

# STATE OF MINNESOTA

## Office of the State Auditor



**Patricia Anderson**  
**State Auditor**

---

**DULUTH/NORTH SHORE SANITARY DISTRICT**  
**DULUTH, MINNESOTA**

**FOR THE YEAR ENDED DECEMBER 31, 2005**

## **Description of the Office of the State Auditor**

The Office of the State Auditor serves as a watchdog for Minnesota taxpayers by helping to ensure financial integrity, accountability, and cost-effectiveness in local governments throughout the state.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 250 financial and compliance audits per year and has oversight responsibilities for over 4,300 local units of government throughout the state. The office currently maintains five divisions:

**Audit Practice** - conducts financial and legal compliance audits for local governments;

**Government Information** - collects and analyzes financial information for cities, towns, counties, and special districts;

**Legal/Special Investigations** - provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

**Pension** - monitors investment, financial, and actuarial reporting for over 700 public pension funds; and

**Tax Increment Financing, Investment and Finance** - promotes compliance and accountability in local governments' use of tax increment financing through financial and compliance audits.

The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employee's Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

Office of the State Auditor  
525 Park Street, Suite 500  
Saint Paul, Minnesota 55103  
(651) 296-2551  
state.auditor@state.mn.us  
www.auditor.state.mn.us

This document can be made available in alternative formats upon request. Call 651-296-2551 [voice] or 1-800-627-3529 [relay service] for assistance; or visit the State Auditor's web site: [www.auditor.state.mn.us](http://www.auditor.state.mn.us).

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

**For the Year Ended December 31, 2005**



**Audit Practice Division  
Office of the State Auditor  
State of Minnesota**

This page was left blank intentionally.

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

TABLE OF CONTENTS

	Reference	Page
<b>Introductory Section</b>		
Organization		1
<b>Financial Section</b>		
Independent Auditor's Report		2
Basic Financial Statements		
Statement of Net Assets	Exhibit A	4
Statement of Revenues, Expenses, and Changes in Net Assets	Exhibit B	5
Statement of Cash Flows	Exhibit C	6
Notes to the Financial Statements		7
<b>Management and Compliance Section</b>		
Schedule of Findings and Questioned Costs	Schedule 1	15
Other Required Reports		
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>		19
Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133		21
Schedule of Expenditures of Federal Awards	Schedule 2	23

This page was left blank intentionally.



This page was left blank intentionally.

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

ORGANIZATION  
DECEMBER 31, 2005

<u>Board of Managers</u>		<u>Term Expires</u>
Orlando (Lars) G. Fladmark	Chair	January 1, 2009
Kevin J. Bovee	Vice Chair	January 1, 2007
Mary Ann Sironen	Secretary	January 1, 2008
Scott Smith	Treasurer	January 1, 2009
Katherine Kuettel		January 1, 2008

This page was left blank intentionally.



This page was left blank intentionally.



PATRICIA ANDERSON  
STATE AUDITOR

# STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

SUITE 500  
525 PARK STREET  
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)  
(651) 296-4755 (Fax)  
state.auditor@state.mn.us (E-mail)  
1-800-627-3529 (Relay Service)

## INDEPENDENT AUDITOR'S REPORT

Members of the Board of Managers  
Duluth/North Shore Sanitary District

We have audited the accompanying basic financial statements of the Duluth/North Shore Sanitary District as of and for the year ended December 31, 2005, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Duluth/North Shore Sanitary District as of and for the year ended December 31, 2005, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Duluth/North Shore Sanitary District has not presented a Management's Discussion and Analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 17, 2006, on our consideration of the Duluth/North Shore Sanitary 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

*/s/Pat Anderson*

PATRICIA ANDERSON  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

End of Fieldwork: July 17, 2006

## **BASIC FINANCIAL STATEMENTS**

This page was left blank intentionally.

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

**EXHIBIT A**

**STATEMENT OF NET ASSETS  
DECEMBER 31, 2005**

**Assets**

**Current assets**

Cash	\$	626,499
Taxes receivable - delinquent		7,900
Accounts receivable		12,765
Claims receivable		12,584
Assets restricted for debt service		
Assessments receivable		135,000
		135,000

**Total current assets** **\$ 794,748**

**Noncurrent assets**

Restricted for debt service		
Assessments receivable		1,849,952
		<b>\$ 1,849,952</b>

**Capital assets**

Non-depreciable	\$	221,650
Depreciable - net of accumulated depreciation		16,763,482
		16,763,482

**Total capital assets** **\$ 16,985,132**

**Total Assets** **\$ 19,629,832**

**Liabilities**

**Current liabilities**

Accounts payable	\$	84,592
Contracts payable		565,149
Due to other governments		172
Accrued interest		57,018
General obligation bonds payable		30,000
General obligation revenue notes - Public Facilities Authority		442,000
		442,000

**Total current liabilities** **\$ 1,178,931**

**Noncurrent liabilities**

General obligation bonds	\$	255,000
General obligation revenue notes - Public Facilities Authority		8,628,050
		8,628,050

**Total noncurrent liabilities** **\$ 8,883,050**

**Total Liabilities** **\$ 10,061,981**

**Net Assets**

Invested in capital assets - net of related debt	\$	7,630,082
Restricted for debt service		1,984,952
Unrestricted		(47,183)
		(47,183)

**Total Net Assets** **\$ 9,567,851**

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

**EXHIBIT B**

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
YEAR ENDED DECEMBER 31, 2005**

<b>Operating Revenues</b>	
Charges for services	<u>\$ 869,773</u>
<b>Operating Expenses</b>	
Professional services	\$ 158,306
Insurance	8,838
Permits and licenses	200
Operations and maintenance	126,543
Supplies	1,574
Utilities	12,309
Western Lake Superior Sanitary District fees	14,576
Miscellaneous	203
Depreciation	<u>623,072</u>
<b>Total Operating Expenses</b>	<u>\$ 945,621</u>
<b>Net Operating Income (Loss)</b>	<u>\$ (75,848)</u>
<b>Nonoperating Revenues (Expenses)</b>	
Property taxes	\$ 187,580
Market value credit aid	14,980
Interest expense	(151,390)
Interest on assessments	<u>2,861</u>
<b>Total Nonoperating Revenues (Expenses)</b>	<u>\$ 54,031</u>
<b>Change in Net Assets</b>	<u>\$ (21,817)</u>
<b>Net Assets - January 1</b>	<u>9,589,668</u>
<b>Net Assets - December 31</b>	<u><u>\$ 9,567,851</u></u>

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

**EXHIBIT C**

**STATEMENT OF CASH FLOWS  
YEAR ENDED DECEMBER 31, 2005**

<b>Cash Flows from Operating Activities</b>	
Cash received from customers	\$ 874,145
Cash paid to suppliers	(298,200)
	<b>\$ 575,945</b>
 <b>Cash Flows from Noncapital Financing Activities</b>	
Property tax levy	\$ 160,255
Market value credit aid	14,980
	<b>\$ 175,235</b>
 <b>Cash Flows from Capital and Related Financing Activities</b>	
Proceeds from Public Facilities Authority general obligation note	\$ 1,224,616
Special assessments	157,804
Payments for capital assets	(1,495,548)
Principal paid on long-term debt	(406,000)
Interest paid on long-term debt	(145,909)
Interest received on assessments	2,861
	<b>\$ (662,176)</b>
 <b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	 <b>\$ 89,004</b>
 <b>Cash - January 1</b>	 <b>537,495</b>
 <b>Cash - December 31</b>	 <b>\$ 626,499</b>
 <b>Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities</b>	
Net operating income (loss)	\$ (75,848)
Adjustments to reconcile net operating income (loss) to net cash provided by (used in) operating activities	
Changes in assets and liabilities	
Depreciation	623,072
(Increase) decrease in receivables	4,372
Increase (decrease) in payables	24,349
	<b>\$ 575,945</b>

This page was left blank intentionally.

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS  
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2005**

---

---

1. Summary of Significant Accounting Policies

The accounting policies of the Duluth/North Shore Sanitary District conform to generally accepted accounting principles.

A. Financial Reporting Entity

The Duluth/North Shore Sanitary District was formed pursuant to Minn. Stat. §§ 115.18 to 115.37. The District was created for the purpose of promoting the public health and welfare by providing an adequate and efficient means of collecting, conveying, pumping, treating, and disposing of domestic sewage within the District. The District will reduce or eliminate the use of on-site septic systems to abate pollution of surface water, ground water, and Lake Superior. The District is governed by a five-member Board consisting of two members appointed by the City of Duluth, two members appointed by the Town of Duluth, and one member appointed by the Town of Lakewood. Each member of the Board must be a voter residing in the District.

The District is a primary government, as defined by Governmental Accounting Standards Board (GASB) Statement 14, and the District has no component units for which it is financially accountable.

B. Basis of Presentation

The accounts of the Duluth/North Shore Sanitary District are presented as an enterprise fund. Enterprise funds are used to account for operations financed and operated in a manner similar to private business enterprises--where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis to be financed or recovered primarily through user charges.

Operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the District. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as taxes, grants, and investment earnings, result from nonexchange

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

---

---

1. Summary of Significant Accounting Policies

B. Basis of Presentation (Continued)

transactions or incidental activities. The District's net assets are reported in three parts: (1) invested in capital assets, net of related debt; (2) restricted net assets; and (3) unrestricted net assets.

C. Basis of Accounting

The District's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Special assessments are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. When both restricted and unrestricted revenues are available for use, it is the District's policy to use restricted resources first, then unrestricted as they are needed. Pursuant to GASB Statement 20, the District has elected to not apply accounting standards issued after November 30, 1989, by the Financial Accounting Standards Board.

D. Assets and Liabilities

Cash

Cash consists of a checking account.

Taxes Receivable and Revenue

In Minnesota, counties act as collection agents for all property taxes. Tax settlements are received four times a year--in January, June, July, and December. The tax levy is recognized as revenue in the year of the levy.

Assessments Receivable and Revenue

Special assessments are levied against benefiting properties with the cost of special assessment improvement projects in accordance with state statutes. Collection of annual assessments, including interest, is handled by St. Louis County in the same manner as property taxes. Property owners may prepay the outstanding balance of any special assessments levied against their property at any time.

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

---

---

1. Summary of Significant Accounting Policies

D. Assets and Liabilities (Continued)

Restricted Assets and Liabilities

Restricted assets consist of monies specified for payment of construction costs or debt service. These assets are offset by the related liabilities or restricted net assets.

Capital Assets

Capital assets are stated at cost. Construction in progress consists of planning, design, engineering costs, and construction of the sewer extension line. Interest on funds borrowed to finance construction is not capitalized because amounts incurred are insignificant. In 2005, the construction on the sewer extension line was completed, and construction-in-progress was broken out into the separate capital asset categories.

Capital assets are stated at cost. Depreciation is determined using the straight-line method for the estimated useful lives of the assets.

<u>Classification</u>	<u>Estimated Life</u>
Buildings and building improvements	10 – 40 years
Improvements other than buildings	10 – 20 years
Equipment and vehicles	5 – 20 years
Infrastructure	10 – 40 years

General Obligation Bonds Payable

In 2004, \$315,000 of general obligation bonds were issued to provide additional funding for the construction of the sanitary sewer collection system.

General Obligation Revenue Notes Payable - Minnesota Public Facilities Authority

General obligation revenue notes payable include amounts drawn down from the Minnesota Public Facilities Authority for construction costs paid during 2005.

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

E. Use of Estimates (Continued)

The preparation of financial statements in conformity with generally accepted accounting principles 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 the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Detailed Notes

A. Deposits

Minn. Stat. § 118A.02 authorizes the District to deposit its cash and to invest in certificates of deposit in financial institutions designated by the District's Board. At December 31, 2005, District deposits totaled \$641,314, all of which were cash deposits insured as required by Minnesota statutes. The carrying value of these deposits was \$626,499. During the year, the District had an adequate amount of insurance and collateral pledged to cover their deposits.

B. Changes in Capital Assets

	Balance January 1, 2005	Increase	Decrease	Balance December 31, 2005
Capital assets not depreciated				
Land	\$ -	\$ 221,650	\$ -	\$ 221,650
Construction in progress	15,883,260	1,499,944	17,383,204	-
Total capital assets not depreciated	\$ 15,883,260	\$ 1,721,594	\$ 17,383,204	\$ 221,650
Capital assets depreciated				
Wet weather storage tank	\$ -	\$ 550,000	\$ -	\$ 550,000
Force main	-	7,627,603	-	7,627,603
Gravity collection system	-	610,950	-	610,950
Main pump station	-	1,359,116	-	1,359,116
Individual treatment systems	-	7,234,760	-	7,234,760
Equipment	-	4,125	-	4,125
Total capital assets depreciated	\$ -	\$ 17,386,554	\$ -	\$ 17,386,554

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

2. Detailed Notes

B. Changes in Capital Assets (Continued)

	Balance January 1, 2005	Increase	Decrease	Balance December 31, 2005
Less: accumulated depreciation for				
Wet weather storage tank	\$ -	\$ 18,333	\$ -	\$ 18,333
Force main	-	185,065	-	185,065
Gravity collection system	-	12,219	-	12,219
Main pump station	-	45,304	-	45,304
Individual treatment systems	-	361,738	-	361,738
Equipment	-	413	-	413
Total accumulated depreciation	\$ -	\$ 623,072	\$ -	\$ 623,072
Total capital assets depreciated	\$ -	\$ 16,763,482	\$ -	\$ 16,763,482
Capital Assets, Net	\$ 15,883,260	\$ 18,485,076	\$ 17,383,204	\$ 16,985,132

C. Construction Funding Sources

Cumulative construction costs and funding sources as of December 31, 2005, follow:

Construction Costs	
Financial planning	\$ 196,136
Engineering and design	1,840,452
Construction	14,809,067
Legal costs	353,836
Land use plan	59,484
Easements	66,898
Other costs	57,331
Total Construction Costs	<u>\$ 17,383,204</u>

Funding Sources	
Minnesota Public Facilities Loan #1	\$ 225,000
Minnesota Public Facilities Loan #2	300,000
Minnesota Public Facilities Loan #3	7,952,500
Minnesota Public Facilities Loan #4	1,328,050
Minnesota Public Facilities Grant	6,000,000
General Obligation Bonds, Series 2004	309,662
Federal Corps of Engineers Grant	484,868
Coastal Program Grant	36,001
Lake County coastal program contribution	4,680
City of Duluth - Community Development Block Grant	150,000
Tax levy and other local sources	592,443
Total Funding Sources	<u>\$ 17,383,204</u>

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

2. Detailed Notes (Continued)

D. Long-Term Debt

The following is a summary of the District's long-term debt activity for the year ended December 31, 2005.

	Balance January 1, 2005	Additions	Reductions	Balance December 31, 2005	Amounts Due Within One Year
Public Facilities Authority					
General Obligation Notes	\$ 8,576,033	\$ 870,017	\$ 376,000	\$ 9,070,050	\$ 442,000
General Obligation Bonds	315,000	-	30,000	285,000	30,000
Total Long-Term Debt	<u>\$ 8,891,033</u>	<u>\$ 870,017</u>	<u>\$ 406,000</u>	<u>\$ 9,355,050</u>	<u>\$ 472,000</u>

Long-term debt comprises the following:

- \$225,000 General Obligation Revenue Note issued to the Minnesota Public Facilities Authority. Note payments are due semi-annually on February and August 20, 2001 through 2020, at an interest rate of 3.52 percent.
- \$300,000 General Obligation Revenue Note issued to the Minnesota Public Facilities Authority. Note payments are due semi-annually on February and August 20, 2002 through 2021, at an interest rate of 3.83 percent.
- \$7,952,500 General Obligation Revenue Note issued to the Minnesota Public Facilities Authority. Note payments are due semi-annually on February and August 20, 2005 through 2023, at an interest rate of 1.63 percent.
- \$1,328,050 General Obligation Revenue Note issued to the Minnesota Public Facilities Authority. Note payments are due semi-annually on February and August 20, 2006 through 2023, at an interest rate of 1.00 percent.
- \$315,000 General Obligation Bonds, Series 2004. Bond payments are due semi-annually on February and August 1, 2005 to 2014, at an effective interest rate of 3.80 percent.

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

---

2. Detailed Notes

D. Long-Term Debt (Continued)

A summary of the annual requirements needed to service the long-term debt at December 31, 2005, is as follows:

<u>Year Ending December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 472,000	\$ 157,346	\$ 629,346
2007	478,000	150,161	628,161
2008	486,000	142,084	628,084
2009	494,000	133,771	627,771
2010	501,000	125,209	626,209
2011 – 2015	2,610,000	489,622	3,099,622
2016 – 2020	2,687,000	263,635	2,950,635
2021 – 2023	1,627,050	50,401	1,677,451
Total	<u>\$ 9,355,050</u>	<u>\$ 1,512,229</u>	<u>\$ 10,867,279</u>

The general obligation bonds and notes will be retired with income from operations, property taxes, and assessments and are exempt from the limitations on net debt imposed by Minnesota law.

3. Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. The District has purchased commercial insurance to insure these risks. There are no employees of the Duluth/North Shore Sanitary District, as the District has contracted out its operation and accounting functions to date. There were no significant reductions in insurance coverage from the previous year. There were no settlements in excess of insurance during the past two years.

4. Subsequent Events

On March 3, 2006, the sewer lines of the Knife River-Larsmont Sanitary District and the Duluth/North Shore Sanitary District were connected with flowage going to the Western Lake Superior Sanitary District for treatment.

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

---

4. Subsequent Events (Continued)

In 2004, S.J. Louis Construction Company served the District a notice of claims for a change order to the original contract because of undisclosed subsurface conditions. On May 4, 2006, a settlement was reached between the District and S.J. Louis Construction Company. As part of the settlement agreement, the District must pay S.J. Louis Construction Company \$225,000 in damages due to the undisclosed subsurface conditions. A liability was added to the District's December 31, 2005, financial statements. In return, S.J. Louis Construction Company has agreed to repair some of its previous construction work for the District and pay the District \$35,000 in property damages.



This page was left blank intentionally.

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

**Schedule 1**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED DECEMBER 31, 2005**

**I. SUMMARY OF AUDITOR'S RESULTS**

- A. Our report expresses an unqualified opinion on the basic financial statements of the Duluth/North Shore Sanitary District.
- B. A reportable condition in internal control was disclosed by the audit of the financial statements of the Duluth/North Shore Sanitary District and is reported in the "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*." The reportable condition was not a material weakness.
- C. No instances of noncompliance material to the financial statements of the Duluth/North Shore Sanitary District were disclosed during the audit.
- D. No matters involving internal control over compliance relating to the audit of the major federal award program were reported in the "Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133."
- E. The Auditor's Report on Compliance for the major federal award program for the Duluth/North Shore Sanitary District expresses an unqualified opinion.
- F. No findings were disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133.
- G. The major program is:
  - Capitalization Grant for Clean Water  
State Revolving Funds
  - CFDA #66.458
- H. The threshold for distinguishing between Types A and B programs was \$300,000.
- I. The Duluth/North Shore Sanitary District was determined to be a low-risk auditee.

**II. FINDINGS RELATED TO FINANCIAL STATEMENTS AUDITED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEM NOT RESOLVED

01-1 Segregation of Duties

Due to the limited number of administrative personnel, segregation of the accounting functions necessary to ensure adequate internal accounting control is not possible. This is not unusual in operations the size of the Duluth/North Shore Sanitary District; however, the Board of Managers should constantly be aware of this condition and realize that the concentration of duties and responsibilities in a limited number of individuals is not desirable from an accounting point of view.

Segregation of duties is defined as an arrangement of responsibilities such that the work of one employee is checked by another. Ideally, no single individual should be able to:

- authorize a transaction,
- record the transaction and maintain related financial records, and
- have custody of assets.

Oversight procedures which the Board of Managers should consider include:

- developing written internal control policies and procedures,
- reviewing monthly bank reconciliations, and
- reviewing monthly financial statements.

We recommend that the Board of Managers be aware of the absence of segregation of the accounting functions and perform oversight procedures to ensure that internal control policies and procedures are in place.

Client's Response:

*We are aware of the necessity for segregation of duties and have fully implemented the concept. Currently we have an accountant responsible for accounts payable. Deposits are either made electronically or by check. Tax levy checks are delivered to the accountant by the treasurer. Monthly customer charges are collected by NTS, the company we have hired to operate the DNSSD. Monthly charges are received either by check or electronic transfer. The deposits are then deposited in the DNSSD account and reported to Ellingson & Ellingson, LTD, the DNSSD's accountant. The accountant presents a list of payables to the Board at its monthly meeting. All payments are approved by vote of the Board, and all checks require the signatures of two Board members. Monthly statements are prepared by Ellingson & Ellingson, LTD, and conveyed to the Board on a monthly basis. We feel we have created a system where at least three people are involved in every transaction. We do not deal with cash, and no person or business entity has control of more than one aspect of any transaction. We will continue to monitor our system and incorporate any fiscally responsible suggestions the State Auditor recommends.*

**III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS**

None.

**IV. OTHER FINDINGS AND RECOMMENDATIONS**

MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEMS RESOLVED

**Collateral Requirements (02-1)**

Minn. Stat. § 118A.03 requires a governmental entity to obtain collateral or a surety bond from a financial institution for deposits in excess of available federal deposit insurance. We noted an insufficient amount of collateral pledged to secure deposits.

**Resolution**

In the current audit period, the District had a sufficient amount of collateral pledged to cover deposits as required by Minn. Stat. § 118A.03.

**Withholding for Out-of-State Contractors (03-1)**

The Project Loan and Bond Purchase Agreement between the Minnesota Public Facilities Authority and the District requires the District to comply with Minn. Stat. § 290.9705, Withholding of Payment to Out-of-State Contractors. This statute requires the District to withhold eight percent of every payment to a non-resident (of Minnesota) construction contractor or receive a waiver of requirement from the Commissioner of the Minnesota Department of Revenue. We noted the District did not withhold eight percent from payments made to a non-resident contractor or receive a waiver from the Commissioner.

**Resolution**

In the current audit period, the District received a waiver of requirement from the Commissioner of the Minnesota Department of Revenue.

## **OTHER REQUIRED REPORTS**

This page was left blank intentionally.



# STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

PATRICIA ANDERSON  
STATE AUDITOR

SUITE 500  
525 PARK STREET  
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)  
(651) 296-4755 (Fax)  
state.auditor@state.mn.us (E-mail)  
1-800-627-3529 (Relay Service)

## **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***

Members of the Board of Managers  
Duluth/North Shore Sanitary District

We have audited the basic financial statements of the Duluth/North Shore Sanitary District as of and for the year ended December 31, 2005, and have issued our report thereon dated July 17, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Duluth/North Shore Sanitary District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the District's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. A reportable condition is described in the accompanying Schedule of Findings and Questioned Costs as item 01-1.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by

employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition indicated above is not a material weakness.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Duluth/North Shore Sanitary District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### Minnesota Legal Compliance

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* contains five categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, and claims and disbursements. Our study included all of the listed categories.

The results of our tests indicate that, for the items tested, the Duluth/North Shore Sanitary District complied with the material terms and conditions of applicable legal provisions.

This report is intended solely for the information and use of the Duluth/North Shore Sanitary District's Board of Managers, management, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than those specified parties.

*/s/Pat Anderson*

PATRICIA ANDERSON  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

End of Fieldwork: July 17, 2006



**STATE OF MINNESOTA**  
**OFFICE OF THE STATE AUDITOR**

SUITE 500  
525 PARK STREET  
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)  
(651) 296-4755 (Fax)  
state.auditor@state.mn.us (E-mail)  
1-800-627-3529 (Relay Service)

PATRICIA ANDERSON  
STATE AUDITOR

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

Members of the Board of Managers  
Duluth/North Shore Sanitary District

Compliance

We have audited the compliance of the Duluth/North Shore Sanitary District with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended December 31, 2005. The Duluth/North Shore Sanitary District's major federal program is identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Duluth/North Shore Sanitary District's management. Our responsibility is to express an opinion on the District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Duluth/North Shore Sanitary 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. Our audit does not provide a legal determination on the District's compliance with those requirements.

In our opinion, the Duluth/North Shore Sanitary District complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2005.

#### Internal Control Over Compliance

The management of the Duluth/North Shore Sanitary District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the District's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

#### Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of the Duluth/North Shore Sanitary District as of and for the year ended December 31, 2005, and have issued our report thereon dated July 17, 2006. Our audit was performed for the purpose of forming an opinion on the District's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the Duluth/North Shore Sanitary District's Board of Managers, management, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than those specified parties.

*/s/Pat Anderson*

PATRICIA ANDERSON  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

End of Fieldwork: July 17, 2006

**DULUTH/NORTH SHORE SANITARY DISTRICT  
DULUTH, MINNESOTA**

Schedule 2

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED DECEMBER 31, 2005**

<b>Federal Grantor Pass-Through Agency Grant Program Title</b>	<b>Pass-Through Grant Numbers</b>	<b>Federal CFDA Number</b>	<b>Expenditures</b>
<b>U.S. Environmental Protection Agency</b>			
Passed Through Minnesota Department of Employment and Economic Development			
Capitalization Grant for Clean Water State Revolving Funds	MPFA-03-0001-R-FY04	66.458	<u>\$ 870,017</u>

Notes to Schedule of Expenditures of Federal Awards

1. The Schedule of Expenditures of Federal Awards presents the activity of federal award programs expended by the Duluth/North Shore Sanitary District. The District's reporting entity is defined in Note 1 to the financial statements.
2. The expenditures on this schedule are on the accrual basis of accounting.
3. During 2005, the Duluth/North Shore Sanitary District did not pass any federal money to subrecipients.