

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, 2012

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

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

For the Year Ended December 31, 2012



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

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

TABLE OF CONTENTS

	<u>Exhibit</u>	<u>Page</u>
Introductory Section		
Organization		1
Financial Section		
Independent Auditor's Report		2
Basic Financial Statements		
Statement of Net Position	1	4
Statement of Revenues, Expenses, and Changes in Net Position	2	6
Statement of Cash Flows	3	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

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

**ORGANIZATION
DECEMBER 31, 2012**

<u>Board of Managers</u>		<u>Term Expires</u>
Kevin J. Bovee	Chair	January 1, 2013
Dean Korri	Vice Chair	January 1, 2014
Scott Smith	Treasurer	January 1, 2014
Katherine Kuettel	Secretary	January 1, 2014
Angela Braud		January 1, 2014

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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

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

INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the Duluth/North Shore Sanitary District as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances,

but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Duluth/North Shore Sanitary District as of December 31, 2012, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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 considers 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 2, 2013, 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* in considering the District's internal control over financial reporting and compliance.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

December 2, 2013

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

BASIC FINANCIAL STATEMENTS

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

EXHIBIT 1

**STATEMENT OF NET POSITION
DECEMBER 31, 2012**

Assets

Current assets

Cash	\$	26,787
Accounts receivable		152,403
Assets restricted for debt service		
Cash		426,375
Assessments receivable		135,000
Assets restricted for capital replacement		
Cash		98,286

Total current assets **\$ 838,851**

Noncurrent assets

Unamortized bond issuance costs	\$	72,030
Assets restricted for debt service		
Assessments receivable		1,453,762

Total noncurrent assets **\$ 1,525,792**

Capital assets

Non-depreciable	\$	221,650
Depreciable, net of accumulated depreciation		12,395,105

Total capital assets **\$ 12,616,755**

Total Assets **\$ 14,981,398**

Liabilities

Current liabilities

Accounts payable	\$	39,109
Accrued interest		27,577
General obligation revenue notes - Public Facilities Authority		389,000

Total current liabilities **\$ 455,686**

Noncurrent liabilities

Accrued interest	\$	816,151
General obligation bonds		2,590,453
General obligation revenue notes - Public Facilities Authority		4,254,058

Total noncurrent liabilities **\$ 7,660,662**

Total Liabilities **\$ 8,116,348**

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

***EXHIBIT 1
(Continued)***

**STATEMENT OF NET POSITION
DECEMBER 31, 2012**

Net Position

Net investment in capital assets	\$ 5,383,244
Restricted for	
Debt service	1,249,826
Capital replacement	98,286
Unrestricted	<u>133,694</u>
Total Net Position	<u><u>\$ 6,865,050</u></u>

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

EXHIBIT 2

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEAR ENDED DECEMBER 31, 2012**

Operating Revenues	
Charges for services	<u>\$ 829,427</u>
Operating Expenses	
Professional services	\$ 111,517
Insurance	10,796
Permits and licenses	100
Operations and maintenance	182,645
Supplies	4,328
Utilities	16,904
Western Lake Superior Sanitary District fees	43,397
Miscellaneous	4,599
Depreciation	<u>634,021</u>
Total Operating Expenses	<u>\$ 1,008,307</u>
Net Operating Income (Loss)	<u>\$ (178,880)</u>
Nonoperating Revenues (Expenses)	
Property taxes	\$ 942
Interest expense	(247,603)
Deferred bond issuance costs	(2,881)
Interest income	2,561
Interest on assessments	<u>23,979</u>
Total Nonoperating Revenues (Expenses)	<u>\$ (223,002)</u>
Change in Net Position	<u>\$ (401,882)</u>
Net Position - January 1	<u>7,266,932</u>
Net Position - December 31	<u><u>\$ 6,865,050</u></u>

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

EXHIBIT 3

**STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2012**

Cash Flows from Operating Activities	
Cash received from customers	\$ 786,963
Cash paid to suppliers	(360,256)
	<u>426,707</u>
Net cash provided by (used in) operating activities	\$ 426,707
Cash Flows from Noncapital Financing Activities	
Property tax levy	\$ 942
	<u>942</u>
Cash Flows from Capital and Related Financing Activities	
Special assessments	\$ 126,000
Principal paid on long-term debt	(383,000)
Interest paid on long-term debt	(81,925)
Interest income	2,561
Interest received on assessments	23,979
	<u>23,979</u>
Net cash provided by (used in) capital and related financing activities	\$ (312,385)
Net Increase (Decrease) in Cash and Cash Equivalents	\$ 115,264
Cash - January 1	436,184
	<u>436,184</u>
Cash - December 31	\$ 551,448
	<u>551,448</u>
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities	
Net operating income (loss)	\$ (178,880)
Adjustments to reconcile net operating income (loss) to net cash provided by (used in) operating activities	
Depreciation	634,021
Changes in assets and liabilities	
(Increase) decrease in receivables	(42,464)
Increase (decrease) in payables	14,030
	<u>14,030</u>
Net Cash Provided by (Used in) Operating Activities	\$ 426,707
	<u>426,707</u>

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

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2012**

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 (*Now see* Minn Stat. §§ 442A.01 to 442A.29 (2013)). 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.

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

1. Summary of Significant Accounting Policies

B. Basis of Presentation (Continued)

Operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the 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 position is reported in three parts: (1) net investment in capital assets, (2) restricted net position, and (3) unrestricted net position.

C. Basis of Accounting

The District's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Special assessments are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

D. Assets, Liabilities and Net Position

Cash

Cash consists of a checking account, a debt service account, a capital replacement account, and sweep savings accounts.

Taxes Receivable and Revenue

In Minnesota, counties act as collection agents for all property taxes. Tax settlements are received three times a year--in January, June, and October. Property taxes are recognized as revenue in the year of the levy.

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

1. Summary of Significant Accounting Policies

D. Assets, Liabilities and Net Position (Continued)

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 2008, 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.

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 position.

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

General obligation bonds payable includes the outstanding balance on the General Obligation Capital Appreciation Refunding Bonds issued in 2007 to refinance the District's overall debt load.

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

1. Summary of Significant Accounting Policies

D. Assets, Liabilities and Net Position (Continued)

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.

Net Position Classifications

Equity is classified as net position. Unrestricted net position is net position that does not meet the definition of “restricted” or “net investment in capital assets.”

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, 2012, is reported as follows:

Cash	\$ 26,787
Restricted assets	
Debt service account	426,375
Capital replacement account	<u>98,286</u>
Total Cash and Restricted Cash	<u>\$ 551,448</u>

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

2. Detailed Notes

A. Deposits (Continued)

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, 2012, District deposits totaled \$551,448, all of which were cash deposits insured as required by Minnesota statutes. The carrying value of these deposits was \$551,448. The District had an adequate amount of insurance and collateral pledged to cover its deposits.

B. Changes in Capital Assets

	Balance January 1, 2012	Increase	Decrease	Balance December 31, 2012
Capital assets not depreciated				
Land	\$ 221,650	\$ -	\$ -	\$ 221,650
Capital assets depreciated				
Wet weather storage tank	\$ 550,000	\$ -	\$ -	\$ 550,000
Force main	7,632,913	-	-	7,632,913
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	19,452	-	-	19,452
Total capital assets depreciated	\$ 17,441,444	\$ -	\$ -	\$ 17,441,444
Less: accumulated depreciation for				
Wet weather storage tank	\$ 128,333	\$ 18,334	\$ -	\$ 146,667
Force main	1,329,479	190,823	-	1,520,302
Gravity collection system	85,533	12,219	-	97,752
Main pump station	317,128	45,304	-	362,432
Individual treatment systems	2,542,444	363,451	-	2,905,895
Equipment	9,401	3,890	-	13,291
Total accumulated depreciation	\$ 4,412,318	\$ 634,021	\$ -	\$ 5,046,339
Total capital assets depreciated, net	\$ 13,029,126	\$ (634,021)	\$ -	\$ 12,395,105
Capital Assets, Net	\$ 13,250,776	\$ (634,021)	\$ -	\$ 12,616,755

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

2. Detailed Notes (Continued)

C. Long-Term Debt

The following is a summary of the District's long-term debt activity for the year ended December 31, 2012.

	Balance January 1, 2012	Additions	Reductions	Balance December 31, 2012	Amounts Due Within One Year
Public Facilities Authority					
General obligation notes	\$ 5,026,058	\$ -	\$ 383,000	\$ 4,643,058	\$ 389,000
General obligation bonds	2,590,453	-	-	2,590,453	-
Total Long-Term Debt	\$ 7,616,511	\$ -	\$ 383,000	\$ 7,233,511	\$ 389,000

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, at an interest rate of 5.10 to 5.22 percent.

A summary of the annual requirements needed to service the long-term debt at December 31, 2012, is as follows:

Year Ending December 31	Principal	Interest	Total
2013	\$ 389,000	\$ 75,682	\$ 464,682
2014	395,000	69,341	464,341
2015	402,000	62,903	464,903
2016	408,000	56,350	464,350
2017	415,000	49,700	464,700
2018 - 2022	2,177,000	144,847	2,321,847
2023 - 2027	1,400,066	1,464,442	2,864,508
2028 - 2032	931,488	2,068,512	3,000,000
2033 - 2037	715,957	2,294,043	3,010,000
Total	\$ 7,233,511	\$ 6,285,820	\$ 13,519,331

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

2. Detailed Notes

C. 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. 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.

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

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2012**

**I. 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

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: Due to the limited number of personnel, segregation of accounting duties necessary to ensure adequate internal accounting control is not possible.

Context: The size of the Duluth/North Shore Sanitary District and its structure limits the internal control that the Board of Managers can design and implement into the organization. Without proper segregation of duties, errors or irregularities may not be detected timely.

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.

Recommendation: Management should be aware that segregation of duties is not adequate from an internal control point of view. 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:

A small organization with limited staffing will continually face the challenge of maximizing internal controls. The District continues to expand its formal framework and systems to ensure adequate internal controls are in place and being followed. The District utilizes contractors, committees and the general Board at various levels of review, oversight and direct participation to meet this end. The Board remains focused on fiscal responsibility and to provide efficient, safe, high-quality service to District customers. The following briefly describes the framework for financial controls:

User Fee and Related Billings/Cash Receipts - In 2011, monthly invoicing and cash receipts were transitioned to RRM Financial Services, Inc., which functions under a two-year Engagement Agreement covering 2011-2012. The responsibility to regularly review accounts receivable lies with the Board of Directors. Bank reconciliation is assigned to the District Bookkeeper and the Board Treasurer reviews bank reconciliation reports for all accounts on a monthly basis.

Accounts Payable - Are received at the District P.O. Box held by the District Bookkeeper. The Superintendent reviews and approves all operation-related. The District Bookkeeper enters Payables into QuickBooks, compares 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 of key balances. 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 develop, evaluate 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. All financial documents are converted to electronic records following year-end. No records are destroyed that do not exist in electronic form. All electronic records can be readily accessed via the District Bookkeeper and converted to paper form if necessary.

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.

Financial Management Improvements - At the close of 2008 and into 2009, the District initiated a series of financial and operational projects to increase the integrity of the financial tracking records relating to District assessments and related financial transactions on a per-property basis. This involved working with St Louis County to confirm all amounts certified to property owners in the District. These balances are being recorded in the QuickBooks file by parcel owner allowing the District to better respond to user inquiries, more efficiently manage cash flow and budget with greater ease and accuracy. The District has also developed a system database with structure and maintenance records for all properties. This has been a major step towards improved management. Although these projects revealed a major adjustment to receivables from the original sewer improvement assessments, it represents the effort and dedication the Board has towards managing the system with financial integrity and control. Going forward rate planning and budgeting are more extensively supported by detailed financial records not otherwise available to the Board or consultants.

In short, the D/NSSD Board feels the steps taken to improve management systems and controls are adequate and greatly improved, despite constraints of budget and personnel.

II. OTHER FINDINGS AND RECOMMENDATIONS

MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM RESOLVED

Insufficient Collateral (11-1)

Governmental entities are required by Minn. Stat. § 118A.03 to obtain collateral to secure deposits to the extent that funds on deposit exceed available federal deposit insurance at the close of the financial institution's banking day. The market value of the collateral should be at least ten percent more than the uninsured and unbonded amount on deposit. In 2011, the District had deposits at the North Shore Bank of Commerce in excess of insurance for deposits and pledged collateral.

Resolution

In 2012, the District obtained the necessary pledged collateral to cover their deposits throughout the year.

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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

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

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

Independent Auditor's Report

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

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the Duluth/North Shore Sanitary District as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated December 2, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Duluth/North Shore Sanitary District's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions 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.

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. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit the attention of those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a deficiency in internal control over financial reporting, described in the accompanying Schedule of Findings and Recommendations as item 01-1, that we consider to be a significant deficiency.

Compliance and Other Matters

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

Minnesota Legal Compliance

The *Minnesota Legal Compliance Audit Guide for Political Subdivisions*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65, 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 audit considered all of the listed categories, except that we did not test for compliance with the provisions for contracting and bidding because there were no new contracts for 2012.

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

Other Matters

The Duluth/North Shore Sanitary District's response to the internal control finding identified in our audit has been included in the Schedule of Findings and Recommendations. The District's response was not subject to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of This Report

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

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

December 2, 2013