

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, 2008

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.

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

For the Year Ended December 31, 2008



**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, 2008

<u>Board of Managers</u>		<u>Term 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

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

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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, 2008, 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, 2008, 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 February 19, 2010, 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

February 19, 2010

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

BASIC FINANCIAL STATEMENTS

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

EXHIBIT A

**STATEMENT OF NET ASSETS
DECEMBER 31, 2008**

Assets

Current assets

Cash	\$	320,731
Taxes receivable - unapportioned		9,075
Accounts receivable		63,335
Assets restricted for debt service		
Cash		180,508
Assessments receivable		140,000
Assets restricted for capital replacement		
Cash		127,173

Total current assets **\$ 840,822**

Noncurrent assets

Unamortized bond issuance costs	\$	83,554
Assets restricted for debt service		
Assessments receivable		1,777,938

Total noncurrent assets **\$ 1,861,492**

Capital assets

Non-depreciable	\$	221,650
Depreciable, net of accumulated depreciation		14,912,202

Total capital assets **\$ 15,133,852**

Total Assets **\$ 17,836,166**

Liabilities

Current liabilities

Accounts payable	\$	49,396
Accrued interest		36,961
General obligation revenue notes - Public Facilities Authority		370,000
Deferred revenue - unavailable		9,075

Total current liabilities **\$ 465,432**

Noncurrent liabilities

Accrued interest	\$	192,600
General obligation bonds		2,590,453
General obligation revenue notes - Public Facilities Authority		5,853,000

Total noncurrent liabilities **\$ 8,636,053**

Total Liabilities **\$ 9,101,485**

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

***EXHIBIT A
(Continued)***

**STATEMENT OF NET ASSETS
DECEMBER 31, 2008**

Net Assets

Invested in capital assets, net of related debt	\$ 6,320,399
Restricted for	
Debt service	1,673,249
Capital replacement	127,173
Unrestricted	<u>613,860</u>
Total Net Assets	<u><u>\$ 8,734,681</u></u>

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

EXHIBIT B

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEAR ENDED DECEMBER 31, 2008**

Operating Revenues	
Charges for services	\$ 714,560
Operating Expenses	
Professional services	\$ 86,778
Insurance	8,238
Permits and licenses	100
Operations and maintenance	142,148
Supplies	18,632
Utilities	14,535
Western Lake Superior Sanitary District fees	39,753
Travel	1,408
Miscellaneous	2,366
Depreciation	630,281
Total Operating Expenses	\$ 944,239
Net Operating Income (Loss)	\$ (229,679)
Nonoperating Revenues (Expenses)	
Property taxes	\$ 18,898
Interest expense	(242,291)
Deferred bond issuance costs	(2,881)
Interest on assessments	14,469
Total Nonoperating Revenues (Expenses)	\$ (211,805)
Change in Net Assets	\$ (441,484)
Net Assets - January 1, as restated (Note 1.F.)	9,176,165
Net Assets - December 31	\$ 8,734,681

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

EXHIBIT C

**STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2008**

Cash Flows from Operating Activities	
Cash received from customers	\$ 708,360
Cash paid to suppliers	(303,829)
	\$ 404,531
Cash Flows from Noncapital Financing Activities	
Property tax levy	\$ 18,898
Cash Flows from Capital and Related Financing Activities	
Special assessments	\$ 130,151
Payments for capital assets	(10,475)
Principal paid on long-term debt	(364,000)
Interest paid on long-term debt	(107,368)
Interest received on assessments	14,469
	\$ (337,223)
Net Increase (Decrease) in Cash and Cash Equivalents	\$ 86,206
Cash - January 1	542,206
Cash - December 31	\$ 628,412
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities	
Net operating income (loss)	\$ (229,679)
Adjustments to reconcile net operating loss to net cash provided by (used in) operating activities	
Depreciation	630,281
Changes in assets and liabilities	
(Increase) decrease in receivables	(6,200)
Increase (decrease) in payables	10,129
	\$ 404,531

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

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2008**

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.

**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 assets are reported in three parts: (1) invested in capital assets, (2) restricted net assets, and (3) unrestricted net assets.

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. 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, a debt service 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.

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

1. Summary of Significant Accounting Policies

D. Assets and Liabilities (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 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.

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

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 and Liabilities (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.

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.

F. Prior Period Adjustment

In 2008, the District completed an analysis of its special assessments receivable relating to the original assessment for the repayment of debt. The original assessment is a 20-year assessment started in 2002 that includes a two percent interest per annum. Once this analysis was completed, the District realized that the determination of the prior years' special assessments receivable was incorrect. The special assessments receivable was reduced each year by both interest and principal received for special assessments when the receivable should have been reduced only by principal. This miscalculation caused the special assessments receivable and net assets to be understated due to the offsetting of prior years' interest earned on special assessments in the determination of the special assessments receivable.

	Net Assets	Noncurrent Assets
December 31, 2007, as previously reported	\$ 9,039,206	\$ 1,771,130
Adjustment for prior years' interest revenue on special assessments	136,959	136,959
January 1, 2008, as restated	\$ 9,176,165	\$ 1,908,089

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

2. Detailed Notes

A. Deposits

The District's total cash as of December 31, 2008, is reported as follows:

Cash	\$	320,731
Restricted assets		
Debt service account		180,508
Capital replacement account		127,173
Total Cash and Restricted Cash	\$	628,412

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, 2008, District deposits totaled \$628,412, all of which were cash deposits insured as required by Minnesota statutes. The carrying value of these deposits was \$628,412. During the year, the District had an adequate amount of insurance and collateral pledged to cover its deposits.

B. Changes in Capital Assets

	Balance January 1, 2008	Increase	Decrease	Balance December 31, 2008
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	10,475	-	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	4,125	-	-	4,125
Total capital assets depreciated	\$ 17,415,642	\$ 10,475	\$ -	\$ 17,426,117

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

2. Detailed Notes

B. Changes in Capital Assets (Continued)

	Balance January 1, 2008	Increase	Decrease	Balance December 31, 2008
Less: accumulated depreciation for				
Wet weather storage tank	\$ 54,999	\$ 18,333	\$ -	\$ 73,332
Force main	566,187	190,561	-	756,748
Gravity collection system	36,657	12,219	-	48,876
Main pump station	135,912	45,304	-	181,216
Individual treatment systems	1,088,640	363,451	-	1,452,091
Equipment	1,239	412	-	1,651
Total accumulated depreciation	\$ 1,883,634	\$ 630,280	\$ -	\$ 2,513,914
Total capital assets depreciated, net	\$ 15,532,008	\$ (619,805)	\$ -	\$ 14,912,203
Capital Assets, Net	\$ 15,753,658	\$ (619,805)	\$ -	\$ 15,133,853

C. Long-Term Debt

The following is a summary of the District's long-term debt activity for the year ended December 31, 2008.

	Balance January 1, 2008	Additions	Reductions	Balance December 31, 2008	Amounts Due Within One Year
Public Facilities Authority					
General Obligation Notes	\$ 6,587,000	\$ -	\$ 364,000	\$ 6,223,000	\$ 370,000
General Obligation Bonds	2,590,453	-	-	2,590,453	-
Total Long-Term Debt	\$ 9,177,453	\$ -	\$ 364,000	\$ 8,813,453	\$ 370,000

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.

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

2. Detailed Notes

C. Long-Term Debt (Continued)

A summary of the annual requirements needed to service the long-term debt at December 31, 2008, is as follows:

<u>Year Ending December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
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	394,000	76,724	470,724
2014 - 2018	2,070,000	285,103	2,355,103
2019 - 2023	2,243,000	110,873	2,353,873
2024 - 2028	1,149,264	1,850,736	3,000,000
2029 - 2033	883,566	2,116,434	3,000,000
2034 - 2037	557,623	1,852,377	2,410,000
Total	<u>\$ 8,813,453</u>	<u>\$ 6,661,410</u>	<u>\$ 15,474,863</u>

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

3. Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. The District has purchased commercial insurance to insure these risks. There are no employees of 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, 2008**

**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 prior period adjustment to convert the District's financial records to the financial statements as reported. This adjustment increased the special assessments receivable and beginning net assets by \$136,959 to account for interest received on special assessments in prior years offset against the receivable.

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 appropriate internal controls are in place and being followed. The District engages 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 2008, monthly invoicing and cash receipts were still processed by NTS, the company hired to function as District Superintendent. At year-end, all billing, cash receipt, and financial functions were transitioned to RRM Financial Services, Inc., which functions under a one-year Engagement Agreement. Throughout 2008, user billings and cash receipts were processed by NTS with summary accounts receivable transactions (monthly billings, daily deposits, etc.) 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 reviews bank reconciliation reports for all accounts on a monthly basis. In 2009, all financial functions were transitioned to RRM Financial Services, Inc.

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 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 the Board, Superintendent, and Bookkeeper. Full documentation is kept for all transactions.

Financial Transition - 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 is also building a system database with structure and maintenance records for all properties. This will be another step towards improved management. All projects are slated to be completed by mid-year 2009.

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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, 2008, and have issued our report thereon dated February 19, 2010. 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 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 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

February 19, 2010