

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2007

Description of the Office of the State Auditor

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

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

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

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

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

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

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

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

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

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

For the Year Ended December 31, 2007



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

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**ORGANIZATION
DECEMBER 31, 2007**

			<u>Term Expires</u>
Elected			
Commissioners			
Chair	Peg Sweeney	St. Louis County	January 2009
Vice Chair	Richard Brenner	Carlton County	January 2009
Board Member	Janice Hall	Cook County	January 2010
Board Member	Charles Lepper	Koochiching County	January 2011
Board Member	Wade Pavleck	Koochiching County	January 2011
Board Member	Rick Goutermont	Lake County	January 2011
Board Member	Keith Nelson	St. Louis County	January 2010
Board Member	Steve O'Neil	St. Louis County	January 2009
Appointed			
Executive Director	Tom Roy		Indefinite

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

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INDEPENDENT AUDITOR'S REPORT

Board of Commissioners
Arrowhead Regional Corrections

We have audited the accompanying financial statements of the governmental activities and the General Fund of Arrowhead Regional Corrections as of and for the year ended December 31, 2007, which collectively comprise Arrowhead Regional Corrections' basic financial statements as listed in the table of contents. These financial statements are the responsibility of Arrowhead Regional Corrections' management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the General Fund of Arrowhead Regional Corrections as of December 31, 2007, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis and the required supplementary information are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming opinions on the financial statements that collectively comprise Arrowhead Regional Corrections' basic financial statements. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements of Arrowhead Regional Corrections. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 8, 2009, on our consideration of Arrowhead Regional Corrections' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

May 8, 2009

MANAGEMENT'S DISCUSSION AND ANALYSIS

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2007
(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, 2007. Please read it in conjunction with the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

Total net assets in 2007, for Arrowhead Regional Corrections, increased \$0.9 million to \$7.4 million, compared to a \$0.2 million increase for 2006.

The Arrowhead Regional Corrections General Fund reported an ending fund balance of \$5.2 million, an increase of \$0.5 million. Over half of the fund balance, \$3.3 million, is reserved and not available for appropriation. The remaining \$1.9 million (unreserved fund balance) has been designated for specific uses.

The General Fund reported an excess of revenues over expenditures of \$0.5 million.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

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

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

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

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

Notes to the financial statements: The notes provide additional information essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found on pages 18 through 31.

Supporting schedules: The budgetary comparison schedule, notes to required supplementary information, and schedule of intergovernmental revenue are provided on pages 32 through 35.

Government-Wide Financial Analysis

Net assets may, over time, be a useful indicator of a government's financial position. In the case of Arrowhead Regional Corrections, assets exceeded liabilities by \$7.4 million.

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

Table 1
Net Assets
(in Millions)

	Governmental Activities	
	2007	2006
Current and other assets	\$ 6.7	\$ 5.8
Capital assets	<u>6.1</u>	<u>6.2</u>
Total Assets	<u>\$ 12.8</u>	<u>\$ 12.0</u>
Other liabilities	\$ 0.6	\$ 0.8
Long-term liabilities outstanding	<u>4.8</u>	<u>4.7</u>
Total Liabilities	<u>\$ 5.4</u>	<u>\$ 5.5</u>
Net Assets		
Invested in capital assets	\$ 6.1	\$ 6.2
Unrestricted	<u>1.3</u>	<u>0.3</u>
Total Net Assets	<u>\$ 7.4</u>	<u>\$ 6.5</u>

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

Governmental Activities

The net assets of Arrowhead Regional Corrections increased by \$0.9 million, or 14.5 percent, from \$6.5 million in 2006 to \$7.4 million for 2007. Arrowhead Regional Corrections is able to report positive balances in net assets unrestricted for 2007 as it did in 2006 because current and other assets are greater than total liabilities.

Current and other assets increased by \$0.9 million as the result of revenues exceeding expenses by the same amount. Due from other governments reflected an increase of \$1.0 million over year-end 2006, while combined cash and investments decreased by \$0.1 million for the same period.

Other liabilities of \$0.6 million consist almost entirely of accounts payable and salaries payable, while the long-term liabilities outstanding are 100 percent compensated absences.

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

Table 2
Changes in Net Assets
(in Millions)

	Governmental Activities	
	2007	2006
Revenues		
Program revenues		
Charges for services	\$ 1.1	\$ 1.0
Operating grants and contributions	2.9	2.3
General revenues		
Community corrections act subsidy	3.9	3.8
Grant and contributions not restricted to specific programs	12.9	11.8
Miscellaneous	0.6	0.5
Total Revenues	\$ 21.4	\$ 19.4
Expenses		
Program expenses		
Administration	\$ 2.0	\$ 1.7
Court and field services	9.7	8.8
Northeast Regional Corrections Center	5.1	5.2
Arrowhead Juvenile Center	3.7	3.5
Total Expenses	\$ 20.5	\$ 19.2
Increase (Decrease) in Net Assets	\$ 0.9	\$ 0.2
Net Assets, January 1	6.5	6.3
Net Assets, December 31	\$ 7.4	\$ 6.5

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

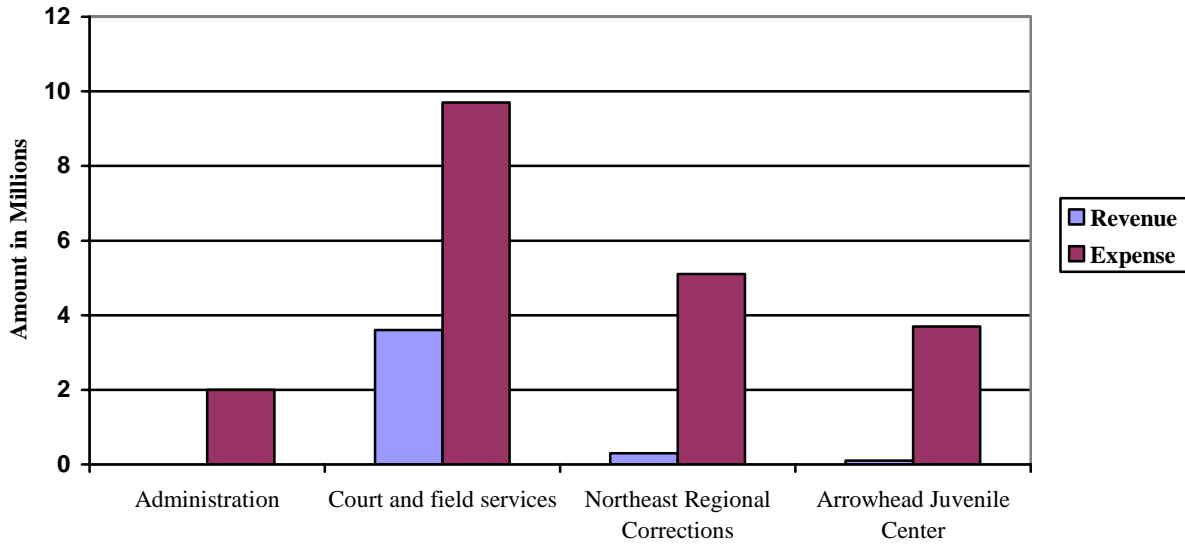
Governmental Activities

Total revenues were \$2.0 million more in 2007 than in 2006, an increase of 10.4 percent.

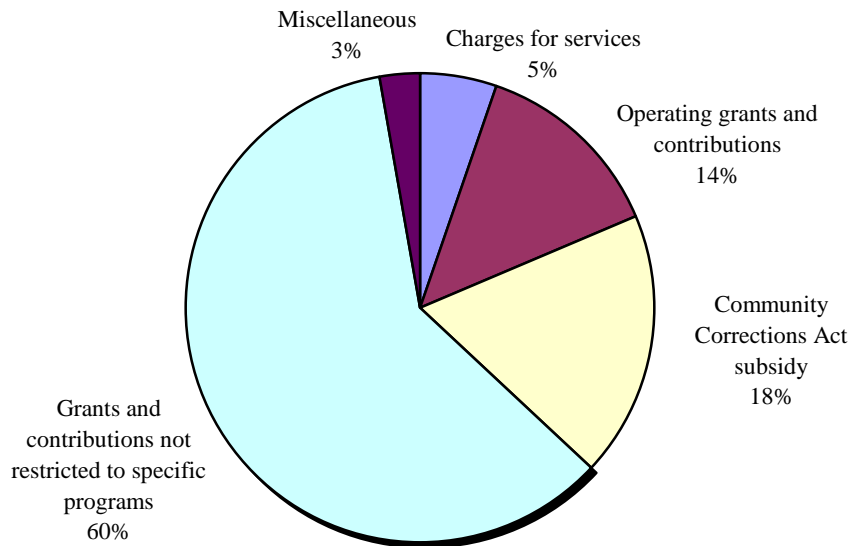
Operating grants and contributions increased by \$0.6 million due to receiving new federal grant revenues for the Drug Court Discretionary Grant and the Byrne Formula Grant Program. General revenues increased by \$1.3 million primarily because the five member counties contributed \$12.7 million in 2007, compared to \$11.8 million in 2006.

Total expenses increased in 2007 by \$1.3 million. The largest increase was again in court and field services which increased by slightly more than \$0.8 million in 2007 after increasing by \$0.6 million in 2006. Court and field services accounted for 47.3 percent of total program expenses.

Expenses and Program Revenues: Governmental Activities



Revenues by Source: Governmental Activities



(Unaudited)

Financial Analysis of the General Fund

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

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

As of December 31, 2007, Arrowhead Regional Corrections' General Fund reported a fund balance of \$5.2 million, compared with \$4.7 million in 2006 and \$3.7 million in 2005. Unreserved fund balance, which is available for spending at Arrowhead Regional Corrections' discretion, was \$1.9 million at the end of the year. Most of the \$1.9 million of unreserved fund balance has been designated for compensated absences. Designations reflect Arrowhead Regional Corrections' self-imposed limitations on otherwise available expendable resources. The remaining \$3.3 million of fund balance is reserved. Fund balance is reserved because it is either unavailable for spending or legally restricted. Reserved for correctional fees of \$3.1 million, or 95.4 percent, is the largest reservation of fund balance.

Personal services make up 76.0 percent of the Arrowhead Regional Corrections' total expenditures, while member contributions at 61.7 percent and state and federal grants at 30.1 percent are responsible for most of the revenues.

General Fund Budgetary Highlights

The Drug Courts expanded their services to the Iron Range for the first time in 2007 due to new grant monies.

Arrowhead Regional Corrections' fees continued to increase in 2007 to a record amount of nearly \$0.7 million. Of that amount, \$0.6 million was used as part of the 2007 budget to support critical correctional services. Arrowhead Regional Corrections' budget for 2007 was 4.0 percent higher than the 2006 budget.

As was the case in 2006, funding received from the state for the Community Corrections Act subsidy increased modestly in 2007 to \$3.9 million.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At year-end, Arrowhead Regional Corrections showed total capital assets of \$6.1 million. These amounts represent a broad range of capital assets, including land, buildings, machinery, and vehicles. Detail is presented immediately below in Table 3.

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

	Governmental Activities	
	2007	2006
Land	\$ 0.5	\$ 0.5
Buildings and improvements	5.5	5.6
Vehicles	0.1	0.1
Totals	<u>\$ 6.1</u>	<u>\$ 6.2</u>

The decrease in capital assets was due to depreciation expense exceeding new purchases by slightly more than \$0.1 million. Purchases during the year of \$0.1 million were for five vehicles, a hot water heater, a surveillance system, and paving a parking lot.

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

Local governments continue to be challenged by a relatively stagnant economy.

Arrowhead Regional Corrections' health insurance premiums for 2008 were increased by 12.5 percent. Employer and employee paid premiums have increased every year since 2003.

Other factors impacting the 2008 budget will be settling salary contracts and rising energy costs.

The Arrowhead Regional Corrections' 2008 budget was passed at a Board meeting in late 2007. The five member counties total contribution will be about the same in 2008 as it was in 2007.

CONTACTING THE ARROWHEAD REGIONAL CORRECTIONS FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of finances and to show Arrowhead Regional Corrections' accountability for the money it receives. If you have a question about this report or need information, contact the Arrowhead Regional Corrections Office at: 100 N. 5th Avenue West, Duluth, Minnesota 55802-1293.

BASIC FINANCIAL STATEMENTS

GOVERNMENT-WIDE FINANCIAL STATEMENTS

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 1

**STATEMENT OF NET ASSETS
DECEMBER 31, 2007**

	<u>Governmental Activities</u>
<u>Assets</u>	
Cash and pooled investments	\$ 2,549,834
Petty cash and change funds	17,186
Investments	1,864,440
Accounts receivable	22,701
Accrued interest receivable	67,311
Due from other governments	2,110,677
Inventories	109,797
Prepaid items	30
Capital assets	
Non-depreciable	476,534
Depreciable - net of accumulated depreciation	<u>5,601,078</u>
Total Assets	<u>\$ 12,819,588</u>
<u>Liabilities</u>	
Accounts payable	\$ 307,274
Salaries payable	295,381
Due to other governments	10,178
Long-term liabilities	
Due within one year	1,146,371
Due in more than one year	<u>3,658,438</u>
Total Liabilities	<u>\$ 5,417,642</u>
<u>Net Assets</u>	
Invested in capital assets	\$ 6,077,612
Unrestricted	<u>1,324,334</u>
Total Net Assets	<u>\$ 7,401,946</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 2

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Expenses</u>	<u>Program Revenues</u>		<u>Net (Expense) Revenue and Change in Net Assets</u>
<u>Functions/Programs</u>		<u>Fees, Charges, Fines, and Other</u>	<u>Operating Grants and Contributions</u>	
Governmental activities				
Administration	\$ 1,961,778	\$ -	\$ -	\$ (1,961,778)
Court and field services	9,681,444	952,163	2,701,656	(6,027,625)
Northeast Regional Corrections Center	5,112,196	163,235	103,222	(4,845,739)
Arrowhead Juvenile Center	<u>3,721,093</u>	<u>36,440</u>	<u>94,778</u>	<u>(3,589,875)</u>
Total Governmental Activities	<u>\$ 20,476,511</u>	<u>\$ 1,151,838</u>	<u>\$ 2,899,656</u>	<u>\$ (16,425,017)</u>
General Revenues				
Community Corrections Act subsidy				\$ 3,903,721
Grants and contributions not restricted to specific programs				12,877,718
Unrestricted investment earnings				88,433
Miscellaneous				<u>494,359</u>
Total general revenues				<u>\$ 17,364,231</u>
Change in net assets				<u>\$ 939,214</u>
Net Assets - Beginning				<u>6,462,732</u>
Net Assets - Ending				<u>\$ 7,401,946</u>

FUND FINANCIAL STATEMENTS

GOVERNMENTAL FUND

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 3

**BALANCE SHEET
GENERAL FUND
DECEMBER 31, 2007**

<u>Assets</u>	
Cash and pooled investments	\$ 2,549,834
Petty cash and change funds	17,186
Investments	1,864,440
Accounts receivable	22,701
Accrued interest receivable	67,311
Due from other governments	2,110,677
Prepaid expense	30
Inventories	109,797
	\$ 6,741,976
	\$ 6,741,976
<u>Liabilities and Fund Balances</u>	
Liabilities	
Accounts payable	\$ 307,274
Salaries payable	295,381
Due to other governments	10,178
Deferred revenue - unavailable	928,679
	\$ 1,541,512
	\$ 1,541,512
Fund Balances	
Reserved for	
Inventories	\$ 109,797
Prepaid items	30
Health and welfare	40,732
Correctional fees	3,105,934
Unreserved	
Designated for compensated absences	1,926,785
Designated for petty cash funds	17,186
	\$ 5,200,464
	\$ 5,200,464
Total Liabilities and Fund Balances	\$ 6,741,976

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 4

**RECONCILIATION OF GENERAL FUND BALANCE SHEET
TO THE GOVERNMENT-WIDE STATEMENT OF NET ASSETS - GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2007**

Fund balances - total governmental funds (Exhibit 3)	\$ 5,200,464
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets, net of accumulated depreciation, used in governmental activities are not financial resources and, therefore, are not reported in the fund.	6,077,612
Other long-term assets are not available to pay for current period expenditures and, therefore, are deferred in the fund.	928,679
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the fund.	
Compensated absences	<u>(4,804,809)</u>
Net Assets of Governmental Activities (Exhibit 1)	<u><u>\$ 7,401,946</u></u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 5

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2007**

Revenues	
Intergovernmental	\$ 19,155,439
Charges for services	1,151,838
Investment earnings	88,433
Miscellaneous	407,479
	<hr/>
Total Revenues	\$ 20,803,189
Expenditures	
Current	
Administration	\$ 1,938,039
Court and field services	9,660,350
Northeast Regional Corrections Center	4,966,091
Arrowhead Juvenile Center	3,626,966
Capital outlay	123,289
	<hr/>
Total Expenditures	\$ 20,314,735
Net Change in Fund Balance	\$ 488,454
Fund Balance - January 1	4,722,660
Increase (decrease) in reserved for inventories	(10,650)
	<hr/>
Fund Balance - December 31	\$ 5,200,464
	<hr/> <hr/>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 6

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE OF THE GENERAL FUND TO THE
GOVERNMENT-WIDE STATEMENT OF ACTIVITIES - GOVERNMENTAL ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2007**

Net change in fund balance - General Fund (Exhibit 5) \$ 488,454

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

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

Deferred revenue - December 31	\$ 928,679	
Deferred revenue - January 1	(316,143)	612,536

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

Expenditures for general capital assets	\$ 123,289	
Net book value of assets disposed of	(4,969)	
Current year depreciation	(235,369)	(117,049)

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

Change in compensated absences	\$ (34,077)	
Change in inventories	(10,650)	(44,727)

Change in Net Assets of Governmental Activities (Exhibit 2) \$ 939,214

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2007**

1. Summary of Significant Accounting Policies

Arrowhead Regional Corrections' financial statements are prepared in accordance with generally accepted accounting principles (GAAP) for the year ended December 31, 2007. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (statements and interpretations). Governments are also required to follow the pronouncements of the Financial Accounting Standards Board issued through November 30, 1989, (when applicable) that do not conflict with or contradict GASB pronouncements. The more significant accounting policies established in GAAP and used by Arrowhead Regional Corrections are discussed below.

A. Financial Reporting Entity

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

B. Basic Financial Statements

1. Government-Wide Statements

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basic Financial Statements

1. Government-Wide Statements (Continued)

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

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

2. Fund Financial Statements

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

C. Measurement Focus and Basis of Accounting

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

C. Measurement Focus and Basis of Accounting (Continued)

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

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

D. Assets, Liabilities, and Net Assets or Equity

1. Cash and Pooled Investments

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

2. Inventories

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

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

3. Capital Assets

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

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized.

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

<u>Assets</u>	<u>Years</u>
Buildings	30 - 70
Building improvements	10 - 20
Furniture, equipment, and vehicles	3 - 15

4. Compensated Absences

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

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

5. Deferred Revenue

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

6. Long-Term Obligations

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

7. Fund Equity

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

8. Use of Estimates

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

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

Minn. Stat. §§ 118A.04 and 118A.05 authorize the types of securities available to Arrowhead Regional Corrections for investment.

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

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

	December 31, 2007
	<hr/>
Cash and pooled investments	\$ 2,549,834
Petty cash and change funds	17,186
Investments	<hr/> 1,864,440
Total	<hr/> <hr/> \$ 4,431,460

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets (Continued)

2. Receivables

Receivables as of December 31, 2007, for Arrowhead Regional Corrections' governmental activities are as follows:

Due from other governments	\$	2,110,677
Accounts		22,701
Accrued interest receivable		67,311
Total Receivables	\$	2,200,689

3. Capital Assets

Capital asset activity for the year ended December 31, 2007, was as follows:

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	\$ 454,123	\$ 22,411	\$ -	\$ 476,534
Capital assets depreciated				
Buildings	\$ 7,731,576	\$ 23,198	\$ 23,004	\$ 7,731,770
Machinery, furniture, and equipment	964,433	77,680	76,246	965,867
Total capital assets depreciated	\$ 8,696,009	\$ 100,878	\$ 99,250	\$ 8,697,637
Less: accumulated depreciation for				
Buildings	\$ 2,132,952	\$ 176,944	\$ 20,539	\$ 2,289,357
Machinery, furniture, and equipment	822,519	58,425	73,742	807,202
Total accumulated depreciation	\$ 2,955,471	\$ 235,369	\$ 94,281	\$ 3,096,559
Total capital assets depreciated, net	\$ 5,740,538	\$ (134,491)	\$ 4,969	\$ 5,601,078
Capital Assets, Net	\$ 6,194,661	\$ (112,080)	\$ 4,969	\$ 6,077,612

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

3. Capital Assets (Continued)

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

Administration	\$	19,568
Court and field services		3,785
Northeast Regional Corrections Center		120,433
Arrowhead Juvenile Center		91,583
Total Depreciation Expense	\$	235,369

B. Liabilities

1. Payables

Payables at December 31, 2007, were as follows:

Accounts	\$	307,274
Salaries		295,381
Due to other governments		10,178
Total Payables	\$	612,833

2. Leases

Operating Leases

Arrowhead Regional Corrections leases office space and office equipment under noncancelable operating leases. Total costs for such leases were \$273,142 for the year ended December 31, 2007. The future minimum lease payments for these leases are as follows:

Year Ending December 31	Amount
2008	\$ 273,142
2009	273,142
2010	273,142
2011	273,142
2012	273,142
Total	\$ 1,365,710

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

B. Liabilities (Continued)

3. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2007, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Compensated absences	\$ 4,770,732	\$ 1,187,655	\$ 1,153,578	\$ 4,804,809	\$ 1,146,371

4. Deferred Compensation

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

5. Other Employee Benefits

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

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

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

Unvested sick leave of \$1,248,121 (total accumulated sick leave less estimated amounts of vested and vesting sick leave) at December 31, 2007, is available to employees in the event of illness-related absences and is not reported in the financial statements.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

B. Liabilities (Continued)

6. Risk Management

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

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

3. Employee Retirement Systems and Pension Plans

A. Plan Description

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

Public Employees Retirement Fund members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security, and Basic Plan members are not. All new members must participate in the Coordinated Plan. Members who are employed in a county correctional institution as a correctional guard or officer, a joint jailer/dispatcher, or as a supervisor of correctional guards or officers or of joint jailer/dispatchers and are directly responsible for the direct security, custody, and control of the county correctional institution and its inmates, are covered by the Public Employees Correctional Fund.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Plan Description (Continued)

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

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

For all Public Employees Retirement Fund members hired prior to July 1, 1989, whose annuity is calculated using Method 1 and Public Employees Correctional Fund members, a full annuity is available when age plus years of service equal 90. A reduced retirement annuity is also available to eligible members seeking early retirement.

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

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Employee Retirement Systems and Pension Plans (Continued)

B. Funding Policy

Pension benefits are funded from member and employer contributions and income from the investment of fund assets. Minn. Stat. ch. 353 sets the rates for employer and employee contributions. These statutes are established and amended by the State Legislature. Arrowhead Regional Corrections makes annual contributions to the pension plans equal to the amount required by state statutes. Public Employees Retirement Fund Basic Plan members and Coordinated Plan members were required to contribute 9.10 and 5.75 percent, respectively, of their annual covered salary in 2007. Contribution rates in the Coordinated Plan increased in 2008 to 6.00 percent. Public Employees Correctional Fund members are required to contribute 5.83 percent of their annual covered salary.

Arrowhead Regional Corrections is required to contribute the following percentages of annual covered payroll in 2007 and 2008:

	2007	2008
Public Employees Retirement Fund		
Basic Plan members	11.78%	11.78%
Coordinated Plan members	6.25	6.50
Public Employees Correctional Fund	8.75	8.75

Arrowhead Regional Corrections' contributions for the years ending December 31, 2007, 2006, and 2005, for the Public Employees Retirement Fund and the Public Employees Correctional Fund were:

	Public Employees Retirement Fund	Public Employees Correctional Fund
2007	\$ 513,309	\$ 259,532
2006	485,595	239,127
2005	394,793	228,257

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

A. Contingent Liabilities

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

B. Claims and Litigation

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

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

C. Participation

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

	<u>Percent (%)</u>
Carlton County	9.53
Cook County	1.52
Koochiching County	2.75
Lake County	2.28
St. Louis County	<u>83.92</u>
Totals	<u><u>100.00</u></u>

Member contributions for the current year totaled \$12,736,820, or 66 percent, of the total intergovernmental revenue received.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

C. Participation (Continued)

Of the various state grants available to Arrowhead Regional Corrections, the most significant is the grant authorized under the Community Corrections Act. Grant proceeds for 2007 totaled \$3,903,721, or 20 percent, of total intergovernmental revenue received.

D. Jointly-Governed Organizations

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

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

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

REQUIRED SUPPLEMENTARY INFORMATION

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

Schedule 1

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Intergovernmental	\$ 19,016,584	\$ 19,101,572	\$ 19,155,439	\$ 53,867
Charges for services	826,250	883,200	1,151,838	268,638
Investment earnings	-	-	88,433	88,433
Miscellaneous	331,600	663,282	407,479	(255,803)
Total Revenues	\$ 20,174,434	\$ 20,648,054	\$ 20,803,189	\$ 155,135
Expenditures				
Current				
Administration				
Administrative support services	\$ 2,030,637	\$ 2,030,637	\$ 1,357,258	\$ 673,379
Research and evaluation	209,168	209,168	194,312	14,856
Staff development	144,603	144,603	98,348	46,255
Arrowhead Council of Churches	25,425	25,425	25,425	-
Women offenders program	174,015	174,015	109,861	64,154
Use of institutions	100,000	100,000	152,835	(52,835)
Total administration	\$ 2,683,848	\$ 2,683,848	\$ 1,938,039	\$ 745,809
Court and field services				
Probation	\$ 8,055,867	\$ 8,055,867	\$ 8,730,040	\$ (674,173)
St. Louis County data processing charges	97,357	97,357	97,357	-
Intensive supervision program	559,157	559,157	383,032	176,125
Short-term consequences	144,493	144,493	172,889	(28,396)
Sentence to serve	179,607	179,607	176,184	3,423
Juvenile restitution	-	-	6,322	(6,322)
Correctional fees	62,500	62,500	94,526	(32,026)
Total court and field services	\$ 9,098,981	\$ 9,098,981	\$ 9,660,350	\$ (561,369)
Northeast Regional Corrections Center				
Administration	\$ 4,419,359	\$ 4,419,359	\$ 4,501,540	\$ (82,181)
Special education	177,099	177,099	184,245	(7,146)
Basic education	127,734	127,734	134,257	(6,523)
Vocational education	142,144	142,144	146,049	(3,905)
Total Northeast Regional Corrections Center	\$ 4,866,336	\$ 4,866,336	\$ 4,966,091	\$ (99,755)
Arrowhead Juvenile Center				
Administration	\$ 3,525,269	\$ 3,525,269	\$ 3,626,966	\$ (101,697)

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

Schedule 1
(Continued)

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Expenditures (Continued)				
Capital outlay				
Court and field services	\$ -	\$ -	\$ 70,917	\$ (70,917)
Northeast Regional Corrections Center	-	-	23,198	(23,198)
Arrowhead Juvenile Center	-	-	29,174	(29,174)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total capital outlay	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 123,289</u>	<u>\$ (123,289)</u>
Total Expenditures	<u>\$ 20,174,434</u>	<u>\$ 20,174,434</u>	<u>\$ 20,314,735</u>	<u>\$ (140,301)</u>
Net Change in Fund Balance	\$ -	\$ 473,620	\$ 488,454	\$ 14,834
Fund Balance - January 1	4,722,660	4,722,660	4,722,660	-
Increase (decrease) in reserved for inventories	<u>-</u>	<u>-</u>	<u>(10,650)</u>	<u>(10,650)</u>
Fund Balance - December 31	<u>\$ 4,722,660</u>	<u>\$ 5,196,280</u>	<u>\$ 5,200,464</u>	<u>\$ 4,184</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED DECEMBER 31, 2007**

Budgetary Data

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

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

The appropriated budget is prepared by each division of Arrowhead Regional Corrections. Department heads may make transfers of appropriations within a department. Transfers of appropriations between departments require Board approval. The legal level of budgetary control (the level at which expenditures may not legally exceed the budget) is at the divisional level. During the year, the Board made supplemental budgetary appropriations of \$473,620 to the revenues in the General Fund.

Encumbrance accounting, under which commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary integration in the General Fund. Encumbrances (purchase orders and contracts) outstanding at year-end are reported as reservations of fund balances and provide authority for the carryover of appropriations to the subsequent year in order to complete these transactions. There were no encumbrances reported at December 31, 2007.

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SUPPLEMENTARY INFORMATION

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

Schedule 2

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
FOR THE YEAR ENDED DECEMBER 31, 2007**

Shared Revenue

State

PERA rate reimbursement	\$ <u>52,153</u>
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Membership Contributions

Shared operations

Carlton County	\$ 1,213,412
Cook County	193,421
Koochiching County	350,003
Lake County	290,936
St. Louis County	10,689,048
Local contributions	<u>98,000</u>

Total shared operations	\$ <u>12,834,820</u>
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Grants

State

Minnesota Department of Education	<u>\$ 89,835</u>
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Minnesota Department of Corrections

Court and field services

Caseload/workload reductions grant	\$ 995,481
Intensive supervision grant	513,570
Sex offender grant	458,942
Felony caseload reductions grant	108,131
Remote electronic monitoring	<u>29,663</u>

Total court and field services	\$ 2,105,787
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Arrowhead Juvenile Center

Sex offender grant	29,583
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Community Corrections Act subsidy

	<u>3,903,721</u>
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Total Minnesota Department of Corrections	\$ <u>6,039,091</u>
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Total State Grants	\$ <u>6,128,926</u>
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Federal

Department of

Agriculture	\$ 65,195
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Justice	60,958
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Education	<u>13,387</u>
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Total Federal Grants	\$ <u>139,540</u>
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Total State and Federal Grants	\$ <u>6,268,466</u>
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Total Intergovernmental Revenue	\$ <u><u>19,155,439</u></u>
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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

Schedule 3

SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2007

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

96-2 **Internal Control/Segregation of Duties**

Management is responsible for establishing and maintaining internal control. This responsibility includes the internal control over the various accounting cycles, the fair presentation of the financial statements and related notes, and the accuracy and completeness of all financial records and related information. Adequate segregation of duties is a key internal control in an organization's accounting system. The size of Arrowhead Regional Corrections and its staffing limits the internal control that management can design and implement into the organization. Management should be aware that segregation of duties is not adequate from an internal control point of view.

Management is responsible for the accuracy and completeness of all financial records and related information. Also, management is responsible for controls over the period-end financial reporting process, including controls over procedures used to enter transaction totals into the general ledger; initiate, authorize, record, and process journal entries into the general ledger; and record recurring and nonrecurring adjustments to the financial statements.

Management has requested that we prepare the annual financial statements and related notes. This arrangement is not unusual for an organization the size of Arrowhead Regional Corrections. This decision was based on the availability of Arrowhead Regional Corrections' staff and the cost benefit of using our expertise.

During our audit, we proposed material adjustments to convert Arrowhead Regional Corrections' financial records to the financial statements as reported. These adjustments increased revenue; reclassified liabilities; reclassified revenues; increased reserved fund balances; and decreased unreserved, designated fund balances.

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

Client's Response:

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

06-1 Capital Assets

For financial reporting and asset management purposes, Arrowhead Regional Corrections is required to keep records of its capital assets. Arrowhead Regional Corrections' capital asset records are recorded on a separate software system maintained by its fiscal agent. Capital asset additions and deletions are entered into this system, and depreciation is calculated by the system. Capital asset policies utilized by Arrowhead Regional Corrections in maintaining the capital asset system have not been formally approved, but current practices parallel the policy utilized by its fiscal agent. A capital asset policy should be adopted that defines Arrowhead Regional Corrections' accounting policies over capital assets, including capitalization threshold, useful lives, and depreciation methods.

Arrowhead Regional Corrections also does not have policies and procedures in place to identify capital asset additions and deletions for entry to the capital asset system. Arrowhead Regional Corrections' fiscal agent enters capital asset additions into the system based on capital expenditure accounts, but Arrowhead Regional Corrections has no procedure in place to review these accounts at year-end. Arrowhead Regional Corrections' staff identify capital asset deletions by reviewing the capital asset listing at year-end and determining which assets have been sold or removed from service.

We recommend the Arrowhead Regional Corrections Board establish a capital asset policy to define Arrowhead Regional Corrections' accounting policies over capital assets. Arrowhead Regional Corrections should also establish policies and procedures to identify capital asset additions and deletions. Department heads should report capital asset additions and deletions to the person maintaining the capital asset records at least

Schedule 3
(Continued)

annually. Also, we recommend a physical inventory of capital assets be performed periodically. This physical inventory can be rotated so that a portion of the capital assets is inventoried each year. Each asset should be counted at least once every five years. Some critical capital assets may need more frequent accounting.

Client's Response:

Arrowhead Regional Corrections has worked closely with the St. Louis County Auditor's Office to regularly review and update the list of capital assets. Additions and deletions are noted to keep the records current.

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

Board of Commissioners
Arrowhead Regional Corrections

We have audited the financial statements of the governmental activities and the General Fund of Arrowhead Regional Corrections as of and for the year ended December 31, 2007, which collectively comprise Arrowhead Regional Corrections' basic financial statements, and have issued our report thereon dated May 8, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Arrowhead Regional Corrections' ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of Arrowhead Regional Corrections' financial statements that is more than inconsequential will not be prevented or detected by Arrowhead Regional Corrections' internal control. We considered the deficiencies described in the accompanying Schedule of Findings and Recommendations as items 96-2 and 06-1 to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Arrowhead Regional Corrections' internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider item 96-2 to be a material weakness.

Compliance and Other Matters

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

Minnesota Legal Compliance

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

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

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

Arrowhead Regional Corrections' written responses to the significant deficiency and material weakness identified in our audit have been included in the Schedule of Findings and Recommendations. We did not audit Arrowhead Regional Corrections' responses and, accordingly, we express no opinion on them.

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

/s/Rebecca Otto

/s/Greg Hierlinger

REBECCA OTTO
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

May 8, 2009