

STATE OF MINNESOTA

Office of the State Auditor



Patricia Anderson
State Auditor

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

TWO-YEAR PERIOD ENDED DECEMBER 31, 2004

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.

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

Two-Year Period Ended December 31, 2004



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

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

ORGANIZATION
DECEMBER 31, 2004

<u>Board of Managers</u>	<u>Term Ending</u>
Robin Whaley, Chair	January 1, 2005
Barbara Eaton, Vice Chair	January 1, 2007
Len Beardsley, Treasurer	January 1, 2006
Doug Homola, Member	January 1, 2005
Lawrence Moon, Member	January 1, 2007

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PATRICIA ANDERSON
STATE AUDITOR

INDEPENDENT AUDITOR'S REPORT

Members of the Board of Managers
Knife River-Larsmont Sanitary District

We have audited the accompanying basic financial statements of the Knife River-Larsmont Sanitary District as of and for the two-year period ended December 31, 2004, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic 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 basic financial statements referred to above present fairly, in all material respects, the financial position of the Knife River-Larsmont Sanitary District as of and for the two-year period ended December 31, 2004, and the changes in its financial position and its cash flows for the two years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in the notes to the financial statements, the Knife River-Larsmont Sanitary District adopted the provisions of Governmental Accounting Standards Board (GASB) Statements No. 34, *Basic Financial Statements--and Management's Discussion and Analysis--for State and Local Governments*, as amended; and No. 38, *Certain Financial Statement Note Disclosures*, as of and for the two-year period ended December 31, 2004. These statements result in a change in the format and content of the basic financial statements.

The Management's Discussion and Analysis is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. The Knife River-Larsmont 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.

/s/Pat Anderson

PATRICIA ANDERSON
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

End of Fieldwork: March 21, 2005

BASIC FINANCIAL STATEMENTS

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

EXHIBIT A

**STATEMENT OF NET ASSETS
DECEMBER 31, 2004**

Assets

Current assets

Cash	\$ 49,315
Petty cash	50
Taxes receivable	1,972
Accounts receivable	25,750
	<hr/>

Total current assets **\$ 77,087**

Capital assets	\$ 3,717,215
Less: allowance for depreciation	(1,979,013)
	<hr/>

Total capital assets (net of accumulated depreciation) **\$ 1,738,202**

Total Assets **\$ 1,815,289**

Liabilities

Current liabilities

Accounts payable	\$ 2,510
Due to other governments	24,726
Deferred revenue	747
	<hr/>

Total Liabilities **\$ 27,983**

Net Assets

Invested in capital assets	\$ 1,738,202
Unrestricted	49,104
	<hr/>

Total Net Assets **\$ 1,787,306**

**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

EXHIBIT B

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
TWO-YEAR PERIOD ENDED DECEMBER 31, 2004**

Operating Revenues	
Charges for services	\$ 132,534
Licenses and permits	9,405
Miscellaneous	179
	<hr/>
Total Operating Revenues	\$ 142,118
	<hr/>
Operating Expenses	
Contracted services	\$ 110,382
Professional services	56,264
Repair and maintenance	48,498
Supplies	11,838
Utilities	8,758
Other services and charges	47,562
Depreciation	152,740
	<hr/>
Total Operating Expenses	\$ 436,042
	<hr/>
Operating Income (Loss)	\$ (293,924)
	<hr/>
Nonoperating Revenues (Expenses)	
Property taxes and aids	\$ 70,410
Interest income	1,793
	<hr/>
Total Nonoperating Revenues (Expenses)	\$ 72,203
	<hr/>
Change in Net Assets	\$ (221,721)
	<hr/>
Net Assets - January 1, 2003 (restated Note 1.F.)	2,009,027
	<hr/>
Net Assets - December 31, 2004	\$ 1,787,306
	<hr/> <hr/>

**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

EXHIBIT C

**STATEMENT OF CASH FLOWS
TWO-YEAR PERIOD ENDED DECEMBER 31, 2004**

Cash Flows from Operating Activities	
Cash received from customers	\$ 139,108
Cash paid to suppliers	<u>(282,373)</u>
Net cash provided by (used for) operating activities	\$ (143,265)
Cash Flows from Noncapital Financing Activities	
Property taxes and aids	70,272
Cash Flows from Investing Activities	
Interest income	<u>1,793</u>
Net Increase (Decrease) in Cash	\$ (71,200)
Cash - January 1, 2003	<u>120,565</u>
Cash - December 31, 2004	<u><u>\$ 49,365</u></u>
 Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used for) Operating Activities	
Net operating income (loss)	\$ (293,924)
Adjustments to reconcile net operating income (loss) to net cash provided by (used for) operating activities	
Depreciation	152,740
Decrease (increase) in receivables	(3,010)
Increase (decrease) in payables	<u>929</u>
Net Cash Provided by (Used for) Operating Activities	<u><u>\$ (143,265)</u></u>

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE TWO-YEAR PERIOD ENDED DECEMBER 31, 2004

1. Summary of Significant Accounting Policies

The accounting policies of the Knife River-Larsmont Sanitary District conform to generally accepted accounting principles.

A. Financial Reporting Entity

The Knife River-Larsmont Sanitary District was formed May 8, 2001, 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 and industrial wastes within the District. The District is governed by a five-member Board. Each member of the Board must be a voter residing in the District.

The Knife River-Larsmont Sanitary District is a primary government, as defined by Governmental Accounting Standards Board (GASB) Statement No. 14, and there are no component units for which the District is financially accountable.

B. Basis of Presentation

The accounts of the Knife River-Larsmont Sanitary District are presented as an enterprise fund. Enterprise funds are used to account for operations that are 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 be financed or recovered primarily through user charges.

C. Basis of Accounting

The District uses the accrual basis of accounting. Revenues are recognized when they are earned, and expenses are recognized when they are incurred. 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.

**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

D. Assets and Liabilities

Cash

Cash consists of an operations checking account and a repair and replacement savings account. Cash and cash equivalents include cash and petty cash.

Taxes Receivable and Revenue

A property tax levy was established to finance operations. 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 December 2004 settlement was not received by the District until January 2005. The tax levy is recognized as revenue in the year of the levy.

Capital Assets

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>
Sewer plant	15 years
Collection system	40 years
Equipment	5 years

E. Use of Estimates

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 these estimates.

**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

F. Restatement

The District implemented GASB Statement No. 34, *Basic Financial Statements--and Management's Discussion and Analysis--for State and Local Governments*. Implementation of this new standard required the District to change the format and content of the financial statements. Implementation of the new standard required the following restatement of fund equity to net assets:

Retained earnings, as previously reported - December 31, 2002	\$ 92,659
Contributions, as previously reported - December 31, 2002	1,916,368
Net Assets (Restated) - January 1, 2003	\$ 2,009,027

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, 2004, District deposits totaled \$52,182, all of which were cash deposits insured or collateralized as required by Minnesota statutes. The carrying value of these deposits was \$49,315.

B. Capital Assets

A summary of the changes in capital assets for the two-year period ended December 31, 2004, follows:

	Balance January 1, 2003	Additions	Deletions	Balance December 31, 2004
Sewer plant	\$ 661,237	\$ -	\$ -	\$ 661,237
Collection system	3,054,790	-	-	3,054,790
Equipment	1,188	-	-	1,188
Total capital assets	\$ 3,717,215	\$ -	\$ -	\$ 3,717,215
Less: accumulated depreciation	(1,826,273)	(152,740)	-	(1,979,013)
Net Capital Assets	\$ 1,890,942	\$ (152,740)	\$ -	\$ 1,738,202

**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

2. Detailed Notes (Continued)

C. Construction Commitment

In November 2004, the District contracted with Frontier Pipeline, LLC, for a sewer extension project. The amount of the contract is \$875,595. The work had not yet started at December 31, 2004.

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 Knife River-Larsmont Sanitary District as the District has hired independent contractors to operate the plant and perform its accounting functions. There were no significant reductions in insurance coverage from the previous year. There were no settlements in excess of insurance during the audit period.

4. Summary of Significant Contingencies and Other Items

A. Contingent Liability

Lake County has paid for certain engineering and other expenses on behalf of the Knife River-Larsmont Sanitary District for the period of 1997 to 2004, with the understanding that if funding becomes available to the District, these expenses would be reimbursed to Lake County. According to Lake County records, the amount owed from the Knife River-Larsmont Sanitary District to Lake County at December 31, 2004, is \$454,772. This is not reported as a liability on the Knife River-Larsmont Sanitary District's financial statements.

B. Subsequent Event

On June 24, 2004, the Knife River-Larsmont Sanitary District Board voted to terminate operations at its treatment plant and connect to the Duluth North Shore Sanitary District sewer line, with the flowage going to the Western Lake Superior Sanitary District for treatment. Connection to the Duluth North Shore Sanitary District is expected to take place in 2005.

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE TWO-YEAR PERIOD ENDED DECEMBER 31, 2004**

I. FINANCIAL STATEMENT AUDIT--INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

02-1 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 Knife River-Larsmont 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.

The District contracts with a clerk/bookkeeper to maintain its records. The duties of the clerk/bookkeeper include preparing and sending out billing books to the Sanitary District users, receiving payments from the users, preparing and making bank deposits, posting customer charges and payments to the customer balance detail and the accounts receivable control ledger, and preparing bank reconciliations.

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 that the Board of Managers should consider include:

- developing written internal control policies and procedures,
- reviewing monthly bank reconciliations, and
- reviewing monthly financial statements including customer balance detail reports.

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

Client's Response:

The KRLSD Board will review bank reconciliation reports monthly. Financial statements are reviewed monthly. Customer balance detail reports are being updated. The Board treasurer will work with the clerk.

02-2 Accounts Receivable

The District's detailed listing of customer accounts receivable had a total balance of \$25,750 at December 31, 2004, but the accounts receivable control ledger had a balance of \$29,397, a \$3,647 difference. Footing and cross-footing errors were also noted in the detailed customer receivable listing and in the control ledger.

The detailed accounting records of the District should accurately support the general ledger balances. Without this correlation of records, the District may not have an accurate listing of money owed to them.

We recommend the District bookkeeper balance the detailed accounts receivable listing to the general ledger control balance on a monthly basis. Differences should be investigated and corrected on a timely basis.

Client's Response:

Customer detailed balances are being updated.

02-3 Delinquent Customer Receivables

The District's customer accounts receivable balance has been steadily increasing. The balance increased \$3,010 during the reporting period, from \$22,740 at January 1, 2002, to \$25,750 at December 31, 2004. Of the receivable balance at December 31, 2004, \$23,386 is over 90 days old.

The District has the option to certify delinquent customer receivables to Lake County to be collected as part of the customer's property taxes, but this option has not been exercised during the past five years, resulting in the increasing balances.

We recommend the District Board of Managers review the detailed listing of receivables, identify troubled accounts, and implement collection procedures as deemed necessary.

Client's Response:

Legal counsel is going over delinquent bill form letters. First notice of tax liens will go out in July and be put on taxes if not paid or arrangement for payment made by October.

02-4 Capital Assets

The Knife River-Larsmont Sanitary District does not maintain detailed capital asset records. The District's records of capital assets are summarized and do not include details such as the contractor or architect, date of acquisition, cost, or payment voucher number.

The above condition results in a lack of documentation of District assets. Because of the absence of specific detailed capital asset records documenting original cost, it would be difficult to identify and remove a capital asset from the records if one is disposed of at some point in the future.

We recommend the District bookkeeper prepare or obtain detailed capital asset records and retain all pertinent documents and records in its files.

Client's Response:

The record for fixed assets that was provided by the former waste water operator was given to the auditor. That is all the information the District has on this matter.

II. OTHER FINDINGS AND RECOMMENDATIONS

MINNESOTA LEGAL COMPLIANCE

ITEM ARISING THIS YEAR

04-1 Uniform Municipal Contracting Law

The Knife River-Larsmont Sanitary District entered into two contracts during the audit period that were subject to Uniform Municipal Contracting Law. One was a contract for \$24,000 with Lakehead Trucking to build a mound system, and the other was a contract for \$26,600 with Twin Ports Paper for repair of the lift stations. The District's plant operator indicated quotes had been obtained for each of these contracts, but the District was unable to locate the quotes for review during our audit.

According to Minn. Stat. § 471.345, subd. 4, if the amount of the contract is estimated to exceed \$10,000 but not to exceed \$50,000, the contract may be made either upon sealed bids or by direct negotiation, by obtaining two or more quotations for the purchase or sale whenever possible. All quotations obtained shall be kept on file for a period of at least one year after the receipt thereof.

We recommend that on future projects, the District retain quotes received on contracts in accordance with Minnesota statutes.

Client's Response:

The contract for Lakehead Trucking was given to the auditor. The contract for Twin Ports Paper could not be found. In the future the District will make sure such contracts are kept on file.



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PATRICIA ANDERSON
STATE AUDITOR

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND MINNESOTA LEGAL COMPLIANCE

Members of the Board of Managers
Knife River-Larsmont Sanitary District

We have audited the basic financial statements of the Knife River-Larsmont Sanitary District as of and for the two-year period ended December 31, 2004, and have issued our report thereon dated March 21, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America.

Internal Control Over Financial Reporting

The management of the Knife River-Larsmont Sanitary District is responsible for establishing and maintaining internal control. In fulfilling this responsibility, management must make estimates and judgments to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that:

- assets are safeguarded against loss from unauthorized use or disposition,
- transactions are executed in accordance with management's authorization, and
- transactions are recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in internal control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit, we considered the Knife River-Larsmont 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 certain matters involving the internal control over financial reporting and its operation that we consider to be

reportable conditions. 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. Reportable conditions are described in the accompanying Schedule of Findings and Recommendations as items 02-1 through 02-4.

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 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 none of the reportable conditions indicated above is a material weakness.

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 Knife River-Larsmont Sanitary District complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Recommendations as item 04-1.

This report is intended solely for the information and use of the Board of Managers and management 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: March 21, 2005