

STATE OF MINNESOTA

Office of the State Auditor



Patricia Anderson
State Auditor

DULUTH/NORTH SHORE SANITARY DISTRICT
DULUTH, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2004

Description of the Office of the State Auditor

The Office of the State Auditor serves as a watchdog for Minnesota taxpayers by helping to ensure financial integrity, accountability, and cost-effectiveness in local governments throughout the state.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 250 financial and compliance audits per year and has oversight responsibilities for over 4,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits for local governments;

Government Information - collects and analyzes financial information for cities, towns, counties, and special districts;

Legal/Special Investigations - provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

Pension - monitors investment, financial, and actuarial reporting for over 700 public pension funds; and

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

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

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

For the Year Ended December 31, 2004



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

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

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

ORGANIZATION
DECEMBER 31, 2004

<u>Board of Managers</u>		<u>Term Expires</u>
Orlando (Lars) G. Fladmark	Chair	January 1, 2006
Kevin J. Bovee	Vice Chair	January 1, 2007
Mary Ann Sironen	Secretary	January 1, 2008
Frederick P. Certano	Treasurer	January 1, 2008
Scott Smith		January 1, 2006

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STATE OF MINNESOTA

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PATRICIA ANDERSON
STATE AUDITOR

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the Duluth/North Shore Sanitary District as of and for the year ended December 31, 2004 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 and for the year ended December 31, 2004, 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.

As discussed in the notes to the financial statements, Duluth/North Shore Sanitary District adopted the provisions of Governmental Accounting Standards Board (GASB) Statements No. 34, *Basic Financial Statements--and Management's Discussion and Analysis--for State and Local Governments*, as amended; and No. 38, *Certain Financial Statement Note Disclosures*, as of and for the year ended December 31, 2004. These statements result in a change in the format and content of the basic financial statements.

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 12, 2005, 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/Pat Anderson

PATRICIA ANDERSON
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

End of Fieldwork: May 12, 2005

FINANCIAL STATEMENTS

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

EXHIBIT A

**STATEMENT OF NET ASSETS
DECEMBER 31, 2004**

Assets

Current Assets

Cash	\$ 354,065
Accounts receivable	17,137
Claims receivable	12,584
Assets restricted for construction	
Cash	19,874
Loans receivable - Minnesota Public Facilities Authority	354,599
Assets restricted for debt service	
Cash	163,556
Assessments receivable	<u>115,000</u>

Total current assets **\$ 1,036,815**

Noncurrent Assets

Restricted for debt service	
Assessments receivable	2,027,756

Capital Assets

Construction in progress	<u>15,883,260</u>
--------------------------	-------------------

Total Assets **\$ 18,947,831**

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

***EXHIBIT A
(Continued)***

**STATEMENT OF NET ASSETS
DECEMBER 31, 2004**

Liabilities

Current Liabilities

Accounts payable	\$ 21,523
Due to other governments	19,597
Accrued interest	51,537
General obligation bonds payable	30,000
General obligation revenue notes - Public Facilities Authority	376,000

Total Current Liabilities **\$ 498,657**

Current Liabilities Payable from Restricted Assets

Construction	
Accounts payable	\$ 23,244
Contracts payable	351,229

Total Current Liabilities Payable from Restricted Assets **\$ 374,473**

Noncurrent Liabilities

General obligation bonds	\$ 285,000
General obligation revenue notes - Public Facilities Authority	8,200,033

Total Noncurrent Liabilities **\$ 8,485,033**

Total Liabilities **\$ 9,358,163**

Net Assets

Invested in capital assets, net of related debt	\$ 6,992,227
Restricted for debt service	2,306,312
Unrestricted	291,129

Total Net Assets **\$ 9,589,668**

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

EXHIBIT B

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEAR ENDED DECEMBER 31, 2004**

Operating Revenues	
Charges for services	\$ <u>97,445</u>
 Operating Expenses	
Professional services	\$ 32,110
Insurance	7,361
Permits and licenses	100
Travel expenses	115
Operations and maintenance	57,853
Supplies	854
Utilities	3,056
WLSSD fees	5,927
Miscellaneous	226
 Total Operating Expenses	 \$ <u>107,602</u>
 Net Operating Income (Loss)	 \$ <u>(10,157)</u>
 Nonoperating Revenues (Expenses)	
Property taxes	\$ 185,602
Market value credit aid	11,097
Special assessments	22,000
U.S. Army Corps of Engineers grant	5,751
City of Duluth - Community Development Block Grant	45,500
St. Louis County - Community Development Block Grant	82,500
Interest expense	(118,098)
Interest on assessments	21,283
 Total Nonoperating Revenues (Expenses)	 \$ <u>255,635</u>
 Change in Net Assets	 \$ 245,478
 Net Assets - January 1	 <u>9,344,190</u>
 Net Assets - December 31	 <u><u>9,589,668</u></u>

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

EXHIBIT C

**STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2004**

Cash Flows from Operating Activities	
Cash received from customers	\$ 80,308
Cash paid to suppliers	(96,010)
	<hr/>
Net cash provided by (used in) operating activities	\$ (15,702)
Cash Flows from Noncapital Financing Activities	
Property tax levy	\$ 185,602
Market value credit aid	11,097
	<hr/>
Net cash provided by (used in) noncapital financing activities	\$ 196,699
Cash Flows from Capital and Related Financing Activities	
Proceeds from Public Facilities Authority general obligation note	\$ 3,923,866
Proceeds from general obligation bonds	309,662
Proceeds from City of Duluth Community Development Block Grant	45,500
Proceeds from St. Louis County Community Development Block Grant	82,500
proceeds from U.S. Army Corps of Engineers grant	223,444
Special assessments	131,663
Payments for construction in progress	(4,217,003)
Principal paid on long-term debt	(320,500)
Interest paid on long-term debt	(87,360)
Interest received on assessments	21,283
	<hr/>
Net cash provided by (used in) capital and related financing activities	\$ 113,055
Net Increase (Decrease) in Cash and Cash Equivalents	\$ 294,052
Cash - January 1	243,443
	<hr/>
Cash - December 31	\$ 537,495
	<hr/> <hr/>
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities	
Net operating income (loss)	\$ (10,157)
Adjustments to reconcile net operating loss to net cash provided by (used in) operating activities	
Changes in assets and liabilities	
(Increase) decrease in receivables	(17,137)
Increase (decrease) in payables	11,592
	<hr/>
Net Cash Provided by (Used in) Operating Activities	\$ (15,702)
	<hr/> <hr/>

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

NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2004

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 to 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 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

A property tax levy was established to finance operations effective 2001. 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

Restricted Assets and Liabilities (Continued)

Restricted amounts due from Minnesota Public Facilities Authority are for construction costs incurred, which had not been drawn down at year-end.

Capital Assets

Capital assets are stated at cost. Construction in progress consists of planning, design, engineering costs, and construction of the sewer extension line. Interest on funds borrowed to finance construction is not capitalized because amounts incurred are insignificant.

General Obligation Bonds Payable

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

General Obligation Revenue Notes Payable - Minnesota Public Facilities Authority

General obligation revenue notes payable include amounts drawn down from the Minnesota Public Facilities Authority for construction costs paid and amounts earned (drawn after year end) for eligible construction costs incurred.

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**

1. Summary of Significant Accounting Policies (Continued)

F. Change in Accounting Principle

The District implemented GASB Statement No. 34, *Basic Financial Statements--and Management's Discussion and Analysis--for State and Local Governments*. Implementation of this new standard required the District to change the format and content of the financial statements.

2. Detailed Notes

A. Deposits

Minn. Stat. § 118A.02 authorizes the District to deposit its cash and to invest in certificates of deposit in financial institutions designated by the District's Board. At December 31, 2004, District deposits totaled \$537,495 all of which were cash deposits insured as required by Minnesota statutes. The carrying value of these deposits was \$537,495. During the year, District deposits exceeded the amount of available insurance and collateral.

B. Changes in Capital Assets

	Balance January 1, 2004	Increase	Decrease	Balance December 31, 2004
Construction In Progress	\$ 11,879,800	\$ 4,003,460	\$ -	\$ 15,883,260

C. Construction Funding Sources

Cumulative construction costs and funding sources as of December 31, 2004, follow:

Construction Costs	
Financial planning	\$ 195,299
Engineering and design	1,616,258
Construction	13,567,389
Legal costs	338,423
Land use plan	59,484
Easements	63,953
Other costs	42,454
Total Construction Costs	\$ 15,883,260

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

2. Detailed Notes

C. Construction Funding Sources (Continued)

Funding Sources	
Minnesota Public Facilities Loan #1	\$ 225,000
Minnesota Public Facilities Loan #2	300,000
Minnesota Public Facilities Loan #3	7,952,500
Minnesota Public Facilities Loan #4	458,033
Minnesota Public Facilities Grant	6,000,000
General Obligation Bonds - Series 2004	254,515
Federal Corps of Engineers Grant	484,868
Coastal Program Grant	36,001
Lake County coastal program contribution	4,680
City of Duluth - Community Development Block Grant	150,000
Tax levy	<u>17,663</u>
Total Funding Sources	<u>\$ 15,883,260</u>

D. Long-Term Debt

The following is a summary of the District's long-term debt activity for the year ended December 31, 2004.

	Balance January 1, 2004	Additions	Reductions	Balance December 31, 2004	Amounts Due Within One Year
Public Facilities Authority					
General Obligation Notes	\$ 5,198,839	\$ 3,697,694	\$ 320,500	\$ 8,576,033	\$ 376,000
General Obligation Bonds	<u>-</u>	<u>315,000</u>	<u>-</u>	<u>315,000</u>	<u>30,000</u>
Total Long-Term Debt	<u>\$ 5,198,839</u>	<u>\$ 4,012,694</u>	<u>\$ 320,500</u>	<u>\$ 8,891,033</u>	<u>\$ 406,000</u>

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

2. Detailed Notes

D. Long-Term Debt (Continued)

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. Amounts drawn or receivable on this note as of December 31, 2004, were \$458,033. 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.

A summary of the annual requirements needed to service the long-term debt at December 31, 2004, is as follows:

<u>Year Ending December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 406,000	\$ 147,028	\$ 553,028
2006	427,342	149,243	576,585
2007	433,577	141,798	575,375
2008	440,813	134,165	574,978
2009	448,053	126,303	574,356
2010 - 2014	2,364,937	505,597	2,870,534
2015 - 2019	2,395,288	289,255	2,684,543
2020 - 2023	<u>1,975,023</u>	<u>79,490</u>	<u>2,054,513</u>
Total	<u>\$ 8,891,033</u>	<u>\$ 1,572,879</u>	<u>\$ 10,463,912</u>

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

2. Detailed Notes

D. Long-Term Debt (Continued)

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. Construction Commitments

As of December 31, 2004, the District had the following commitments with respect to unfinished construction projects:

<u>Contractor</u>	<u>Project</u>	<u>Remaining Construction Commitment</u>
Frontier Pipeline	Sewer Collection System - B	\$ 17,197
Frontier Pipeline	Sewer Collection System - C	41,740

4. Contingent Liabilities

S. J. Louis Construction Co. has served the District a notice of claims for a change order to the original contract because of undisclosed subsurface conditions. The District's architect has denied the change order and the Board of Managers has concurred. The Board intends to vigorously defend its position through the mediation and litigation process. The Board is not able to determine the ultimate outcome of this claim.

5. Risk Management

The District is exposed to various risk 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 audit period.

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

Schedule 1

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2004

I. SUMMARY OF AUDITOR'S RESULTS

- A. Our report expresses an unqualified opinion on the financial statements of the Duluth/North Shore Sanitary District.
- B. A reportable condition in internal controls was disclosed by the audit of financial statements of the District and is reported in the "Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*." The reportable condition was not a material weakness.
- C. No instances of noncompliance material to the financial statements of the Duluth/North Shore Sanitary District were disclosed during the audit.
- D. No matters involving internal control over compliance relating to the audit of the major federal award program were reported in the "Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133."
- E. The Auditor's Report on Compliance for the major federal award program for the Duluth/North Shore Sanitary District expresses an unqualified opinion.
- F. No findings were disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133.
- G. The major program is:
 - Capitalization Grant for Clean Water
State Revolving Funds
 - CFDA #66.458
- H. The threshold for distinguishing between Types A and B program was \$300,000.
- I. The Duluth/North Shore Sanitary District was not determined to be a low-risk auditee.

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEM NOT RESOLVED

01-1 Segregation of Duties

Due to the limited number of administrative personnel, segregation of the accounting functions necessary to ensure adequate internal accounting control is not possible. This is not unusual in operations the size of the Duluth/North Shore Sanitary District; however, the Board of Managers should constantly be aware of this condition and realize that the concentration of duties and responsibilities in a limited number of individuals is not desirable from an accounting point of view.

Segregation of duties is defined as an arrangement of responsibilities such that the work of one employee is checked by another. Ideally, no single individual should be able to:

- authorize a transaction,
- record the transaction and maintain related financial records, and
- have custody of assets.

Oversight procedures which the Board of Managers should consider include:

- developing written internal control policies and procedures,
- reviewing monthly bank reconciliations, and
- reviewing monthly financial statements.

We recommend that the Board of Managers be aware of the lack of segregation of the accounting functions and perform oversight procedures to ensure that internal control policies and procedures are in place.

Client's Response:

We are both aware of the necessity for segregation of duties and have fully implemented the concept. Currently we have a bookkeeper responsible for accounts payable. Deposits are either made electronically or by check. Tax levy checks are delivered to the bookkeeper 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 Eikill and Schilling, the DNSSD's accountant. The bookkeeper 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 Eikill and Schilling 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.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

None.

IV. OTHER FINDINGS AND RECOMMENDATIONS

A. MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

02-1 Collateral Requirements

At various dates during 2004, District deposits in the North Shore Bank of Commerce exceeded the amount of FDIC insurance available and collateral pledged to secure the deposits. The highest daily bank balance noted during the year was \$867,346, which exceeded FDIC insurance and collateral coverage by \$107,103. Minn. Stat. § 118A.03 requires a governmental entity to obtain collateral or a surety bond from a financial institution for deposits in excess of available federal deposit insurance. The amount of pledged collateral, based on its market value, must be at least ten percent more than the uninsured amount on deposit plus accrued interest. Unsecured deposits expose the District to risk of loss due to financial institution default.

We recommend the District review the requirements of Minn. Stat. ch. 118A and request the financial institution furnish additional collateral or a corporate surety bond for the deposits exceeding FDIC coverage.

Client's Response:

After the last audit we discussed the necessity of bonding over the FDIC insured limit. Unfortunately, it is very difficult for us to predict the balance in our account. All of the construction money is pass-through, and the amount is dependent on the construction progress. We are currently bonded at the \$500,000 level and do not expect to exceed that level. In addition, it is difficult to adjust the bonding level on less than a weekly basis. We will continue oversight on our balance and the amount of bonding and expect, as the construction is completed, that we will be able to predict our balance to the bank with much greater accuracy.

03-1

Withholdings for Out-of-State Contractors

The Project Loan and Bond Purchase Agreement dated June 5, 2002, between the Minnesota Public Facilities Authority and the District requires:

Article II Section 2.2 Construction Compliance. (d) The Borrower (District) will comply with Minnesota Statutes, Section 290.9705, as amended or supplemented from time to time, Withholding of Payment to Out-of-State Contractors, for all contracts that exceed, or are expected to exceed \$100,000 by either: (i) depositing with the Commissioner of the Minnesota Department of Revenue eight percent (8%) of every payment made to non-resident (of Minnesota) construction contractors; or (ii) receiving a waiver of the requirement from the Commissioner of the Minnesota Department of Revenue.

The District did not withhold eight percent from payments made to a non-resident contractor or receive a waiver from the Commissioner.

We recommend the District comply with this statute in regards to payments made to non-resident construction contractors.

Client's Response:

The Duluth/North Shore Sanitary District is aware of the findings applied and received an exemption as of June 22, 2005, for the contractor in question.

PREVIOUSLY REPORTED ITEMS RESOLVED

Prompt Payment of Invoices (01-2)

Minn. Stat. § 471.425 requires political subdivisions to make payment on vendor invoices according to the terms of the contract or within 35 days of the date of receipt. We noted invoices not paid within the required timelines.

Resolution

In the current audit period, all invoices reviewed were paid timely in accordance with Minn. Stat. § 471.425.

Certified Payrolls (03-2)

The Project Loan and Bond Purchase Agreement between the Minnesota Public Facilities Authority and the District requires the District and its construction contractors to comply with State wage requirements. The District had not obtained certified payrolls from the contractors documenting the wage requirements were met.

Resolution

Certified payrolls of the contractors were obtained by the District and available for inspection in the current audit period.

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OTHER REQUIRED REPORTS

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PATRICIA ANDERSON
STATE AUDITOR

**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING 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, 2004, and have issued our report thereon dated May 12, 2005. 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 in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the District's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. A reportable condition is described in the accompanying Schedule of Findings and Questioned Costs as item 01-1.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by

employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition indicated 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, except as described in the Schedule of Findings and Questioned Costs as items 02-1 and 03-1.

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

/s/Pat Anderson

PATRICIA ANDERSON
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

End of Fieldwork: May 12, 2005



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PATRICIA ANDERSON
STATE AUDITOR

REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

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

Compliance

We have audited the compliance of Duluth/North Shore Sanitary District with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended December 31, 2004. Duluth/North Shore Sanitary District's major federal program is identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Duluth/North Shore Sanitary District's management. Our responsibility is to express an opinion on the Duluth/North Shore Sanitary District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Duluth/North Shore Sanitary District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Duluth/North Shore Sanitary District's compliance with those requirements.

In our opinion, Duluth/North Shore Sanitary District complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2004.

Internal Control Over Compliance

The management of Duluth/North Shore Sanitary District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the District's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of Duluth/North Shore Sanitary District as of and for the year ended December 31, 2004, and have issued our report thereon dated May 12, 2005. Our audit was performed for the purpose of forming an opinion on the financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of the District Board, management, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Pat Anderson

PATRICIA ANDERSON
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

End of Fieldwork: May 12, 2005

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

Schedule 2

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2004**

Federal Grantor Pass-Through Agency Grant Program Title	Federal CFDA Number	Expenditures
Department of Defense, Army Corps of Engineers		
Direct		
Environmental Assistance Grant Program	12.106	\$ 5,751
Environmental Protection Agency		
Passed Through Minnesota Department of Employment and Economic Development		
Capitalization Grant for Clean Water State Revolving Funds	66.458	<u>3,697,694</u>
Total Expenditures of Federal Awards		<u>\$ 3,703,445</u>

Notes to Schedule of Expenditures of Federal Awards

1. The Schedule of Expenditures of Federal Awards presents the activity of federal award programs expended by the Duluth/North Shore Sanitary District. The District's reporting entity is defined in Note 1 to the financial statements.
2. The expenditures on this schedule are on the accrual basis of accounting.
3. During 2004, the Duluth/North Shore Sanitary District did not pass any federal money to subrecipients.