

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, 2007

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@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.

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

For the Year Ended December 31, 2007



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

This page was left blank intentionally.

**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	6
Statement of Cash Flows	Exhibit C	7
Notes to the Financial Statements		8
Management and Compliance Section		
Schedule of Findings and Recommendations		15
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>		18

This page was left blank intentionally.

This page was left blank intentionally.

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

ORGANIZATION
DECEMBER 31, 2007

<u>Board of Managers</u>		<u>Terms Expires</u>
Kevin J. Bovee	Chair	January 1, 2010
Dean Korri	Vice Chair	January 1, 2011
Katherine Kuettel	Secretary	January 1, 2011
Scott Smith	Treasurer	January 1, 2009
John Bowen		January 1, 2009

This page was left blank intentionally.

This page was left blank intentionally.



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, 2007, 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, 2007, 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 May 13, 2009, on our consideration of the 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

May 13, 2009

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

BASIC FINANCIAL STATEMENTS

This page was left blank intentionally.

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

EXHIBIT A

**STATEMENT OF NET ASSETS
DECEMBER 31, 2007**

Assets

Current assets

Cash	\$	367,546
Taxes receivable - unapportioned		9,075
Accounts receivable		57,135
Assets restricted for debt service		
Cash		81,100
Assessments receivable		140,000
Assets restricted for capital replacement		
Cash		93,560

Total current assets **\$ 748,416**

Noncurrent assets

Unamortized bond issuance costs	\$	86,435
Assets restricted for debt service		
Assessments receivable		1,771,130

Total noncurrent assets **\$ 1,857,565**

Capital assets

Non-depreciable	\$	221,650
Depreciable, net of accumulated depreciation		15,532,008

Total capital assets **\$ 15,753,658**

Total Assets **\$ 18,359,639**

Liabilities

Current liabilities

Accounts payable	\$	39,267
Accrued interest		39,123
General obligation revenue notes - Public Facilities Authority		364,000
Deferred revenue - unavailable		9,075

Total current liabilities **\$ 451,465**

Noncurrent liabilities

Accrued interest	\$	55,515
General obligation bonds		2,590,453
General obligation revenue notes - Public Facilities Authority		6,223,000

Total noncurrent liabilities **\$ 8,868,968**

Total Liabilities **\$ 9,320,433**

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

***EXHIBIT A
(Continued)***

**STATEMENT OF NET ASSETS
DECEMBER 31, 2007**

Net Assets

Invested in capital assets, net of related debt	\$ 6,576,205
Restricted for	
Debt service	1,670,430
Capital replacement	93,560
Unrestricted	<u>699,011</u>
Total Net Assets	<u><u>\$ 9,039,206</u></u>

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

EXHIBIT B

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEAR ENDED DECEMBER 31, 2007**

Operating Revenues	
Charges for services	\$ <u>809,218</u>
Operating Expenses	
Professional services	\$ 125,922
Insurance	8,645
Permits and licenses	386
Operations and maintenance	137,812
Supplies	22,014
Utilities	13,933
Western Lake Superior Sanitary District fees	32,647
Travel	1,100
Miscellaneous	1,812
Depreciation	<u>630,281</u>
Total Operating Expenses	\$ <u>974,552</u>
Net Operating Income (Loss)	\$ <u>(165,334)</u>
Nonoperating Revenues (Expenses)	
Property taxes	\$ 348,825
Market value credit aid	17,525
Interest expense	(200,075)
Bond premium	(42,050)
Interest on assessments	4,306
Miscellaneous	<u>6,492</u>
Total Nonoperating Revenues (Expenses)	\$ <u>135,023</u>
Change in Net Assets	\$ (30,311)
Net Assets - January 1	<u>9,069,517</u>
Net Assets - December 31	\$ <u><u>9,039,206</u></u>

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

EXHIBIT C

**STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2007**

Cash Flows from Operating Activities	
Cash received from customers	\$ 786,737
Cash paid to suppliers	(346,763)
	\$ 439,974
 Cash Flows from Noncapital Financing Activities	
Property tax levy	\$ 356,725
Market value credit aid	17,525
	\$ 374,250
 Cash Flows from Capital and Related Financing Activities	
Proceeds from general obligation capital appreciation refunding bonds	\$ 2,590,453
Special assessments	(98,152)
Payments for capital assets	(14,161)
Principal paid on long-term debt	(2,967,950)
Interest paid on long-term debt	(172,046)
Bond issuance costs	(121,993)
Interest received on assessments	4,306
	\$ (779,543)
Net Increase (Decrease) in Cash and Cash Equivalents	\$ 34,681
Cash - January 1	507,525
Cash - December 31	\$ 542,206
 Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities	
Net operating income (loss)	\$ (165,334)
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	(22,481)
Increase (decrease) in payables	(2,492)
	\$ 439,974

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

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2007**

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 Lakewood Township. 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 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 are available for use, it is the District's policy to use restricted resources first, then unrestricted resources 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 and sweep savings accounts.

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. Residual receipts on tax levies are 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. Beginning in 2007, benefiting properties were issued an additional special assessment to cover debt service costs in excess of the original improvement project assessment. 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.

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

1. Summary of Significant Accounting Policies

D. Assets and Liabilities (Continued)

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.

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 2007, \$2,590,453 of General Obligation Capital Appreciation Refunding Bonds were issued to refinance the District's overall debt load. These bonds were issued to refund the General Obligation Bonds, Series 2004; General Obligation Sewer Revenue Refunding Bonds, Series 2006; and \$1,683,050 of General Obligation Revenue Notes issued by the Minnesota Public Facilities Authority.

General Obligation Revenue Notes Payable - Minnesota Public Facilities Authority

General obligation revenue notes payable includes the remaining Minnesota Public Facilities Authority Note issued in 2003 to fund the construction of the sanitary sewer collection system.

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

1. Summary of Significant Accounting Policies (Continued)

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.

2. Detailed Notes

A. Deposits

The District's total cash as of December 31, 2007, is reported as follows:

Cash	\$ 367,546
Restricted assets	
Debt service account	81,100
Capital replacement account	<u>93,560</u>
Total Cash and Restricted Cash	<u>\$ 542,206</u>

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, 2007, District deposits totaled \$545,065, all of which were cash deposits insured as required by Minnesota statutes. The carrying value of these deposits was \$542,206. During the year, the District had an adequate amount of insurance and collateral pledged to cover its deposits.

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

2. Detailed Notes (Continued)

B. Changes in Capital Assets

	Balance January 1, 2007	Increase	Decrease	Balance December 31, 2007
Capital assets not depreciated				
Land	\$ 221,650	\$ -	\$ -	\$ 221,650
Capital assets depreciated				
Wet weather storage tank	\$ 550,000	\$ -	\$ -	\$ 550,000
Force main	7,622,438	-	-	7,622,438
Gravity collection system	610,950	-	-	610,950
Main pump station	1,359,116	-	-	1,359,116
Individual treatment systems	7,269,013	-	-	7,269,013
Equipment	4,125	-	-	4,125
Total capital assets depreciated	\$ 17,415,642	\$ -	\$ -	\$ 17,415,642
Less: accumulated depreciation for				
Wet weather storage tank	\$ 36,666	\$ 18,333	\$ -	\$ 54,999
Force main	375,626	190,561	-	566,187
Gravity collection system	24,438	12,219	-	36,657
Main pump station	90,608	45,304	-	135,912
Individual treatment systems	725,189	363,451	-	1,088,640
Equipment	826	413	-	1,239
Total accumulated depreciation	\$ 1,253,353	\$ 630,281	\$ -	\$ 1,883,634
Total capital assets depreciated, net	\$ 16,162,289	\$ (630,281)	\$ -	\$ 15,532,008
Capital Assets, Net	\$ 16,383,939	\$ (630,281)	\$ -	\$ 15,753,658

C. Long-Term Debt

The following is a summary of the District's long-term debt activity for the year ended December 31, 2007.

	Balance January 1, 2007	Additions	Reductions	Balance December 31, 2007	Amounts Due Within One Year
Public Facilities Authority					
General Obligation Notes	\$ 8,628,050	\$ -	\$ 2,041,050	\$ 6,587,000	\$ 364,000
General Obligation Bonds	926,900	2,590,453	926,900	2,590,453	-
Total Long-Term Debt	\$ 9,554,950	\$ 2,590,453	\$ 2,967,950	\$ 9,177,453	\$ 364,000

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

2. Detailed Notes

C. Long-Term Debt (Continued)

Long-term debt comprises the following:

- \$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.
- \$2,590,453 General Obligation Capital Appreciation Refunding Bonds due in annual installments of \$128,932 to \$254,880 on August 1, 2024 to 2037; interest rate is 5.10 to 5.22 percent, including unamortized premium of \$42,050. These bonds were issued to refund the General Obligation Bonds, Series 2004, General Obligation Sewer Revenue Refunding Bonds, Series 2006, and \$1,683,050 of General Obligations Revenue Notes issued by the Minnesota Public Facilities Authority. The net present value loss of the refunding issue is \$462,186 and results in an increase of \$334,725 in future debt service payments.

A summary of the annual requirements needed to service the long-term debt at December 31, 2007, is as follows:

<u>Year Ending December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 364,000	\$ 107,368	\$ 471,368
2009	370,000	101,435	471,435
2010	376,000	95,404	471,404
2011	382,000	89,275	471,275
2012	388,000	83,049	471,049
2013 - 2017	2,037,000	318,306	2,355,306
2018 - 2022	2,207,000	146,847	2,353,847
2023 - 2027	1,406,008	1,464,539	2,870,547
2028 - 2032	931,488	2,068,512	3,000,000
2033 - 2037	715,957	2,294,043	3,010,000
Total	<u>\$ 9,177,453</u>	<u>\$ 6,768,778</u>	<u>\$ 15,946,231</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.

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

3. Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. The District has purchased commercial insurance to insure these risks. There are no employees of the 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 three years.

This page was left blank intentionally.

This page was left blank intentionally.

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

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2007**

**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.

During our audit, we proposed a material adjustment to convert the District's financial records to the financial statements as reported. This adjustment was recorded to account for additional revenue earned by the District from the annual debt service charge. The adjustment increased charges for services and decreased general obligation bonds payable from restricted assets by \$320,800.

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:

In recognition of the need to maximize segregation of duties in a small organization with limited staffing and systems the District has a formal framework to ensure appropriate internal controls. The District has separated all possible cash-related functions to ensure ample oversight and participation by various levels of District contractors and Board members. Given the District does not have employees, it has secured contracts or Engagement Letters with the appropriate operational vendors to supplement Board oversight and to provide prompt, consistent and high-quality service to District customers. The following briefly describes the framework for financial controls:

User Fee and Related Billings/Cash Receipts - In 2007/2008 monthly invoicing and cash receipts were processed by NTS, the company hired to function as District Superintendent. Summary accounts receivable records are maintained by the District Bookkeeper ensuring billings, receipts and balances agree with actual bank activity. The responsibility to regularly review accounts receivable lies with the Board of Directors. Bank reconciliation is assigned to the District Bookkeeper, currently RRM Financial Services, Inc. The Board Treasurer receives electronic copies of all bank reconciliation documents monthly for review.

Accounts Payable - Are received at the District P.O. Box or sent electronically to NTS by select vendors. The Superintendent reviews and approves all operation-related invoices following comparison with the District budget currently in force. Upon approval, invoices are sent electronically, with the appropriate approval (initials) and coding, to the District Bookkeeper for entry into QuickBooks. The Bookkeeper enters the payables, also comparing activity with the District budget, and prepares the checks for presentation and signature by the Board at a regular monthly Board meeting. A summary of all checks presented for signature, along with account balances, is provided to all Board members. Checks require two signatures.

Monthly Reporting and Communication - includes Budget versus Actual reporting, monthly financial statements from QuickBooks for current period and year-to-date, along with supporting schedules for accounts payable, accounts receivable and cash flow. The Board packet is provided electronically in advance to the Board for review and in hard-copy at the monthly Board meeting. The Bookkeeper regularly communicates with the Superintendent and the Board regarding financial transactions and user correspondence. The Superintendent attends all Board meetings and is in contact regularly with Board members. The Board works in tandem with contractors to prepare, review and approve an annual budget, which is available on the District website once approved. The annual budget includes expectations for operational costs, debt reduction and capital repairs and replacements. Extensive support is used to prepare and analyze the annual budget and ongoing activity is regularly compared to these assumptions to identify areas of possible divergence. All Board meetings are open to the Public.

Financial Records - are maintained at the accounting office of the District Bookkeeper. Select operational records are maintained at the Superintendent's office, located in the District.

Minimum Standards - the District attempts to ensure that all material transactions receive review by a minimum of three parties; typically Board, Superintendent and Bookkeeper. Full documentation is kept for all transactions.

This page was left blank intentionally.



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 basic financial statements of the Duluth/North Shore Sanitary District as of and for the year ended December 31, 2007, and have issued our report thereon dated May 13, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the 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 to be 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 than 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 consider the significant deficiency described above as item 01-1 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 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 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.

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 material weakness identified in our audit has been included in the Schedule of Findings and Recommendations. We did not audit the District's response 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

/s/Greg Hierlinger

REBECCA OTTO
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

May 13, 2009