

# STATE OF MINNESOTA

## Office of the State Auditor



**Rebecca Otto**  
**State Auditor**

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MANAGEMENT AND COMPLIANCE REPORT  
PREPARED AS RESULT OF THE AUDIT OF

**LINCOLN COUNTY**  
**IVANHOE, MINNESOTA**

YEAR ENDED DECEMBER 31, 2008

## **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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**LINCOLN COUNTY  
IVANHOE, MINNESOTA**

**Year Ended December 31, 2008**



**Management and Compliance Report**

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

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**LINCOLN COUNTY  
IVANHOE, MINNESOTA**

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**LINCOLN COUNTY  
IVANHOE, MINNESOTA**

**Schedule 1**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED DECEMBER 31, 2008**

**I. SUMMARY OF AUDITOR'S RESULTS**

- A. Our report expresses unqualified opinions on the basic financial statements of Lincoln County.
- B. Significant deficiencies in internal control were disclosed by the audit of financial statements of Lincoln County and are reported in the "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*." None were material weaknesses.
- C. No instances of noncompliance material to the financial statements of Lincoln County were disclosed during the audit.
- D. No matters involving internal control over compliance relating to the audit of the major federal award program were reported in the "Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133."
- E. The Auditor's Report on Compliance for the major federal award program for Lincoln County expresses an unqualified opinion.
- F. No findings were disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133.
- G. The major program is:
  - Highway Planning and Construction
  - CFDA #20.205
- H. The threshold for distinguishing between Types A and B programs was \$300,000.
- I. Lincoln County was not determined to be a low-risk auditee.

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

98-1 Departmental Internal Accounting Controls

One basic objective of internal control is to provide for segregation of incompatible duties. In other words, responsibilities should be separated among employees so that a single employee is not able to authorize a transaction, record the transaction in accounts, and be responsible for custody of the asset resulting from the transaction.

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

Some of the County's departments that collect fees have segregation of duties weaknesses. These departments generally have one staff person who is responsible for billing, collecting, depositing, and recording receipts as well as reconciling bank accounts.

We recommend the County Board segregate accounting duties as much as possible. When it is not feasible to segregate certain duties, Lincoln County management should be aware of the lack of segregation of the accounting functions and, if possible, implement oversight procedures to ensure that the internal control policies and procedures are being followed by staff.

Client's Response:

*Lincoln County is aware of the lack of segregation of the accounting functions. Due to the small size of Lincoln County, we continuously strive to implement feasible internal controls with our limited staff.*

06-4 Audit Adjustments

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 of the financial statements on a timely basis. One control deficiency that typically is considered significant is identification by the auditor of a material misstatement in the financial statements that was not initially identified by the entity's internal controls. During our audit, we proposed audit adjustments, which were reviewed and approved by the appropriate staff and are reflected in the financial statements. By definition, however, independent external auditors cannot be considered part of the government's internal control.

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

We recommend that the County modify internal controls over financial reporting to detect misstatements in the financial statements.

Client's Response:

*The County has hired a CPA Firm, which has resulted in reduced adjusting entries. Internal controls continue to be reviewed.*

ITEM ARISING THIS YEAR

08-1 Information System Risk Management

County management is responsible for internal controls related to its information system. This responsibility extends to monitoring ongoing activities provided by service organizations. Lincoln County contracts with Computer Professionals Unlimited, Inc. (CPUI), a service organization, to provide:

- computer hardware for hosting the County's applications;
- processing of accounting transactions and other data;
- daily, weekly, and full system backups of applications and processed data; and
- disaster recovery planning for continued operations.

The County has not developed a formal plan to identify and manage risks associated with this information system arrangement. The County could partially manage these risks if CPUI obtained an audit of its control objectives and control activities. These audits are performed in accordance with Statement on Auditing Standards (SAS) No. 70, *Service Organizations, as amended*. At the present time, a SAS 70 Service Auditor's Report for CPUI was not available.

During our site visit to CPUI, we noted that computers were not located in a restricted area away from public view. The computers are in an unlocked cage. Daily backup tapes for information processed Monday through Thursday are kept on site in a locked metal cabinet; however, the cabinet is not designed to protect the tapes from the heat that would be generated in the event of a fire. One fire extinguisher was observed in the office. Weekly and full system backup information is kept at an offsite location.

We recommend that Lincoln County management establish a formal plan to meet its responsibilities for monitoring internal controls related to its information system. This should include documented consideration of services provided by CPUI. To specifically address hardware and backup physical control weaknesses associated with CPUI, we recommend County management work with CPUI to manage and minimize those risks. Also, the County should consider the possibility of requesting that CPUI obtain a SAS 70 audit.

Client's Response:

*Lincoln County has contacted CPUI. Procedures are being implemented to reduce risk.*

PREVIOUSLY REPORTED ITEMS RESOLVED

**Budgeting Procedures (00-3)**

Although the County adopted a formal budget, expenditure estimates and the annual budget appropriations to the various operational funds within the County were not always clear. The Board-approved budget did not agree with the revenue and expenditure budgets on the County's accounting system in 2007.

**Resolution**

Improvements were made to the budgeting process as the Board-approved budget reconciled to revenue and expenditure budgets in the County's accounting system.

**Financial Reporting (05-1)**

As is the case with many small and medium-sized entities, the County relied on its independent external auditors to assist in the preparation of the basic financial statements, including notes to the financial statements, as part of its external financial reporting process. The County lacked internal control over preparation of financial statements in accordance with generally accepted accounting principles.

**Resolution**

In 2008, Lincoln County hired a CPA firm to assist in preparing the financial statements and notes.

**Accounting Policies and Procedures Manual (06-7)**

Lincoln County did not have a current and comprehensive accounting policies and procedures manual.

**Resolution**

The County Board approved an accounting policies and procedures manual on February 17, 2009.

**Segregation of Duties - Payroll (07-1)**

During the review of the County's payroll function, we noted the person who processes payroll also has the ability to change pay rates and add new employees.

**Resolution**

Someone independent of the payroll process now monitors each payroll, changes to pay rates, and additions of employees on a monthly basis.

**Timely Remittance (07-2)**

During our review of the Recorder's Office and Solid Waste Department, we noted that monies were not remitted to the County for deposit on a timely basis.

**Resolution**

Remittances from various departments were made to the County on a timely basis.

**Access to Computer Programs and Functions (07-3)**

The County did not limit access to accounting system programs and functions to those employees whose job duties require them to have such access. In one case, a former employee that left service in 2003 was shown as having access to various functions in the computer system.

**Resolution**

The County took steps to improve controls over its computer systems by reviewing program access and starting to restrict access to select County employees.

**III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS**

None.

**IV. OTHER FINDINGS AND RECOMMENDATIONS**

A. MANAGEMENT PRACTICES

PREVIOUSLY REPORTED ITEMS RESOLVED

**Disaster Recovery and Business Continuity Plans (07-4)**

Lincoln County did not have disaster recovery or business continuity plans that would direct its response if a disaster or major computer breakdown were to occur.

**Resolution**

A disaster recovery plan and business continuity plan were approved with the County's accounting policies and procedures manual on February 17, 2009.

**Difficulties Encountered While Performing the Audit (07-5)**

The Office of the State Auditor (OSA) encountered difficulties obtaining necessary information while performing the 2007 audit.

**Resolution**

The OSA experienced no significant difficulties in obtaining necessary information for the audit.

B. OTHER ITEM FOR CONSIDERATION

Other Postemployment Benefits (OPEB)

The Governmental Accounting Standards Board (GASB) issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which governs employer accounting and financial reporting for OPEB. This standard, similar to what GASB Statement 27 did for government employee pension benefits and plans, provides the accounting and reporting standards for the various OPEB many local governments offer to their employees. OPEB can include many different benefits offered to retirees such as health, dental, life, and long-term care insurance coverage.

If retirees are included in an insurance plan and pay a rate similar to that paid for younger active employees, this implicit subsidy is considered OPEB. In fact, local governments may be required to continue medical insurance coverage pursuant to Minn. Stat. § 471.61, subd. 2b. This benefit is common when accumulated sick leave is used to pay for retiree medical insurance. Under the new GASB statement, accounting for OPEB is now similar to the accounting used by governments for pension plans.

In 2008, the Legislature enacted a new law, Minn. Stat. § 471.6175, intended to help counties address their OPEB liability in at least three important ways:

- it allows counties to create both revocable and irrevocable OPEB trusts;
- it authorizes the use of a different list of permissible investments for both revocable and irrevocable OPEB trusts; and
- it also permits counties to invest OPEB trust assets with the State Board of Investment, bank trust departments, and certain insurance companies.

Some of the issues that the County Board will need to address in order to comply with GASB Statement 45 are:

- determine if employees are provided OPEB;
- if OPEB are being provided, the County Board will have to determine whether it will advance fund the benefits or pay for them on a pay-as-you-go basis;
- if OPEB are being provided, and the County Board determines that the establishment of a trust is desirable in order to fund the OPEB, the County Board will have to comply with the new legislation enacted authorizing the creation of an OPEB trust and establishing an applicable investment standard;
- if an OPEB trust will be established, the County will have to decide whether to establish a revocable or an irrevocable trust, and report that trust appropriately in the financial statements; and
- in order to determine annual costs and liabilities that need to be recognized, the County Board will have to decide whether to hire an actuary.

GASB Statement 45 is applicable to Lincoln County for the year ended December 31, 2009.



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

Board of County Commissioners  
Lincoln County

We have audited the financial statements of the governmental activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lincoln County as of and for the year ended December 31, 2008, and have issued our report thereon dated November 30, 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 Lincoln County's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in 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 the County's 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 the County's financial statements that is more than inconsequential will not be prevented or detected by the County's internal control. We considered the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 98-1, 06-4, and 08-1 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 Lincoln County's 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, we believe none of the significant deficiencies described above are material weaknesses.

#### Compliance and Other Matters

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

#### Minnesota Legal Compliance

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for 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, Lincoln County complied with the material terms and conditions of applicable legal provisions.

Also included in the Schedule of Findings and Questioned Costs is an other item for consideration. We believe this information to be of benefit to Lincoln County, and it is reported for that purpose.

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

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

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

November 30, 2009

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

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## REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of County Commissioners  
Lincoln County

### Compliance

We have audited the compliance of Lincoln County with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended December 31, 2008. Lincoln County's major federal program is identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the County's management. Our responsibility is to express an opinion on the County's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Lincoln County's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the County's compliance with those requirements.

In our opinion, Lincoln County complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2008.

#### Internal Control Over Compliance

The management of Lincoln County is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the County's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over compliance.

A control deficiency in internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the County's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the County's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the County's internal control.

Our consideration of the internal control over compliance 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 or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

#### Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lincoln County as of and for the year ended December 31, 2008, which collectively comprise the County's basic financial statements, and have issued our report thereon dated November 30, 2009. Our audit was performed for the purpose of forming opinions on the County's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is

presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. 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.

This report is intended solely for the information and use of the Board of County Commissioners, management, others within the County, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than those specified parties.

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

November 30, 2009

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**LINCOLN COUNTY  
IVAHHOE, MINNESOTA**

Schedule 2

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED DECEMBER 31, 2008**

<b>Federal Grantor Pass-Through Agency Grant Program Title</b>	<b>Federal CFDA Number</b>	<b>Expenditures</b>
<b>U.S. Department of Housing and Urban Development</b>		
Passed Through Minnesota Department of Employment and Economic Development Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii	14.228	<u>\$ 293,273</u>
<b>U.S. Department of Transportation</b>		
Passed Through Minnesota Department of Transportation Highway Planning and Construction	20.205	\$ 684,000
Formula Grants for Other Than Urbanized Areas	20.509	64,348
State and Community Highway Safety	20.600	<u>49,992</u>
<b>Total U.S. Department of Transportation</b>		<u>\$ 798,340</u>
<b>U.S. Election Assistance Commission</b>		
Passed Through Minnesota Secretary of State Help America Vote Act Requirements Payments	90.401	<u>\$ 10,319</u>
<b>U.S. Department of Homeland Security</b>		
Passed Through Minnesota Department of Public Safety Emergency Management Performance Grants	97.042	\$ 5,285
Homeland Security Grant Program	97.067	<u>2,144</u>
<b>Total U.S. Department of Homeland Security</b>		<u>\$ 7,429</u>
<b>Total Federal Awards</b>		<u>\$ 1,109,361</u>

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**LINCOLN COUNTY  
IVANHOE, MINNESOTA**

**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED DECEMBER 31, 2008**

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1. Reporting Entity

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

2. Basis of Presentation

The accounting records for grant programs are maintained on the modified accrual basis of accounting. Under the modified accrual basis, revenues are recorded when susceptible to accrual--when both measurable and available. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Lincoln County considers all revenues to be available if collected within 60 days of the current period. Expenditures are recorded when the liability is incurred.

The information in the schedule is presented in accordance with the requirements of Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

3. Reconciliation to Schedule of Intergovernmental Revenues

Federal grant revenue per Schedule of Intergovernmental Revenues	\$ 1,099,042
Help America Vote Act Requirements Payments grant monies unspent in 2006 and 2007 and expended in 2008 (CFDA #90.401)	<u>10,319</u>
Expenditures per Schedule of Expenditures of Federal Awards	<u><u>\$ 1,109,361</u></u>

4. Passed Through to Subrecipients

During 2008, the County did not pass any federal money to subrecipients.

5. Pass-Through Grant Numbers

Pass-through grant numbers were not assigned by the pass-through agencies.