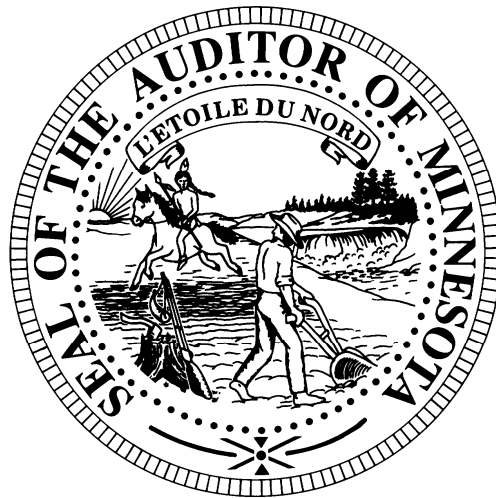


STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2006

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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**SHETEK AREA WATER AND SEWER
COMMISSION
SLAYTON, MINNESOTA**

For the Year Ended December 31, 2006



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

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**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

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**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

ORGANIZATION
2006

<u>Name</u>	<u>Position</u>	<u>Term Expires</u>
Commissioners		
Dean Salmon	President	December 2008
Jon Hoyme	Vice President	December 2006
Nancy Snedeker	Secretary	December 2007
Ted Haugen	Member	December 2009
Tom Gervais	Member	December 2009
Advisory Commissioners		
Warren Reed	Member	December 2007
Dave Marks	Member	December 2008
Tim Alcorn	Member	December 2006
Lars Johansson	Member	December 2009
Jon Harback	Member	December 2009

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REBECCA OTTO
STATE AUDITOR

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INDEPENDENT AUDITOR'S REPORT

Board Members
Shetek Area Water and Sewer Commission

We have audited the accompanying financial statements of the Shetek Area Water and Sewer Commission as of and for the year ended December 31, 2006, which comprise the Commission's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commission'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; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic 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 Shetek Area Water and Sewer Commission as of December 31, 2006, and the respective changes in its financial position and its cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In 2006, due to construction of a new sewer system, the Commission now reports on the accrual basis; formerly, it reported its fund transactions on the modified accrual basis and its government-wide statements on the accrual basis of accounting.

The Shetek Area Water and Sewer Commission 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 a part of, the basic financial statements.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 15, 2008, on our consideration of the Shetek Area Water and Sewer Commission'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

April 15, 2008

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

FINANCIAL STATEMENTS

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**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

EXHIBIT 1

**STATEMENT OF NET ASSETS
DECEMBER 31, 2006**

Assets

Current assets	
Cash and investments pooled with Murray County	\$ 255,878
Special assessments receivable - current	277,107
Special assessments receivable - noncurrent	8,823,897
Due from other governments	<u>2,001,875</u>
Total current assets, unrestricted	\$ 11,358,757
Restricted assets	
Cash and investments pooled with Murray County	<u>507,723</u>
Total current assets	\$ 11,866,480
Capital assets	
Nondepreciable	<u>9,252,615</u>
Total Assets	\$ 21,119,095

Liabilities

Current liabilities	
Accounts payable	\$ 57,551
Salaries payable	3,038
Contracts payable	<u>1,710,209</u>
Total current liabilities	\$ 1,770,798
Noncurrent liabilities	
Revenue notes payable	<u>10,079,483</u>
Total Liabilities	\$ 11,850,281

Net Assets

Restricted for debt service	\$ 507,723
Unrestricted	<u>8,761,091</u>
Total Net Assets	\$ 9,268,814

**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

EXHIBIT 2

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Operating Revenues	
Miscellaneous	\$ <u>560</u>
Operating Expenses	
Personal services	\$ 22,055
Professional services	141,088
Site or ground improvements	708,710
Other services and charges	8,831
Supplies	3,068
Advertising	2,665
Insurance	<u>1,313</u>
Total Operating Expenses	\$ <u>887,730</u>
Operating Income (Loss)	\$ <u>(887,170)</u>
Nonoperating Revenues (Expenses)	
Contribution from Murray County	\$ 69,056
Special assessments	<u>356,112</u>
Total Nonoperating Revenues (Expenses)	\$ <u>425,168</u>
Income (Loss) Before Contributions	\$ <u>(462,002)</u>
Capital contributions	<u>9,252,615</u>
Change in net assets	\$ <u>8,790,613</u>
Net Assets - January 1, as previously reported	\$ (3,430)
Prior period adjustment (Note 1.F.)	<u>481,631</u>
Net Assets - January 1, as restated	\$ <u>478,201</u>
Net Assets - December 31	\$ <u><u>9,268,814</u></u>

**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

EXHIBIT 3

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2006
Increase (Decrease) in Cash and Cash Equivalents**

Cash Flows from Operating Activities	
Cash received from vendor	\$ 560
Cash paid to suppliers	(830,575)
	<hr/>
Net cash provided by (used in) operating activities	\$ (830,015)
Cash Flows from Noncapital Financing Activities	
Intergovernmental	\$ 69,293
Repayment of negative cash balance implicitly financed	(233)
	<hr/>
Net cash provided by (used in) noncapital financing activities	\$ 69,060
Cash Flows from Capital and Related Financing Activities	
Proceeds from capital debt	\$ 8,077,608
Special assessments	507,723
Construction of capital assets	(7,060,775)
	<hr/>
Net cash provided by (used in) capital and related financing activities	\$ 1,524,556
Net Increase (Decrease) in Cash	\$ 763,601
Cash and Cash Equivalents - January 1	<hr/> -
Cash and Cash Equivalents - December 31	\$ 763,601 <hr/> <hr/>
Reconciliation of Cash and Cash Equivalents to the Statement of Net Assets - Exhibit 2	
Cash and investments pooled with Murray County	\$ 255,878
Restricted cash and investments pooled with Murray County	507,723
	<hr/>
Total Cash and Cash Equivalents	\$ 763,601 <hr/> <hr/>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities	
Operating income (loss)	\$ (887,170)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities	
Increase (decrease) in accounts payable	\$ 54,117
Increase (decrease) in salaries payable	3,038
	<hr/>
Total adjustments	\$ 57,155
Net Cash Provided by (Used in) Operating Activities	\$ (830,015) <hr/> <hr/>

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**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2006**

1. Summary of Significant Accounting Policies

The accounting policies of the Shetek Area Water and Sewer Commission conform to generally accepted accounting principles.

A. Financial Reporting Entity

The Shetek Area Water and Sewer Commission was formed May 8, 2001, pursuant to Minn. Stat. §§ 115.18 to 115.37. The Commission 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 Shetek area. The Commission is governed by a five-member Board. Each member of the Board must be a voter residing in the area.

The Shetek Area Water and Sewer Commission is a component unit of Murray County, as defined by Governmental Accounting Standards Board (GASB) Statement 14, and there are no component units for which the Commission is financially accountable.

B. Basis of Presentation

The accounts of the Shetek Area Water and Sewer Commission 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.

The Commission's statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues. Operating revenues result from exchange transactions associated with providing water and sewer services, the Commission's principal activity. Nonexchange revenues, including contributions from Murray County, are reported as nonoperating revenues.

**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

C. Basis of Accounting

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

D. Assets and Liabilities

Deposits and Investments

The Commission's cash balance is combined with Murray County as part of its pooled cash and investments account. Investments are reported at fair value, based on market prices.

Cash and Cash Equivalents

The Commission has defined cash and cash equivalents to include restricted and unrestricted cash held by Murray County as part of its pooled cash and investments account. The Murray County pooled investment account is treated as a cash equivalent because the Commission can deposit or effectively withdraw cash at any time without prior notice or penalty.

Due From Other Governments

The amount reported as due from other governments at December 31, 2006, is receivable from the Minnesota Public Facilities Authority and represents draw-downs requested on the revenue notes.

Restricted Assets

Certain funds of the Commission 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, applicable laws and regulations limit their use. When the Commission has both restricted and unrestricted assets available to finance a particular program, it is the Commission's policy to use restricted assets before unrestricted assets.

**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets and Liabilities (Continued)

Special Assessments Receivable and Revenue

Special assessments were levied to pay debt associated with the sewer system construction and are reported as capital contributions in an amount equal to the capital asset. In Minnesota, counties act as collection agents for special assessments levied with property taxes. Tax settlements, including special assessment collections, are received four times a year--in January, June, July, and December. The special assessments levy is recognized as capital contributions in the year of the levy.

Capital Assets

Capital assets are stated at cost. Depreciation will be determined using the straight-line method for the estimated useful lives of the assets. Since there were no depreciable capital assets at the end of 2006, no determination has been made for estimated useful lives.

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.

F. Prior Period Adjustment

Net assets of the Shetek Area Water and Sewer Commission at January 1, 2006, have been restated. Previously, the Commission did not capitalize engineering costs related to the sewer system being installed. These costs are part of the total construction costs capitalized as construction-in-progress, and will be depreciated when the project is completed. The restatement capitalizes engineering costs as construction-in-progress at December 31, 2005. The restatement is as follows:

Net assets, as previously reported	\$ (3,430)
Correction of error in recording construction-in-progress	<u>481,631</u>
Net assets, as restated	<u>\$ 478,201</u>

**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

G. Change in Accounting

In 2006, due to construction of a new sewer system, the Commission now reports on the accrual basis; formerly, it reported its fund transactions on the modified accrual basis and its government-wide financial statements on the accrual basis of accounting.

2. Detailed Notes

A. Deposits

Cash transactions are administered by the Murray County Auditor/Treasurer who is, according to Minn. Stat. §§ 118A.02 and 118A.04, authorized to deposit its cash and to invest in certificates of deposit in financial institutions designated by the Commission's Board. Minnesota statutes require that all County deposits be covered by insurance, surety bond, or collateral, a requirement which Murray County was in compliance with at December 31, 2006. As of December 31, 2006, the Commission had \$763,601 on deposit with Murray County.

B. Capital Assets

A summary of the changes in capital assets for the year ended December 31, 2006, follows:

	Balance January 1, 2006 (Restated)	Additions	Deletions	Balance December 31, 2006
Capital assets not depreciated				
Land	\$ -	\$ 326,000	\$ -	\$ 326,000
Construction in progress	481,631	8,444,984	-	8,926,615
Total Capital Assets, Net	<u>\$ 481,631</u>	<u>\$ 8,770,984</u>	<u>\$ -</u>	<u>\$ 9,252,615</u>

**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

2. Detailed Notes (Continued)

C. Construction Funding Sources

Cumulative construction and debt-related costs and funding sources as of December 31, 2006, follow:

Construction costs		
Engineering and design	\$	1,044,871
Construction		7,881,744
Total Construction Costs	\$	8,926,615
Funding sources		
Minnesota Public Facilities Water Pollution Control Revolving Fund loan	\$	6,873,004
Wastewater Infrastructure Fund loan		3,206,479
Total Funding Sources	\$	10,079,483

D. Long-Term Obligations

The following is a summary of the Commission's long-term debt activity for the year ended December 31, 2006:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Public Facilities Authority General Obligation Notes	\$ -	\$ 10,079,483	\$ -	\$ 10,079,483	\$ -

Long-term debt is composed of the following:

\$15,144,000 General Obligation Notes issued to the Minnesota Public Facilities Authority: \$11,554,549 from the Water Pollution Control Revolving Fund and \$3,589,451 from the Wastewater Infrastructure Fund. Amounts drawn or receivable on this note as of December 31, 2006, were \$10,079,483: \$6,873,004 from the Water Pollution Control Revolving Fund and \$3,206,479 from the Wastewater Infrastructure Fund. Note payments for the Water Pollution Control Revolving Fund are due semi-annually for interest and annually for principal on February 20 and August 20, 2008 through 2026, at an interest rate of 1.01 percent. The Wastewater Infrastructure Fund note payments do not begin until the Revolving Fund loans are repaid. The principal payments are due semi-annually beginning on February 20, 2027 through 2032, and are interest-free.

**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

2. Detailed Notes

D. Long-Term Obligations (Continued)

Debt service requirements at December 31, 2006, are as follows:

Year Ended December 31	Minnesota Public Facilities Authority Loans		
	Water Pollution Control Revolving Fund		Wastewater Infrastructure Fund
	Principal	Interest	Principal
2008	\$ 329,268	\$ 62,249	\$ -
2009	333,106	66,092	-
2010	336,675	62,727	-
2011	340,243	59,327	-
2012	343,812	55,891	-
2013 - 2017	1,769,622	226,704	-
2018 - 2022	1,861,821	135,500	-
2023 - 2027	1,558,457	39,549	300,151
2028 - 2032	-	-	2,906,328
Total	<u>\$ 6,873,004</u>	<u>\$ 708,039</u>	<u>\$ 3,206,479</u>

The general obligation revenue notes will be retired with income from operations, special assessments, and unused construction funding and are exempt from the limitations on net debt imposed by Minnesota Law.

E. Construction Commitment

As of December 31, 2006, the Commission had the following commitment with respect to the unfinished construction project.

Contractor	Project	Remaining Construction Commitment
Duininck Bros., Inc.	Wastewater Collection System	<u>\$ 4,818,338</u>

**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

3. Risk Management

The Shetek Area Water and Sewer Commission 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 Commission has purchased commercial insurance to insure these risks. There are no employees of the Shetek Area Water and Sewer Commission as the Commission 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

A. Contingent Liability

Murray County has paid for certain engineering and other expenses on behalf of the Shetek Area Water and Sewer Commission for the period of 1997 to 2006, with the understanding that if funding becomes available to the Commission, these expenses would be reimbursed to Murray County. According to Murray County records, the amount owed from the Shetek Area Water and Sewer Commission to Murray County at December 31, 2006, is \$112,143. This is not reported as a liability on the Shetek Area Water and Sewer Commission's financial statements.

B. Subsequent Events

On August 1, 2007, the County issued \$1,715,000 in General Obligation Water Revenue Bonds, Series 2007, for the Shetek Area Water and Sewer Commission to pay for activities not covered by the loans received through the Minnesota Public Facilities Authority.

On December 1, 2007, the County issued \$2,080,000 in General Obligation Sewer Revenue Bonds, Series 2007B, for the Shetek Area Water and Sewer Commission to pay for activities not covered by the loans received through the Minnesota Public Facilities Authority.

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**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

Schedule 1

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2006**

I. SUMMARY OF AUDITOR'S RESULTS

- A. Our report expresses an unqualified opinion on the financial statements of the Shetek Area Water and Sewer Commission.
- B. A significant deficiency in internal control was disclosed by the audit of financial statements of the Shetek Area Water and Sewer Commission and is reported in the "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*." The significant deficiency is a material weakness.
- C. No instances of noncompliance material to the financial statements of the Shetek Area Water and Sewer Commission were disclosed during the audit.
- D. No matters involving internal controls over compliance relating to the audit of the major federal award program is reported in the "Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133."
- E. The Auditor's Report on Compliance for the major federal award programs for the Shetek Area Water and Sewer Commission expresses an unqualified opinion.
- F. No findings were disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133.
- G. The major program is:
 - Capitalization Grant for Clean Water State
Revolving Funds
 - CFDA #66.458
- H. The threshold for distinguishing between Types A and B programs was \$300,000.
- I. The Shetek Area Water and Sewer Commission was determined not to be a low-risk auditee.

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

INTERNAL CONTROL

ITEM ARISING THIS YEAR

06-1 Internal Control/Segregation of Duties

Management 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 Shetek Area Water and Sewer Commission and its staffing limits the internal control that management can design and implement into the organization. Management should be aware that segregation of duties is not adequate from an internal control point of view.

Management is responsible for the accuracy and completeness of all financial records and related information. Also, management 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.

Management has requested that we prepare the annual financial statements and related notes. This arrangement is not unusual for organizations the size of the Shetek Area Water and Sewer Commission. These decisions were based on the availability of the fiscal agent's staff and the cost-benefit of using our expertise. During our audit, we proposed numerous adjustments to convert the Commission's financial records to the financial statements as reported.

We recommend the Commission be mindful that limited staffing causes inherent risks in safeguarding its assets and proper reporting of its financial activity. We recommend the Commission continue to implement oversight procedures and monitor those procedures to determine if they are still effective internal controls.

Client's Response:

Murray County (fiscal agent) is aware that because of the size of the accounting staff, it is impossible to achieve proper segregation of duties. The County continues to find ways to implement internal controls and oversight procedures.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

None.

IV. MINNESOTA LEGAL COMPLIANCE

None.

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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 Members
Shetek Area Water and Sewer Commission

We have audited the financial statements of the Shetek Area Water and Sewer Commission, a component unit of Murray County, as of and for the year ended December 31, 2006, and have issued our report thereon dated April 15, 2008. 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 Shetek Area Water and Sewer Commission'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 Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph of this section and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management 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 Commission'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 Commission's financial statements that is more than inconsequential will not be prevented or detected by the Commission's internal control. We consider the deficiency described as item 06-1 in the accompanying Schedule of Findings and Questioned Costs to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Shetek Area Water and Sewer Commission's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiency described above to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Shetek Area Water and Sewer Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Minnesota Legal Compliance

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* contains five categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, and claims and disbursements. Our study included all of the listed categories.

The results of our tests indicate that, for the items tested, the Shetek Area Water and Sewer Commission complied with the material terms and conditions of applicable legal provisions.

The Commission's written response to the material weakness identified in our audit has not been subjected to any auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board members, management, others within the Shetek Area Water and Sewer Commission, and federal awarding agencies and pass-through entities 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 15, 2008

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REBECCA OTTO
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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board Members
Shetek Area Water and Sewer Commission

Compliance

We have audited the compliance of the Shetek Area Water and Sewer Commission with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended December 31, 2006. The Shetek Area Water and Sewer Commission's major federal program is identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Commission's management. Our responsibility is to express an opinion on the Commission's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Shetek Area Water and Sewer Commission's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Commission's compliance with those requirements.

In our opinion, the Shetek Area Water and Sewer Commission complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2006.

Internal Control Over Compliance

The management of the Shetek Area Water and Sewer Commission is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Commission's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control over compliance.

A control deficiency in internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Commission's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the Commission's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the Shetek Area Water and Sewer Commission's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies of internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the Shetek Area Water and Sewer Commission as of and for the year ended December 31, 2006, and have issued our report thereon dated April 15, 2008. Our audit was performed for the purpose of forming an opinion on the financial statements of the Shetek Area Water and Sewer Commission. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by

OMB Circular A-133 and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of the Board members of the Commission, management, others within the Commission, and federal awarding agencies and pass-through entities 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 15, 2008

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**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

Schedule 2

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Federal Grantor Pass-Through Agency Grant Program Title	Federal CFDA Number	Pass-Through Grant Number	Expenditures
U.S. Environmental Protection Agency			
Passed Through Minnesota Department of Employment and Economic Development			
Capitalization Grant for Clean Water State Revolving Funds	66.458	MPFA-04-0009-R-FY07	<u>\$ 6,873,004</u>

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**SHETEK AREA WATER AND SEWER COMMISSION
SLAYTON, MINNESOTA**

**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2006**

1. Reporting Entity

The Schedule of Expenditures of Federal Awards presents the activities of federal award programs expended by the Shetek Area Water and Sewer Commission. The Commission's reporting entity is defined in Note 1 to the financial statements.

2. Basis of Presentation

The expenditures on the Schedule of Expenditures of Federal Awards are on the accrual basis of accounting used by the Commission. Under 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.

The information in the schedule is presented in accordance with the requirements of Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. CFDA No. 66.458 is a loan from the Minnesota Public Facilities Authority.

3. Passed Through to Subrecipients

During 2006, the Commission did not pass any federal money to subrecipients.