

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

ARROWHEAD REGIONAL CORRECTIONS
DULUTH, 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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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

For the Year Ended December 31, 2010



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

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**ORGANIZATION
DECEMBER 31, 2010**

			<u>Term Expires</u>
Elected			
Commissioners			
Chair	Janice Hall	Cook County	January 2012
Vice Chair	Wade Pavleck	Koochiching County	January 2011
Board Member	Richard Brenner	Carlton County	January 2012
Board Member	Brian McBride	Koochiching County	January 2011
Board Member	Rick Goutermont	Lake County	January 2011
Board Member	Keith Nelson	St. Louis County	January 2012
Board Member	Christopher Dahlberg	St. Louis County	January 2012
Board Member	Peg Sweeney	St. Louis County	January 2012
Appointed			
Executive Director	Tom Roy		Indefinite

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

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INDEPENDENT AUDITOR'S REPORT

Board of Commissioners
Arrowhead Regional Corrections

We have audited the accompanying financial statements of the governmental activities and the General Fund of Arrowhead Regional Corrections as of and for the year ended December 31, 2010, which collectively comprise Arrowhead Regional Corrections' basic financial statements as listed in the table of contents. These financial statements are the responsibility of Arrowhead Regional Corrections' management. Our responsibility is to express opinions 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 the *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 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 the 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the General Fund of Arrowhead Regional Corrections as of December 31, 2010, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Required Supplementary Information as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental

Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In accordance with auditing standards generally accepted in the United States of America, we have applied certain limited procedures to the required supplementary information, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Arrowhead Regional Corrections' basic financial statements taken as a whole. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. This information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 26, 2012, on our consideration of Arrowhead Regional Corrections' 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

March 26, 2012

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

MANAGEMENT'S DISCUSSION AND ANALYSIS

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2010
(Unaudited)**

Our Management's Discussion and Analysis (MD&A) of Arrowhead Regional Corrections' financial performance provides an overview of the financial activities for the fiscal year ended December 31, 2010. Please read it in conjunction with the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

Total net assets for Arrowhead Regional Corrections decreased \$1.3 million to \$7.0 million in 2010.

Total fund balance for the Arrowhead Regional Corrections' General Fund was \$6.1 million at the end of 2010, a decrease of \$.9 million over 2009.

Most of the fund balance, 84.5 percent, is unreserved and available for spending at the discretion of Arrowhead Regional Corrections. Over half of the unreserved fund balance has been designated for compensated absences. Designations are self-imposed limitations on otherwise expendable financial resources.

The Arrowhead Regional Corrections' General Fund reported expenditures in excess of revenues in 2010 due to planned use of fund balance.

OVERVIEW OF THE FINANCIAL STATEMENTS

This MD&A is intended to serve as an introduction to Arrowhead Regional Corrections' basic financial statements. The basic financial statements comprise three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report contains other supporting schedules in addition to the basic financial statements.

Government-wide financial statements: The Statement of Net Assets and the Statement of Activities report information about Arrowhead Regional Corrections as a whole and about its activities. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All current year revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report Arrowhead Regional Corrections' net assets and changes to them. Think of Arrowhead Regional Corrections' net assets--the difference between assets and liabilities--as one way to measure Arrowhead Regional Corrections' financial health or financial position. Over time, increases or decreases in Arrowhead Regional Corrections' net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other non-financial factors, such as the condition of buildings and structures, to assess the overall health of Arrowhead Regional Corrections. The government-wide financial statements can be found on pages 12 and 13.

Fund financial statements: These statements provide detailed information about the General Fund, not Arrowhead Regional Corrections as a whole. The Arrowhead Regional Corrections' General Fund is considered a governmental fund.

All of Arrowhead Regional Corrections' services are reported in the General Fund, which focuses on how money flows into and out of the fund and any balance left at year-end is available for spending. This fund is reported using the modified accrual method of accounting, which measures cash and all other financial assets that can be readily converted to cash. The General Fund statements provide a detailed short-term view of Arrowhead Regional Corrections' operations and the basic services it provides. General Fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance Arrowhead Regional Corrections' programs. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and the General Fund in a reconciliation following each of the fund financial statements. The basic financial statements for the General Fund can be found on pages 14 through 17.

Notes to the financial statements: The notes provide additional information essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found on pages 18 through 34.

Supporting schedules: The Budgetary Comparison Schedule, Schedule of Funding Progress - Other Postemployment Benefits, notes to required supplementary information, and Schedule of Intergovernmental Revenue are provided on pages 35 through 39.

Government-Wide Financial Analysis

Net assets may, over time, be a useful indicator of a government's financial position. In the case of Arrowhead Regional Corrections, assets exceeded liabilities by \$7.0 million.

By far, the largest portion of Arrowhead Regional Corrections' net assets is the investment in capital assets. Because Arrowhead Regional Corrections uses these capital assets to provide services to participants, they are not available for future spending.

Table 1
Net Assets
(in Millions)

	Governmental Activities	
	2010	2009
Current and other assets	\$ 7.0	\$ 8.1
Capital assets	5.8	5.8
Total Assets	\$ 12.8	\$ 13.9
Other liabilities	\$ 0.8	\$ 0.7
Long-term liabilities outstanding	5.0	4.9
Total Liabilities	\$ 5.8	\$ 5.6
Net Assets		
Invested in capital assets	\$ 5.8	\$ 5.8
Unrestricted	1.2	2.5
Total Net Assets	\$ 7.0	\$ 8.3

The following analysis focuses on Arrowhead Regional Corrections' net assets (Table 1).

Governmental Activities

The total net assets of Arrowhead Regional Corrections decreased \$1.3 million in 2010 after increases of \$0.4 million in 2009 and \$0.5 million in 2008. Arrowhead Regional Corrections continues to report positive balances in net assets because total assets exceed total liabilities.

Current and other assets decreased by \$1.1 million because cash and pooled investments decreased by more than \$1.2 million. This large decrease in cash and pooled investments was due to \$1.2 million of fund balance being used by the Arrowhead Regional Corrections' Board to balance its 2010 budget.

Total liabilities increased slightly. Other liabilities, which consist almost entirely of accounts payable and salaries payable, increased \$0.1 million, while long-term liabilities outstanding are 100 percent compensated absences and also increased by \$0.1 million.

A detailed analysis of capital assets is presented in Table 3, under the heading Capital Assets and Debt Administration.

Table 2
Changes in Net Assets
(in Millions)

	Governmental Activities	
	2010	2009
Revenues		
Program revenues		
Charges for services	\$ 1.2	\$ 1.2
Operating grants and contributions	2.8	2.6
General revenues		
Community Corrections Act subsidy	3.9	4.0
Grants and contributions not restricted to specific programs	12.0	13.0
Miscellaneous	0.2	0.6
Total Revenues	<u>\$ 20.1</u>	<u>\$ 21.4</u>
Expenses		
Program expenses		
Administration	\$ 1.7	\$ 1.7
Court and field services	9.9	9.5
Northeast Regional Corrections Center (NERCC)	5.7	5.7
Arrowhead Juvenile Center (AJC)	4.1	4.1
Total Expenses	<u>\$ 21.4</u>	<u>\$ 21.0</u>
Increase (Decrease) in Net Assets	\$ (1.3)	\$ 0.4
Net Assets, January 1	<u>8.3</u>	<u>7.9</u>
Net Assets, December 31	<u>\$ 7.0</u>	<u>\$ 8.3</u>

The following analysis focuses on Arrowhead Regional Corrections' changes in net assets (Table 2).

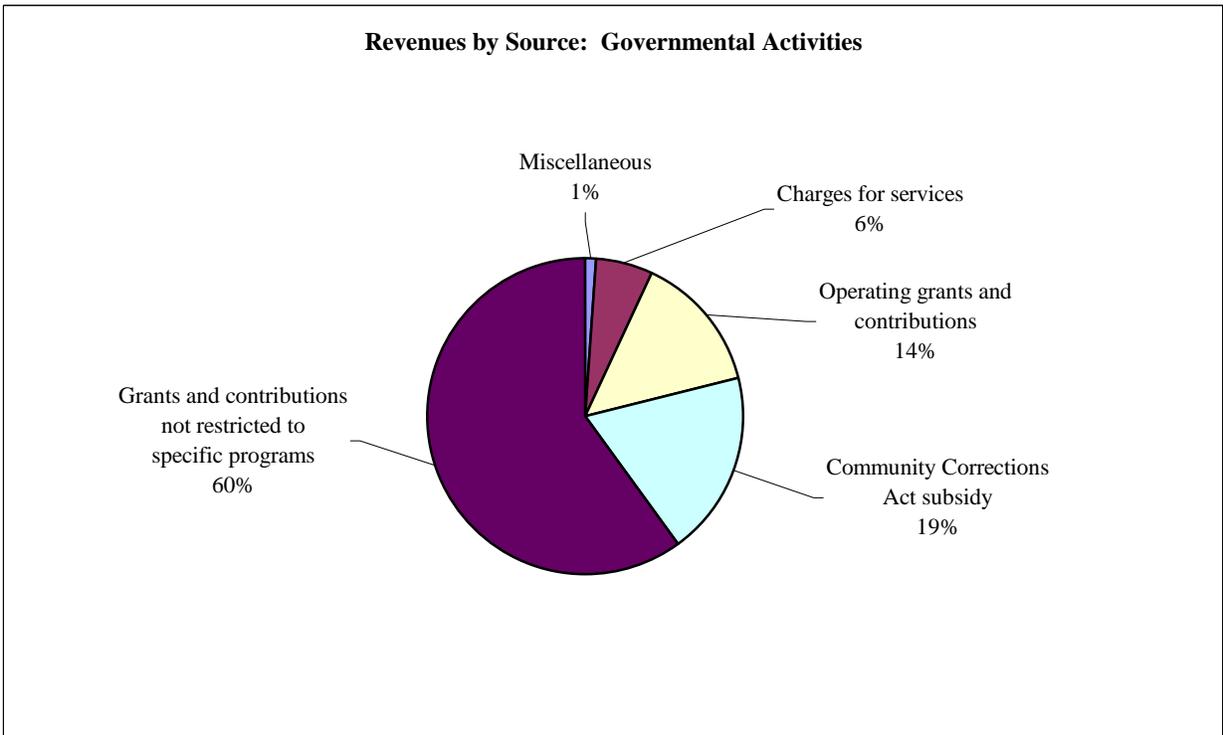
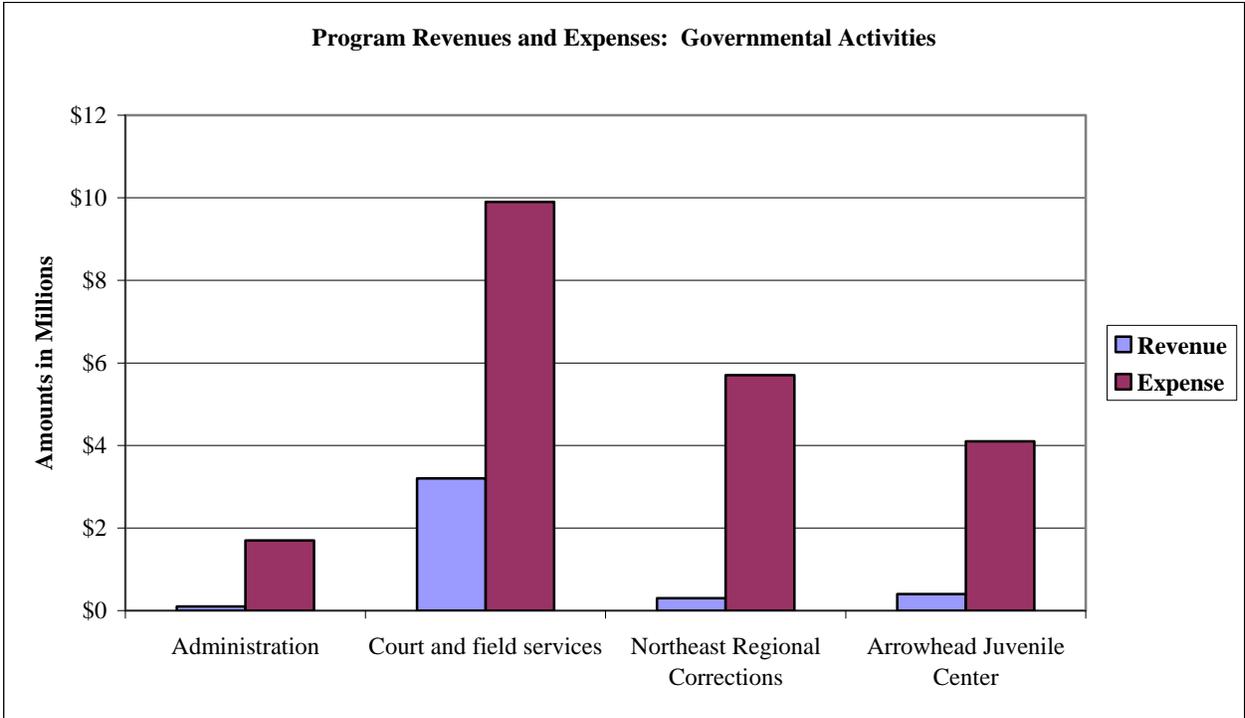
Governmental Activities

Revenues collected in 2010 by Arrowhead Regional Corrections totaled \$20.1 million or \$1.3 million less than 2009.

In 2010, revenues from operating grants and contributions increased \$0.2 million, charges for service were the same as 2009, while general revenues decreased \$1.5 million over 2009.

Member county contributions (general revenues) were \$11.9 million in 2010, \$12.9 million for 2009, \$12.8 million in 2008, and \$12.7 million in 2007.

Total expenses for 2010 were \$0.4 million more than 2009. While Court and Field Services expense increased by \$0.4 million, the other three programs remained the same in 2010 as 2009.



Financial Analysis of the General Fund

As noted earlier, Arrowhead Regional Corrections uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

General Fund. The focus of Arrowhead Regional Corrections' General Fund is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing Arrowhead Regional Corrections' financing requirements. In particular, unreserved fund balance may serve as a useful measure of Arrowhead Regional Corrections' net resources available for spending at the end of the fiscal year.

As of December 31, 2010, Arrowhead Regional Corrections' General Fund reported a fund balance of \$6.1 million, compared with \$7.0 million in 2009 and \$6.3 million in 2008. Unreserved fund balance, which is available for spending at Arrowhead Regional Corrections' discretion, was \$5.2 million at the end of the year. Over 69.0 percent of the unreserved fund balance, or \$3.6 million, has been designated for compensated absences. Designations reflect Arrowhead Regional Corrections' self-imposed limitations on otherwise available expendable resources. The remaining \$0.9 million of fund balance is reserved. Fund balance is reserved because it is either unavailable for spending or legally restricted. Encumbrances have been reserved for \$0.8 million at year-end for spending on capital improvement projects in 2011.

Expenditures for personal services accounted for more than 75.0 percent of the Arrowhead Regional Corrections' total expenditures in 2010 and 2009. Intergovernmental revenues (monies received from member counties, state grants, and federal grants) accounted for over 92.8 percent of Arrowhead Regional Corrections' total revenues for the year. For 2010, actual expenditures exceeded actual revenues by \$0.8 million.

General Fund Budgetary Highlights

Budgets can be amended during the year by Arrowhead Regional Corrections' Board. Budget revisions are reviewed by administration and submitted to the Board for approval.

The five member counties total contribution was reduced by \$1.0 million as a result of \$1.2 million in fund balance being used to fund the 2010 budget.

During the year, appropriations increased the original revenue budget by less than \$0.1 million. The original expenditure budget was increased by more than \$1.1 million to cover proposed capital improvements.

Total expenditures for Arrowhead Regional Corrections for 2010 were \$1.7 million under budget. The majority of the unspent budget monies were for capital improvements and contractual services.

Total revenues for 2010 were \$0.3 million less than the final budget.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At year-end, Arrowhead Regional Corrections showed total capital assets of \$5.8 million. These amounts represent a broad range of capital assets, including land, buildings, machinery, vehicles, furniture, and equipment. Detail is presented immediately below in Table 3.

Table 3
Capital Assets at Year-End
(Net of Depreciation, in Millions)

	Governmental Activities	
	2010	2009
Land	\$ 0.5	\$ 0.5
Buildings	5.0	5.1
Machinery, vehicles, furniture, and equipment	0.3	0.2
Totals	<u>\$ 5.8</u>	<u>\$ 5.8</u>

Total capital assets did not change in 2010 because new purchases of \$0.2 million were offset by \$0.2 million of depreciation expense. Purchases during the year included six vehicles and a septic system at NERCC.

Additional information on Arrowhead Regional Corrections' capital assets can be found in the notes to the financial statements.

Debt Administration

At year-end, Arrowhead Regional Corrections did not have any bonded debt.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

St. Louis County had an average unemployment rate of 7.6 percent for 2010, a decrease of 0.5 percent compared to 2009.

Arrowhead Regional Corrections has authorized capital improvements in 2010 at both AJC and NERCC with completion in 2011. Projects include roof replacement at both facilities and duct work at AJC. The capital improvements will be paid by using unreserved fund balances.

Other factors impacting the 2011 budget will be salary negotiations and increasing health insurance premiums. Health insurance premiums have increased every year since 2003.

The Arrowhead Regional Corrections' 2011 budget was passed at a Board meeting in late 2010.

CONTACTING THE ARROWHEAD REGIONAL CORRECTIONS' FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of finances and to show Arrowhead Regional Corrections' accountability for the money it receives. If you have a question about this report or need information, contact the Arrowhead Regional Corrections Office at: 211 West Second Street, Suite 450, Duluth, Minnesota 55802-1293.

BASIC FINANCIAL STATEMENTS

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 1

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

Assets

Cash and pooled investments	\$ 3,037,794
Petty cash and change funds	8,695
Investments	2,716,012
Accounts receivable	43,850
Due from other governments	1,059,131
Inventories	118,631
Capital assets	
Non-depreciable	504,808
Depreciable - net of accumulated depreciation	<u>5,334,664</u>
Total Assets	<u>\$ 12,823,585</u>

Liabilities

Accounts payable	\$ 254,254
Salaries payable	504,815
Due to other governments	15,040
Long-term liabilities	
Due within one year	1,201,236
Due in more than one year	<u>3,783,378</u>
Total Liabilities	<u>\$ 5,758,723</u>

Net Assets

Invested in capital assets	\$ 5,839,472
Unrestricted	<u>1,225,390</u>
Total Net Assets	<u><u>\$ 7,064,862</u></u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 2

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<u>Expenses</u>	<u>Program Revenues</u>		<u>Net (Expense) Revenue and Change in Net Assets</u>
<u>Functions/Programs</u>		<u>Fees, Charges, Fines, and Other</u>	<u>Operating Grants and Contributions</u>	
Governmental activities				
Administration	\$ 1,735,582	\$ -	\$ 75,000	\$ (1,660,582)
Court and field services	9,859,548	792,057	2,432,129	(6,635,362)
Northeast Regional Corrections Center	5,686,947	217,397	103,496	(5,366,054)
Arrowhead Juvenile Center	4,106,523	227,203	134,148	(3,745,172)
Total Governmental Activities	<u>\$ 21,388,600</u>	<u>\$ 1,236,657</u>	<u>\$ 2,744,773</u>	<u>\$ (17,407,170)</u>
General Revenues				
Community Corrections Act subsidy				\$ 3,911,889
Grants and contributions not restricted to specific programs				11,974,230
Unrestricted investment earnings				14,859
Miscellaneous				206,930
Total general revenues				<u>\$ 16,107,908</u>
Change in net assets				\$ (1,299,262)
Net Assets - Beginning				<u>8,364,124</u>
Net Assets - Ending				<u>\$ 7,064,862</u>

FUND FINANCIAL STATEMENTS

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GOVERNMENTAL FUND

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 3

**BALANCE SHEET
GENERAL FUND
DECEMBER 31, 2010**

Assets

Cash and pooled investments	\$	3,037,794
Petty cash and change funds		8,695
Investments		2,716,012
Accounts receivable		43,850
Due from other governments		1,059,131
Inventories		118,631
		118,631
Total Assets	\$	<u><u>6,984,113</u></u>

Liabilities and Fund Balance

Liabilities

Accounts payable	\$	254,254
Salaries payable		504,815
Due to other governments		15,040
Deferred revenue - unavailable		89,698
		89,698
Total Liabilities	\$	<u><u>863,807</u></u>

Fund Balance

Reserved for		
Inventories	\$	118,631
Drug court		9,058
Health and welfare		14,922
Encumbrances		805,097
Unreserved		
Designated for future expenditures		1,550,000
Designated for compensated absences		3,575,667
Designated for petty cash funds		8,695
Undesignated		38,236
		38,236
Total Fund Balance	\$	<u><u>6,120,306</u></u>
Total Liabilities and Fund Balance	\$	<u><u>6,984,113</u></u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 4

**RECONCILIATION OF GENERAL FUND BALANCE SHEET
TO THE GOVERNMENT-WIDE STATEMENT OF NET ASSETS - GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2010**

Fund balance - General Fund (Exhibit 3)		\$ 6,120,306
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets, net of accumulated depreciation, used in governmental activities are not financial resources and, therefore, are not reported in the fund.		5,839,472
Other long-term assets are not available to pay for current period expenditures and, therefore, are deferred in the fund.		89,698
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the fund.		
Net other postemployment benefits liability	\$ (207,711)	
Compensated absences	<u>(4,776,903)</u>	<u>(4,984,614)</u>
Net Assets of Governmental Activities (Exhibit 1)		<u><u>\$ 7,064,862</u></u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 5

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

Revenues	
Intergovernmental	\$ 19,025,533
Charges for services	1,236,657
Investment earnings	14,859
Miscellaneous	<u>210,210</u>
Total Revenues	<u>\$ 20,487,259</u>
Expenditures	
Current	
Administration	\$ 1,730,166
Court and field services	9,798,070
Northeast Regional Corrections Center	5,522,123
Arrowhead Juvenile Center	4,010,406
Capital outlay	<u>247,083</u>
Total Expenditures	<u>\$ 21,307,848</u>
Net Change in Fund Balance	\$ (820,589)
Fund Balance - January 1	6,956,155
Increase (decrease) in reserved for inventories	<u>(15,260)</u>
Fund Balance - December 31	<u><u>\$ 6,120,306</u></u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 6

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE OF THE GENERAL FUND TO THE
GOVERNMENT-WIDE STATEMENT OF ACTIVITIES - GOVERNMENTAL ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2010**

Net change in fund balance - General Fund (Exhibit 5) \$ (820,589)

Amounts reported for governmental activities in the statement of activities are different because:

In the fund, under the modified accrual basis, receivables not available for expenditure are deferred. In the statement of activities, those revenues are recognized when earned. The adjustment to revenue between the fund statement and the statement of activities is the increase or decrease in revenue deferred as unavailable.

Deferred revenue - December 31	\$ 89,698	
Deferred revenue - January 1	(487,619)	(397,921)

Governmental funds report capital outlay as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. Also, in the statement of activities, only the gain or loss on the disposal of assets is reported; whereas, in the governmental fund, the proceeds from the sale increase financial resources. Therefore, the change in net assets differs from the change in fund balance by the net book value of the assets sold.

Expenditures for general capital assets	\$ 247,083	
Net book value of assets disposed of	(1,959)	
Current year depreciation	(245,584)	(460)

Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in the governmental fund.

Change in compensated absences	\$ 73,530	
Change in other postemployment benefits	(138,562)	
Change in inventories	(15,260)	(80,292)

Change in Net Assets of Governmental Activities (Exhibit 2) \$ (1,299,262)

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2010**

1. Summary of Significant Accounting Policies

Arrowhead Regional Corrections' financial statements are prepared in accordance with generally accepted accounting principles (GAAP) for the year ended December 31, 2010. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (statements and interpretations). Governments are also required to follow the pronouncements of the Financial Accounting Standards Board issued through November 30, 1989, (when applicable) that do not conflict with or contradict GASB pronouncements. The more significant accounting policies established in GAAP and used by Arrowhead Regional Corrections are discussed below.

A. Financial Reporting Entity

Arrowhead Regional Corrections was established pursuant to the Community Corrections Act, Minn. Stat. §§ 401.01-.16, and a joint powers agreement, effective January 1, 1993, between Carlton, Cook, Koochiching, Lake, and St. Louis Counties, pursuant to Minn. Stat. § 471.59. As required by accounting principles generally accepted in the United States of America, these financial statements present Arrowhead Regional Corrections (primary government). Arrowhead Regional Corrections is governed by an eight-member Board. One member is appointed from the Board of Commissioners of each participating county, except for St. Louis County, which has three members from its Board of County Commissioners. In addition, the right to have an additional member is annually rotated among Carlton, Cook, Koochiching, and Lake Counties. Except for the rotating Board member position, all Board members serve two-year terms. The Board is organized with a chair and vice chair elected at the annual meeting in January of each year.

B. Basic Financial Statements

1. Government-Wide Statements

The government-wide financial statements (the statement of net assets and the statement of activities) display information about the primary government. These statements include the financial activities of Arrowhead Regional Corrections. Eliminations have been made to minimize the double counting of internal activities.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basic Financial Statements

1. Government-Wide Statements (Continued)

The government-wide statement of net assets is reported on a full accrual, economic resource basis, which recognizes long-term assets and receivables as well as long-term debt and obligations. Arrowhead Regional Corrections' net assets are reported in two parts: (1) invested in capital assets and (2) unrestricted net assets. Arrowhead Regional Corrections first utilizes restricted resources to finance qualifying activities.

The statement of activities demonstrates the degree to which the direct expenses of each function of Arrowhead Regional Corrections' governmental activities are offset by program revenues. Direct expenses are those clearly identifiable with a specific function or activity. Program revenues include: (1) fees and charges paid by the recipients of goods, services, or privileges provided by a given function or activity; and (2) grants and contributions restricted to meeting the operational or capital requirements of a particular function or activity. Revenues not classified as program revenues are presented as general revenues.

2. Fund Financial Statements

The fund financial statements provide information about Arrowhead Regional Corrections' General Fund. The General Fund is Arrowhead Regional Corrections' primary operating fund. It accounts for all financial resources of the general government.

C. Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

C. Measurement Focus and Basis of Accounting (Continued)

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Arrowhead Regional Corrections considers all revenues as available if collected within 60 days after the end of the current period. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on long-term debt, compensated absences, and claims and judgments, which are recognized as expenditures to the extent that they have matured. Proceeds of long-term debt and acquisitions under capital leases are reported as other financing sources.

When both restricted and unrestricted resources are available for use, it is Arrowhead Regional Corrections' policy to use restricted resources first and then unrestricted resources as needed.

D. Assets, Liabilities, and Net Assets or Equity

1. Cash and Pooled Investments

Arrowhead Regional Corrections' available cash balances are pooled and invested by St. Louis County in accordance with Minnesota statutes. The County's cash balances and investments are at fair value based on quoted market prices. Additional disclosures defining cash and pooled investments can be found in the St. Louis County Comprehensive Annual Financial Report.

2. Inventories

All inventories are valued at cost using the first in/first out method. Inventories in governmental funds are recorded as expenditures when purchased rather than when consumed. Inventories at the government-wide level are reported as expenses when consumed.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity (Continued)

3. Capital Assets

Capital assets, which include property, plant, and equipment, are reported in the governmental activities column in the government-wide financial statements. Capital assets are defined by Arrowhead Regional Corrections as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed.

Donated capital assets are recorded at estimated fair value at the date of donation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized.

Arrowhead Regional Corrections revised its capital assets policy in 2010, which resulted in some changes to the estimated useful lives of some of its assets. These changes were found to not have any material effect on the financial statements. Property, plant, and equipment of Arrowhead Regional Corrections are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings	30
Building improvements	15
Furniture, equipment, and vehicles	3 - 12

4. Compensated Absences

The liability for compensated absences reported in the financial statements consists of unpaid, accumulated annual vacation and sick leave balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who are currently eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. Compensated absences are accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in the governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity (Continued)

5. Deferred Revenue

The General Fund and the government-wide financial statements defer revenue for resources that have been received, but not yet earned. Governmental funds also report deferred revenue in connection with receivables for revenues not considered to be available to liquidate liabilities of the current period.

6. Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the governmental activities statement of net assets.

7. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts not available for appropriation or legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans subject to change.

8. Use of Estimates

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

Arrowhead Regional Corrections is authorized by Minn. Stat. §§ 118A.02 and 118A.04 to deposit its cash and to invest in certificates of deposit in financial institutions designated by the St. Louis County Board of Commissioners and the Arrowhead Regional Corrections Board. The County invests the funds of Arrowhead Regional Corrections. By agreement, Arrowhead Regional Corrections retains the interest earned on investments purchased with funds designated for compensated absences. The County retains the interest from the remainder of the funds. Minnesota statutes require that all County deposits be covered by insurance, surety bond, or collateral.

Arrowhead Regional Corrections invests in the types of securities authorized by Minn. Stat. §§ 118A.04 and 118A.05.

Additional disclosures, as required by GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*; GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*; and GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, are disclosed on an entity-wide basis in the St. Louis County Comprehensive Annual Financial Report.

The following is a summary of Arrowhead Regional Corrections' cash:

	December 31, 2010
	<hr/>
Cash and pooled investments	\$ 3,037,794
Petty cash and change funds	8,695
Investments	<hr/> 2,716,012
	<hr/>
Total	\$ 5,762,501
	<hr/>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets (Continued)

2. Receivables

Receivables as of December 31, 2010, for Arrowhead Regional Corrections' governmental activities are as follows:

Due from other governments	\$	1,059,131
Accounts		43,850
Total Receivables	\$	1,102,981

3. Capital Assets

Capital asset activity for the year ended December 31, 2010, was as follows:

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	\$ 476,534	\$ -	\$ -	\$ 476,534
Construction in progress	-	28,274	-	28,274
Total capital assets not depreciated	\$ 476,534	\$ 28,274	\$ -	\$ 504,808
Capital assets depreciated				
Buildings	\$ 7,797,609	\$ 102,072	\$ 11,580	\$ 7,888,101
Machinery, furniture, and equipment	1,141,183	116,737	31,000	1,226,920
Total capital assets depreciated	\$ 8,938,792	\$ 218,809	\$ 42,580	\$ 9,115,021
Less: accumulated depreciation for				
Buildings	\$ 2,654,300	\$ 187,469	\$ 9,621	\$ 2,832,148
Machinery, furniture, and equipment	921,094	58,115	31,000	948,209
Total accumulated depreciation	\$ 3,575,394	\$ 245,584	\$ 40,621	\$ 3,780,357
Total capital assets depreciated, net	\$ 5,363,398	\$ (26,775)	\$ 1,959	\$ 5,334,664
Total Capital Assets, Net	\$ 5,839,932	\$ 1,499	\$ 1,959	\$ 5,839,472

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

3. Capital Assets (Continued)

Depreciation expense was charged to functions/programs of Arrowhead Regional Corrections as follows:

Administration	\$ 610
Court and field services	30,167
Northeast Regional Corrections Center	125,529
Arrowhead Juvenile Center	<u>89,278</u>
Total Depreciation Expense	<u>\$ 245,584</u>

B. Liabilities

1. Payables

Payables at December 31, 2010, were as follows:

Accounts	\$ 254,254
Salaries	504,815
Due to other governments	<u>15,040</u>
Total Payables	<u>\$ 774,109</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

B. Liabilities (Continued)

2. Leases

Operating Leases

Arrowhead Regional Corrections leases office space and office equipment under noncancelable operating leases. Total costs for such leases were \$517,647 for the year ended December 31, 2010. The future minimum lease payments for these leases are as follows:

<u>Year Ending December 31</u>	<u>Amount</u>
2011	\$ 517,647
2012	517,647
2013	517,647
2014	517,647
2015	517,647
Total	<u>\$ 2,588,235</u>

3. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2010, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Compensated absences	\$ 4,850,433	\$ 1,085,822	\$ 1,159,352	\$ 4,776,903	\$ 1,201,236
Net other postemployment benefits (Note 5)	69,149	230,626	92,064	207,711	-
Total Long-Term Liabilities	<u>\$ 4,919,582</u>	<u>\$ 1,316,448</u>	<u>\$ 1,251,416</u>	<u>\$ 4,984,614</u>	<u>\$ 1,201,236</u>

4. Deferred Compensation

Arrowhead Regional Corrections' employees participate in St. Louis County's deferred compensation plan.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

B. Liabilities (Continued)

5. Other Employee Benefits

Under Arrowhead Regional Corrections' personnel policies and union contracts, its employees are granted vacation and sick leave in varying amounts based upon length of service. Vacation leave accrual varies from 2.0 to 9.0 hours per biweekly pay period. Sick leave accrual is from 2.0 to 5.5 hours per biweekly pay period.

Unused accumulated vacation is paid to employees at termination. All vacation pay is accrued when earned in the government-wide financial statements.

Vested sick leave is paid to employees at retirement or is used for the payment of employees' health insurance coverage during their retirement. The vested sick leave and unvested sick leave likely to become vested (vesting sick leave) are estimated using the vesting method prescribed by GASB Statement 16. Both vested and vesting amounts are recognized in the government-wide statements as liabilities, but not in the governmental fund.

Unvested sick leave of \$1,368,970 (total accumulated sick leave less estimated amounts of vested and vesting sick leave) at December 31, 2010, is available to employees in the event of illness-related absences and is not reported in the financial statements.

6. Risk Management

Arrowhead Regional Corrections is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; injuries to employees; or natural disasters. Risk management is handled through a combination of purchased commercial insurance and participation in the St. Louis County self-insurance program. Arrowhead Regional Corrections did not have a loss exceeding the limits of insurance coverage for any of the past three years. There were no significant reductions in insurance from the prior year.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

B. Liabilities

6. Risk Management (Continued)

St. Louis County handles its self-insurance through three internal service funds. Additional disclosures as required by GASB Statement No. 10, *Accounting and Reporting for Risk Financing and Related Insurance Issues*, are disclosed on an entity-wide basis in the St. Louis County Comprehensive Annual Financial Report.

3. Employee Retirement Systems and Pension Plans

A. Plan Description

All full-time and certain part-time employees of Arrowhead Regional Corrections are covered by defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the General Employees Retirement Fund and the Public Employees Correctional Fund, which are cost-sharing, multiple-employer retirement plans. These plans are established and administered in accordance with Minn. Stat. chs. 353 and 356.

General Employees Retirement Fund members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security, and Basic Plan members are not. All new members must participate in the Coordinated Plan, and benefits vest after three years of credited service (five years for those first eligible for membership after June 30, 2010).

Members who are employed in a county correctional institution as a correctional guard or officer, a joint jailer/dispatcher, or as a supervisor of correctional guards or officers or of joint jailer/dispatchers and are directly responsible for the direct security, custody, and control of the county correctional institution and its inmates, are covered by the Public Employees Correctional Fund. For members who are first eligible for membership after June 30, 2010, benefits vest on a graduated schedule starting with 50 percent after five years and increasing 10 percent for each year of service until fully vested after ten years. Members eligible for membership before July 1, 2010, are fully vested after three years of service.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Plan Description (Continued)

PERA provides retirement benefits as well as disability benefits to members and benefits to survivors upon death of eligible members. Benefits are established by state statute and vest after three years of credited service. Defined retirement benefits are based on a member's average yearly salary for the five highest-paid consecutive years of allowable service, age, and years of credit at termination of service.

Two methods are used to compute benefits for Coordinated and Basic Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Basic Plan member is 2.2 percent of average salary for each of the first ten years of service and 2.7 percent for each year thereafter. For a Coordinated Plan member, the annuity accrual rate is 1.2 percent of average salary for each of the first ten years and 1.7 percent for each successive year. Under Method 2, the annuity accrual rate is 2.7 percent of average salary for Basic Plan members and 1.7 percent for Coordinated Plan members for each year of service. For Public Employees Correctional Fund members, the annuity accrual rate is 1.9 percent of average salary for each year of service.

For all General Employees Retirement Fund members hired prior to July 1, 1989, whose annuity is calculated using Method 1, and Public Employees Correctional Fund members, a full annuity is available when age plus years of service equal 90. Normal retirement age is 55 for Public Employees Correctional Fund members, and either 65 or 66 (depending on hire date) for General Employees Retirement Fund members. A reduced retirement annuity is also available to eligible members seeking early retirement.

The benefit provisions stated in the previous paragraphs of this section are current provisions and apply to active plan participants. Vested, terminated employees who are entitled to benefits but are not yet receiving them are bound by the provisions in effect at the time they last terminated public service.

PERA issues a publicly available financial report that includes financial statements and required supplementary information for the General Employees Retirement Fund and the Public Employees Correctional Fund. That report may be obtained on the internet at www.mnpera.org; by writing to PERA at 60 Empire Drive, Suite 200, Saint Paul, Minnesota 55103-2088; or by calling 651-296-7460 or 1-800-652-9026.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Employee Retirement Systems and Pension Plans (Continued)

B. Funding Policy

Pension benefits are funded from member and employer contributions and income from the investment of fund assets. Rates for employer and employee contributions are set by Minn. Stat. ch. 353. These statutes are established and amended by the State Legislature. Arrowhead Regional Corrections makes annual contributions to the pension plans equal to the amount required by state statutes. General Employees Retirement Fund Basic Plan members and Coordinated Plan members are required to contribute 9.10 and 6.00 percent, respectively, of their annual covered salary. Public Employees Correctional Fund members are required to contribute 5.83 percent of their annual covered salary.

Arrowhead Regional Corrections is required to contribute the following percentages of annual covered payroll in 2010:

General Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	7.00
Public Employees Correctional Fund	8.75

Arrowhead Regional Corrections' contributions for the years ending December 31, 2010, 2009, and 2008, for the General Employees Retirement Fund and the Public Employees Correctional Fund were:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
General Employees Retirement Fund	\$ 555,414	\$ 536,660	\$ 491,505
Public Employees Correctional Fund	323,900	309,688	295,255

These contribution amounts are equal to the contractually required contributions for each year as set by state statute.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

A. Contingent Liabilities

Amounts received or receivable from grant agencies are subject to audit and adjustment by grantor agencies, principally the federal government. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of the expenditures that may be disallowed by the grantor cannot be determined at this time, although Arrowhead Regional Corrections expects such amounts, if any, to be immaterial.

B. Claims and Litigation

Arrowhead Regional Corrections, in connection with the normal conduct of its affairs, is involved in various claims, judgments, and litigation.

The County Attorney estimates that the potential claims against Arrowhead Regional Corrections that would not be covered by insurance will not have a material adverse effect on the financial condition of Arrowhead Regional Corrections.

C. Participation

The budget of Arrowhead Regional Corrections is financed through state grants and contributions from the participating counties. County contributions are shared in the following proportion:

	<u>Percent (%)</u>
Carlton County	9.36
Cook County	1.49
Koochiching County	1.59
Lake County	1.50
St. Louis County	<u>86.06</u>
Total	<u><u>100.00</u></u>

Member contributions for the current year totaled \$11,923,374, or 63 percent, of the total intergovernmental revenue received.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

C. Participation (Continued)

Of the various state grants available to Arrowhead Regional Corrections, the most significant is the grant authorized under the Community Corrections Act. Grant proceeds for 2010 totaled \$3,911,889, or 21 percent, of total intergovernmental revenue received.

D. Jointly-Governed Organizations

Arrowhead Regional Corrections, in conjunction with other governmental entities and various private organizations, formed the jointly-governed organizations listed below:

- Duluth Family Service Collaborative,
- Koochiching County Family Services Collaborative,
- North St. Louis County Family Services Collaborative, and
- North Shore Collaborative.

The Collaboratives were established to create opportunities to enhance family strengths and support through service coordination and access to informal communication. Arrowhead Regional Corrections has no operational or financial control over the Collaboratives. During the year, Arrowhead Regional Corrections had expenditures of \$500 related to the North Shore Collaborative.

5. Other Postemployment Benefits

A. Plan Description and Funding Policy

Arrowhead Regional Corrections provides health insurance benefits for certain retired employees under a single-employer self-insured plan. Arrowhead Regional Corrections provides postemployment health care benefits in accordance with Minn. Stat. § 471.61, subd. 2b. Active employees who retire from Arrowhead Regional Corrections when eligible to receive a retirement benefit from PERA (or similar plan) and do not participate in any other health benefits program providing coverage similar to that herein described, will be eligible to continue coverage with respect to both themselves and their eligible dependent(s) under the Arrowhead Regional Corrections' health benefits program. The retiree must pay 100 percent of the total premium cost. Since the premium is a blended rate determined on the entire active and retiree population, the retirees are receiving an implicit rate subsidy.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

5. Other Postemployment Benefits (Continued)

B. Annual OPEB Cost and Net OPEB Obligation

Arrowhead Regional Corrections' annual other postemployment benefits (OPEB) cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The following table shows the components of Arrowhead Regional Corrections' annual OPEB cost for 2010, the amount actually contributed to the plan, and changes in Arrowhead Regional Corrections' net OPEB obligation:

ARC	\$	231,778
Interest on net OPEB obligation		3,043
Adjustment to ARC		(4,195)
		(4,195)
Annual OPEB cost	\$	230,626
Contributions during the year		(92,064)
		(92,064)
Increase (decrease) in net OPEB obligation	\$	138,562
Net OPEB - Beginning of Year		69,149
		69,149
Net OPEB - End of Year	\$	207,711

Arrowhead Regional Corrections' annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2010 were as follows:

Fiscal Year Ended	Annual OPEB Cost	Employer Contribution	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
December 31, 2010	\$ 230,626	\$ 92,064	39.92%	\$ 207,711

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

5. Other Postemployment Benefits (Continued)

C. Funded Status and Funding Progress

The actuarial accrued liability for benefits at January 1, 2010, the most recent actuarial valuation date, is \$2,433,608. Arrowhead Regional Corrections currently has no assets that have been irrevocably deposited in a trust for future health benefits; thus, the entire amount is unfunded. The covered payroll (annual payroll of active employees covered by the plan) is \$11,417,275. The ratio of the unfunded actuarially accrued liabilities to covered payroll is 21.32 percent.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and health care cost trends. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The Schedule of Funding Progress - Other Postemployment Benefits, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

D. Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques designed to reduce the effect of short-term volatility in actuarial accrued liabilities, consistent with the long-term perspective of the calculations.

In the January 1, 2010, actuarial valuation, the entry age normal actuarial cost method was used. The actuarial assumptions included a 4.4 percent discount rate, which is based on the estimated long-term investment yield on the general assets of Arrowhead Regional Corrections. The annual health care cost trend rate is initially 1.19 percent, which is the actual increase in premiums from 2010 to 2011, then climbs to 7.90 percent in 2011, and is reduced incrementally to an ultimate rate of 5.0 percent after 20 years. The unfunded actuarial accrued liability is being amortized as a level dollar amount over 30 years.

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REQUIRED SUPPLEMENTARY INFORMATION

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT A-1

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Intergovernmental	\$ 18,635,077	\$ 18,711,136	\$ 19,025,533	\$ 314,397
Charges for services	1,623,134	1,623,134	1,236,657	(386,477)
Investment earnings	40,000	40,000	14,859	(25,141)
Miscellaneous	407,197	414,544	210,210	(204,334)
Total Revenues	<u>\$ 20,705,408</u>	<u>\$ 20,788,814</u>	<u>\$ 20,487,259</u>	<u>\$ (301,555)</u>
Expenditures				
Current				
Administration				
Administrative support services	\$ 1,703,773	\$ 1,338,199	\$ 1,244,240	\$ 93,959
Research and evaluation	206,755	206,755	139,477	67,278
Staff development	142,449	142,449	121,877	20,572
Arrowhead Council of Churches	26,469	26,469	26,469	-
Women offenders program	174,015	174,015	174,015	-
Use of institutions	100,000	100,000	24,088	75,912
Total administration	<u>\$ 2,353,461</u>	<u>\$ 1,987,887</u>	<u>\$ 1,730,166</u>	<u>\$ 257,721</u>
Court and field services				
Probation	\$ 9,060,613	\$ 9,271,482	\$ 8,841,699	\$ 429,783
St. Louis County data processing charges	131,307	131,307	131,307	-
Intensive supervision program	368,634	368,634	379,373	(10,739)
Short-term consequences	171,743	173,346	172,869	477
Sentence to serve	189,066	207,836	207,836	-
Juvenile restitution	-	870	870	-
Correctional fees	62,500	64,116	64,116	-
Total court and field services	<u>\$ 9,983,863</u>	<u>\$ 10,217,591</u>	<u>\$ 9,798,070</u>	<u>\$ 419,521</u>
Northeast Regional Corrections Center				
Administration	\$ 5,119,069	\$ 5,114,850	\$ 4,939,451	\$ 175,399
Special education	205,955	205,955	199,266	6,689
Basic education	150,260	151,726	148,847	2,879
Vocational education	156,122	234,559	234,559	-
Total Northeast Regional Corrections Center	<u>\$ 5,631,406</u>	<u>\$ 5,707,090</u>	<u>\$ 5,522,123</u>	<u>\$ 184,967</u>
Arrowhead Juvenile Center				
Administration	<u>\$ 3,936,676</u>	<u>\$ 4,056,032</u>	<u>\$ 4,010,406</u>	<u>\$ 45,626</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

*EXHIBIT A-1
(Continued)*

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Expenditures (Continued)				
Capital outlay				
2011 Capital Improvements	\$ -	\$ 1,038,175	\$ -	\$ 1,038,175
Court and field services	-	-	69,941	(69,941)
Arrowhead Juvenile Center	-	-	42,803	(42,803)
Northeast Regional Corrections Center	-	-	134,339	(134,339)
Total capital outlay	\$ -	\$ 1,038,175	\$ 247,083	\$ 791,092
Total Expenditures	\$ 21,905,406	\$ 23,006,775	\$ 21,307,848	\$ 1,698,927
Net Change in Fund Balance	\$ (1,199,998)	\$ (2,217,961)	\$ (820,589)	\$ 1,397,372
Fund Balance - January 1	6,956,155	6,956,155	6,956,155	-
Increase (decrease) in reserved for inventories	-	-	(15,260)	(15,260)
Fund Balance - December 31	\$ 5,756,157	\$ 4,738,194	\$ 6,120,306	\$ 1,382,112

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT A-2

SCHEDULE OF FUNDING PROGRESS - OTHER POSTEMPLOYMENT BENEFITS
DECEMBER 31, 2010

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a/c))
January 1, 2008	\$ -	\$1,731,675	\$1,731,675	0.0%	\$11,245,904	15.40%
January 1, 2010	-	2,433,608	2,433,608	0.0	11,417,275	21.32

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED DECEMBER 31, 2010**

1. Budgetary Data

The Arrowhead Regional Corrections Board adopts annual revenue and expenditure budgets for the General Fund on a basis consistent with generally accepted accounting principles. The budget is subject to approval by member counties and the State of Minnesota.

On or before mid-June of each year, all divisions submit requests for appropriations to the Executive Director so that a budget can be prepared. Before September 15, the proposed budget is presented to the Board for review and approval.

The appropriated budget is prepared by each division of Arrowhead Regional Corrections. Department heads may make transfers of appropriations within a department. Transfers of appropriations between departments require Board approval. The legal level of budgetary control (the level at which expenditures may not legally exceed the budget) is at the divisional level.

Encumbrance accounting, under which commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary integration in the General Fund. Encumbrances (purchase orders and contracts) outstanding at year-end are reported as reservations of fund balances and provide authority for the carryover of appropriations to the subsequent year in order to complete these transactions. There were funds of \$805,097 encumbered at the end of December 31, 2010. These funds were encumbered towards paying for the capital improvement projects planned for 2011 at the Arrowhead Juvenile Center and the Northeast Regional Corrections Centers. The projects consist of roof and heating duct replacement at the Arrowhead Juvenile Center along with roof replacement at the Northeast Regional Corrections Center.

2. Other Postemployment Benefits

Arrowhead Regional Corrections currently has no assets that have been irrevocably deposited in a trust for future health benefits. Therefore, the actuarial value of the assets is zero.

Arrowhead Regional Corrections implemented Governmental Accounting Standards Statement 45 in the fiscal year ended December 31, 2008. Information for prior years is not available.

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SUPPLEMENTARY INFORMATION

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT B-1

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

Shared Revenue	
State	
PERA rate reimbursement	\$ <u>50,856</u>
Membership Contributions	
Shared operations	
Carlton County	\$ 1,116,301
Cook County	177,490
Koochiching County	188,928
Lake County	179,036
St. Louis County	<u>10,261,619</u>
Total shared operations	\$ <u>11,923,374</u>
Grants	
State	
Minnesota Department of Education	\$ <u>94,645</u>
Minnesota Department of Corrections	
Court and field services	
Caseload/workload reductions grant	\$ 1,685,591
Intensive supervision grant	261,150
Sex offender grant	357,780
Felony caseload reductions grant	94,226
Challenge incarceration program	105,699
Remote electronic monitoring	<u>24,754</u>
Total court and field services	\$ 2,529,200
Arrowhead Juvenile Center	
Sex offender grant	69,204
Community Corrections Act subsidy	<u>3,911,889</u>
Total Minnesota Department of Corrections	\$ <u>6,510,293</u>
Total state grants	\$ <u>6,604,938</u>
Federal	
Department of	
Agriculture	\$ 65,466
Justice	297,048
Education	<u>8,851</u>
Total federal grants	\$ <u>371,365</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

*EXHIBIT B-1
(Continued)*

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

Grants (Continued)

Other Grants

North St. Louis County Family Services Collaborative
Detention Assessment Team

\$ 75,000

Total state, federal, and other grants

\$ 7,051,303

Total Intergovernmental Revenue

\$ 19,025,533

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, 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***

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEM NOT RESOLVED

96-2 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 Arrowhead Regional Corrections 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 the Office of the State Auditor prepare the annual financial statements and related notes. This arrangement is not unusual for an organization the size of Arrowhead Regional Corrections. This decision was based on the availability of Arrowhead Regional Corrections staff and the cost benefit of using our expertise.

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

Client's Response:

The Arrowhead Regional Corrections' management team continues to be aware of the lack of segregation of accounting functions as a result of our limited number of office personnel. Internal control policies and procedures are reviewed and revised on a regular basis and will continue to be followed by employees.

II. MINNESOTA LEGAL COMPLIANCE

ITEM ARISING THIS YEAR

10-1 Uniform Municipal Contracting Law

During 2010, Arrowhead Regional Corrections purchased six vehicles to be used in its operations for a total cost of \$102,371. The vehicles were purchased from the same dealer after soliciting quotations from three other dealerships. The quotations were not maintained on file. Sealed bids were not solicited by public notice as required for contracts expected to exceed \$100,000, under Minn. Stat. § 471.345, subd. 3.

We recommend Arrowhead Regional Corrections abide by the Uniform Municipal Contracting Law for future contracts that are estimated to exceed \$100,000 by soliciting sealed bids in compliance with Minn. Stat. § 471.345.

Client's Response:

Arrowhead Regional Corrections will comply with Minn. Stat. § 471.345 by utilizing the services of the St. Louis County Purchasing Department to accept sealed bids solicited by public notice for all items estimated to exceed \$100,000.



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 Commissioners
Arrowhead Regional Corrections

We have audited the financial statements of the governmental activities and the General Fund of Arrowhead Regional Corrections as of and for the year ended December 31, 2010, which collectively comprise Arrowhead Regional Corrections' basic financial statements, and have issued our report thereon dated March 26, 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 Arrowhead Regional Corrections' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Arrowhead Regional Corrections' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Arrowhead Regional Corrections' internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management 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 Arrowhead Regional Corrections' financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined above. However, we identified a deficiency in internal control over financial reporting, described in the Schedule of Findings and Recommendations as item 96-2, that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

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

Minnesota Legal Compliance

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

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

The results of our tests indicate that for the items tested, Arrowhead Regional Corrections complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Recommendations as item 10-1.

Arrowhead Regional Corrections' written responses to the internal control and legal compliance findings identified in our audit have been included in the Schedule of Findings and Recommendations. We did not audit Arrowhead Regional Corrections' responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Arrowhead Regional Corrections Board, management, and others within Arrowhead Regional Corrections 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

March 26, 2012

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR