

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

**PIKE LAKE AREA WASTEWATER
COLLECTION SYSTEM
DULUTH, MINNESOTA**

YEAR ENDED DECEMBER 31, 2015

Description of the Office of the State Auditor

The mission of the Office of the State Auditor is to oversee local government finances for Minnesota taxpayers by helping to ensure financial integrity and accountability in local governmental financial activities.

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 150 financial and compliance audits per year and has oversight responsibilities for over 3,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits of 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 approximately 700 public pension funds; and

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

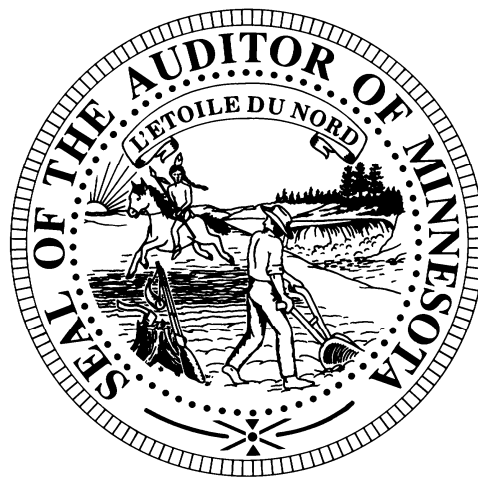
The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employees Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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**PIKE LAKE AREA WASTEWATER
COLLECTION SYSTEM
DULUTH, MINNESOTA**

Year Ended December 31, 2015



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

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**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

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**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

**ORGANIZATION
DECEMBER 31, 2015**

<u>Board of Directors</u>	<u>Position</u>	<u>Township</u>	<u>Term Ending</u>
Duane (Dewey) Johnson	Chair	Canosia	March 31, 2016
Kurt Brooks	Vice Chair	Grand Lake	March 31, 2017
Duayne Anderson	Treasurer	Grand Lake	December 31, 2016
Scott Campbell	Supervisor	Canosia	March 31, 2016
Kevin Connick	Supervisor	Canosia	December 31, 2016
Steve Torgeson	Supervisor	Grand Lake	December 31, 2016

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

OFFICE OF THE STATE AUDITOR

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Pike Lake Area Wastewater Collection System
Duluth, Minnesota

Report on the Financial Statements

We have audited the accompanying financial statements of the Pike Lake Area Wastewater Collection System as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the System's basic financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the System's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal

control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Pike Lake Area Wastewater Collection System as of December 31, 2015, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter - Change in Accounting Principle

As discussed in Note 1 to the financial statements, in 2015 the System adopted new accounting guidance by implementing the provisions of Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions*, as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, and by GASB Statement No. 82, *Pension Issues*, which represents a change in accounting principles. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Required Supplementary Information as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the GASB, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not part of the basic financial statements, is required by the GASB, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Pike Lake Area Wastewater Collection System's basic financial statements. The supplementary information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 16, 2016, on our consideration of the Pike Lake Area Wastewater Collection System'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* in considering the Pike Lake Area Wastewater Collection System's internal control over financial reporting and compliance.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

December 16, 2016

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

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BASIC FINANCIAL STATEMENTS

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**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

EXHIBIT 1

**STATEMENT OF NET POSITION
DECEMBER 31, 2015**

Assets

Current assets

Cash	\$	254,474
Taxes receivable		25,895
Accounts receivable		33,510
Due from other governments		565,858
Assets restricted for debt service		
Cash		288,831
Assets restricted for capital replacement		
Cash		45,043
		45,043

Total current assets **\$ 1,213,611**

Capital assets

Depreciable - net of accumulated depreciation		4,452,491
		4,452,491

Total Assets **\$ 5,666,102**

Deferred Outflows of Resources

Deferred pension outflows	\$	780
		780

Liabilities

Current liabilities

Accounts payable	\$	5,242
Salaries payable		449
		449

Total current liabilities **\$ 5,691**

Noncurrent liabilities

Net pension liability		5,183
		5,183

Total Liabilities **\$ 10,874**

Deferred Inflows of Resources

Deferred pension inflows	\$	261
		261

Net Position

Investment in capital assets	\$	4,452,491
Restricted for		
Debt service		854,689
Capital replacement		45,043
Unrestricted		303,524
		303,524

Total Net Position **\$ 5,655,747**

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

EXHIBIT 2

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED DECEMBER 31, 2015**

Operating Revenues	
Charges for services	\$ <u>371,177</u>
Operating Expenses	
Wages and benefits	\$ 19,903
Western Lake Superior Sanitary District fees	74,132
Operations and maintenance	140,491
Supplies	1,524
Travel	457
Professional services	38,504
Insurance	2,859
Rent and storage	5,680
Miscellaneous	20,866
Depreciation	<u>137,550</u>
Total Operating Expenses	\$ <u>441,966</u>
Operating Income (Loss)	\$ (70,789)
Nonoperating Revenues	
Interest income	<u>4,444</u>
Change in Net Position	\$ (66,345)
Net Position - January 1, as restated (Note 1.F.)	<u>5,722,092</u>
Net Position - December 31	\$ <u><u>5,655,747</u></u>

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

EXHIBIT 3

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2015**

Cash Flows from Operating Activities	
Cash receipts from customers	\$ 383,113
Cash paid to suppliers	(285,980)
Payments to employees	(19,282)
	<hr/>
Net cash provided by (used in) operating activities	\$ 77,851
Cash Flows from Noncapital Financing Activities	
Special assessments received from towns	\$ 195,770
Principal paid on behalf of towns for long-term debt	(204,992)
Interest paid on behalf of towns for long-term debt	(12,126)
	<hr/>
Net cash provided by (used in) noncapital financing activities	\$ (21,348)
Cash Flows from Capital and Related Financing Activities	
Acquisition of capital assets	\$ (45,623)
	<hr/>
Cash Flows from Investing Activities	
Interest income	\$ 4,444
	<hr/>
Net Increase (Decrease) in Cash	\$ 15,324
Cash - January 1	573,024
	<hr/>
Cash - December 31	\$ 588,348
	<hr/> <hr/>
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities	
Operating Income (Loss)	\$ (70,789)
	<hr/>
Adjustments to reconcile net operating income (loss) to net cash provided by (used in) operating activities	
Depreciation	\$ 137,550
Decrease (increase) in receivables	12,025
Decrease (increase) in taxes receivable	(89)
Decrease (increase) in deferred pension outflows	(534)
Increase (decrease) in accounts payable	(1,467)
Increase (decrease) in salaries payable	408
Increase (decrease) in deferred pension inflows	261
Increase (decrease) in net pension liability	486
	<hr/>
Total adjustments	\$ 148,640
	<hr/>
Net Cash Provided by (Used in) Operating Activities	\$ 77,851
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**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2015**

1. Summary of Significant Accounting Policies

The accounting policies of the Pike Lake Area Wastewater Collection System conform to generally accepted accounting principles.

A. Financial Reporting Entity

The Pike Lake Area Wastewater Collection System was formed February 3, 1998, pursuant to Minn. Stat. § 471.59, *Joint Exercise of Powers*. The System was created for the purpose of providing the equipment, services, and other items necessary and appropriate for the establishment, operation, and maintenance of a joint wastewater collection system for the mutual benefit of the Towns of Canosia and Grand Lake. The System is governed by a six-member Board, with three members appointed by each Town. All members have equal voting rights.

The Pike Lake Area Wastewater Collection System was constructed with general obligation revenue bonds from the Public Facilities Authority and Wastewater Infrastructure grants. The Towns of Canosia and Grand Lake provided this funding to the Pike Lake Area Wastewater Collection System, which then administered the construction contracts. These expenditures were funded 69 percent by the Town of Canosia and 31 percent by the Town of Grand Lake. The Pike Lake Area Wastewater Collection System receives resources from System operations and special assessments levied by the Towns of Canosia and Grand Lake to repay the general obligation revenue bonds.

B. Basis of Presentation

The accounts of the Pike Lake Area Wastewater Collection System 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.

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basis of Presentation (Continued)

Operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the System. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as grants and investment earnings, result from nonexchange transactions or incidental activities. The System's net position is reported in three parts: (1) investment in capital assets, (2) restricted net position, and (3) unrestricted net position.

C. Basis of Accounting

The Pike Lake Area Wastewater Collection System's financial statements are reported using the economic resources measurement focus and the full accrual basis of accounting. Revenues are recognized when earned, and expenses are recognized when a liability is incurred, regardless of the timing of related cash flows.

When an expense is incurred for purposes for which both restricted and unrestricted net position are available, it is the System's policy to use restricted resources first.

D. Assets and Liabilities

Cash

Cash consists of an operations checking account, an operations savings account, a repair and replacement savings account, and a debt service savings account.

Accounts Receivable

Accounts receivable consists primarily of the December user charges.

Due From Other Governments

Due from other governments consists of the amounts that the Towns of Canosia and Grand Lake owe the Pike Lake Area Wastewater Collection System for the debt service payments made by the System on behalf of the Towns. The Towns of Canosia and Grand Lake turn over their assessments to the Pike Lake Area Wastewater Collection

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets and Liabilities

Due From Other Governments (Continued)

System, and these assessments are used to make the annual debt payments by the System on behalf of the Towns. The debt is not reported as the System's debt, but rather the Towns' debt. As of December 31, the balance of the PFA loan for the towns of Canosia and Grand Lake are \$665,393 and \$295,431, respectively; for a total of \$960,824.

Restricted Assets

Restricted assets consist of monies specified for payment of collection system repair and replacement costs or debt service.

Capital Assets

Capital assets are stated at cost. Donated capital assets are recorded at estimated fair value at the date of donation.

Depreciation is determined using the straight-line method for the estimated useful lives of the assets.

<u>Classification</u>	<u>Estimated Life</u>
Sewer lines	50 years
Lift stations	10 years
Equipment	10 years

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized.

Net interest costs on funds borrowed to finance construction of capital assets in proprietary funds are capitalized during the construction period and amortized over the life of the related asset.

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets and Liabilities (Continued)

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position reports a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and will not be recognized as an outflow of resources (expense) until then. Currently, the System has one item, deferred pension outflows, which qualifies for reporting in this category. These outflows arise under the full accrual basis of accounting and consist of pension plan contributions paid subsequent to the measurement date and also the differences between projected and actual earnings on pension plan investments and, accordingly, are reported in the statement of net position.

In addition to liabilities, the statement of net position reports a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) or offset against expenses until that time. Currently, the System has one type of deferred inflows, deferred pension inflows. These inflows arise only under the full accrual basis of accounting and consist of differences between expected and actual pension plan economic experience and, accordingly, are reported in the statement of net position.

Classification of Net Position

Net position is classified in the following categories:

Investment in capital assets - the amount of net position representing capital assets, net of accumulated depreciation.

Restricted - the amount of net position for which external restrictions have been imposed by creditors, grantors, contributors, or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.

Unrestricted - the amount of net position that does not meet the definition of restricted or investment in capital assets.

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets and Liabilities (Continued)

Pension Plan

For purposes of measuring the net pension liability, deferred outflows/inflows of resources, and pension expense, information about the fiduciary net position of the Public Employees Retirement Association (PERA) and additions to/deductions from PERA's fiduciary net position have been determined on the same basis as they are reported by PERA, except that PERA's fiscal year-end is June 30. For this purpose, plan contributions are recognized as of employer payroll paid dates, and benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Plan investments are reported at fair value.

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 those estimates.

F. Change in Accounting Principles

During the year ended December 31, 2015, the Pike Lake Area Wastewater Collection System adopted new accounting guidance by implementing the provisions of GASB Statements 68, 71, and 82. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*, requires governments providing defined benefit pensions to employees through pension plans administered through trusts to record their proportionate share of the net pension obligation as a liability on their financial statements along with related deferred outflows of resources, deferred inflows of resources, and pension expense. This statement also requires additional note disclosures and schedules in the required supplementary information.

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

F. Change in Accounting Principles (Continued)

GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, addresses an issue regarding amounts associated with contributions made to a pension plan after the measurement date of the net pension liability.

GASB Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, modifies the measure of payroll that is presented in the required supplementary information schedules.

GASB Statements 68 and 71 require the System to report its proportionate share of the PERA total employers' unfunded pension liability. As a result, beginning net position has been restated to record the System's net pension liability and related deferred outflows of resources.

Net Position, January 1, 2015, as previously reported	\$ 5,726,543
Change in accounting principles	<u>(4,451)</u>
Net Position, January 1, 2015, as restated	<u>\$ 5,722,092</u>

2. Detailed Notes

A. Deposits

The System is authorized by Minn. Stat. § 118A.02 to deposit its cash and to invest in certificates of deposit in financial institutions designated by the System's Board. The System does not have a policy on custodial credit risk. At December 31, 2015, the System's deposits totaled \$618,089, all of which were cash deposits insured as required by Minnesota statutes. The carrying value of these deposits was \$588,348. During 2015, the System had an adequate amount of insurance and collateral pledged to cover its deposits.

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

2. Detailed Notes (Continued)

B. Capital Assets

A summary of the changes in capital assets for the year ended December 31, 2015, follows:

	Balance January 1	Additions	Deletions	Balance December 31
Capital assets depreciated				
Sewer lines	\$ 6,289,172	\$ -	\$ -	\$ 6,289,172
Lift stations	1,518,510	21,500	-	1,540,010
Equipment	225,661	24,123	-	249,784
	<u>\$ 8,033,343</u>	<u>\$ 45,623</u>	<u>\$ -</u>	<u>\$ 8,078,966</u>
Total capital assets depreciated				
Less: accumulated depreciation for				
Sewer lines	\$ 1,811,933	\$ 125,783	\$ -	\$ 1,937,716
Lift stations	1,518,510	2,150	-	1,520,660
Equipment	158,482	9,617	-	168,099
	<u>\$ 3,488,925</u>	<u>\$ 137,550</u>	<u>\$ -</u>	<u>\$ 3,626,475</u>
Total accumulated depreciation				
Total Capital Assets, Net	<u>\$ 4,544,418</u>	<u>\$ (91,927)</u>	<u>\$ -</u>	<u>\$ 4,452,491</u>

C. Net Position

Net position is reported in three broad components--investment in capital assets, restricted, and unrestricted. In addition, the System's Board has designated a portion of unrestricted net position for capital improvements. These designations are internal and can be changed by the System's Board. The amount designated for capital improvements at December 31, 2015, was \$181,746.

3. Defined Benefit Pension Plan

A. Plan Description

All full-time and certain part-time employees of the Pike Lake Area Wastewater Collection System are covered by defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

3. Defined Benefit Pension Plan

A. Plan Description (Continued)

the General Employees Retirement Fund, which is a cost-sharing, multiple-employer retirement plan. The plan is established and administered in accordance with Minn. Stat. chs. 353 and 356. PERA's defined benefit pension plans are tax qualified plans under Section 401(a) of the Internal Revenue Code.

General Employees Retirement Fund members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security and Basic Plan members are not. The Basic Plan was closed to new members in 1967. All new members must participate in the Coordinated Plan, for which benefits vest after five years of credited service. No System employees belong to the Basic Plan.

B. Benefits Provided

PERA provides retirement benefits as well as disability benefits to members and benefits to survivors upon death of eligible members. Benefit provisions are established by state statute and can be modified only by the state legislature. Benefit increases are provided to benefit recipients each January. Increases are related to the funding ratio of the plan. Benefit recipients receive a future annual 1.0 percent post-retirement benefit increase. If the funding ratio reaches 90 percent for two consecutive years, the benefit increase will revert to 2.5 percent. If, after reverting to a 2.5 percent benefit increase, the funding ratio declines to less than 80 percent for one year or less than 85 percent for two consecutive years, the benefit increase will decrease to 1.0 percent.

The benefit provisions stated in the following paragraph of this section are current provisions and apply to active plan participants. Vested, terminated employees who are entitled to benefits but are not yet receiving them are bound by the provisions in effect at the time they last terminated their public service.

Benefits are based on a member's highest average salary for any five successive years of allowable service, age, and years of credit at termination of service. Two methods are used to compute benefits for General Employees Retirement Fund Coordinated Plan members. The retiring member receives the higher of a step-rate benefit accrual

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

3. Defined Benefit Pension Plan

B. Benefits Provided (Continued)

formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Coordinated Plan member is 1.2 percent of average salary for each of the first ten years of service and 1.7 percent for each remaining year. Under Method 2, the annuity accrual rate is 1.7 percent for Coordinated Plan members for each year of service.

For General Employees Retirement Fund members hired prior to July 1, 1989, a full annuity is available when age plus years of service equal 90, and normal retirement age is 65. For members hired on or after July 1, 1989, normal retirement age is the age for unreduced Social Security benefits capped at 66. Disability benefits are available for vested members and are based on years of service and average high-five salary.

C. Contributions

Pension benefits are funded from member and employer contributions and income from the investment of fund assets. Rates for employer and employee contributions are set by Minn. Stat. ch. 353. These statutes are established and amended by the state legislature. Coordinated Plan members were required to contribute 6.50 percent of their annual covered salary in 2015.

In 2015, the Pike Lake Area Wastewater Collection System was required to contribute the following percentage of annual covered salary:

General Employees Retirement Fund Coordinated Plan members	7.50%
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The Coordinated Plan member and employer contribution rates each reflect a 0.25 percent increase from 2014.

The Pike Lake Area Wastewater Collection System contributions for the General Employees Retirement Fund for the year ended December 31, 2015, were \$559. The contributions are equal to the contractually required contributions as set by state statute.

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

3. Defined Benefit Pension Plan (Continued)

D. Pension Costs

At December 31, 2015, the Pike Lake Area Wastewater Collection System reported a liability of \$5,183 for its proportionate share of the General Employees Retirement Fund's net pension liability. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Pike Lake Area Wastewater Collection System's proportion of the net pension liability was based on the Pike Lake Area Wastewater Collection System's contributions received by PERA during the measurement period for employer payroll paid dates from July 1, 2014, through June 30, 2015, relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2015, the Pike Lake Area Collection System's proportion was 0.0001 percent. It was 0.0001 percent measured as of June 30, 2014. The Pike Lake Area Wastewater Collection System recognized pension expense of \$772 for its proportionate share of the General Employees Retirement Fund's pension expense.

The Pike Lake Area Wastewater Collection System reported its proportionate share of the General Employees Retirement Fund's deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual economic experience	\$ -	\$ 261
Difference between projected and actual investment earnings	491	-
Contributions paid to PERA subsequent to the measurement date	<u>289</u>	<u>-</u>
Total	<u>\$ 780</u>	<u>\$ 261</u>

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

3. Defined Benefit Pension Plan

D. Pension Costs (Continued)

A total of \$289 reported as deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2016. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended December 31	Pension Expense Amount
2016	\$ 37
2017	37
2018	37
2019	119

E. Actuarial Assumptions

The total pension liability in the June 30, 2015, actuarial valuation was determined using the individual entry age normal actuarial cost method and the following additional actuarial assumptions:

Inflation	2.75 percent per year
Active member payroll growth	3.50 percent per year
Investment rate of return	7.90 percent

Salary increases were based on a service-related table. Mortality rates for active members, retirees, survivors, and disabilitants were based on RP-2000 tables for males or females, as appropriate, with slight adjustments. The cost of living benefit increases for retirees was assumed to be 1.0 percent effective every January 1 through 2035, and 2.5 percent thereafter.

Actuarial assumptions used in the June 30, 2015, valuation were based on the results of actuarial experience studies. The experience study in the General Employees Retirement Fund was for the period July 1, 2004, through June 30, 2008, with an update of economic assumptions in 2014.

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

3. Defined Benefit Pension Plan

E. Actuarial Assumptions (Continued)

In 2015, an updated experience study was done for PERA’s General Employees Retirement Fund for the six-year period ending June 30, 2014, which would result in a larger pension liability. However, PERA will not implement the changes in assumptions until its June 30, 2016, estimate of pension liability.

The long-term expected rate of return on pension plan investments is 7.9 percent. The State Board of Investment, which manages the investments of PERA, prepares an analysis of the reasonableness of the long-term expected rate of return on a regular basis using a building-block method in which best-estimate ranges of expected future rates of return are developed for each major asset class. These ranges are combined to produce an expected long-term rate of return by weighting the expected future rates of return by the target asset allocation percentages. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Domestic stocks	45%	5.50%
International stocks	15	6.00
Bonds	18	1.45
Alternative assets	20	6.40
Cash	2	0.50

F. Discount Rate

The discount rate used to measure the total pension liability was 7.9 percent. The discount rate did not change since the prior measurement date. The projection of cash flows used to determine the discount rate assumed that employee and employer contributions will be made at the rate specified in statute. Based on that assumption, the pension plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

3. Defined Benefit Pension Plan (Continued)

G. Pension Liability Sensitivity

The following presents the System's proportionate share of the net pension liability calculated using the discount rate disclosed in the preceding paragraph, as well as what the System's proportionate share of the net pension liability would be if it were calculated using a discount rate 1.0 percentage point lower or 1.0 percentage point higher than the current discount rate:

	1% Decrease in Discount Rate (6.9%)	Discount Rate (7.9%)	1% Increase in Discount Rate (8.9%)
Proportionate share of the General Employees Retirement Fund net pension liability	\$ 8,149	\$ 5,183	\$ 2,733

H. Pension Plan Fiduciary Net Position

Detailed information about the pension plan's fiduciary net position is available in a separately issued PERA financial report that includes financial statements and required supplementary information. That report may be obtained on the internet at www.mnpera.org; by writing to PERA at 60 Empire Drive, Suite 200, St. Paul, Minnesota 55103-2088; or by calling 651-296-7460 or 1-800-652-9026.

4. Risk Management

The Pike Lake Area Wastewater Collection System is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The System has purchased commercial insurance to insure these risks. There were no significant reductions in insurance coverage from the previous year. There were no settlements in excess of insurance during the last three years.

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REQUIRED SUPPLEMENTARY INFORMATION

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**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

EXHIBIT A-1

**SCHEDULE OF PROPORTIONATE SHARE OF NET PENSION LIABILITY
PERA GENERAL EMPLOYEES RETIREMENT FUND
DECEMBER 31, 2015**

Measurement Date	Employer's Proportion of the Net Pension Liability (Asset)	Employer's Proportionate Share of the Net Pension Liability (Asset) (a)	Covered Payroll (b)	Employer's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of Covered Payroll (a/b)	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
2015	0.0001%	\$ 5,183	\$ 6,993	74.12%	78.19%

This schedule is intended to show information for ten years. Additional years will be displayed as they become available. The measurement date for each year is June 30.

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

EXHIBIT A-2

**SCHEDULE OF CONTRIBUTIONS
PERA GENERAL EMPLOYEES RETIREMENT FUND
DECEMBER 31, 2015**

Year Ending	Statutorily Required Contributions (a)	Actual Contributions in Relation to Statutorily Required Contributions (b)	Contribution (Deficiency) Excess (b-a)	Covered Payroll (c)	Actual Contributions as a Percentage of Covered Payroll (b/c)
2015	\$ 559	\$ 559	\$ -	\$ 7,453	7.50%

This schedule is intended to show information for ten years. Additional years will be displayed as they become available. The Pike Lake Area Wastewater Collection System's year-end is December 31.

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SUPPLEMENTARY INFORMATION

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**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

EXHIBIT B-1

**COMBINING STATEMENT OF NET POSITION
DECEMBER 31, 2015**

	Canosia	Grand Lake	Total
<u>Assets</u>			
Current assets			
Cash	\$ 302,784	\$ (48,310)	\$ 254,474
Taxes receivable	17,868	8,027	25,895
Accounts receivable	23,122	10,388	33,510
Due from other governments	408,108	157,750	565,858
Assets restricted for debt service			
Cash	199,293	89,538	288,831
Assets restricted for capital replacement			
Cash	31,080	13,963	45,043
Total current assets	\$ 982,255	\$ 231,356	\$ 1,213,611
Capital assets			
Depreciable - net of accumulated depreciation	3,072,422	1,380,069	4,452,491
Total Assets	\$ 4,054,677	\$ 1,611,425	\$ 5,666,102
<u>Deferred Outflows of Resources</u>			
Deferred pension outflows	\$ 538	\$ 242	\$ 780
<u>Liabilities</u>			
Current liabilities			
Accounts payable	\$ 3,617	\$ 1,625	\$ 5,242
Salaries payable	310	139	449
Total current liabilities	\$ 3,927	\$ 1,764	\$ 5,691
Noncurrent liabilities			
Net pension liability	3,576	1,607	5,183
Total Liabilities	\$ 7,503	\$ 3,371	\$ 10,874
<u>Deferred Inflows of Resources</u>			
Deferred pension inflows	\$ 180	\$ 81	\$ 261
<u>Net Position</u>			
Investment in capital assets	\$ 3,072,422	\$ 1,380,069	\$ 4,452,491
Restricted for			
Debt service	607,401	247,288	854,689
Capital replacement	31,079	13,963	45,042
Unrestricted	336,630	(33,105)	303,525
Total Net Position	\$ 4,047,532	\$ 1,608,215	\$ 5,655,747

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

EXHIBIT B-2

**COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED DECEMBER 31, 2015**

	Canosia	Grand Lake	Total
Operating Revenues			
Charges for services	<u>\$ 256,112</u>	<u>\$ 115,065</u>	<u>\$ 371,177</u>
Operating Expenses			
Wages and benefits	\$ 13,733	\$ 6,170	\$ 19,903
Western Lake Superior Sanitary District fees	51,151	22,981	74,132
Operations and maintenance	96,939	43,552	140,491
Supplies	1,052	472	1,524
Travel	315	142	457
Professional services	26,568	11,936	38,504
Insurance	1,973	886	2,859
Rent and storage	3,919	1,761	5,680
Miscellaneous	14,398	6,468	20,866
Depreciation	<u>94,909</u>	<u>42,641</u>	<u>137,550</u>
Total Operating Expenses	<u>\$ 304,957</u>	<u>\$ 137,009</u>	<u>\$ 441,966</u>
Operating Income (Loss)	<u>\$ (48,845)</u>	<u>\$ (21,944)</u>	<u>\$ (70,789)</u>
Nonoperating Revenues			
Interest income	<u>3,066</u>	<u>1,378</u>	<u>4,444</u>
Change in Net Position	<u>\$ (45,779)</u>	<u>\$ (20,566)</u>	<u>\$ (66,345)</u>
Net Position - January 1, as restated (Note 1.F.)	<u>4,093,311</u>	<u>1,628,781</u>	<u>5,722,092</u>
Net Position - December 31	<u><u>\$ 4,047,532</u></u>	<u><u>\$ 1,608,215</u></u>	<u><u>\$ 5,655,747</u></u>

**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

EXHIBIT B-3

**COMBINING STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2015**

	<u>Canosia</u>	<u>Grand Lake</u>	<u>Total</u>
Cash Flows from Operating Activities			
Cash receipts from customers	\$ 271,590	\$ 111,523	\$ 383,113
Cash paid to suppliers	(197,327)	(88,653)	(285,980)
Payments to employees	(13,304)	(5,978)	(19,282)
Net cash provided by (used in) operating activities	<u>\$ 60,959</u>	<u>\$ 16,892</u>	<u>\$ 77,851</u>
Cash Flows from Noncapital Financing Activities			
Special assessments received from towns	\$ 127,844	\$ 67,926	\$ 195,770
Principal paid on behalf of towns for long-term debt	(139,480)	(65,512)	(204,992)
Interest paid on behalf of towns for long-term debt	(7,470)	(4,656)	(12,126)
Net cash provided by (used in) noncapital financing activities	<u>\$ (19,106)</u>	<u>\$ (2,242)</u>	<u>\$ (21,348)</u>
Cash Flows from Capital and Related Financing Activities			
Acquisition or construction of capital assets	<u>\$ (31,480)</u>	<u>\$ (14,143)</u>	<u>\$ (45,623)</u>
Cash Flows from Investing Activities			
Interest income	<u>\$ 3,066</u>	<u>\$ 1,378</u>	<u>\$ 4,444</u>
Net Increase (Decrease) in Cash	\$ 13,439	\$ 1,885	\$ 15,324
Cash - January 1	<u>519,718</u>	<u>53,306</u>	<u>573,024</u>
Cash - December 31	<u>\$ 533,157</u>	<u>\$ 55,191</u>	<u>\$ 588,348</u>
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities			
Operating income (loss)	<u>\$ (48,845)</u>	<u>\$ (21,944)</u>	<u>\$ (70,789)</u>
Adjustments to reconcile net operating income (loss) to net cash provided by (used in) operating activities			
Depreciation	\$ 94,909	\$ 42,641	\$ 137,550
Decrease (increase) in receivables	13,706	(1,681)	12,025
Decrease (increase) in taxes receivable	1,772	(1,861)	(89)
Decrease (increase) in deferred pension outflows	(368)	(166)	(534)
Increase (decrease) in accounts payable	(1,012)	(455)	(1,467)
Increase (decrease) in salaries payable	282	126	408
Increase (decrease) in deferred pension inflows	180	81	261
Increase (decrease) in net pension liability	335	151	486
Total adjustments	<u>\$ 109,804</u>	<u>\$ 38,836</u>	<u>\$ 148,640</u>
Net Cash Provided by (Used in) Operating Activities	<u>\$ 60,959</u>	<u>\$ 16,892</u>	<u>\$ 77,851</u>

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**PIKE LAKE AREA WASTEWATER COLLECTION SYSTEM
DULUTH, MINNESOTA**

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2015**

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEM NOT RESOLVED

Finding 2008-001

Internal Controls/Segregation of Duties

Criteria: Management is responsible for establishing and maintaining internal control. This responsibility includes the internal control over the various accounting cycles, the fair presentation of the financial statements and related notes, and the accuracy and completeness of all financial records and related information. Also, management is responsible for controls over the period-end financial reporting process, including controls over procedures used to enter transaction totals in the general ledger; initiate, authorize, record, and process journal entries into the general ledger; and record recurring and nonrecurring adjustments to the financial statements. Adequate segregation of duties is a key internal control in an organization's accounting system.

Condition: The limited number of personnel results in a lack of segregation of accounting duties necessary to ensure adequate internal accounting control.

Context: It is not unusual for an organization the size of the Pike Lake Area Wastewater Collection System to be limited in the internal control that management can design and implement into the organization.

Effect: Inadequate segregation of duties could adversely affect the Pike Lake Area Wastewater Collection System's ability to detect misstatements in a timely manner by personnel in the normal course of performing their assigned functions.

Cause: The size of the Pike Lake Area Wastewater Collection System and its staffing limits the internal control that management can design and implement into the organization.

Recommendation: Management should be aware that segregation of duties is not adequate from an internal control point of view. We recommend the Board of Directors and management be mindful that limited staffing causes inherent risks in safeguarding the Pike Lake Area Wastewater Collection System's assets and the proper reporting of its financial activity. We recommend the Board of Directors and management continue to implement oversight procedures and monitor those procedures to determine if they are still effective internal controls.

Client's Response:

The Pike Lake Area Wastewater System Joint Powers Board is very aware of the importance of segregation of duties to insure internal controls. Due to the size and limited resources of our organization, we have Evergreen Accounting handling many of the financial duties of the Pike Lake Area Wastewater Collection System (PLAWCS). We have implemented several procedures to monitor our financial activities and records.

Our Treasurer receives the bank statements and then e-mails them to Evergreen Accounting to reconcile. After accounts are reconciled, they are e-mailed back with the reconciliations for the Treasurer to review.

The Board receives a complete package of financial statements; a recap of bills being paid and copies of large bills which are reviewed before each monthly Board meeting. Evergreen Accounting also attends the meetings to be available to answer any questions the Board may have.

The payment of the bills is approved at the Board meeting each month, the check numbers are recorded in our minutes, we have three people from the Board sign the checks and then the secretary mails them out.

An annual budget is approved each year and the actual costs and year to date budget projections and deviations are reviewed and discussed each month. Operating, Capital and Debt Service balances and remaining loan balances are also compared and monitored on a monthly basis.

The Board provides an effective level of oversight to protect the PLAWCS' resources and to manage risks to our townships and our PLAWCS customers.



REBECCA OTTO
STATE AUDITOR

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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*

Independent Auditor's Report

Board of Directors
Pike Lake Area Wastewater Collection System
Duluth, Minnesota

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Pike Lake Area Wastewater Collection System as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the System's basic financial statements, and have issued our report thereon dated December 16, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Pike Lake Area Wastewater Collection System's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the System's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit the attention of those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a deficiency in internal control over financial reporting, described in the accompanying Schedules of Findings and Recommendations as item 2008-001, that we consider to be a significant deficiency.

Compliance and Other Matters

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

Minnesota Legal Compliance

The *Minnesota Legal Compliance Audit Guide for Other Political Subdivisions*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65, contains six categories of compliance to be tested in connection with the audit of the System's financial statements: contracting and bidding, deposits and investments, conflicts of interest, claims and disbursements, miscellaneous provisions, and tax increment financing. Our audit considered all of the listed categories, except that we did not test for compliance with the provisions for contracting and bidding because there were no applicable procurements. We also did not test for compliance with the provisions for tax increment financing because the System does not administer any tax increment financing districts.

In connection with our audit, nothing came to our attention that caused us to believe that the Pike Lake Area Wastewater Collection System failed to comply with the provisions of the *Minnesota Legal Compliance Audit Guide for Other Political Subdivisions*. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the System's noncompliance with the above referenced provisions.

Pike Lake Area Wastewater Collection System's Response to Finding

The Pike Lake Area Wastewater Collection System's response to the internal control finding identified in our audit has been included in the Schedule of Findings and Recommendations. The System's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting, compliance, and the provisions of the *Minnesota Legal Compliance Audit Guide for Other Political Subdivisions* and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control over financial reporting or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance. Accordingly, this communication is not suitable for any other purpose.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

December 16, 2016