 90,000 gallons and above as follows: 2008-2009 \$2.42, \$3.63, \$4.84; 2009-2010 \$2.49, \$3.74, \$4.99
Water and sewer usage charges are for each thousand gallons metered or fraction of a thousand gallons. The base charges are for one month of service for water and sewer.

The budget for fiscal 2011-2012 at year-end had total revenues 100.61% of budget, total expenses 100.46% of budget and total net revenue 101.02% of budget. There were no sewer or water assets contributed to the District and net income was \$1,143,002, which was 89.20% of budget.

The operating revenues were at 97.88% of budget and operating expenses were at 102.50% of budget. As a result, there was a \$105,652 operating loss. Administrative expenses for general administration, water administration and sewer administration all came in under budget. The sewer operations expense was 105.67% of budget. The sewer and water department's operating budget is separated into seven categories: vehicles, operating expenses, repairs and maintenance, professional services, miscellaneous, asset replacement & depreciation and special projects. The sewer department was over budget in all categories except miscellaneous, asset replacement & depreciation and special projects. The sewer department vehicles category was over by 12.51% in fuel and 120.51% over in vehicle repairs. Fuel costs have increased and the vehicles are aging causing the budget variance. In the sewer operating category there were three main sub-categories responsible for the variance, power costs over approximately 16.33% for the treatment plant, filter building chlorine chemicals over 88.85%, and lab fees over 55.26%. The power budget was decreased from the prior year due to experience but the reduction in power costs were not realized in the current year. The chemicals and lab fees saw price increases, which were not anticipated. The repairs and maintenance category had two sub-categories responsible for the variance: treatment plant and filter building repairs and maintenance over approximately 146.23%, and irrigation maintenance over 124.99%. Both the treatment plant and filter building required unexpected repairs. The irrigation system that provides grey water to the golf course had unanticipated repairs. In the professional services category the District spent approximately \$17,500 on a nutrient management plan engineering study required by the Montana Department of Environmental Quality. Total sewer plant operations expense was 105.67% of budget.

The water plant operation was over budget in two categories: vehicles and repairs and maintenance. In the vehicles category, fuel was over 23.56% and repairs and maintenance were over 12.95%. Again, fuel costs were up and an aging vehicle fleet required additional maintenance. In the repairs and maintenance category two sub-categories were over budget: repairs-distribution system over 27.45% and generator semi annual check-up over 1,118.94%. The water department had more repairs than anticipated in the budget. The generator check-ups had been done by a local contractor in the last few years. However, the full maintenance on the generators had not been done. As a result, a new contractor was brought in to fully assess the condition of the generators and provide maintenance costing approximately \$15,000. Future annual costs are estimated to be approximately \$7,000. Total water plant operations expense was 104.00% of budget.

Total non-operating revenues were at 104.26% of budget and non-operating expenses were at 93.07% of budget. Tax receipts from both Gallatin and Madison County were slightly higher than budgeted, 2.4% and 8.83% over budget respectively. The plant investment fee sub-category was budgeted at \$45,000, however, \$113,915 was collected. The District budgeted \$150,000 in capital contributions but none were received. Both the water and sewer debt service interest costs were under budget because no additional funding was requested. As a result, net non-operating revenues were \$1,248,654.

The District has a total of seven State Revolving Fund loans with an outstanding balance at fiscal year-end of \$14,994,309 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 taxes. The District currently has a commitment from the Big Sky Area Resort Tax for two of the seven loans, \$500,000 annually. This commitment will end in fiscal year 2012-2013 as the two SRF loans will be paid off. For the other five loans, the District applies annually for funding to the Big Sky Area Resort Tax. For fiscal 2011-2012 the District secured \$250,000 for the water and sewer debt service from the Resort Tax. The District used approximately \$400,000 in plant investment fees to service the debt. The Resort Tax Board allocated \$0.00 in additional debt service for fiscal 2012-2013. The District will contribute another \$400,000 in plant investment fees toward debt service in fiscal 2012-2013. To service the debt in the next fiscal year, since no money was received from resort tax, the District has to increase the mills levied on water debt service from 21.63 mills to 27.80 mills and increase the mills levied on sewer from 21.05 mills to 26.40 mills.

The District closed out the open sewer State Revolving Fund loan for the wastewater treatment plant project that had an unused balance in the amount of \$273,137. The District's State Revolving Fund loan for water system upgrades in the amount of \$5,000,000 is still open. The balance on the water State Revolving Fund loan was \$141,521 at fiscal year-end. The District intends on using the remaining funds to complete the wells in the Meadow Village. Based on the current funding and expected future funding sources, the existing State Revolving Fund loan 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 water and sewer operations.

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363
STATEMENT OF NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2012

ASSETS

Current assets:	
Cash and cash equivalents	\$ 11,237,453
Investments	1,643
Accounts receivable	602,134
Prepaid expenses	12,216
Water meter inventory	<u>38,572</u>
Total current assets	<u>11,892,018</u>
Noncurrent assets:	
Restricted cash and cash equivalents:	
Debt service fund	810,973
Notes receivable	97,800
Capital assets, net of accumulated depreciation, where applicable:	
Land and land easements	1,072,806
Depreciable buildings and infrastructure, net	<u>41,251,604</u>
Total noncurrent assets	<u>43,233,183</u>
Total assets	<u><u>\$ 55,125,201</u></u>

LIABILITIES AND FUND EQUITY

Current liabilities:

Accounts payable and accrued expenses	\$ 358,825
Performance bonds and retainage payable	736,124
Water reserve payable	78,857
Current portion of long-term debt	<u>1,499,243</u>
Total current liabilities	<u>2,673,049</u>

Long-term liabilities:

Deferred revenue	97,800
Compensated absences payable	84,860
General obligation bonds	14,994,309
Less: current portion of long-term debt	<u>(1,499,243)</u>
Total long-term liabilities	<u>13,677,726</u>
Total liabilities	<u>16,350,775</u>

Net assets:

Invested in capital assets, net of related debt	27,330,101
Unrestricted	10,633,352
Restricted for debt service	<u>810,973</u>
Total fund equity	<u>38,774,426</u>
Total liabilities and fund equity	<u>\$ 55,125,201</u>

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, 2012

Operating revenues:	
Sewer services	\$ 1,288,657
Water services	<u>1,049,751</u>
 Total operating revenue	 <u>2,338,408</u>
 Operating expenses:	
General and administrative:	
Meetings	1,044
Directors' expense	3,882
Salaries	215,046
Payroll taxes and benefits	32,420
Utilities	5,850
Janitorial and carpet services	639
Office supplies and expense	8,226
Telephone	5,394
Postage and shipping	11,682
Advertising	40
Insurance	112,906
Dues and subscriptions	1,080
Vehicle expense	5,846
Legal fees	3,347
Computer maintenance	6,034
Audit expense	8,540
Bank service charges	60
State annual filing fee	845
Miscellaneous	2,155
GIS mapping and other consulting fees	50
Office building repair & maintenance	1,625
Education expenses	2,555
Election fees	<u>140</u>
 Total general and administrative	 <u>429,406</u>

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, 2012

Operating expenses (Continued):

Sewer general and administrative:

Salaries and wages	112,737
Workers' compensation insurance	43,660
Payroll taxes and benefits	17,433
Dues and subscriptions	323
Telephone	4,412
Office supplies	491
Education expense	3,959

Total sewer general and administrative	183,015
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Sewer plant expense:

Fuel - equipment and vehicles	10,325
Vehicle repair and maintenance	5,513
Vehicle insurance	2,288
Utilities	141,242
Chemicals	28,423
Waste water monitoring	24,066
Lab testing equipment	363
Compost supplies	2,250
Safety equipment	550
Welding & welding supplies	1,089
Sewer repairs and maintenance	17,830
Treatment plant repairs and maintenance	21,405
Maintenance and repairs - building and grounds	19,909
Tools	6,238
Jetting - sewer lines	27,107
Engineering	17,315
Miscellaneous	1,504
Depreciation expense	639,060

Total sewer plant expense	966,477
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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, 2012

Operating expenses (Continued):

Water general and administrative:

Salaries and wages	154,420
Workers' compensation insurance	48,752
Payroll taxes and benefits	23,839
Dues and subscriptions	2,768
Telephone	6,108
Office supplies	11
Education expense	1,451
Public water supply fees	3,810

Total water general and administrative	241,159
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Water plant expense:

Fuel - equipment and vehicles	10,554
Vehicle repair and maintenance	8,426
Vehicle insurance	2,288
Utilities	144,163
Chemicals	1,511
Lab fees	2,251
Lab testing equipment	414
Safety equipment	1,696
Repairs and maintenance	87,959
Tools	8,984
Equipment rental	1,338
Special projects	3,713
Professional services	21,049
Miscellaneous	1,387
Depreciation expense	328,270

Total water plant expense	624,003
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Total operating expenses	2,444,060
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Operating (loss)	(105,652)
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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, 2012

Nonoperating revenues (expenses):	
Other nonoperating revenue	14,640
Other nonoperating expenses	(23,979)
Interest income	63,201
Tax receipts for bond payments	921,149
Plant investment charges	113,915
Resort tax revenue	750,000
Interest expense	<u>(590,272)</u>
Total nonoperating revenues (expenses)	<u>1,248,654</u>
Increase in net assets	1,143,002
Net assets, beginning of year	<u>37,631,424</u>
Net assets, end of year	<u><u>\$ 38,774,426</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, 2012

Increase in cash and cash equivalents:

Cash flows from operating activities

Receipts from customers	\$ 2,343,403
Payments to suppliers	(483,113)
Payments to employees	<u>(983,630)</u>
Net cash provided by operating activities	<u>876,660</u>

Cash flows from capital and related financing activities

Principal paid on capital debt	(1,383,000)
Purchases of capital assets	(425,255)
Interest paid on capital debt	(620,318)
Taxes collected for bond payments	921,149
Resort taxes received for bond payments	750,000
Other receipts (payments)	<u>104,576</u>
Net cash (used) by capital and related financing activities	<u>(652,848)</u>

Cash flows from investing activities:

Interest	67,812
Proceeds from performance bonds and fees	<u>26,829</u>
Net cash provided by investing activities	<u>94,641</u>

Net increase in cash and cash equivalents **318,453**

Cash and cash equivalents - beginning of the year **11,729,973**

Cash and cash equivalents - end of the year **\$ 12,048,426**

Cash and cash equivalents as presented on the statement of net assets:

Cash and cash equivalents	\$ 11,237,453
Restricted cash and cash equivalents	<u>810,973</u>
	<u><u>\$ 12,048,426</u></u>

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

Operating (loss)	<u>\$ (105,652)</u>
Adjustments to reconcile operating (loss) to net cash provided by operating activities:	
Depreciation	967,330
(Increase) decrease in current assets:	
Accounts receivable	(18,283)
Prepaid expenses	(4,143)
Inventory	639
(Increase) decrease in current liabilities:	
Accounts payable and accrued expenses	14,402
Compensated absences payable	(911)
Water reserve payable	23,278
	<u>982,312</u>
Net cash provided by operating activities	<u><u>\$ 876,660</u></u>

See accompanying notes to financial statements

BIG SKY COUNTY WATER & SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

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, 2012

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. Use of Restricted/Unrestricted Net Assets

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, the District's policy is to apply restricted net assets first.

F. 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.

G. Restricted Cash

According to a bond resolution, cash in the amount of \$810,973 is restricted; this is the amount that has accumulated in the Debt Service Fund. This restriction is for debt repayment.

(continued)

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

H. Inventory

Inventory is recorded at lower of cost (first-in, first-out) or market and consists primarily of operating materials.

I. Internal Balances

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

J. 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.

K. Compensated Absences

Employees accrue vacation time at 10 hours per month (increasing to 12 hours per month after 10 years of service and up to 16 hours per month after 21 years of service) 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.

L. 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.

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.

(continued)

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

L. Net Assets (continued)

- **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.”

M. 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.

N. Budget

The District is not legally required to adopt a budget; therefore management has decided not to present the budget in the financial statements.

O. 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.

P. 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, 2012

2. CASH AND INVESTMENTS

As of June 30, 2012, the carrying amount of the District's deposits (cash and interest-bearing money market accounts) at local banks was \$12,048,226 and the bank balance was \$12,027,913. Of the bank balance, \$750,000 was covered by federal depository insurance and \$11,277,913 was covered by collateral held by the pledging bank's agent in the District's name.

At June 30, 2012, 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, 2012 was \$1,643.

At the time that this report was issued, the following information was available regarding this investment as of June 30, 2012:

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 and to utilize an amortized cost unit value rather than fair value to report net assets.

GASB 40

Effective June 30, 2005, the State of Montana Board of Investments implemented the provisions of GASB Statement No. 40 – *Deposit and Investment Risk Disclosures*. The unaudited financial statements as of June 30, 2011 and 2010 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 2011 are disclosed in STIP's financial statements.

An unaudited copy of the STIP fiscal year 2011 financial statements is available online at <http://www.investmentmt.com/content/STIP/Docs/2011STIPFinancial.pdf>.

BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

3. CHANGES IN CAPITAL ASSETS

	Balance <u>7/1/11</u>	<u>Additions</u>	<u>Retirements</u>	<u>Transfers</u>	Balance <u>6/30/12</u>
Capital assets not being depreciated:					
Land	\$ 1,014,689	\$ -	\$ -	\$ -	\$ 1,014,689
Land easements	58,117	-	-	-	58,117
Water construction in progress	<u>5,000</u>	<u>-</u>	<u>-</u>	<u>(5,000)</u>	<u>-</u>
Total capital assets not being depreciated	<u>1,077,806</u>	<u>-</u>	<u>-</u>	<u>(5,000)</u>	<u>1,072,806</u>
Capital assets being depreciated:					
Office building	518,259	-	-	-	518,259
Sewer infrastructure	33,446,569	242,789	-	-	33,689,358
Water infrastructure	<u>18,182,488</u>	<u>182,466</u>	<u>-</u>	<u>5,000</u>	<u>18,369,954</u>
Total capital assets being depreciated	52,147,316	425,255	-	5,000	52,577,571
Accumulated depreciation	<u>(10,358,637)</u>	<u>(967,330)</u>	<u>-</u>	<u>-</u>	<u>(11,325,967)</u>
Net depreciable capital assets	<u>41,788,679</u>	<u>(542,075)</u>	<u>-</u>	<u>5,000</u>	<u>41,251,604</u>
Total capital assets	<u>\$42,866,485</u>	<u>\$ (542,075)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$42,324,410</u>

As of June 30, 2012, approximately \$768,064 of interest has been capitalized as capital assets.

4. OUTSTANDING DEBT

The following is a summary of long-term debt at June 30, 2012:

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.

\$ 449,000

(continued)

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

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. \$ 36,000

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. Payable in 40 semi-annual installments of approximately \$256,000 until July 1, 2023. 4,681,000

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 \$20,000 until July 1, 2023. 357,000

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, 2010 was \$6,226,862. 4,035,862

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. 1,403,000

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, 2010 was \$4,697,529. Payable in 40 semi-annual installments of approximately \$171,000 until January 1, 2028. 4,032,447

Total \$ 14,994,309

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

4. OUTSTANDING DEBT (Continued)

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.

	<u>Balance</u>			<u>Balance</u>	<u>Amounts</u>
	<u>6/30/11</u>	<u>Additions</u>	<u>Reductions</u>	<u>6/30/12</u>	<u>Due within</u>
					<u>One Year</u>
Bonds payable:					
State Revolving Loan #1	\$ 882,000	\$ -	\$ (433,000)	\$ 449,000	\$ 449,000
State Revolving Loan #2	71,000	-	(35,000)	36,000	36,000
SRF Treatment Plant	4,996,000	-	(315,000)	4,681,000	328,000
SRF Water Meters	381,000	-	(24,000)	357,000	25,000
SRF Water Tank	1,488,000	-	(85,000)	1,403,000	89,000
GO Bonds Treatment Plant	4,330,862	-	(295,000)	4,035,862	288,847
SRF Water System Improvements	<u>4,228,447</u>	<u>-</u>	<u>(196,000)</u>	<u>4,032,447</u>	<u>198,536</u>
Total bonds payable	16,377,309	-	(1,383,000)	14,994,309	1,414,383
Compensated absences	<u>85,771</u>	<u>-</u>	<u>(911)</u>	<u>84,860</u>	<u>84,860</u>
Total long-term liabilities	<u>\$16,463,080</u>	<u>\$ -</u>	<u>\$(1,383,911)</u>	<u>\$15,079,169</u>	<u>\$1,499,243</u>

Debt service requirements at June 30, 2012, were as follows:

<u>Year Ended</u>		
<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2013	1,414,383	569,627
2014	964,832	518,719
2015	1,001,979	481,052
2016	1,040,849	441,901
2017	1,082,473	401,238
2018-2022	6,081,097	1,337,755
2023-2027	3,288,786	276,380
2028	<u>119,910</u>	<u>3,815</u>
Total	<u>\$ 14,994,309</u>	<u>\$ 4,030,487</u>

(continued)

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

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.

The District was in compliance with the bond covenants at June 30, 2012.

5. DEFERRED REVENUE

On October 6, 1997, the District entered into an agreement with Farmhouse Partners – Big Sky Limited Partnership to defer the payment of plant investment charges. Interest is paid at a rate of 1-4% annually until December 31, 2012 at which time the principal will be paid. The principal balance of this note is offset by deferred revenue.

Changes in deferred revenue were as follows:

	<u>Balance</u> <u>6/30/11</u>	<u>Additions</u>	<u>Revenue</u> <u>Recognized</u>	<u>Balance</u> <u>6/30/12</u>
Farmhouse	97,800	-	-	97,800

6. NET ASSETS – RESTRICTED

Net assets are restricted as follows:

Restricted for debt service \$ 810,973

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

7. EMPLOYEE BENEFIT PLANS

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 7.07% of members' compensation, which was \$36,441, \$35,132, and \$35,342 for the fiscal years ended June 30, 2012, 2011 and 2010, respectively. Plan members are required to contribute 6.9% of their compensation, which was \$35,565, \$34,288, and \$34,492 for the years ended June 30, 2012, 2011, and 2010, respectively. The State is required to contribute .1% of members' compensation, which was \$515, \$497, and \$500 for the years ended June 30, 2012, 2011, and 2010, respectively. One hundred percent of required contributions were made for all three years.

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. 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.

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.

Deferred Compensation Plan

In February 2009, the District entered into an agreement with the Montana Public Employees' Retirement Board to allow its employees to participate in the State of Montana 457 Deferred Compensation Plan (Plan). The Plan is sponsored by the Montana Public Employees' Retirement Board and is authorized by Internal Revenue Code Section 457(b) and is subject to specific Internal Revenue Service laws and requirements.

During the fiscal year ended June 30, 2012 the maximum contribution that the employees could make to the Plan was \$17,000. The District contributes 6.2% of each participant's wages.

During the fiscal years ended June 30, 2012, 2011 and 2010 the District contributed \$28,817, \$27,559, and 28,343, respectively to the plan and the employees contributed \$41,219, \$38,227, and \$37,729, respectively to the plan.

BIG SKY WATER AND SEWER DISTRICT NO. 363
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2012

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.

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 the business-type activities and the major fund of Big Sky County Water and Sewer District No. 363 as of and for the year ended June 30, 2012, which collectively comprise the Big Sky County Water and Sewer District No. 363's basic financial statements and have issued our report thereon dated [DATE]. 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

Management of Big Sky County Water and Sewer District No. 363 is responsible for establishing and maintaining effective 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 as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Big Sky County Water and 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 and Sewer District No. 363's internal control over financial reporting.

A *deficiency in internal control* 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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.

[DATE]
Board of Directors
Page Two

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 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 Big Sky County Water and Sewer District No. 363 and is not intended to be and should not be used by anyone other than these specified parties.

[DATE]

**BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012**

None

**BIG SKY COUNTY WATER AND SEWER DISTRICT NO. 363
CURRENT STATUS OF PRIOR YEAR RECOMMENDATIONS
FOR THE YEAR ENDED JUNE 30, 2012**

There were no findings, questioned costs, or reportable conditions for the year ended June 30, 2011.

August 28, 2012

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

We were engaged to audit 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, 2012. 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 24, 2012, 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

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested.

Our audit will include obtaining an understanding of the entity and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, extent, and timing of further audit procedures. Material misstatements may result from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets or (4) violations of laws or governmental regulations that are attributable to the entity or to acts by management or employees acting on behalf of the entity. We will communicate our significant findings at the conclusion of the audit. We will also communicate any internal control related matters that are required to be communicated under professional standards.

We expect to begin our audit on approximately August 20, 2012 and issue our report on approximately November 30, 2012.

August 28, 2012

Big Sky County Water & Sewer District No. 363

Page 2

This information is intended solely for the use of the Board of Directors and management of Big Sky County Water & Sewer District No. 363 and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

HOLMES & TURNER

[DATE]

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

We have audited the financial statements of Big Sky County Water & Sewer District No. 363 for the year ended June 30, 2012, and have issued our report thereon dated [DATE]. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter dated August 28, 2012. Professional standards require also require that we communicate to you the following information related to our audit.

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, 2012. 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 entries with a status of "adjusting" were posted by the Financial Officer; the journal entries with a status of "potential" were not posted and are not required to be posted to the financial statements as they are immaterial to the financial statements.

[DATE]
Board of Directors
Page 2

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 [DATE].

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

Prepared by _____

Big Sky Water and Sewer District Adjusting Journal Entries

BSWATER

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Reviewed by _____

Reference	Type	Date Account Number	Description	Debit	Credit	Misstatement
AJE01	Adjusting	06/30/12				
		03-2205-0	SRF Loan C-301184-04 Trmt P	3,000.00		
		02-4210-0	SRF - Interest Expense		1,890.00	
		02-4310-0	SRF Interest Expense		1,110.00	
			Correct allocation of principal and interest			
P1	Potential	06/30/12				
		03-1207-0	Other receivables	41,664.62		
		03-1207-0	Other receivables	23,618.96		
		01-9998-0	Equity		68,042.13	
		01-9998-0	Equity		53,600.40	
		01-4113-0	Madison Co Tax Receipts Wate	56,358.95		
			Taxes receivable not recorded.			
P2	Potential	06/30/12				
		03-1600-0	Fixed Assets-Swr	11,000.00		
		01-3047-0	Rent Inc-Lower Level New Offi		11,000.00	
			Interest in Big Sky S&R Building.			
		TOTAL		<u>135,642.53</u>	<u>135,642.53</u>	