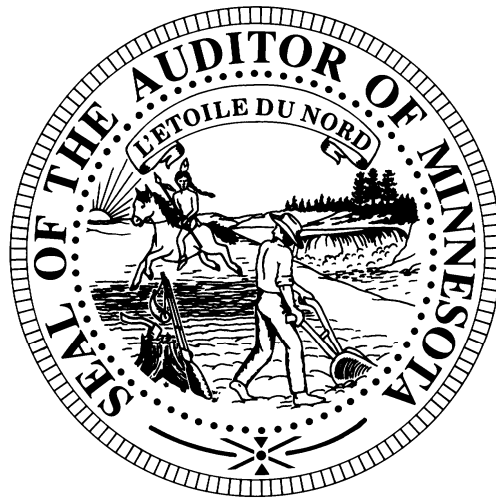


STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

KNIFE RIVER-LARSMONT SANITARY DISTRICT
KNIFE RIVER, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2010

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.

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

For the Year Ended December 31, 2010



**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, 2010**

<u>Board of Managers</u>	<u>Term Ending</u>
Robert Entzion, Chair	January 1, 2012
Mike Ojard, Vice Chair	January 1, 2013
Randy Ellestad, Treasurer	January 1, 2013
Tom Bothwell, Member	January 1, 2014
Robert Mitchell, Member	January 1, 2012

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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, 2010, 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, 2010, 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 May 24, 2012, 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

May 24, 2012

/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 1

**STATEMENT OF NET ASSETS
DECEMBER 31, 2010**

Assets

Current assets

Cash	\$ 220,482
Petty cash	50
Accounts receivable	41,335
Assets restricted for capital replacement	
Cash	<u>3,288</u>

Total current assets **\$ 265,155**

Capital assets

Depreciable - net of accumulated depreciation	<u>2,723,919</u>
---	------------------

Total Assets **\$ 2,989,074**

Liabilities

Current liabilities

Accounts payable	\$ 19,157
Due to other governments	24,726
Public Facilities Authority (PFA) loans payable	<u>43,000</u>

Total current liabilities **\$ 86,883**

Noncurrent liabilities

PFA loans payable	<u>666,212</u>
-------------------	----------------

Total Liabilities **\$ 753,095**

Net Assets

Invested in capital assets - net of related debt	\$ 2,014,707
Restricted for	
Capital replacement	3,288
Unrestricted	<u>217,984</u>

Total Net Assets **\$ 2,235,979**

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

EXHIBIT 2

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2010**

Operating Revenues	
Charges for services	\$ 98,295
Miscellaneous	7,532
	<hr/>
Total Operating Revenues	\$ 105,827
Operating Expenses	
Contracted services	\$ 26,946
Professional services	5,404
Repair and maintenance	37,220
Supplies	174
Utilities	10,401
Insurance	6,156
Other services and charges	23,667
Depreciation	117,625
	<hr/>
Total Operating Expenses	\$ 227,593
Operating Income (Loss)	\$ (121,766)
Nonoperating Revenues (Expenses)	
Interest income	\$ 1,380
Interest expense	(9,854)
	<hr/>
Total Nonoperating Revenues (Expenses)	\$ (8,474)
Change in Net Assets	\$ (130,240)
Net Assets - January 1	2,366,219
	<hr/>
Net Assets - December 31	\$ 2,235,979
	<hr/> <hr/>

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

EXHIBIT 3

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2010**

Cash Flows from Operating Activities	
Cash receipts from customers	\$ 150,049
Cash paid to suppliers	<u>(100,069)</u>
Net cash provided by (used in) operating activities	<u>\$ 49,980</u>
Cash Flows from Capital and Related Financing Activities	
Principal paid on long-term debt	\$ (43,000)
Interest paid on long-term debt	<u>(9,854)</u>
Net cash provided by (used in) capital and related financing activities	<u>\$ (52,854)</u>
Cash Flows from Investing Activities	
Interest income	<u>\$ 1,380</u>
Net Increase (Decrease) in Cash	\$ (1,494)
Cash - January 1	<u>225,314</u>
Cash - December 31	<u><u>\$ 223,820</u></u>
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used for) Operating Activities	
	\$ (121,766)
Adjustments to reconcile net operating income (loss) to net cash provided by (used for) operating activities	
Depreciation	117,625
Decrease (increase) in receivables	44,222
Decrease (increase) in inventories	13,075
Increase (decrease) in payables	<u>(3,176)</u>
Net Cash Provided by (Used in) Operating Activities	<u><u>\$ 49,980</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, 2010**

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 three parts: (1) invested in capital assets, net of related debt; (2) restricted for capital replacement; and (3) 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.

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. For the year ended December 31, 2010, the Board wrote off 22 accounts totaling \$46,405 which was netted against charges for services.

Inventory

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

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

1. Summary of Significant Accounting Policies

D. Assets and Liabilities (Continued)

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, 2010, the District's deposits totaled \$240,286, all of which were cash deposits insured as required by Minnesota statutes. The carrying value of these deposits was \$223,770. 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, 2010, follows:

	Balance January 1, 2010	Additions	Deletions	Balance December 31, 2010
Capital assets depreciated				
Collection system	\$ 4,705,002	\$ -	\$ -	\$ 4,705,002
Equipment	1,188	-	-	1,188
Total capital assets depreciated	\$ 4,706,190	\$ -	\$ -	\$ 4,706,190
Less: accumulated depreciation for				
Collection system	\$ 1,863,458	\$ 117,625	\$ -	\$ 1,981,083
Equipment	1,188	-	-	1,188
Total accumulated depreciation	\$ 1,864,646	\$ 117,625	\$ -	\$ 1,982,271
Total Capital Assets, Net	\$ 2,841,544	\$ (117,625)	\$ -	\$ 2,723,919

**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, 2010:

	Balance January 1, 2010	Additions	Reductions	Balance December 31, 2010	Due Within One Year
Public Facilities Authority general obligation notes	\$ 752,212	\$ -	\$ 43,000	\$ 709,212	\$ 43,000

Long-term debt is composed of the following:

\$882,212 General Obligation Revenue 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, 2010, are as follows:

Year Ending December 31	General Obligation Revenue Note	
	Principal	Interest
2011	\$ 43,000	\$ 9,290
2012	44,000	8,728
2013	44,000	8,150
2014	45,000	7,575
2015	45,000	6,985
2016 - 2020	236,000	25,860
2021 - 2025	252,212	10,009
Total	\$ 709,212	\$ 76,597

The 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 system 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, 2010. 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, 2010**

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

A. COMPLIANCE

PREVIOUSLY REPORTED ITEM NOT RESOLVED

09-1 Public Facilities Authority (PFA) Capital Replacement Fund Requirement

As part of the Knife River-Larsmont Sanitary District's PFA 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 certify the account balance to the PFA annually and receive PFA approval for the use of the capital replacement funds.

The District has not been properly determining the required amount to be deposited into the capital replacement account. Rather than an amount based on flowage as required, the District has been depositing \$682 per month into the capital replacement account resulting in it being overfunded. For 2010, the District certified the correctly calculated balance to the PFA. However, we recommend the District also adjust the general ledger and bank accounts to reflect the correctly calculated balance.

Client's Response:

The capital replacement account was put in a separate account, and monthly flow for this account was calculated correctly @ \$0.10 for every 1,000 gallons starting in January 2011.

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, net assets, and expenses to increase and revenues to decrease.

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

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 the files.

Client's Response:

In 2012, we have established detailed capital records which will be updated yearly.

06-1

Tax Levy Checking Account Reconciliations

The District's tax levy checking account bank balance is not reconciled to the general ledger. As a result, the general ledger balance at December 31, 2010, was overstated by \$16,516. The problem originated at a time when it was unclear who was responsible for this account.

Performing complete and timely bank reconciliations is a control designed to detect errors and irregularities in a timely manner. By not reconciling the District's checking account on a regular basis, the District does not have an accurate cash balance at year-end.

We recommend the Board Treasurer reconcile the tax levy checking account 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 tax levy checking account has been reconciled and the discrepancies between the bank balance and general ledger balance has been resolved starting in 2012.

ITEMS ARISING THIS YEAR

10-1 Public Facilities Authority General Ledger Account Activity

The District's general ledger did not include all the transactions of its PFA savings account. An analysis of the bank account activity showed the District did not post any normal deposits and wire transfers out to its general ledger resulting in the ledger balance being overstated by \$28,925 at December 31, 2010. The account is used by the District to deposit funds for the payment of the PFA general obligation notes.

Changing from a manual accounting system may have contributed to the incomplete records. Accounting records must be complete to ensure proper reporting.

We recommend the District record all financial transactions in its general ledger.

Client's Response:

Starting in 2011, all of our financial transactions are in QuickBooks and are put into the general ledger.

10-2 Documentation of Claims Review and Approval

The District requires the Board Treasurer to review all claims and sign the payment voucher signifying the Treasurer's review and approval. In 2010, 5 of 15 disbursements tested did not contain the Treasurer's signature to indicate his review and approval of claims for payment.

When the review and approval of claims is not done or not documented, that oversight control cannot be verified, and errors or irregularities may not be detected timely.

We recommend the Board monitor internal control procedures to ensure the proper oversight for claims is performed and documented.

Client's Response:

The Board has reviewed this procedure with the Board Treasurer and Secretary to make sure this process is followed.

PREVIOUSLY REPORTED ITEMS RESOLVED

Delinquent Customer Receivables (02-3)

The District's customer accounts receivables had been steadily increasing for several years. The balance increased from \$17,416 to \$85,557 at December 31, 2009. Of the receivable balance at December 31, 2009, \$77,501 was over 90 days old.

Resolution

In 2010, the District hired an independent contractor to aid the bookkeeper with entering the District's financial information into QuickBooks. As part of this transition from the manual accounting system to the electronic system, the District analyzed receivables and wrote off \$46,405 in delinquent receivables. The District also approved a policy for handling delinquent accounts receivable.

Signature Requirement (08-2)

In 2009, the District had three checks totaling \$464.19 that had only one Board member signature. Minnesota Statutes indicate that three signatures are required on sanitary district checks - the board chair, treasurer, and secretary.

Resolution

The District amended its policy to require three signatures on all checks.

**Repair and Replacement Account General Ledger Documentation
(09-2)**

The 2009 general ledger did not include the transactions of the District's Repair and Replacement savings account.

Resolution

The Repair and Replacement savings account was included as part of the District's QuickBooks general ledger in 2010.

II. OTHER FINDINGS AND RECOMMENDATIONS

A. MINNESOTA LEGAL COMPLIANCE

ITEM ARISING THIS YEAR

10-3 Board Approval of Claims

State law requires that claims be approved by the Board prior to payment. See Minn. Stat. §§ 115.25, 115.30, and 412.271. In 2010, there were four months (January, March, May, and November) that did not have a monthly Board meeting. We were informed that if there were not a monthly Board meeting, the bookkeeper would contact each Board member by phone, review the bills with them for approval, and pay them. This process was not documented, and the claims for these four months were paid without the Board approval required by statute.

Pursuant to Minn. Stat. § 115.30, the District has the powers of a statutory city. This means there are two options available to the District for paying bills prior to Board approval. First, the Board may delegate the authority to pay claims under Minn. Stat. § 412.271, subd. 8. When doing so, the Board must create internal control procedures commensurate with the delegation of authority. Second, the District can pay claims based upon contract, when such payments cannot be deferred without loss to the District, by obtaining the signatures of a majority of the Board pursuant to Minn. Stat. § 412.271, subd. 4. The claim must be formally acted upon at the next meeting.

We recommend that the District follow state law by only paying claims that have been approved by the Board, or pursuant to the delegation authorized in Minn. Stat. § 412.271, subd. 8, or the procedure set forth in Minn. Stat. § 412.271, subd. 4.

Client's Response:

Only claims by the Board will be paid monthly and will be recorded per Minn. Stat.

B. MANAGEMENT PRACTICES

PREVIOUSLY REPORTED ITEM RESOLVED

Manual General Ledger System (09-3)

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

Resolution

During 2010, the District converted the manual accounting system to a QuickBooks computerized accounting system.

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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*

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, 2010, and have issued our report thereon dated May 24, 2012. 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, 06-1, and 10-1 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 02-4 and 10-2 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 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, 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 10-3.

The Knife River-Larsmont Sanitary District's written responses to the compliance, 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 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

May 24, 2012