

STATE OF MINNESOTA

Office of the State Auditor



Patricia Anderson
State Auditor

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, 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.

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

For the Year Ended December 31, 2005



**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, 2005**

<u>Board of Managers</u>	<u>Term Ending</u>
Robert Mitchell, Chair	January 1, 2009
Mike Ojard, Vice Chair	January 1, 2007
Robert Entzion, Treasurer	January 1, 2009
Barbara Eaton, Member	January 1, 2007
Tom Bothwell, Member	January 1, 2008

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STATE OF MINNESOTA

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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 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 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 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 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 1, 2006, on our consideration of Knife River-Larsmont 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: June 1, 2006

BASIC FINANCIAL STATEMENTS

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

EXHIBIT A

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

Assets

Current assets

Cash	\$ 46,288
Petty cash	50
Taxes receivable	1,708
Accounts receivable	33,979
Due from other governments	96,184

Total current assets **\$ 178,209**

Restricted assets

Construction account	
Restricted cash and pooled investments	<u>\$ 10,237</u>

Capital assets

Non-depreciable	\$ 1,578,162
Depreciable, net of accumulated depreciation	1,661,832

Total capital assets **\$ 3,239,994**

Total Assets **\$ 3,428,440**

Liabilities

Current liabilities

Accounts payable	\$ 16,962
Contracts payable	85,495
Due to other governments	24,726
Deferred revenue	501
PFA loans payable	19,773

Total current liabilities **\$ 147,457**

Noncurrent liabilities

PFA loans payable	855,594
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Total Liabilities **\$ 1,003,051**

Net Assets

Invested in capital assets, net of related debt	\$ 2,364,627
Restricted for construction	10,237
Unrestricted	50,525

Total Net Assets **\$ 2,425,389**

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

EXHIBIT B

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

Operating Revenues	
Charges for services	\$ 90,249
Licenses and permits	13,725
Miscellaneous	1,198
	<hr/>
Total Operating Revenues	\$ 105,172
Operating Expenses	
Contracted services	\$ 55,325
Professional services	55,939
Repair and maintenance	3,180
Supplies	4,866
Utilities	5,013
Other services and charges	26,663
Depreciation	76,370
Interest expense	4,829
Bond issuance costs	10,561
PFA loan issuance costs	2,000
	<hr/>
Total Operating Expenses	\$ 244,746
Operating Income (Loss)	\$ (139,574)
Nonoperating Revenues (Expenses)	
Property taxes and aids	\$ 40,211
Interest income	486
	<hr/>
Total Nonoperating Revenues (Expenses)	\$ 40,697
Capital Contributions	
Minnesota Public Facilities Authority - Grant	\$ 620,000
Corp of Engineers Section 569 Grant	110,421
Coastal Zone Management Grant	6,539
	<hr/>
Total Capital Contributions	\$ 736,960
Change in Net Assets	\$ 638,083
Net Assets - January 1, 2005	1,787,306
	<hr/>
Net Assets - December 31, 2005	\$ 2,425,389
	<hr/> <hr/>

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

EXHIBIT C

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

Cash Flows from Operating Activities	
Cash received from customers	\$ 96,943
Cash paid to suppliers	<u>(51,039)</u>
Net cash provided by (used for) operating activities	<u>\$ 45,904</u>
 Cash Flows from Noncapital Financing Activities	
Property taxes and aids	<u>\$ 40,229</u>
 Cash Flows from Capital and Related Financing Activities	
Proceeds from Public Facilities Authority general obligation note	\$ 875,367
Proceeds from Public Facilities Authority Grant	620,000
Proceeds from a Corp of Engineers Section 569 Grant	14,237
Proceeds from a Coastal Zone Management Grant	6,539
Proceeds from general obligation temporary construction bonds	573,961
Payments for construction in process	(1,578,162)
Principal paid on long-term debt	(573,961)
Interest paid on long-term debt	(4,829)
Bond and note issuance costs	<u>(12,561)</u>
Net cash provided by (used for) capital and related financing activities	<u>\$ (79,409)</u>
 Cash Flows from Investing Activities	
Interest income	<u>\$ 486</u>
Net Increase (Decrease) in Cash	\$ 7,210
Cash - January 1, 2005	<u>49,365</u>
Cash - December 31, 2005	<u><u>\$ 56,575</u></u>
 Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used for) Operating Activities	
Net operating income (loss)	\$ (139,574)
Adjustments to reconcile net operating income (loss) to net cash provided by (used for) operating activities	
Depreciation	76,370
Decrease (increase) in receivables	(8,229)
Increase (decrease) in payables	99,947
Increase (decrease) in debt related costs	<u>17,390</u>
Net Cash Provided by (Used for) Operating Activities	<u><u>\$ 45,904</u></u>

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, 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 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 waste 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 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 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 earned, and expenses are recognized when 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 2005 settlement was not received by the District until January 2006. 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**

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 \$158,441, all of which were cash deposits insured or collateralized as required by Minnesota statutes. The carrying value of these deposits was \$56,525.

B. Capital Assets

A summary of the changes in capital assets for the year ended December 31, 2005, follows:

	Balance January 1, 2005	Additions	Deletions	Balance December 31, 2005
Capital assets not depreciated				
Construction in progress	\$ -	\$ 1,578,162	\$ -	\$ 1,578,162
Capital assets depreciated				
Sewer plant	\$ 661,237	\$ -	\$ -	\$ 661,237
Collection system	3,054,790	-	-	3,054,790
Equipment	1,188	-	-	1,188
Total capital assets depreciated	\$ 3,717,215	\$ -	\$ -	\$ 3,717,215
Less: accumulated depreciation for				
Sewer plant	\$ 661,237	\$ -	\$ -	\$ 661,237
Collection system	1,316,588	76,370	-	1,392,958
Equipment	1,188	-	-	1,188
Total capital assets depreciated	\$ 1,979,013	\$ 76,370	\$ -	\$ 2,055,383
Total capital assets depreciated, Net	\$ 1,738,202	\$ (76,370)	\$ -	\$ 1,661,832
Total Capital Assets, Net	\$ 1,738,202	\$ 1,501,792	\$ -	\$ 3,239,994

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

2. Detailed Notes (Continued)

C. Construction Funding Sources

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

Construction costs	
Engineering and design	\$ 91,252
Construction	880,962
Legal costs	5,348
Hook-up fee paid to Duluth/North Shore Sanitary District	600,600
Total construction costs	\$ 1,578,162
Debt-related costs	17,389
Total Construction and Debt-Related Costs	\$ 1,595,551
Funding sources	
Minnesota Public Facilities loan	\$ 875,367
Minnesota Public Facilities grant	620,000
Corps of Engineers Section 569	100,184
Total Funding Sources	\$ 1,595,551

D. Short-Term Debt

In 2005, there was \$950,000 in General Obligation Temporary Construction Bonds issued. Amounts drawn on this bond during the year were \$573,961. In December 2005, this bond was paid off with the Minnesota Public Facilities grant.

E. Long-Term Obligations

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

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Public Facilities Authority General Obligation Notes	\$ -	\$ 875,367	\$ -	\$ 875,367	\$ 19,773

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

2. Detailed Notes

E. Long-Term Obligations (Continued)

Long-term debt is composed of the following:

\$882,212 General Obligation Note issued to the Minnesota Public Facilities Authority. Amounts drawn or receivable on this note as of December 31, 2005, were \$875,367. Note payments are due semi-annually on February 20 and August 20, 2006 through 2025, at an interest rate of 1.31 percent.

Debt service requirements at December 31, 2005, are as follows:

<u>Year Ending December 31</u>	<u>General Obligation Revenue Note</u>	
	<u>Principal</u>	<u>Interest</u>
2006	\$ 19,773	\$ 5,734
2007	39,936	11,078
2008	40,461	10,553
2009	40,993	10,021
2010	41,532	9,482
2011 - 2015	215,991	39,080
2016 - 2020	230,563	24,508
2021 - 2025	246,118	8,953
Total	<u>\$ 875,367</u>	<u>\$ 119,409</u>

The general obligation note will be retired with income from operations, property taxes, investment income, and unused construction funding and are exempt from the limitations on net debt imposed by Minnesota Law.

F. Construction Commitment

As of December 31, 2005, the District had the following commitment with respect to the unfinished construction project.

<u>Contractor</u>	<u>Project</u>	<u>Remaining Construction Commitment</u>
Frontier Pipeline	Pipeline Extension	<u>\$ 61,890</u>

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

3. Risk Management

The Knife River-Larsmont Sanitary 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 2005, 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, 2005, is \$462,372. 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. On March 3, 2006, the sewer lines of the Knife River-Larsmont Sanitary District and the Duluth/North Shore Sanitary District were connected, with the flowage going to the Western Lake Superior Sanitary District for treatment.

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, 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 Knife River-Larsmont Sanitary District.
- B. Reportable conditions in internal control were disclosed by the audit of financial statements of the Knife River-Larsmont Sanitary District and are 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*." None were material weaknesses.
- C. No instances of noncompliance material to the financial statements of the Knife River-Larsmont 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 Knife River-Larsmont 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 Knife River-Larsmont Sanitary District was not determined to be a low-risk auditee.

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

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 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 which 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:

Board members are aware of all transactions made by the bookkeeper. Monthly bank reconciliations and financial statements are reviewed by Board members at monthly Board meetings. The Board Treasurer goes over all bills submitted to the District and they are reviewed by the entire Board at monthly meetings before payments are sent out.

02-3 Delinquent Customer Receivables

The District's customer accounts receivable balance has been steadily increasing. The balance increased \$8,229 during the reporting period, from \$25,750 at January 1, 2005, to \$33,979 at December 31, 2005. Of the receivable balance at December 31, 2005, \$30,741 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 six years, resulting in increasing balances.

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

Client's Response:

Arrangements will be made for collections of delinquent customer accounts with the County Auditor's office.

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 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:

There are no records of previous capital assets. Detailed records are being kept of any current capital assets.

PREVIOUSLY REPORTED ITEM RESOLVED

Accounts Receivable (02-2)

The District's detailed listing of customer accounts receivable balance did not tie to the accounts receivable control ledger; there was a difference of \$3,647 between the detailed listing of customer accounts receivable and the accounts receivable control ledger.

Resolution

In the current audit period, the detailed listing of customer accounts receivable balance tied to the accounts receivable control log.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

None.

IV. OTHER FINDINGS AND RECOMMENDATIONS

MINNESOTA LEGAL COMPLIANCE

ITEM ARISING THIS YEAR

05-1 Collateral Pledged to Secure Deposits

In 2005, the District started a construction project to connect the Knife River-Larsmont Sanitary District to the Duluth/North Shore Sanitary District. During the year, the District received money from a temporary construction bond, a Public Facilities Authority grant, and a Public Facilities Authority loan to fund the project. These extra funds caused the bank deposits to be undercollateralized. For example, on December 20, 2005, the District received \$820,452 from a Public Facilities Authority loan, which resulted in unsecured District deposits of \$812,390. In 2005, no collateral was pledged to the District.

Minn. Stat. § 118A.03 requires that to the extent that funds deposited are in excess of available federal deposit insurance, “. . . the total collateral computed at its market value shall be at least ten percent more than the amount on deposit plus accrued interest at the close of the financial institution’s banking day.” Unsecured District deposits expose the District to loss if the financial institution fails.

We recommend the District obtain the required collateral and closely monitor deposits and the related collateral pledged to secure those deposits to ensure sufficient coverage.

Client’s Response:

The District is working with our banking institution, The Lake Bank N.A., on this requirement.

PREVIOUSLY REPORTED ITEM RESOLVED

Uniform Municipal Contracting Law (04-1)

According to Minn. Stat. § 471.345, subd. 4, if the amount of a contract is estimated to exceed \$10,000 but not to exceed \$50,000, a contract may be made either upon sealed bid or by direct negotiation, by obtaining two or more quotations for the purchase or sale whenever possible. In the prior year, the District entered into two contracts between \$10,000 and \$50,000 that were subject to this statute. The District obtained quotes for these contracts but was unable to locate the quotes for review during our audit.

Resolution

In the current audit period, the District did not enter into any contracts.

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OFFICE OF THE STATE AUDITOR

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PATRICIA ANDERSON
STATE AUDITOR

**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
Knife River-Larsmont Sanitary District

We have audited the basic financial statements of the Knife River-Larsmont Sanitary District as of and for the year ended December 31, 2005, and have issued our report thereon dated June 1, 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 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. The reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 02-1, 02-3, and 02-4.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Knife River-Larsmont 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 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 Questioned Costs as item 05-1.

This report is intended solely for the information and use of the 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: June 1, 2006



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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
Knife River-Larsmont Sanitary District

Compliance

We have audited the compliance of the Knife River-Larsmont 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 Knife River-Larsmont 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 District's management. Our responsibility is to express an opinion on the Knife River-Larsmont Sanitary 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 Knife River-Larsmont 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 Knife River-Larsmont Sanitary District's compliance with those requirements.

In our opinion, the Knife River-Larsmont 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 Knife River-Larsmont 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 Knife River-Larsmont Sanitary District as of and for the year ended December 31, 2005, and have issued our report thereon dated June 1, 2006. Our audit was performed for the purpose of forming an opinion on the 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 for the information of the 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: June 1, 2006

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

Schedule 2

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

Federal Grantor Pass-Through Agency Grant Program Title	Pass-Through Grant Numbers	Federal CFDA Number	Expenditures
U.S. Department of Commerce			
Passed Through Minnesota Department of Natural Resources Coastal Zone Management Grant		11.419	\$ 6,539
U.S. Department of Defense, Army Corps of Engineers			
Direct Corps of Engineers Section 569		12.113	100,184
U.S. Environmental Protection Agency			
Passed Through Minnesota Department of Employment and Economic Development Capitalization Grant for Clean Water State Revolving Funds (Loan)	MPFA-03-0019-R-FY06	66.458	<u>875,367</u>
Total Expenditures of Federal Awards			<u>\$ 982,090</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 Knife River-Larsmont 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 Knife River-Larsmont Sanitary District did not pass any federal money to subrecipients.