

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2014

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 150 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 700 public pension funds; and

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

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

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

For the Year Ended December 31, 2014



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

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

ORGANIZATION
DECEMBER 31, 2014

			<u>Term Expires</u>
Elected			
Commissioners			
Chair	Rick Goutermont	Lake County	January 2017
Vice Chair	Richard Brenner	Carlton County	January 2017
Board Member	Janice Hall	Cook County	January 2015
Board Member	Brian McBride	Koochiching County	January 2017
Board Member	Wade Pavleck	Koochiching County	January 2019
Board Member	Christopher Dahlberg	St. Louis County	January 2017
Board Member	Keith Nelson	St. Louis County	January 2019
Board Member	Pete Stauber	St. Louis County	January 2017
Appointed			
Executive Director	Kay Arola		Indefinite

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

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INDEPENDENT AUDITOR'S REPORT

Board of Commissioners
Arrowhead Regional Corrections
Duluth, Minnesota

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and the General Fund of Arrowhead Regional Corrections as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise Arrowhead Regional Corrections' basic financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to Arrowhead Regional Corrections' preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not

for the purpose of expressing an opinion on the effectiveness of Arrowhead Regional Corrections' internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the General Fund of Arrowhead Regional Corrections as of December 31, 2014, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Required Supplementary Information as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, 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.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Arrowhead Regional Corrections' basic financial statements. The Schedule of Intergovernmental Revenue 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. Such 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.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

January 7, 2016

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MANAGEMENT'S DISCUSSION AND ANALYSIS

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2014
(Unaudited)**

Our Management's Discussion and Analysis (MD&A) of Arrowhead Regional Corrections' (ARC) financial performance provides an overview of the financial activities for the fiscal year ended December 31, 2014. Please read it in conjunction with the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

Total net position for Arrowhead Regional Corrections increased \$7.5 million to \$15.2 million.

Total fund balance for the Arrowhead Regional Corrections General Fund was \$5.4 million at the end of 2014, an increase of \$1.5 million from 2013.

Most of the fund balance, 98 percent, was committed or assigned by ARC for a specific purpose. Of this, 61 percent was committed towards retiree obligations and vesting sick leave to pay for employee sick leave reserve balances at retirement.

The Arrowhead Regional Corrections General Fund reported \$1.5 million revenues in excess of expenditures mainly due to an investment by its five member counties to help fund \$7.5 million in renovations of a capital nature at the Northeast Regional Corrections Center (NERCC).

OVERVIEW OF THE FINANCIAL STATEMENTS

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

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

These two statements report Arrowhead Regional Corrections' net position and changes to it. Arrowhead Regional Corrections' net position--the difference between assets and liabilities--is one way to measure Arrowhead Regional Corrections' financial health, or financial position. Over time, increases or decreases in Arrowhead Regional Corrections' net position are one indicator of whether its financial health is improving or deteriorating. You will need to consider other non-financial factors, such as the condition of buildings and structures, to assess the overall health of Arrowhead Regional Corrections. The government-wide financial statements can be found on pages 13 and 14.

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

All of Arrowhead Regional Corrections' services are reported in the General Fund, which focuses on how money flows into and out of the fund, and any balance left at year-end is available for spending. This fund is reported using the modified accrual method of accounting, which measures cash and all other financial assets that can be readily converted to cash. The General Fund statements provide a detailed short-term view of Arrowhead Regional Corrections' operations and the basic services it provides. General Fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance Arrowhead Regional Corrections' programs. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Position and the Statement of Activities) and the General Fund in a reconciliation following each of the fund financial statements. The basic financial statements for the General Fund can be found on pages 15 through 18.

Notes to the financial statements: The notes provide additional information essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found on pages 19 through 36.

Supporting schedules: The budgetary comparison schedule, notes to required supplementary information, and schedule of intergovernmental revenue are provided on pages 37 through 41.

Government-Wide Financial Analysis

Net position may, over time, be a useful indicator of a government's financial position. In the case of Arrowhead Regional Corrections, assets exceeded liabilities by \$15.2 million.

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

Table 1
Net Position
(in Millions)

	Governmental Activities	
	2014	2013
Current and other assets	\$ 8.6	\$ 6.8
Capital assets	13.6	7.6
Total Assets	\$ 22.2	\$ 14.4
Other liabilities	\$ 2.7	\$ 2.0
Long-term liabilities outstanding	4.3	4.7
Total Liabilities	\$ 7.0	\$ 6.7
Net Position		
Investment in capital assets	\$ 13.6	\$ 7.6
Unrestricted	1.6	0.1
Total Net Position	\$ 15.2	\$ 7.7

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

Governmental Activities

The total net position of Arrowhead Regional Corrections increased \$7.5 million in 2014 to \$15.2 million. Arrowhead Regional Corrections continues to report positive balances in net position because total assets exceed total liabilities.

Current and other assets increased by \$1.8 million in 2014 to \$8.6 million. The difference is a result of an increase of the asset - cash and investments. The State of Minnesota's 2014 legislative appropriation of a \$1.0 million end-grant for the NERCC campus renovations has yet to be received.

Total liabilities increased slightly to \$7.0 million. Other liabilities, which consist of accounts payable, salaries payable, contracts payable, due to other governments, and unearned revenue, increased \$0.7 million, and long-term liabilities outstanding, which are 100 percent compensated absences, decreased by \$0.4 million.

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

Table 2
Changes in Net Position
(in Millions)

	Governmental Activities	
	2014	2013
Revenues		
Program revenues		
Capital grants and contributions	\$ 6.0	\$ 0.7
Fees, charges, fines, and other	1.2	1.3
Operating grants and contributions	3.2	2.8
General revenues		
Community Corrections Act subsidy	3.9	3.9
Grants and contributions not restricted to specific programs	15.5	14.8
Miscellaneous and other	0.2	0.2
Total Revenues	<u>\$ 30.0</u>	<u>\$ 23.7</u>
Expenses		
Program expenses		
Administration	\$ 1.9	\$ 2.3
Court and field services	10.8	10.2
Northeast Regional Corrections Center (NERCC)	5.7	5.7
Arrowhead Juvenile Center (AJC)	4.1	4.0
Total Expenses	<u>\$ 22.5</u>	<u>\$ 22.2</u>
Increase (Decrease) in Net Position	\$ 7.5	\$ 1.5
Net Position, January 1	<u>7.7</u>	<u>6.2</u>
Net Position, December 31	<u><u>\$ 15.2</u></u>	<u><u>\$ 7.7</u></u>

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

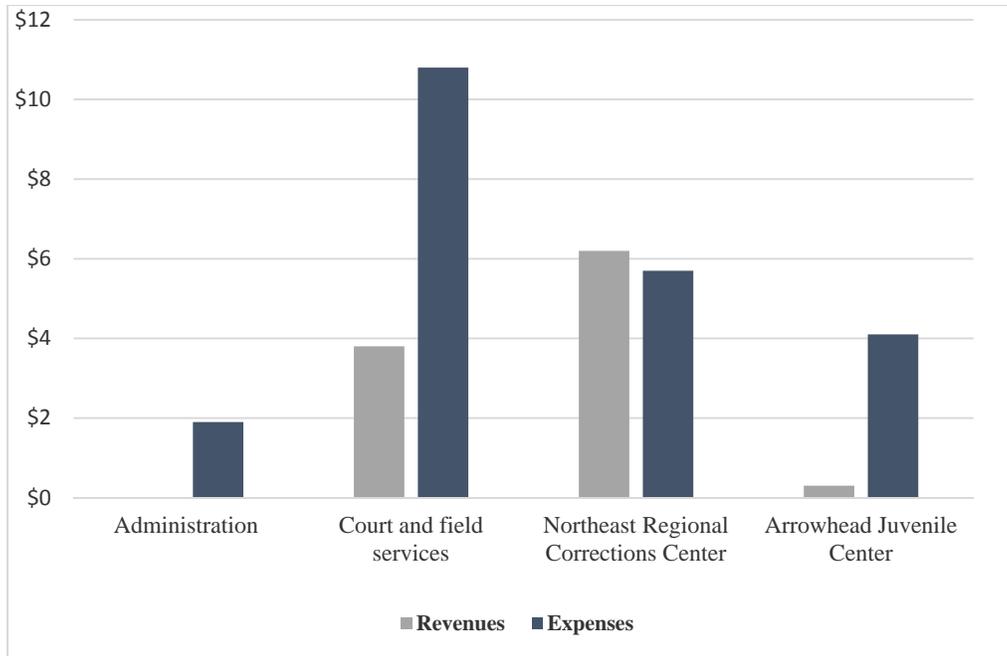
Governmental Activities

Revenues collected in 2014 by Arrowhead Regional Corrections totaled \$30.0 million, or \$6.3 million more than 2013.

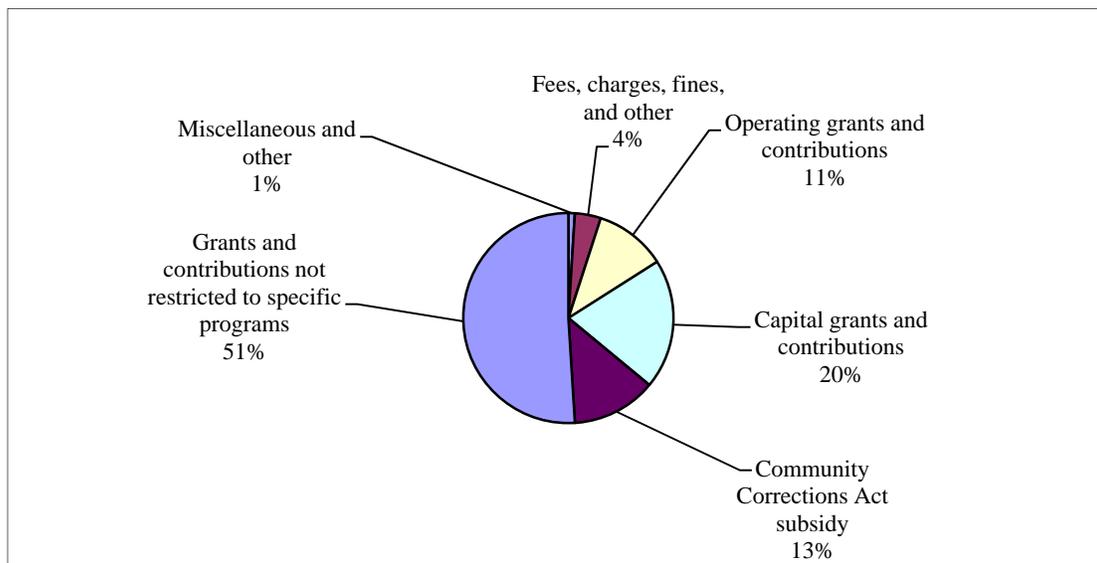
Member county contributions (general revenues) were \$15.3 million in 2014, \$14.8 million in 2013, \$13.7 million in 2012, \$12.0 million in 2011, and \$11.9 million in 2010.

Total expenses for 2014 were \$0.3 million more than 2013. Court and field services' total expenses increased by \$0.6 million from 2013, while Arrowhead Juvenile Center's total expenses increased by \$0.1 million. Administration expenses decreased by \$0.4 million compared to 2013.

Program Revenues and Expenses: Governmental Activities
(Amounts in Millions)



Revenues by Source: Governmental Activities



Financial Analysis of the General Fund

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

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

As of December 31, 2014, the Arrowhead Regional Corrections General Fund reported a fund balance of \$5.4 million, compared with \$3.9 million in 2013. County shares increased by \$0.5 million in 2014 so that ARC will no longer be using reserves to fund current year operations.

Expenditures for personnel services accounted for approximately 59 percent of Arrowhead Regional Corrections' total expenditures in 2014. Intergovernmental revenues (monies received from member counties and federal, state, and local grants) accounted for 95 percent of Arrowhead Regional Corrections' total revenues for the year.

General Fund Budgetary Highlights

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

The five member counties total contributions had an increase of \$0.5 million in 2014.

During the year, the final revenue and expenditure budgets both increased from the original budget. The changes were due to grant budget adjustments that happened during the year.

Total expenditures for Arrowhead Regional Corrections for 2014 were \$2.0 million under budget. The majority of the unspent budget monies were encumbered for capital improvements at the NERCC.

Total revenues for 2014 were \$0.9 million less than the final budget. Intergovernmental revenues and charges for services came in \$0.9 million below the budget projections.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At year-end, Arrowhead Regional Corrections showed total capital assets of \$13.6 million. These amounts represent a broad range of capital assets, including land, buildings, machinery, vehicles, furniture, and equipment. Detail is presented immediately below in Table 3.

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

	Governmental Activities	
	2014	2013
Construction in progress	\$ 6.3	\$ 1.6
Land	0.5	0.5
Buildings	6.4	5.2
Machinery, vehicles, furniture, and equipment	0.4	0.3
Totals	<u>\$ 13.6</u>	<u>\$ 7.6</u>

Total capital assets increased by \$6.0 million in 2014 mainly due to the \$7.5 million NERCC main building renovation project. Some of the purchases during the year included passenger vehicles, building and farm equipment, and lighting upgrades.

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

Debt Administration

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

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The Arrowhead Regional Corrections Board set the 2015 budget at \$24.8 million, an increase of 8.5 percent from the 2014 budget. The main funding for this increased budget came from the county shares.

The average unemployment rate for the five member counties was 5.7 percent for 2014, while the average unemployment rate was 6.2 percent for the United States and 4.1 percent for the State of Minnesota.

The 2015 budget was passed on September 19, 2014, at a meeting of the Arrowhead Regional Corrections Board of Commissioners.

CONTACTING ARROWHEAD REGIONAL CORRECTIONS FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of finances and to show Arrowhead Regional Corrections' accountability for the money it receives. If you have a question about this report or need information, contact the Arrowhead Regional Corrections Office at: 100 North 5th Avenue West, Duluth, Minnesota 55802-1202.

BASIC FINANCIAL STATEMENTS

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 1

**STATEMENT OF NET POSITION
GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2014**

Assets

Cash and pooled investments	\$ 3,772,773
Petty cash and change funds	5,045
Investments	2,946,202
Accounts receivable	97,315
Accrued interest receivable	2,440
Due from other governments	1,669,469
Inventories	122,644
Capital assets	
Non-depreciable	6,759,219
Depreciable - net of accumulated depreciation	<u>6,872,267</u>
Total Assets	<u>\$ 22,247,374</u>

Liabilities

Accounts payable	\$ 595,234
Salaries payable	765,122
Contracts payable	1,127,486
Due to other governments	21,229
Unearned revenue - grants	194,414
Long-term liabilities	
Due within one year	1,158,644
Due in more than one year	<u>3,183,892</u>
Total Liabilities	<u>\$ 7,046,021</u>

Net Position

Investment in capital assets	\$ 13,631,486
Unrestricted	<u>1,569,867</u>
Total Net Position	<u>\$ 15,201,353</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 2

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2014**

	Program Revenues			Net (Expense)
Expenses	Fees, Charges, Fines, and Other	Operating Grants and Contributions	Capital Grants and Contributions	Revenue and Change in Net Position
<u>Functions/Programs</u>				
Governmental activities				
Administration	\$ 1,926,349	\$ -	\$ -	\$ (1,926,349)
Court and field services	10,775,796	814,100	3,000,433	(6,961,263)
Northeast Regional Corrections Center	5,696,887	226,720	93,834	623,667
Arrowhead Juvenile Center	4,122,757	150,845	112,356	(3,859,556)
	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	\$ 6,000,000
	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	\$ 6,000,000
	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	\$ 6,000,000
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	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	\$ 6,000,000
	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	\$ 6,000,000
	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	\$ 6,000,000
	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	\$ 6,000,000
	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	\$ 6,000,000
	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	\$ 6,000,000
	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	\$ 6,000,000
	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	\$ 6,000,000
	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	\$ 6,000,000
	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	\$ 6,000,000
	\$ 22,521,789	\$ 1,191,665	\$ 3,206,623	

FUND FINANCIAL STATEMENTS

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GOVERNMENTAL FUND

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 3

**BALANCE SHEET
GENERAL FUND
DECEMBER 31, 2014**

Assets

Cash and pooled investments	\$	3,772,773
Petty cash and change funds		5,045
Investments		2,946,202
Accounts receivable		97,315
Accrued interest receivable		2,440
Due from other governments		1,669,469
Inventories		122,644
		122,644
Total Assets	\$	8,615,888

**Liabilities, Deferred Inflows of Resources,
and Fund Balance**

Liabilities		
Accounts payable	\$	595,234
Salaries payable		765,122
Contracts payable		1,127,486
Due to other governments		21,229
Unearned revenue - grants		194,414
		194,414
Total Liabilities	\$	2,703,485
Deferred Inflows of Resources		
Unavailable revenue - grants		531,103
		531,103
Fund Balance		
Nonspendable		
Inventories		122,644
Committed to		
Retiree obligations		1,985,520
Vesting sick leave		1,198,372
Assigned to		
Capital equipment		125,379
Capital improvements and emergency repairs		1,946,131
Health and welfare		3,254
		3,254
Total Fund Balance	\$	5,381,300
Total Liabilities, Deferred Inflows of Resources, and Fund Balance	\$	8,615,888

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 4

**RECONCILIATION OF THE GENERAL FUND BALANCE SHEET TO
THE GOVERNMENT-WIDE STATEMENT OF NET POSITION--GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2014**

Fund balance - total governmental funds (Exhibit 3)	\$ 5,381,300
Amounts reported for governmental activities in the statement of net position 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.	13,631,486
Other long-term assets are not available to pay for current period expenditures and, therefore, are reported as deferred inflows of resources in the governmental funds.	531,103
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the governmental funds.	
Compensated absences	<u>(4,342,536)</u>
Net Position of Governmental Activities (Exhibit 1)	<u>\$ 15,201,353</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 5

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2014**

Revenues	
Intergovernmental	\$ 28,961,904
Charges for services	1,191,665
Investment earnings	12,043
Miscellaneous	178,868
	<hr/>
Total Revenues	\$ 30,344,480
Expenditures	
Current	
Administration	\$ 1,966,585
Court and field services	10,883,362
Northeast Regional Corrections Center	5,575,453
Arrowhead Juvenile Center	4,075,606
Capital outlay	6,391,456
	<hr/>
Total Expenditures	\$ 28,892,462
Net Change in Fund Balance	\$ 1,452,018
Fund Balance - January 1	3,921,759
Increase (decrease) in inventories	7,523
	<hr/>
Fund Balance - December 31	\$ 5,381,300
	<hr/> <hr/>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 6

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCE OF THE GENERAL FUND TO THE
GOVERNMENT-WIDE STATEMENT OF ACTIVITIES--GOVERNMENTAL ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2014**

Net change in fund balance - total governmental funds (Exhibit 5) \$ 1,452,018

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

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

Unavailable revenue - December 31	\$ 531,103	
Unavailable revenue - January 1	<u>(901,344)</u>	(370,241)

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

Expenditures for general capital assets	\$ 6,391,456	
Current year depreciation	<u>(359,524)</u>	6,031,932

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 compensated absences	\$ (182,682)	
Change in OPEB liability	513,900	
Change in inventories	<u>7,523</u>	<u>338,741</u>

Change in Net Position of Governmental Activities (Exhibit 2) \$ 7,452,450

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2014**

1. Summary of Significant Accounting Policies

Arrowhead Regional Corrections' financial statements are prepared in accordance with generally accepted accounting principles (GAAP) for the year ended December 31, 2014. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (statements and interpretations). The more significant accounting policies established in GAAP and used by Arrowhead Regional Corrections are discussed below.

A. Financial Reporting Entity

Arrowhead Regional Corrections provides correctional services to the five counties of Northeastern Minnesota's Arrowhead region. Arrowhead Regional Corrections was established pursuant to the Community Corrections Act, Minn. Stat. §§ 401.01-.16, and a joint powers agreement, effective January 1, 1993, between Carlton, Cook, Koochiching, Lake, and St. Louis Counties, pursuant to Minn. Stat. § 471.59.

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

St. Louis County reports the financial transactions of Arrowhead Regional Corrections in an agency fund on its annual financial statements.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

B. Basic Financial Statements

1. Government-Wide Statements

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

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

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

2. Fund Financial Statements

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

C. Measurement Focus and Basis of Accounting

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

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

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity

1. Cash and Pooled Investments

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

2. Inventories and Prepaid Items

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

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.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity
(Continued)

3. Capital Assets

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

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

Property, plant, and equipment of Arrowhead Regional Corrections are depreciated using the straight-line method over the following estimated useful lives:

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

4. Compensated Absences

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity
(Continued)

5. Unearned Revenue

Governmental funds and the government-wide financial statements report unearned revenue in connection with resources that have been received but not yet earned.

6. Long-Term Obligations

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

7. Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents consumption of net position that applies to a future period(s) and will not be recognized as an outflow of resources (expenditure/expense) until then. Currently, Arrowhead Regional Corrections has no items that qualify for reporting in this category.

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. Arrowhead Regional Corrections has only one type of item, which arises only under the modified accrual basis of accounting that qualifies for reporting in this category. Accordingly, the item, unavailable revenue, is reported only in the governmental fund balance sheet. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity
(Continued)

8. Classification of Net Position

Net position in the government-wide statement of net position is classified in the following categories:

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

Restricted net position - the amount of net position 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 position - the amount of net position that does not meet the definition of restricted or investment in capital assets.

9. Classification of Fund Balance

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

Nonspendable - amounts that cannot be spent because they are not in spendable form, or are legally or contractually required to be maintained intact. The “not in spendable form” criterion includes items that are not expected to be converted to cash.

Restricted - amounts for which constraints have been placed on the use of resources either externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity

9. Classification of Fund Balance (Continued)

Committed - amounts that can be used only for the specific purposes imposed by formal action (resolution) of the Board of Commissioners. Those committed amounts cannot be used for any other purpose unless the Board removes or changes the specified use by taking the same type of action (resolution) it employed to previously commit these amounts.

Assigned - amounts Arrowhead Regional Corrections intends to use for specific purposes that do not meet the criteria to be classified as restricted or committed. In the General Fund, assigned amounts represent intended uses established by the Board of Commissioners or the Executive Director who has been delegated that authority by Board resolution.

Unassigned - unassigned fund balance is the residual classification for the General Fund and includes all spendable amounts not contained in the other fund balance classifications.

Arrowhead Regional Corrections 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.

10. Use of Estimates

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity
(Continued)

11. Future Change in Accounting Standards

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, replaces Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 50, *Pension Disclosures*, as they relate to employer governments that provide pensions through pension plans administered as trusts or similar arrangement that meet certain criteria. GASB Statement 68 requires governments providing defined benefit pension plans to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. This statement will be effective for Arrowhead Regional Corrections' calendar year 2015. Arrowhead Regional Corrections has not yet determined the financial statement impact of adopting this new standard.

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments (Continued)

Arrowhead Regional Corrections invests in the types of securities authorized by Minn. Stat. §§ 118A.04 and 118A.05. Additional disclosures, as required by GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*; GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*; and GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, are disclosed on an entity-wide basis in the St. Louis County Comprehensive Annual Financial Report.

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

	December 31, 2014
Cash and pooled investments	\$ 3,772,773
Petty cash and change funds	5,045
Investments	2,946,202
Total	\$ 6,724,020

2. Capital Assets

Capital asset activity for the year ended December 31, 2014, was as follows:

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	\$ 476,534	\$ -	\$ -	\$ 476,534
Construction in progress	1,569,394	6,197,675	1,484,384	6,282,685
Total capital assets not depreciated	\$ 2,045,928	\$ 6,197,675	\$ 1,484,384	\$ 6,759,219
Capital assets depreciated				
Buildings	\$ 8,672,546	\$ 1,509,377	\$ -	\$ 10,181,923
Machinery, vehicles, furniture, and equipment	1,374,622	168,788	-	1,543,410
Total capital assets depreciated	\$ 10,047,168	\$ 1,678,165	\$ -	\$ 11,725,333

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

2. Capital Assets (Continued)

	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
Less: accumulated depreciation for Buildings	\$ 3,450,753	\$ 279,589	\$ -	\$ 3,730,342
Machinery, vehicles, furniture, and equipment	<u>1,042,789</u>	<u>79,935</u>	<u>-</u>	<u>1,122,724</u>
Total accumulated depreciation	<u>\$ 4,493,542</u>	<u>\$ 359,524</u>	<u>\$ -</u>	<u>\$ 4,853,066</u>
Total capital assets depreciated, net	<u>\$ 5,553,626</u>	<u>\$ 1,318,641</u>	<u>\$ -</u>	<u>\$ 6,872,267</u>
Total Capital Assets, Net	<u><u>\$ 7,599,554</u></u>	<u><u>\$ 7,516,316</u></u>	<u><u>\$ 1,484,384</u></u>	<u><u>\$ 13,631,486</u></u>

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

Administration	\$ 610
Court and field services	44,867
Northeast Regional Corrections Center	203,492
Arrowhead Juvenile Center	<u>110,555</u>
Total Depreciation Expense	<u><u>\$ 359,524</u></u>

B. Liabilities

1. Operating Leases

Arrowhead Regional Corrections leases office space and office equipment under non-cancelable operating leases. Total costs for such leases were \$485,705 for the year ended December 31, 2014. The future minimum lease payments for these leases are as follows:

<u>Year Ending December 31</u>	<u>Amount</u>
2015	\$ 121,577
2016	20,394
2017	3,827
2018	1,488
2019	<u>316</u>
Total	<u><u>\$ 147,602</u></u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

B. Liabilities (Continued)

2. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2014, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Compensated absences	\$ 4,159,854	\$ 1,267,842	\$ 1,085,160	\$ 4,342,536	\$ 1,158,644
Net other postemployment benefits (Note 5)	513,900	-	513,900	-	-
Total Long-Term Liabilities	<u>\$ 4,673,754</u>	<u>\$ 1,267,842</u>	<u>\$ 1,599,060</u>	<u>\$ 4,342,536</u>	<u>\$ 1,158,644</u>

3. Deferred Compensation

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

4. Other Employee Benefits

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

For employees who have been employed by Arrowhead Regional Corrections for at least five years and meet certain other requirements, the cash equivalent of their accrued sick leave and vacation will be placed into the employee's account with the Post-Retirement Health Care Savings Plan upon retirement.

The vested sick leave and unvested sick leave likely to become vested (vesting sick leave) are estimated using the vesting method prescribed by GASB Statement 16. Both vested and vesting amounts are recognized in the government-wide statements as liabilities, but not in the governmental fund.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

B. Liabilities (Continued)

5. Risk Management

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

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

3. Employee Retirement Systems and Pension Plans

A. Plan Description

All full-time and certain part-time employees of Arrowhead Regional Corrections are covered by defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the General Employees Retirement Fund and the 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 five years of credited service.

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Plan Description (Continued)

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.

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 highest average salary for any five successive 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 remaining year. For a Coordinated Plan member, the annuity accrual rate is 1.2 percent of average salary for each of the first ten years and 1.7 percent for each successive year. Under Method 2, the annuity accrual rate is 2.7 percent of average salary for Basic Plan members and 1.7 percent for Coordinated Plan members for each year of service. For Public Employees Correctional Fund members, the annuity accrual rate is 1.9 percent of average salary for each year of service.

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Plan Description (Continued)

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

B. Funding Policy

Pension benefits are funded from member and employer contributions and income from the investment of fund assets. Rates for employer and employee contributions are set by Minn. Stat. ch. 353. These statutes are established and amended by the State Legislature. Arrowhead Regional Corrections makes annual contributions to the pension plans equal to the amount required by state statutes. General Employees Retirement Fund Basic Plan members and Coordinated Plan members are required to contribute 9.10 and 6.25 percent, respectively, of their annual covered salary in 2014. Public Employees Correctional Fund members are required to contribute 5.83 percent of their annual covered salary.

In 2014, Arrowhead Regional Corrections is required to contribute the following percentages of annual covered payroll:

General Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	7.25
Public Employees Correctional Fund	8.75

Arrowhead Regional Corrections' contributions for the years ending December 31, 2014, 2013, and 2012, for the General Employees Retirement Fund and the Public Employees Correctional Fund were:

	2014	2013	2012
General Employees Retirement Fund	\$ 607,503	\$ 561,441	\$ 547,667
Public Employees Correctional Fund	331,698	325,291	326,595

These contribution amounts are equal to the contractually required contributions for each year as set by state statute. Contribution rates increased on January 1, 2015, in the General Employees Retirement Fund Coordinated Plan (6.50 percent for members and 7.50 percent for employers).

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

A. Contingent Liabilities

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

B. Claims and Litigation

Arrowhead Regional Corrections, in connection with the normal conduct of its affairs, is involved in various claims, judgments, and litigation. The St. Louis County Attorney estimates that the potential claims against Arrowhead Regional Corrections that would not be covered by insurance will not have a material adverse effect on the financial condition of Arrowhead Regional Corrections.

C. Participation

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

	<u>Percent (%)</u>
Carlton County	11.24
Cook County	1.27
Koochiching County	1.57
Lake County	2.19
St. Louis County	<u>83.73</u>
Total	<u>100.00</u>

Member contributions towards operations for the current year totaled \$15,348,192 or 53 percent, of the total intergovernmental revenue received.

Of the various state grants available to Arrowhead Regional Corrections, the most significant is the grant authorized under the Community Corrections Act. Grant proceeds for 2014 totaled \$3,924,037 or 14 percent, of total intergovernmental revenue.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

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

D. Capital Renovation Project at Northeast Regional Corrections Center

In 2013, the Board of Arrowhead Regional Corrections approved a renovation and improvement project (the Project) for the Northeast Regional Corrections Center (NERCC). The NERCC facility is currently a 150-bed minimum-security facility which has significant deferred maintenance and several life safety and code issues which need to be addressed. The Project is designed to address these life safety and code issues while also adding increased functionality at the NERCC facility by adding medium-security capacity, special management, intake, visiting and gathering areas, along with multi-use activity areas. These improvements will allow the NERCC to accommodate a greater population of pre-trial and post-conviction inmates from county jails.

The Board has received and approved a guaranteed maximum price for the Project of \$6,000,000. The cost of the Project will be distributed proportionally to the member counties based on their average usage of the NERCC over a five-year period. On January 6, 2014, St. Louis County issued \$5,470,000 in General Obligation Capital Improvement Bonds, Series 2014A, to finance its share of the Project (87.6 percent), with the remainder of the cost being borne by the four other member counties. Capital outlays for the Project totaled \$4,954,066 during 2015.

E. Trust Fund

Not shown on Arrowhead Regional Corrections' balance sheet as of December 31, 2014, are funds held in trust for residents or for their benefit. The account balance at December 31, 2014, is as follows:

Northeast Regional Corrections Center Residents' Trust Fund	\$ <u>27,023</u>
---	------------------

F. Jointly-Governed Organizations

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

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

F. Jointly-Governed Organizations (Continued)

- Northern St. Louis County Drug Court,
- St. Louis County Drug Court, and
- Carlton County Drug Court.

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

Drug Courts are collaborations between the courts, probation, law enforcement, treatment providers and community partners that work to reduce recidivism of offenders who are chemically dependent. In lieu of incarceration, specialty courts use a treatment-based approach coupled with intensive supervision and judicial oversight to help chemically-dependent offenders maintain sobriety. The offenders enter the specialty courts for at least a year, during which time they are expected to complete treatment and remain accountable to probation through providing random urinalysis tests and complying with random home visits. Arrowhead Regional Corrections provides probation services for the Drug Courts.

Sentencing to Service

Arrowhead Regional Corrections, in conjunction with other local governments, participates in the State of Minnesota's Sentencing to Service (STS) program. STS is a project of the State Department of Administration's Strive Toward Excellence in Performance (STEP) program. STEP's goal is a statewide effort to make positive improvements in public services. It gives the courts an alternative to jail or fines for the nonviolent offenders who can work on a variety of community or state projects. Private funding, funds from various foundations and initiative funds, as well as the Minnesota Departments of Corrections and Natural Resources, provide the funds needed to operate the STS program. Although Arrowhead Regional Corrections has no operational or financial control over the STS program, Arrowhead Regional Corrections budgets for a percentage of this program. STS crews supervised by Department of Corrections' staff provide community work services at work sites in both Carlton and St. Louis Counties.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

5. Other Postemployment Benefits

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

Starting in 2014, St. Louis County elected to report Arrowhead Regional Corrections' liability for other postemployment benefits in its comprehensive annual financial report (CAFR). St. Louis County believes that ultimately, as the largest contributor to Arrowhead Regional Corrections, it would be responsible for fulfilling any obligations for postemployment benefits in the event that Arrowhead Regional Corrections was unable to. Consequently, a liability for other postemployment benefits is not reported on Arrowhead Regional Corrections' financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT A-1

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2014**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Intergovernmental	\$ 24,028,061	\$ 29,719,944	\$ 28,961,904	\$ (758,040)
Charges for services	1,277,251	1,326,051	1,191,665	(134,386)
Investment earnings	4,092	4,092	12,043	7,951
Miscellaneous	170,064	172,917	178,868	5,951
Total Revenues	\$ 25,479,468	\$ 31,223,004	\$ 30,344,480	\$ (878,524)
Expenditures				
Current				
Administration				
Administrative support services	\$ 1,905,634	\$ 1,500,503	\$ 1,420,537	\$ 79,966
Research and evaluation	211,508	195,008	185,103	9,905
Staff development	104,085	120,585	119,753	832
Arrowhead Council of Churches	26,469	26,469	26,469	-
Women offenders program	200,000	213,998	214,723	(725)
Total administration	\$ 2,447,696	\$ 2,056,563	\$ 1,966,585	\$ 89,978
Court and field services				
Probation	\$ 11,059,845	\$ 10,066,899	\$ 9,541,243	\$ 525,656
St. Louis County data processing charges	360,861	360,919	360,919	-
Intensive supervision program	510,100	405,048	405,048	-
Short-term consequences	176,723	176,917	175,576	1,341
Sentencing to service	235,000	235,000	234,911	89
Correctional fees	165,682	165,682	165,665	17
Total court and field services	\$ 12,508,211	\$ 11,410,465	\$ 10,883,362	\$ 527,103
Northeast Regional Corrections Center				
Administration	\$ 5,533,732	\$ 5,600,769	\$ 5,142,128	\$ 458,641
Special education	211,831	211,831	223,616	(11,785)
Basic education	157,762	157,761	162,612	(4,851)
Vocational education	51,829	51,829	47,097	4,732
Total Northeast Regional Corrections Center	\$ 5,955,154	\$ 6,022,190	\$ 5,575,453	\$ 446,737
Arrowhead Juvenile Center				
Administration	\$ 4,174,803	\$ 4,144,186	\$ 4,075,606	\$ 68,580

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

***EXHIBIT A-1
(Continued)***

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2014**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Expenditures (Continued)				
Capital outlay				
Administration	\$ 256,829	\$ 268,329	\$ -	\$ 268,329
Court and field services	61,300	72,576	72,576	-
Northeast Regional Corrections Center	110,000	6,809,212	6,267,120	542,092
Arrowhead Juvenile Center	68,380	68,380	51,760	16,620
Total capital outlay	\$ 496,509	\$ 7,218,497	\$ 6,391,456	\$ 827,041
Total Expenditures	\$ 25,582,373	\$ 30,851,901	\$ 28,892,462	\$ 1,959,439
Net Change in Fund Balance	\$ (102,905)	\$ 371,103	\$ 1,452,018	\$ 1,080,915
Fund Balance - January 1	3,921,759	3,921,759	3,921,759	-
Increase (decrease) in inventories	-	-	7,523	7,523
Fund Balance - December 31	\$ 3,818,854	\$ 4,292,862	\$ 5,381,300	\$ 1,088,438

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED DECEMBER 31, 2014**

Budgetary Data

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

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

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

Encumbrance accounting, under which commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary integration in the General Fund. Encumbrances (purchase orders and contracts) outstanding at year-end are reported as assignments of fund balances and provide authority for the carryover of appropriations to the subsequent year in order to complete these transactions. There were funds of \$1,195,533 encumbered at the end of December 31, 2014, which were allocated for capital improvements at the Northeast Regional Corrections Center.

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SUPPLEMENTARY INFORMATION

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT B-1

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
FOR THE YEAR ENDED DECEMBER 31, 2014**

Shared Revenue	
State	
PERA rate reimbursement	<u>\$ 51,881</u>
Membership Contributions	
Shared operations	
Carlton County	\$ 1,725,346
Cook County	194,461
Koochiching County	240,720
Lake County	336,758
St. Louis County	<u>12,850,907</u>
Total shared operations	<u>\$ 15,348,192</u>
Northeast Regional Corrections Center capital renovation project	
Carlton County	\$ 492,000
Cook County	81,600
Koochiching County	41,400
Lake County	132,000
St. Louis County	<u>5,253,000</u>
Total Northeast Regional Corrections Center capital renovation project	<u>\$ 6,000,000</u>
Total membership contributions	<u>\$ 21,348,192</u>
Grants	
State	
Minnesota Department of Education	<u>\$ 86,167</u>
Minnesota Department of Corrections	
Court and field services	
Caseload/workload reductions grant	\$ 1,335,322
Intensive supervision grant	346,805
Sex offender grant	386,233
Felony caseload reductions grant	128,026
Challenge incarceration program	104,917
Remote electronic monitoring	<u>25,641</u>
Total court and field services	<u>\$ 2,326,944</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

***EXHIBIT B-1
(Continued)***

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
FOR THE YEAR ENDED DECEMBER 31, 2014**

Grants

State

Minnesota Department of Corrections (Continued)

Northeast Regional Corrections Center State bonding funds	737,000
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Arrowhead Juvenile Center Sex offender grant	61,650
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Community Corrections Act subsidy	3,924,037
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Total Minnesota Department of Corrections	\$ 7,049,631
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Total state grants	\$ 7,135,798
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Federal

Department of Agriculture	\$ 50,706
Justice	175,386
Transportation	48,102
Education	7,667

Total federal grants	\$ 281,861
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Other Grants

Local	\$ 64,172
North St. Louis County Family Services Collaborative Detention Assessment Team	80,000

Total other grants	\$ 144,172
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Total state, federal, and other grants	\$ 7,561,831
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Total Intergovernmental Revenue	\$ 28,961,904
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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2014**

I. INTERNAL CONTROL OVER FINANCIAL REPORTING

PREVIOUSLY REPORTED ITEM NOT RESOLVED

Finding 1996-002

Internal Control/Segregation of Duties

Criteria: Management is responsible for establishing and maintaining internal control. This responsibility includes the internal control over the various accounting cycles, the fair presentation of the financial statements and related notes, and the accuracy and completeness of all financial records and related information. Also, management is responsible for controls over the period-end financial reporting process, including controls over procedures used to enter transaction totals into the general ledger; initiate, authorize, record, and process journal entries into the general ledger; and record recurring and nonrecurring adjustments to the financial statements. Adequate segregation of duties is a key internal control in an organization's accounting system.

Condition: The limited number of staff results in a lack of segregation of duties necessary to ensure adequate internal accounting control.

Context: It is not unusual for an organization the size of Arrowhead Regional Corrections to be limited in the internal control that management can design and implement into the organization.

Effect: Inadequate segregation of duties could adversely affect Arrowhead Regional Corrections' ability to detect or prevent misstatements in a timely manner by personnel in the normal course of performing their assigned functions.

Cause: The size of Arrowhead Regional Corrections and its staffing limits the internal control that management can design and implement into the organization. Management has identified departments where inadequate segregation of duties exist. Management has determined that, given limited resources, it is not feasible to achieve the desired level of segregation of duties in these departments.

Recommendation: We recommend that the Board and management be aware of the lack of segregation of duties in the accounting functions and, where possible, continue to implement oversight procedures to ensure that the internal control policies and procedures are implemented to the extent possible.

Client's Response:

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

PREVIOUSLY REPORTED ITEM RESOLVED

Payroll Reporting Procedures (2013-001)

In the previous year, our testing of internal controls over payroll transactions noted that one of the eleven timesheets tested was not signed by the employee.

Resolution

In the current year, our testing of internal controls over payroll transactions showed that all timesheets tested were signed appropriately by the employee.

II. OTHER ITEM FOR CONSIDERATION

GASB Statement No. 68, Accounting and Financial Reporting for Pensions

The Governmental Accounting Standards Board (GASB) is the independent organization that establishes standards of accounting and financial reporting for state and local governments. Effective for your calendar year 2015 financial statements, the GASB changed those standards as they apply to employers that provide pension benefits.

GASB Statement 68 significantly changes pension accounting and financial reporting for governmental employers that prepare financial statements on the accrual basis by separating pension accounting methodology from pension funding methodology. Statement 68 requires employers to include a portion of the Public Employees Retirement Association (PERA) total employers' unfunded liability, called the "net pension liability" on the face of Arrowhead Regional Corrections' government-wide statement of financial position. Arrowhead Regional Corrections' financial position will be immediately impacted by its unfunded share of the pension liability.

Statement 68 changes the amount employers report as pension expense and defers some allocations of expenses to future years—deferred outflows or inflows of resources. It requires pension costs to be calculated by an actuary; whereas, in the past pension costs were equal to the amount of employer contributions sent to PERA during the year. Additional footnote disclosures and required supplementary information schedules are also required by Statement 68.

The net pension liability that will be reported in Arrowhead Regional Corrections' financial statements is an accounting estimate of the proportionate share of PERA's unfunded liability at a specific point in time. That number will change from year to year and is based on assumptions about the probability of the occurrence of events far into the future. Those assumptions include how long people will live, how long they will continue to work, projected salary increases, and how well pension trust investments will do. PERA has been proactive in taking steps towards implementation and will be providing most of the information needed by employers to report their net pension liability and deferred outflows/inflows of resources.

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REBECCA OTTO
STATE AUDITOR

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COMMUNICATION OF SIGNIFICANT DEFICIENCIES AND/OR MATERIAL WEAKNESSES IN INTERNAL CONTROL OVER FINANCIAL REPORTING AND OTHER MATTERS

Board of Commissioners
Arrowhead Regional Corrections
Duluth, Minnesota

We have audited, in accordance with the auditing standards generally accepted in the United States of America, the financial statements of the governmental activities and the General Fund of Arrowhead Regional Corrections as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise Arrowhead Regional Corrections' basic financial statements, and have issued our report thereon dated January 7, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Arrowhead Regional Corrections' internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Arrowhead Regional Corrections' internal control. Accordingly, we do not express an opinion on the effectiveness of Arrowhead Regional Corrections' internal control.

A deficiency in internal control 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, such that there is a reasonable possibility that a material misstatement of Arrowhead Regional Corrections' financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material

weaknesses may exist that have not been identified. Our audit was also not designed to identify deficiencies in internal control that might be significant deficiencies. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A significant deficiency is reported in the Schedule of Findings and Recommendations as item 1996-002.

Other Matters

Also included in the Schedule of Findings and Recommendations is an other item for consideration. We believe this information to be of benefit to Arrowhead Regional Corrections, and it is reported for that purpose.

Arrowhead Regional Corrections' written response to the internal control finding identified in our audit has been included in the Schedule of Findings and Recommendations. We did not audit Arrowhead Regional Corrections' response and, accordingly, we express no opinion on it.

Purpose of This Report

This communication is intended solely for the information and use of management, the Board of Commissioners, and others within Arrowhead Regional Corrections, and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

January 7, 2016

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR



REBECCA OTTO
STATE AUDITOR

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INDEPENDENT AUDITOR'S REPORT ON MINNESOTA LEGAL COMPLIANCE

Board of Commissioners
Arrowhead Regional Corrections
Duluth, Minnesota

We have audited, in accordance with auditing standards generally accepted in the United States of America, the accompanying financial statements of the governmental activities and the General Fund of Arrowhead Regional Corrections as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise Arrowhead Regional Corrections' basic financial statements and have issued our report thereon dated January 7, 2016.

The *Minnesota Legal Compliance Audit Guide for Political Subdivisions*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65, contains six categories of compliance to be tested in connection with the audit of Arrowhead Regional Corrections' financial statements: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, and miscellaneous provisions. Our audit considered all of the listed categories, except that we did not test for compliance with the provisions for public indebtedness because Arrowhead Regional Corrections had no long-term debt.

In connection with our audit, nothing came to our attention that caused us to believe that Arrowhead Regional Corrections failed to comply with the provisions of the *Minnesota Legal Compliance Audit Guide for Political Subdivisions*. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding Arrowhead Regional Corrections' noncompliance with the above referenced provisions.

This report is intended solely for the information and use of those charged with governance and management of Arrowhead Regional Corrections and the State Auditor and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

January 7, 2016

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