

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

LAKE COUNTY
TWO HARBORS, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2011

Description of the Office of the State Auditor

The mission of the Office of the State Auditor is to oversee local government finances for Minnesota taxpayers by helping to ensure financial integrity and accountability in local governmental financial activities.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 160 financial and compliance audits per year and has oversight responsibilities for over 3,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits of local governments;

Government Information - collects and analyzes financial information for cities, towns, counties, and special districts;

Legal/Special Investigations - provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

Pension - monitors investment, financial, and actuarial reporting for approximately 730 public pension funds; and

Tax Increment Financing - promotes compliance and accountability in local governments' use of tax increment financing through financial and compliance audits.

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

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

For the Year Ended December 31, 2011



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

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

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TWO HARBORS, MINNESOTA**

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

ORGANIZATION
DECEMBER 31, 2011

			<u>Term Expires</u>
Elected			
Commissioner	Thomas Clifford	District 1	January 2013
Commissioner	Derrick Goutermont	District 2	January 2013
Commissioner	Brad Jones	District 3	January 2013
Commissioner	Paul Bergman	District 4	January 2015
Commissioner	Rich Sve	District 5	January 2013
Attorney	Laura M. Auron		January 2015
Auditor/Treasurer	Steven R. McMahon		January 2015
Recorder	Erica Koski		January 2015
Sheriff	Carey Johnson		January 2015
Appointed			
Assessor	Jack Renick		December 2012
Examiner of Titles	David Adams (St. Louis County)		Indefinite
Health Officer	Harold B. Leppink, M.D.		Indefinite
Highway Engineer	Alan Goodman		May 2012
Veterans Service Officer	Nazareth V. Sando		September 2015
Clerk of the Board	Laurel Buchanan		Indefinite
County Administrator	Matthew Huddleston		Indefinite
Human Services			
Board Members	Thomas Clifford		January 2013
	Derrick Goutermont		January 2013
	Brad Jones		January 2013
	Paul Bergman		January 2015
	Rich Sve		January 2013
	Kathy Goedel		Indefinite
	Christine Johnson		Indefinite
Director	Vickie Thompson		Indefinite

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

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INDEPENDENT AUDITOR'S REPORT

Board of County Commissioners
Lake County

We have audited the accompanying financial statements of the governmental activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lake County, Minnesota, as of and for the year ended December 31, 2011, which collectively comprise the County's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Lake County's 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; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Nonprofit 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 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lake County as of December 31, 2011, 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.

As discussed in Note 1.D.11. to the financial statements, the County adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, as of and for the year ended December 31, 2011. GASB Statement 54 provides clearer fund balance classifications that can be more consistently applied and clarifies existing governmental fund type definitions.

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 GASB, 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 Lake County's basic financial statements as a whole. The supplementary information, including the Schedule of Expenditures of Federal Awards required by OMB Circular A-133, 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 November 8, 2012, on our consideration of Lake County's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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

November 8, 2012

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

MANAGEMENT'S DISCUSSION AND ANALYSIS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2011
(Unaudited)**

Lake County's Management's Discussion and Analysis (MD&A) provides an overview of the County's financial activities for the fiscal year ended December 31, 2011. Since this information is designed to focus on the current year's activities, resulting changes, and currently known facts, it should be read in conjunction with the County's financial statements.

FINANCIAL HIGHLIGHTS

- Governmental activities' total net assets are \$103,218,363, of which \$87,289,791 is invested in capital assets, net of related debt, and \$1,817,557 is restricted to specific purposes.
- Lake County's net assets increased by \$1,888,465 for the year ended December 31, 2011. The Lake County Housing and Redevelopment Authority is shown as a "Discretely Presented Component Unit." The net assets of the County's discretely presented component unit increased by \$229,831.
- The net cost of governmental activities was \$9,559,962 for the current fiscal year. The net cost was funded by general revenues and other items totaling \$11,448,427.
- Governmental funds' fund balances increased by \$290,497.

OVERVIEW OF THE FINANCIAL STATEMENTS

This MD&A is intended to serve as an introduction to the basic financial statements. Lake County's basic financial statements consist of three parts: government-wide financial statements, fund financial statements, and notes to the financial statements. The MD&A (this section), certain budgetary comparison schedules, and the schedule of funding progress are required to accompany the basic financial statements and, therefore, are included as required supplementary information.

There are two government-wide financial statements. The statement of net assets and the statement of activities provide information about the activities of the County as a whole and present a longer-term view of the County's finances. Fund financial statements report the County's operations in more detail than the government-wide statements by providing information about the County's most significant funds. For governmental activities, these statements tell how these services were financed in the short term as well as what remains for

future spending. The remaining statements provide financial information about activities for which the County acts solely as a trustee or agent for the benefit of those outside of the government.

Government-Wide Financial Statements--The Statement of Net Assets and the Statement of Activities

The statement of net assets and the statement of activities report information about the County as a whole and about its activities in a way that helps the reader determine whether the County's financial condition has improved or declined as a result of the year's 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 of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the County's net assets and changes in them. You can think of the County's net assets--the difference between assets and liabilities--as one way to measure the County's financial health or financial position. Over time, increases or decreases in the County's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the County's property tax base and the condition of County roads, to assess the overall health of the County.

In the statement of net assets and the statement of activities, we divide the County into three kinds of activities:

- **Governmental activities**--Most of the County's basic services are reported here, including general government, public safety, highways and streets, sanitation, human services, health, culture and recreation, conservation of natural resources, and economic development. Property taxes and state and federal grants finance most of these activities.
- **Component unit**--The County includes another separate legal entity in its report. The entity, the Lake County Housing and Redevelopment Authority, is presented in a separate column. Although legally separate, this "component unit" is important because the County is financially accountable for it. Further financial information for this component unit is available in separately issued and audited financial statements.

The government-wide financial statements can be found in Exhibits 1 and 2.

Fund Financial Statements

The fund financial statements provide detailed information about the most significant funds--not the County as a whole. Some funds are required to be established by state law and by bond covenants. However, the County Board establishes some funds to help it control and manage money for a particular purpose or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money.

- Governmental funds - All of the County's basic services are reported in governmental funds, which focus on how money flows in and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting. This method measures cash and all other financial assets that can be readily converted to cash. The governmental fund statements provide a detailed short-term view of the County's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the County's programs. We describe the relationship (or differences) between governmental activities (reported in the statement of net assets and the statement of activities) and governmental funds in reconciliation in a statement following each governmental fund financial statement.

The basic financial statements for governmental funds can be found in Exhibits 3 through 6.

Reporting the County's Fiduciary Responsibilities

The County is the trustee, or fiduciary, over assets that can be used only for the trust beneficiaries, based on the trust arrangement. All of the County's fiduciary activities are reported in a separate statement of fiduciary net assets. We exclude these activities from the County's other financial statements because the County cannot use these assets to finance its operations. The County is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

The fiduciary funds financial statement is Exhibit 7.

LAKE COUNTY AS A WHOLE

Our analysis below focuses on the net assets (Table 1) and changes in net assets (Table 2) of the County's governmental activities.

Table 1
Net Assets
(in Thousands)

	Governmental Activities	
	2011	2010
Current and other assets	\$ 19,963	\$ 19,565
Capital assets	91,746	90,680
Total Assets	\$ 111,709	\$ 110,245
Long-term debt outstanding	\$ 5,151	\$ 5,825
Other liabilities	3,340	3,090
Total Liabilities	\$ 8,491	\$ 8,915

	Governmental Activities	
	2011	2010
Net Assets		
Invested in capital assets, net of debt	\$ 87,290	\$ 85,350
Restricted	1,817	1,452
Unrestricted	<u>14,111</u>	<u>14,528</u>
Total Net Assets	<u>\$ 103,218</u>	<u>\$ 101,330</u>

Table 2
Changes in Net Assets
(in Thousands)

	Governmental Activities	
	2011	2010
Revenues		
Program revenues		
Fees, fines, charges, and other	\$ 1,944	\$ 2,444
Operating grants and contributions	11,078	10,341
Capital grants and contributions	2,776	4,244
General revenues		
Property taxes	7,455	7,480
Other taxes	2,056	1,873
Unrestricted grants and contributions	1,606	1,058
Investment earnings	146	52
Gain on sale of capital asset	17	622
Miscellaneous	<u>168</u>	<u>252</u>
Total Revenues	<u>\$ 27,246</u>	<u>\$ 28,366</u>
Expenses		
General government	\$ 4,405	\$ 4,229
Public safety	4,353	4,187
Culture and recreation	899	1,033
Highways and streets	6,935	6,520
Human services	2,705	3,003
Health	3,223	3,046
Sanitation	270	276
Conservation of natural resources	1,118	1,140
Economic development	1,232	640
Interest	<u>218</u>	<u>254</u>
Total Expenses	<u>\$ 25,358</u>	<u>\$ 24,328</u>
Increase (Decrease) in Net Assets	\$ 1,888	\$ 4,038
Net Assets, January 1	<u>101,330</u>	<u>97,292</u>
Net Assets, December 31	<u>\$ 103,218</u>	<u>\$ 101,330</u>

Lake County sold Sunrise Nursing Home (business-type activities) in 2010. Therefore, there are no longer any business-type activities reported in the financial statements.

Governmental Activities

The cost of all governmental activities this year was \$25,357,751. However, as shown in the statement of activities, the amount that our taxpayers ultimately financed for these activities through County taxes and other general revenues was \$9,559,962, because some of the cost was paid by those who directly benefited from the programs (\$1,943,988) or by other governments and organizations that subsidized certain programs with grants and contributions (\$13,853,801). Table 3 presents the cost of each of the County's five largest program functions, as well as each function's net cost (total cost, less revenues generated by the activities). The net cost shows the financial burden that was placed on the County's taxpayers by each of these functions.

Table 3
Governmental Activities
(in Thousands)

	Total Cost of Services		Net Cost of Services	
	2011	2010	2011	2010
Highways and streets	\$ 6,935	\$ 6,520	\$ 2,595	\$ 352
General government	4,405	4,229	880	758
Public safety	4,353	4,187	2,686	2,968
Health	3,223	3,046	427	51
Human services	2,705	3,003	1,121	1,479
All others	3,737	3,343	1,851	1,691
Total	\$ 25,358	\$ 24,328	\$ 9,560	\$ 7,299

General Fund Budgetary Highlights

Over the course of the year, the County Board reviews the County's General Fund budget and may make budget amendments. These budget amendments fall into three categories: new information changing original budget estimations, greater than anticipated revenues or costs, and final agreement reached on employee contracts. The General Fund budget was not amended significantly in 2011.

In the General Fund, the actual charges to appropriations (expenditures) were \$559,511 greater than the final budget amounts. Unbudgeted expenditures included \$280,776 of unbudgeted trail expenditures and \$235,686 of unbudgeted small cities development program expenditures.

Resources available for appropriation were also above the final budgeted amount by \$1,021,488. This was primarily due to greater than expected collections in intergovernmental revenues.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of 2011, the County had \$91,746,537 invested in a broad range of capital assets, including land, buildings, highways and streets, and equipment. (See Table 4.)

Table 4
Capital Assets at Year-End
(Net of Depreciation, in Thousands)

	Governmental Activities	
	2011	2010
Land	\$ 3,990	\$ 3,990
Buildings and improvements	10,939	11,189
Machinery, vehicles, furniture, and equipment	2,854	2,098
Infrastructure	73,964	73,403
Totals	<u>\$ 91,747</u>	<u>\$ 90,680</u>

The County's fiscal year 2012 capital budget calls for it to spend another \$218,000 for miscellaneous improvements at various buildings and \$3,250,000 for road construction. The road construction will be funded by state-aid construction funds.

Debt

At year-end, the County had \$3,104,285 in bonds and notes outstanding versus \$3,949,091 last year--a decrease of 21 percent--as shown in Table 5. Capital leases payable decreased by \$52,146.

Table 5
Outstanding Debt at Year-End
(in Thousands)

	Governmental Activities	
	2011	2010
General obligation bonds	\$ 3,080	\$ 3,765
Notes payable	24	184
Capital leases	1,581	1,633
Compensated absences	1,174	1,128
Net other postemployment benefits	179	127
Total	<u>\$ 6,038</u>	<u>\$ 6,837</u>

The state limits the amount of net debt that the County can issue to three percent of the market value of all taxable property in the County. The County's outstanding net debt is below this state-imposed limit.

Other obligations include accrued vacation pay, sick leave payable, and net other postemployment benefits. More detailed information about the County's long-term liabilities is presented in the notes to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The County's elected and appointed officials considered many factors when setting the fiscal year 2012 budget and tax rates.

- County General Fund expenditures for 2012 are budgeted to decrease ten percent over 2011.
- Property tax levies did not increase for 2012.

CONTACTING LAKE COUNTY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the County's finances and to show the County's accountability for the money it receives. If you have questions about this report, or need additional financial information, contact the County Auditor/Treasurer Steven McMahon, Lake County Courthouse, 601 - 3rd Avenue, Two Harbors, Minnesota 55616.

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BASIC FINANCIAL STATEMENTS

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 1

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

	Primary Government Governmental Activities	Housing and Redevelopment Authority Component Unit
<u>Assets</u>		
Cash and pooled investments	\$ 12,800,489	\$ 336,895
Cash with management company for operations	-	86,908
Receivables - net	6,373,203	140,156
Due from component unit	400,403	-
Inventories	354,961	-
Prepaid items	13,096	-
Restricted assets		
Cash and pooled investments	-	69,197
Cash with management company for security deposits	-	14,731
Deferred charges	20,400	-
Capital assets		
Non-depreciable capital assets	3,990,362	-
Depreciable capital assets - net of accumulated depreciation	87,756,175	1,195,087
Total Assets	\$ 111,709,089	\$ 1,842,974
<u>Liabilities</u>		
Accounts payable and other current liabilities	\$ 1,335,211	\$ 23,138
Accrued interest payable	62,634	3,544
Advance from other governments	1,055,187	-
Due to primary government	-	400,403
Unearned revenue	-	860
Payable from restricted assets		
Security deposits payable	-	14,731
Long-term liabilities		
Due within one year	886,620	33,218
Due in more than one year	5,151,074	790,156
Total Liabilities	\$ 8,490,726	\$ 1,266,050
<u>Net Assets</u>		
Invested in capital assets - net of related debt	\$ 87,289,791	\$ 371,713
Restricted for		
General government	315,906	-
Public safety	395,954	-
Highways and streets	53,228	-
Conservation of natural resources	118,603	-
Debt service	933,866	69,197
Operations	-	86,908
Unrestricted	14,111,015	49,106
Total Net Assets	\$ 103,218,363	\$ 576,924

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

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2011**

	Expenses	Fees, Charges, Fines, and Other
<u>Functions/Programs</u>		
Primary government		
Governmental activities		
General government	\$ 4,405,017	\$ 537,731
Public safety	4,352,952	277,113
Highways and streets	6,934,952	254,255
Sanitation	270,179	58,759
Human services	2,704,837	138,646
Health	3,222,742	197,993
Culture and recreation	899,310	-
Conservation of natural resources	1,118,058	478,845
Economic development	1,232,003	646
Interest	217,701	-
	\$ 25,357,751	\$ 1,943,988
Total Primary Government	\$ 25,357,751	\$ 1,943,988
Component unit		
Housing and Redevelopment Authority	\$ 297,311	\$ 193,283
 General Revenues		
		Property taxes
		Mortgage registry and deed tax
		Payments in lieu of tax
		Tax increments
		Taxes - other
		Grants and contributions not restricted to specific programs
		Unrestricted investment earnings
		Gain on sale of capital assets
		Miscellaneous
		Total general revenues
		Change in net assets
		Net Assets - Beginning
		Net Assets - Ending

EXHIBIT 2

<u>Program Revenues</u>		<u>Net (Expense) Revenue and Changes in Net Assets</u>	
<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	<u>Primary Government Governmental Activities</u>	<u>Discretely Presented Component Unit</u>
\$ 2,987,204	\$ -	\$ (880,082)	
1,390,214	-	(2,685,625)	
2,810,211	1,275,179	(2,595,307)	
-	-	(211,420)	
1,445,241	-	(1,120,950)	
2,597,812	-	(426,937)	
415,008	-	(484,302)	
177,105	-	(462,108)	
604,601	151,226	(475,530)	
-	-	(217,701)	
<u>\$ 12,427,396</u>	<u>\$ 1,426,405</u>	<u>\$ (9,559,962)</u>	
<u>\$ -</u>	<u>\$ -</u>		<u>\$ (104,028)</u>
		\$ 7,454,840	\$ 109,468
		10,772	-
		762,743	-
		195,829	191,484
		1,086,452	-
		1,606,279	18,461
		146,183	1,947
		17,290	-
		168,039	12,529
		<u>\$ 11,448,427</u>	<u>\$ 333,889</u>
		\$ 1,888,465	\$ 229,861
		<u>101,329,898</u>	<u>347,063</u>
		<u>\$ 103,218,363</u>	<u>\$ 576,924</u>

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FUND FINANCIAL STATEMENTS

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GOVERNMENTAL FUNDS

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2011**

	General	Road and Bridge
<u>Assets</u>		
Cash and pooled investments	\$ 6,392,817	\$ 643,834
Escheat cash	36,538	-
Petty cash and change funds	1,350	1,000
Undistributed cash in agency funds	154,323	47,325
Taxes receivable - prior	285,310	91,034
Accounts receivable	120,341	57,170
Accrued interest receivable	25,797	-
Loans receivable	112,399	-
Due from other funds	977,184	-
Due from other governments	2,695,430	844,117
Due from component unit	-	-
Prepaid expense	-	-
Inventories	-	354,961
Leases receivable	335,000	-
	\$ 11,136,489	\$ 2,039,441
Total Assets	\$ 11,136,489	\$ 2,039,441

EXHIBIT 3

<u>Human Services</u>	<u>Forfeited Tax</u>	<u>Broadband Capital Projects</u>	<u>Nonmajor Funds</u>	<u>Total</u>
\$ 5,031,368	\$ -	\$ -	\$ 404,160	\$ 12,472,179
-	-	-	-	36,538
1,000	50	-	-	3,400
69,856	-	-	16,868	288,372
140,292	-	-	31,222	547,858
34,594	719,535	-	-	931,640
-	-	-	-	25,797
-	-	-	-	112,399
-	-	-	-	977,184
681,834	-	199,128	-	4,420,509
-	-	-	400,403	400,403
13,096	-	-	-	13,096
-	-	-	-	354,961
-	-	-	-	335,000
<u>\$ 5,972,040</u>	<u>\$ 719,585</u>	<u>\$ 199,128</u>	<u>\$ 852,653</u>	<u>\$ 20,919,336</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2011**

	General	Road and Bridge
<u>Liabilities and Fund Balances</u>		
Liabilities		
Accounts payable	\$ 93,662	\$ 190,536
Escheat payable	36,538	-
Salaries payable	138,769	41,247
Contracts payable	-	391,825
Due to other funds	-	-
Due to other governments	51,477	4,879
Deferred revenue - unavailable	646,526	194,735
Advances from other governments	-	1,055,187
	\$ 966,972	\$ 1,878,409
Fund Balances		
Nonspendable		
Loans receivables	\$ 44,481	\$ -
Inventories	-	354,961
Restricted for		
Law library	10,188	-
Recorder's technology equipment	198,607	-
Enhanced 911	319,429	-
County property recorder's fee	107,111	-
Law and prosecutorial equipment	71,525	-
Election equipment	24,911	-
Sheriff's contingency fund	5,000	-
Title III forest	118,603	-
Debt service	-	474,992
Capital projects	-	203,511
Committed to		
Broadband project	3,500,000	-
Rescue squad capital expenditures	25,019	-
Out-of-home placement costs	-	-
Forestry road grant	-	-
Unorganized townships	-	-
Emergency services	-	-
Assigned to		
Resource development	-	-
Human services	-	-
Unassigned	5,744,643	(872,432)
	\$ 10,169,517	\$ 161,032
Total Fund Balances	\$ 10,169,517	\$ 161,032
Total Liabilities and Fund Balances	\$ 11,136,489	\$ 2,039,441

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

EXHIBIT 3
(Continued)

<u>Human Services</u>	<u>Forfeited Tax</u>	<u>Broadband Capital Projects</u>	<u>Nonmajor Funds</u>	<u>Total</u>
\$ 97,179	\$ 4,122	\$ 86,224	\$ -	\$ 471,723
-	-	-	-	36,538
36,629	7,505	-	-	224,150
-	-	-	-	391,825
15,725	73,602	781,769	106,088	977,184
61,026	-	-	93,594	210,976
121,415	627,104	70,189	26,663	1,686,632
-	-	-	-	1,055,187
\$ 331,974	\$ 712,333	\$ 938,182	\$ 226,345	\$ 5,054,215
\$ -	\$ -	\$ -	\$ -	\$ 44,481
-	-	-	-	354,961
-	-	-	-	10,188
-	-	-	-	198,607
-	-	-	-	319,429
-	-	-	-	107,111
-	-	-	-	71,525
-	-	-	-	24,911
-	-	-	-	5,000
-	-	-	-	118,603
-	-	-	458,874	933,866
-	-	-	-	203,511
-	-	-	-	3,500,000
-	-	-	-	25,019
1,000,000	-	-	-	1,000,000
-	15,887	-	-	15,887
-	-	-	84,097	84,097
-	-	-	83,337	83,337
4,640,066	-	-	-	4,640,066
-	(8,635)	(739,054)	-	4,124,522
\$ 5,640,066	\$ 7,252	\$ (739,054)	\$ 626,308	\$ 15,865,121
\$ 5,972,040	\$ 719,585	\$ 199,128	\$ 852,653	\$ 20,919,336

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 4

**RECONCILIATION OF GOVERNMENTAL FUNDS BALANCE SHEET TO
THE GOVERNMENT-WIDE STATEMENT OF NET ASSETS--GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2011**

Fund balances - total governmental funds (Exhibit 3)		\$ 15,865,121
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 governmental funds.		91,746,537
Other long-term assets are not available to pay for current period expenditures and, therefore, are deferred in the governmental funds.		1,686,632
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the governmental funds.		
General obligation bonds	\$ (3,080,000)	
Notes payable	(24,285)	
Capital leases payable	(1,580,257)	
Compensated absences	(1,173,700)	
Net other postemployment benefits payable	(179,451)	
Accrued interest payable	(62,634)	
Deferred debt issuance charges	20,400	
	(6,079,927)	(6,079,927)
Net Assets of Governmental Activities (Exhibit 1)		<u>\$ 103,218,363</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2011**

	General	Road and Bridge
Revenues		
Taxes	\$ 4,751,888	\$ 1,647,191
Licenses and permits	8,931	-
Intergovernmental	6,471,075	5,015,440
Charges for services	558,260	250,987
Fines and forfeits	4,213	-
Investment earnings	145,688	319
Miscellaneous	255,803	5,563
	\$ 12,195,858	\$ 6,919,500
Expenditures		
Current		
General government	\$ 4,297,700	\$ -
Public safety	5,063,906	-
Highways and streets	-	7,503,017
Sanitation	267,918	-
Human services	-	-
Health	-	-
Culture and recreation	821,271	-
Conservation of natural resources	230,874	-
Economic development	281,676	-
Capital outlay		
Conservation of natural resources	-	-
Economic development	-	-
Debt service		
Principal	23,808	494,738
Interest	-	43,546
Administrative (fiscal) charges	-	402
	\$ 10,987,153	\$ 8,041,703
Excess of Revenues Over (Under) Expenditures	\$ 1,208,705	\$ (1,122,203)
Other Financing Sources (Uses)		
Transfers in	\$ -	\$ 14,474
Transfers out	(155,832)	-
Capital lease purchase	-	134,259
	\$ (155,832)	\$ 148,733
Net Change in Fund Balances	\$ 1,052,873	\$ (973,470)
Fund Balances - January 1, as restated (Note 1.E.)	9,116,644	1,015,424
Increase (decrease) in inventories	-	119,078
	\$ 10,169,517	\$ 161,032
Fund Balances - December 31	\$ 10,169,517	\$ 161,032

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

EXHIBIT 5

<u>Human Services</u>	<u>Forfeited Tax</u>	<u>Broadband Capital Projects</u>	<u>Nonmajor Funds</u>	<u>Total</u>
\$ 1,914,885	\$ -	\$ -	\$ 667,164	\$ 8,981,128
-	1,799	-	112	10,842
4,311,985	32,889	128,939	358,358	16,318,686
253,178	20,394	-	-	1,082,819
-	-	-	-	4,213
-	-	-	176	146,183
83,461	558,473	-	70,385	973,685
\$ 6,563,509	\$ 613,555	\$ 128,939	\$ 1,096,195	\$ 27,517,556
\$ -	\$ -	\$ -	\$ -	\$ 4,297,700
-	-	-	104,924	5,168,830
-	-	-	-	7,503,017
-	-	-	-	267,918
2,603,367	-	-	-	2,603,367
3,221,324	-	-	-	3,221,324
-	-	-	-	821,271
-	601,015	-	235,799	1,067,688
-	-	-	195,829	477,505
-	44,861	-	-	44,861
-	-	754,498	-	754,498
-	-	-	512,665	1,031,211
-	-	-	176,855	220,401
-	-	-	403	805
\$ 5,824,691	\$ 645,876	\$ 754,498	\$ 1,226,475	\$ 27,480,396
\$ 738,818	\$ (32,321)	\$ (625,559)	\$ (130,280)	\$ 37,160
\$ -	\$ -	\$ -	\$ 141,358	\$ 155,832
-	-	-	-	(155,832)
-	-	-	-	134,259
\$ -	\$ -	\$ -	\$ 141,358	\$ 134,259
\$ 738,818	\$ (32,321)	\$ (625,559)	\$ 11,078	\$ 171,419
4,901,248	39,573	(113,495)	615,230	15,574,624
-	-	-	-	119,078
\$ 5,640,066	\$ 7,252	\$ (739,054)	\$ 626,308	\$ 15,865,121

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 6

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE
GOVERNMENT-WIDE STATEMENT OF ACTIVITIES--GOVERNMENTAL ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2011**

Net change in fund balances - total governmental funds (Exhibit 5) \$ 171,419

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

In the funds, 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 statements and the statement of activities is the increase or decrease in revenue deferred as unavailable.

Deferred revenue - December 31	\$ 1,686,632	
Deferred revenue - January 1	<u>(1,957,972)</u>	(271,340)

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. In the statement of activities, the gain or loss on the disposal of capital assets is reported; in the governmental funds, proceeds from the sale increase financial resources. The difference is the net book value of assets sold.

Expenditures for general capital assets and infrastructure	\$ 4,234,896	
Current year depreciation	<u>(3,168,375)</u>	1,066,521

Debt issuances provide current financial resources to governmental funds, but increase long-term liabilities in the statement of net assets. Debt repayment is an expenditure in funds, but a reduction of a liability in the statement of net assets.

Debt issued		
Capital lease	(134,259)	(134,259)

Principal repayments		
General obligation bonds	\$ 685,000	
Notes payable	159,806	
Capital lease	<u>186,405</u>	1,031,211

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 governmental funds.

Change in accrued interest payable	\$ 12,684	
Change in deferred bond issuance costs	(9,179)	
Change in compensated absences	(45,432)	
Change in other postemployment benefits	(52,238)	
Change in inventories	<u>119,078</u>	<u>24,913</u>

Change in Net Assets of Governmental Activities (Exhibit 2) \$ 1,888,465

FIDUCIARY FUNDS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 7

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

	<u>Agency</u>
<u>Assets</u>	
Cash and pooled investments	<u>\$ 573,984</u>
<u>Liabilities</u>	
Accounts payable	\$ 195,316
Taxes collected in advance	11,878
Due to other governments	329,080
Customer deposits - current	<u>37,710</u>
Total Liabilities	<u>\$ 573,984</u>

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

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

1. Summary of Significant Accounting Policies

The County's financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as of and for the year ended December 31, 2011. 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 the County are discussed below.

A. Financial Reporting Entity

Lake County was established March 1, 1866, and is an organized county having the powers, duties, and privileges granted counties by Minn. Stat. ch. 373. As required by accounting principles generally accepted in the United States of America, these financial statements present Lake County (primary government) and its component unit for which the County is financially accountable. The County is governed by a five-member Board of Commissioners elected from districts within the County. The Board is organized with a chair and vice chair elected at the annual meeting in January of each year.

Discretely Presented Component Unit

While part of the reporting entity, the discretely presented component unit is presented in a separate column in the government-wide financial statements to emphasize that it is legally separate from the County. The following component unit of Lake County is discretely presented:

Component Unit	Component Unit Included in Reporting Entity Because	Separate Financial Statements
Lake County Housing and Redevelopment Authority	The County appoints members, and the Authority is a potential financial burden.	Lake County Housing and Redevelopment Authority P. O. Box 103 Silver Bay, Minnesota 55614

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

A. Financial Reporting Entity

Discretely Presented Component Unit (Continued)

The Lake County Housing and Redevelopment Authority is governed by a five-member Board appointed by the Lake County Board of Commissioners. The Lake County Housing and Redevelopment Authority has all of the powers and duties of a county housing and redevelopment authority under the provisions of Minn. Stat. §§ 469.001-.047.

Joint Ventures

The County participates in several joint ventures described in Note 7.D. The County also participates in jointly-governed organizations described in Note 7.E.

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 and its component unit. These statements include the financial activities of the overall County government, except for fiduciary activities. Eliminations have been made to minimize the double counting of internal activities. Governmental activities normally are supported by taxes and intergovernmental revenues.

In the government-wide statement of net assets, the governmental activities column: (a) is presented on a consolidated basis by column; and (b) is reported on a full accrual, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations. The County's net assets are reported in three parts: (1) invested in capital assets, net of related debt; (2) restricted net assets; and (3) unrestricted net assets. The County first utilizes restricted resources to finance qualifying activities.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basic Financial Statements

1. Government-Wide Statements (Continued)

The statement of activities demonstrates the degree to which the direct expenses of each function of the County's governmental activities are offset by program revenue. Direct expenses are those clearly identifiable with a specific function or activity. Program revenues include: (1) fees, fines, 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. Revenue not classified as program revenue, including all taxes, are presented as general revenue.

2. Fund Financial Statements

The fund financial statements provide information about the County's funds, including its fiduciary funds. Separate statements for each fund category--governmental and fiduciary--are presented. The emphasis of governmental fund financial statements is on major individual governmental funds, with each displayed as separate columns in the fund financial statements. All remaining governmental funds are aggregated and reported as nonmajor funds.

The County reports the following major governmental funds:

The General Fund is the County's primary operating fund. It accounts for all financial resources of the general government, except those accounted for in another fund.

The Road and Bridge Special Revenue Fund is used to account for property tax and intergovernmental revenues and expenditures of the County Highway Department, which is responsible for the construction and maintenance of roads, bridges, and other projects affecting County roadways.

The Human Services Special Revenue Fund is used to account for property tax and intergovernmental revenues used for economic assistance and community social services programs.

The Forfeited Tax Special Revenue Fund is used to account for revenues from the sale or lease of lands forfeited to the State of Minnesota and for revenues dedicated for use in memorial forests and various land and timber projects.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basic Financial Statements

2. Fund Financial Statements (Continued)

The Broadband Capital Projects Fund is used to account for financial resources to be used for the acquisition or construction of major capital assets relating to the County's broadband system.

Additionally, the County reports the following fund type:

Agency funds are custodial in nature and do not present results of operations or have a measurement focus. These funds account for assets that the County holds for others in an agent capacity.

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. Property taxes are recognized as revenue in the year for which they are levied. Shared revenues are generally recognized in the period the appropriation goes into effect. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

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. Lake County considers all revenue as available if collected within 90 days after the end of the current period, except for taxes, which have a 60-day accrual period. Property and other taxes, licenses, and interest are all considered susceptible to accrual. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, compensated absences, and claims and judgments, which are recognized as expenditures to the extent that they have matured. Proceeds of general 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 the County's policy to use restricted resources first and then unrestricted resources as needed.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

D. Assets, Liabilities, and Net Assets or Equity

1. Cash and Cash Equivalents

The County has defined cash and cash equivalents to include cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition. Additionally, each fund's equity in the County's investment pool is treated as a cash equivalent because the funds can deposit or effectively withdraw cash at any time without prior notice or penalty. Cash and cash equivalents do not include restricted accounts.

2. Deposits and Investments

The cash balances of substantially all funds are pooled and invested by the County Auditor/Treasurer for the purpose of increasing earnings through investment activities. Pooled and fund investments are reported at their fair value at December 31, 2011, based on market prices. Pursuant to Minn. Stat. § 385.07, investment earnings on cash and pooled investments are credited to the General Fund. Other funds received investment earnings based on other state statutes, grant agreements, contracts, and bond covenants. Pooled investment earnings for 2011 were \$146,183.

Lake County invests in an external investment pool, the Minnesota Association of Governments Investing for Counties (MAGIC) Fund, which is created under a joint powers agreement pursuant to Minn. Stat. § 471.59. The MAGIC Fund is not registered with the Securities and Exchange Commission (SEC), but does operate in a manner consistent with Rule 2a-7 prescribed by the SEC pursuant to the Investment Company Act of 1940 (17 C.F.R. § 270.2a-7). The investment in the pool is measured at the net asset value per share provided by the pool.

3. Receivables and Payables

Activity between funds representative of lending/borrowing arrangements outstanding at the end of the fiscal year is referred to as either "due to/from other funds" (the current portion of interfund loans) or "advances to/from other funds" (the noncurrent portion of interfund loans).

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

3. Receivables and Payables (Continued)

All other outstanding balances between funds are reported as “due to/from other funds.”

Property taxes are levied as of January 1 on property values assessed as of the same date. The tax levy notice is mailed in March with the first half payment due May 15 and the second half payment due October 15. Unpaid taxes at December 31 become liens on the respective property and are classified in the financial statements as delinquent taxes receivable.

Loans receivable consist of outstanding loans to individuals for shoreline erosion projects and loans to individuals for economic development.

4. Inventories and Prepaid Items

The Road and Bridge Special Revenue Fund inventory is valued at cost using the average cost method and consists of expendable supplies and parts held for consumption and sand and gravel stockpiles. Inventories in governmental funds are recorded as expenditures when purchased rather than when consumed. Inventories at the government-wide level are recorded as expenses when consumed.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

5. Restricted Assets

Certain funds of the County are classified as restricted assets on the statement of net assets because the restriction is either imposed by law through constitutional provisions or enabling legislation or imposed externally by creditors, grantors, contributors, or laws or regulations of other governments. Therefore, their use is limited by applicable laws and regulations.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

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

6. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets (for example, roads, bridges, and similar items), are reported in the governmental activities column in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. 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.

Property, plant, and equipment of the primary government, as well as the component unit, are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings	5 - 50
Improvements other than buildings	8 - 20
Public domain infrastructure	50 - 75
Furniture, equipment, and vehicles	5 - 20

7. Compensated Absences

The liability for compensated absences reported in the financial statements consists of unpaid, accumulated annual and sick leave balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are 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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

7. Compensated Absences (Continued)

Lake County's employees (except for Highway Department employees) participate in a postretirement health savings plan administered by the Minnesota State Retirement System. At retirement, depending on the employee's years of service, he or she is issued a lump sum payout of either 10 or 20 percent of the vested sick leave as well as two to three years of insurance coverage. The lump sum payouts are paid directly into the postretirement health savings plan.

8. Deferred Revenue

All County funds 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 revenue not considered to be available to liquidate liabilities of the current period.

9. 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 column of the statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of the debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources, while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

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

10. Classification of Net Assets

Net assets in government-wide statements are classified in the following categories:

Invested in capital assets, net of related debt - the amount of net assets representing capital assets net of accumulated depreciation and reduced by outstanding debt attributed to the acquisition, construction, or improvement of the assets.

Restricted net assets - the amount of net assets for which external restrictions have been imposed by creditors, grantors, contributors, or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets - the amount of net assets that do not meet the definition of restricted or invested in capital assets, net of related debt.

11. Classification of Fund Balances

Beginning in 2011, Lake County implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The standard's objectives are to enhance the usefulness of fund balance information included in the financial report through clearer fund balance classifications that can be consistently applied and to clarify existing governmental fund type definitions.

Fund balance is divided into five classifications based primarily on the extent to which the County is bound to observe constraints imposed upon the use of the resources in the governmental funds. The classifications are as follows:

Nonspendable - amounts that cannot be spent because they are not in spendable form, such as fund balance associated with inventories, prepaids, or permanent funds.

Restricted - amounts that are restricted by external parties such as creditors or imposed by grants, law or legislation.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

11. Classification of Fund Balances (Continued)

Committed - amounts that can be used only for the specific purposes determined by a formal action of Lake County's highest level of decision-making authority; which is the Lake County Board of Commissioners. Fund balance commitments are established, modified, or rescinded by County Board action through a Board resolution.

Assigned - amounts intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the General Fund, assigned fund balance represents the remaining amount of fund balance that is not restricted or committed.

Unassigned - the residual classification for the General Fund and includes all spendable amounts not contained in the other fund balance classifications. In other governmental funds, the unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted or committed.

The County applies restricted resources first when expenditures are incurred for purposes for which either restricted or unrestricted (committed, assigned, and unassigned) amounts are available. Similarly, within unrestricted fund balance, committed amounts are reduced first followed by assigned, and then unassigned amounts when expenditures are incurred for purposes for which amounts in any of the unrestricted fund balance classifications could be used.

12. 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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

E. Restatement of Fund Balance

The implementation of GASB Statement 54 required the County to report the Economic Development Special Revenue Fund as part of the General Fund. The Economic Development Special Revenue Fund was previously reported as a nonmajor special revenue fund. The following table summarizes the restatement of fund balance:

	General Fund	Nonmajor Governmental Funds
Fund Balance - January 1, as previously reported	\$ 9,076,357	\$ 655,517
Restatement	40,287	(40,287)
Fund Balance -January 1, as restated	\$ 9,116,644	\$ 615,230

2. Stewardship, Compliance, and Accountability

A. Deficit Fund Equity

Broadband Capital Projects Fund

At December 31, 2011, the Broadband Capital Projects Fund had a deficit fund balance of \$739,054. This deficit is expected to be eliminated through the County Board's pledge of \$3.5 million towards the Broadband Project.

B. Excess of Expenditures Over Appropriations

For the year ended December 31, 2011, expenditures exceeded appropriations in the following funds:

	Final Budget	Expenditures	Excess
General Fund	\$ 10,427,642	\$ 10,987,153	\$ 559,511
Special Revenue Funds			
Road and Bridge	5,363,825	8,041,703	2,677,878
Forfeited Tax	634,361	645,876	11,515
Resource Development	234,588	470,256	235,668
Debt Service Fund	454,598	651,295	196,697

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

The County's total cash and investments are reported as follows:

Primary government	
Cash and pooled investments	\$ 12,800,489
Component unit	
Cash and pooled investments	336,895
Cash with management company for operations	86,908
Restricted cash and pooled investments	69,197
Restricted cash with management company for security deposits	14,731
Fiduciary funds	
Cash and pooled investments	<u>573,984</u>
 Total Cash and Investments	 <u>\$ 13,882,204</u>

a. Deposits

The County is authorized by Minn. Stat. §§ 118A.02 and 118A.04 to designate a depository for public funds and to invest in certificates of deposit. The County is required by Minn. Stat. § 118A.03 to protect all County deposits with insurance, surety bond, or collateral. The market value of collateral pledged shall be at least ten percent more than the amount on deposit at the close of the financial institution's banking day, not covered by insurance or bonds.

Authorized collateral includes treasury bills, notes and bonds; issues of U.S. government agencies; general obligations rated "A" or better and revenue obligations rated "AA" or better; irrevocable standby letters of credit issued by the Federal Home Loan Bank; and certificates of deposit. Minnesota statutes require that securities pledged as collateral be held in safekeeping in a restricted account at the Federal Reserve Bank or in an account at a trust department of a commercial bank or other financial institution not owned or controlled by the financial institution furnishing the collateral.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

a. Deposits (Continued)

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a financial institution failure, the County's deposits may not be returned to it. The County does not have a deposit policy for custodial credit risk. As of December 31, 2011, the primary government's bank balances of \$509,171 were not exposed to custodial credit risk.

The Lake County Housing and Redevelopment Authority component unit does not have a deposit policy for custodial credit risk other than complying with the requirements of Minnesota statutes. As of December 31, 2011, the Authority's deposits were not exposed to custodial credit risk.

b. Investments

The County may invest in the following types of investments as authorized by Minn. Stat. §§ 118A.04 and 118A.05:

- (1) securities which are direct obligations or are guaranteed or insured issues of the United States, its agencies, its instrumentalities, or organizations created by an act of Congress, except mortgage-backed securities defined as "high risk" by Minn. Stat. § 118A.04, subd. 6;
- (2) mutual funds through shares of registered investment companies provided the mutual fund receives certain ratings depending on its investments;
- (3) general obligations of the State of Minnesota and its municipalities, and in certain state agency and local obligations of Minnesota and other states provided such obligations have certain specified bond ratings by a national bond rating service;
- (4) bankers' acceptances of United States banks;

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

b. Investments (Continued)

- (5) commercial paper issued by United States corporations or their Canadian subsidiaries that is rated in the highest quality category by two nationally recognized rating agencies and matures in 270 days or less; and
- (6) with certain restrictions, in repurchase agreements, securities lending agreements, joint powers investment trusts, and guaranteed investment contracts.

Interest Rate Risk

Interest rate risk is the risk that changes in the market interest rates will adversely affect the fair value of an investment. The County minimizes its exposure to interest rate risk by investing in both short-term and long-term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of an investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. It is the County's policy to invest only in securities that meet the ratings requirements set by state statute.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

b. Investments (Continued)

Custodial Credit Risk

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities in the possession of an outside party. The County does not have an investment policy for custodial credit risk. All of Lake County's investments in negotiable certificates of deposit and government securities are held by the counterparty to the transactions. These investments are covered by Securities Investor Protection Corporation (SIPC) insurance or excess SIPC insurance and are therefore, not subject to custodial credit risk.

Concentration of Credit Risk

The concentration of credit risk is the risk of loss that may be caused by the County's investment in a single issuer. It is the policy of the County to diversify investments to avoid risk and also for cash-flow purposes.

The following table presents the County's deposit and investment balances at December 31, 2011, and information relating to potential investment risks:

Investment Type	Credit Risk		Concentration Risk Over 5% of Portfolio	Interest Rate Risk Maturity Date	Carrying (Fair) Value
	Credit Rating	Rating Agency			
U.S. government agency securities					
Federal National Mortgage Association	N/R	N/A		02/01/2019	\$ 95,225
Federal National Mortgage Association	AAA	Moody's		08/24/2021	600,090
Total Federal National Mortgage Association			5.0%		\$ 695,315

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments (Continued)

Investment Type	Credit Risk		Concentration Risk Over 5% of Portfolio	Interest Rate Risk Maturity Date	Carrying (Fair) Value
	Credit Rating	Rating Agency			
Federal Home Loan Bank Bonds	AAA	Moody's		08/24/2021	\$ 300,236
Federal Home Loan Bank Bonds	AAA	Moody's		09/09/2021	1,250,238
Federal Home Loan Bank Bonds	AAA	Moody's		09/30/2021	654,758
Total Federal Home Loan Bank Bonds			16.5%		\$ 2,205,232
Government National Mortgage Association Note	N/R	N/A	<5%	02/15/2019	\$ 7,479
Federal Home Loan Mortgage Corporation	AAA	Moody's		09/30/2021	\$ 626,331
Federal Home Loan Mortgage Corporation	AAA	Moody's		09/30/2021	546,161
Federal Home Loan Mortgage Corporation	AAA	Moody's		12/01/2021	500,485
Total Federal Home Loan Mortgage Corporation			12.5%		\$ 1,672,977
Investment pools/mutual funds					
MAGIC Fund	N/R	N/A	64.2%	N/A	\$ 8,303,378
Wells Fargo Government Money Market	AAA	Moody's	<5%	N/A	215,509
Total investment pools/mutual funds					\$ 8,518,887
Total investments					\$ 13,099,890
Deposits - primary government					234,645
Deposits - component unit					507,731
Petty cash					3,400
Escheat cash					36,538
Total Cash and Investments					\$ 13,882,204

N/A - Not Applicable

N/R - Not Rated

<5% - Concentration is less than 5% of investments

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

A. Assets (Continued)

2. Receivables

Receivables as of December 31, 2011, for the County's governmental activities are as follows:

	Total Receivables	Amounts Not Scheduled for Collection During the Subsequent Year
Governmental Activities		
Taxes	\$ 547,858	\$ -
Due from other governments	4,420,509	-
Accounts	931,640	-
Interest	25,797	-
Loans receivable	112,399	68,143
Leases receivable	335,000	-
Total Governmental Activities	\$ 6,373,203	\$ 68,143

3. Capital Assets

Capital asset activity for the year ended December 31, 2011, was as follows:

Governmental Activities

	Beginning Balance	Increase	Decrease	Reclassify	Ending Balance
Capital assets not depreciated					
Land	\$ 3,990,362	\$ -	\$ -	\$ -	\$ 3,990,362
Capital assets depreciated					
Buildings	\$ 16,313,520	\$ 59,804	\$ -	\$ 2,984	\$ 16,376,308
Improvements other than buildings	536,277	153,035	-	(13,789)	675,523
Machinery, furniture, and equipment	9,444,358	1,617,429	78,567	10,805	10,994,025
Infrastructure	93,661,831	2,404,628	-	-	96,066,459
Total capital assets depreciated	\$ 119,955,986	\$ 4,234,896	\$ 78,567	\$ -	\$ 124,112,315

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

A. Assets

3. Capital Assets

Governmental Activities (Continued)

	Beginning Balance	Increase	Decrease	Reclassify	Ending Balance
Less: accumulated depreciation for					
Buildings	\$ 5,327,569	\$ 417,696	\$ -	\$ -	\$ 5,745,265
Improvements other than buildings	333,175	34,483	-	-	367,658
Machinery, furniture, and equipment	7,346,114	872,762	78,567	-	8,140,309
Infrastructure	20,259,474	1,843,434	-	-	22,102,908
Total accumulated depreciation	\$ 33,266,332	\$ 3,168,375	\$ 78,567	\$ -	\$ 36,356,140
Total capital assets depreciated, net	\$ 86,689,654	\$ 1,066,521	\$ -	\$ -	\$ 87,756,175
Governmental Activities Capital Assets, Net	\$ 90,680,016	\$ 1,066,521	\$ -	\$ -	\$ 91,746,537

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental Activities	
General government	\$ 225,416
Public safety	427,666
Highways and streets, including depreciation of infrastructure assets	2,199,414
Human services	97,266
Sanitation	13,749
Culture and recreation	182,576
Conservation of natural resources	22,288
Total Depreciation Expense - Governmental Activities	<u>\$ 3,168,375</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds (Continued)

B. Interfund Receivables, Payables, and Transfers

1. Due To/From Other Funds

The composition of interfund balances as of December 31, 2011, is as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>	<u>Purpose</u>
General	Human Services	\$ 15,725	Reimbursement for services
	Forfeited Tax Special Revenue	73,602	Deficit cash balance
	Broadband Capital Projects	781,769	Deficit cash balance
	Other Governmental Funds	<u>106,088</u>	Temporary loan
Total Due To/From Other Funds		<u>\$ 977,184</u>	

2. Due To/From Primary Government and Component Units

<u>Receivable Entity</u>	<u>Payable Entity</u>	<u>Amount</u>	<u>Purpose</u>
Primary Government - Debt Service	Component Unit - Lake County Housing and Redevelopment Authority	<u>\$ 400,403</u>	Shortfalls in tax increment collections funded by primary government

3. Interfund Transfers

Interfund transfers for the year ended December 31, 2011, consisted of the following:

Transfers to Other Governmental Funds from General Fund	\$ 141,358	Clair Nelson Memorial Forest Land Lease
Transfers to Road and Bridge Special Revenue Fund from General Fund	<u>14,474</u>	Reimbursements for services
Total Transfers	<u>\$ 155,832</u>	

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds (Continued)

C. Liabilities

1. Payables

Payables at December 31, 2011, were as follows:

	Governmental Activities
Accounts payable	\$ 471,722
Escheat property payable	36,538
Salaries payable	224,150
Contracts payable	391,825
Due to other governments	210,976
Total Payables	\$ 1,335,211

2. Long-Term Debt

Governmental Activities

Type of Indebtedness	Final Maturity	Installment Amounts	Interest Rate (%)	Original Issue Amount	Outstanding Balance December 31, 2011
General obligation bonds					
G.O. Capital Improvement Bonds, Series 2005A	2019	\$155,000 - \$310,000	3.375 - 3.80	\$ 3,200,000	\$ 2,170,000
G.O. State-Aid Highway Bonds, Series 2005B	2013	\$455,000 - \$460,000	3.25 - 3.50	3,200,000	910,000
Total General Obligation Bonds				\$ 6,400,000	\$ 3,080,000
Other long-term debt					
General obligation revenue note	2012	\$20,304 - \$24,286	2.00 3.25 -	\$ 222,422	\$ 24,285
Capital lease	2021	\$146,667 \$4,893 -	5.375	2,200,000	1,466,666
Capital lease	2016	\$28,719	3.75	134,259	113,591
Total Other Long-Term Debt				\$ 2,556,681	\$ 1,604,542

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

C. Liabilities (Continued)

3. Debt Service Requirements

Debt service requirements at December 31, 2011, were as follows:

Governmental Activities

Year Ending December 31	General Obligation Bonds		Other Long-Term Debt	
	Principal	Interest	Principal	Interest
2012	\$ 690,000	\$ 99,048	\$ 196,620	\$ 51,854
2013	700,000	74,710	173,314	45,743
2014	255,000	57,748	174,331	39,959
2015	265,000	48,388	175,386	34,138
2016	275,000	38,667	151,560	28,623
2017 - 2021	895,000	51,669	733,331	71,500
Total	<u>\$ 3,080,000</u>	<u>\$ 370,230</u>	<u>\$ 1,604,542</u>	<u>\$ 271,817</u>

4. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2011, was as follows:

Governmental Activities

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
General obligation bonds	\$ 3,765,000	\$ -	\$ 685,000	\$ 3,080,000	\$ 690,000
Notes payable	184,091	-	159,806	24,285	24,285
Total bonds and notes payable	\$ 3,949,091	\$ -	\$ 844,806	\$ 3,104,285	\$ 714,285
Capital lease payable	1,632,403	134,259	186,405	1,580,257	172,335
Compensated absences	1,128,268	577,536	532,103	1,173,701	-
Net other postemployment benefits	127,213	96,696	44,458	179,451	-
Governmental Activities Long-Term Liabilities	<u>\$ 6,836,975</u>	<u>\$ 808,491</u>	<u>\$ 1,607,772</u>	<u>\$ 6,037,694</u>	<u>\$ 886,620</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

C. Liabilities

4. Changes in Long-Term Liabilities (Continued)

The County has covenanted to provide ongoing disclosure of certain annual financial information and operating data with respect to the County, including audited financial statements of the County.

4. Pension Plans

A. Defined Benefit Plan

Plan Description

All full-time and certain part-time employees of Lake County are covered by defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the General Employees Retirement Fund, the Public Employees Police and Fire Fund, and the Local Government Correctional Service Retirement Fund (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).

All police officers, firefighters, and peace officers who qualify for membership by statute are covered by the Public Employees Police and Fire Fund. 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 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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Pension Plans

A. Defined Benefit Plan

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. 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 General Employees Retirement Fund 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 Police and Fire Fund members, the annuity accrual rate is 3.0 percent of average salary 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 for all Public Employees Police and Fire Fund 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 Police and Fire Fund members and Public Employees Correctional Fund members, and either 65 or 66 (depending on date hired) 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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Pension Plans

A. Defined Benefit Plan

Plan Description (Continued)

PERA issues a publicly available financial report that includes financial statements and required supplementary information for the General Employees Retirement Fund, the Public Employees Police and Fire 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.

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. The County 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 6.25 percent, respectively, of their annual covered salary. Public Employees Police and Fire Fund members are required to contribute 9.60 percent. Public Employees Correctional Fund members are required to contribute 5.83 percent of their annual covered salary.

The County is required to contribute the following percentages of annual covered payroll in 2011:

General Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	7.25
Public Employees Police and Fire Fund	14.40
Public Employees Correctional Fund	8.75

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Pension Plans

A. Defined Benefit Plan

Funding Policy (Continued)

The County's contributions for the years ending December 31, 2011, 2010, and 2009, for the General Employees Retirement Fund, the Public Employees Police and Fire Fund, and the Public Employees Correctional Fund were:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
General Employees Retirement Fund	\$ 372,065	\$ 480,493	\$ 456,644
Public Employees Police and Fire Fund	158,741	166,913	149,311
Public Employees Correctional Fund	44,979	45,371	43,115

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

B. Defined Contribution Plan

Four County Commissioners of Lake County are covered by the Public Employees Defined Contribution Plan, a multiple-employer, deferred compensation plan administered by PERA. The plan is established and administered in accordance with Minn. Stat. ch. 353D, which may be amended by the State Legislature. The plan is a tax qualified plan under Section 401(a) of the Internal Revenue Code, and all contributions by or on behalf of employees are tax deferred until time of withdrawal.

Plan benefits depend solely on amounts contributed to the plan plus investment earnings, less administrative expenses. For those qualified personnel who elect to participate, Minn. Stat. § 353D.03 specifies plan provisions, including the employee and employer contribution rates. An eligible elected official who decides to participate contributes 5.00 percent of salary, which is matched by the employer. Employees may elect to make member contributions in an amount not to exceed the employer share. Employee and employer contributions are combined and used to purchase shares in one or more of the seven accounts of the Minnesota Supplemental Investment Fund. For administering the plan, PERA receives 2.00 percent of employer contributions and 0.25 percent of the assets in each member account annually.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Pension Plans

B. Defined Contribution Plan (Continued)

Total contributions by dollar amount and percentage of covered payroll made by the County during the year ended December 31, 2011, were:

	<u>Employee</u>	<u>Employer</u>
Contribution amount	\$ 6,657	\$ 6,657
Percentage of covered payroll	5%	5%

Required contribution rates were 5.00 percent.

5. Postemployment Benefits

A. Plan Description and Funding Policy

Lake County explicitly subsidizes the cost of retiree health insurance coverage for certain retired employees through a sick leave reserve program under a single-employer self-insured plan. Highway Department employees with at least 10 years of service who are eligible to receive a retirement benefit from PERA are eligible for up to 2 years of health insurance premiums paid by the County at the single rate. Highway Department employees with 20 or more years of service are eligible for up to 3 years of health insurance premiums. At retirement, each eligible employee's sick leave hours are converted to a dollar amount using the employee's hourly pay rate at retirement. The period of time for which the employee may receive the paid health insurance benefit is limited to the dollar value of the employee's accumulated sick leave at retirement. As of December 31, 2011, there was one retiree using sick leave balances for insurance premiums.

Active employees who retire from the County when eligible to receive a retirement benefit from PERA, who do not qualify for the aforementioned benefits and do not participate in any other health benefits program providing similar coverage, will be eligible to continue coverage with respect to both themselves and their eligible dependents under the County's health benefits program. These retirees are required to 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. As of December 31, 2011, six retirees were receiving health benefits from the County's health plan. The authority to provide these benefits is established in Minn. Stat. § 471.61, subd. 2a.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Postemployment Benefits

A. Plan Description and Funding Policy (Continued)

The cost of other postemployment benefits is funded on a “pay-as-you-go” method.

B. Annual OPEB Cost and Net OPEB Obligation

The County’s 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 accrued liabilities (or funding excess) over a period not to exceed 30 years. The following table shows the components of the County’s annual OPEB cost for 2011, the amount actually contributed to the plan, and changes in the County’s net OPEB obligation:

ARC	\$	98,739
Interest on net OPEB obligation		5,725
Adjustment to ARC		(7,768)

Annual OPEB cost	\$	96,696
Contributions during the year		(44,458)

Increase in net OPEB obligation	\$	52,238
Net OPEB - Beginning of Year		127,213

Net OPEB - End of Year	\$	179,451

The County’s annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2011, 2010, and 2009 were as follows:

	2011	2010	2009
Percentage of annual OPEB cost contributed	46%	50.1%	80.4%
Annual OPEB cost	\$ 96,696	\$ 85,266	\$ 85,937
Employer contributions	(44,458)	(42,704)	(69,085)
Net Increase in Net OPEB Obligation	\$ 52,238	\$ 42,562	\$ 16,852

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Postemployment Benefits (Continued)

C. Funded Status and Funding Progress

The actuarial accrued liability for benefits at January 1, 2011, the most recent actuarial date, is \$638,272. The County 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 \$6,162,682. The ratio of the unfunded actuarially accrued liabilities (UAAL) to covered payroll is 10.4 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.

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, 2011, actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 4.5 percent discount rate, which is based on the estimated long-term investment yield on the general assets of the County. The annual health care cost trend rate is 8.5 percent initially, reduced incrementally to an ultimate rate of 5.0 percent after 7 years. The unfunded actuarial accrued liability is being amortized as a level dollar amount on a closed basis over 30 years.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

6. Postemployment Health Care Plans

A. MSRS Health Care Savings Plan

All Lake County employees (except for Highway Department employees) are eligible to participate in a Health Care Savings Plan (HCSP) administered by the Minnesota State Retirement System (MSRS). The plan is authorized under Minn. Stat. § 352.98 and through an Internal Revenue Service (IRS) private letter ruling establishing the HCSP as a tax-exempt benefit as of July 29, 2002. The plan is open to any active public employees in Minnesota if they are covered under certain public service retirement plans.

Under the terms of the HCSP, employees are allowed to save money, tax-free, to use upon termination of employment to pay for eligible health care expenses. The IRS private letter ruling requires mandatory participation of all employees in each bargaining unit in order to gain tax-free benefits. Allowable amounts deposited into individual accounts must be negotiated by each individual bargaining unit and the employer. The plan must be written into the collective bargaining agreement or a Memo of Understanding. For those employees not covered by a bargaining unit, amounts to be deposited into individual accounts must be agreed to by the employer and included in a written personnel policy.

Under Lake County's plan, both unionized and non-represented employees are required to contribute, at retirement, a lump sum of 10 or 20 percent of their eligible unused sick time plus the value of 24 or 36 months of health insurance premiums into their HCSP account, depending on the years of service.

B. VEBA Plan

The Lake County Board of Commissioners approved a Voluntary Employees' Beneficiary Association (VEBA) plan for funding employee health benefits as authorized under Sections 501(c)(9) and 213(d) of the IRS code for members of the Sheriff's Deputy Union, Sheriff's Dispatchers/Corrections Union, Courthouse, Human Services, and for non-represented employees. The VEBA plan is a health reimbursement plan providing for individual employer funded accounts that can be used to help pay eligible medical expenses incurred by participating employees. The plan is used in combination with a high deductible health care plan. Funding is provided through pre-tax contributions from Lake County on employee health care elections.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

6. Postemployment Health Care Plans

B. VEBA Plan (Continued)

In 2011, the maximum County contribution for active employees is \$1,690 for employees with single coverage and \$3,250 for employees with family coverage. Any balance remaining in an employee's account at year-end rolls over into the subsequent year. Upon retirement, any balance remaining in the VEBA account may be used to pay medical expenses.

Eligibility requirements include:

- be an active employee or retiree of a public entity,
- active employees must have a high deductible health care plan, and
- be a member of a bargaining unit that has approved the VEBA plan.

7. Summary of Significant Contingencies and Other Items

A. Risk Management

The County 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. To manage its workers' compensation and property and casualty risks, the County has entered into a joint powers agreement with other Minnesota counties to form the Minnesota Counties Intergovernmental Trust (MCIT). The County is a member of both the MCIT Workers' Compensation and Property and Casualty Divisions. The County self-insures for employee dental coverage and participates in a health insurance pool for employee health coverage. For other risks, the County carries commercial insurance. The County retains risk for the deductible portions of the insurance policies. The amounts of these deductibles are considered immaterial to the financial statements. There were no significant reductions in insurance from the prior year. The amount of settlements did not exceed insurance coverage for the past three fiscal years.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

A. Risk Management (Continued)

The Workers' Compensation Division of MCIT is self-sustaining based on the contributions charged, so that total contributions plus compounded earnings on these contributions will equal the amount needed to satisfy claims liabilities and other expenses. MCIT participates in the Workers' Compensation Reinsurance Association with coverage at \$450,000 in 2011 and \$460,000 in 2012. Should the MCIT Workers' Compensation Division liabilities exceed assets, MCIT may assess the County in a method and amount to be determined by MCIT.

The Property and Casualty Division of MCIT is self-sustaining, and the County pays an annual premium to cover current and future losses. MCIT carries reinsurance for its property lines to protect against catastrophic losses. Should the MCIT Property and Casualty Division liabilities exceed assets, MCIT may assess the County in a method and amount to be determined by MCIT.

The North East Service Cooperative (NESC) is a joint powers entity which sponsors a plan to provide group employee health benefits to its participating members. All members pool premiums and losses; however, a particular member may receive increases or decreases depending on a good or bad year of claims experience. Premiums are determined annually by the NESC and are based partially on the experience of the County and partially on the experience of the group. The NESC solicits proposals from carriers and negotiates the contracts.

The County retains the risk of loss from claims related to employee dental. The County has contracted with Delta Dental to administer the County's dental claims. The County provides dental coverage to permanent full-time employees based on negotiated union contracts to cover a portion of the dental claims. Claims are recognized as they are paid. The amount of claims incurred at the balance sheet date which have not been accrued in the financial statements is immaterial.

	Year Ended December 31	
	2011	2010
Unpaid claims, beginning of fiscal year	\$ -	\$ -
Incurred claims (including incurred but not reported)	92,709	123,166
Claims payments	(92,709)	(123,166)
Unpaid Claims, End of Fiscal Year	\$ -	\$ -

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items (Continued)

B. 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 the County expects such amounts, if any, to be immaterial.

The County is a defendant in various lawsuits. Although the outcome of these lawsuits is not presently determinable, in the opinion of the County Attorney, the resolution of these matters will not have a material adverse effect on the financial condition of the government.

C. Other Commitments

Lake County has entered into a joint powers agreement with the Town of Silver Creek to assist the Town in financing a wastewater collection, treatment, and disposal system in the Castle Danger area. The County has agreed to contribute \$65,586 per year through the year 2017 to help finance this project. The total amount to be contributed is \$1,035,000, of which \$681,446 has been paid through December 31, 2011. The outstanding commitment at December 31, 2011, is \$353,554. The agreement may be terminated by the mutual agreement of the two parties. This amount has not been recorded as a liability in Lake County's financial statements.

D. Joint Ventures

Arrowhead Regional Corrections

The County, in a joint powers agreement pursuant to Minn. Stat. § 471.59, participates with Carlton, Cook, Koochiching, and St. Louis Counties in the Arrowhead Regional Corrections Board, which was established pursuant to the Community Corrections Act, Minn. Stat. §§ 401.01-.16.

The Arrowhead Regional Corrections Board comprises three major divisions: juvenile institutional services, adult institutional services, and court and field services. These divisions are composed of the five participating counties' probation departments, the Arrowhead Juvenile Detention Center, and the Northeast Regional Corrections Center.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Arrowhead Regional Corrections (Continued)

Arrowhead Regional Corrections is governed by an eight-member Board, composed of one member appointed from each of the participating counties' Boards of Commissioners, except for St. Louis County, which has three members appointed by its Board. In addition, the right to have an additional member is annually rotated among Carlton, Cook, Koochiching, and Lake Counties.

Arrowhead Regional Corrections is financed through state grants and contributions from the participating counties. During 2010 (the most recent information available), county contributions were in the following proportion:

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>

Following is a summary of the financial information from Arrowhead Regional Corrections' government-wide statements for December 31, 2010:

Total Assets	\$ 12,823,585
Total Liabilities	5,758,723
Total Net Assets	7,064,862
Total Revenues	20,089,338
Total Expenses	21,388,600
Change in Net Assets	(1,299,262)

Lake County provided \$265,965 in funding during 2011. Separate financial information can be obtained from:

Arrowhead Regional Corrections
211 West Second Street, Suite 450
Duluth, Minnesota 55802

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures (Continued)

Community Health Board

Carlton, Cook, Lake, and St. Louis Counties entered into a joint powers agreement creating and operating the Carlton, Cook, Lake, and St. Louis County Community Health Board. This agreement was entered into January 1, 1977, and is established pursuant to Minn. Stat. § 471.59.

The Community Health Board is composed of nine members. The Carlton, Cook, and Lake County Boards of Commissioners each appoint two members; the St. Louis County Board of Commissioners appoints three members. Financing is obtained through federal and state grants. Lake County provided no funding to this organization in 2011.

At December 31, 2011, the Community Health Board's summary of financial information was:

Total Assets	\$	1,188,582
Total Liabilities		940,509
Total Net Assets		248,073
Total Revenues		6,073,622
Total Expenses		6,031,081
Change in Net Assets		42,541

Separate financial information can be obtained from:

Carlton, Cook, Lake, and St. Louis Counties
Community Health Board
404 West Superior Street, Suite 220
Duluth, Minnesota 55802

Northeast Minnesota Office of Job Training

Aitkin, Carlton, Cook, Itasca, Koochiching, Lake, and St. Louis Counties (excluding the City of Duluth) entered into a joint powers agreement pursuant to Minn. Stat. § 471.59 for the purpose of developing and implementing a private and public job training program. The United States Congress, through the Job Training Partnership Act of 1982, authorized states to establish "service delivery areas" to provide programs

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Northeast Minnesota Office of Job Training (Continued)

to achieve full employment through the use of grants. The counties identified above are defined as such a service delivery area, and the Northeast Minnesota Office of Job Training is designated as the grant recipient and administrator for such service delivery area. Lake County is not a funding mechanism for this organization.

The governing body is composed of seven members, one from the Board of Commissioners of each of the participating counties.

A summary of the financial information of the Northeast Minnesota Office of Job Training's government-wide statements for June 30, 2011, was:

Total Assets	\$ 3,057,757
Total Liabilities	1,682,354
Total Net Assets	1,375,403
Total Revenues	7,948,201
Total Expenses	7,939,583
Change in Net Assets	8,618

Separate financial information can be obtained from:

Northeast Minnesota Office of Job Training
820 North Ninth Street, Suite 240
P. O. Box 1028
Virginia, Minnesota 55792

Minnesota Counties Information Systems

The Counties of Aitkin, Carlton, Cass, Chippewa, Cook, Crow Wing, Dodge, Itasca, Koochiching, Lac qui Parle, Lake, Sherburne, and St. Louis entered into a joint powers agreement, pursuant to Minn. Stat. § 471.59, creating and operating Minnesota Counties Information Systems (MCIS). MCIS operates and maintains data processing facilities and management information systems for the benefit of members of this agreement.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Minnesota Counties Information Systems (Continued)

MCIS is governed by a 13-member board. Each participating county appoints a member. Financing is obtained through user charges to the members. Cass County is the fiscal agent for MCIS.

Each county's share of the assets and liabilities cannot be accurately determined since it will depend on the number of counties that are members when the agreement is dissolved.

A summary of the financial information of MCIS at December 31, 2010 (the most recent information available), was:

Total Assets	\$ 1,527,727
Total Liabilities	349,605
Total Net Assets	1,178,122
Total Revenues	2,984,785
Total Expenses	2,591,311
Change in Net Assets	393,474

Separate financial information can be obtained from:

Minnesota Counties Information Systems
413 Southeast 7th Avenue
Grand Rapids, Minnesota 55744

Northern Counties Land Use Board

The Northern Counties Land Use Board was established through a joint powers agreement, pursuant to Minn. Stat. § 471.59, for the purpose of helping to formulate land use plans for the protection, sustainable use, and development of lands and natural resources.

The joint powers are the Counties of Aitkin, Cook, Koochiching, Lake, Lake of the Woods, Marshall, Pennington, Roseau, and St. Louis. Three elected County Commissioners from St. Louis County and two from each of the other counties make up the membership of the Board. St. Louis County handles all of the financial transactions for this organization through its Northern Counties Land Use Board Agency Fund.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Northern Counties Land Use Board (Continued)

A summary of the financial statements at December 31, 2011, is shown below:

Total Assets	\$	117,632
Total Liabilities		991
Total Net Assets		116,641
Total Revenues		17,500
Total Expenditures		8,183
Change in Fund Balance		9,317

Lake County made contributions of \$2,000 in 2011 to the Northern Counties Land Use Board.

Separate financial information can be obtained from:

Northern Counties Land Use Board
St. Louis County Courthouse
100 N. 5th Avenue West, #214
Duluth, Minnesota 55802

North Shore Collaborative

The North Shore Collaborative was established in 1995 pursuant to Minn. Stat. § 124D.23. The Collaborative includes Lake County, Cook County, Independent School District 381, Independent School District 166, and the Grand Portage Reservation. The purpose of the Collaborative is to form a coalition of agencies, schools, and communities along the North Shore that will systematically address the mental health and other needs of the whole person for all children and youth; ensure their graduation from high school; and assist them in becoming healthy, happy, productive citizens.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures

North Shore Collaborative (Continued)

Control of the North Shore Collaborative is vested in a Board of Directors. Lake County has three members on the Board. Financing is provided by state and federal grants, appropriations from Collaborative members, and miscellaneous revenues. Lake County is the fiscal agent for the Collaborative and handles all of the financial transactions for the organization. Financial information for the Collaborative for the fiscal year ended December 31, 2011, is as follows:

Total Assets	<u>\$ 195,316</u>
Total Liabilities	<u>\$ 195,316</u>

Arrowhead Health Alliance

Carlton, Cook, Koochiching, and Lake Counties entered into a joint powers agreement, pursuant to Minn. Stat. §§ 471.59 and 256B.692, for the purpose of organizing, governing, planning, and administering a county-based purchasing entity to participate in prepaid health care programs through the Minnesota Department of Human Services and the federal Centers for Medicare and Medicaid Services.

Control of the Arrowhead Health Alliance is vested in a Board of Directors composed of one representative from each of the member counties. Carlton County is the fiscal agent for the Arrowhead Health Alliance.

Lake County contributed \$78,697 in start-up funds to the Arrowhead Health Alliance in 2007. The County has provided no further funding.

Northeast Minnesota Regional Radio Board

The Northeast Minnesota Regional Radio Board was established through a joint powers agreement, pursuant to Minn. Stat. §§ 471.59 and 403.39, to provide for regional administration of enhancements to the Statewide Public Safety Radio and Communication System (ARMER) and to enhance and improve interoperable public safety communications.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Northeastern Minnesota Regional Radio Board (Continued)

The joint powers are the Counties of Aitkin, Carlton, Cass, Cook, Crow Wing, Itasca, Kanabec, Koochiching, Lake, Pine, and St. Louis and the Cities of Duluth, Hibbing, International Falls, and Virginia. Control of the Northeast Minnesota Regional Radio Board is vested in a Board of Directors composed of one County Commissioner from each of the member counties and one City Councilor from each of the member cities. In addition, there is one member from the Northeast Minnesota Regional Advisory Committee, one member from the Northeast Minnesota Regional Radio System User Committee, and one member from the Northeast Minnesota Owners and Operators Committee who are also voting members of the Board.

Itasca County is the fiscal agent for the Northeast Minnesota Regional Radio Board. Funding is provided by grants and contributions from participating members. Lake County contributed \$226 in funding in 2011.

E. Jointly-Governed Organizations

Lake County, in conjunction with other local governments, has formed joint powers boards to provide a variety of services. The County appoints at least one member to the following organizations:

The North Shore Management Board provides Lake Superior Shoreline planning for Cook, Lake, and St. Louis Counties; the Cities of Beaver Bay, Grand Marais, Silver Bay, and Two Harbors; and the Towns of Duluth and Lakewood. Lake County did not provide any funding to the North Shore Management Board in 2011.

The St. Louis and Lake Counties Regional Railroad Authority operates a tourism train within the counties. Lake County did not provide any funding to the Regional Railroad Authority in 2011.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items (Continued)

F. Related-Party Transactions - Lake County Housing and Redevelopment Authority

The Lake County Housing and Redevelopment Authority is a discretely presented component unit of Lake County. The following are related-party transactions:

SEGOG Property

In June 2005, the County entered into an agreement with the Authority to sell 70 acres of land to the Authority for \$250,000. The property will be used for housing development to meet the County's housing needs and to assist in fostering economic development in the County. The purchase price of \$250,000 will be paid to the County as individual lots are sold in the development. This agreement has not been finalized as of December 31, 2011, and no cash payments have been made.

Tax Increment Shortfalls

The Authority's tax increment revenues have not been sufficient to cover bond payments on the Cove Point and Superior Shores tax increment bonds. Lake County has made the bond payments on these bond issues; however, the Lake County Housing and Redevelopment Authority remains obligated to Lake County for these shortfalls. A receivable has been set up on the County's financial statements in the amount of \$400,403.

G. Tax-Forfeited Land

The County manages approximately 150,000 acres of state-owned, tax-forfeited land. This land generates revenues primarily from recreational land leases and land and timber sales. Land management costs, including forestry costs such as site preparation, seedlings, tree planting, and logging roads, are accounted for as current operating expenditures.

8. Subsequent Events

Flood Damage

On June 19 and 20, 2012, the County incurred significant flood damage to its infrastructure due to an unprecedented rain event. Preliminary infrastructure damage estimates are \$2 million. The County anticipates receiving funding from various state and federal sources for disaster recovery costs.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

A. Summary of Significant Accounting Policies

In addition to those identified in Note 1, the County's discretely presented component unit, the Lake County Housing and Redevelopment Authority, has the following significant accounting policies.

Reporting Entity

The Lake County Housing and Redevelopment Authority was established June 13, 1984, and became active in 1986, having all the powers and duties of a county housing and redevelopment authority under the provisions of Minn. Stat. §§ 469.001-.047. The Authority is governed by a five-member Board appointed by the Lake County Board of Commissioners. The Board is organized with a chair, vice chair, secretary, and treasurer, elected annually.

Basis of Presentation

The Lake County Housing and Redevelopment Authority prepares separate financial statements.

The Authority reports a major governmental fund, the General Fund, and a major enterprise fund--the Silverpointe Enterprise Fund.

Measurement Focus and Basis of Accounting

The government-wide and proprietary fund 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. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

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. The Lake County Housing and Redevelopment Authority considers all revenues as available if collected

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

A. Summary of Significant Accounting Policies

Measurement Focus and Basis of Accounting (Continued)

within 90 days after the end of the current period, except for taxes, which have a 60-day accrual period. Property and other taxes, licenses, and interest are all considered to be susceptible to accrual.

Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, and claims and judgments, which are recognized as expenditures to the extent that they have matured. Proceeds of general 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 the Authority's policy to use restricted resources first and then unrestricted resources as needed.

The Authority's cash and cash equivalents consist of savings and checking accounts, cash on hand, and certificates of deposit, and do not include restricted accounts.

Receivables and Payables

All outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

Property taxes, including property taxes captured as tax increment, are levied as of January 1 on property values assessed as of the same date. The tax levy notice is mailed in March with the first half payment due May 15 and the second half payment due October 15. The Authority approved an annual levy for operating purposes. Property taxes, including tax increment, are collected by Lake County. Unpaid taxes at December 31 become liens on the respective property and are classified in the financial statements as taxes receivable.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

A. Summary of Significant Accounting Policies (Continued)

Restricted Assets

Certain funds of the Authority are classified as restricted assets on the statement of net assets because the restriction is either imposed by law through constitutional provisions or enabling legislation or imposed externally by creditors, grantors, contributors, or laws or regulations of other governments. Therefore, their use is limited by applicable laws and regulations.

Capital Assets

Capital assets, which include land, buildings and structures, and equipment, are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$1,000 and have an expected life of at least five years. Such assets are recorded at historical cost.

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.

Buildings and structures and equipment of the Authority are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings and structures	25 - 40
Equipment	7

Long-Term Obligations

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures (Continued)

B. Detailed Notes on All Funds

1. Assets

Deposits and Investments

a. Deposits

The Authority's total deposits are reported as follows:

Government-wide statement of net assets	
Cash	\$ 336,895
Cash with management company for operations	86,908
Restricted cash and pooled investments	69,197
Restricted cash with management company for security deposits	<u>14,731</u>
 Total Cash	 \$ <u>507,731</u>

The Authority is authorized by Minn. Stat. §§ 118A.02 and 118A.04 to designate a depository for public funds and to invest in certificates of deposit. The Authority is required by Minn. Stat. § 118A.03 to protect Authority deposits with insurance, surety bond, or collateral. The market value of collateral pledged shall be at least ten percent more than the amount on deposit at the close of the financial institution's banking day, not covered by insurance or bonds.

Authorized collateral includes treasury bills, notes and bonds; issues of U.S. government agencies; general obligations rated "A" or better and revenue obligations rated "AA" or better; irrevocable standby letters of credit issued by the Federal Home Loan Bank; and certificates of deposit. Minnesota statutes require that securities pledged as collateral be held in safekeeping in a restricted account at the Federal Reserve Bank or in an account at a trust department of a commercial bank or other financial institution not owned or controlled by the financial institution furnishing the collateral.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

B. Detailed Notes on All Funds

1. Assets

Deposits and Investments

a. Deposits (Continued)

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a financial institution failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk other than complying with the requirements of Minnesota statutes. As of December 31, 2011, the Authority's deposits were not exposed to custodial credit risk.

b. Investments

The types of investments the Authority is authorized by Minn. Stat. §§ 118A.04 and 118A.05 are the same as are available to the County and are detailed in Note 3.A.1.b.

As of, and during the year ended December 31, 2011, the Authority did not own any investments that required disclosure regarding interest rate risk, credit risk, custodial credit risk, or concentration of credit risk.

Loan Receivable

The Authority has a \$11,381 loan receivable from the Town of Crystal Bay for the Finland Coop Roofing Project, an unrelated organization. The loan has an interest rate of three percent with annual payments of \$1,007 due on January 10 of each year.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

B. Detailed Notes on All Funds

1. Assets (Continued)

Capital Assets

Capital asset activity for the year ended December 31, 2011, was as follows:

Governmental Activities

	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
Capital assets depreciated				
Equipment	\$ 1,866	\$ -	\$ -	\$ 1,866
Less: accumulated depreciation for				
Equipment	<u>534</u>	<u>267</u>	<u>-</u>	<u>801</u>
Governmental Activities				
Capital Assets, Net	<u>\$ 1,332</u>	<u>\$ (267)</u>	<u>\$ -</u>	<u>\$ 1,065</u>

Business-Type Activities

	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
Capital assets depreciated				
Buildings and structures	\$ 1,879,117	\$ -	\$ -	\$ 1,879,117
Equipment	<u>5,378</u>	<u>-</u>	<u>-</u>	<u>5,378</u>
Total capital assets depreciated	<u>\$ 1,884,495</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,884,495</u>
Less: accumulated depreciation for				
Buildings and structures	\$ 638,117	\$ 46,978	\$ -	\$ 685,095
Equipment	<u>5,378</u>	<u>-</u>	<u>-</u>	<u>5,378</u>
Total accumulated depreciation	<u>\$ 643,495</u>	<u>\$ 46,978</u>	<u>\$ -</u>	<u>\$ 690,473</u>
Business-Type Activities				
Capital Assets, Net	<u>\$ 1,241,000</u>	<u>\$ (46,978)</u>	<u>\$ -</u>	<u>\$ 1,194,022</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

B. Detailed Notes on All Funds

1. Assets

Capital Assets (Continued)

Depreciation expense was charged to functions/programs of the Authority as follows:

Governmental Activities	\$	267
Urban and economic development	<u> </u>	<u> </u>
Business-Type Activities		
Senior housing	<u> </u>	<u>46,978</u>

2. Liabilities

Long-Term Debt

Business-Type Activities

Type of Indebtedness	Final Maturity	Installment Amounts	Interest Rate (%)	Original Issue Amount	Outstanding Balance December 31, 2011
1996 General Obligation Senior Housing Bonds	2026	Varies	5.00	\$ 1,160,642	\$ 823,374

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

B. Detailed Notes on All Funds

2. Liabilities (Continued)

Debt Service Requirements

Debt service requirements at December 31, 2011, were as follows:

Business-Type Activities

<u>Year Ending December 31</u>	<u>Revenue Bonds</u>	
	<u>Principal</u>	<u>Interest</u>
2012	\$ 33,218	41,071
2013	35,060	39,230
2014	36,879	37,411
2015	38,793	35,497
2016	40,709	33,581
2017 - 2021	237,971	133,478
2022 - 2026	400,744	61,485
Totals	<u>\$ 823,374</u>	<u>\$ 381,753</u>

Changes in Long-Term Liabilities

Business-Type Activities

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds payable					
General Obligation					
Senior Housing Bonds	\$ 855,020	\$ -	\$ 31,646	\$ 823,374	\$ 33,218

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures (Continued)

C. Summary of Significant Contingencies and Other Items

Tax Increment Financing Districts

The Authority administers the following tax increment financing district established pursuant to Minn. Stat. §§ 469.174-.1791.

District Number 2

Blue Water/Superior Shores Project

The bonds for District Number 2 were general obligation bonds issued by Lake County and paid off in 2009. The County is holding the tax increment district open in order to recover some of the shortfall between tax increment collections and debt service payments that accumulated over the years. The County collects and pays the debt service payments pursuant to the amended Tax Increment Pledge Agreement, and the Authority recognizes the tax increment revenues and tax increment distributions to Lake County in its financial statements.

Risk Management

The Authority is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; or natural disasters. To manage these risks, the Authority has joined the Minnesota Counties Intergovernmental Trust (MCIT). The Authority retains risk for the deductible portions of the insurance policies. The amounts of these deductibles are considered immaterial to the financial statements. There were no significant reductions in insurance from the prior year.

The amount of settlements did not exceed insurance coverage for the past three fiscal years.

Financial Condition

The General Fund has a deficit fund balance of \$77,666 at December 31, 2011. The Authority's Board is looking into ways to improve its financial condition, including working with other similarly situated parties and the Minnesota Legislature to amend tax increment laws. The Authority is also in discussion with Lake County regarding its current obligations and the availability of alternative revenue sources.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

C. Summary of Significant Contingencies and Other Items (Continued)

Related-Party Transactions

The Lake County Housing and Redevelopment Authority related-party transactions are described in detail in Note 7.F.

D. Joint Ventures

In 2008, the Lake County Housing and Development Authority entered into a joint powers agreement with Cook County/Grand Marais Joint Economic Development Authority pursuant to Minn. Stat. § 471.59 for the purpose of preserving the existing housing market, encouraging new housing construction, and providing housing opportunities to the residents of Lake and Cook Counties. The power of each party will be exercised jointly under this agreement with the assistance of a housing coordinator to be retained by both parties. The Lake County Housing and Redevelopment Authority is the fiscal agent, and all the financial information is included as part of the Lake County Housing and Redevelopment Authority's financial statements. During 2011, this joint venture was dissolved.

E. Subsequent Events

On April 12, 2012, the Authority issued \$860,000 of Housing Development General Obligation Bonds to refund the outstanding maturities of the Silver Bay Senior Housing Bonds of 1996.

REQUIRED SUPPLEMENTARY INFORMATION

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT A-1

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2011**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Revenues				
Taxes	\$ 5,150,520	\$ 5,150,520	\$ 4,751,888	\$ (398,632)
Licenses and permits	7,500	7,500	8,931	1,431
Intergovernmental	5,299,687	5,299,687	6,471,075	1,171,388
Charges for services	497,700	497,700	558,260	60,560
Fines and forfeits	1,500	1,500	4,213	2,713
Investment earnings	126,000	126,000	145,688	19,688
Miscellaneous	91,463	91,463	255,803	164,340
Total Revenues	\$ 11,174,370	\$ 11,174,370	\$ 12,195,858	\$ 1,021,488
Expenditures				
Current				
General government				
Commissioners	\$ 441,394	\$ 441,394	\$ 466,400	\$ (25,006)
Courts	39,500	39,500	19,239	20,261
Law library	24,000	24,000	21,249	2,751
County administration	196,723	196,723	171,878	24,845
County auditor	543,064	543,064	527,269	15,795
County assessor	394,792	394,792	415,615	(20,823)
Elections	6,235	6,235	5,910	325
Accounting and auditing	70,600	70,600	63,031	7,569
Data processing	650,047	650,047	616,387	33,660
Personnel	212,691	212,691	183,123	29,568
Attorney	383,473	383,473	363,653	19,820
Recorder	269,548	269,548	316,032	(46,484)
Planning and zoning	244,974	244,974	382,259	(137,285)
Buildings and plant	687,649	687,649	627,700	59,949
Veterans service officer	78,148	78,148	75,747	2,401
Training	4,500	4,500	2,002	2,498
Motor pool	35,716	35,716	25,422	10,294
Other general government	-	-	14,784	(14,784)
Total general government	\$ 4,283,054	\$ 4,283,054	\$ 4,297,700	\$ (14,646)
Public safety				
Sheriff	\$ 2,182,208	\$ 2,182,208	\$ 2,224,782	\$ (42,574)
Ambulance	43,530	43,530	43,379	151
Emergency services	135,829	135,829	90,512	45,317
Coroner	18,000	18,000	25,246	(7,246)
County jail	910,171	910,171	937,199	(27,028)
Community corrections	290,726	290,726	268,431	22,295
Sentence to serve	73,616	73,616	63,019	10,597
Emergency management	60,793	99,083	388,356	(289,273)
Other public safety	1,276,036	1,276,036	1,022,982	253,054
Total public safety	\$ 4,990,909	\$ 5,029,199	\$ 5,063,906	\$ (34,707)

The notes to the required supplementary information are an integral part of this schedule.

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**EXHIBIT A-1
(Continued)**

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2011**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Expenditures				
Current (Continued)				
Sanitation				
Solid waste	\$ 153,699	\$ 153,699	\$ 125,116	\$ 28,583
Recycling	145,054	145,054	129,742	15,312
Hazardous waste	27,400	27,400	13,060	14,340
Total sanitation	\$ 326,153	\$ 326,153	\$ 267,918	\$ 58,235
Culture and recreation				
Historical society	\$ 35,000	\$ 35,000	\$ 35,000	\$ -
Arenas	245,574	245,574	237,820	7,754
Humane Society	-	3,500	3,500	-
Memorial Day observance	3,000	3,000	3,000	-
Recreation board	138,875	138,875	138,875	-
Trails	-	-	280,776	(280,776)
County/regional library	122,300	122,300	122,300	-
Total culture and recreation	\$ 544,749	\$ 548,249	\$ 821,271	\$ (273,022)
Conservation of natural resources				
County extension	\$ 102,013	\$ 102,013	\$ 98,751	\$ 3,262
Soil and water conservation	44,165	44,165	44,200	(35)
Agricultural society/County fair	24,185	24,185	24,134	51
Water planning	18,886	18,886	20,164	(1,278)
CWP project	-	-	43,625	(43,625)
Wetland challenge	5,000	5,000	-	5,000
Total conservation of natural resources	\$ 194,249	\$ 194,249	\$ 230,874	\$ (36,625)
Economic development				
Information centers	\$ 18,738	\$ 18,738	\$ 17,990	\$ 748
Airports	28,000	28,000	28,000	-
Housing and Redevelopment Authority	-	-	235,686	(235,686)
Total economic development	\$ 46,738	\$ 46,738	\$ 281,676	\$ (234,938)
Debt service				
Principal	\$ -	\$ -	\$ 23,808	\$ (23,808)
Total Expenditures	\$ 10,385,852	\$ 10,427,642	\$ 10,987,153	\$ (559,511)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

*EXHIBIT A-1
(Continued)*

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2011**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Excess of Revenues Over (Under) Expenditures	\$ 788,518	\$ 746,728	\$ 1,208,705	\$ 461,977
Other Financing Sources (Uses)				
Transfers out	59,000	59,000	(155,832)	(214,832)
Net Change in Fund Balance	\$ 847,518	\$ 805,728	\$ 1,052,873	\$ 247,145
Fund Balance - January 1, as restated (Note 1.E.)	<u>9,116,644</u>	<u>9,116,644</u>	<u>9,116,644</u>	<u>-</u>
Fund Balance - December 31	<u>\$ 9,964,162</u>	<u>\$ 9,922,372</u>	<u>\$ 10,169,517</u>	<u>\$ 247,145</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT A-2

**BUDGETARY COMPARISON SCHEDULE
ROAD AND BRIDGE SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2011**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 1,491,377	\$ 1,491,377	\$ 1,647,191	\$ 155,814
Intergovernmental	3,740,186	3,740,187	5,015,440	1,275,253
Charges for services	63,000	63,000	250,987	187,987
Investment earnings	100	100	319	219
Miscellaneous	14,000	14,000	5,563	(8,437)
Total Revenues	\$ 5,308,663	\$ 5,308,664	\$ 6,919,500	\$ 1,610,836
Expenditures				
Current				
Highways and streets				
Administration	\$ 345,760	\$ 345,760	\$ 483,632	\$ (137,872)
Maintenance	2,346,810	2,346,810	2,422,621	(75,811)
Construction	1,264,414	1,264,414	3,468,916	(2,204,502)
Equipment maintenance and shop	912,301	912,301	1,127,848	(215,547)
Total highways and streets	\$ 4,869,285	\$ 4,869,285	\$ 7,503,017	\$ (2,633,732)
Debt service				
Principal	\$ 455,000	\$ 455,000	\$ 494,738	\$ (39,738)
Interest	39,130	39,130	43,546	(4,416)
Administrative (fiscal) charges	410	410	402	8
Total debt service	\$ 494,540	\$ 494,540	\$ 538,686	\$ (44,146)
Total Expenditures	\$ 5,363,825	\$ 5,363,825	\$ 8,041,703	\$ (2,677,878)
Excess of Revenues Over (Under) Expenditures	\$ (55,162)	\$ (55,161)	\$ (1,122,203)	\$ (1,067,042)
Other Financing Sources (Uses)				
Transfers in	\$ 40,000	\$ 40,000	\$ 14,474	\$ (25,526)
Capital lease purchase	-	-	134,259	134,259
Total Other Financing Sources (Uses)	\$ 40,000	\$ 40,000	\$ 148,733	\$ 108,733
Net Change in Fund Balance	\$ (15,162)	\$ (15,161)	\$ (973,470)	\$ (958,309)
Fund Balance - January 1	-	-	1,015,424	1,015,424
Increase (decrease) in inventories	-	-	119,078	119,078
Fund Balance - December 31	\$ (15,162)	\$ (15,161)	\$ 161,032	\$ 176,193

The notes to the required supplementary information are an integral part of this schedule.

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT A-3

**BUDGETARY COMPARISON SCHEDULE
HUMAN SERVICES SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2011**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 2,130,218	\$ 2,130,218	\$ 1,914,885	\$ (215,333)
Intergovernmental	4,186,758	4,186,758	4,311,985	125,227
Charges for services	109,500	109,500	253,178	143,678
Miscellaneous	33,313	33,313	83,461	50,148
Total Revenues	\$ 6,459,789	\$ 6,459,789	\$ 6,563,509	\$ 103,720
Expenditures				
Current				
Human services				
Income maintenance	\$ 972,712	\$ 972,712	\$ 750,345	\$ 222,367
Social services	2,499,865	2,499,865	1,853,022	646,843
Total human services	\$ 3,472,577	\$ 3,472,577	\$ 2,603,367	\$ 869,210
Health				
Nursing service	\$ 80,871	\$ 80,871	\$ 80,757	\$ 114
Transportation	9,732	9,732	10,589	(857)
Environmental health	99,909	99,909	72,997	26,912
Mental health	2,396,614	2,396,614	2,779,970	(383,356)
Health education	353,354	353,354	277,011	76,343
Total health	\$ 2,940,480	\$ 2,940,480	\$ 3,221,324	\$ (280,844)
Total Expenditures	\$ 6,413,057	\$ 6,413,057	\$ 5,824,691	\$ 588,366
Net Change in Fund Balance	\$ 46,732	\$ 46,732	\$ 738,818	\$ 692,086
Fund Balance - January 1	4,901,248	4,901,248	4,901,248	-
Fund Balance - December 31	\$ 4,947,980	\$ 4,947,980	\$ 5,640,066	\$ 692,086

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT A-4

**BUDGETARY COMPARISON SCHEDULE
FORFEITED TAX SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2011**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Licenses and permits	\$ 570	\$ 570	\$ 1,799	\$ 1,229
Intergovernmental	22,241	22,241	32,889	10,648
Charges for services	295,000	295,000	20,394	(274,606)
Miscellaneous	424,975	424,975	558,473	133,498
Total Revenues	\$ 742,786	\$ 742,786	\$ 613,555	\$ (129,231)
Expenditures				
Current				
Conservation of natural resources				
Land use	\$ 602,361	\$ 602,361	\$ 597,616	\$ 4,745
Other conservation	-	-	3,399	(3,399)
Capital outlay				
Conservation of natural resources	32,000	32,000	44,861	(12,861)
Total Expenditures	\$ 634,361	\$ 634,361	\$ 645,876	\$ (11,515)
Net Change in Fund Balance	\$ 108,425	\$ 108,425	\$ (32,321)	\$ (140,746)
Fund Balance - January 1	39,573	39,573	39,573	-
Fund Balance - December 31	\$ 147,998	\$ 147,998	\$ 7,252	\$ (140,746)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT A-5

**SCHEDULE OF FUNDING PROGRESS - OTHER POSTEMPLOYMENT BENEFITS
DECEMBER 31, 2011**

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	\$ -	\$ 618,083	\$ 618,083	0.00%	\$ 5,722,969	10.8%
January 1, 2011	-	638,272	638,272	0.00	6,162,682	10.4

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED DECEMBER 31, 2011**

1. Budgetary Information

Annual budgets are adopted on a basis consistent with generally accepted accounting principles for all governmental funds. All annual appropriations lapse at fiscal year-end.

In July of each year, all departments and agencies submit requests for appropriations to the County Auditor/Treasurer so that a budget can be prepared. Before September 15, the proposed budget is presented to the County Board for review. A final budget is adopted by the Board and certified to the Auditor/Treasurer by December 30.

The appropriated budget is prepared by fund, function, and department. The County's department heads may make transfers of appropriations within a department with County Board approval. Transfers of appropriations between departments also require approval of the County Board. The legal level of budgetary control (the level at which expenditures may not legally exceed appropriations) is the fund level.

Encumbrance accounting is employed in governmental funds. Encumbrances (for example, purchase orders or contracts) outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be reapportioned and honored during the subsequent year.

2. Excess of Expenditures Over Appropriations

For the year ended December 31, 2011, expenditures exceeded appropriations in the following funds:

General Fund	\$	559,511
Road and Bridge Special Revenue Fund		2,677,878
Forfeited Tax Special Revenue Fund		11,515

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Schedule of Funding Progress - Other Postemployment Benefits

Beginning in 2008, Lake County implemented Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. Since the County has not irrevocably deposited funds in a trust for future health benefits, the actuarial value of the assets is zero. Currently, only two actuarial valuations are available. Future reports will provide additional trend analysis to meet the three-year valuation funding status requirement as the information becomes available.

See Note 5. in the notes to the financial statements for additional information regarding the County's other postemployment benefits.

SUPPLEMENTARY INFORMATION

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

NONMAJOR GOVERNMENTAL FUNDS

The Resource Development Special Revenue Fund is used to account for intergovernmental revenue used for resource development, forest management, game and fish habitat improvement, and recreational development and maintenance of County-administered natural resources land.

The Unorganized Townships Special Revenue Fund is used to account for the activities of Unorganized Townships 1 and 2 related to fire protection and election services. Activities related to road maintenance in the unorganized townships are accounted for in the County's Road and Bridge Special Revenue Fund.

The Debt Service Fund is used to account for the accumulation of resources for and the payment of principal, interest, and related costs of general long-term debt.

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-1

**COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
DECEMBER 31, 2011**

	Special Revenue			
	Resource Development	Unorganized Townships	Debt Service	Total
<u>Assets</u>				
Cash and pooled investments	\$ 83,337	\$ 172,932	\$ 147,891	\$ 404,160
Undistributed cash in agency funds	-	3,746	13,122	16,868
Taxes receivable				
Prior	-	6,325	24,897	31,222
Due from component unit	-	-	400,403	400,403
Total Assets	\$ 83,337	\$ 183,003	\$ 586,313	\$ 852,653
 <u>Liabilities and Fund Balances</u>				
Liabilities				
Due to other funds	\$ -	\$ -	\$ 106,088	\$ 106,088
Due to other governments	-	93,594	-	93,594
Deferred revenue - unavailable	-	5,312	21,351	26,663
Total Liabilities	\$ -	\$ 98,906	\$ 127,439	\$ 226,345
Fund Balances				
Restricted for debt service	\$ -	\$ -	\$ 458,874	\$ 458,874
Committed to unorganized townships emergency services	-	84,097	-	84,097
Assigned to resource development	83,337	-	-	83,337
Total Fund Balances	\$ 83,337	\$ 84,097	\$ 458,874	\$ 626,308
Total Liabilities and Fund Balances	\$ 83,337	\$ 183,003	\$ 586,313	\$ 852,653

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-2

**COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
NONMAJOR GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2011**

	<u>Special Revenue</u>		<u>Debt Service</u>	<u>Total</u>
	<u>Resource Development</u>	<u>Unorganized Township</u>		
Revenues				
Taxes	\$ -	\$ 110,332	\$ 556,832	\$ 667,164
Licenses and permits	-	112	-	112
Intergovernmental	304,992	10,177	43,189	358,358
Investment earnings	-	-	176	176
Miscellaneous	-	-	70,385	70,385
Total Revenues	\$ 304,992	\$ 120,621	\$ 670,582	\$ 1,096,195
Expenditures				
Current				
Public safety	\$ -	\$ 104,924	\$ -	\$ 104,924
Conservation of natural resources	235,799	-	-	235,799
Economic development	-	-	195,829	195,829
Debt service				
Principal	146,667	-	365,998	512,665
Interest	87,790	-	89,065	176,855
Administrative (fiscal) charges	-	-	403	403
Total Expenditures	\$ 470,256	\$ 104,924	\$ 651,295	\$ 1,226,475
Excess of Revenues Over (Under) Expenditures	\$ (165,264)	\$ 15,697	\$ 19,287	\$ (130,280)
Other Financing Sources (Uses)				
Transfers in	141,358	-	-	141,358
Net Change in Fund Balance	\$ (23,906)	\$ 15,697	\$ 19,287	\$ 11,078
Fund Balance - January 1, as restated (Note 1.E.)	107,243	68,400	439,587	615,230
Fund Balance - December 31	\$ 83,337	\$ 84,097	\$ 458,874	\$ 626,308

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-3

**BUDGETARY COMPARISON SCHEDULE
RESOURCE DEVELOPMENT SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2011**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Intergovernmental	\$ 100,000	\$ 100,000	\$ 304,992	\$ 204,992
Expenditures				
Current				
Conservation of natural resources				
Forestry	\$ -	\$ -	\$ 90,287	\$ (90,287)
Other conservation	-	-	145,512	(145,512)
Debt service				
Principal	146,667	146,667	146,667	-
Interest	87,921	87,921	87,790	131
Total Expenditures	\$ 234,588	\$ 234,588	\$ 470,256	\$ (235,668)
Excess of Revenues Over (Under) Expenditures	\$ (134,588)	\$ (134,588)	\$ (165,264)	\$ (30,676)
Other Financing Sources (Uses)				
Transfers in	-	-	141,358	141,358
Net Change in Fund Balance	\$ (134,588)	\$ (134,588)	\$ (23,906)	\$ 110,682
Fund Balance - January 1	107,243	107,243	107,243	-
Fund Balance - December 31	\$ (27,345)	\$ (27,345)	\$ 83,337	\$ 110,682

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-4

**BUDGETARY COMPARISON SCHEDULE
UNORGANIZED TOWNSHIPS SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2011**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 120,540	\$ 120,540	\$ 110,332	\$ (10,208)
Licenses and permits	50	50	112	62
Intergovernmental	-	-	10,177	10,177
	<u>-</u>	<u>-</u>	<u>10,177</u>	<u>10,177</u>
Total Revenues	\$ 120,590	\$ 120,590	\$ 120,621	\$ 31
Expenditures				
Current				
Public safety				
Emergency services	114,300	114,300	104,924	9,376
	<u>114,300</u>	<u>114,300</u>	<u>104,924</u>	<u>9,376</u>
Net Change in Fund Balance	\$ 6,290	\$ 6,290	\$ 15,697	\$ 9,407
Fund Balance - January 1	68,400	68,400	68,400	-
	<u>68,400</u>	<u>68,400</u>	<u>68,400</u>	<u>-</u>
Fund Balance - December 31	\$ 74,690	\$ 74,690	\$ 84,097	\$ 9,407
	<u><u>74,690</u></u>	<u><u>74,690</u></u>	<u><u>84,097</u></u>	<u><u>9,407</u></u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-5

**BUDGETARY COMPARISON SCHEDULE
DEBT SERVICE FUND
FOR THE YEAR ENDED DECEMBER 31, 2011**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 615,877	\$ 615,877	\$ 556,832	\$ (59,045)
Intergovernmental	-	-	43,189	43,189
Investment earnings	200	200	176	(24)
Miscellaneous	70,322	70,322	70,385	63
Total Revenues	\$ 686,399	\$ 686,399	\$ 670,582	\$ (15,817)
Expenditures				
Current				
Economic development				
Housing and Redevelopment Authority	\$ -	\$ -	\$ 195,829	\$ (195,829)
Debt service				
Principal	363,672	363,672	365,998	(2,326)
Interest	88,976	88,976	89,065	(89)
Bond issuance costs	450	450	-	450
Administrative (fiscal) charges	1,500	1,500	403	1,097
Total Expenditures	\$ 454,598	\$ 454,598	\$ 651,295	\$ (196,697)
Net Change in Fund Balance	\$ 231,801	\$ 231,801	\$ 19,287	\$ (212,514)
Fund Balance - January 1	439,587	439,587	439,587	-
Fund Balance - December 31	\$ 671,388	\$ 671,388	\$ 458,874	\$ (212,514)

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FIDUCIARY FUNDS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT C-1

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2011**

	Balance January 1	Additions	Deductions	Balance December 31
<u>CITIES, TOWNS, AND OTHER GOVERNMENTS</u>				
<u>Assets</u>				
Cash and pooled investments	\$ <u>1,531</u>	\$ <u>11,773,844</u>	\$ <u>11,772,285</u>	\$ <u>3,090</u>
<u>Liabilities</u>				
Due to other governments	\$ <u>1,531</u>	\$ <u>11,773,844</u>	\$ <u>11,772,285</u>	\$ <u>3,090</u>
 <u>TAXES AND PENALTIES</u>				
<u>Assets</u>				
Cash and pooled investments	\$ <u>275,809</u>	\$ <u>18,535,408</u>	\$ <u>18,493,255</u>	\$ <u>317,962</u>
<u>Liabilities</u>				
Taxes collected in advance	\$ 7,445	\$ 11,878	\$ 7,445	\$ 11,878
Due to other governments	<u>268,364</u>	<u>18,523,530</u>	<u>18,485,810</u>	<u>306,084</u>
Total Liabilities	\$ <u>275,809</u>	\$ <u>18,535,408</u>	\$ <u>18,493,255</u>	\$ <u>317,962</u>
 <u>STATE</u>				
<u>Assets</u>				
Cash and pooled investments	\$ <u>30,001</u>	\$ <u>195,434</u>	\$ <u>205,529</u>	\$ <u>19,906</u>
<u>Liabilities</u>				
Due to other governments	\$ <u>30,001</u>	\$ <u>195,434</u>	\$ <u>205,529</u>	\$ <u>19,906</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

*EXHIBIT C-1
(Continued)*

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2011**

	<u>Balance January 1</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance December 31</u>
<u>SEWER SYSTEM DEPOSITS</u>				
<u>Assets</u>				
Cash and pooled investments	\$ <u>44,640</u>	\$ <u>5,000</u>	\$ <u>11,930</u>	\$ <u>37,710</u>
<u>Liabilities</u>				
Customer deposits - current	\$ <u>44,640</u>	\$ <u>5,000</u>	\$ <u>11,930</u>	\$ <u>37,710</u>
 <u>NORTH SHORE COLLABORATIVE</u>				
<u>Assets</u>				
Cash and pooled investments	\$ <u>159,230</u>	\$ <u>113,830</u>	\$ <u>77,744</u>	\$ <u>195,316</u>
<u>Liabilities</u>				
Accounts payable	\$ <u>159,230</u>	\$ <u>113,830</u>	\$ <u>77,744</u>	\$ <u>195,316</u>
 <u>SUNRISE NURSING HOME</u>				
<u>Assets</u>				
Cash and pooled investments	\$ <u>265,121</u>	\$ <u>10,944</u>	\$ <u>276,065</u>	\$ <u>-</u>
<u>Liabilities</u>				
Accounts payable	\$ <u>265,121</u>	\$ <u>10,944</u>	\$ <u>276,065</u>	\$ <u>-</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

*EXHIBIT C-1
(Continued)*

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2011**

	Balance January 1	Additions	Deductions	Balance December 31
<u>TOTAL ALL AGENCY FUNDS</u>				
<u>Assets</u>				
Cash and pooled investments	\$ <u>776,332</u>	\$ <u>30,634,460</u>	\$ <u>30,836,808</u>	\$ <u>573,984</u>
<u>Liabilities</u>				
Accounts payable	\$ 424,351	\$ 124,774	\$ 353,809	\$ 195,316
Taxes collected in advance	7,445	11,878	7,445	11,878
Due to other governments	299,896	30,492,808	30,463,624	329,080
Customer deposits - current	<u>44,640</u>	<u>5,000</u>	<u>11,930</u>	<u>37,710</u>
Total Liabilities	\$ <u>776,332</u>	\$ <u>30,634,460</u>	\$ <u>30,836,808</u>	\$ <u>573,984</u>

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OTHER SCHEDULES

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT D-1

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2011**

Shared Revenue

State

Highway users tax	\$	2,986,578
County program aid		120,153
PERA rate reimbursement		24,475
Disparity reduction aid		155,178
Police aid		104,771
Taconite credit		546,176
Enhanced 911		83,677
Market value credit		195,669

Total shared revenue **\$ 4,216,677**

Reimbursement for Services

State

Minnesota Department of Human Services	\$	234,918
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Payments

State

Payments in lieu of taxes	\$	762,743
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Local

Region III funding from other counties		162,213
Arrowhead Regional Development Commission		78,375
Local		564,628

Total payments **\$ 1,567,959**

Grants

State

Minnesota Department of Public Safety	\$	31,726
Health		87,637
Natural Resources		622,829
Pollution Control		104,700
Transportation		297,022
Human Services		2,838,640
Employment and Economic Security		65,382
Board of Water and Soil Resources		134,982
Office of Environmental Assistance		55,950

Total state **\$ 4,238,868**

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

***EXHIBIT D-1
(Continued)***

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2011**

Grants (Continued)

Federal

Department of	
Agriculture	\$ 3,414,070
Interior	239,697
Housing and Urban Development	235,686
Transportation	853,127
Health and Human Services	743,106
Homeland Security	574,578

Total federal **\$ 6,060,264**

Total state and federal grants **\$ 10,299,132**

Total Intergovernmental Revenue **\$ 16,318,686**

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT D-2

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2011**

Federal Grantor Pass-Through Agency Grant Program Title	Contract Number/ Pass-Through Grant Numbers	Federal CFDA Number	Expenditures
U.S. Department of Agriculture			
Direct			
U.S. Forest Service Cooperative Agreement	10.R9-9-95-35B		\$ 13,500
U.S. Forest Service Cooperative Agreement - Aquatic passages	11-PA-11090903-027		175,240
Capital Improvement and Maintenance - ARRA		10.687	47,599
Wildland Fire Management - ARRA		10.688	89,507
Broadband Initiatives Program - ARRA		10.787	151,226
Passed Through Carlton, Cook, Lake, and St. Louis Community Health Board Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)		10.557	44,676
Passed Through Minnesota Department of Human Services State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (SNAP)		10.561	77,561
Passed Through Minnesota Department of Natural Resources Cooperative Forestry Assistance		10.664	92,690
Passed Through Minnesota Department of Management & Budget Schools and Roads - Grants to State		10.665	<u>2,807,435</u>
Total U.S. Department of Agriculture			<u>\$ 3,499,434</u>
U.S. Department of Housing and Urban Development			
Passed Through Minnesota Department of Employment and Economic Development			
Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii	CDAP-09-0063-0-FY10 CDAP-10-0078-0-FY11	14.228	<u>\$ 235,686</u>
U.S. Department of the Interior			
Direct			
Payments in Lieu of Taxes		15.226	<u>\$ 239,697</u>
U.S. Department of Transportation			
Highway Planning and Construction Cluster			
Passed Through Minnesota Department of Transportation Highway Planning and Construction	SP-38-090-03 SP-38-090-06 SP-38-595-03 SP-38-620-03	20.205	\$ 718,640
Passed Through Minnesota Department of Natural Resources Recreational Trails Program	Forest 2011-2	20.219	<u>71,482</u>
Total U.S. Department of Transportation			<u>\$ 790,122</u>

The notes to the Schedule of Expenditures of Federal Awards are an integral part of this schedule.

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**EXHIBIT D-2
(Continued)**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2011**

Federal Grantor Pass-Through Agency Grant Program Title	Contract Number/ Pass-Through Grant Numbers	Federal CFDA Number	Expenditures
U.S. Department of Health and Human Services			
Passed Through Carlton, Cook, Lake, and St. Louis Community Health Board			
The Affordable Care Act: Centers for Disease Control and Prevention - Investigations and Technical Assistance		93.283	\$ 18,329
PPHF 2012 National Public Health Improvement Initiative		93.507	738
Temporary Assistance for Needy Families Cluster			
Temporary Assistance for Needy Families		93.558	9,454
Immunization - ARRA		93.712	4,380
Medical Assistance Program		93.778	6,348
Maternal and Child Health Services Block Grant		93.994	10,221
Passed Through Minnesota Department of Human Services			
Promoting Safe and Stable Families		93.556	4,578
Temporary Assistance for Needy Families Cluster			
Temporary Assistance for Needy Families		93.558	62,871
Emergency Contingency Fund for Temporary Assistance for Families (TANF) State Program - ARRA		93.714	4,608
Child Support Enforcement		93.563	215,565
Child Care Mandatory and Matching Funds of the Child Care and Development Fund		93.596	4,155
Foster Care - Title IV-E		93.658	51,692
Social Services Block Grant		93.667	101,040
Chafee Foster Care Independence Program		93.674	1,701
Children's Health Insurance Program		93.767	59
Medical Assistance Program		93.778	246,794
Block Grants for Community Mental Health Services		93.958	573
Total U.S. Department of Health and Human Services			\$ 743,106
U.S. Department of Homeland Security			
Direct			
Port Security Grant Program		97.056	\$ 378,727
Passed Through Minnesota Department of Natural Resources			
Boating Safety Financial Assistance		97.012	19,045
Passed Through Minnesota Department of Public Safety			
Hazard Mitigation Grant		97.039	19,452
Emergency Management Performance Grants	2011-EMPG-04341	97.042	36,654
Homeland Security Grant Program	2008-OSGP-09832		
	2009-OSGP-01830		
	2009-OSGP-10981		
	2010-OSGP-01833	97.067	120,700
Total U.S. Department of Homeland Security			\$ 574,578
Total Federal Awards			\$ 6,082,623

The notes to the Schedule of Expenditures of Federal Awards are an integral part of this schedule.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2011**

1. Reporting Entity

The Schedule of Expenditures of Federal Awards presents the activities of federal award programs expended by Lake County. The County's reporting entity is defined in Note 1 to the financial statements.

2. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Lake County under programs of the federal government for the year ended December 31, 2011. The information in this schedule is presented in accordance with the requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the schedule presents only a selected portion of the operations of Lake County, it is not intended to and does not present the financial position, changes in net assets, or cash flows of Lake County.

3. Summary of Significant Accounting Policies

Expenditures reported on the schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through entity identifying numbers are presented where available.

4. Clusters

Clusters of programs are groupings of closely related programs that share common compliance requirements. Total expenditures by cluster are:

Highway Planning and Construction Cluster	\$	790,122
Temporary Assistance for Needy Families Cluster		76,933

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Reconciliation to Schedule of Intergovernmental Revenue

Federal grant revenue per Schedule of Intergovernmental Revenue	\$ 6,060,264
Grants received more than 90 days after year-end, deferred in 2011	
Cooperative Forestry Assistance	63,077
Broadband Initiatives Program	70,189
Highway Planning and Construction	55,977
Deferred in 2010, recognized as revenue in 2011	
Broadband Initiatives Program	(47,902)
Highway Planning and Construction	(118,982)
	<hr/>
Expenditures Per Schedule of Expenditures of Federal Awards	<u>\$ 6,082,623</u>

6. American Recovery and Reinvestment Act

The American Recovery and Reinvestment Act of 2009 (ARRA) requires recipients to clearly distinguish ARRA funds from non-ARRA funding. In the schedule, ARRA funds are denoted by the addition of ARRA to the program name.

7. Subrecipients

During 2011, the County did not pass any federal money to subrecipients.

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2011**

I. SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: **Unqualified**

Internal control over financial reporting:

- Material weaknesses identified? **Yes**
- Significant deficiencies identified? **Yes**

Noncompliance material to the financial statements noted? **No**

Federal Awards

Internal control over major programs:

- Material weaknesses identified? **Yes**
- Significant deficiencies identified? **No**

Type of auditor's report issued on compliance for major programs: **Unqualified**

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133? **Yes**

The major programs are:

Schools and Roads - Grants to States	CFDA #10.665
Broadband Initiatives Program - ARRA	CFDA #10.787
Port Authority Grant Program	CFDA #97.056

The threshold for distinguishing between Types A and B programs was \$300,000.

Lake County qualified as low-risk auditee? **No**

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

96-11 Segregation of Duties

Criteria: A good system of internal control provides for an adequate segregation of duties so that no one individual handles a transaction from its inception to completion.

Condition: At Lake County, some individuals who collect and receipt cash, can also post receipts to the general ledger system and make bank deposits. Also, an individual who maintains the general ledger, makes journal entries, and reconciles bank accounts also does some cash receipting. In addition, the same person who processes cash disbursements has the ability to print and sign checks. At the department level, many of these functions are also not segregated.

Context: Due to the limited number of office personnel within the County, segregation of the accounting functions necessary to ensure adequate internal accounting control is not possible. This is not unusual in operations the size of Lake County; however, the County's management should constantly be aware of this condition and realize that the concentration of duties and responsibilities in a limited number of individuals is not desirable from an accounting point of view.

Effect: Inadequate segregation of duties could adversely affect the County's ability to detect misstatements in amounts that would be material in relation to the financial statements in a timely period by employees in the normal course of performing their assigned functions.

Cause: The County does not have the economic resources needed to hire additional qualified accounting staff in order to segregate duties in every department.

Recommendation: We recommend that the County's elected officials and management be aware of the lack of segregation of duties of the accounting functions and, where possible, implement oversight procedures to ensure that the internal control policies and procedures are being implemented by staff to the extent possible.

Client's Response:

The County's management is aware of this condition. Limited staff prohibits the extensive segregation of duties that is desired. Occasional re-assignment of duties will be attempted in order to increase the segregation.

03-2 Capital Assets

Criteria: A capital assets policy should be adopted which defines the County's accounting policies over capital assets, such as capitalization thresholds, useful lives, and depreciation methods. A physical inventory should be taken of capital assets at least every five years.

Condition: The County Board has not adopted a capital asset policy. There has not been a physical inventory of capital assets since the records were first established in 2003.

Context: The County maintains its capital asset records on a capital asset software system. Additions and deletions are entered into this system and depreciation is calculated by the system. However, the capital asset policies utilized by the County in maintaining this system have not been formally approved by the County Board.

Effect: Without a written capitalization policy, the County may capitalize or depreciate assets inconsistently from year to year. Without a physical inventory of capital assets, it is possible that items that were disposed of will not be properly taken off inventory.

Cause: The County Board has not established or approved a capital asset policy, and no one has been assigned the responsibility of setting up a system to do a physical inventory of capital assets.

Recommendation: We recommend the County Board establish a capital asset policy to define the County's accounting policies over capital assets. The policy should also establish procedures to identify capital additions and deletions. Also, we recommend a physical inventory of capital assets be performed at least once every five years. This physical inventory can be rotated so that a portion of the capital assets is inventoried each year.

Client's Response:

The County intends to develop policies and procedures for capital assets and determine a process of doing a physical inventory as time permits.

06-2 Budgeting

Criteria: The budget policy should address how the budget will be monitored.

Condition: The County Board has adopted a formal budget policy which addresses when budget amendments must be approved by the County Board or County Auditor/Treasurer. However, the budget policy does not address how the budget will be monitored or who will monitor it.

Context: To be an effective financial management tool, a budget should be monitored to determine that departments are not overspending their budgets.

Effect: There is no formal process for monitoring the budget. This could result in over expenditure of budgets.

Cause: The County Board has not determined the procedures to be used for monitoring the budget and has not addressed this in the budget policy.

Recommendation: We recommend the budget policy be revised to include budget monitoring procedures. These procedures could include department head review of monthly budget to actual reports or County Budget Officer review of budget to actual reports. Reviewers should indicate their review of budget to actual reports by signing off on them.

Client's Response:

The County intends to amend the budget policy, and the amended policy will address monitoring procedures.

06-3 Audit Adjustments

Criteria: 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 of the financial statements on a timely basis. Statement on Auditing Standards 115 defines a material weakness as a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the County's financial statements will not be prevented, or detected and corrected, on a timely basis.

Condition: During our audit, we identified material adjustments that resulted in significant changes to the County's financial statements.

Context: The inability to detect significant misstatements in the financial statements increases the likelihood that the financial statements would not be fairly presented.

Effect: Audit adjustments were necessary to record additional receivables, to allocate unallocated revenues and expenses, to reclassify fund balances to the appropriate GASB 54 fund balance classifications, and to make other reclassification entries as necessary. Audit adjustments were also necessary to adjust the modified accrual financial statements to the accrual basis for the government-wide financial statements.

Cause: The County provides cash basis financial statements and prepares some of the modified accrual information necessary to adjust the cash basis financial statements to the modified accrual basis. However, the County staff do not have the time nor the technical expertise to ensure that all material adjustments have been made.

Recommendation: We recommend the County staff review the trial balances and journal entries in detail to ensure they have an understanding of all audit adjustments made so that, in future audits, this information can be prepared by the County.

Client's Response:

It is anticipated that the Financial Coordinator and the County Auditor will review the trial balances and journal entries.

06-4 Accounting Policies and Procedures Manual

Criteria: All governments should document their accounting policies and procedures. Although other methods might suffice, this documentation is traditionally in the form of an accounting policies and procedures manual.

Condition: The County does not have a current and comprehensive accounting policies and procedures manual.

Context: This manual should be on hand to document the accounting policies and procedures which make up the County's internal control system. It can also help to prevent deterioration of key elements in the County's internal control system and help to avoid circumvention of County policies.

Effect: An accounting policies and procedures manual will enhance employees' understanding of their role and function in the internal control system, establish responsibilities, provide guidance for employees, improve efficiency and consistency of transaction processing, and improve compliance with established policies.

Cause: Lake County has various policies and procedures documents that have been adopted by the County Board. Some of these policies are accounting-related policies, and others are administrative in nature. The policies have not been integrated into a comprehensive accounting policies and procedures manual.

Recommendation: We recommend the County establish an accounting policies and procedures manual. The accounting policies and procedures manual should be prepared by appropriate levels of management and be approved by the County Board to emphasize its importance and authority. The documentation should describe procedures as they are intended to be performed, indicate which employees are to perform which procedures, and explain the design and purpose of control-related procedures to increase employee understanding and support for controls.

Client's Response:

The Auditor will attempt to draft a policy and procedures manual for the County Board's review and approval.

06-6 New Vendors

Criteria: Before being added to the accounts payable system, all new vendors should be verified as to their validity.

Condition: Lake County does not have any formal procedures for reviewing new vendors that have been added to the accounts payable system or for determining if they are legitimate vendors.

Context: There are generally a minimum of 5 to 10 new vendors added to the accounts payable system each year.

Effect: Without procedures to review and verify new vendors, fictitious vendors could be established.

Cause: Formal policies and procedures have never been established and approved to review new vendors created or to establish their validity.

Recommendation: We recommend the County Auditor develop written policies and procedures for staff to follow when setting up new a vendor that verifies the validity of the vendor, such as looking up the vendor in the phone book or on the internet or requiring the company to send information about its business. An active vendor's listing should be periodically reviewed by someone independent of the accounts payable processing function. That person should document the review by signing off on the report.

Client's Response:

The County's current policy is for the person responsible for creating a new vendor to check by internet and other sources that the vendor is legitimate. The Auditor does an occasional review of the new vendor list.

06-7 Payroll

Criteria: Internal controls would be strengthened if someone independent of the payroll processing function reviewed the payroll edit reports to make sure all changes made to the payroll system master file were authorized by the personnel department.

Condition: In Lake County, the payroll clerk can input master file changes to the payroll system, review and clear the payroll edit reports, and run the final payroll and checks.

Context: Lake County has limited staff which does not allow for the desired segregation of duties in this area.

Effect: The lack of segregation of duties over the payroll function could allow for opportunities to make changes to the payroll system master file which are not authorized by the personnel office.

Cause: Lake County has limited staff and the time frame within which payroll must be processed also limits the amount of review which can be done by someone independent of the payroll processing function.

Recommendation: We recommend that someone independent of the payroll processing review the payroll edit reports to make sure all changes made to the payroll system master file were authorized. This independent person should also review the final payroll reports and check to verify all employees paid are actual employees and the hours worked appear to be correct. The functions of generating and signing payroll checks should be segregated from the payroll processing function, if possible

Client's Response:

The County intends to have the Human Resources Administrator review payroll edits. The Auditor and/or the Financial Coordinator will review the payroll before processing.

07-1 Approval of Time Sheets

Criteria: Time sheets should have two attestations of the hours worked. One attestation should be made by the employee, and the other should be made by the employee's supervisor or other appropriate person.

Condition: Lake County supervisors and certain employees who do not have immediate supervisors approve their own timesheets.

Context: Five employee timesheets out of 40 we tested during our 2011 audit did not have secondary/supervisory signatures.

Effect: Supervisors and certain other employees without immediate supervisor are in a position to approve their own time worked, including compensatory time and overtime in some cases, and vacation and sick leave hours taken.

Cause: It has been Lake County's practice to not require secondary approval on these timesheets.

Recommendation: We recommend that all timesheets have two attestations of hours worked. One attestation should be made by the employee, and the other should be made by the employee's supervisor or other appropriate person.

Client's Response:

The County will require all timesheets to have two attestations, one of which will be the employee and the other will be the supervisor or other appropriate person.

PREVIOUSLY REPORTED ITEMS RESOLVED

Preparation of Financial Statements (03-4)

The County needed to broaden its participation in the preparation of its financial statements and not rely so extensively on its external auditors for financial reporting.

Resolution

The County provides a general ledger, accruals, trial balances, and other supporting schedules necessary for preparing fund level and government-wide financial statements. The County has improved its understanding and preparation of underlying accounting data used in the preparation of the financial statements.

Journal Entries (06-1)

The County needed to establish procedures to have an individual who does not record journal entries to review and approve manual journal entries.

Resolution

Journal entries are reviewed by Steve McMahon and Lola Haus every month. When the month is closed, Lola prints a General Journal Report for all journal entries made that month. She and Steve sign the report verifying that the report has been reviewed and all journal entries made are legitimate. Some journal entries are Board-approved, and a copy of the minutes is attached to the journal entry printout.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

ITEM ARISING THIS YEAR

11-1 Identification of Federal Awards

Programs: U.S. Forest Service Cooperative Agreement - Aquatic Passages (Contract No. 11-PA-11090903-027), Broadband Initiatives Program (CFDA No. 10.787), Highway Planning and Construction Grant (CFDA No. 20.205), Cooperative Forestry Assistance (CFDA No. 10.664), Wildland Fire Management Grant (CFDA No. 10.688), and Port Security Grant Program (CFDA No. 97.056)

Criteria: The Office of Management and Budget's (OMB) Circular A- 133, *Audits of States, Local Governments, and Non-Profit Organizations*, *Auditee Responsibilities* subpart C.300(a) and (d) requires, "The auditee shall identify, in its accounts, all Federal

awards received and expended and the Federal programs under which they were received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity. The auditee shall prepare appropriate financial statements, including the Schedule of Expenditures of Federal awards (SEFA) in accordance with subpart C.310.”

Condition: Lake County did not identify several programs on the SEFA for which there were federal funds expended. Also, federal expenditures were not correctly reported for other programs.

Context: The SEFA prepared by Lake County did not correctly identify federal programs and amounts expended for the following more significant programs:

- The County did not identify \$175,240 in U.S. Forest Service cooperative agreements. These are federal funds, but there is no CFDA number assigned.
- The County over reported expenditures on the Broadband Initiatives Program (CFDA No. 10.787) by \$361,774. These expenditures were related to a building purchase which was not completed until 2012.
- The County under reported expenditures on the Highway Planning and Construction Grant (CFDA No. 20.205) by \$145,017.
- The County did not identify \$92,690 of Cooperative Forestry Assistance (CFDA No. 10.664) funding passed through the Minnesota Department of Natural Resources.
- The County did not identify \$89,507 of Wildland Fire Management Grant (CFDA No. 10.688) direct funding.
- The County did not identify \$378,727 as direct federal Port Security Grant Program (CFDA No. 97.056) funding on the SEFA.

Effect: The inability to identify and accurately record federal financial assistance in the SEFA results in a deficiency in internal control over SEFA preparation, and the reporting of federal financial assistance in accordance with OMB Circular A-133.

Cause: The County erred in its determination and classification of the actual amounts received and expended under these federal programs. The County’s procedures and internal controls for identifying federal financial assistance for preparation of its SEFA are inadequate.

Recommendation: We recommend that County management develop a process for adequately identifying federal revenues and accumulating the information needed to prepare the SEFA. Those responsible for compiling the SEFA should understand the components of the SEFA and properly gather the correct information and maintain supporting documentation. For each federal award identified, the County should determine the correct program CFDA title and number, award number and year, federal grantor agency, pass-through agency, amount received and expended, and whether American Recovery and Reinvestment Act (ARRA) funding is involved. The County should also reconcile the SEFA amounts to the general ledger and financial statements.

Corrective Action Plan:

Name of Contact Person Responsible For Corrective Action:

Lake County Auditor, Steve McMahon

Corrective Action Planned:

The County will attempt to develop a process to identify federal revenues and accumulate the information needed to prepare SEFA.

Anticipated Completion Date:

Third quarter of 2013

IV. OTHER FINDINGS AND RECOMMENDATIONS

MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM RESOLVED

Prompt Payment (09-3)

The County needed to establish procedures that would ensure that vendors are paid within 35 days of the receipt of an invoice in accordance with Minn. Stat. § 475.425, subd. 2.

Resolution

During our 2011 disbursements testing, we did not note any payments which were not paid within 35 days.



REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of County Commissioners
Lake County

We have audited the financial statements of the governmental activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lake County as of and for the year ended December 31, 2011, which collectively comprise the County's basic financial statements, and have issued our report thereon dated November 8, 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

Management of Lake County is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Lake County's 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 the County's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material

weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the County's financial statements will not be prevented, or detected and corrected, on a timely basis. We considered the deficiency described in the accompanying Schedule of Findings and Questioned Costs as item 06-3 to be a material weakness.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 96-11, 03-2, 06-2, 06-4, 06-6, 06-7, and 07-1 to be significant deficiencies.

Compliance and Other Matters

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

Minnesota Legal Compliance

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

The *Minnesota Legal Compliance Audit Guide for Political Subdivisions* contains seven categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, miscellaneous provisions, and tax increment financing. Our study included all of the listed categories, except that the testing for compliance with tax increment financing was done with the audit of the Lake County Housing and Redevelopment Authority component unit.

The results of our tests indicate that for the items tested, Lake County complied with the material terms and conditions of applicable legal provisions.

Lake County's written responses to the internal control findings identified in our audit have been included in the Schedule of Findings and Questioned Costs. We did not audit the County's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Board of County Commissioners, management, others within Lake County, 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

/s/Greg Hierlinger

REBECCA OTTO
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

November 8, 2012

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REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of County Commissioners
Lake County

Compliance

We have audited Lake County's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2011. Lake County's major federal programs are 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 each of its major federal programs is the responsibility of the County's management. Our responsibility is to express an opinion on the County'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 Lake County'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 County's compliance with those requirements.

In our opinion, Lake County complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2011.

Internal Control Over Compliance

Management of Lake County 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 County's internal control over compliance with requirements that could have a direct and material effect on a major federal program to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 County's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified a certain deficiency in internal control over compliance that we consider to be a material weakness.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as item 11-1 to be a material weakness.

Lake County's corrective action plan to the federal award finding identified in our audit is included in the accompanying Schedule of Findings and Questioned Costs. We did not audit the County's corrective action plan and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of County Commissioners, management and others within the County, 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

November 8, 2012

/s/Greg Hierlinger

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DEPUTY STATE AUDITOR