STATE OF MINNESOTA

Office of the State Auditor

Rebecca Otto
State Auditor

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

FOR THE YEARS ENDED DECEMBER 31,
2007 AND 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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KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

For the Years Ended December 31, 2007 and 2008

Audit Practice Division
Office of the State Auditor
State of Minnesota

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KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

TABLE OF CONTENTS

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Introductory Section

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KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

ORGANIZATION
DECEMBER 31, 2008

Board of Managers	Term Ending
Robert Mitchell, Chair	January 1, 2009
Mike Ojard, Vice Chair	January 1, 2010
Robert Entzion, Treasurer	January 1, 2009
Randy Ellestad, Member	January 1, 2010
Tom Bothwell, Member	January 1, 2011

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Financial Section

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STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

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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 years ended December 31, 2007 and 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 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 and for the years ended December 31, 2007 and 2008, and the changes in its financial position and its cash flows for the years 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 October 26, 2009, 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	*/s/Greg Hierlinger*
REBECCA OTTO STATE AUDITOR	GREG HIERLINGER, CPA DEPUTY STATE AUDITOR

October 26, 2009

BASIC FINANCIAL STATEMENTS

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KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

EXHIBIT A

STATEMENT OF NET ASSETS
DECEMBER 31, 2007 AND 2008

	2007	2008
Assets		
Current assets		
Cash	$ 161,541	$ 174,748
Petty cash	50	50
Taxes receivable	7,856	6,501
Accounts receivable	58,930	68,411
Inventories	13,075	13,075
Assets restricted for capital replacement		
Cash	66,074	99,609
Total current assets	**$ 307,526**	**$ 362,394**
Capital assets		
Depreciable - net of accumulated depreciation	3,080,667	2,961,751
Total Assets	**$ 3,388,193**	**$ 3,324,145**
Liabilities		
Current liabilities		
Accounts payable	$ 69,764	$ 73,494
Due to other governments	24,726	24,726
Deferred revenue	813	2,511
Public Facilities Authority (PFA) loans payable	41,000	42,000
Total current liabilities	**$ 136,303**	**$ 142,731**
Noncurrent liabilities		
PFA loans payable	794,212	752,212
Total Liabilities	**$ 930,515**	**$ 894,943**
Net Assets		
Invested in capital assets - net of related debt	$ 2,245,455	$ 2,167,539
Unrestricted	212,223	261,663
Total Net Assets	**$ 2,457,678**	**$ 2,429,202**

The notes to the financial statements are an integral part of this statement.

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

EXHIBIT B

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2007 AND 2008

	2007	2008
Operating Revenues		
Charges for services	$ 119,503	$ 116,792
License and permits	1,500	8,700
Miscellaneous	19,587	10,086
Total Operating Revenues	**$ 140,590**	**$ 135,578**
Operating Expenses		
Contracted services	$ 29,749	$ 27,073
Professional services	27,351	5,143
Repair and maintenance	36,060	25,370
Supplies	348	347
Utilities	8,776	12,427
Insurance	6,242	6,228
Other services and charges	27,570	23,454
Refund of overpayments	62,357	70,743
Depreciation	118,916	118,916
Total Operating Expenses	**$ 317,369**	**$ 289,701**
Operating Income (Loss)	**$ (176,779)**	**$ (154,123)**
Nonoperating Revenues (Expenses)		
Property taxes	$ 120,360	$ 119,422
Intergovernmental	-	12,000
Interest income	2,971	5,166
Interest expense	(11,469)	(10,941)
Total Nonoperating Revenues (Expenses)	**$ 111,862**	**$ 125,647**
Change in Net Assets	$ **(64,917)**	$ **(28,476)**
Net Assets - January 1	**2,522,595**	**2,457,678**
Net Assets - December 31	**$ 2,457,678**	**$ 2,429,202**

The notes to the financial statements are an integral part of this statement.

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

EXHIBIT C

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2007 AND 2008

	2007	2008
Cash Flows from Operating Activities		
Cash receipts from customers	$ 128,170	$ 126,097
Cash paid to suppliers	(158,516)	(167,055)
Net cash provided by (used in) operating activities	**$ (30,346)**	**$ (40,958)**
Cash Flows from Noncapital Financing Activities		
Property taxes and aids	**$ 115,256**	**$ 122,475**
Cash Flows from Capital and Related Financing Activities		
Proceeds from GIS Mapping Grant	$ -	$ 12,000
Principal paid on long-term debt	(41,000)	(41,000)
Interest paid on long-term debt	(11,469)	(10,941)
Net cash provided by (used in) capital and related financing activities	**$ (52,469)**	**$ (39,941)**
Cash Flows from Investing Activities		
Interest income	**$ 2,971**	**$ 5,166**
Net Increase (Decrease) in Cash	**$ 35,412**	**$ 46,742**
Cash - January 1	**192,253**	**227,665**
Cash - December 31	**$ 227,665**	**$ 274,407**
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used for) Operating Activities	**$ (176,779)**	**$ (154,123)**
Adjustments to reconcile net operating income (loss) to net cash provided by (used for) operating activities		
Depreciation	118,916	118,916
Decrease (increase) in receivables	(12,420)	(9,481)
Decrease (increase) in inventories	(4,260)	-
Increase (decrease) in payables	44,197	3,730
Net Cash Provided by (Used in) Operating Activities	**$ (30,346)**	**$ (40,958)**

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NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2008

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.

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 cash and petty cash.

Taxes Receivable and Revenue

A property tax levy was established to finance operations. 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 December 2007 settlement was not received by the District until January 2008, and the December 2008 settlement was not received by the District until January 2009. The tax levy is recognized as revenue in the year of the levy.

Accounts Receivable

Accounts receivable consists of the December user charges and delinquent accounts. 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.

Inventory

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

1. Summary of Significant Accounting Policies

   D. Assets and Liabilities (Continued)

   Capital Assets

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

Classification	Estimated Life
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.

2. Detailed Notes

   A. Deposits

   Minn. Stat. § 118A.02 authorizes the District to deposit its cash and to invest in certificates of deposit in financial institutions designated by the District's Board. The District does not have a policy on custodial credit risk. At December 31, 2007 and 2008, the District's deposits totaled $232,613 and $275,252, respectively, all of which were cash deposits insured as required by Minnesota statutes. The carrying value of these deposits was $227,615 and $274,357. In 2008, the District had an adequate amount of insurance and collateral pledged to cover its deposits but, in 2007, the District did not have an adequate amount of insurance and collateral pledged to cover its deposits.

2. Detailed Notes (Continued)

B. Capital Assets

A summary of the changes in capital assets for the years ended December 31, 2007 and 2008, follows:

	Balance January 1, 2007	Additions	Transfer/ Reclassify	Balance December 31, 2007
Capital assets depreciated				
Sewer plant	$ 661,237	$ -	$ -	$ 661,237
Collection system	4,705,002	-	-	4,705,002
Equipment	7,643	-	-	7,643
Total capital assets depreciated	$ 5,373,882	$ -	$ -	$ 5,373,882
Less: accumulated depreciation for				
Sewer plant	$ 661,237	$ -	$ -	$ 661,237
Collection system	1,510,583	117,625	-	1,628,208
Equipment	2,479	1,291	-	3,770
Total accumulated depreciation	$ 2,174,299	$ 118,916	$ -	$ 2,293,215
Total Capital Assets, Net	$ 3,199,583	$ (118,916)	$ -	$ 3,080,667

	Balance January 1, 2008	Additions	Transfer/ Reclassify	Balance December 31, 2008
Capital assets depreciated				
Sewer plant	$ 661,237	$ -	$ -	$ 661,237
Collection system	4,705,002	-	-	4,705,002
Equipment	7,643	-	-	7,643
Total capital assets depreciated	$ 5,373,882	$ -	$ -	$ 5,373,882
Less: accumulated depreciation for				
Sewer plant	$ 661,237	$ -	$ -	$ 661,237
Collection system	1,628,208	117,625	-	1,745,833
Equipment	3,770	1,291	-	5,061
Total accumulated depreciation	$ 2,293,215	$ 118,916	$ -	$ 2,412,131
Total Capital Assets, Net	$ 3,080,667	$ (118,916)	$ -	$ 2,961,751

2. Detailed Notes

B. Capital Assets (Continued)

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.

C. Long-Term Obligations

The following is a summary of the District's long-term debt activity for the years ended December 31, 2007 and 2008:

	Balance January 1, 2007	Additions	Reductions	Balance December 31, 2007	Due Within One Year
Public Facilities Authority general obligation notes	$ 876,212	$ -	$ 41,000	$ 835,212	$ 41,000

	Balance January 1, 2008	Additions	Reductions	Balance December 31, 2008	Due Within One Year
Public Facilities Authority general obligation notes	$ 835,212	$ -	$ 41,000	$ 794,212	$ 42,000

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.

2. Detailed Notes

C. Long-Term Obligations (Continued)

Debt service requirements at December 31, 2007 and 2008, are as follows:

Year Ending December 31, 2007	General Obligation Revenue Note Principal	General Obligation Revenue Note Interest
2008	$ 41,000	$ 10,942
2009	42,000	10,404
2010	43,000	9,854
2011	43,000	9,290
2012	44,000	8,728
2013 - 2017	227,000	34,898
2018 - 2022	242,000	19,638
2023 - 2025	153,212	4,044
Total	$ 835,212	$ 107,798

Year Ending December 31, 2008	General Obligation Revenue Note Principal	General Obligation Revenue Note Interest
2009	$ 42,000	$ 10,404
2010	43,000	9,854
2011	43,000	9,290
2012	44,000	8,728
2013	44,000	8,150
2014 - 2018	230,000	31,926
2019 - 2023	245,000	16,468
2024 - 2025	103,212	2,036
Total	$ 794,212	$ 96,856

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

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, 2007 and 2008. This is not reported as a liability on the Knife River-Larsmont Sanitary District's financial statements.

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Management and
Compliance Section

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KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2008

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

A. COMPLIANCE

ITEM ARISING THIS YEAR

08-1 Public Facilities Authority Compliance Requirement

As part of the District's Public Facilities Authority Loans agreement, the District is required to have an annual audit performed. This audit is then due to the Public Facilities Authority within 30 days after the completion of the audit, but no later than one year after the end of the audit.

The District's 2007 audit was not completed within the necessary time frame as stated in the Public Facilities Authority Loan agreement.

Client's Response:

Information will be provided on time for 2009.

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, decreased assets and net assets, and increased liabilities, revenues and expenses in 2007. These adjustments decreased assets, liabilities, and net assets and increased revenues and expenses in 2008.

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 District is implementing QuickBooks into the accounting of all facets of financial reporting.

02-3 Delinquent Customer Receivables

The District's customer accounts receivable balance has been steadily increasing. The balance increased $12,420 to $58,930 at December 31, 2007, and $9,481 during 2008 to $68,411 at December 31, 2008. Of the receivable balance at December 31, 2007 and 2008, $52,952 and $61,764, respectively, 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 eight 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 District will be putting delinquent accounts on property taxes for 2009.

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:

There is not a record of capital assets.

06-1 Checking Account Reconciliations

The District's 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 $1,728 in 2007 and $1,930 in 2008. This overstatement was caused by an error and several unrecorded items in the District's general ledger.

In 2008, the District opened a new checking account. The District made expenditures out of this account but did not complete any reconciliation on this account.

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 both checking accounts 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 District Treasurer will work with the bookkeeper on this matter.

ITEM ARISING THIS YEAR

08-2 Dual Signature Requirement

Two checks totaling $1,571.38 had only one Board member signature when the checks should have had two Board member signatures. The two-signature requirement is a key internal control activity designed to manage and reduce risk.

We recommend that the Board have two Board members sign all checks before the checks are sent out for payment.

Client's Response:

The Board will make sure that all checks have two signatures on them.

II. OTHER FINDINGS AND RECOMMENDATIONS

MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM NOT RESOLVED

06-2 Board Minutes

Minn. Stat. § 13D.01, subd. 4, requires the District to record the votes of its governing body in a journal which must be kept accessible to the public. This journal must be kept as a permanent record under Minn. Stat. §§ 15.17; 138.17.

Legally, the minutes must record the vote of each member on each action taken by the Board (except for payments of judgments, claims, and amounts fixed by statute). We recommend that minutes also include: the subject matter of a motion; the persons making and seconding the motion; the character of resolutions or ordinances offered, including a brief description of their subject matter; and whether the motion was defeated or adopted.

The District Board cannot act without voting, and all votes must be recorded in the minutes. We found that, during 2007 and 2008, the District opened two new bank accounts that were not approved in the Board minutes. The District also hired a new individual to perform the operations and maintenance of the collection system which was not approved in a Board motion.

We recommend that the District prepare and maintain its Board minutes in accordance with Minnesota statutes.

Client's Response:

The Board will make sure all voting on actions be recorded.

PREVIOUSLY REPORTED ITEM RESOLVED

Collateral Pledged to Secure Deposits (05-1)

The District did not have any pledged collateral in the prior year including 2007 to cover its unsecured deposits as required by Minn. Stat. § 118A.03. In 2007, the District had unsecured deposits of $132,407.

Resolution

The FDIC deposit insurance increased from $100,000 to $250,000 in 2008. This increase in insurance coverage was enough to cover the District's deposits. The District did not need any collateral. This change in FDIC coverage is expected to last until December 31, 2009.

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OFFICE OF THE 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 years ended December 31, 2007 and 2008, and have issued our report thereon dated October 26, 2009. 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 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 certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 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 deficiencies described in the accompanying Schedule of Findings and Recommendations as items 02-1, 02-3, 02-4, 06-1, and 08-2 to be significant deficiencies 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, of the significant deficiencies described above, we consider item 02-1 to be a material weakness.

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 that is required to be reported under *Government Auditing Standards*, and which is described in the accompanying Schedule of Findings and Recommendations as item 08-1.

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, except as described in the Schedule of Findings and Recommendations as item 06-2.

The Knife River-Larsmont Sanitary District's written responses to the significant deficiencies, the material weakness, and the legal compliance finding 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

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

October 26, 2009