



Independent Auditor's Report and
Financial Statements
**Lockwood Area/
Yellowstone County
Water & Sewer District**
June 30, 2014 and 2013

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ORGANIZATION – BOARD OF DIRECTORS AND OFFICIALS

For the Years Ended June 30, 2014 and 2013

BOARD OF DIRECTORS

Carl Peters, President

Merrill Walker, Vice President

Nancy Belk, Secretary/Treasurer

Gary Forrester

Carlota Hecker

GENERAL MANAGER

Woody Woods

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the Year Ended June 30, 2014

INTRODUCTION

The management of the Lockwood Water & Sewer District (the District) offers readers of these financial statements this overview and summary analysis of the financial activities of the District for the year July 1, 2013 through June 30, 2014. This section of the financial report is designed to assist the reader in focusing on significant financial activities and issues, as well as important changes in the District's financial position and results of operations, which may affect the District's ability to address subsequent years' challenges. This discussion is designed to be used in conjunction with the financial statements and notes, which follow this section.

The District accounts for the separate revenue and expenses of the water system and the sewer system, as well as property assessment income and administration expenses of the sewer planning budget. No individual system subsidizes the other and each system stands on its own. The property assessments for the sewer planning budget are used to pay for costs of past and future bond issue elections, the facility plan and updates prepared by a professional engineering consultant and professional attorney services such as bond counsel as well as minor budget items to facilitate the administration of the budget and board expenses. A portion of sewer Project 2011-01 was completed outside of the EPA superfund site. The construction of a low pressure sewer system within the EPA superfund site will be completed and operational by the end of fall in 2014. This will complete the Phase I sewer system that began construction in July of 2009. The sewer system has been in operation since June of 2011. Costs for those improvements are being financed by an existing General Obligation Bond.

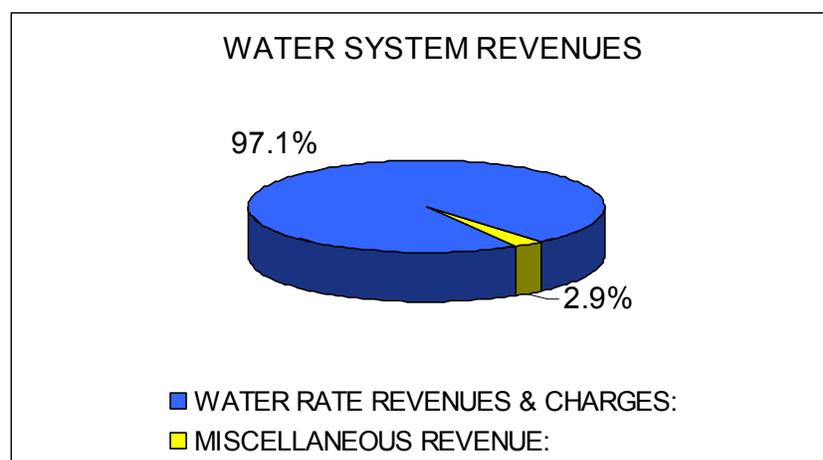
FINANCIAL HIGHLIGHTS

The District's financial condition is strong. The District operates well within the financial policies and guidelines set by the Board and management. The following are key financial highlights:

- The long term debt for the water system is related to successful bond issues in December 2004 and December 2006 that authorized the District to borrow up to \$2.1 Million in low interest funds from the Montana Drinking Water State Revolving Fund Program (DWSRF) to construct a \$1.82 Million Pre-treatment Facility at the Lockwood Water Plant and a \$1.1 Million Mid-Zone Booster Station located at the intersection of Noblewood Drive and Westgate Drive. A new \$900,000 Clearwell at the Water Treatment Plant was constructed in 2012. Loans (WRF-06072R) with a balance of \$84,000 and (WRF-06082R) with a balance of \$87,000 bear interest rates of 1.25% and will be paid off in 2015. Loan (WRF-08121R) with a balance of \$376,000 bears an interest rate of 2.25%, loan (WRF-09126R) with a balance of \$475,000 bears an interest rate of 3.00%, and (WRF-12246R) with a balance of \$253,000 bears an interest rate of 2.00%. As of June 30, 2014, the total outstanding debt for the DWSRF Loans is \$1,275,000. All interest rates on the existing loans with the Montana Drinking Water State Revolving Fund Program (DWSRF) were reduced in 2013, which will result in substantial savings to the District over the life of the loans. The Pre-treatment Facility loan will be paid off in July of 2015.

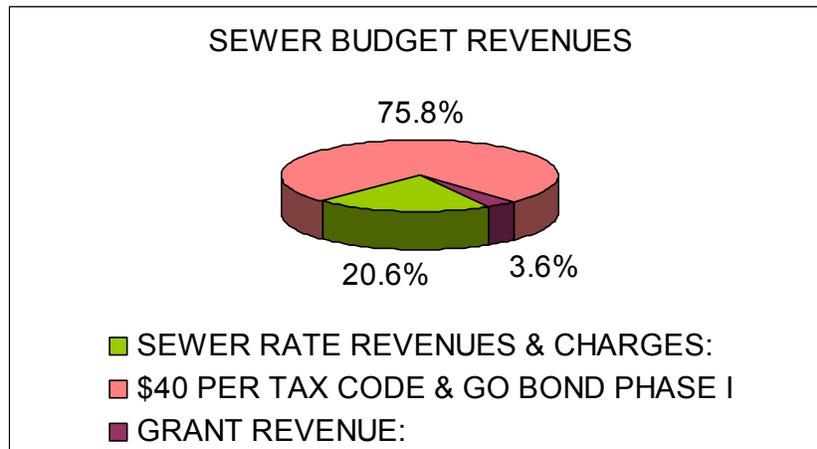
MANAGEMENT'S DISCUSSION AND ANALYSIS

- The long term debt for the Phase I Sewer Subdistrict system is related to the successful bond issue election in September 2008 that authorized the District to borrow up to \$14.0 Million in low interest funds from the Department of Natural Resources and Conservation Revolving Loan Program to construct the Phase I Sewer Subdistrict. Loans (SRF-10196R) with a balance of \$3,256,000, (SRF-11271R) with a balance of \$774,000, (SRF-11284R) with a balance of \$2,945,000, (SRF-13307) with a balance of \$672,000, (SRF-13308) with a balance of \$1,982,185, and Loan (SRF-10195) with a balance of \$294,000 bears an interest rate of 0.75%. Montana Coal Board Loan (WDL-12-3642 with a balance of \$566,249 bears an interest rate of 3.00%. As of June 30, 2014, the total outstanding debt for the WPCSRF Loans and the Montana Coal Board Loan is \$10,489,434. Interest rates on three of the WPCSRF Loans were reduced in 2013, which will result in substantial savings to the District over the life of the loans.
- Total assets of the District at year-end were \$32.727 million and exceeded the liabilities by \$20.68 million (i.e. fund equity). In comparison to the prior fiscal year, total assets and total fund equity increased by \$883,007 and \$520,808 respectively.
- The District's long term debt of \$11,939,434 was an increase from the prior year by \$539,882.
- The District's total liabilities, which consist of current liabilities in the amount of \$744,072 and long term liabilities in the amount of \$11,257,252 was an increase from the prior year by \$374,073.
- Total Operating Revenue for the year was down \$185,214 (6.89%) from the previous year.
- Total Operating Expenses, excluding depreciation and amortization, for the year were down \$282,323 (21.85%) from the previous year.
- **WATER SYSTEM REVENUE:** In fiscal year 2014, 97.1% of the Operating Revenue of the water system came from water rate revenues. The remaining 2.9% came from fire line charges, late payment penalties, service charges and material sales. Water operating revenues were down 3.06% compared to the previous fiscal year. This is due to higher precipitation.

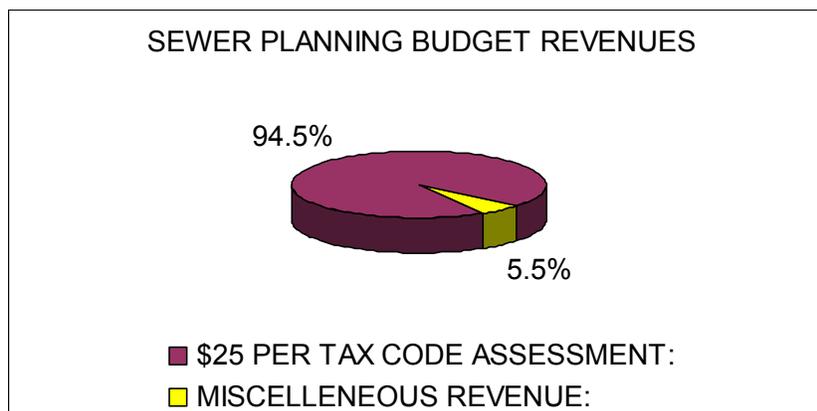


MANAGEMENT'S DISCUSSION AND ANALYSIS

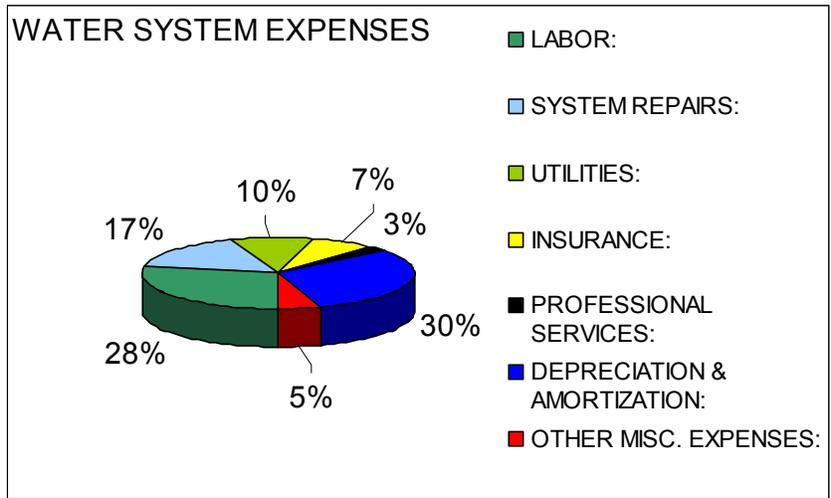
- **SEWER BUDGET REVENUE:** In fiscal year 2014, 20.6% of the Operating Revenue of the sewer system came from sewer rate revenues. GO Bond and property assessments accounted for 75.8% and the remaining 3.6% came from Grant revenues. Sewer operating revenues were down 12.9% compared to the previous fiscal year. This is due to the reduction in grant revenue. Actual rate revenues and charges were up 27.1% with the addition of eighteen (18) new sewer hookups.



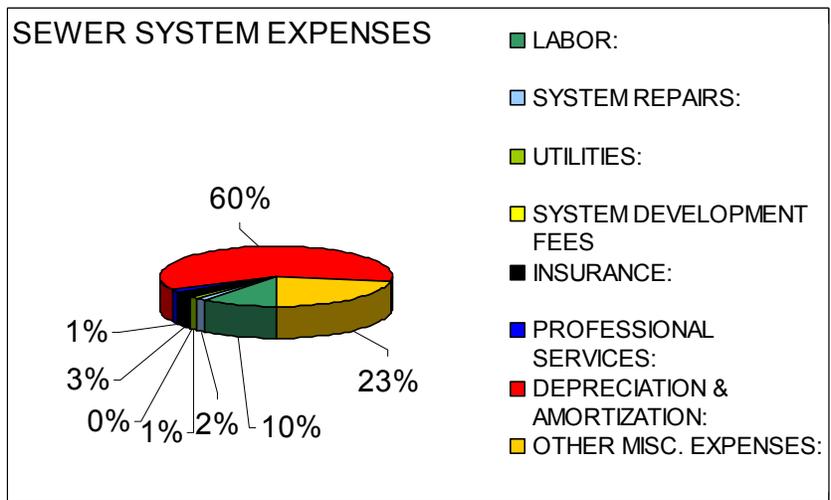
- **SEWER PLANNING BUDGET REVENUE:** In fiscal year 2014, the income from a \$25 assessment per tax code within the LWSD District provided 94.5% of the revenues of the sewer planning budget and miscellaneous revenue accounted for the remaining 5.5%.



- **WATER SYSTEM EXPENSES:** Operating expenses for the water system were down 1.9% for the 2014 fiscal year from the previous period. Labor (wages, payroll taxes, benefits) accounted for (28%) of the operating expenses for the period. System repairs (17%), utilities (10%), insurance (7%), professional services (3%), depreciation and amortization (30%) and miscellaneous expenses (5%), make up the remainder of the water operations expenses. The miscellaneous expenses are spread over a host of categories such as office expense, vehicle operating expense, postage, water sampling and training costs. All expense categories are reflected on the *Statement of Revenue, Expenses, and Changes in Net Position* in the accompanying financial statements.



- **SEWER SYSTEM EXPENSES:** Operating expenses for the sewer system were down 23% for the 2014 fiscal year from the previous period. Labor (wages, payroll taxes, benefits) accounted for (10%) of the operating expenses for the period. System repairs (2%), utilities (1%), insurance (3%), professional services (1%), depreciation and amortization (60%), system development fees (0%) and miscellaneous expenses (23%), make up the remainder of the sewer operations expenses. The miscellaneous sewer expenses are spread over a host of categories such as office expense, vehicle operating expense, postage, bank charges, meeting expense, liability insurance and minimal office supplies. All expense categories are reflected on the Statement of Revenue, Expenses, and Changes in Net Position in the accompanying financial statements.



- **NON-OPERATING REVENUES:** Non-operating revenues in fiscal year 2014 included \$21,058 in interest income and \$103,790 from capital contributions. Capital contributions are defined in the Notes to Financial Statements in the accompanying financial statements. These contributions are related to System Development Fees paid by new customers of the water and sewer systems, and contributed capital assets which are water mains installed by private developers that have been assumed by the District.

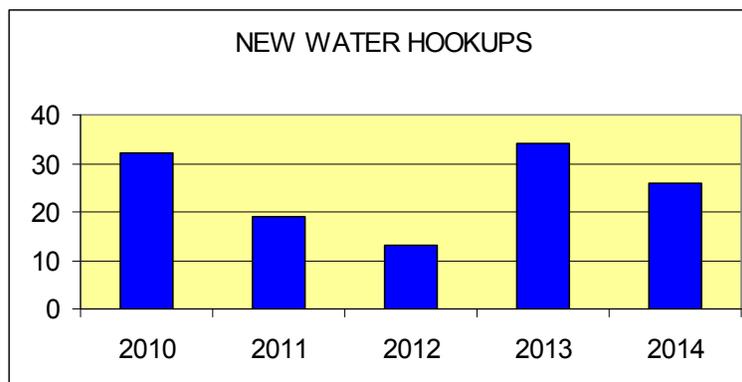
MANAGEMENT'S DISCUSSION AND ANALYSIS

- **NON-OPERATING EXPENSES:** Non-operating expenses in fiscal year 2014 totaled \$352,044. This expense is directly related to the interest payments on the Drinking Water State Revolving Fund Loans. Refer to the first two paragraphs of the financial highlights found on page 2 of these statements.

GROWTH, WATER SYSTEM CAPITAL IMPROVEMENTS, WATER RATES, SEWER SYSTEM AND SEWER PLANNING BUDGET

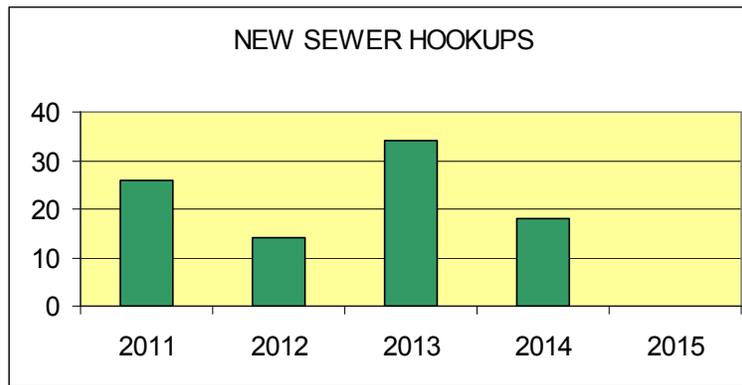
- **Growth:**

The District continues to see some growth, however; new home construction is still slowed due to current economic conditions. It has been the policy of the Board and Management that developers defray the cost of improvements to the water system caused by the additional demands of new development. System Development Fees (SDFs) are charged to a customer when a new service is added to the water system. In fiscal year 2007, a new Mid-Zone SDF was implemented to defray costs of the new Booster Station constructed in 2008. In fiscal year 2014 twenty-six (26) additional services (4 Mid-Zone residential, 19 residential and 3 commercial) were added and \$74,712 of SDFs was collected. In fiscal year 2013 thirty-four (34) additional services (6 Mid-Zone residential, 26 residential and 2 commercial) were added and \$68,781 of SDFs was collected. (In fiscal year 2012, thirteen (13) additional services (2 Mid-Zone residential & 11 residential) were added and \$26,847 of SDFs was collected. In comparison, nineteen (19) additional services were added and \$45,902 of SDFs was collected in fiscal year 2011. Thirty-two (32) additional services were added and \$67,556 of SDFs was collected in fiscal year 2010. Developers are responsible for the installation and the costs related to the installation of water mains in new developments unless the District needs the infrastructure to be larger than the needs of the development. The District then may share in the cost of water mains above 8-inch pipe.



- **Sewer System:**

The District expects to see growth in Lockwood with the completion of the Phase I Sewer Subdistrict and future sewer Phases. System Development Fees (SDFs) and user rates were established by Resolution No. 97 on May 18, 2011. SDFs will be collected as hookups to the sewer system are made each year. In fiscal year 2014, eighteen (18) additional services (12 Commercial, 1 for Lockwood School and 5 residential) were added and \$29,078 of SDFs was collected with \$25,600 from Lockwood School. In fiscal year 2013, thirty-four (34) additional services (21 Commercial, 11 residential and 2 extra) were added and \$5,492 of SDFs was collected. In fiscal year 2011, fourteen (14) additional services (12 Commercial & 2 residential) were added and \$2,277 of SDFs was collected. Twenty-six (26) commercial and residential hookups were made to the system in 2011.



➤ Water System Capital Improvements:

The District maintains a 15 Year Capital Improvements Plan (CIP) that was adopted in 2000. The District's CIP plan is available for review at the District office.

In 2005, the District hired a professional engineering firm to complete a Water System Master Plan Study. The study evaluated the water system for needed improvements as it exists and for the future needs of the system. In addition, the study incorporated growth trends, water demand requirements and future regulatory needs for a twenty year planning horizon. That study was completed in September of 2006. The Master Plan Study is being re-evaluated now that the District's new sewer system is in operation

➤ Water Rates:

As mentioned previously, the District's Board of Directors approves an annual operating budget for each fiscal year. In conjunction with the annual review, the Board and Management review the District's water rates with respect to the following year's budget and with the next four to five years in mind. A new rate study was prepared for the District by the Montana Rural Water Systems rate expert in conjunction with the Master Plan that was completed in 2006. The District adopted new rates which went into effect on August 1, 2011. The new rates will be sufficient to operate the District in a responsible manner. The 2015 fiscal year water operations budget has been adopted and is available for review at the District office.

➤ Sewer System Budget:

A successful General Obligation Bond election was held on September 4, 2008 to finance the Phase I Sewer Subdistrict. Construction of the Phase I Sewer Subdistrict began in July 2009 and will continue through the end of 2014. An annual \$40 per tax code assessment for all properties in the District began in fiscal year 2012 to cover the monthly Reserve Capacity Fee charged to the District, by the City of Billings, for treatment of the District's wastewater. The 2015 fiscal year sewer operations budget has been adopted and is available for review at the District office.

MANAGEMENT'S DISCUSSION AND ANALYSIS

➤ Sewer Planning Budget:

The 2015 fiscal year sewer planning budget has been adopted and is available for review at the District office.

The annual \$25 per tax code assessment will remain unchanged. The Board of Directors was successful in obtaining a \$750,000 TSEP Grant and \$100,000 RRGL Grant to help finance the Phase II Sewer Project. In addition the District has received a Grant/Loan combination in the amount of \$4.89 million from the United States Department of Agriculture/Rural Development to help lower the cost of Phase II.

CONTACTING THE DISTRICT'S MANAGEMENT

This financial report is designed to provide our customers and creditors with a general overview of the District's finances and to show the District's accountability for the funds and assets it receives. If you have any questions about this report, or should you need additional financial information, contact the District office at 1644 Old Hardin Road, Billings, Montana, 59101 or e-mail at: contactus@lockwoodwater.com. The District also maintains a web site on the Internet at www.lockwoodwater.com.

INDEPENDENT AUDITOR'S REPORT

March 18, 2015

The Board of Directors
Lockwood Area/Yellowstone County Water & Sewer District
Billings, Montana

Report on the Financial Statements

We have audited the accompanying financial statements of Lockwood Water and Sewer District, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise Lockwood Water and Sewer District's basic financial statements as listed in the table of contents.

The financial statements of Lockwood Water and Sewer District as of June 30, 2013 were audited by Galusha, Higgins & Galusha, PC which combined its practice with Wipfli LLP as of December 31, 2014 whose report dated November 25, 2013 expressed an unmodified opinion on those statements.

Management's Responsibility for the Financial Statements

Lockwood Water and Sewer District's 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Lockwood Water and Sewer District, as of June 30, 2014 and 2013, 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 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 Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Lockwood Water and Sewer District's basic financial statements. The accompanying Statements of Net Position – Proprietary Funds, Statements of Revenues, Expenses and Changes in Net Position – Proprietary Funds, Statements of Cash Flows – Proprietary Funds and the Schedule of Expenditures of Federal Awards, required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The accompanying Statements of Net Position – Proprietary Funds, Statements of Revenues, Expenses and Changes in Net Position – Proprietary Funds, Statements of Cash Flows – Proprietary Funds and the Schedule of Expenditures of Federal Awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Statements of Net Position – Proprietary Funds, Statements of Revenues, Expenses and Changes in Net Position – Proprietary Funds, Statements of Cash Flows – Proprietary Funds and the Schedule of Expenditures of Federal Awards, are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 18, 2015 on our consideration of Lockwood Water and Sewer District'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 Lockwood Water and Sewer District's internal control over financial reporting and compliance.



Wipfli LLP
Billings, Montana

BASIC FINANCIAL STATEMENTS:

STATEMENTS OF NET POSITION

June 30,

	<u>2014</u>	<u>2013</u>
<u>ASSETS</u>		
Current Assets		
Cash and cash equivalents	5,517,703	5,254,205
Accounts receivable (net of allowance)	138,215	177,662
Special property assessments receivable	144,301	144,655
Interest receivable	7,208	7,208
Prepaid expenses	5,297	5,297
	<u>5,812,724</u>	<u>5,589,027</u>
Restricted Cash and Investments		
Restricted for bond payments:		
Revenue bond account	110,966	99,947
Reserve account	195,180	195,180
Restricted for future capital improvements	867,575	792,862
	<u>1,173,721</u>	<u>1,087,989</u>
Capital Assets (at cost)		
Construction in progress	31,204	53,763
Water and sewer system infrastructure	29,787,762	28,460,149
System materials and supplies	52,475	52,948
Land, buildings and improvements	3,056,439	3,052,568
Vehicles	138,816	152,816
Office equipment and furniture	101,510	113,151
	<u>33,168,206</u>	<u>31,885,395</u>
Less: Accumulated depreciation	7,431,365	6,722,719
	<u>25,736,841</u>	<u>25,162,676</u>
Other Assets		
Intangible assets (net of amortization)	4,602	4,602
	<u>4,602</u>	<u>4,602</u>
<u>TOTAL ASSETS</u>	<u>32,727,888</u>	<u>31,844,294</u>

The accompanying notes are an integral part of these financial statements.

BASIC FINANCIAL STATEMENTS

STATEMENTS OF NET POSITION - CONTINUED June 30,

	<u>2014</u>	<u>2013</u>
<u>LIABILITIES, DEFERRED INFLOW</u>		
<u>OF RESOURCES AND NET POSITION</u>		
Current Liabilities		
Current maturities of long-term debt	682,182	644,669
Accounts payable	125	140,237
Accrued construction costs	0	34,531
Accrued interest payable	14,954	4,790
Accrued payroll expense	0	743
Compensated absences payable	47,398	47,398
	<u>744,659</u>	<u>872,368</u>
Long-Term Liabilities		
Bonds payable	519,066	458,694
Revolving note payable	10,738,186	10,296,189
	<u>11,257,252</u>	<u>10,754,883</u>
Deferred Inflow of Resources		
Unearned tax revenue	48,151	60,025
	<u>48,151</u>	<u>60,025</u>
Net Position		
Net investment in capital assets	13,797,407	13,763,124
Restricted for bond payments and future capital improvements	1,269,307	1,154,497
Unrestricted	5,611,112	5,239,397
	<u>20,677,826</u>	<u>20,157,018</u>
<u>TOTAL LIABILITIES, DEFERRED INFLOW</u>		
<u>OF RESOURCES AND NET POSITION</u>	<u><u>32,727,888</u></u>	<u><u>31,844,294</u></u>

The accompanying notes are an integral part of these financial statements.

BASIC FINANCIAL STATEMENTS

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

For the Year Ended June 30,

	2014	2013
Operating Revenue		
Water service revenue	1,546,398	1,596,816
Sewer usage revenue	168,324	132,414
Grant revenue	29,673	240,479
Miscellaneous revenue	47,042	51,453
Property assessments	711,609	663,598
Gain on disposal of asset	0	3,500
Total Operating Revenue	<u>2,503,046</u>	<u>2,688,260</u>
Operating Expenses		
Advertising	240	386
Amortization	0	18,030
Bank charges	90	140
Board expense	2,804	1,520
Depreciation	745,312	680,725
Engineering	3,616	3,499
Insurance	99,195	106,982
Legal, audit and accounting	32,094	34,470
Maintenance, repairs and supplies	184,992	242,110
Miscellaneous	153,898	293,033
Office supplies and postage	8,745	8,958
Payroll taxes and employee benefits	30,576	32,156
Retirement plan contribution	24,222	20,523
Salaries and wages	306,937	297,640
Service installations	14,731	8,563
System development	20	94,940
Telephone and radio	5,748	6,259
Training and travel	4,756	3,086
Utilities	107,117	104,104
Vehicle expense	14,126	14,222
Water sampling	15,823	19,462
Total Operating Expenses	<u>1,755,042</u>	<u>1,990,808</u>
Operating Income	<u>748,004</u>	<u>697,452</u>
Non-Operating Revenue (Expense)		
Interest income	21,058	28,169
Interest expense	(352,044)	(411,160)
Total Non-Operating Revenue (Expense)	<u>(330,986)</u>	<u>(382,991)</u>
Income Before Contributions	417,018	314,461
Capital contributions	103,790	78,095
Change in Net Position	520,808	392,556
Net Position - Beginning	<u>20,157,018</u>	<u>19,764,462</u>
Net Position - Ending	<u><u>20,677,826</u></u>	<u><u>20,157,018</u></u>

The accompanying notes are an integral part of these financial statements.

BASIC FINANCIAL STATEMENTS

STATEMENTS OF CASH FLOWS

For the Year Ended June 30,

	<u>2014</u>	<u>2013</u>
Cash Flows from Operating Activities		
Receipts from customers	1,801,211	1,860,859
Receipts from grantors	17,799	610,591
Receipts from property assessments	711,963	646,319
Payments to suppliers	(878,179)	(1,737,219)
Payments to employees	(306,937)	(297,640)
Net Cash Provided by Operating Activities	<u>1,345,857</u>	<u>1,082,910</u>
Cash Flows from Capital and Related Financing Activities		
Capital contributions	103,790	78,095
Purchases of capital assets	(1,319,477)	(2,906,132)
Proceeds from debt	1,033,550	3,800,342
Principal paid on debt	(493,668)	(326,129)
Interest paid on debt	(341,880)	(406,370)
Net Cash Provided/(Used) by Capital and Related Financing Activities	<u>(1,017,685)</u>	<u>239,806</u>
Cash Flows from Investing Activities		
Interest earnings	21,058	28,169
Net Cash Provided by Investing Activities	<u>21,058</u>	<u>28,169</u>
Net Increase in Cash and Cash Equivalents	349,230	1,350,885
Cash and Cash Equivalents		
Beginning of period	<u>6,342,194</u>	<u>4,991,309</u>
Cash and Cash Equivalents		
End of period	<u>6,691,424</u>	<u>6,342,194</u>
Cash and Cash Equivalents - Per Balance Sheet		
Unrestricted cash and cash equivalents	5,517,703	5,254,205
Restricted cash:		
Restricted for future capital improvements	867,575	792,862
Restricted for bond payments	306,146	295,127
	<u>6,691,424</u>	<u>6,342,194</u>

The accompanying notes are an integral part of these financial statements.

BASIC FINANCIAL STATEMENTS

STATEMENTS OF CASH FLOWS – CONTINUED

For the Year Ended June 30,

	<u>2014</u>	<u>2013</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	748,004	697,452
Adjustments to reconcile operating income to net cash provided by operating activities:		
Amortization	0	18,030
Depreciation	745,312	680,725
Gain on Disposal of property	0	(3,500)
(Increase) decrease in current assets:		
Receivables	39,801	433,009
Due from other funds	0	531,258
Increase(decrease) in current liabilities:		
Accounts payable	(174,643)	(743,549)
Payroll taxes payable	(743)	743
Unearned tax revenue	(11,874)	0
Due to other funds	0	(531,258)
Net Cash Provided by Operating Activities	<u>1,345,857</u>	<u>1,082,910</u>

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

For the Years Ended June 30, 2014 and 2013

Note A. Summary of Significant Accounting Policies

Reporting Entity - The Lockwood Area/Yellowstone County Water & Sewer District (the District) was incorporated January 23, 1997, for the purpose of planning, constructing and operating a sanitary sewer facility in the unincorporated Lockwood Area of Yellowstone County and, also, to provide water services for that area. A special property assessment has been levied each year to provide funds for engineering, legal, election and planning costs for the proposed sewer system. On May 1, 2001, the District acquired, through election, the assets and liabilities of the Lockwood Water Users Association which consisted of an operating water system.

The District is considered to be a primary government since it is governed by a Board of Directors elected by members of the District and establishes its own budget independent of any other government entity. The daily affairs of the District are conducted under the supervision of the District's general manager.

Measurement Focus, Basis of Accounting and Basis of Presentation - The District's activities are similar to those found in the private sector where determination of net income is necessary or useful for sound financial administration and, therefore, the District is considered to be a proprietary governmental unit.

The accounting and financial reporting treatment applied to the District is determined by its measurement focus. The transactions of the District are accounted for on a flow of economic resources measurement focus and the accrual basis of accounting. The accounting objectives are determinations of net income, financial position and cash flow. The economic resources measurement focus means all assets and liabilities (whether current or non-current) are included on the statement of net position and the statement of revenues, expenses and changes in net position present increases (revenues) and decreases (expenses) in net total net position. Under the accrual basis of accounting, revenues are recognized when earned. Net position (i.e., total assets plus deferred outflows less liabilities and deferred inflows) is segregated into "net investment in capital assets"; "restricted for bond payments and future capital improvements" and "unrestricted" components.

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 connection with a proprietary fund's principal ongoing operations. Operating expenses for the proprietary funds include the cost of personal and contractual services, supplies and depreciation of capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Pursuant to the Governmental Accounting Standards Board (GASB) Statement No. 20 "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting", the District follows GASB guidance as applicable to proprietary funds and the Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins Issued on or before November 30, 1989 that do not conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents – Cash and cash equivalents, for purposes of the statement of cash flows, include restricted and unrestricted cash on deposit, certificates of deposit, repurchase agreements, money market accounts, and investment grade commercial paper that are readily convertible into cash and purchased with original maturities of three months or less.

NOTES TO FINANCIAL STATEMENTS-CONTINUED

For the Years Ended June 30, 2014 and 2013

Accounts Receivable - Water Revenue – Balances due from customers for water charges are recorded as accounts receivable net of an allowance for doubtful accounts. The District provides an allowance for doubtful accounts equal to the estimated uncollectible amounts. The District’s estimate of \$2,100 and \$2,100, respectively for June 30, 2014 and 2013 is based on historical collection experience. It is reasonably possible that the District’s estimate of the allowance for doubtful accounts will change. Management closely monitors outstanding balances and shuts off the water service if an account becomes 90 days delinquent. The water is turned back on when the account is paid in full. If the property is sold, the amount owed must be paid before water service will be restored to that property. The allowance for doubtful accounts includes accounts that no longer receive water service because of non-payment plus an estimate of any accounts that may become uncollectible in the future.

Special Property Assessments Receivable - The special property assessments have been levied annually by the District to cover expenses related to the planning of the proposed sewer system. The special property assessments are collected by Yellowstone County who remits the revenues to the District.

Restricted Cash and Investments - Pursuant to the terms of the DNRC Water Revenue Fund General Obligation Bonds payable, the District is required to maintain a Revenue Bond account and a Reserve account. The Revenue Bond account consists of the loan repayments made by the District and is used to pay the interest and principal amounts on the bonds as they become due. A predetermined balance is required in the Reserve account which may be used to pay interest and principal on the bonds as they become due if there are not sufficient amounts in the Revenue Bond account. The trust accounts are administered by a third party trustee.

Under accounting principles generally accepted in the United States, the District is required to comply with GASB Statement No. 31, “Accounting and Financial Reporting for Certain Investments and External Investment Pools.” This pronouncement requires governmental entities to record certain investments at fair market value, rather than historical cost.

System Materials and Supplies - Materials and supplies on hand for use in the system are recorded at cost and are separately classified in the capital assets category. Such items are capitalized as part of the water system cost as they are installed.

Capital Assets – Property and equipment are recorded at cost. Expenditures for major additions and improvements are capitalized and minor replacements, maintenance, and repairs are charged to expense as incurred. The Board has approved a capitalization policy of \$500. Property and equipment acquired through contributions from developers or other customers are capitalized at the estimated fair market value at the date of the contribution. Construction in progress is recorded at cost. When property and equipment are retired or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is included in the results of operations for the respective period. Depreciation is provided over the estimated useful lives of the related assets using the straight-line method for financial statement purposes. The estimated useful lives for significant property and equipment categories are as follows:

Water and sewer infrastructure system	12-50 years
Buildings and improvements	25-50 years
Vehicles	3-5 years
Office equipment and furniture	4-12 years

NOTES TO FINANCIAL STATEMENTS-CONTINUED

For the Years Ended June 30, 2014 and 2013

Construction in Progress and Estimated Cost to Complete Construction of New Facility – The sewer system began operations on June 1, 2011. Project 2011-01, the last of the five projects of the Phase I Sewer Subdistrict, will be completed and operational by the end of calendar year 2014. The estimated cost to be incurred to complete the Phase I Sewer Subdistrict construction of the facility is approximately \$1.1 million.

Intangible assets – Intangible assets consist of fees paid to the City of Billings for a sewer rate study and are recorded at cost. Amortization is provided over the estimated useful life of the related asset using the straight-line method for financial statement purposes. The estimated useful life for the intangible asset is 3 years.

Compensated Absences - Under the District’s policy and state law, employees are permitted to accumulate a limited amount of earned but unused vacation benefits and sick leave which will be paid to employees upon separation from District service. Accumulated vacation and the eligible portion of sick leave to be paid to employees are recorded as an expense and liability as the benefits are earned.

Capital Contributions - Capital contributions are treated as non-exchange transactions under GASB Statement No. 33 and are recognized in the Statement of Revenues, Expenses and Changes in Net Position when earned. They include system development fees, developer contributed capital assets, capital grants and any other supplemental contributions from customers, federal, state and local governments in support of system improvements. Capital contributions for the year ended June 30, 2014 and 2013, consisted of System Development Fees of \$103,790 and \$78,095, respectively.

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).

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Date of Management Review - Management has performed a review of the activities and transactions subsequent to June 30, 2014 to determine the need for any adjustments to and/or disclosure within the audited financial statements for the year ended June 30, 2014. Management has performed this analysis through March 18, 2015, the date the financial statements were available to be issued.

BASIC FINANCIAL STATEMENTS

NOTES TO FINANCIAL STATEMENTS-CONTINUED

For the Years Ended June 30, 2014 and 2013

Note B. Cash and Equivalents

The District is authorized by statute to invest in time or savings deposits with banks; investments in the State Short-Term Investment Pool (STIP); repurchase agreements; registered warrants of the District or of municipalities or school districts located in the District; U.S. government treasury bills, notes, bonds and other treasury obligations such as state and local government series; general obligations of certain agencies of the United States such as Federal Home Loan Bank; and U.S. government security money market funds if the funds meet certain conditions. The District's composition of cash and investments at fair value on June 30, 2014 and 2013 is as follows:

Current cash and investments:	<u>2014</u>	<u>2013</u>
Cash	111,985	61,693
Repurchase agreements	3,313,901	3,037,675
Certificates of deposit	2,797,283	2,785,590
Money market accounts	468,255	457,236
	<u>6,691,424</u>	<u>6,342,194</u>
Less: Restricted for future capital improvements	(867,575)	(792,862)
Restricted for bond payments	(306,146)	(295,127)
Total Current Cash and Investments	<u><u>5,517,703</u></u>	<u><u>5,254,205</u></u>

Concentration of Credit Risk for Cash Deposits at Banks – Financial instruments that potentially subject the District to concentrations of credit risk consist primarily of cash deposits. Accounts at each institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to certain limits. At June 30, 2014 and 2013, the District held repurchase agreements in the amount of \$3,136,850 and \$3,099,368, respectively that were either uninsured or unregistered investments for which the securities are held by the broker, dealer or by its trust departments or agent but not in the district's name. All other cash deposits were insured by the FDIC.

BASIC FINANCIAL STATEMENTS

NOTES TO FINANCIAL STATEMENTS-CONTINUED

For the Years Ended June 30, 2014 and 2013

Note C. Changes in Capital Assets

During the year ended June 30, 2014, changes in capital assets were as follows:

	Beginning Balance	Additions	Transfers/ Deletions	Ending Balance
Construction in progress	53,763	1,231,955	(1,254,514)	31,204
Water and sewer system infrastructure	28,460,149	1,327,613	0	29,787,762
System materials and supplies	52,948	0	(473)	52,475
Land, building and improvements	3,052,568	3,871	0	3,056,439
Office equipment and furniture	113,151	11,025	(22,666)	101,510
Vehicles	152,816	0	(14,000)	138,816
	<u>31,885,395</u>	<u>2,574,464</u>	<u>(1,291,653)</u>	<u>33,168,206</u>
Less: Accumulated Depreciation	<u>6,722,719</u>	<u>745,312</u>	<u>(36,666)</u>	<u>7,431,365</u>
	<u><u>25,162,676</u></u>	<u><u>1,829,152</u></u>	<u><u>(1,254,987)</u></u>	<u><u>25,736,841</u></u>

Depreciation expense for the year ended June 30, 2014 was \$745,312.

During the year ended June 30, 2013, changes in capital assets were as follows:

	Beginning Balance	Additions	Transfers/ Deletions	Ending Balance
Construction in progress	2,022,601	2,845,750	(4,814,588)	53,763
Water and sewer system infrastructure	23,642,265	3,296	4,814,588	28,460,149
System materials and supplies	49,135	3,813	0	52,948
Land, building and improvements	3,052,568	0	0	3,052,568
Office equipment and furniture	111,708	1,443	0	113,151
Vehicles	116,151	55,330	(18,665)	152,816
	<u>28,994,428</u>	<u>2,909,632</u>	<u>(18,665)</u>	<u>31,885,395</u>
Less: Accumulated Depreciation	<u>6,060,659</u>	<u>680,725</u>	<u>(18,665)</u>	<u>6,722,719</u>
	<u><u>22,933,769</u></u>	<u><u>2,228,907</u></u>	<u><u>0</u></u>	<u><u>25,162,676</u></u>

Depreciation expense for the year ended June 30, 2013 was \$680,725.

BASIC FINANCIAL STATEMENTS

NOTES TO FINANCIAL STATEMENTS-CONTINUED For the Years Ended June 30, 2014 and 2013

Note D. Long-Term Debt

Long-term debt activity for the year ended June 30, 2014 is as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Drinking Water State Revolving Fund Program for construction of pre-sedimentation plant. Payable in semi-annual payments due January 1 and July 1. Final payment due July 1, 2015.				
WRF-06072R dated July 12, 2005 with an interest rate of 1.25%. (80% federal funded)	138,000	0	54,000	84,000
WRF-06082R dated October 12, 2005 with an interest rate of 1.25%. (80% federal funded)	144,000	0	57,000	87,000
Drinking Water State Revolving Fund Program for the construction of a Mid-Zone Booster Station, Irrigation Channel Intake and WTP Backup Power Generator. Payable in semi-annual payments due January 1 and July 1. Final payment due July 1, 2028.				
WRF-08121R dated April 12, 2008 with an interest rate of 2.25%. (80% federal funded)	398,000	0	22,000	376,000
WRF-09126R dated October 2, 2008 with an interest rate of 3.00%. (80% federal funded)	501,000	0	26,000	475,000
Drinking Water State Revolving Fund Program for the construction of the Clearwell tank addition for water treatment. Payable in semi-annual payments due January 1 and July 1. Final payment due July 1, 2021.				
WFR-12246R dated September 13, 2011 with an interest rate of 2.00%. (80% federal funded)	282,487	0	29,487	253,000
Waste Water Revolving Fund Program for the construction of a Sanitary Sewer Collection System. Payable in semi-annual payments due January 1 and July 1, starting in 2011. Final payment due July 1, 2040.				
SRF - 10196R dated September 15, 2009 with an interest rate of 3.75%. (100% state funded)	3,338,000	0	82,000	3,256,000

BASIC FINANCIAL STATEMENTS

NOTES TO FINANCIAL STATEMENTS-CONTINUED For the Years Ended June 30, 2014 and 2013

	Beginning Balance	Additions	Reductions	Ending Balance
American Recovery and Reinvestment Act of 2009, State Revolving Fund for Phase 1 of the Sanitary Sewer Collection System. Payable in semi-annual payments due January 1 and July 1 starting in 2011. Final payment due July 1, 2030.				
SRF - 10195 dated April 17, 2009 with an interest rate of 0.75%. (100% federal funded)	312,000	0	18,000	294,000
Waste Water Revolving Fund Program for the construction of a Sanitary Sewer Collection System. Payable in semi-annual payments due January 1 and July 1, starting in 2012. Final payment due July 1, 2039.				
SRF - 11271R dated August 15, 2010 with an interest rate of 3.75%. (83% federal funded)	792,000	0	18,000	774,000
Waste Water Revolving Fund Program for the construction of a Sanitary Sewer Collection System. Payable in semi-annual payments due January 1 and July 1, starting in 2012. Final payment due July 1, 2041.				
SRF - 11284R dated January 14, 2011 with an interest rate of 3.75%. (100% state funded)	3,017,000	0	72,000	2,945,000
Waste Water Revolving Fund Program for the construction of a Sanitary Sewer Collection System. Payable in semi-annual payments due January 1 and July 1, starting in 2013. Final payment due July 1, 2043.				
SRF - 13307 dated August 13, 2012 with an interest rate of 3.00%. (100% state funded)	686,000	0	14,000	672,000
SRF - 13308 dated August 13, 2012 with an interest rate of 3.00%. (100% state funded)	1,110,189	925,996	54,000	1,982,185
SRF - 13313 dated October 16, 2012 with an interest rate of 3.00%. (100% state funded)	175,000	0	0	175,000

BASIC FINANCIAL STATEMENTS

NOTES TO FINANCIAL STATEMENTS-CONTINUED

For the Years Ended June 30, 2014 and 2013

	Beginning Balance	Additions	Reductions	Ending Balance
Montana Coal Board Loan				
for the required purchase of reserve capacity from the city of Billings. Payable in semi-annual payments due January 1 and July 1, starting in 2012. Final payment due July 1, 2031. Total loan amount is \$1,078,526 with \$444,945 drawn to date.				
Coal Board loan dated August 5, 2011 with an interest rate of 3.00%.	505,876	107,554	47,181	566,249
	11,399,552	1,033,550	493,668	11,939,434

Annual principal and interest payments required are as follows:

Year Ended October 31,	Principal	Interest	Total
2015	682,182	399,523	1,081,705
2016	454,303	374,141	828,444
2017	420,054	360,848	780,902
2018	429,688	256,606	686,294
2019	440,371	333,954	774,325
Later Years	9,512,836	3,774,275	13,287,111
	11,939,434	5,499,347	17,438,780

Borrowings under the bonds are subject to certain financial covenants and restrictions on indebtedness, financial guarantees, accounting records, insurance and other related items. At June 30, 2014 and 2013, the District was in compliance with all covenants.

Subsequent year end the Montana Department of Natural Resources forgave the Waste Water loan SRF-13313 in the amount of \$175,000.

Note E. Net Position

Net position is comprised of the various net earnings from operating and non-operating revenues, expenses and contributions of capital. Net position is classified in the following three components: Net Investment in Capital Assets; Restricted for bond payments and future capital improvements; and Unrestricted. Net Investment in capital assets, consists of all capital assets, net of accumulated depreciation and reduced by any outstanding debt that is attributable to the acquisition, construction and improvement of those assets. The net position restricted for bond payments and future capital improvements consists of cash and cash equivalents restricted by the District for future capital improvement projects. Unrestricted net position consists of all other net assets not included in the above categories.

NOTES TO FINANCIAL STATEMENTS-CONTINUED

For the Years Ended June 30, 2014 and 2013

Note F. Retirement Plan

The employees of the District have elected to participate in the State of Montana's Public Employees' Retirement Plan (PERS). Mandatory employee contributions of 7.90% of total compensation are made through payroll deductions and the District contributes an additional 8.07% on behalf of the employees. For the Years ended June 30, 2014 and 2013, the District's retirement contribution totaled \$24,222 and \$20,523, respectively.

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 years of service regardless of age. Rights become vested after 5 years of service. The authority to establish, amend, and provide cost of living adjustments for the plan is assigned to the State Legislature.

The PERS financial information is reported in the Public Employees' Retirement Board's Comprehensive Annual Financial Report for the fiscal year end. It is available from the PERS at 100 North Park Avenue, Suite 200, P.O. Box 200131, Helena, Montana 59620-0131, (406) 444-3154.

Note G. Compensation of Board Members

Montana Code Annotated #7-13-2273 states that board members of a district shall be compensated for their services. For year ended June 30, 2014 and 2013, total compensation paid to board members was \$7,200 and \$7,200, respectively.

Note H. 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; (e) workers' compensation; i.e. employee injuries; and (f) medical insurance costs of employees. A variety of methods are used to provide insurance for these risks.

The District has insurance coverage through the Montana Association of Counties Joint Powers Insurance Authority Property and Casualty Pool Policy for property and content damage, employee torts and professional liability. Workers' compensation insurance and medical insurance are purchased from reputable commercial insurance companies. Due to the lack of coverage available, the District has no coverage for potential losses from environmental damages. Settled claims resulting from these risks did not exceed commercial insurance coverage during the period ended June 30, 2014.

Note I. Economic Dependency

In 2014 and 2013, the five largest customers accounted for 32% and 26% of water revenues, respectively and 67% and 63% of sewer revenues, respectively.

NOTES TO FINANCIAL STATEMENTS-CONTINUED

For the Years Ended June 30, 2014 and 2013

Note J. Related Parties

The Lockwood Water and Sewer District shares cost with Lockwood Irrigation District for the repair of a causeway damaged by flooding. The Lockwood Irrigation District is considered a related party because the manager of the Lockwood Irrigation District is also a board member of the Lockwood Water and Sewer District. For the years ended June 30, 2014 and 2013 the Lockwood Water and Sewer District paid the Lockwood Irrigation District \$105,272 and \$0, respectively for their share of cost associated with the repair of jointly used causeway.

SUPPLEMENTAL INFORMATION

SUPPLEMENTAL INFORMATION

STATEMENT OF NET POSITION - PROPRIETARY FUNDS - JUNE 30, 2014

	<u>Water</u>	<u>Sewer</u>	<u>Total</u>
<u>ASSETS</u>			
Current Assets			
Cash and cash equivalents	4,496,718	1,020,985	5,517,703
Accounts receivable (net of allowance)	112,203	26,012	138,215
Special property assessments receivable	0	144,301	144,301
Interest receivable	7,208	0	7,208
Prepaid expenses	1,680	3,617	5,297
	<hr/>	<hr/>	<hr/>
Total Current Assets	4,617,809	1,194,915	5,812,724
Restricted Cash and Investments			
Restricted for bond payments:			
Revenue bond account	110,966	0	110,966
Reserve account	195,180	0	195,180
Restricted for future capital improvements	867,575	0	867,575
	<hr/>	<hr/>	<hr/>
Total Restricted Cash and Investments	1,173,721	0	1,173,721
Capital Assets (at cost)			
Construction in progress	0	31,204	31,204
Water and sewer system infrastructure	12,221,777	17,565,985	29,787,762
System materials and supplies	52,475	0	52,475
Land, buildings and improvements	3,036,730	19,709	3,056,439
Vehicles	111,356	27,460	138,816
Office equipment and furniture	101,510	0	101,510
	<hr/>	<hr/>	<hr/>
	15,523,848	17,644,358	33,168,206
Less: Accumulated depreciation	6,452,684	978,681	7,431,365
	<hr/>	<hr/>	<hr/>
Total Capital Assets	9,071,164	16,665,677	25,736,841
Other Assets			
Intangible assets (net of amortization)	0	4,602	4,602
	<hr/>	<hr/>	<hr/>
<u>TOTAL ASSETS</u>	<u>14,862,694</u>	<u>17,865,194</u>	<u>32,727,888</u>

SUPPLEMENTAL INFORMATION

STATEMENT OF NET POSITION - PROPRIETARY FUNDS - JUNE 30, 2014 - CONTINUED

	<u>Water</u>	<u>Sewer</u>	<u>Total</u>
<u>LIABILITIES, DEFERRED INFLOW</u>			
<u>OF RESOURCES AND NET POSITION</u>			
Current Liabilities			
Current maturities of long-term debt	194,000	488,182	682,182
Accounts payable	125	0	125
Accrued interest payable	14,954	0	14,954
Accrued payroll expense	0	0	0
Compensated absences payable	47,398	0	47,398
Total Current Liabilities	<u>256,477</u>	<u>488,182</u>	<u>744,659</u>
Long-Term Liabilities			
Bonds payable	0	519,066	519,066
Revolving note payable	<u>1,081,000</u>	<u>9,657,186</u>	<u>10,738,186</u>
Total Long-term Liabilities	<u>1,081,000</u>	<u>10,176,252</u>	<u>11,257,252</u>
Deferred Inflow of Resources			
Unearned tax revenue	<u>0</u>	<u>48,151</u>	<u>48,151</u>
Total Deferred Inflow of Resources	<u>0</u>	<u>48,151</u>	<u>48,151</u>
Net Position			
Net investment in capital assets	7,796,164	6,001,243	13,797,407
Restricted for bond payments and future capital improvements	1,173,721	95,586	1,269,307
Unrestricted	<u>4,555,332</u>	<u>1,055,780</u>	<u>5,611,112</u>
Total Net Position	<u>13,525,217</u>	<u>7,152,609</u>	<u>20,677,826</u>
<u>TOTAL LIABILITIES, DEFERRED INFLOW</u>			
<u>OF RESOURCES AND NET POSITION</u>			
	<u><u>14,862,694</u></u>	<u><u>17,865,194</u></u>	<u><u>32,727,888</u></u>

SUPPLEMENTAL INFORMATION

STATEMENT OF NET POSITION - PROPRIETARY FUNDS - JUNE 30, 2013

	<u>Water</u>	<u>Sewer</u>	<u>Total</u>
<u>ASSETS</u>			
Current Assets			
Cash and cash equivalents	4,200,744	1,053,461	5,254,205
Accounts receivable (net of allowance)	153,787	23,875	177,662
Special property assessments receivable	0	144,655	144,655
Interest receivable	7,208	0	7,208
Prepaid expenses	1,680	3,617	5,297
	<hr/>	<hr/>	<hr/>
Total Current Assets	4,363,419	1,225,608	5,589,027
Restricted Cash and Investments			
Restricted for bond payments:			
Revenue bond account	99,947	0	99,947
Reserve account	195,180	0	195,180
Restricted for future capital improvements	792,862	0	792,862
	<hr/>	<hr/>	<hr/>
Total Restricted Cash and Investments	1,087,989	0	1,087,989
Capital Assets (at cost)			
Construction in progress	19,232	34,531	53,763
Water and sewer system infrastructure	11,851,694	16,608,455	28,460,149
System materials and supplies	52,948	0	52,948
Land, buildings and improvements	3,032,859	19,709	3,052,568
Vehicles	125,356	27,460	152,816
Office equipment and furniture	113,151	0	113,151
	<hr/>	<hr/>	<hr/>
	15,195,240	16,690,155	31,885,395
Less: Accumulated depreciation	6,165,357	557,362	6,722,719
	<hr/>	<hr/>	<hr/>
Total Capital Assets	9,029,883	16,132,793	25,162,676
Other Assets			
Intangible assets (net of amortization)	0	4,602	4,602
	<hr/>	<hr/>	<hr/>
<u>TOTAL ASSETS</u>	<u>14,481,291</u>	<u>17,363,003</u>	<u>31,844,294</u>

SUPPLEMENTAL INFORMATION

STATEMENT OF NET POSITION - PROPRIETARY FUNDS - JUNE 30, 2013- CONTINUED

	<u>Water</u>	<u>Sewer</u>	<u>Total</u>
<u>LIABILITIES, DEFERRED INFLOW</u>			
<u>OF RESOURCES AND NET POSITION</u>			
Current Liabilities			
Current maturities of long-term debt	185,487	459,182	644,669
Accounts payable	45,297	94,940	140,237
Accrued construction costs	0	34,531	34,531
Accrued interest payable	4,790	0	4,790
Accrued payroll expense	743	0	743
Compensated absences payable	47,398	0	47,398
	<u>283,715</u>	<u>588,653</u>	<u>872,368</u>
Total Current Liabilities			
Long-Term Liabilities			
Bonds payable	0	458,694	458,694
Revolving note payable	1,278,000	9,018,189	10,296,189
	<u>1,278,000</u>	<u>9,476,883</u>	<u>10,754,883</u>
Total Long-term Liabilities			
Deferred Inflow of Resources			
Unearned tax revenue	0	60,025	60,025
	<u>0</u>	<u>60,025</u>	<u>60,025</u>
Total Deferred Inflow of Resources			
Net Position			
Net investment in capital assets	7,566,396	6,196,728	13,763,124
Restricted for bond payments and future capital improvements	1,087,989	66,508	1,154,497
Unrestricted	4,265,191	974,206	5,239,397
	<u>12,919,576</u>	<u>7,237,442</u>	<u>20,157,018</u>
Total Net Position			
<u>TOTAL LIABILITIES, DEFERRED INFLOW</u>			
<u>OF RESOURCES AND NET POSITION</u>			
	<u>14,481,291</u>	<u>17,363,003</u>	<u>31,844,294</u>

SUPPLEMENTAL INFORMATION

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION – PROPRIETARY FUNDS - FOR THE YEAR ENDED JUNE 30, 2014

	Water	Sewer	Total
Operating Revenue			
Water service revenue	1,546,398	0	1,546,398
Sewer usage revenue	0	168,324	168,324
Grant Revenue	0	29,673	29,673
Miscellaneous revenue	45,962	1,080	47,042
Assessments	0	711,609	711,609
Total Operating Revenue	1,592,360	910,686	2,503,046
Operating Expenses			
Advertising	0	240	240
Bank charges	0	90	90
Board expense	587	2,217	2,804
Depreciation	323,993	421,319	745,312
Engineering	3,616	0	3,616
Insurance	76,695	22,500	99,195
Legal, audit and accounting	22,848	9,246	32,094
Maintenance, repairs and supplies	173,836	11,156	184,992
Miscellaneous	9,514	144,384	153,898
Office supplies and postage	7,370	1,375	8,745
Payroll taxes and employee benefits	25,675	4,901	30,576
Retirement plan contribution	24,222	0	24,222
Salaries and wages	240,732	66,205	306,937
Service installations	13,644	1,087	14,731
System development	0	20	20
Telephone and radio	4,796	952	5,748
Training and travel	4,756	0	4,756
Utilities	101,148	5,969	107,117
Vehicle expense	11,576	2,550	14,126
Water sampling	6,755	9,068	15,823
Total Operating Expenses	1,051,763	703,279	1,755,042
Operating Income	540,597	207,407	748,004
Non-Operating Revenue (Expense)			
Interest income	21,058	0	21,058
Interest expense	(30,726)	(321,318)	(352,044)
Total Non-Operating Revenue (Expense)	(9,668)	(321,318)	(330,986)
Income Before Contributions	530,929	(113,911)	417,018
Capital contributions	74,712	29,078	103,790
Change in Net Position	605,641	(84,833)	520,808
Total Net Position - Beginning	12,919,576	7,237,442	20,157,018
Total Net Position - Ending	13,525,217	7,152,609	20,677,826

SUPPLEMENTAL INFORMATION

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION – PROPRIETARY FUNDS - FOR THE YEAR ENDED JUNE 30, 2013

	Water	Sewer	Total
Operating Revenue			
Water service revenue	1,596,816	0	1,596,816
Sewer usage revenue	0	132,414	132,414
Grant Revenue	0	240,479	240,479
Miscellaneous revenue	42,315	9,138	51,453
Assessments	0	663,598	663,598
Gain on disposal of asset	3,500	0	3,500
Total Operating Revenue	1,642,631	1,045,629	2,688,260
Operating Expenses			
Advertising	0	386	386
Amortization	0	18,030	18,030
Bank charges	0	140	140
Board expense	603	917	1,520
Depreciation	322,789	357,936	680,725
Engineering	574	2,925	3,499
Insurance	84,432	22,550	106,982
Legal, audit and accounting	27,841	6,629	34,470
Maintenance, repairs and supplies	199,384	42,726	242,110
Miscellaneous	17,004	276,029	293,033
Office supplies and postage	7,705	1,253	8,958
Payroll taxes and employee benefits	25,337	6,819	32,156
Retirement plan contribution	20,523	0	20,523
Salaries and wages	232,752	64,888	297,640
Service installations	7,153	1,410	8,563
System development	0	94,940	94,940
Telephone and radio	5,397	862	6,259
Training and travel	3,046	40	3,086
Utilities	100,192	3,912	104,104
Vehicle expense	11,940	2,282	14,222
Water sampling	5,550	13,912	19,462
Total Operating Expenses	1,072,222	918,586	1,990,808
Operating Income	570,409	127,043	697,452
Non-Operating Revenue (Expense)			
Interest income	28,169	0	28,169
Interest expense	(47,339)	(363,821)	(411,160)
Total Non-Operating Revenue (Expense)	(19,170)	(363,821)	(382,991)
Income Before Contributions	551,239	(236,778)	314,461
Capital contributions	68,781	9,314	78,095
Change in Net Position	620,020	(227,464)	392,556
Total Net Position - Beginning	12,299,556	7,464,906	19,764,462
Total Net Position - Ending	12,919,576	7,237,442	20,157,018

SUPPLEMENTAL INFORMATION

STATEMENT OF CASH FLOWS PROPRIETARY FUNDS - FOR THE YEAR ENDED JUNE 30, 2014

	Water	Sewer	Total
Cash Flows from Operating Activities			
Receipts from customers	1,633,944	167,267	1,801,211
Receipts from grantors	0	17,799	17,799
Receipts from property assessments	0	711,963	711,963
Payments to suppliers	(532,953)	(345,226)	(878,179)
Payments to employees	(240,732)	(66,205)	(306,937)
Net Cash Provided by Operating Activities	<u>860,259</u>	<u>485,598</u>	<u>1,345,857</u>
Cash Flows from Capital and Related Financing Activities			
Capital contributions	74,712	29,078	103,790
Purchases of capital assets	(365,274)	(954,203)	(1,319,477)
Proceeds from debt	0	1,033,550	1,033,550
Principal paid on debt	(188,487)	(305,181)	(493,668)
Interest paid on debt	(20,562)	(321,318)	(341,880)
Net Cash Used by Capital and Related Financing Activities	<u>(499,611)</u>	<u>(518,074)</u>	<u>(1,017,685)</u>
Cash Flows from Investing Activities			
Interest earnings	21,058	0	21,058
Net Cash Provided by Investing Activities	<u>21,058</u>	<u>0</u>	<u>21,058</u>
Net Increase in Cash and Cash Equivalents	381,706	(32,476)	349,230
Cash and Cash Equivalents			
Beginning of period	<u>5,288,733</u>	<u>1,053,461</u>	<u>6,342,194</u>
Cash and Cash Equivalents			
End of period	<u>5,670,439</u>	<u>1,020,985</u>	<u>6,691,424</u>
Cash and Cash Equivalents - Per Balance Sheet			
Unrestricted cash and cash equivalents	4,496,718	1,020,985	5,517,703
Restricted cash:			
Restricted for future capital improvements	867,575	0	867,575
Restricted for bond payments	306,146	0	306,146
	<u>5,670,439</u>	<u>1,020,985</u>	<u>6,691,424</u>

SUPPLEMENTAL INFORMATION

**STATEMENT OF CASH FLOWS PROPRIETARY FUNDS -
FOR THE YEAR ENDED JUNE 30, 2014 - CONTINUED**

	<u>Water</u>	<u>Sewer</u>	<u>Total</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities			
Operating income	540,597	207,407	748,004
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	323,993	421,319	745,312
(Increase) decrease in current assets:			
Receivables	41,584	(1,783)	39,801
Increase(decrease) in current liabilities:			
Accounts payable	(45,172)	(129,471)	(174,643)
Payroll taxes payable	(743)	0	(743)
Unearned tax revenue	0	(11,874)	(11,874)
	<u>860,259</u>	<u>485,598</u>	<u>1,345,857</u>
Net Cash Provided by Operating Activities			

SUPPLEMENTAL INFORMATION

STATEMENT OF CASH FLOWS PROPRIETARY FUNDS - FOR THE YEAR ENDED JUNE 30, 2013

	Water	Sewer	Total
Cash Flows from Operating Activities			
Receipts from customers	1,734,133	126,726	1,860,859
Receipts from grantors	0	610,591	610,591
Receipts from property assessments	0	646,319	646,319
Interfund transfers	(531,258)	531,258	0
Payments to suppliers	(649,972)	(1,087,247)	(1,737,219)
Payments to employees	(232,752)	(64,888)	(297,640)
Net Cash Provided by Operating Activities	<u>320,151</u>	<u>762,759</u>	<u>1,082,910</u>
Cash Flows from Capital and Related Financing Activities			
Capital contributions	68,781	9,314	78,095
Purchases of capital assets	(233,176)	(2,672,956)	(2,906,132)
Proceeds from debt	251,049	3,549,293	3,800,342
Principal paid on debt	(95,000)	(231,129)	(326,129)
Interest paid on debt	(42,549)	(363,821)	(406,370)
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>(50,895)</u>	<u>290,701</u>	<u>239,806</u>
Cash Flows from Investing Activities			
Interest earnings	28,169	0	28,169
Net Cash Provided by Investing Activities	<u>28,169</u>	<u>0</u>	<u>28,169</u>
Net Increase in Cash and Cash Equivalents	297,425	1,053,460	1,350,885
Cash and Cash Equivalents			
Beginning of period	<u>4,991,308</u>	<u>1</u>	<u>4,991,309</u>
End of period	<u>5,288,733</u>	<u>1,053,461</u>	<u>6,342,194</u>
Cash and Cash Equivalents - Per Balance Sheet			
Unrestricted cash and cash equivalents	4,200,744	1,053,461	5,254,205
Restricted cash:			
Restricted for future capital improvements	792,862	0	792,862
Restricted for bond payments	295,127	0	295,127
	<u>5,288,733</u>	<u>1,053,461</u>	<u>6,342,194</u>

SUPPLEMENTAL INFORMATION

**STATEMENT OF CASH FLOWS PROPRIETARY FUNDS -
FOR THE YEAR ENDED JUNE 30, 2013 - CONTINUED**

	<u>Water</u>	<u>Sewer</u>	<u>Total</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities			
Operating income	570,409	127,043	697,452
Adjustments to reconcile operating income to net cash provided by operating activities:			
Amortization	0	18,030	18,030
Depreciation	322,789	357,936	680,725
Gain on Disposal of property	(3,500)	0	(3,500)
(Increase) decrease in current assets:			
Receivables	95,002	338,007	433,009
Due from other funds	0	531,258	531,258
Increase(decrease) in current liabilities:			
Accounts payable	(134,034)	(609,515)	(743,549)
Payroll taxes payable	743	0	743
Due to other funds	(531,258)	0	(531,258)
Net Cash Provided by Operating Activities	<u>320,151</u>	<u>762,759</u>	<u>1,082,910</u>

SUPPLEMENTAL INFORMATION

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS For the Year Ended June 30, 2014

<u>Federal Grantor/Pass-Through Grantor/ Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Contract Number</u>	<u>Disbursements or Expenditures</u>
Environmental Protection Agency			
Passed through Department of Environmental Quality Capitalization Grants for Clean Water State Revolving Fund	66.458	SRF - 13308	790,380
Surveys, Studies, Investigations, and Special Purposes Grant	66.606	XP - 98823801-3	<u>29,673</u>
Total Federal Financial Assistance			<u><u>820,053</u></u>

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For the Year Ended June 30, 2014

Note A Basis of Accounting

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Lockwood Water and Sewer District and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States and Local Governments and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

**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**

March 18, 2015

The Board of Directors
Lockwood Area/Yellowstone County Water & Sewer District
Billings, Montana

We have audited, 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, the financial statements of Lockwood Water and Sewer District as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise Lockwood Water and Sewer District's basic financial statements, and have issued our report thereon dated March 18, 2015.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Lockwood Water and Sewer District'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 Lockwood Water and Sewer District's internal control. Accordingly, we do not express an opinion on the effectiveness of Lockwood Water and Sewer District's internal control.

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.

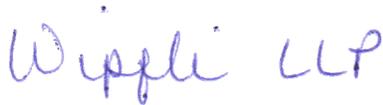
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Lockwood Water and Sewer District 's financial statements are free from 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*.

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 on 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.



Wipfli LLP
Billings, Montana

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM
AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB
CIRCULAR A-133**

March 18, 2015

Board of Directors
Lockwood Area/Yellowstone County Water & Sewer District
Billings, Montana

Report on Compliance for Each Major Federal Program

We have audited Lockwood Water and Sewer District's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* that could have a direct and material effect on Lockwood Water and Sewer District's major federal program for the year ended June 30, 2014. Lockwood Water and Sewer District's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Lockwood Water and Sewer District's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Lockwood Water and Sewer District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Lockwood Water and Sewer District's compliance.

Opinion on Each Major Federal Program

In our opinion, Lockwood Water and Sewer District complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on of its major federal program for the year ended June 30, 2014.

Report on Internal Control over Compliance

Management of Lockwood Water and Sewer District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Lockwood Water and Sewer District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program as a basis for designing auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Lockwood Water and Sewer District's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance 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 compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.



Wipfli LLP
Billings, Montana

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the Year Ended June 30, 2014

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: Unmodified Opinion

Internal control over financial reporting:
Material weakness(es) identified? _____ Yes X No

Significant deficiency(ies) identified not considered
to be material weaknesses? _____ Yes X No

Noncompliance material to the financial statements noted? _____ Yes X No

Federal Awards

Internal control over major programs:
Material weakness(es) identified? _____ Yes X No

Significant deficiency(ies) identified not considered
to be material weaknesses? _____ Yes X No

Type of auditor's report issued on compliance for major programs: Unmodified Opinion

Any audit findings disclosed that are required to be
reported in accordance with Section 510(a) of Circular A-133, _____ Yes X No

Identification of major programs:

CFDA Number(s) Name of Federal
66.458 Program or Cluster
Capitalization Grants for Clean Water
State Revolving Fund

Dollar threshold used to distinguish between
Type A and Type B programs: \$300,000

Auditee qualified as low-risk auditee? X Yes _____ No

Section II - Financial Statement Findings

None

Section III - Federal Award Findings and Questioned Costs

None

Section IV - Prior Year Audit Findings

None