STATE OF MINNESOTA

Office of the State Auditor

Rebecca Otto
State Auditor

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2011

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 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@osa.state.mn.us
www.auditor.state.mn.us

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

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

For the Year Ended December 31, 2011

Audit Practice Division
Office of the State Auditor
State of Minnesota

This page was left blank intentionally.

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

TABLE OF CONTENTS

This page was left blank intentionally.

Introductory Section

This page was left blank intentionally.

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

ORGANIZATION
DECEMBER 31, 2011

Board of Managers	Term Ending
Robert Entzion, Chair	January 1, 2012
Mike Ojard, Vice Chair	January 1, 2013
Randy Ellestad, Treasurer	January 1, 2013
Tom Bothwell, Member	January 1, 2014
Robert Mitchell, Member	January 1, 2012

This page was left blank intentionally.

Financial Section

This page was left blank intentionally.

STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

REBECCA OTTO
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

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, 2011, 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 December 31, 2011, 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.

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 a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who consider it to be an essential part of the 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 the missing information.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 2, 2013, on our consideration of the 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/Rebecca Otto	*/s/Greg Hierlinger*
REBECCA OTTO STATE AUDITOR	GREG HIERLINGER, CPA DEPUTY STATE AUDITOR

May 2, 2013

BASIC FINANCIAL STATEMENTS

This page was left blank intentionally.

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

EXHIBIT 1

STATEMENT OF NET ASSETS
DECEMBER 31, 2011

Assets		
Current assets		
Cash	$	194,920
Accounts receivable		38,359
Assets restricted for capital replacement		
Cash		3,921
Total current assets	**$**	**237,200**
Capital assets		
Depreciable - net of accumulated depreciation		2,606,294
Total Assets	**$**	**2,843,494**
Liabilities		
Current liabilities		
Accounts payable	$	19,817
Due to other governments		37,667
Public Facilities Authority (PFA) loans payable		44,000
Total current liabilities	**$**	**101,484**
Noncurrent liabilities		
PFA loans payable		622,212
Total Liabilities	**$**	**723,696**
Net Assets		
Invested in capital assets - net of related debt	$	1,940,082
Restricted for		
Capital replacement		3,921
Unrestricted		175,795
Total Net Assets	**$**	**2,119,798**

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

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

EXHIBIT 2

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2011

Operating Revenues		
Charges for services	$	114,970
Miscellaneous		20,530
Total Operating Revenues	**$**	**135,500**
Operating Expenses		
Contracted services	$	26,880
Professional services		10,505
Repair and maintenance		31,732
Supplies		1,144
Utilities		10,790
Insurance		6,715
Other services and charges		37,382
Depreciation		117,625
Total Operating Expenses	**$**	**242,773**
Operating Income (Loss)	**$**	**(107,273)**
Nonoperating Revenues (Expenses)		
Interest income	$	383
Interest expense		(9,291)
Total Nonoperating Revenues (Expenses)	**$**	**(8,908)**
Change in Net Assets	$	**(116,181)**
Net Assets - January 1		**2,235,979**
Net Assets - December 31	**$**	**2,119,798**

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

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

EXHIBIT 3

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2011

Cash Flows from Operating Activities		
Cash receipts from customers	$	138,476
Cash paid to suppliers		(111,547)
Net cash provided by (used in) operating activities	**$**	**26,929**
Cash Flows from Capital and Related Financing Activities		
Principal paid on long-term debt	$	(43,000)
Interest paid on long-term debt		(9,291)
Net cash provided by (used in) capital and related financing activities	**$**	**(52,291)**
Cash Flows from Investing Activities		
Interest income	**$**	**383**
Net Increase (Decrease) in Cash	**$**	**(24,979)**
Cash - January 1		**223,820**
Cash - December 31	**$**	**198,841**
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities	**$**	**(107,273)**
Adjustments to reconcile net operating income (loss) to net cash provided by (used in) operating activities		
Depreciation		117,625
Decrease (increase) in receivables		2,976
Increase (decrease) in payables		13,601
Net Cash Provided by (Used in) Operating Activities	**$**	**26,929**

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

This page was left blank intentionally.

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.

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, net of related debt; (2) restricted for capital replacement; and (3) unrestricted net assets.

1. Summary of Significant Accounting Policies (Continued)

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.

D. Assets and Liabilities

Cash

Cash consists of an operations checking account, a repair and replacement savings account, a project savings account, and a Larsmont savings account. Cash and cash equivalents include both restricted and unrestricted cash and petty cash.

Accounts Receivable

Accounts receivable consists of the December user charges, delinquent accounts, and annual debt service charge. The delinquent account balance is approximately 90 percent of the accounts receivable balance. The District does not set up an allowance for doubtful accounts; instead, it is the District's policy to certify these delinquent accounts over to Lake County to be placed on the individual's taxes. The District has not turned over the delinquent accounts to the County in many years.

Restricted Assets

Certain funds of the District are classified as restricted assets on the statement of net assets because the restriction is either imposed by law through constitutional provisions or enabling legislation or imposed externally by creditors, grantors, contributors, or laws or regulations of other governments. Therefore, their use is limited by applicable laws and regulations.

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.

Classification	Estimated Life
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.

2. Detailed Notes

A. Deposits

The District is authorized by Minn. Stat. § 118A.02 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, 2011, the District's deposits totaled $216,477, all of which were cash deposits insured as required by Minnesota statutes. The carrying value of these deposits was $198,841. The District had an adequate amount of insurance and collateral pledged to cover its deposits.

2. Detailed Notes (Continued)

B. Capital Assets

A summary of the changes in capital assets for the year ended December 31, 2011, follows:

	Balance January 1, 2011	Additions	Deletions	Balance December 31, 2011
Capital assets depreciated				
Collection system	$ 4,705,002	$ -	$ -	$ 4,705,002
Equipment	1,188	-	-	1,188
Total capital assets depreciated	$ 4,706,190	$ -	$ -	$ 4,706,190
Less: accumulated depreciation for				
Collection system	$ 1,981,083	$ 117,625	$ -	$ 2,098,708
Equipment	1,188	-	-	1,188
Total accumulated depreciation	$ 1,982,271	$ 117,625	$ -	$ 2,099,896
Total Capital Assets, Net	$ 2,723,919	$ (117,625)	$ -	$ 2,606,294

C. Long-Term Obligations

The following is a summary of the District's long-term debt activity for the year ended December 31, 2011:

	Balance January 1, 2011	Additions	Reductions	Balance December 31, 2011	Due Within One Year
Public Facilities Authority general obligation notes	$ 709,212	$ -	$ 43,000	$ 666,212	$ 44,000

Long-term debt is composed of the following:

$882,212 General Obligation Revenue Note issued to the Minnesota Public Facilities Authority. Amounts drawn or receivable on this note as of December 31, 2006, were $876,212. Note payments are due semi-annually on February 20 and August 20, 2006 through 2025, at an interest rate of 1.31 percent.

2. Detailed Notes

C. Long-Term Obligations (Continued)

Debt service requirements at December 31, 2011, are as follows:

Year Ending December 31	General Obligation Revenue Note Principal	General Obligation Revenue Note Interest
2012	$ 44,000	$ 8,727
2013	44,000	8,151
2014	45,000	7,575
2015	45,000	6,985
2016	46,000	6,396
2017 - 2021	239,000	22,769
2022 - 2025	203,212	6,705
Total	$ 666,212	$ 67,308

The note will be retired with income from operations, annual debt service charge, property taxes, investment income, and unused construction funding and is exempt from the limitations on net debt imposed by Minnesota law.

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 system 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

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 is $462,372 at December 31, 2011. This is not reported as a liability on the Knife River-Larsmont Sanitary District's financial statements.

Management and Compliance Section

This page was left blank intentionally.

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2011

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

A. COMPLIANCE

PREVIOUSLY REPORTED ITEM RESOLVED

Public Facilities Authority (PFA) Capital Replacement Fund Requirement (09-1)

The District was not properly determining the required amount to be deposited into the capital replacement account. Rather than an amount based on flowage as required, the District was depositing $682 per month into the capital replacement account, resulting in it being overfunded. For 2010, the District certified the correctly calculated balance to the PFA. However, the general ledger and bank accounts were not adjusted to reflect the correctly calculated balance.

Resolution

In 2011, the District adjusted the general ledger and bank accounts to reflect the actual balance of the PFA capital replacement fund.

B. INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

02-1 Internal Control/Segregation of Duties

Criteria: 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. 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 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. In addition, audit adjustments were necessary to convert the District's financial records to the financial statements as reported. These adjustments were determined to be material to the financial statements.

Context: It is not unusual for an organization the size of the Knife River-Larsmont Sanitary District to be limited in the internal control that the Board of Managers can design and implement into the organization.

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

Cause: The size, structure, and economic resources of the District limit the internal control that management can design and implement into the organization. Based on the availability of the District's staff and the cost benefit of using our expertise, the Board of Managers has requested that we prepare the annual financial statements and related notes.

Recommendation: The Board of Managers should be aware that segregation of duties is not adequate from an internal control point of view. We recommend the Knife River-Larsmont 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 Knife River-Larsmont Sanitary District continue to implement oversight procedures and monitor those procedures to determine if they are still effective internal controls.

<u>Client's Response</u>:

The Secretary/Treasurer does the accounting. A Board member (Treasurer) approves bank accounts and receivables. The full Board approves monthly bills, bank accounts, and receivables.

10-2 <u>Documentation of Claims Review and Approval</u>

Criteria: The District requires the Board Treasurer to review all claims and sign the payment voucher signifying the Treasurer's review and approval.

Condition: We noted payment vouchers that did not contain the Treasurer's signature indicating the review and approval of claims.

Context: Disbursements paid in August, September, and October did not contain the Treasurer's signature indicating review and approval.

Effect: When the review and approval of claims is not done or not documented, that oversight control cannot be verified, and errors or irregularities may not be detected timely.

Cause: The Treasurer did not sign all of the District's payment vouchers indicating his review and approval.

Recommendation: We recommend the Board monitor internal control procedures to ensure the proper oversight for claims is performed and documented.

Client's Response:

The full Board has reviewed this procedure with the Secretary/Treasurer and the Board member (Treasurer) to make sure this process is followed.

PREVIOUSLY REPORTED ITEMS RESOLVED

Capital Assets (02-4)

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

Resolution

In 2011, the District added its capital asset information to the QuickBooks computerized accounting system.

Tax Levy Checking Account Reconciliations (06-1)

The District's tax levy checking account bank balance was not reconciled to the general ledger. As a result, the general ledger balance at December 31, 2010, was overstated by $16,516.

Resolution

In June 2011, the District closed the tax levy checking account by transferring the funds to the tax levy savings account.

Public Facilities Authority General Ledger Account Activity (10-1)

The District's general ledger did not include all the transactions of its Public Facilities Authority savings account. An analysis of the bank account activity showed the District did not post any normal deposits and wire transfers out to its general ledger, resulting in the ledger balance being overstated by $28,925 at December 31, 2010.

Resolution

In 2011, the general ledger included all of the activity of the Public Facilities Authority savings account.

II. OTHER FINDINGS AND RECOMMENDATIONS

MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM NOT RESOLVED

10-3 Board Approval of Claims

Criteria: State law requires that claims be approved by the Board prior to payment. *See* Minn. Stat. §§ 115.25, 115.30, and 412.271. The Board can only transact public business at a public meeting. Minn. Stat. § 13D.01. The District has the powers of a statutory city pursuant to Minn. Stat. § 115.30, which means the District has two options for paying bills prior to Board approval. First, the Board may delegate the authority to pay claims under Minn. Stat. § 412.271, subd. 8. When doing so, the Board must create internal control procedures commensurate with the delegation of authority. Second, the District can pay claims based upon contract, when such payments cannot be deferred without loss to the District, by obtaining the signatures of a majority of the Board pursuant to Minn. Stat. § 412.271, subd. 4. The claim must be formally acted upon at the next meeting.

Condition: The District did not have a monthly Board meeting for December 2011. We were informed that if there was not a monthly Board meeting, the bookkeeper would contact each Board member by phone, review the bills with them for approval, and pay them. The serial contacting of board members as a substitute for a vote required at a meeting is likely a violation of the open meeting law. *See* Minn. Stat. ch. 13D. For December no process was documented, and the claims for this month were paid without any Board member approval.

Context: In 2011, there was one month of claims paid by the District that did not have any documentation that the claims for payment were approved by the District's Board of Managers.

Effect: The District was not in compliance with Minn. Stat. §§ 115.25, 115.30, and 412.271.

Cause: There was no documentation that the December 2011 claims for payment were approved by the Board, since there was no meeting in December 2011.

Recommendation: We recommend that the District follow state law by only paying claims that have been approved by the Board at a public meeting, or pursuant to the delegation authorized in Minn. Stat. § 412.271, subd. 8, or the procedure set forth in Minn. Stat. § 412.271, subd. 4.

Client's Response:

The District will only pay claims approved by the Board and will be recorded per Minn. Stat.

This page was left blank intentionally.

STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

REBECCA OTTO
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*

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, 2011, and have issued our report thereon dated May 2, 2013. 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

Management of the Knife River-Larsmont Sanitary District is responsible for establishing and maintaining effective internal control over financial reporting. In planning and preforming our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an 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 and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Recommendations, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness and another deficiency that we consider to be a significant deficiency.

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 District's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency described in the accompanying Schedule of Findings and Recommendations as item 02-1 to be a material weakness.

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 attention by those charged with governance. We consider the deficiency described in the accompanying Schedule of Findings of Recommendations as item 10-2 to be a significant deficiency.

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 Political Subdivisions*, 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 Political Subdivisions* contains six categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, and miscellaneous provisions. Our study included all of the listed categories, except that we did not test for compliance in contracting and bidding, because the Knife River-Larsmont Sanitary District did not enter into any applicable contracts.

The results of our tests indicate that for the items tested, the District complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Recommendations as item 10-3.

The Knife River-Larsmont Sanitary District's written responses to the internal control and legal compliance findings identified in our audit have been included in the Schedule of Findings and Recommendations. We did not audit the District's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the District's Board of Managers, management, and others within the Knife River-Larsmont 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

May 2, 2013