

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2009

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.

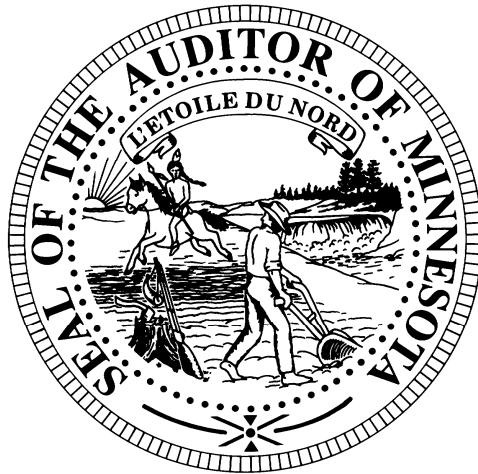
The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employees Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

For the Year Ended December 31, 2009



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

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

**ORGANIZATION
DECEMBER 31, 2009**

<u>Board of Managers</u>	<u>Term Ending</u>
Robert Mitchell, Chair	January 1, 2012
Mike Ojard, Vice Chair	January 1, 2010
Robert Entzion, Treasurer	January 1, 2012
Randy Ellestad, Member	January 1, 2010
Tom Bothwell, Member	January 1, 2011

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

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INDEPENDENT AUDITOR'S REPORT

Board of Managers
Knife River-Larsmont Sanitary District

We have audited the accompanying basic financial statements of the Knife River-Larsmont Sanitary District as of and for the year ended December 31, 2009, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Knife River-Larsmont Sanitary District as of December 31, 2009, 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 Knife River-Larsmont 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 10, 2011, on our consideration of the Knife River-Larsmont Sanitary District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

February 10, 2011

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

BASIC FINANCIAL STATEMENTS

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

EXHIBIT A

**STATEMENT OF NET ASSETS
DECEMBER 31, 2009**

Assets

Current assets

Cash	\$ 222,638
Petty cash	50
Accounts receivable	85,557
Inventories	13,075
Assets restricted for capital replacement Cash	<u>2,626</u>

Total current assets **\$ 323,946**

Capital assets

Depreciable - net of accumulated depreciation	<u>2,841,544</u>
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Total Assets **\$ 3,165,490**

Liabilities

Current liabilities

Accounts payable	\$ 22,333
Due to other governments	24,726
Public Facilities Authority (PFA) loans payable	<u>43,000</u>

Total current liabilities **\$ 90,059**

Noncurrent liabilities

PFA loans payable	<u>709,212</u>
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Total Liabilities **\$ 799,271**

Net Assets

Invested in capital assets - net of related debt	\$ 2,089,332
Restricted for Capital replacement	2,626
Unrestricted	<u>274,261</u>

Total Net Assets **\$ 2,366,219**

**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

EXHIBIT B

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2009**

Operating Revenues	
Charges for services	\$ 161,433
Licenses and permits	8,650
Miscellaneous	2,595
	<hr/>
Total Operating Revenues	\$ 172,678
Operating Expenses	
Contracted services	\$ 27,348
Professional services	12,513
Repair and maintenance	15,425
Supplies	418
Utilities	10,256
Insurance	6,278
Other services and charges	22,898
Refund of overpayments	21,534
Depreciation	118,916
	<hr/>
Total Operating Expenses	\$ 235,586
Operating Income (Loss)	\$ (62,908)
Nonoperating Revenues (Expenses)	
Property taxes	\$ 3,800
Gain on sale of capital asset	3,209
Interest income	3,320
Interest expense	(10,404)
	<hr/>
Total Nonoperating Revenues (Expenses)	\$ (75)
Change in Net Assets	\$ (62,983)
Net Assets - January 1	2,429,202
	<hr/>
Net Assets - December 31	\$ 2,366,219
	<hr/> <hr/>

**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

EXHIBIT C

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2009**

Cash Flows from Operating Activities	
Cash receipts from customers	\$ 155,532
Cash paid to suppliers	<u>(167,831)</u>
Net cash provided by (used in) operating activities	<u>\$ (12,299)</u>
Cash Flows from Noncapital Financing Activities	
Property taxes	<u>\$ 7,790</u>
Cash Flows from Capital and Related Financing Activities	
Proceeds from sale of capital assets	\$ 4,500
Principal paid on long-term debt	(42,000)
Interest paid on long-term debt	<u>(10,404)</u>
Net cash provided by (used in) capital and related financing activities	<u>\$ (47,904)</u>
Cash Flows from Investing Activities	
Interest income	<u>\$ 3,320</u>
Net Increase (Decrease) in Cash	\$ (49,093)
Cash - January 1	<u>274,407</u>
Cash - December 31	<u><u>\$ 225,314</u></u>
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used for) Operating Activities	
Adjustments to reconcile net operating income (loss) to net cash provided by (used for) operating activities	\$ (62,908)
Depreciation	118,916
Decrease (increase) in receivables	(17,146)
Increase (decrease) in payables	<u>(51,161)</u>
Net Cash Provided by (Used in) Operating Activities	<u><u>\$ (12,299)</u></u>

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2009**

1. Summary of Significant Accounting Policies

The accounting policies of the Knife River-Larsmont Sanitary District conform to generally accepted accounting principles.

A. Financial Reporting Entity

The Knife River-Larsmont Sanitary District was formed May 8, 2001, pursuant to Minn. Stat. §§ 115.18 to 115.37. The District was created for the purpose of promoting the public health and welfare by providing an adequate and efficient means of collecting, conveying, pumping, treating, and disposing of domestic sewage and industrial waste within the District. The District is governed by a five-member Board. Each member of the Board must be a voter residing in the District.

The Knife River-Larsmont Sanitary District is a primary government, as defined by Governmental Accounting Standards Board (GASB) Statement 14, and there are no component units for which the District is financially accountable.

B. Basis of Presentation

The accounts of the Knife River-Larsmont Sanitary District are presented as an enterprise fund. Enterprise funds are used to account for operations financed and operated in a manner similar to private business enterprises--where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

Operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the District. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as taxes, grants, and investment earnings, result from nonexchange transactions or incidental activities. The District's net assets are reported in two parts: (1) invested in capital assets, net of related debt; and (2) unrestricted net assets.

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

1. Summary of Significant Accounting Policies (Continued)

C. Basis of Accounting

The District uses the accrual basis of accounting. Revenues are recognized when earned, and expenses are recognized when incurred. Pursuant to GASB Statement 20, the District has elected to not apply accounting standards issued after November 30, 1989, by the Financial Accounting Standards Board.

D. Assets and Liabilities

Cash

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

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. The tax levy is recognized as revenue in the year of the levy. As of 2009, the District is no longer levying property taxes. Instead, the District started an annual debt service charge to be used for the payment of its outstanding debt.

Accounts Receivable

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

**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets and Liabilities (Continued)

Inventory

Inventory is valued at cost using the first in/first out method. Inventory is recorded as an expense when consumed.

Restricted Assets

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

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>
Sewer plant	15 years
Collection system	40 years
Equipment	5 years

E. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

2. Detailed Notes

A. Deposits

The District is authorized by Minn. Stat. § 118A.02 to deposit its cash and to invest in certificates of deposit in financial institutions designated by the District's Board. The District does not have a policy on custodial credit risk. At December 31, 2009, the District's deposits totaled \$242,054, all of which were cash deposits insured as required by Minnesota statutes. The carrying value of these deposits was \$225,264. The District had an adequate amount of insurance and collateral pledged to cover its deposits.

B. Capital Assets

A summary of the changes in capital assets for the year ended December 31, 2009, follows:

	Balance January 1, 2009	Additions	Deletions	Balance December 31, 2009
Capital assets depreciated				
Sewer plant	\$ 661,237	\$ -	\$ 661,237	\$ -
Collection system	4,705,002	-	-	4,705,002
Equipment	7,643	-	6,455	1,188
Total capital assets depreciated	<u>\$ 5,373,882</u>	<u>\$ -</u>	<u>\$ 667,692</u>	<u>\$ 4,706,190</u>
Less: accumulated depreciation for				
Sewer plant	\$ 661,237	\$ -	\$ 661,237	\$ -
Collection system	1,745,833	117,625	-	1,863,458
Equipment	5,061	1,291	5,164	1,188
Total accumulated depreciation	<u>\$ 2,412,131</u>	<u>\$ 118,916</u>	<u>\$ 666,401</u>	<u>\$ 1,864,646</u>
Total Capital Assets, Net	<u>\$ 2,961,751</u>	<u>\$ (118,916)</u>	<u>\$ 1,291</u>	<u>\$ 2,841,544</u>

On June 24, 2004, the Knife River-Larsmont Sanitary District Board voted to terminate operations at its treatment plant and to connect to the Duluth/North Shore Sanitary District sewer line. On March 3, 2006, the Knife River-Larsmont Sanitary District's sewer line was connected to the Duluth/North Shore Sanitary District, with the flowage going to the Western Lake Superior Sanitary District. As of March 2006, the District is no longer operating its sewer treatment plant and does not have the capability of reopening the plant in the future. In 2009, the sewer treatment plant was deleted from the District's capital assets.

**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

2. Detailed Notes (Continued)

C. Long-Term Obligations

The following is a summary of the District's long-term debt activity for the year ended December 31, 2009:

	Balance January 1, 2009	Additions	Reductions	Balance December 31, 2009	Due Within One Year
Public Facilities Authority general obligation notes	\$ 794,212	\$ -	\$ 42,000	\$ 752,212	\$ 43,000

Long-term debt is composed of the following:

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

Debt service requirements at December 31, 2009, are as follows:

Year Ending December 31	General Obligation Revenue Note	
	Principal	Interest
2010	\$ 43,000	\$ 9,854
2011	43,000	9,290
2012	44,000	8,728
2013	44,000	8,150
2014	45,000	7,575
2015 - 2019	233,000	28,913
2020 - 2024	248,000	13,258
2025	52,212	684
Total	\$ 752,212	\$ 86,452

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

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

3. Risk Management

The Knife River-Larsmont Sanitary District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. The District has purchased commercial insurance to insure these risks. There are no employees of the Knife River-Larsmont Sanitary District, as the District has hired independent contractors to operate the plant and perform its accounting functions. There were no significant reductions in insurance coverage from the previous year. There were no settlements in excess of insurance during the audit period.

4. Summary of Significant Contingencies and Other Items

Contingent Liability

Lake County has paid for certain engineering and other expenses on behalf of the Knife River-Larsmont Sanitary District for the period of 1997 to 2005, with the understanding that if funding becomes available to the District, these expenses would be reimbursed to Lake County. According to Lake County records, the amount owed from the Knife River-Larsmont Sanitary District to Lake County is \$462,372 at December 31, 2009. This is not reported as a liability on the Knife River-Larsmont Sanitary District's financial statements.

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**KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA**

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2009**

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

A. COMPLIANCE

ITEM ARISING THIS YEAR

09-1 Public Facilities Authority Capital Replacement Fund Requirement

As part of the Knife River-Larsmont Sanitary District's Public Facilities Loan Agreement, the District is required to deposit \$0.10 for every 1,000 gallons of flowage into a capital replacement account. The capital replacement account is restricted for capital repairs to the sewer system and is required to be accounted for in a separate account. The District must also receive approval from the Public Facilities Authority before the capital replacement funds may be used.

The District is not properly determining the required amount to be deposited into the repair and replacement account or properly accounting for its capital replacement funds in a separate account on the general ledger.

Client's Response:

We will calculate monthly flow X \$0.10 for 2006, 2007, 2008, 2009, and 2010 and be current by January 2011.

PREVIOUSLY REPORTED ITEM RESOLVED

Public Facilities Authority Compliance Requirement (08-1)

The District did not have an annual audit completed for the 2007 audit year. Instead, a two-year audit was completed for the 2007 and 2008 audit years, which violated the annual audit requirement of the Public Facilities Authority Loan agreement.

Resolution

The District completed an annual audit of the 2009 financial information and was in compliance with the annual audit requirement of its Public Facilities Authority Loan agreement.

B. INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

02-1 Internal Control/Segregation of Duties

The Knife River-Larsmont Sanitary District's 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 Knife River-Larsmont Sanitary District and its staffing limits the internal control that management can design and implement into the organization. The Board of Managers should be aware that 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.

The Board of Managers has requested that the external auditors prepare the annual financial statements and related notes. This arrangement is not unusual for an organization the size of the Knife River-Larsmont Sanitary District. This decision was based on the availability of the District's staff and the cost benefit of using the auditors' expertise.

During our audit, we proposed numerous adjustments to convert the District's financial records to the financial statements as reported. These adjustments, which were determined to be material to the financial statements, caused assets, liabilities, and net assets to decrease and revenues and expenses to increase.

We recommend the Board of Managers 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 Board of Managers continue to implement oversight procedures and monitor those procedures to determine if they are still effective internal controls.

Client's Response:

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

02-3

Delinquent Customer Receivables

The District's customer accounts receivable balance has been steadily increasing. The balance increased \$17,146 to \$85,557 at December 31, 2009. Of the receivable balance at December 31, 2009, \$77,501 is over 90 days old.

The District has the option to certify delinquent customer receivables to Lake County to be collected as part of the customer's property taxes, but this option has not been exercised during the past nine years, resulting in increasing balances.

We recommend the Board of Managers review the detailed listing of receivables, identify troubled accounts, and implement collection procedures as deemed necessary.

Client's Response:

The Board sent a letter to all delinquent accounts. The Board certified delinquent accounts (over one year delinquent) to be placed on the individual's taxes.

02-4

Capital Assets

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

The above condition results in a lack of documentation of District assets. Because of the absence of specific detailed capital records documenting original cost, it would be difficult to identify and remove a capital asset from the records if one is disposed of at some point in the future.

We recommend the District bookkeeper prepare or obtain detailed capital asset records and retain all pertinent documents and records in its files.

Client's Response:

We have not been able to find any record of capital assets. We do have records of current capital assets, such as grinder pumps, generators, etc.

06-1

Checking Account Reconciliations

The District's tax levy checking account is not being reconciled to the general ledger. As a result, the amount recorded at year-end in the checking account was overstated by \$16,790 in 2009. This overstatement was caused by deposits and checks not recorded in the general ledger and the lack of bank reconciliations.

By not reconciling the District's checking accounts on a regular basis, the District does not have an accurate cash balance at year-end.

We recommend that, for the tax levy checking account, the Board Treasurer reconcile the bank balance to the general ledger balance on a monthly basis. Any discrepancies between the bank balance and the general ledger balance should be resolved in a timely manner.

Client's Response:

The Larsmont tax levy checking account will be reconciled monthly, and the discrepancies between the bank balance and general ledger balance will be resolved.

08-2

Signature Requirement

Three checks totaling \$464.19 had only one Board member signature. Requiring multiple signatures on checks is an important internal control activity designed to manage and reduce risk. Board policy requires two Board member signatures.

Minnesota Statutes indicate that an additional, third signature is required on sanitary district checks. First, Minn. Stat. § 115.32, subd. 1 states, "[e]xcept as otherwise provided, the chair, vice-chair, secretary, and treasurer of the district shall have like powers and duties, respectively, as the mayor, acting mayor, clerk, and treasurer of a statutory city." Second, Minn. Stat. § 412.271, subd. 1, provides that city checks (called "orders") must be "drawn by the mayor and clerk upon the treasurer," meaning they must be signed by the mayor, clerk, and treasurer. Sanitary district checks, therefore, should be signed by the chair, the secretary, and the treasurer.

We recommend that the Board have all checks signed by multiple signatories, and that it amend its policy to comply with Minnesota law by requiring checks to be signed by the chair, the secretary, and the treasurer.

Client's Response:

The KRLSD Board will change its policy of check signings from the current 2 signatures on a check to the policy of Minnesota Statutes which requires the signature of chair, secretary, and treasurer on each check.

ITEM ARISING THIS YEAR

09-2 Repair and Replacement Account General Ledger Documentation

The District's general ledger did not include the transactions of the District's Repair and Replacement savings account. The account is used by the District to pay for repairs and maintenance to the District's sewer system. The auditor needed to analyze the Repair and Replacement savings account in order to add the account's transactions to the District's financial statements.

We recommend that the District maintain all of the necessary information in its general ledger.

Client's Response:

Information was available but not in the general ledger. This has been rectified.

II. OTHER FINDINGS AND RECOMMENDATIONS

A. MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM RESOLVED

Board Minutes (06-2)

The District was not properly recording the actions of the Board, such as the opening of new bank accounts and the hiring of a systems operator, in its Board minutes as required by Minn. Stat. § 13D.01, subd. 4.

Resolution

The District properly included all Board actions in the 2009 Board minutes.

B. MANAGEMENT PRACTICES

ITEM ARISING THIS YEAR

09-3 Manual General Ledger System

The District utilizes a manual accounting system that consists of a disbursements journal and receipts (receivables control log) journal that are posted monthly to the general ledger. The general ledger does not include all of the account information for the District, such as charges for services.

The manual ledger system should be maintained in pen. Any changes or errors should not be erased or whited out, instead, a line should be drawn through the change or error.

The District should have a general ledger that will document its complete financial activity, including all assets, liabilities, fund balances, revenues, and expenses. The accounting system should be kept current in order to provide for timely reporting.

We recommend that the District maintain accurate and complete financial records, preferably through the use of a computerized accounting system that assists in providing timely financial reporting.

Client's Response:

Installation of a QuickBook system is in progress.



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STATE AUDITOR

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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*

Board of Managers
Knife River-Larsmont Sanitary District

We have audited the basic financial statements of the Knife River-Larsmont Sanitary District as of and for the year ended December 31, 2009, and have issued our report thereon dated February 10, 2011. 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 Knife River-Larsmont 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 and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Recommendations, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Recommendations as items 02-1 and 06-1 to be material weaknesses.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings of Recommendations as items 02-3, 02-4, 08-2, and 09-2 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Knife River-Larsmont Sanitary District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards*, and which is described in the accompanying Schedule of Findings and Recommendations as item 09-1.

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, except that we did not test for compliance in contracting and bidding, because the Knife River-Larsmont Sanitary District did not enter into any applicable contracts.

The results of our tests indicate that, for the items tested, the District complied with the material terms and conditions of applicable legal provisions.

Also included in the Schedule of Findings and Recommendations is a management practices comment. We believe this recommendation to be of benefit to the District, and it is reported for that purpose.

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

This report is intended solely for the information and use of the District's Board of Managers, management, and others within the Knife River-Larsmont Sanitary District and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto

/s/Greg Hierlinger

REBECCA OTTO
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

February 10, 2011