

STATE OF MINNESOTA

Office of the State Auditor



Julie Blaha
State Auditor

ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA

YEAR ENDED DECEMBER 31, 2018

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 100 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 600 public pension funds; and

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

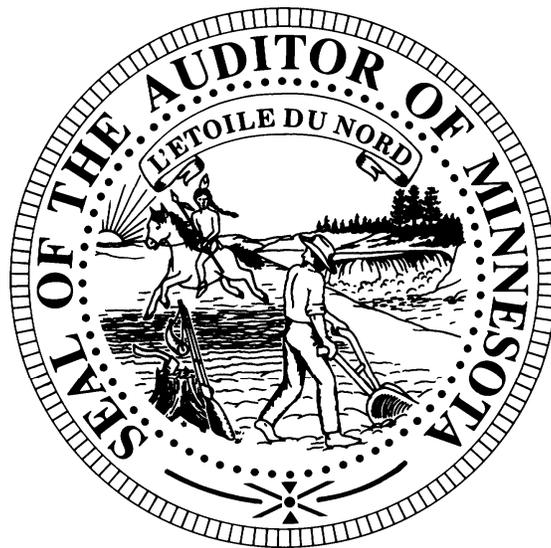
The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employees Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

Year Ended December 31, 2018



**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**

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

ORGANIZATION
DECEMBER 31, 2018

| | | | <u>Term Expires</u> |
|--------------------|--------------------|--------------------|---------------------|
| Elected | | | |
| Commissioners | | | |
| Chair | Derrick Goutermont | Lake County | January 2021 |
| Vice Chair | Frank Jewell | St. Louis County | January 2023 |
| Board Member | Richard Brenner | Carlton County | January 2021 |
| Board Member | Robert Deschampe | Cook County | January 2023 |
| Board Member | Brian McBride | Koochiching County | January 2021 |
| Board Member | Wade Pavleck | Koochiching County | January 2023 |
| Board Member | Keith Nelson | St. Louis County | January 2023 |
| Board Member | Beth Olson | St. Louis County | January 2021 |
| Appointed | | | |
| Executive Director | Kay Arola | | Indefinite |

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JULIE BLAHA
STATE AUDITOR

STATE OF MINNESOTA

OFFICE OF THE STATE AUDITOR

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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, 2018, 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 from 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, 2018, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter – Change in Accounting Principle

As discussed in Note 1.E. to the financial statements, in 2018, Arrowhead Regional Corrections adopted new accounting guidance by implementing the provisions of Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which represents a change in accounting principles. Our opinion is not modified with respect to this matter.

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 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. 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 Supplementary Information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. The Supplementary Information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. 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 Supplementary Information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

/s/Julie Blaha

JULIE BLAHA
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

October 29, 2019

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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, 2018
(Unaudited)**

Our Management's Discussion and Analysis (MD&A) of Arrowhead Regional Corrections' financial performance provides an overview of the financial activities for the fiscal year ended December 31, 2018. Please read it in conjunction with the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

Total net position for Arrowhead Regional Corrections increased \$0.2 million to \$4.7 million.

Total fund balance for the Arrowhead Regional Corrections' General Fund was \$5.8 million at the end of 2018, an increase of \$1.1 million from 2017.

A large portion of fund balance, 34 percent, was assigned by Arrowhead Regional Corrections for the purchase and/or repair of capital equipment and improvements.

Arrowhead Regional Corrections' General Fund reported \$1.1 million of revenues in excess of expenditures.

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, deferred outflows of resources, liabilities, and deferred inflows of resources using the full 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 plus deferred outflows of resources and liabilities plus deferred inflows of resources—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. 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 47.

Supporting schedules: The budgetary comparison schedule, notes to required supplementary information, and schedule of intergovernmental revenue are provided on pages 48 through 60.

Government-Wide Financial Analysis

Net position over time may be a useful indicator of a government's financial position. In the case of Arrowhead Regional Corrections, assets and deferred outflows exceeded liabilities and deferred inflows by \$4.7 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 | |
|-------------------------------------|-------------------------|---------|
| | 2018 | 2017 |
| Assets | | |
| Current and other assets | \$ 6.7 | \$ 5.9 |
| Capital assets | 16.4 | 16.8 |
| Total Assets | \$ 23.1 | \$ 22.7 |
| Deferred pension outflows | \$ 3.5 | \$ 6.2 |
| Liabilities | | |
| Other liabilities | \$ 0.8 | \$ 1.0 |
| Long-term liabilities outstanding | 13.9 | 20.3 |
| Total Liabilities | \$ 14.7 | \$ 21.3 |
| Deferred Inflows of Resources | | |
| Deferred OPEB inflows | \$ 0.1 | \$ - |
| Deferred pension inflows | 7.1 | 3.1 |
| Total Deferred Inflows of Resources | \$ 7.2 | \$ 3.1 |
| Net Position | | |
| Investment in capital assets | \$ 16.5 | \$ 16.8 |
| Unrestricted | (11.8) | (12.3) |
| Total Net Position | \$ 4.7 | \$ 4.5 |

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

Governmental Activities

In 2018, the total net position of Arrowhead Regional Corrections increased by \$0.2 million to \$4.7 million. Arrowhead Regional Corrections continues to report positive balances in net position because total assets and deferred outflows exceed total liabilities and deferred inflows.

Current and other assets increased by \$0.8 million in 2018 to \$6.7 million. Cash and investments increased by \$0.9 million in 2018, while due from other governments decreased by \$0.1 million.

Total liabilities decreased to \$14.7 million. Other liabilities, which consist of accounts payable, salaries payable, contracts payable, due to other governments, and unearned revenue, decreased \$0.2 million. Long-term liabilities consists of net pension liability, net other postemployment benefits liability, and compensated absences. Long-term liabilities decreased by \$6.4 million almost entirely due to a decrease in Arrowhead Regional Corrections' share of net pension liability.

A detailed analysis of capital assets is presented in Table 3 under the heading Capital Assets at Year-End.

Table 2
Changes in Net Position
(in Millions)

| | Governmental Activities | |
|--|-------------------------|----------------------|
| | 2018 | 2017 |
| Revenues | | |
| Program revenues | | |
| Capital grants and contributions | \$ - | \$ - |
| Fees, charges, fines, and other | 1.0 | 1.1 |
| Operating grants and contributions | 1.2 | 1.3 |
| General revenues | | |
| Community Corrections Act subsidy | 6.0 | 5.9 |
| Grants and contributions not restricted to specific programs | 18.9 | 17.7 |
| Miscellaneous and other | 0.3 | 0.3 |
| Total Revenues | <u>\$ 27.4</u> | <u>\$ 26.3</u> |
| Expenses | | |
| Program expenses | | |
| Administration | \$ 3.1 | \$ 2.4 |
| Court and field services | 12.1 | 12.6 |
| Northeast Regional Corrections Center (NERCC) | 6.6 | 8.2 |
| Arrowhead Juvenile Center (AJC) | 4.2 | 5.4 |
| Total Expenses | <u>\$ 26.0</u> | <u>\$ 28.6</u> |
| Increase (Decrease) in Net Position | \$ 1.4 | \$ (2.3) |
| Net Position, January 1 – restated* | <u>3.3</u> | <u>6.8</u> |
| Net Position, December 31 | <u><u>\$ 4.7</u></u> | <u><u>\$ 4.5</u></u> |

*Amount includes a prior period adjustment for a change in accounting principles.

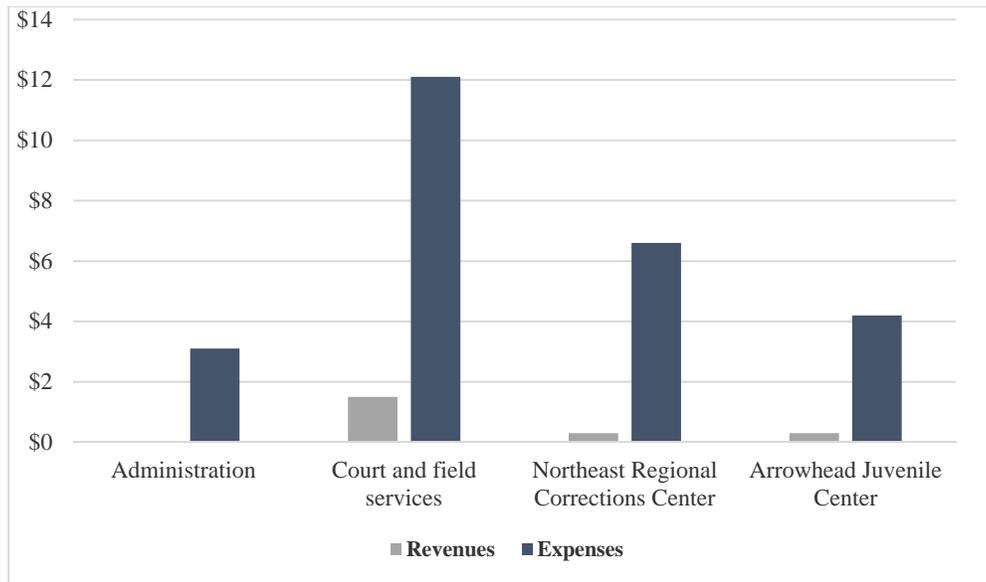
The following analysis focuses on Arrowhead Regional Corrections' changes in net position (Table 2).

Governmental Activities

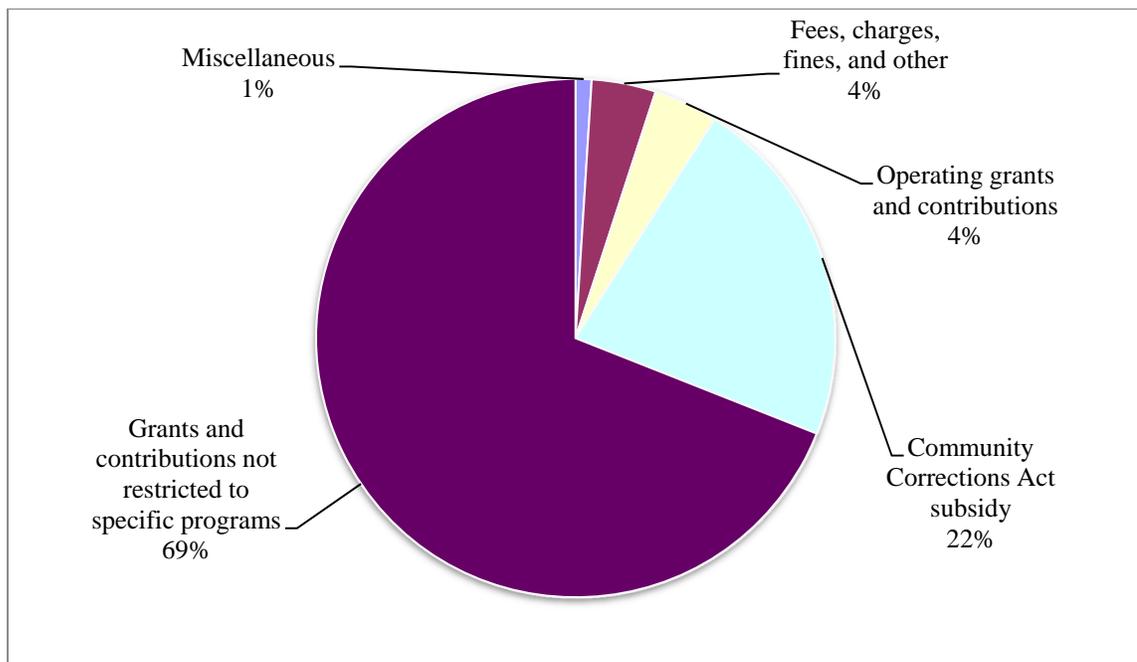
Revenues collected in 2018 by Arrowhead Regional Corrections totaled \$27.4 million, or \$1.1 million more than 2017. Member county contributions (general revenues) were \$18.9 million in 2018, \$17.7 million in 2017, \$15.9 million in 2016, \$16.4 million in 2015, \$15.3 million in 2014, \$14.8 million in 2013, \$13.7 million in 2012, \$12.0 million in 2011, and \$11.9 million in 2010.

Total expenses for 2018 were \$2.6 million less than 2017. Administration services' total expenses increased by \$0.7 million. Court and field services' total expenses decreased by \$0.5 million from 2017. NERCC's total expenses decreased by \$1.6 million from 2017, while AJC's total expenses decreased by \$1.2 million.

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 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.

In 2018, the fund balance of Arrowhead Regional Corrections' General Fund increased by \$1.1 million to \$5.8 million. Due to a \$0.4 million decrease in capital outlay expenditures, a \$0.5 million increase in personnel services expenditures, a \$0.1 million increase in operating services expenditures, and a \$0.2 million decrease in charges for services revenues, shares paid by the member counties increased by \$1.2 million from 2017.

Expenditures for personnel services accounted for approximately 75 percent of Arrowhead Regional Corrections' total expenditures in 2018. 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 \$1.2 million in 2018.

Actual expenditures ended the year \$1.5 million under final budget. Expenditure budgets for personnel (\$0.4 million), operating (\$0.8 million), and capital outlay (\$0.3 million) accounted for the unspent budget, of which \$0.5 million was due to outstanding encumbrances at year-end.

Total revenues for 2018 were \$0.3 million less than the final budget. Intergovernmental revenues came in \$0.3 million below the budget projections.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At year-end, Arrowhead Regional Corrections showed total capital assets of \$16.4 million. These amounts represent a broad range of capital assets, including land, buildings, machinery, vehicles, furniture, and equipment. Detail is presented in Table 3.

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

| | Governmental Activities | |
|---|-------------------------|---------|
| | 2018 | 2017 |
| Construction in progress | \$ 0.1 | \$ 1.4 |
| Land | 0.5 | 0.5 |
| Buildings | 14.9 | 14.1 |
| Machinery, vehicles, furniture, and equipment | 0.9 | 0.8 |
| Totals | \$ 16.4 | \$ 16.8 |

Total capital assets decreased by \$0.4 million in 2018 mainly due to the recognition of depreciation expense. Some of the depreciation expense was offset by purchases during the year, which included passenger vehicles, building and farm equipment, and system/structural improvements.

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 2019 budget at \$27.6 million, an increase of 2.0 percent from the 2018 budget. The main funding for this increased budget came from the county shares.

The average unemployment rate for the five member counties was 4.1 percent for 2018, while the average unemployment rate was 3.9 percent for the United States and 2.9 percent for the State of Minnesota.

The 2019 budget was passed on December 21, 2018, 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, 2018**

Assets

| | |
|---|-----------------------------|
| Cash and investments | \$ 6,042,348 |
| Petty cash and change funds | 4,980 |
| Accounts receivable | 74,723 |
| Accrued interest receivable | 13,750 |
| Due from other governments | 410,470 |
| Inventories | 128,379 |
| Capital assets | |
| Non-depreciable | 608,489 |
| Depreciable – net of accumulated depreciation | <u>15,824,444</u> |
| Total Assets | <u>\$ 23,107,583</u> |

Deferred Outflows of Resources

| | |
|---------------------------|----------------------------|
| Deferred pension outflows | <u>\$ 3,509,799</u> |
|---------------------------|----------------------------|

Liabilities

| | |
|---|-----------------------------|
| Accounts payable | \$ 307,929 |
| Salaries payable | 363,978 |
| Due to other governments | 114,281 |
| Long-term liabilities | |
| Due in more than one year | 5,043,929 |
| Other postemployment benefits liability | 1,135,515 |
| Net pension liability | <u>7,752,288</u> |
| Total Liabilities | <u>\$ 14,717,920</u> |

Deferred Inflows of Resources

| | |
|--|----------------------------|
| Deferred other postemployment benefits inflows | \$ 40,401 |
| Deferred pension inflows | <u>7,206,772</u> |
| Total Deferred Inflows of Resources | <u>\$ 7,247,173</u> |

Net Position

| | |
|------------------------------|-----------------------------------|
| Investment in capital assets | \$ 16,432,933 |
| Unrestricted | <u>(11,780,644)</u> |
| Total Net Position | <u><u>\$ 4,652,289</u></u> |

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 2

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2018**

| | | Program Revenues | | | |
|--|---------------------------------------|--|--|---|------------------------|
| Expenses | Fees, Charges, Fines, and Other | Operating Grants and Contributions | Capital Grants and Contributions | Net (Expense) Revenue and Change in Net Position | |
| <u>Functions/Programs</u> | | | | | |
| Governmental activities | | | | | |
| Administration | \$ 3,145,182 | \$ - | \$ - | \$ - | \$ (3,145,182) |
| Court and field services | 12,086,892 | 656,280 | 863,207 | - | (10,567,405) |
| Northeast Regional Corrections Center | 6,621,084 | 108,489 | 180,159 | - | (6,332,436) |
| Arrowhead Juvenile Center | 4,186,091 | 222,688 | 117,188 | - | (3,846,215) |
| | \$ 26,039,249 | \$ 987,457 | \$ 1,160,554 | \$ - | \$ (23,891,238) |
| General Revenues | | | | | |
| Community Corrections Act subsidy | | | | \$ 5,998,659 | |
| Grants and contributions not restricted to specific programs | | | | 18,888,096 | |
| Unrestricted investment income | | | | 81,280 | |
| Miscellaneous | | | | 272,257 | |
| | | | | \$ 25,240,292 | |
| | | | | | \$ 1,349,054 |
| | | | | | 3,303,235 |
| | | | | | \$ 4,652,289 |

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, 2018**

Assets

| | | |
|-----------------------------|-----------|------------------|
| Cash and investments | \$ | 6,042,348 |
| Petty cash and change funds | | 4,980 |
| Accounts receivable | | 74,723 |
| Accrued interest receivable | | 13,750 |
| Due from other governments | | 410,470 |
| Inventories | | 128,379 |
| | | 128,379 |
| Total Assets | \$ | 6,674,650 |

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

| | | |
|---|-----------|------------------|
| Liabilities | | |
| Accounts payable | \$ | 307,929 |
| Salaries payable | | 363,978 |
| Due to other governments | | 114,281 |
| | | 114,281 |
| Total Liabilities | \$ | 786,188 |
| Deferred Inflows of Resources | | |
| Unavailable revenue – grants | \$ | 123,069 |
| | | 123,069 |
| Fund Balance | | |
| Nonspendable | | |
| Inventories | \$ | 128,379 |
| Assigned to | | |
| Capital equipment | | 150,000 |
| Capital improvements and emergency repairs | | 1,815,942 |
| Health and welfare | | 14,277 |
| Unassigned | | 3,656,795 |
| Total Fund Balance | \$ | 5,765,393 |
| Total Liabilities, Deferred Inflows of Resources, and Fund Balance | \$ | 6,674,650 |

**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, 2018**

| | | |
|---|--------------------|-------------------------|
| Fund balance – total governmental funds (Exhibit 3) | \$ | 5,765,393 |
| 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 fund. | | 16,432,933 |
| 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 fund. | | 123,069 |
| Deferred outflows of resources are not available resources and, therefore, are not reported in the General Fund. | | |
| Deferred pension outflows | | 3,509,799 |
| Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the General Fund. | | |
| Compensated absences | \$ (5,043,929) | |
| Other postemployment benefits liability | (1,135,515) | |
| Net pension liability | <u>(7,752,288)</u> | (13,931,732) |
| Deferred inflows of resources are created as a result of various differences related to other postemployment benefits and pensions that are not recognized in the General Fund. | | |
| Deferred other postemployment benefits inflows | \$ (40,401) | |
| Deferred pension inflows | <u>(7,206,772)</u> | <u>(7,247,173)</u> |
| Net Position of Governmental Activities (Exhibit 1) | \$ | <u>4,652,289</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, 2018**

| | |
|---|-----------------------------|
| Revenues | |
| Intergovernmental | \$ 26,009,486 |
| Charges for services | 983,570 |
| Investment earnings | 81,280 |
| Miscellaneous | <u>272,257</u> |
| Total Revenues | <u>\$ 27,346,593</u> |
| Expenditures | |
| Current | |
| Administration | \$ 3,052,148 |
| Court and field services | 11,916,149 |
| Northeast Regional Corrections Center | 6,399,585 |
| Arrowhead Juvenile Center | 4,362,034 |
| Capital outlay | <u>530,134</u> |
| Total Expenditures | <u>\$ 26,260,050</u> |
| Net Change in Fund Balance | \$ 1,086,543 |
| Fund Balance – January 1 | 4,678,190 |
| Increase (decrease) in inventories | <u>660</u> |
| Fund Balance – December 31 | <u>\$ 5,765,393</u> |

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 6

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCE OF THE GENERAL FUND TO THE
GOVERNMENT-WIDE STATEMENT OF ACTIVITIES—GOVERNMENTAL ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2018**

Net change in fund balance – total governmental funds (Exhibit 5) \$ 1,086,543

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 | \$ 123,069 | |
| Unavailable revenue – January 1 | <u>(137,854)</u> | (14,785) |

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.

| | | |
|---|------------------|-----------|
| Expenditures for general capital assets | \$ 530,134 | |
| Loss on the disposal of capital assets | (2,982) | |
| Current year depreciation | <u>(908,232)</u> | (381,080) |

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 | \$ (339,355) | |
| Change in inventories | 660 | |
| Change in other postemployment benefits, as restated | 72,187 | |
| Change in net pension obligation | 7,812,975 | |
| Change in deferred pension outflows | (6,215,164) | |
| Change in deferred other postemployment benefits inflows | (40,401) | |
| Change in deferred pension inflows | <u>(4,142,325)</u> | <u>(2,851,423)</u> |

Change in Net Position of Governmental Activities (Exhibit 2) \$ (2,160,745)

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2018**

1. Summary of Significant Accounting Policies

Arrowhead Regional Corrections' financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for the year ended December 31, 2018. 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 as an agency fund on its annual financial statements.

Jointly-Governed Organizations

Arrowhead Regional Corrections participates in jointly-governed organizations described in Note 3.F.

**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 three parts: (1) investment in capital assets, (2) restricted net position, and (3) 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 full 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. Interest is considered to be susceptible to accrual. 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 Investments

Arrowhead Regional Corrections' available cash balances are invested by St. Louis County in accordance with Minnesota statutes. Additional disclosures defining cash and investments can be found in the St. Louis County Comprehensive Annual Financial Report.

2. Inventories

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

3. Receivables

No allowance for uncollectible accounts receivable has been provided because such amounts are not expected to be material. Arrowhead Regional Corrections has no accounts receivable scheduled to be collected beyond one year.

**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)

4. 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 acquisition value. 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 |

5. 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)

6. 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. For the year ended December 31, 2018, Arrowhead Regional Corrections had no unearned revenue.

7. 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.

8. Pension Plan

For purposes of measuring the net pension liability, deferred outflows/inflows of resources, and pension expense, information about the fiduciary net position of the Public Employees Retirement Association (PERA) and additions to/deductions from PERA's fiduciary net position have been determined on the same basis as they are reported by PERA, except that PERA's fiscal year-end is June 30. For this purpose, plan contributions are recognized as of employer payroll paid dates and benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Plan investments are reported at fair value.

9. Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position reports 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. Arrowhead Regional Corrections reports deferred outflows of resources only under the full accrual basis of accounting associated with pension plans and, accordingly, are reported only in the statement of net position.

**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. Deferred Outflows/Inflows of Resources (Continued)

In addition to liabilities, the statement of financial position reports 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 two types of deferred inflows. The governmental fund reports unavailable revenue which arises only under the modified accrual basis of accounting that qualifies for reporting in this category and 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 became available. Arrowhead Regional Corrections also reports deferred inflows of resources with pension and other postemployment benefits (OPEB). These inflows arise only under the full accrual basis of accounting and, accordingly, are reported only in the statement of net position.

10. 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.

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.

**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. 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.

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
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

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

11. Classification of Fund Balance (Continued)

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.

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, deferred outflows of resources, liabilities, and deferred inflows of resources; 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.

E. Change in Accounting Principles

During the year ended December 31, 2018, Arrowhead Regional Corrections adopted new accounting guidance by implementing the provisions of GASB Statement 75. GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, changes standards for recognizing and measuring OPEB liabilities and related deferred outflows of resources, deferred inflows of resources, and OPEB expense. This statement also requires additional note disclosures and a schedule in the required supplementary information. Beginning net position has been restated to reflect this change.

| | <u>Governmental Activities</u> |
|---|------------------------------------|
| Net Position, January 1, 2018, as previously reported | \$ 4,510,937 |
| Change in accounting principles | <u>(1,207,702)</u> |
| Net Position, January 1, 2018, as restated | <u>\$ 3,303,235</u> |

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

Arrowhead Regional Corrections is authorized by Minn. Stat. §§ 118A.02 and 118A.04 to deposit its cash and to invest in certificates of deposit in financial institutions designated by the St. Louis County Board of Commissioners and the Arrowhead Regional Corrections Board. Minnesota statutes require that all Arrowhead Regional Corrections' deposits be covered by insurance, surety bond, or collateral. Arrowhead Regional Corrections may invest in the types of securities authorized by Minn. Stat. §§ 118A.04-.05.

Arrowhead Regional Corrections deposits all its cash with its fiscal agent, St. Louis County. Additional disclosures are included in the St. Louis County Comprehensive Annual Financial Report.

Arrowhead Regional Corrections invests funds in St. Louis County's investment pool; at year-end, \$3,948,469 is invested in the pool. The fair value of the investment is the fair value per share of the underlying portfolio. Arrowhead Regional Corrections invests in this pool for the purpose of joint investment with the County in order to enhance investment earnings. There are no redemption limitations.

In addition, Arrowhead Regional Corrections invests in the MAGIC Term Series pool through St. Louis County, which is not pooled with other St. Louis County funds, for the purpose of the joint investment of Arrowhead Regional Corrections' money with those of other counties to enhance the investment earnings accruing to each member.

MAGIC is a local government investment pool which is quoted at a net asset value (NAV). Shares of MAGIC Term Series are purchased to mature upon pre-determined maturity dates selected by the County at the time of purchase. Should the County, on Arrowhead Regional Corrections' behalf, need to redeem shares in a MAGIC Term Series prematurely, they must provide notice at least seven days prior to the premature redemption date. The value of a premature redemption is equal to the original price for such share, plus dividends thereon, at the projected yield, less such share's allocation of any losses incurred by the series, less a premature redemption penalty, if any.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets (Continued)

2. Capital Assets

Capital asset activity for the year ended December 31, 2018, was as follows:

| | <u>Beginning Balance</u> | <u>Increase</u> | <u>Decrease</u> | <u>Ending Balance</u> |
|---|------------------------------|----------------------------|----------------------------|-----------------------------|
| Capital assets not depreciated | | | | |
| Land | \$ 476,534 | \$ - | \$ - | \$ 476,534 |
| Construction in progress | <u>1,460,690</u> | <u>161,027</u> | <u>1,489,762</u> | <u>131,955</u> |
| Total capital assets not depreciated | <u>\$ 1,937,224</u> | <u>\$ 161,027</u> | <u>\$ 1,489,762</u> | <u>\$ 608,489</u> |
| Capital assets depreciated | | | | |
| Buildings | \$ 19,403,664 | \$ 1,502,060 | \$ - | \$ 20,905,724 |
| Machinery, vehicles, furniture, and equipment | <u>1,962,336</u> | <u>356,810</u> | <u>225,566</u> | <u>2,093,580</u> |
| Total capital assets depreciated | <u>\$ 21,366,000</u> | <u>\$ 1,858,870</u> | <u>\$ 225,566</u> | <u>\$ 22,999,304</u> |
| Less: accumulated depreciation for | | | | |
| Buildings | \$ 5,286,036 | \$ 723,662 | \$ - | \$ 6,009,698 |
| Machinery, vehicles, furniture, and equipment | <u>1,203,175</u> | <u>184,570</u> | <u>222,583</u> | <u>1,165,162</u> |
| Total accumulated depreciation | <u>\$ 6,489,211</u> | <u>\$ 908,232</u> | <u>\$ 222,583</u> | <u>\$ 7,174,860</u> |
| Total capital assets depreciated, net | <u>\$ 14,876,789</u> | <u>\$ 950,638</u> | <u>\$ 2,983</u> | <u>\$ 15,824,444</u> |
| Total Capital Assets, Net | <u><u>\$ 16,814,013</u></u> | <u><u>\$ 1,111,665</u></u> | <u><u>\$ 1,492,745</u></u> | <u><u>\$ 16,432,933</u></u> |

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

| | |
|---------------------------------------|-------------------|
| Administration | \$ 4,190 |
| Court and field services | 56,943 |
| Northeast Regional Corrections Center | 630,672 |
| Arrowhead Juvenile Center | <u>216,427</u> |
| Total Depreciation Expense | <u>\$ 908,232</u> |

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds (Continued)

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 \$512,991 for the year ended December 31, 2018. The future minimum lease payments for these leases are as follows:

| Year Ending December 31 | Amount |
|----------------------------|-----------|
| 2019 | \$ 18,956 |
| 2020 | 9,729 |
| 2021 | 8,713 |
| 2022 | 2,523 |
| Total | \$ 39,921 |

2. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2018, was as follows:

Governmental Activities

| | Beginning Balance | Additions | Reductions | Ending Balance | Due Within One Year |
|----------------------|----------------------|--------------|--------------|-------------------|------------------------|
| Compensated absences | \$ 4,704,574 | \$ 1,860,037 | \$ 1,520,682 | \$ 5,043,929 | \$ - |

3. 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.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

B. Liabilities

3. Other Employee Benefits (Continued)

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.

C. Other Postemployment Benefits (OPEB)

Plan Description and Funding Policy

Arrowhead Regional Corrections administers an OPEB plan, a single-employer defined benefit health care plan, to eligible retirees and their dependents.

Arrowhead Regional Corrections provides health insurance benefits for eligible retired employees and their spouses as required by Minn. Stat. § 471.61, subd. 2b. Retirees are required to pay 100 percent of the total premium cost. Since the premium is determined on the entire active and retiree population, the retirees are receiving an implicit rate subsidy.

Benefit and eligibility provisions are established through negotiations between St. Louis County, Arrowhead Regional Corrections, and the various unions representing each entity's employees. Benefits and eligibility provisions are renegotiated each bargaining period.

No assets have been accumulated in a trust that meets the criteria in paragraph four of GASB 75. The OPEB plan does not issue a stand-alone financial report.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

C. Other Postemployment Benefits (OPEB)

Plan Description and Funding Policy (Continued)

As of the December 31, 2018, actuarial valuation, the following employees were covered by the benefit terms:

| | |
|--|-------------------|
| Inactive employees or beneficiaries currently receiving benefit payments | 18 |
| Active plan participants | <u>225</u> |
| Total | <u><u>243</u></u> |

Total OPEB Liability

Arrowhead Regional Corrections' total OPEB liability was \$1,135,515, which was measured as of December 31, 2018, and was determined by an actuarial valuation as of January 1, 2018.

The total OPEB liability in the fiscal year-end December 31, 2018, actuarial valuation was determined using the following actuarial assumptions and other inputs, applied to all periods included in the measurement, unless otherwise specified:

| | |
|------------------------|--|
| Actuarial Cost Method | Entry Age Normal Percent of Pay |
| Inflation | 2.50 percent |
| Salary increases | 3.25 percent, average wage inflation plus merit/productivity increases |
| Health care cost trend | 6.60 percent, decreasing to an ultimate rate of 4.00 percent over 56 years |

The current year discount rate is 4.10 percent. For the current valuation, the discount rate was based on the estimated yield of the 20-year Bond Buyer G.O. Index as of the end of December 2018.

Mortality rates are based on RP-2014 Employee and Healthy Annuitant mortality tables for males and females without collar or amount adjustments with generational mortality improvements using Scale MP-2018.

The actuarial assumptions are currently based on a combination of historical information and the most recent actuarial valuation for PERA as of July 1, 2018.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

C. Other Postemployment Benefits (OPEB) (Continued)

Changes in the Total OPEB Liability

| | Total OPEB Liability |
|--|-------------------------|
| Balance at December 31, 2017 | \$ 1,207,702 |
| Changes for the year | |
| Service cost | \$ 67,574 |
| Interest | 41,593 |
| Differences between expected and actual experience | (1,066) |
| Changes in assumptions | (46,802) |
| Benefit payments | (133,486) |
| Net change | \$ (72,187) |
| Balance at December 31, 2018 | \$ 1,135,515 |

OPEB Liability Sensitivity

The following presents the total OPEB liability of Arrowhead Regional Corrections, calculated using the discount rate previously disclosed, as well as what Arrowhead Regional Corrections' total OPEB liability would be if it were calculated using a discount rate that is 1.00 percentage point lower or 1.00 percentage point higher than the current discount rate:

| | Discount Rate | Total OPEB Liability |
|-------------|---------------|-------------------------|
| 1% Decrease | 3.10% | \$ 1,204,721 |
| Current | 4.10 | 1,135,515 |
| 1% Increase | 5.10 | 1,069,662 |

The following presents the total OPEB liability of Arrowhead Regional Corrections, calculated using the health care cost trend previously disclosed, as well as what Arrowhead Regional Corrections' total OPEB liability would be if it were calculated using health care cost trend rates that are 1.00 percentage point lower or 1.00 percentage point higher than the current health care cost trend rate:

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

C. Other Postemployment Benefits (OPEB)

OPEB Liability Sensitivity (Continued)

| | <u>Health Care Trend Rate</u> | <u>Total OPEB Liability</u> |
|-------------|-------------------------------|---------------------------------|
| 1% Decrease | 5.60% Decreasing to 3.00% | \$ 1,028,095 |
| Current | 6.60% Decreasing to 4.00% | 1,135,515 |
| 1% Increase | 7.60% Decreasing to 5.00% | 1,260,793 |

OPEB Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

For the year ended December 31, 2018, Arrowhead Regional Corrections recognized OPEB expense of \$101,700. Arrowhead Regional Corrections reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

| | <u>Deferred Outflows of Resources</u> | <u>Deferred Inflows of Resources</u> |
|---|---|--|
| Differences between expected and actual economic experience | \$ - | \$ 900 |
| Changes in actuarial assumptions | - | 39,501 |
| Total | <u>\$ -</u> | <u>\$ 40,401</u> |

Amounts reported as deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

| <u>Year Ended December 31</u> | <u>OPEB Expense Amount</u> |
|-----------------------------------|------------------------------------|
| 2019 | \$ (7,468) |
| 2020 | (7,468) |
| 2021 | (7,468) |
| 2022 | (7,468) |
| 2023 | (7,468) |
| Thereafter | (3,061) |

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

C. Other Postemployment Benefits (OPEB) (Continued)

Changes in Actuarial Assumptions

The following changes in actuarial assumptions occurred in 2018:

- The discount rate used changed from 3.44 percent to 4.10 percent.
- The inflation rate used changed from 2.75 percent to 2.50 percent.
- The salary increase assumption was updated to reflect the reduction in inflation.
- The medical trend rate assumption was updated to reflect the reduction in inflation.
- The mortality assumption was updated to reflect mortality improvements using Scale MP-2018, the most recently published mortality improvement scale available as of the measurement date.
- The retirement assumption has been updated to follow the PERA actuarial valuation as of July 1, 2018.

D. Defined Benefit Pension Plans

1. 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 Plan (the General Employees Plan) and the Public Employees Local Government Correctional Service Retirement Plan (the Correctional Plan), which are cost-sharing, multiple-employer retirement plans. These plans are established and administered in accordance with Minn. Stat. chs. 353 and 356. PERA's defined benefit pension plans are tax qualified plans under Section 401(a) of the Internal Revenue Code.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

D. Deferred Benefit Pension Plans

1. Plan Description (Continued)

The General Employees Plan (accounted for in the General Employees Fund) has multiple benefit structures with members belonging to the Coordinated Plan, the Basic Plan, or the Minneapolis Employees Retirement Fund. Coordinated Plan members are covered by Social Security and Basic Plan and Minneapolis Employees Retirement Fund members are not. The Basic Plan was closed to new members in 1967. The Minneapolis Employees Retirement Fund was closed to new members during 1978 and merged into the General Employees Plan in 2015. All new members must participate in the Coordinated Plan, for which benefits vest after five years of credited service. No Arrowhead Regional Corrections employees belong to either the Basic Plan or the Minneapolis Employees Retirement Fund.

Local government employees of a county-administered facility who are responsible for the direct security, custody, and control of the county correctional facility and its inmates are covered by the Correctional Plan (accounted for in the Correctional Fund). For members hired after June 30, 2010, benefits vest on a prorated basis starting with 50 percent after five years and increasing ten percent for each year of service until fully vested after ten years.

2. Benefits Provided

PERA provides retirement benefits as well as disability benefits to members and benefits to survivors upon death of eligible members. Benefit provisions are established by state statute and can be modified only by the state legislature. Benefit increases are provided to benefit recipients each January. Increases are related to the funding ratio of the plan. General Employees Plan recipients receive a future annual 1.00 percent for the post-retirement benefit increase, while Correctional Plan benefit recipients receive 2.50 percent. If the funding ratio reaches 90 percent for two consecutive years, the benefit increase will be 2.50 percent. If, after reverting to a 2.50 percent benefit increase, the funding ratio declines to less than 80 percent for one year or less than 85 percent for two consecutive years, the benefit increase will decrease to 1.00 percent.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

D. Defined Benefit Pension Plans

2. Benefits Provided (Continued)

The benefit provisions stated in the following paragraph 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 their public service.

Benefits are based on a member's highest average salary for any 60 consecutive months of allowable service, age, and years of credit at termination of service. In the General Employees Plan, two methods are used to compute benefits for Coordinated Plan members. Members hired prior to July 1, 1989, receive 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 Coordinated Plan member is 1.20 percent of average salary for each of the first ten years of service and 1.70 percent of average salary for each remaining year. Under Method 2, the annuity accrual rate is 1.70 percent for Coordinated Plan members for each year of service. Only Method 2 is used for members hired after June 30, 1989. For Correctional Plan members, the annuity accrual rate is 1.90 percent of average salary for each year of service.

For General Employees Plan members hired prior to July 1, 1989, a full annuity is available when age plus years of service equal 90, and normal retirement age is 65. For members hired on or after July 1, 1989, normal retirement age is the age for unreduced Social Security benefits capped at 66. For Correctional Plan members, normal retirement age is 55, and for members who were hired prior to July 1, 1989, a full annuity is available when age plus years of service equal 90. Disability benefits are available for vested members and are based on years of service and average high-five salary.

3. Contributions

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. General Employees Plan members were required

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

D. Defined Benefit Pension Plans

3. Contributions (Continued)

to contribute 6.50 percent of their annual covered salary in 2018. Correctional Plan members were required to contribute 5.83 percent of their annual covered salary in 2018.

In 2018, Arrowhead Regional Corrections was required to contribute the following percentages of annual covered salary:

| | |
|---|-------|
| General Employees Plan – Coordinated Plan members | 7.50% |
| Correctional Plan | 8.75 |

The employee and employer contribution rates did not change from the previous year.

Arrowhead Regional Corrections' contributions for the year ended December 31, 2018, to the pension plans were:

| | |
|------------------------|------------|
| General Employees Plan | \$ 679,254 |
| Correctional Plan | 403,995 |

The contributions are equal to the contractually required contributions as set by state statute.

4. Pension Costs

General Employees Plan

At December 31, 2018, Arrowhead Regional Corrections reported a liability of \$7,383,842 for its proportionate share of the General Employees Plan's net pension liability. The net pension liability was measured as of June 30, 2018, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. Arrowhead Regional Corrections' proportion of the net pension liability was based on Arrowhead Regional Corrections' contributions received by PERA during the measurement period for employer payroll paid dates from July 1, 2017, through June 30, 2018, relative to the total

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

D. Defined Benefit Pension Plans

4. Pension Costs

General Employees Plan (Continued)

employer contributions received from all of PERA's participating employers. At June 30, 2018, Arrowhead Regional Corrections' proportion was 0.1331 percent. It was 0.1398 percent measured as of June 30, 2017. Arrowhead Regional Corrections recognized pension expense of \$554,490 for its proportionate share of the General Employees Plan's pension expense.

Arrowhead Regional Corrections also recognized \$56,495 as revenue, which results in a reduction of the net pension liability, for its proportionate share of the State of Minnesota's contribution to the General Employees Plan, which qualifies as a special funding situation. Legislation requires the State of Minnesota to contribute \$16 million to the General Employees Plan for the fiscal years ended June 30, 2018 and 2019, and \$6 million thereafter, through calendar year 2031.

| | |
|--|---------------------|
| Arrowhead Regional Corrections' proportionate share of the net pension liability | \$ 7,383,842 |
| State of Minnesota's proportionate share of the net pension liability associated with Arrowhead Regional Corrections | <u>242,263</u> |
| Total | <u>\$ 7,626,105</u> |

Arrowhead Regional Corrections reported its proportionate share of the General Employees Plan's deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

D. Defined Benefit Pension Plans

4. Pension Costs

General Employees Plan (Continued)

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|--------------------------------------|-------------------------------------|
| Differences between expected and actual economic experience | \$ 204,837 | \$ 219,885 |
| Changes in actuarial assumptions | 720,182 | 858,240 |
| Difference between projected and actual investment earnings | - | 782,621 |
| Changes in proportion | 158,330 | 389,461 |
| Contributions paid to PERA subsequent to the measurement date | 341,300 | - |
| Total | \$ 1,424,649 | \$ 2,250,207 |

The \$341,300 reported as deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2019. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

| Year Ended December 31 | Pension Expense Amount |
|---------------------------|------------------------------|
| 2019 | \$ 158,145 |
| 2020 | (446,667) |
| 2021 | (724,223) |
| 2022 | (154,113) |

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

D. Defined Benefit Pension Plans

4. Pension Costs (Continued)

Correctional Plan

At December 31, 2018, Arrowhead Regional Corrections reported a liability of \$368,446 for its proportionate share of the Correctional Plan's net pension liability. The net pension liability was measured as of June 30, 2018, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. Arrowhead Regional Corrections' proportion of the net pension liability was based on Arrowhead Regional Corrections' contributions received by PERA during the measurement period for employer payroll paid dates from July 1, 2017, through June 30, 2018, relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2018, Arrowhead Regional Corrections' proportion was 2.2402 percent. It was 2.3300 percent measured as of June 30, 2017. Arrowhead Regional Corrections recognized pension expense of (\$436,505) for its proportionate share of the Correctional Plan's pension expense.

Arrowhead Regional Corrections reported its proportionate share of the Correctional Plan's deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | <u>Deferred Outflows of Resources</u> | <u>Deferred Inflows of Resources</u> |
|---|---|--|
| Differences between expected and actual economic experience | \$ 19,281 | \$ 40,962 |
| Changes in actuarial assumptions | 1,768,893 | 4,289,805 |
| Difference between projected and actual investment earnings | - | 433,850 |
| Changes in proportion | 93,648 | 191,948 |
| Contributions paid to PERA subsequent to the measurement date | <u>203,328</u> | <u>-</u> |
| Total | <u>\$ 2,085,150</u> | <u>\$ 4,956,565</u> |

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

D. Defined Benefit Pension Plans

4. Pension Costs

Correctional Plan (Continued)

The \$203,328 reported as deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2019. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

| Year Ended December 31 | Pension Expense Amount |
|---------------------------|------------------------------|
| 2019 | \$ 170,319 |
| 2020 | (1,674,594) |
| 2021 | (1,493,333) |
| 2022 | (77,135) |

Total Pension Expense

The total pension expense for all plans recognized by Arrowhead Regional Corrections for the year ended December 31, 2018, was \$117,985.

5. Actuarial Assumptions

The total pension liability in the June 30, 2018, actuarial valuation was determined using the individual entry-age normal actuarial cost method and the following additional actuarial assumptions:

| | |
|------------------------------|-----------------------|
| Inflation | 2.50 percent per year |
| Active member payroll growth | 3.25 percent per year |
| Investment rate of return | 7.50 percent |

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

D. Defined Benefit Pension Plans

5. Actuarial Assumptions (Continued)

Salary increases were based on a service-related table. Mortality rates for active members, retirees, survivors, and disabilitants for all plans were based on RP-2014 tables for males or females, as appropriate, with slight adjustments. Cost of living benefit increases for retirees are assumed to be 1.25 percent for the General Employees Plan and 2.00 percent for the Correctional Plan.

Actuarial assumptions used in the June 30, 2018, valuation were based on the results of actuarial experience studies. The experience study for the General Employees Plan was dated June 30, 2015. The experience study for the Correctional Plan was dated February 2012. Economic assumptions were updated in 2017 based on a review of inflation and investment return assumptions.

The long-term expected rate of return on pension plan investments is 7.50 percent. The State Board of Investment, which manages the investments of PERA, prepares an analysis of the reasonableness of the long-term expected rate of return on a regular basis using a building-block method in which best-estimate ranges of expected future rates of return are developed for each major asset class. These ranges are combined to produce an expected long-term rate of return by weighting the expected future rates of return by the target asset allocation percentages. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

| <u>Asset Class</u> | <u>Target Allocation</u> | <u>Long-Term Expected Real Rate of Return</u> |
|--------------------------------------|--------------------------|---|
| Domestic stocks | 36% | 5.10% |
| International stocks | 17 | 5.30 |
| Bonds (fixed income) | 20 | 0.75 |
| Alternative assets (private markets) | 25 | 5.90 |
| Cash | 2 | 0.00 |

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

D. Defined Benefit Pension Plans (Continued)

6. Discount Rate

The discount rate used to measure the total pension liability was 7.50 percent in 2018, which remained consistent with 2017. The projection of cash flows used to determine the discount rate assumed that employee and employer contributions will be made at the rate specified in statute. Based on that assumption, the fiduciary net position of the General Employees Plan and the Correctional Plan were projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

7. Changes in Actuarial Assumptions and Plan Provisions

The following changes in actuarial assumptions occurred in 2018:

General Employees Plan

- The mortality projection scale was changed from MP-2015 to MP-2017.
- The assumed benefit increase rate was changed from 1.00 percent per year through 2044 and 2.50 percent per year thereafter, to 1.25 percent per year.

Correctional Plan

- The single discount rate was changed from 5.96 percent per annum to 7.50 percent per annum.
- The mortality projection scale was changed from MP-2016 to MP-2017.
- The assumed post-retirement benefit increase was changed from 2.50 percent per year to 2.00 percent per year.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

D. Defined Benefit Pension Plans (Continued)

8. Pension Liability Sensitivity

The following presents Arrowhead Regional Corrections' proportionate share of the net pension liability calculated using the discount rate previously disclosed, as well as what Arrowhead Regional Corrections' proportionate share of the net pension liability would be if it were calculated using a discount rate 1.00 percentage point lower or 1.00 percentage point higher than the current discount rate:

| | Proportionate Share of the | | | |
|-------------|----------------------------|--------------------------|-------------------|--------------------------|
| | General Employees Plan | | Correctional Plan | |
| | Discount Rate | Net Pension Liability | Discount Rate | Net Pension Liability |
| 1% Decrease | 6.50% | \$ 11,999,689 | 6.50% | \$ 3,153,261 |
| Current | 7.50 | 7,383,842 | 7.50 | 368,446 |
| 1% Increase | 8.50 | 3,573,593 | 8.50 | (1,859,321) |

9. Pension Plan Fiduciary Net Position

Detailed information about the pension plan's fiduciary net position is available in a separately issued PERA financial report that includes financial statements and required supplementary information. That report may be obtained on the internet at www.mnpera.org; by writing to PERA at 60 Empire Drive, Suite 200, St. Paul, Minnesota 55103-2088; or by calling 651-296-7460 or 1-800-652-9026.

3. Summary of Significant Contingencies and Other Items

A. 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 risk pool. Arrowhead Regional Corrections did not have a loss exceeding the limits of insurance coverage for any of the past three years. There were no significant reductions in insurance from the prior year.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Summary of Significant Contingencies and Other Items

A. Risk Management (Continued)

St. Louis County handles its risk pool through 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.

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 Arrowhead Regional Corrections expects such amounts, if any, to be immaterial.

C. 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.

D. 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 | 10.15 |
| Cook County | 1.90 |
| Koochiching County | 3.03 |
| Lake County | 3.28 |
| St. Louis County | <u>81.64</u> |
| Total | <u>100.00</u> |

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Summary of Significant Contingencies and Other Items

D. Participation (Continued)

Member contributions towards operations for the current year totaled \$18,965,409, or 73 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 2018 totaled \$5,998,659, or 23 percent, of total intergovernmental revenue.

E. Trust Fund

Not shown on Arrowhead Regional Corrections' balance sheet as of December 31, 2018, are funds held in trust for residents or for their benefit. The account balance at December 31, 2018, is as follows:

| | |
|---|------------------|
| Northeast Regional Corrections Center Residents' Trust Fund | <u>\$ 27,723</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
- Northern St. Louis County Drug Court
- St. Louis County Drug Court
- 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.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Summary of Significant Contingencies and Other Items

F. Jointly-Governed Organizations (Continued)

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.

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REQUIRED SUPPLEMENTARY INFORMATION

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT A-1

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2018**

| | <u>Budgeted Amounts</u> | | <u>Actual Amounts</u> | <u>Variance with Final Budget</u> |
|--|-------------------------|----------------------|---------------------------|---------------------------------------|
| | <u>Original</u> | <u>Final</u> | | |
| Revenues | | | | |
| Intergovernmental | \$ 28,421,406 | \$ 26,256,250 | \$ 26,009,486 | \$ (246,764) |
| Charges for services | 1,144,847 | 1,083,761 | 983,570 | (100,191) |
| Investment earnings | 30,000 | 30,000 | 81,280 | 51,280 |
| Miscellaneous | 205,500 | 205,500 | 272,257 | 66,757 |
| Total Revenues | \$ 29,801,753 | \$ 27,575,511 | \$ 27,346,593 | \$ (228,918) |
| Expenditures | | | | |
| Current | | | | |
| Administration | | | | |
| Administrative support services | \$ 2,512,068 | \$ 2,503,919 | \$ 2,420,640 | \$ 83,279 |
| Research and evaluation | 307,737 | 307,737 | 275,103 | 32,634 |
| Staff development | 157,219 | 157,219 | 121,746 | 35,473 |
| Arrowhead Council of Churches | 27,000 | 27,000 | 27,000 | - |
| Women offenders program | 213,207 | 213,207 | 207,659 | 5,548 |
| Total administration | \$ 3,217,231 | \$ 3,209,082 | \$ 3,052,148 | \$ 156,934 |
| Court and field services | | | | |
| Probation | \$ 11,449,233 | \$ 11,178,054 | \$ 10,857,497 | \$ 320,557 |
| Intensive supervision program | 687,167 | 467,421 | 461,836 | 5,585 |
| Short-term consequences | 235,747 | 235,747 | 239,897 | (4,150) |
| Sentencing to service | 264,692 | 264,692 | 231,935 | 32,757 |
| Correctional fees | 145,379 | 145,379 | 124,984 | 20,395 |
| Total court and field services | \$ 12,782,218 | \$ 12,291,293 | \$ 11,916,149 | \$ 375,144 |
| Northeast Regional Corrections Center | | | | |
| Administration | \$ 6,490,132 | \$ 6,477,473 | \$ 5,994,673 | \$ 482,800 |
| Special education | 238,361 | 238,361 | 227,248 | 11,113 |
| Basic education | 176,284 | 176,284 | 177,664 | (1,380) |
| Vocational education | 73,122 | 71,844 | - | 71,844 |
| Total Northeast Regional Corrections Center | \$ 6,977,899 | \$ 6,963,962 | \$ 6,399,585 | \$ 564,377 |
| Arrowhead Juvenile Center | | | | |
| Administration | \$ 4,481,730 | \$ 4,438,183 | \$ 4,362,034 | \$ 76,149 |

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**EXHIBIT A-1
(Continued)**

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2018**

| | <u>Budgeted Amounts</u> | | <u>Actual Amounts</u> | <u>Variance with Final Budget</u> |
|---|-------------------------|----------------------|---------------------------|---------------------------------------|
| | <u>Original</u> | <u>Final</u> | | |
| Expenditures (Continued) | | | | |
| Capital outlay | | | | |
| Economic development | | | | |
| Administration | \$ 35,000 | \$ 36,905 | \$ 36,834 | \$ 71 |
| Court and field services | 70,000 | 70,218 | 56,720 | 13,498 |
| Northeast Regional Corrections Center | 2,115,779 | 405,645 | 236,705 | 168,940 |
| Arrowhead Juvenile Center | 243,122 | 287,665 | 199,875 | 87,790 |
| Total capital outlay | \$ 2,463,901 | \$ 800,433 | \$ 530,134 | \$ 270,299 |
| Total Expenditures | \$ 29,922,979 | \$ 27,702,953 | \$ 26,260,050 | \$ 1,442,903 |
| Net Change in Fund Balance | \$ (121,226) | \$ (127,442) | \$ 1,086,543 | \$ 1,213,985 |
| Fund Balance – January 1 | 4,678,190 | 4,678,190 | 4,678,190 | - |
| Increase (decrease) in inventories | - | - | 660 | 660 |
| Fund Balance – December 31 | \$ 4,556,964 | \$ 4,550,748 | \$ 5,765,393 | \$ 1,214,645 |

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT A-2

**SCHEDULE OF CHANGES IN TOTAL OPEB LIABILITY AND RELATED RATIOS
OTHER POSTEMPLOYMENT BENEFITS
DECEMBER 31, 2018**

| | 2018 |
|--|---------------------|
| Total OPEB Liability | |
| Service cost | \$ 67,574 |
| Interest | 41,593 |
| Differences between expected and actual experience | (1,066) |
| Changes of assumption or other inputs | (46,802) |
| Benefit payments | (133,486) |
| Net change in total OPEB liability | \$ (72,187) |
| Total OPEB Liability – Beginning, as restated | 1,207,702 |
| Total OPEB Liability – Ending | \$ 1,135,515 |
| | |
| Covered-employee payroll | \$ 13,314,818 |
| Total OPEB liability (asset) as a percentage of covered-employee payroll | 8.53% |

This schedule is intended to show information for ten years. Additional years will be displayed as they become available.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT A-3

**SCHEDULE OF PROPORTIONATE SHARE OF NET PENSION LIABILITY
PERA GENERAL EMPLOYEES RETIREMENT PLAN
DECEMBER 31, 2018**

| Measurement Date | Employer's Proportion of the Net Pension Liability (Asset) | Employer's Proportionate Share of the Net Pension Liability (Asset) (a) | State's Proportionate Share of the Net Pension Liability Associated with Arrowhead Regional Corrections (b) | Employer's Proportionate Share of the Net Pension Liability and the State's Related Share of the Net Pension Liability (Asset) (a + b) | Covered Payroll (c) | Employer's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of Covered Payroll (a/c) | Plan Fiduciary Net Position as a Percentage of the Total Pension Liability |
|-----------------------------|---|--|--|---|------------------------------------|---|---|
| 2018 | 0.1331 % | \$ 7,383,842 | \$ 242,263 | \$ 7,626,105 | \$ 8,967,200 | 82.34 % | 79.53 % |
| 2017 | 0.1398 | 8,924,740 | 112,207 | 9,036,947 | 9,005,067 | 99.11 | 75.90 |
| 2016 | 0.1359 | 11,034,406 | 144,140 | 11,178,546 | 8,463,387 | 130.38 | 68.91 |
| 2015 | 0.1412 | 7,317,717 | N/A | 7,317,717 | 8,298,257 | 88.18 | 78.19 |

This schedule is intended to show information for ten years. Additional years will be displayed as they become available.
The measurement date for each year is June 30.
N/A – Not Applicable

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT A-4

**SCHEDULE OF CONTRIBUTIONS
PERA GENERAL EMPLOYEES RETIREMENT PLAN
DECEMBER 31, 2018**

| Year Ending | Statutorily Required Contributions (a) | Actual Contributions in Relation to Statutorily Required Contributions (b) | Contribution (Deficiency) Excess (b - a) | Covered Payroll (c) | Actual Contributions as a Percentage of Covered Payroll (b/c) |
|------------------------|---|---|---|------------------------------------|--|
| 2018 | \$ 679,254 | \$ 679,254 | \$ - | \$ 9,056,720 | 7.50 % |
| 2017 | 661,122 | 661,122 | - | 8,814,960 | 7.50 |
| 2016 | 639,937 | 639,937 | - | 8,532,493 | 7.50 |
| 2015 | 656,183 | 656,183 | - | 8,749,107 | 7.50 |

This schedule is intended to show information for ten years. Additional years will be displayed as they become available. Arrowhead Regional Corrections' year-end is December 31.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT A-5

**SCHEDULE OF PROPORTIONATE SHARE OF NET PENSION LIABILITY
PERA PUBLIC EMPLOYEES LOCAL GOVERNMENT CORRECTIONAL SERVICE RETIREMENT PLAN
DECEMBER 31, 2018**

| Measurement Date | Employer's Proportion of the Net Pension Liability (Asset) | Employer's Proportionate Share of the Net Pension Liability (Asset) (a) | Covered Payroll (b) | Employer's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of Covered Payroll (a/b) | Plan Fiduciary Net Position as a Percentage of the Total Pension Liability |
|-----------------------------|---|--|------------------------------------|---|---|
| 2018 | 2.2402 % | \$ 368,446 | \$ 4,556,949 | 8.09 % | 97.64 % |
| 2017 | 2.3300 | 6,640,523 | 4,651,543 | 142.76 | 67.89 |
| 2016 | 2.2800 | 8,329,159 | 4,247,280 | 196.11 | 58.16 |
| 2015 | 2.2200 | 343,212 | 3,986,802 | 8.61 | 96.95 |

This schedule is intended to show information for ten years. Additional years will be displayed as they become available. The measurement date for each year is June 30.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT A-6

**SCHEDULE OF CONTRIBUTIONS
PERA PUBLIC EMPLOYEES LOCAL GOVERNMENT CORRECTIONAL SERVICE RETIREMENT PLAN
DECEMBER 31, 2018**

| Year Ending | Statutorily Required Contributions (a) | Actual Contributions in Relation to Statutorily Required Contributions (b) | Contribution (Deficiency) Excess (b - a) | Covered Payroll (c) | Actual Contributions as a Percentage of Covered Payroll (b/c) |
|------------------------|---|---|---|------------------------------------|--|
| 2018 | \$ 403,995 | \$ 403,995 | \$ - | \$ 4,617,086 | 8.75 % |
| 2017 | 395,650 | 395,650 | - | 4,521,714 | 8.75 |
| 2016 | 385,572 | 385,572 | - | 4,406,537 | 8.75 |
| 2015 | 377,145 | 377,145 | - | 4,310,229 | 8.75 |

This schedule is intended to show information for ten years. Additional years will be displayed as they become available. Arrowhead Regional Corrections' year-end is December 31.

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED DECEMBER 31, 2018**

1. 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 \$460,151 encumbered at the end of December 31, 2018. Of that amount, \$135,000 was encumbered for air unit replacements at Northeast Regional Corrections Center, \$77,830 was encumbered for capital improvements at the Arrowhead Juvenile Center, \$71,002 was encumbered for ancillary services of the Ignition Interlock Device Program, \$20,833 was encumbered for clinical preventive services, and \$23,840 was encumbered for Community Coach Services.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Other Postemployment Benefits Funded Status

In 2018, Arrowhead Regional Corrections implemented Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. See Note 2.C. in the notes to the financial statements for additional information regarding Arrowhead Regional Corrections other postemployment benefits.

3. Employer Contributions to Other Postemployment Benefits

Assets have not been accumulated in a trust that meets the criteria in paragraph four of GASB Statement 75 to pay related benefits.

The following changes in actuarial assumptions occurred in 2018:

- The discount rate was updated to 4.10 percent (from 3.44 percent).
- Inflation was updated to 2.50 percent (from 2.75 percent).
- The salary increase assumption was updated to reflect the reduction in inflation.
- The medical trend rate assumption was updated to reflect the reduction in inflation.
- The mortality assumption was updated from the assumption used in the January 1, 2018, actuarial report to reflect mortality improvements using Scale MP-2018, the most recently published mortality improvement scale available as of the measurement date.

4. Defined Benefit Pension Plans – Changes in Significant Plan Provisions, Actuarial Methods, and Assumptions

The following changes were reflected in the valuation performed on behalf of the Public Employees Retirement Association for the year ended June 30:

General Employees Retirement Plan

2018

- The mortality projection scale was changed from MP-2015 to MP-2017.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

4. Defined Benefit Pension Plans – Changes in Significant Plan Provisions, Actuarial Methods, and Assumptions

General Employees Retirement Plan

2018 (Continued)

- The assumed benefit increase rate was changed from 1.00 percent per year through 2044 and 2.50 percent per year thereafter, to 1.25 percent per year.

2017

- The Combined Service Annuity (CSA) loads were changed from 0.80 percent for active members and 60 percent for vested and non-vested deferred members (30 percent for deferred Minneapolis Employees Retirement Fund members). The revised CSA loads are now 0.00 percent for active member liability, 15 percent for vested deferred member liability, and 3.00 percent for non-vested deferred member liability.
- The assumed post-retirement benefit increase rate was changed from 1.00 percent per year for all years to 1.00 percent per year through 2044 and 2.50 percent per year thereafter.
- Minneapolis Employees Retirement Fund plan provisions change the employer supplemental contribution to \$21 million in calendar years 2017 and 2018 and returns to \$31 million through calendar year 2031. The state's required contribution is \$16 million in PERA's fiscal years 2018 and 2019 and returns to \$6 million annually through calendar year 2031.

2016

- The assumed post-retirement benefit increase rate was changed from 1.00 percent per year through 2035 and 2.50 percent per year thereafter, to 1.00 percent for all future years.
- The assumed investment rate was changed from 7.90 percent to 7.50 percent. The single discount rate was also changed from 7.90 percent to 7.50 percent.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

4. Defined Benefit Pension Plans – Changes in Significant Plan Provisions, Actuarial Methods, and Assumptions

General Employees Retirement Plan

2016 (Continued)

- Other assumptions were changed pursuant to the experience study dated June 30, 2015. The assumed payroll growth and inflation were decreased by 0.25 percent. Payroll growth was reduced from 3.50 percent to 3.25 percent. Inflation was reduced from 2.75 percent to 2.50 percent.

Public Employees Local Governmental Correctional Service Retirement Plan

2018

- The single discount rate was changed from 5.96 percent per annum to 7.50 percent per annum.
- The mortality projection scale was changed from MP-2016 to MP-2017.
- The assumed post-retirement benefit increase was changed from 2.50 percent per year to 2.00 percent per year.

2017

- The base mortality table for healthy annuitants was changed from the RP-2000 fully generational table to the RP-2014 fully generational table (with a base year of 2006), with male rates adjusted by a factor of 0.96. The mortality improvement scale was changed from Scale AA to Scale MP-2016 and is applied to healthy and disabled members. The base mortality table for disabled annuitants was changed from the RP-2000 disabled mortality table to the RP-2014 disabled annuitant mortality table (with future mortality improvement according to Scale MP-2016).
- The CSA load was 30 percent for vested and non-vested, deferred members. The CSA has been changed to 35 percent for vested members and 1.00 percent for non-vested members.
- The single discount rate was changed from 5.31 percent per annum to 5.96 percent per annum.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

4. Defined Benefit Pension Plans – Changes in Significant Plan Provisions, Actuarial Methods, and Assumptions

Public Employees Local Governmental Correctional Service Retirement Plan (Continued)

2016

- The assumed investment rate was changed from 7.90 percent to 7.50 percent. The single discount rate was changed from 7.90 percent to 5.31 percent.
- The assumed payroll growth and inflation were decreased by 0.25 percent. Payroll growth was reduced from 3.50 percent to 3.25 percent. Inflation was reduced from 2.75 percent to 2.50 percent.

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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, 2018**

| | |
|---|-----------------------------|
| Shared Revenue | |
| State | |
| PERA rate reimbursement | <u>\$ 49,537</u> |
| Membership Contributions | |
| Shared operations | |
| Carlton County | \$ 1,924,183 |
| Cook County | 360,229 |
| Koochiching County | 575,456 |
| Lake County | 621,828 |
| St. Louis County | <u>15,483,713</u> |
| Total shared operations | <u>\$ 18,965,409</u> |
| Grants | |
| State | |
| Minnesota Department of Corrections | \$ 6,636,563 |
| Education | 73,052 |
| Public Safety | <u>55,855</u> |
| Total state grants | <u>\$ 6,765,470</u> |
| Federal | |
| Department of Agriculture | \$ 56,295 |
| Justice | 66,492 |
| Transportation | 99,682 |
| Education | <u>6,512</u> |
| Total federal grants | <u>\$ 228,981</u> |
| Other | |
| Local | <u>\$ 89</u> |
| Total state, federal, and other grants | <u>\$ 6,994,540</u> |
| Total Intergovernmental Revenue | <u><u>\$ 26,009,486</u></u> |

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JULIE BLAHA
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE 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, 2018, and the related notes to the financial statements, which collectively comprise Arrowhead Regional Corrections' basic financial statements and have issued our report thereon dated October 29, 2019.

The *Minnesota Legal Compliance Audit Guide for Other Political Subdivisions*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65, contains six categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, claims and disbursements, miscellaneous provisions, and tax increment financing. Our audit considered all of the listed categories, except that we did not test for compliance with the provisions for tax increment financing because Arrowhead Regional Corrections administers no tax increment financing districts.

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 Other 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 the Board of Commissioners 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/Julie Blaha

JULIE BLAHA
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

October 29, 2019