

# STATE OF MINNESOTA

## Office of the State Auditor



**Rebecca Otto**  
**State Auditor**

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

FOR THE YEAR ENDED DECEMBER 31, 2011

## **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.

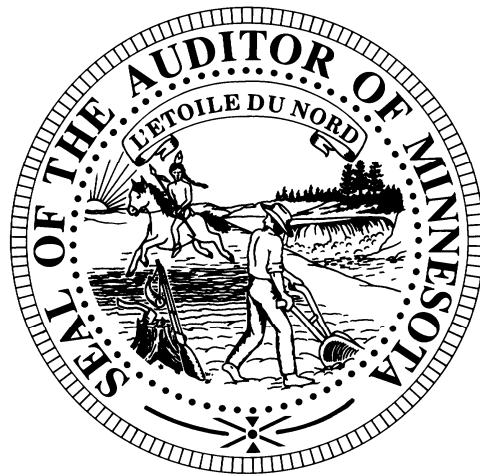
The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employees Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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This document can be made available in alternative formats upon request. Call 651-296-2551 [voice] or 1-800-627-3529 [relay service] for assistance; or visit the Office of the State Auditor's web site: [www.auditor.state.mn.us](http://www.auditor.state.mn.us).

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

**For the Year Ended December 31, 2011**



**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>
<b>Introductory Section</b>		
Organization		1
<b>Financial Section</b>		
Independent Auditor's Report		2
Basic Financial Statements		
Statement of Net Assets	1	4
Statement of Revenues, Expenses, and Changes in Net Assets	2	6
Statement of Cash Flows	3	7
Notes to the Financial Statements		8
<b>Management and Compliance Section</b>		
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>		19

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

**ORGANIZATION  
DECEMBER 31, 2011**

<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, 2012
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

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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, 2011, 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 Duluth/North Shore Sanitary District as of December 31, 2011, 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.

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 consider 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 4, 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* and should be considered in assessing the results of our audit.

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

April 4, 2013

## **BASIC FINANCIAL STATEMENTS**

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

*EXHIBIT 1*

**STATEMENT OF NET ASSETS  
DECEMBER 31, 2011**

**Assets**

**Current assets**

Cash	\$	81,417
Accounts receivable		109,939
Assets restricted for debt service		
Cash		279,672
Assessments receivable		135,000
Assets restricted for capital replacement		
Cash		75,095

**Total current assets** **\$ 681,123**

**Noncurrent assets**

Unamortized bond issuance costs	\$	74,911
Assets restricted for debt service		
Assessments receivable		1,579,762

**Total noncurrent assets** **\$ 1,654,673**

**Capital assets**

Non-depreciable	\$	221,650
Depreciable, net of accumulated depreciation		13,029,126

**Total capital assets** **\$ 13,250,776**

**Total Assets** **\$ 15,586,572**

**Liabilities**

**Current liabilities**

Accounts payable	\$	25,079
Accrued interest		29,852
General obligation revenue notes - Public Facilities Authority		383,000

**Total current liabilities** **\$ 437,931**

**Noncurrent liabilities**

Accrued interest	\$	648,198
General obligation bonds		2,590,453
General obligation revenue notes - Public Facilities Authority		4,643,058

**Total noncurrent liabilities** **\$ 7,881,709**

**Total Liabilities** **\$ 8,319,640**

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

***EXHIBIT 1  
(Continued)***

**STATEMENT OF NET ASSETS  
DECEMBER 31, 2011**

**Net Assets**

Invested in capital assets, net of related debt	\$ 5,634,264
Restricted for	
Debt service	1,365,125
Capital replacement	75,095
Unrestricted	<u>192,448</u>
<b>Total Net Assets</b>	<b><u><u>\$ 7,266,932</u></u></b>

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

**EXHIBIT 2**

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
YEAR ENDED DECEMBER 31, 2011**

<b>Operating Revenues</b>	
Charges for services	<u>\$ 812,109</u>
<b>Operating Expenses</b>	
Professional services	\$ 97,085
Insurance	10,002
Permits and licenses	100
Operations and maintenance	193,620
Supplies	5,264
Utilities	17,183
Western Lake Superior Sanitary District fees	31,340
Travel	362
Miscellaneous	7,307
Depreciation	<u>634,020</u>
<b>Total Operating Expenses</b>	<u>\$ 996,283</u>
<b>Net Operating Income (Loss)</b>	<u>\$ (184,174)</u>
<b>Nonoperating Revenues (Expenses)</b>	
Property taxes	\$ 1,111
Interest expense	(245,459)
Deferred bond issuance costs	(2,881)
Interest income	2,534
Special assessments	5,500
Interest on assessments	<u>26,160</u>
<b>Total Nonoperating Revenues (Expenses)</b>	<u>\$ (213,035)</u>
<b>Change in Net Assets</b>	<u>\$ (397,209)</u>
<b>Net Assets - January 1</b>	<u>7,664,141</u>
<b>Net Assets - December 31</b>	<u><u>\$ 7,266,932</u></u>

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

**EXHIBIT 3**

**STATEMENT OF CASH FLOWS  
YEAR ENDED DECEMBER 31, 2011**

<b>Cash Flows from Operating Activities</b>	
Cash received from customers	\$ 797,413
Cash paid to suppliers	(364,256)
	<u>                    </u>
<b>Net cash provided by (used in) operating activities</b>	<b>\$ 433,157</b>
 <b>Cash Flows from Noncapital Financing Activities</b>	
Property tax levy	\$ 1,111
	<u>                    </u>
 <b>Cash Flows from Capital and Related Financing Activities</b>	
Special assessments	\$ 120,731
Principal paid on long-term debt	(376,000)
Interest paid on long-term debt	(88,053)
Interest income	2,534
Interest received on assessments	26,160
	<u>                    </u>
<b>Net cash provided by (used in) capital and related financing activities</b>	<b>\$ (314,628)</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>\$ 119,640</b>
<b>Cash - January 1</b>	<b>316,544</b>
<b>Cash - December 31</b>	<b>\$ 436,184</b>
 <b>Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities</b>	
Net operating income (loss)	\$ (184,174)
Adjustments to reconcile net operating income (loss) to net cash provided by (used in) operating activities	
Depreciation	634,020
Changes in assets and liabilities	
(Increase) decrease in receivables	(14,696)
Increase (decrease) in payables	(1,993)
	<u>                    </u>
<b>Net Cash Provided by (Used in) Operating Activities</b>	<b>\$ 433,157</b>

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

**NOTES TO THE FINANCIAL STATEMENTS  
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2011**

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1. Summary of Significant Accounting Policies

The accounting policies of the Duluth/North Shore Sanitary District conform to generally accepted accounting principles.

A. Financial Reporting Entity

The Duluth/North Shore Sanitary District was formed pursuant to Minn. Stat. §§ 115.18 to 115.37. The District was created for the purpose of promoting the public health and welfare by providing an adequate and efficient means of collecting, conveying, pumping, treating, and disposing of domestic sewage within the District. The District will reduce or eliminate the use of on-site septic systems to abate pollution of surface water, ground water, and Lake Superior. The District is governed by a five-member Board consisting of two members appointed by the City of Duluth, two members appointed by the Town of Duluth, and one member appointed by Lakewood Township. Each member of the Board must be a voter residing in the District.

The District is a primary government, as defined by Governmental Accounting Standards Board (GASB) Statement 14, and the District has no component units for which it is financially accountable.

B. Basis of Presentation

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

Operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the District. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as taxes, grants, and investment earnings, result from nonexchange transactions or incidental activities. The District's net assets are reported in three parts: (1) invested in capital assets, (2) restricted net assets, and (3) unrestricted net assets.

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

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1. Summary of Significant Accounting Policies (Continued)

C. Basis of Accounting

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

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.

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

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1. Summary of Significant Accounting Policies

D. Assets and Liabilities (Continued)

Restricted Assets and Liabilities

Restricted assets consist of monies specified for payment of construction costs or debt service. These assets are offset by the related liabilities or restricted net assets.

Capital Assets

Capital assets are stated at cost. Depreciation is determined using the straight-line method for the estimated useful lives of the assets.

<u>Classification</u>	<u>Estimated Life</u>
Buildings and building improvements	10 - 40 years
Improvements other than buildings	10 - 20 years
Equipment and vehicles	5 - 20 years
Infrastructure	10 - 40 years

General Obligation Bonds Payable

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.

General Obligation Revenue Notes Payable - Minnesota Public Facilities Authority

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

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

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1. Summary of Significant Accounting Policies (Continued)

E. Use of Estimates

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

2. Detailed Notes

A. Deposits

The District's total cash as of December 31, 2011, is reported as follows:

Cash	\$ 81,417
Restricted assets	
Debt service account	279,672
Capital replacement account	<u>75,095</u>
Total Cash and Restricted Cash	<u>\$ 436,184</u>

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, 2011, District deposits totaled \$472,169, all of which were cash deposits insured as required by Minnesota statutes. The carrying value of these deposits was \$436,184. During the year, the District did not have an adequate amount of insurance and collateral pledged to cover its deposits.



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

2. Detailed Notes (Continued)

B. Changes in Capital Assets

	Balance January 1, 2011	Increase	Decrease	Balance December 31, 2011
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	\$ 110,000	\$ 18,333	\$ -	\$ 128,333
Force main	1,138,656	190,823	-	1,329,479
Gravity collection system	73,314	12,219	-	85,533
Main pump station	271,824	45,304	-	317,128
Individual treatment systems	2,178,993	363,451	-	2,542,444
Equipment	5,511	3,890	-	9,401
Total accumulated depreciation	\$ 3,778,298	\$ 634,020	\$ -	\$ 4,412,318
Total capital assets depreciated, net	\$ 13,663,146	\$ (634,020)	\$ -	\$ 13,029,126
Capital Assets, Net	\$ 13,884,796	\$ (634,020)	\$ -	\$ 13,250,776

C. Long-Term Debt

The following is a summary of the District's long-term debt activity for the year ended December 31, 2011.

	Balance January 1, 2011	Additions	Reductions	Balance December 31, 2011	Amounts Due Within One Year
Public Facilities Authority					
General obligation notes	\$ 5,402,058	\$ -	\$ 376,000	\$ 5,026,058	\$ 383,000
General obligation bonds	2,590,453	-	-	2,590,453	-
Total Long-Term Debt	\$ 7,992,511	\$ -	\$ 376,000	\$ 7,616,511	\$ 383,000

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

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2. Detailed Notes

C. Long-Term Debt (Continued)

Long-term debt comprises the following:

- \$7,952,500 General Obligation Revenue Note issued to the Minnesota Public Facilities Authority. Note payments are due semi-annually on February and August 20, 2005 through 2023, at an interest rate of 1.63 percent.
- \$2,590,453 General Obligation Capital Appreciation Refunding Bonds due in annual installments of \$128,932 to \$254,880 on August 1, 2024 to 2037, 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, 2011, is as follows:

<u>Year Ending December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 383,000	\$ 81,925	\$ 464,925
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 - 2021	2,142,000	179,761	2,321,761
2022 - 2026	1,632,632	1,096,661	2,729,293
2027 - 2031	981,852	2,018,148	3,000,000
2032 - 2036	754,095	2,250,905	3,005,000
2037	128,932	476,068	605,000
Total	<u>\$ 7,616,511</u>	<u>\$ 6,367,744</u>	<u>\$ 13,984,255</u>

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

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

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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, 2011**

**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:** The limited number of personnel results in a lack of segregation of accounting duties necessary to ensure adequate internal accounting control.

**Context:** It is not unusual for an organization the size of the Duluth/North Shore Sanitary District to be limited in the internal control that the Board of Managers can design and implement into the organization.

**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

#### ITEM ARISING THIS YEAR

##### 11-1 Insufficient Collateral

**Criteria:** 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.

**Condition:** On June 30, 2011, the District had deposits at the North Shore Bank of Commerce in excess of insurance for deposits and pledged collateral.

**Context:** On June 30, 2011, the District had unsecured deposits of \$29,283 of total deposits of \$506,795.

**Effect:** The District was not in compliance with Minn. Stat. § 118A.03 which requires funds on deposit in excess of available federal deposit insurance to be secured by a corporate surety bond or pledged collateral.

**Cause:** The District received a large deposit in June 2011 and did not review the collateral pledged to determine if it was adequate to cover the deposit received.

**Recommendation:** The District should monitor all District deposits to determine there is adequate collateral pledged to secure deposits in accordance with Minn. Stat. § 118A.03 and obtain the required collateral.

Client's Response:

*The District Bookkeeper will monitor the amounts on deposit in the District's bank accounts and notify the District Treasurer and the bank when deposits in excess of FDIC limits are anticipated so that the bank may meet the 110% collateral requirements with respect to the excess amounts. In conjunction with our review of the State Auditor's "Statement of Position Deposits of Public Funds (Depositories and Collateral)", the District will request that the bank provide the District with a copy of the minutes or the resolution adopted either by the loan committee or the board of directors of the bank approving the pledge of collateral to the District's funds.*



REBECCA OTTO  
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**

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, 2011, and have issued our report thereon dated April 4, 2013. 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

Management of the Duluth/North Shore Sanitary District is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our audit 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.

A deficiency in internal control over financial reporting 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 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.

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined above. However, we identified a deficiency in internal control over financial reporting, described in the Schedule of Findings and Recommendations as item number 01-1 that we consider to be a significant deficiency in internal control over financial reporting. 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.

### 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 Political Subdivisions*, 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 Political Subdivisions* 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, except as described in the Schedule of Findings and Recommendations as item 11-1.

The Duluth/North Shore Sanitary District's written responses to the internal control and legal compliance 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, 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*

REBECCA OTTO  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

April 4, 2013