

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

DULUTH/NORTH SHORE SANITARY DISTRICT
DULUTH, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2006

Description of the Office of the State Auditor

The mission of the State Auditor's Office 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 160 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 730 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.

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

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

For the Year Ended December 31, 2006



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

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

TABLE OF CONTENTS

	<u>Reference</u>	<u>Page</u>
Introductory Section		
Organization		1
Financial Section		
Independent Auditor's Report		2
Basic Financial Statements		
Statement of Net Assets	Exhibit A	4
Statement of Revenues, Expenses, and Changes in Net Assets	Exhibit B	5
Statement of Cash Flows	Exhibit C	6
Notes to the Financial Statements		7
Management and Compliance Section		
Schedule of Findings and Recommendations	Schedule 1	14
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>		16

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

ORGANIZATION
DECEMBER 31, 2006

<u>Board of Managers</u>		<u>Terms Expires</u>
Orlando (Lars) G. Fladmark	Chair	January 1, 2009
Kevin J. Bovee	Vice Chair	January 1, 2010
Mary Ann Sironen	Secretary	January 1, 2008
Scott Smith	Treasurer	January 1, 2009
Katherine Kuettel		January 1, 2008

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

OFFICE OF THE STATE AUDITOR

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

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

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying basic financial statements of the Duluth/North Shore Sanitary District as of and for the year ended December 31, 2006, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Duluth/North Shore Sanitary District as of December 31, 2006, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated October 30, 2007, on our consideration of Duluth/North Shore Sanitary District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

October 30, 2007

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

BASIC FINANCIAL STATEMENTS

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

EXHIBIT A

**STATEMENT OF NET ASSETS
DECEMBER 31, 2006**

Assets

Current assets

Cash	\$	507,525
Customer deposits		4,167
Taxes receivable - unapportioned		9,075
Taxes receivable - delinquent		7,900
Accounts receivable		30,487
Assets restricted for debt service		
Assessments receivable		135,000
		135,000

Total current assets **\$ 694,154**

Noncurrent assets

Restricted for debt service		
Assessments receivable		1,677,978
		\$ 1,677,978

Capital Assets

Non-depreciable	\$	221,650
Depreciable, net of accumulated depreciation		16,162,289
		16,162,289

Total capital assets **\$ 16,383,939**

Total Assets **\$ 18,756,071**

Liabilities

Current liabilities

Accounts payable	\$	41,759
Contracts payable		14,161
Accrued interest		66,609
General obligation bonds payable		166,814
General obligation revenue notes - Public Facilities Authority		448,000
Deferred revenue - unavailable		9,075
		9,075

Total current liabilities **\$ 746,418**

Noncurrent liabilities

General obligation bonds	\$	760,086
General obligation revenue notes - Public Facilities Authority		8,180,050
		8,180,050

Total noncurrent liabilities **\$ 8,940,136**

Total Liabilities **\$ 9,686,554**

Net Assets

Invested in capital assets, net of related debt	\$	6,828,989
Restricted for debt service		1,812,978
Unrestricted		427,550
		427,550

Total Net Assets **\$ 9,069,517**

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

EXHIBIT B

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEAR ENDED DECEMBER 31, 2006**

Operating Revenues		
Charges for services	\$	<u>378,936</u>
Operating Expenses		
Professional services	\$	152,254
Insurance		12,202
Permits and licenses		312
Operations and maintenance		138,171
Supplies		9,359
Utilities		13,063
Western Lake Superior Sanitary District fees		16,258
Travel		385
Miscellaneous		1,518
Depreciation		<u>630,281</u>
Total Operating Expenses	\$	<u>973,803</u>
Net Operating Income (Loss)	\$	<u>(594,867)</u>
Nonoperating Revenues (Expenses)		
Property taxes	\$	242,210
Market value credit aid		16,051
Interest expense		(166,936)
Interest on assessments		<u>5,208</u>
Total Nonoperating Revenues (Expenses)	\$	<u>96,533</u>
Change in Net Assets	\$	<u>(498,334)</u>
Net Assets - January 1		<u>9,567,851</u>
Net Assets - December 31	\$	<u>9,069,517</u>

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

EXHIBIT C

**STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2006**

Cash Flows from Operating Activities	
Cash received from customers	\$ 369,631
Cash paid to suppliers	<u>(347,635)</u>
Net cash provided by (used in) operating activities	<u>\$ 21,996</u>
Cash Flows from Noncapital Financing Activities	
Property tax levy	\$ 242,038
Market value credit aid	<u>16,051</u>
Net cash provided by (used in) noncapital financing activities	<u>\$ 258,089</u>
Cash Flows from Capital and Related Financing Activities	
Proceeds from General Obligation Sewer Revenue Refunding Bond	\$ 671,900
Special assessments	171,974
Payments for capital assets	(618,796)
Principal paid on long-term debt	(472,000)
Interest paid on long-term debt	(157,345)
Interest received on assessments	<u>5,208</u>
Net cash provided by (used in) capital and related financing activities	<u>\$ (399,059)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>\$ (118,974)</u>
Cash - January 1	<u>626,499</u>
Cash - December 31	<u><u>\$ 507,525</u></u>
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities	
Net operating income (loss)	\$ (594,867)
Adjustments to reconcile net operating loss to net cash provided by (used for) operating activities	
Changes in assets and liabilities	
Depreciation	630,281
(Increase) decrease in receivables	(9,305)
Increase (decrease) in payables	<u>(4,113)</u>
Net Cash Provided by (Used in) Operating Activities	<u><u>\$ 21,996</u></u>

The notes to the financial statements are an integral part of this statement.

Page 6

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

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2006**

1. Summary of Significant Accounting Policies

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

A. Financial Reporting Entity

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

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

B. Basis of Presentation

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

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

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

1. Summary of Significant Accounting Policies (Continued)

C. Basis of Accounting

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

D. Assets and Liabilities

Cash

Cash consists of a checking account.

Taxes Receivable and Revenue

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

Assessments Receivable and Revenue

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

Restricted Assets and Liabilities

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

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

1. Summary of Significant Accounting Policies

D. Assets and Liabilities (Continued)

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>
Buildings and building improvements	10 - 40 years
Improvements other than buildings	10 - 20 years
Equipment and vehicles	5 - 20 years
Infrastructure	10 - 40 years

General Obligation Bonds Payable

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

In 2006, \$671,900 of general obligation sewer revenue refunding bonds were issued to pay the general obligation note payments due August 26, 2006, to the Minnesota Public Facilities Authority, project construction costs, and bond issuance costs.

General Obligation Revenue Notes Payable - Minnesota Public Facilities Authority

General obligation revenue notes payable includes amounts from four separate Minnesota Public Facilities Authority Notes issued to fund the construction of the sanitary sewer collection system.

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.

**DULUTH/NORTH SHORE SANITARY DISTRICT
DULUTH, 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. The District does not have a policy on custodial credit risk. At December 31, 2006, District deposits totaled \$469,621, all of which were cash deposits insured as required by Minnesota statutes. The carrying value of these deposits was \$507,525. During the year, the District had an adequate amount of insurance and collateral pledged to cover their deposits.

B. Changes in Capital Assets

	Balance January 1, 2006	Increase	Decrease	Transfer/ Reclass	Balance December 31, 2006
Capital assets not depreciated					
Land	\$ 221,650	\$ -	\$ -	\$ -	\$ 221,650
Construction in progress	-	29,088	-	(29,088)	-
Total capital assets not depreciated	\$ 221,650	\$ 29,088	\$ -	\$ (29,088)	\$ 221,650
Capital assets depreciated					
Wet weather storage tank	\$ 550,000	\$ -	\$ -	\$ -	\$ 550,000
Force main	7,627,603	-	-	(5,165)	7,622,438
Gravity collection system	610,950	-	-	-	610,950
Main pump station	1,359,116	-	-	-	1,359,116
Individual treatment systems	7,234,760	-	-	34,253	7,269,013
Equipment	4,125	-	-	-	4,125
Total capital assets depreciated	\$ 17,386,554	\$ -	\$ -	\$ 29,088	\$ 17,415,642
Less: accumulated depreciation for					
Wet weather storage tank	\$ 18,333	\$ 18,333	\$ -	\$ -	\$ 36,666
Force main	185,065	190,561	-	-	375,626
Gravity collection system	12,219	12,219	-	-	24,438
Main pump station	45,304	45,304	-	-	90,608
Individual treatment systems	361,738	363,451	-	-	725,189
Equipment	413	413	-	-	826
Total accumulated depreciation	\$ 623,072	\$ 630,281	\$ -	\$ -	\$ 1,253,353
Total capital assets	\$ 16,763,482	\$ (630,281)	\$ -	\$ 29,088	\$ 16,162,289
Capital Assets, Net	\$ 16,985,132	\$ (601,193)	\$ -	\$ -	\$ 16,383,939

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

2. Detailed Notes (Continued)

C. Long-Term Debt

The following is a summary of the District's long-term debt activity for the year ended December 31, 2006.

	Balance January 1, 2006	Additions	Reductions	Balance December 31, 2006	Amounts Due Within One Year
Public Facilities Authority					
General Obligation Notes	\$ 9,070,050	\$ -	\$ 442,000	\$ 8,628,050	\$ 448,000
General Obligation Bonds	<u>285,000</u>	<u>671,900</u>	<u>30,000</u>	<u>926,900</u>	<u>166,814</u>
 Total Long-Term Debt	 <u>\$ 9,355,050</u>	 <u>\$ 671,900</u>	 <u>\$ 472,000</u>	 <u>\$ 9,554,950</u>	 <u>\$ 614,814</u>

Long-term debt comprises the following:

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

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

2. Detailed Notes

C. Long-Term Debt (Continued)

- \$671,900 General Obligation Sewer Revenue Refunding Bond, Series 2006. Bond payments are due annually on March 1, 2007 to 2011, at an effective interest rate of 4.72 percent.

A summary of the annual requirements needed to service the long-term debt at December 31, 2006, is as follows:

<u>Year Ending December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 614,814	\$ 167,339	\$ 782,153
2008	614,737	167,340	782,077
2009	628,813	152,951	781,764
2010	642,176	138,025	780,201
2011	639,360	122,635	761,995
2012 - 2016	2,621,000	443,481	3,064,481
2017 - 2021	2,716,000	218,777	2,934,777
2022 - 2023	1,078,050	24,918	1,102,968
Total	<u>\$ 9,554,950</u>	<u>\$ 1,435,466</u>	<u>\$ 10,990,416</u>

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

3. Risk Management

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

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

4. Subsequent Events

Pursuant to Minn. Stat. chs. 115, 444, and 475, the Duluth/North Shore Sanitary District sold \$2,590,453 of General Obligation Capital Appreciation Refunding Bonds, Series 2007, dated August 1, 2007. These refunding bonds were issued to refund, on a current basis, the General Obligation Sewer Revenue Notes, Series 2000A, 2000B and 2004, the General Obligation Bonds, Series 2004, and the General Obligation Sewer Revenue Refunding Bonds, Series 2006.

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

Schedule 1

SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2006

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEM NOT RESOLVED

01-1 Internal Control/Segregation of Duties

The Board of Managers 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. Adequate segregation of duties is a key internal control in an organization's accounting system. The size of the Duluth/North Shore Sanitary District and its staffing limits the internal control that the Board of Managers can design and implement into the organization. The Board of Managers should be aware that the segregation of duties is not adequate from an internal control point of view.

The Board of Managers is responsible for the accuracy and completeness of all financial records and related information. Also, the Board of Managers is responsible for controls over the period-end financial reporting process, including controls over procedures used to enter transaction totals into the general ledger; initiate, authorize, record, and process journal entries into the general ledger; and record recurring and nonrecurring adjustments to the financial statements.

The Board of Managers has requested that we prepare the annual financial statements and related notes. This arrangement is not unusual for an organization the size of the Duluth/North Shore Sanitary District. This decision was based on the availability of the District's staff and the cost-benefit of using our expertise.

During our audit, we proposed significant adjustments to convert the District's financial records to the financial statements as reported. These adjustments increased assessments receivable, interest expense, and property tax revenue; decreased operations and maintenance expense; and adjusted net assets to properly reflect amounts invested in capital assets net of related debt, restricted for debt service, and unrestricted.

Schedule 1
(Continued)

We recommend the Duluth/North Shore Sanitary District be mindful that limited staffing causes inherent risks in safeguarding the District's assets and the proper reporting of its financial activity. We recommend the Duluth/North Shore Sanitary District continue to implement oversight procedures and monitor those procedures to determine if they are still effective internal controls.

Client's Response:

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



REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

OFFICE OF THE STATE AUDITOR

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

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

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

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

We have audited the financial statements of Duluth/North Shore Sanitary District as of and for the year ended December 31, 2006, and have issued our report thereon dated October 30, 2007. 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 Duluth/North Shore Sanitary District's internal control over financial reporting as a basis for designing our auditing procedures 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 District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph of this section and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination

of control deficiencies, that adversely affects the District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the District's financial statements that is more inconsequential will not be prevented or detected by the District's internal control. We considered the deficiency described in the accompanying Schedule of Findings and Recommendations as item 01-1 to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the District's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe the significant deficiency described above is not a material weakness.

Compliance and Other Matters

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

Minnesota Legal Compliance

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

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

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

The Duluth/North Shore Sanitary District's written response to the significant deficiency identified in our audit has not been subjected to any auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the District's Board, management, and others within the Duluth/North Shore Sanitary District and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

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