

FLATHEAD COUNTY  
WATER AND SEWER DISTRICT #8

FLATHEAD COUNTY, MONTANA

Fiscal Year Ended June 30, 2014

**AUDIT REPORT**

**Denning, Downey & Associates, P.C.**  
CERTIFIED PUBLIC ACCOUNTANTS

FLATHEAD COUNTY WATER AND SEWER DISTRICT #8

FLATHEAD COUNTY, MONTANA

Fiscal Year Ended June 30, 2014

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FLATHEAD COUNTY WATER AND SEWER DISTRICT #8

FLATHEAD COUNTY, MONTANA

**ORGANIZATION**

Fiscal Year Ended June 30, 2014

**BOARD OF DIRECTORS**

Jacque Cuffe	President
David Baker	Director
Tom Bertelsen	Director
Terry Snipes	Director
Bob Hensley	Director

**DISTRICT OFFICIALS**

Randy Schwickert	District Attorney
Annette Schmidt	Secretary/Treasurer
Mark Munsigner	Operator

Flathead County Water and Sewer District #8  
229-A Butterfly Ln.  
Whitefish, MT 59937  
406.730.1031

Management Discussion and Analysis  
For Fiscal Year Ending June 30, 2014

**Purpose**

Flathead County Water and Sewer District #8 provides water services 194 water connection in the Flathead County subdivision of Happy Valley. There is no sewer service as all homes utilize personal septic systems.

**Rates**

The base rate for service is \$26.00 per month which includes the first 1,000 gallons of water. Water used over and above the first 1,000 gallons is assessed at \$1.79 per 1,000 gallons or portion thereof. All users are connected to their own meter. Meters are read once per month with payment due 15 days later. Due to State of Montana conditions, the District is required to set rates that will equate to a system-wide average monthly water bill of not less than \$33.08.

The system-wide average monthly water bill for this fiscal year was \$33.20.

At this time there is no need to alter the rate structure.

**Financial**

This annual report consists of a series of financial statements. The Statement of Net Position and the Statement of Revenues Expenditures and Changes in Net Position provide information about the activities of the Water Fund.

In fiscal year 2014, the District's net assets decreased by \$33,510. The District's liabilities decreased in fiscal year 2014 by \$7,347. The District's Charges for Services decreased by \$2,941, Special Assessments by \$13,433, and Intergovernmental revenues by \$13,438 while expenditures slightly increased by \$6,159 leading to a decrease in net position by \$35,913.

Flathead County Water District #8, Flathead County, Montana  
MD & A Comparisons  
June 30, 2014

**Table 1 - Net Position**

	<b>Business-type Activities</b>		
	<b><u>FY14</u></b>	<b><u>FY13</u></b>	<b><u>Change Inc (Dec)</u></b>
Current and other assets	\$ 221,298	\$ 203,600	\$ 17,698
Capital assets	803,884	855,092	(51,208)
Total assets	1,025,182	1,058,692	(33,510)
Long-term debt outstanding	\$ 675,642	\$ 682,989	\$ (7,347)
Total liabilities	675,642	682,989	(7,347)
Net investment in capital assets	128,242	172,103	(43,861)
Restricted	10,855	116,474	(105,619)
Unrestricted	210,443	87,126	123,317
Total net position	\$ 349,540	\$ 375,703	\$ (26,163)

**Table 2 - Changes in Net Position**

	<b>Business-type Activities</b>		
	<b><u>FY14</u></b>	<b><u>FY13</u></b>	<b><u>Change Inc (Dec)</u></b>
<b>Revenues</b>			
<i>Program revenues (by major source):</i>			
Charges for services	\$ 79,971	\$ 82,912	\$ (2,941)
Special assessments	33,630	47,063	(13,433)
Miscellaneous	308	307	1
Interest/investment earnings	236	179	57
Intergovernmental	-	13,438	(13,438)
Total revenues	\$ 114,145	\$ 143,899	\$ (29,754)
<b>Program expenses</b>			
Water	\$ 128,728	\$ 122,569	\$ 6,159
Total expenses	\$ 128,728	\$ 122,569	\$ 6,159
Excess (deficiency) before special items and transfers	(14,583)	21,330	(35,913)
<b>Increase (decrease) in net position</b>	<b>\$ (14,583)</b>	<b>\$ 21,330</b>	<b>\$ (35,913)</b>

As of the end of this Fiscal Year, the District has cash totaling \$217,375 in five bank accounts maintained at two different banking institutions, Glacier Bank and Whitefish Credit Union. This is an increase of \$17,125 from June 30, 2013. The District has \$803,884 in Net Capital Assets, a decrease of \$51,208, due to depreciation.

The District is required by United States Rural Development to maintain a Debt Services Reserve Account to which \$310.00 per month (\$3,720 annually) is added for the first ten years following the initiation of the loan. These payments have been made as scheduled. This account is included in the above cash figure.

The only long-term liability is a loan from United States Rural Development with a remaining balance due of \$675,642. Payments are made bi-annually in the amount of \$18,277. The District for these payments come from a SID collected by Flathead County via the annual property tax assessments and then forwarded to the District bi-annually.

The District retains Denning, Downey & Associates, CPAs as the certified public accountants charged with completing annual District audits. Copies of these audits are available for public inspection by contacting the District Secretary at the above address.

### **Future Plans**

At this time there are no plans for major improvements or modifications to the system. The financial accounts mentioned above are maintained to provide the resources for repairs to the system as needed.

***Denning, Downey & Associates, P.C.***  
***CERTIFIED PUBLIC ACCOUNTANTS***

*1740 U.S. Hwy 93 South, P.O. Box 1957, Kalispell, MT 59903-1957*

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**INDEPENDENT AUDITOR'S REPORT**

Board of Directors  
Flathead County Water and Sewer District #8  
Flathead County  
Whitefish, Montana

**Report on the Financial Statements**

We have audited the accompanying financial statements of the business-type activities of Flathead County Water and Sewer District #8, Flathead County, Montana, as of and for the year ended June 30, 2014, and the related notes to the financial statements which collectively comprise the District's basic financial statements as listed in the table of contents.

**Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

## **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 of Flathead County Water and Sewer District #8, Flathead County, Montana, as of and for the year ended June 30, 2014, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## **Other Matters**

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 2 through 4 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. 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.

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated March 20, 2015, on our consideration of the Flathead County Water and Sewer District #8, Flathead County, Montana'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 that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Flathead County Water and Sewer District #8, Flathead County, Montana's internal control over financial reporting and compliance.

*Derring, Downey and Associates, CPA's, P.C.*

March 20, 2015

**Flathead County Water District #8, Flathead County, Montana**  
**Statement of Net Position**  
**Proprietary Funds**  
**June 30, 2014**

		<u>Business-Type Activities - Enterprise Funds</u>
		<u>Water</u>
<b>ASSETS</b>		
Current assets:		
Cash and investments	\$	206,520
Special assessments receivable		1,371
Accounts receivable - net		2,552
Total current assets	\$	<u>210,443</u>
Noncurrent assets:		
Restricted cash and investments	\$	10,855
Capital assets - land		29,896
Capital assets - depreciable, net		773,988
Total noncurrent assets	\$	<u>814,739</u>
Total assets	\$	<u>1,025,182</u>
<b>LIABILITIES</b>		
Current liabilities:		
Current portion of long-term capital liabilities	\$	<u>7,665</u>
Noncurrent liabilities:		
Noncurrent portion of long-term capital liabilities	\$	<u>667,977</u>
Total liabilities	\$	<u>675,642</u>
<b>NET POSITION</b>		
Net investment in capital assets	\$	128,242
Restricted for debt service		10,855
Unrestricted		210,443
Total net position	\$	<u>349,540</u>
Total liabilities and net position	\$	<u><u>1,025,182</u></u>

**Flathead County Water District #8, Flathead County, Montana**  
**Statement of Revenues, Expenses, and Changes in Net Position**  
**Proprietary Funds**  
**For the Fiscal Year Ended June 30, 2014**

	<b>Business-Type Activities - Enterprise Funds</b>
	<b>Water</b>
<b>OPERATING REVENUES</b>	
Charges for services	\$ 79,971
Miscellaneous revenues	308
Special assessments	33,630
Total operating revenues	\$ 113,909
<b>OPERATING EXPENSES</b>	
Supplies	\$ 19,660
Purchased services	28,713
Depreciation	51,148
Total operating expenses	\$ 99,521
Operating income (loss)	\$ 14,388
<b>NON-OPERATING REVENUES (EXPENSES)</b>	
Interest revenue	\$ 236
Debt service interest expense	(29,207)
Total non-operating revenues (expenses)	\$ (28,971)
Change in net position	\$ (14,583)
Net Position - Beginning of the year	\$ 375,703
Restatements	(11,580)
Net Position - Beginning of the year - Restated	\$ 364,123
Net Position - End of the year	\$ 349,540

**Flathead County Water District #8, Flathead County, Montana**  
**Statement of Cash Flows**  
**Proprietary Fund Type**  
**Fiscal Year Ended June 30, 2014**

		<b>Business - Type Activities -</b>
		<b>Enterprise Fund</b>
		<b>Water</b>
<b>Cash flows from operating activities:</b>		
Cash received from providing services	\$	80,769
Cash received from special assessments		32,259
Cash received from miscellaneous sources		308
Cash payments to suppliers		(19,660)
Cash payments for professional services		(28,713)
Net cash provided (used) by operating activities	\$	64,963
<b>Cash flows from capital and related financing activities:</b>		
Principal paid on debt	\$	(7,347)
Interest paid on debt		(29,207)
Net cash provided (used) by capital and related financing activities	\$	(36,554)
<b>Cash flows from investing activities:</b>		
Interest on investments	\$	236
<b>Net increase (decrease) in cash and cash equivalents</b>	\$	28,645
<b>Cash and cash equivalents at beginning</b>		200,250
<b>Cash and cash equivalents at end</b>	\$	217,375
<b>Reconciliation of operating income (loss) to net cash provided (used) by operating activities:</b>		
Operating income (loss)	\$	14,388
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation		51,148
Changes in assets and liabilities:		
Decrease in accounts receivable		798
Increase in assessments receivable		(1,371)
Net cash provided (used) by operating activities	\$	64,963

See accompanying notes to the financial statements

FLATHEAD COUNTY WATER AND SEWER DISTRICT #8  
FLATHEAD COUNTY, MONTANA  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2014

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The District complies with generally accepted accounting principles (GAAP). GAAP includes all relevant Governmental Accounting Standards Board (GASB) pronouncements.

**Financial Reporting Entity**

In determining the financial reporting entity, the District complies with the provisions of GASB statement No. 14, *The Financial Reporting Entity*, as amended by GASB statement No. 61, *The Financial Reporting Entity: Omnibus*, and includes all component units of which the District appointed a voting majority of the component units' board; the District is either able to impose its' will on the unit or a financial benefit or burden relationship exists.

*Primary Government*

The District is a political subdivision of the State of Montana governed by five-member Board of Directors. All five members of the board are elected constituents of the District. The District is considered a primary government because it is a general purpose local government. Further, it meets the following criteria: (a) It has a separately elected governing body (b) It is legally separate and (c) It is fiscally independent from the State and other local governments.

**Basis of Presentation, Measurement Focus and Basis of Accounting.**

**Fund Financial Statements:**

*Basis of Presentation*

Fund financial statements of the reporting District are organized into funds, each of which is considered to be separate accounting entities. Each fund is accounted for by providing a separate set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements. The District has only one fund.

FLATHEAD COUNTY WATER AND SEWER DISTRICT #8  
FLATHEAD COUNTY, MONTANA  
**NOTES TO THE FINANCIAL STATEMENTS**  
June 30, 2014

*Measurement Focus and Basis of Accounting*

***Proprietary Funds:***

All proprietary funds are accounted for using the accrual basis of accounting. These funds account for operations that are primarily financed by user charges. The economic resource focus concerns determining costs as a means of maintaining the capital investment and management control. Revenues are recognized when earned and expenses are recognized when incurred. Allocations of costs, such as depreciation, are recorded in proprietary funds.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connections with a proprietary fund's principal ongoing operations. The principal operating revenues for enterprise funds are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

***Major Funds:***

The District reports the following major proprietary funds:

*Water Fund* – An enterprise fund that accounts for the activities of the District's water distribution operations.

**NOTE 2. CASH, CASH EQUIVALENTS, AND INVESTMENTS**

**Cash Composition**

Composition of cash, deposits and investments at fair value on June 30, 2014, are as follows:

FLATHEAD COUNTY WATER AND SEWER DISTRICT #8  
 FLATHEAD COUNTY, MONTANA  
**NOTES TO THE FINANCIAL STATEMENTS**  
 June 30, 2014

	<u>Primary Government</u>
<u>Cash on hand and deposits:</u>	
Cash in banks:	
Demand deposits	\$ 198,453
Savings deposits	18,922
Total	<u>\$ 217,375</u>

Total cash is insured by FDIC and NCUA.

**Credit Risk**

Section 7-6-202, MCA, limits investments of public money of a local government in the following eligible securities:

(a) United States government treasury bills, notes and bonds and in the United States treasury obligations, such as state and local government series (SLGLS), separate trading of registered interest and principal of securities (STRIPS), or similar United States treasury obligations;

(b) United States treasury receipts in a form evidencing the holder's ownership of future interest or principal payments on specific United States treasury obligations that, in the absence of payment default by the United States, are held in a special custody account by an independent trust company in a certificate or book entry form with the federal reserve bank of New York; or

(c) Obligations of the following agencies of the United States, subject to the limitations in subsection 2 (not included):

- (i) federal home loan bank;
- (ii) federal national mortgage association;
- (iii) federal home mortgage corporation; and
- (iv) federal farm credit bank.

With the exception of the assets of a local government group self-insurance program, investments may not have a maturity date exceeding 5 years except when the investment is used in an escrow account to refund an outstanding bond issue in advance.

Section 7-6-205 and Section 7-6-206, MCA, state that demand deposits may be placed only in banks and Public money not necessary for immediate use by a county, city, or town that is not invested as authorize in Section 7-6-202 may be placed in time or savings deposits with a bank, savings and loan association, or credit union in the state or place in repurchase agreements as authorized in Section 7-6-213.

FLATHEAD COUNTY WATER AND SEWER DISTRICT #8  
 FLATHEAD COUNTY, MONTANA  
**NOTES TO THE FINANCIAL STATEMENTS**  
 June 30, 2014

Section 7-6-202, MCA, as amended, now limits authorized investments in certain securities that previously were permissible investments. The amendment does not apply to and does not require the sale of securities that were legal investments before the effective date of this act. However, the investments reported as collateralized mortgage obligations above are not authorized investments at the current time.

The government has no investment policy that would further limit its investment choices.

The government has no investments that require credit risk disclosure.

For purposes of the Statement of Cash Flows, cash equivalents include all cash and investments.

**NOTE 3. RESTRICTED CASH/INVESTMENTS**

The following restricted cash/investments were held by the District as of June 30, 2014. These amounts are reported within the cash/investment account on the Statement of Net Position.

<u>Description</u>	<u>Amount</u>
Debt Service Reserve	\$ <u>10,855</u>

**NOTE 4. INVENTORIES**

The cost of inventories are recorded as an expenditure when purchased.

**NOTE 5. CAPITAL ASSETS**

The District's assets are capitalized at historical cost or estimated historical cost. District policy has set the capitalization threshold for reporting capital assets at \$5,000. Gifts or contributions of capital assets are recorded at fair market value when received. The costs of normal maintenance and repairs are charged to operations as incurred. Improvements are capitalized and depreciated over the remaining useful lives of the related fixed assets, as applicable. Depreciation is recorded on a straight-line basis over the useful lives of the assets as follows:

Buildings	40-60 years
Improvements	15-30 years
Infrastructure	5-60 years
Machinery and Equipment	3-10 years

FLATHEAD COUNTY WATER AND SEWER DISTRICT #8  
 FLATHEAD COUNTY, MONTANA  
**NOTES TO THE FINANCIAL STATEMENTS**  
 June 30, 2014

A summary of changes in business-type capital assets was as follows:

Business-type activities:

	<u>Balance</u> <u>July 1, 2013</u>	<u>Additions</u>	<u>Restatements</u>	<u>Balance</u> <u>June 30, 2014</u>
Capital assets not being depreciated:				
Land	\$ 29,896	\$ -	\$ -	\$ 29,896
Other capital assets:				
Improvements other than buildings	\$ 2,228	\$ -	\$ -	\$ 2,228
Source of Supply	109,183	-	-	109,183
Transmission and distribution	1,230,449	-	-	1,230,449
Total other capital assets at historical cost	\$ 1,341,860	\$ -	\$ -	\$ 1,341,860
Less: accumulated depreciation	\$ (516,664)	\$ (51,148)	\$ (60)	\$ (567,872)
Total	<u>\$ 855,092</u>	<u>\$ (51,148)</u>	<u>\$ (60)</u>	<u>\$ 803,884</u>

**NOTE 6. LONG TERM DEBT OBLIGATIONS**

In the proprietary financial statements, outstanding debt is reported as liabilities.

Business-type Activities:

	<u>Balance</u> <u>July 1, 2013</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2014</u>	<u>Due Within</u> <u>One Year</u>
Contracted debt	\$ 682,989	\$ (7,347)	\$ 675,642	\$ 7,665

\*See Note 7

**Loans/Contracted Debt**

Loans/contracted debts outstanding as of June 30, 2014 were as follows:

<u>Purpose</u>	<u>Origination</u> <u>Date</u>	<u>Interest</u> <u>Rate</u>	<u>Term</u>	<u>Maturity</u> <u>Date</u>	<u>Principal</u> <u>Amount</u>	<u>Balance</u> <u>June 30, 2014</u>
USDA RD loan	8/4/11	4.25%	40 yrs	8/4/51	\$ 700,000	\$ 675,642

**FLATHEAD COUNTY WATER AND SEWER DISTRICT #8**  
**FLATHEAD COUNTY, MONTANA**  
**NOTES TO THE FINANCIAL STATEMENTS**  
 June 30, 2014

Annual requirement to amortize debt:

For Fiscal <u>Year Ended</u>	<u>Principal</u>	<u>Interest</u>
2015	\$ 7,665	\$ 28,889
2016	7,997	28,557
2017	8,344	28,210
2018	8,705	27,849
2019	9,083	27,471
2020	9,476	27,078
2021	9,887	26,667
2022	10,315	26,239
2023	10,763	25,791
2024	11,229	25,325
2025	11,716	24,838
2026	12,223	24,331
2027	12,753	23,801
2028	13,306	23,248
2029	13,882	22,672
2030	14,484	22,070
2031	15,112	21,442
2032	15,767	20,787
2033	16,450	20,104
2034	17,163	19,391
2035	17,907	18,647
2036	18,683	17,871
2037	19,492	17,062
2038	20,337	16,217
2039	21,218	15,336
2040	22,138	14,416
2041	23,097	13,457
2042	24,098	12,456
2043	25,143	11,411
2044	26,232	10,322
2045	27,369	9,185
2046	28,555	7,999
2047	29,793	6,761
2048	31,084	5,470
2049	32,431	4,123
2050	33,837	2,717
2051	35,303	1,251
2052	2,606	56
Total	\$ <u>675,642</u>	<u>679,518</u>

FLATHEAD COUNTY WATER AND SEWER DISTRICT #8  
 FLATHEAD COUNTY, MONTANA  
**NOTES TO THE FINANCIAL STATEMENTS**  
 June 30, 2014

**NOTE 7.     RESTATEMENTS**

During the current fiscal year, the following adjustments relating to prior years' transactions were made to net position.

<u>Fund</u>	<u>Amount</u>	<u>Reason for Adjustment</u>
Water	\$ 11,520	Assessment Revenue understated in current year and overstated in prior year
Water	<u>        60</u>	Understated depreciation expense
	<u>\$ 11,580</u>	

**NOTE 8.     RISK MANAGEMENT**

The District faces 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, (e) workers' compensation, i.e., employee injuries, and (f) medical insurance costs of employees. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Insurance Policies:

Commercial policies transferring all risks of loss, except for relatively small deductible amounts are purchased for property and content damage, employees torts, and professional liabilities. And, given the lack of coverage available, the District has no coverage for potential losses from environmental damages.

***Denning, Downey & Associates, P.C.***  
**CERTIFIED PUBLIC ACCOUNTANTS**

1740 U.S. Hwy 93 South, P.O. Box 1957, Kalispell, MT 59903-1957

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**INDEPENDENT AUDITOR'S 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***

Board of Directors  
Flathead County Water and Sewer District #8  
Flathead County  
Whitefish, Montana

We have audited, in accordance with the 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, the financial statements of the business-type activities of Flathead County Water and Sewer District #8, Flathead County, Montana, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Flathead County Water and Sewer District #8's basic financial statements and have issued our report thereon dated March 20, 2015.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered Flathead County Water and Sewer District #8, Flathead County, Montana's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Flathead County Water and Sewer District #8, Flathead County, Montana's internal control. Accordingly, we do not express an opinion on the effectiveness of Flathead County Water and Sewer District #8'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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described below that we consider to be significant deficiencies listed as item 2014-001.

## **2014-001      Internal Controls**

### **Condition:**

1. The Secretary/Treasurer is responsible for collecting all receipts, posting to the accounting system, making adjustments, making the deposit, and reconciling the bank statements.
2. The Secretary/Treasurer is responsible for preparing the utility bills, posting to the utility billings system, and for making adjustments to the utility billing system.
3. Cash is deposited weekly or bi-weekly depending on volume.

### **Context:**

When interviewing the Secretary/Treasurer on Internal Controls, it became clear that the Secretary/Treasurer is the sole person responsible for all accounting functions at the District. The District is not large enough to be able to hire an additional employee to separate out the functions and as such, this has been a continued finding.

### **Criteria:**

Separation of duties is one of the key concepts of internal control. Segregation of duty assists with the prevention of fraud and errors and is achieved by allocating the tasks and responsibilities for a specific business process among several users.

### **Effect:**

Improper segregation of duties increases the District's vulnerability for misappropriation of funds and improper transactions that will not be detected on a timely basis.

### **Cause:**

The District, like many small government entities in Montana, has limited staff. As a result, it is difficult to maintain a system of checks and balances.

### **Recommendation:**

We recommend that the cash receipting duties be segregated to the greatest extent possible. The person responsible for receipting cash should be different from the person that records the collection. The deposits should then be reviewed and performed by the department head. The same should go for Utility billing.

### **Auditee Response:**

The District is aware of the issues raised and does its best to segregate duties as much as possible; however, the District does not have the funds available to hire an additional employee at this time.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Flathead County Water and Sewer District #8'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 instances of noncompliance or other matters that are required to be reported under *Governmental Auditing Standards* and which are described below as item 2014-002.

### **2014-002      Incorrectly reporting employees as subcontractors**

#### **Condition:**

The District pays the Board and the Secretary/Treasurer on a set base rate as established by the board. No payroll taxes are calculated or paid by the employees or the District.

#### **Context:**

It was discovered when a search for payroll expenditures was performed that the District had nothing coded as payroll. Upon inquiry of the District it became known that the District pays each person as a subcontractor and files a 1099 form each year. Upon research of the laws pertaining to subcontractors, at the Montana Department of Labor Website and the IRS website, it was found that the person must be free from control or direction of the hiring agent, engaged in their own independently established business, occupation, trade or profession, and hold an Independent Contractor's Exemption Certificate or carry workers compensation on themselves. Further, MCA stated and Employee or Worker for purposes of worker's compensation coverage includes all elected and appointed paid public officers (MCA 39-71-118(1)(a)). Based on this information that was obtained from the IRS website and MCA, a questionnaire was formed. In interviewing the Secretary/Treasurer, it became known that the only person that qualifies as a subcontractor is the operator as he does fit all of the requirements of a true subcontractor, all others being paid as subcontractors are being incorrectly reported.

#### **Criteria:**

According to the Montana Department of labor and Internal Revenue Service, in order to be an independent contractor, you must be free from control or direction of the hiring agent, engaged in their own independently established business, occupation, trade, or profession, and hold an Independent Contractor Exemption Certificate (ICEC) or carry workers compensation on themselves. MCA 3-71-118 specifically states that and Employee or Worker for Worker's Compensation Purposes includes all elected and appointed paid public officers.

#### **Effect:**

The District is not properly reporting these persons as employees and filing the proper payroll employer portions of payroll taxes.

#### **Cause:**

The District did not understand the rules involved in order to pay as a subcontractor.

**Recommendation:**

Obtain W-2's from the Employees and immediately start calculating, deducting, and paying the applicable payroll taxes.

**Auditee Response:**

The District will take the recommendation under advisement.

**Flathead County Water and Sewer District #8's Response to Findings**

Flathead County Water and Sewer District #8's response to the findings identified in our audit is described above. Flathead County Water and Sewer District #8's response was not subject to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Denning, Downey and Associates, CPA's, P.C.*

March 20, 2015

**Denning, Downey & Associates, P.C.**  
**CERTIFIED PUBLIC ACCOUNTANTS**

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**REPORT ON PRIOR AUDIT REPORT RECOMMENDATIONS**

Board of Directors  
Flathead County Water and Sewer District #8  
Flathead County  
Whitefish, Montana

The prior audit report contained one recommendation. The action taken on each recommendation is as follows:

<u>Recommendation</u>	<u>Action Taken</u>
Internal Controls	Repeated

*Denning, Downey and Associates, CPAs, P.C.*

March 20, 2015