

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

LAKE COUNTY
TWO HARBORS, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2006

Description of the Office of the State Auditor

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

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

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

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

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

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

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

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

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

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

For the Year Ended December 31, 2006



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

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

ORGANIZATION
DECEMBER 31, 2006

| | | | <u>Term Expires</u> |
|--------------------------|--------------------------------|------------|---------------------|
| Elected | | | |
| Commissioner | Clair Nelson | District 1 | January 2009 |
| Commissioner | Derrick Goutermont | District 2 | January 2007 |
| Commissioner | Scott Larson | District 3 | January 2009 |
| Commissioner | Willard Clark | District 4 | January 2007 |
| Commissioner | Lenore Johnson | District 5 | January 2009 |
| Attorney | Russell H. Conrow | | January 2007 |
| Auditor/Treasurer | Steven R. McMahon | | January 2007 |
| Recorder | Erica Koski | | January 2007 |
| Sheriff | Steve Peterson | | January 2007 |
| Appointed | | | |
| Assessor | Bruce Giddings | | December 2008 |
| Examiner of Titles | David Adams (St. Louis County) | | Indefinite |
| Health Officer | Harold B. Leppink, M.D. | | Indefinite |
| Highway Engineer | Alan Goodman | | May 2008 |
| Veterans Service Officer | George Scheidt | | September 2008 |
| Clerk of the Board | Wilma Rahn | | Indefinite |
| Human Services | | | |
| Board Members | Clair Nelson | | January 2009 |
| | Derrick Goutermont | | January 2007 |
| | Scott Larson | | January 2009 |
| | Willard Clark | | January 2007 |
| | Lenore Johnson | | January 2009 |
| | Kathy Goedel | | Indefinite |
| | Christine Johnson | | Indefinite |
| Director | Dennis Henkel | | Indefinite |
| Nursing Home | | | |
| Board Members | Clair Nelson | | December 2009 |
| | Derrick Goutermont | | December 2007 |
| | Scott Larson | | December 2009 |
| | Willard Clark | | December 2007 |
| | Lenore Johnson | | December 2009 |
| | Kathy Goedel | | Indefinite |
| | Deade Johnson | | Indefinite |

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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INDEPENDENT AUDITOR'S REPORT

Board of County Commissioners
Lake County

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lake County, Minnesota, as of and for the year ended December 31, 2006, including the Nursing Home Enterprise Fund as of and for the year ended September 30, 2006, which collectively comprise the County's basic financial statements. These financial statements are the responsibility of Lake County's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 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 financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lake County as of December 31, 2006, including the Nursing Home Enterprise Fund at September 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the years 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 listed in the table of contents 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 Lake County's basic financial statements. The supplementary information and other schedule listed in the table of contents are presented for purposes of additional analysis and are 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 28, 2007, on our consideration of Lake County's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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

September 28, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2006
(Unaudited)**

Lake County's Management's Discussion and Analysis (MD&A) provides an overview of the County's financial activities for the fiscal year ended December 31, 2006. Since this information is designed to focus on the current year's activities, resulting changes, and currently known facts, it should be read in conjunction with the County's financial statements.

FINANCIAL HIGHLIGHTS

- Governmental activities' total net assets are \$83,571,753, of which \$69,884,820 is invested in capital assets, net of related debt, and \$3,153,730 is restricted to specific purposes.
- Business-type activities have total net assets of \$2,671,167. Invested in capital assets, net of related debt represents \$2,176,479 of the total.
- Lake County's net assets increased by \$2,435,511 for the year ended December 31, 2006. Of the increase, \$2,605,539 was an increase in the governmental activities' net assets; and \$170,028 represented a decrease in business-type activities' net assets. The Lake County Housing and Redevelopment Authority (HRA) is shown as a "Discretely Presented Component Unit." The net assets of the County's discretely presented component unit decreased by \$137,964.
- The net cost of governmental activities was \$7,456,852 for the current fiscal year. The net cost was funded by general revenues and other items totaling \$10,062,391.
- Governmental funds' fund balances decreased by \$1,890,312.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

There are two government-wide financial statements. The Statement of Net Assets and the Statement of Activities provide information about the activities of the County as a whole and present a longer-term view of the County's finances. Fund financial statements report the County's operations in more detail than the government-wide statements by providing information about the County's most significant funds. For governmental activities, these statements tell how these services were financed in the short-term as well as what remains for future spending. The remaining statements provide financial information about activities for which the County acts solely as a trustee or agent for the benefit of those outside of the government.

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

The statement of net assets and the statement of activities report information about the County as a whole and about its activities in a way that helps the reader determine whether the County's financial condition has improved or declined as a result of the year's activities. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

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

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

- Governmental activities--Most of the County's basic services are reported here, including general government, public safety, highways and streets, sanitation, human services, health, culture and recreation, conservation of natural resources, and economic development. Property taxes and state and federal grants finance most of these activities.
- Business-type activities--The County charges a fee to customers to help it cover all or most of the cost of services it provides. The County's nursing home activities are reported here.
- Component unit--The County includes another separate legal entity in its report. The entity, the Lake County Housing and Redevelopment Authority, is presented in a separate column. Although legally separate, this "component unit" is important because the County is financially accountable for it.

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

Fund Financial Statements

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

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

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

- Proprietary funds--When the County charges customers for the services it provides--whether to outside customers or to other units of the County--these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the statement of net assets and the statement of activities. In fact, the County's proprietary funds are substantially the same as the business-type activities we report in the government-wide statements but provide more detail and additional information, such as cash flows, for proprietary funds.

Proprietary fund financial statements may be found in Exhibits 7 through 9.

Reporting the County's Fiduciary Responsibilities

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

The fiduciary funds financial statement is Exhibit 10.

LAKE COUNTY AS A WHOLE

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

Table 1
Net Assets
(In Thousands)

| | Governmental Activities | | Business-Type Activities | | Primary Government | |
|--|-------------------------|--------------------|--------------------------|-----------------|--------------------|--------------------|
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| Current and other assets | \$ 19,911 | \$ 21,382 | \$ 760 | \$ 827 | \$ 20,671 | \$ 22,209 |
| Capital assets | 76,649 | 71,817 | 2,181 | 2,272 | 78,830 | 74,089 |
| Total Assets | \$ 96,560 | \$ 93,199 | \$ 2,941 | \$ 3,099 | \$ 99,501 | \$ 96,298 |
| Long-term debt outstanding | \$ (10,342) | \$ (9,595) | \$ (71) | \$ (72) | \$ (10,413) | \$ (9,667) |
| Other liabilities | (2,647) | (2,638) | (199) | (186) | (2,846) | (2,824) |
| Total Liabilities | \$ (12,989) | \$ (12,233) | \$ (270) | \$ (258) | \$ (13,259) | \$ (12,491) |
| Net Assets | | | | | | |
| Invested in capital assets, net of debt | \$ 69,885 | \$ 67,228 | \$ 2,176 | \$ 2,265 | \$ 72,061 | \$ 69,493 |
| Restricted | 3,154 | 792 | - | - | 3,154 | 792 |
| Unrestricted | 10,532 | 12,946 | 495 | 576 | 11,027 | 13,522 |
| Total Net Assets | \$ 83,571 | \$ 80,966 | \$ 2,671 | \$ 2,841 | \$ 86,242 | \$ 83,807 |

Table 2
Changes in Net Assets
(In Thousands)

| | Governmental Activities | | Business-Type Activities | | Primary Government | |
|---------------------------------------|-------------------------|------------------|--------------------------|-----------------|--------------------|------------------|
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| Revenues | | | | | | |
| Program revenues | | | | | | |
| Fees, fines, charges, and other | \$ 1,811 | \$ 2,245 | \$ 3,036 | \$ 3,199 | \$ 4,847 | \$ 5,444 |
| Operating grants and contributions | 7,342 | 5,484 | 132 | - | 7,474 | 5,484 |
| Capital grants and contributions | 1,937 | 1,956 | - | - | 1,937 | 1,956 |
| General revenues | | | | | | |
| Property taxes | 5,214 | 4,773 | - | - | 5,214 | 4,773 |
| Other taxes | 1,882 | 1,681 | - | - | 1,882 | 1,681 |
| Unrestricted grants and contributions | 2,098 | 2,147 | 2 | - | 2,100 | 2,147 |
| Investment earnings | 646 | 340 | 6 | 7 | 652 | 347 |
| Miscellaneous | 222 | 187 | (71) | 7 | 151 | 194 |
| Total Revenues | \$ 21,152 | \$ 18,813 | \$ 3,105 | \$ 3,213 | \$ 24,257 | \$ 22,026 |

(Unaudited)

Page 7

| | Governmental Activities | | Business-Type Activities | | Primary Government | |
|-----------------------------------|-------------------------|------------------|--------------------------|-----------------|--------------------|------------------|
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| Expenses | | | | | | |
| General government | \$ 3,983 | \$ 3,663 | \$ - | \$ - | \$ 3,983 | \$ 3,663 |
| Public safety | 3,107 | 3,061 | - | - | 3,107 | 3,061 |
| Culture and recreation | 629 | 622 | - | - | 629 | 622 |
| Highways and streets | 4,848 | 5,552 | - | - | 4,848 | 5,552 |
| Human services | 3,854 | 3,527 | 3,275 | 3,123 | 7,129 | 6,650 |
| Health | 418 | 309 | - | - | 418 | 309 |
| Sanitation | 341 | 310 | - | - | 341 | 310 |
| Conservation of natural resources | 978 | 1,045 | - | - | 978 | 1,045 |
| Economic development | 48 | 49 | - | - | 48 | 49 |
| Interest | 341 | 197 | - | - | 341 | 197 |
| Total Expenses | <u>\$ 18,547</u> | <u>\$ 18,335</u> | <u>\$ 3,275</u> | <u>\$ 3,123</u> | <u>\$ 21,822</u> | <u>\$ 21,458</u> |
| Increase (Decrease) in Net Assets | \$ 2,605 | \$ 478 | \$ (170) | \$ 90 | \$ 2,435 | \$ 568 |
| Net Assets, January 1 | <u>80,966</u> | <u>80,488</u> | <u>2,841</u> | <u>2,751</u> | <u>83,807</u> | <u>83,239</u> |
| Net Assets, December 31 | <u>\$ 83,571</u> | <u>\$ 80,966</u> | <u>\$ 2,671</u> | <u>\$ 2,841</u> | <u>\$ 86,242</u> | <u>\$ 83,807</u> |

Governmental Activities

The cost of all governmental activities this year was \$18,547,474. However, as shown in the Statement of Activities, the amount that our taxpayers ultimately financed for these activities through County taxes and other general revenues was only \$7,456,852, because some of the cost was paid by those who directly benefited from the programs (\$1,811,019) or by other governments and organizations that subsidized certain programs with grants and contributions (\$9,279,603).

Table 3 presents the cost of each of the County's five largest program functions, as well as each function's net cost (total cost less revenues generated by the activities). The net cost shows the financial burden that was placed on the County's taxpayers by each of these functions.

Table 3
Governmental Activities
(In Thousands)

| | Total Cost of Services | | Net Cost of Services | |
|-----------------------------------|------------------------|------------------|----------------------|-----------------|
| | 2006 | 2005 | 2006 | 2005 |
| Highways and streets | \$ 4,847 | \$ 5,552 | \$ (319) | \$ 1,807 |
| General government | 3,983 | 3,663 | 2,178 | 1,925 |
| Human services | 3,854 | 3,527 | 1,734 | 1,479 |
| Public safety | 3,107 | 3,061 | 2,345 | 2,393 |
| Conservation of natural resources | 978 | 1,045 | 437 | 50 |
| All others | 1,778 | 1,487 | 1,082 | 996 |
| Total | <u>\$ 18,547</u> | <u>\$ 18,335</u> | <u>\$ 7,457</u> | <u>\$ 8,650</u> |

General Fund Budgetary Highlights

Over the course of the year, the County Board reviews the County's General Fund budget and may make budget amendments. These budget amendments fall into three categories: new information changing original budget estimations, greater than anticipated revenues or costs, and final agreement reached on employee contracts.

In the General Fund, the actual charges to appropriations (expenditures) were \$804,377 greater than the final budget amounts. Unbudgeted expenditures included expenditures for the replacement of the cooling system and playing surface of the Lake County Ice Arena and state pass-through recreation grants.

Resources available for appropriation were also above the final budgeted amount by \$847,047. Greater than expected collections in intergovernmental revenue offset reductions in anticipated tax revenue and permit fees. Interest earnings and miscellaneous revenues exceeded budgeted amounts.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of 2006, the County had \$78,830,046 invested in a broad range of capital assets, including land, buildings, highways and streets, and equipment. (See Table 4 below.)

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

| | Governmental Activities | | Business-Type Activities | | Totals | |
|--|-------------------------|-----------|--------------------------|----------|-----------|-----------|
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| Land | \$ 3,899 | \$ 1,651 | \$ 15 | \$ 15 | \$ 3,914 | \$ 1,666 |
| Construction in progress | - | 3,153 | - | - | - | 3,153 |
| Buildings and improvements | 10,915 | 6,131 | 2,060 | 2,144 | 12,975 | 8,275 |
| Machinery, vehicles, furniture, and equipment | 2,123 | 1,815 | 106 | 113 | 2,229 | 1,928 |
| Infrastructure | 59,712 | 59,067 | - | - | 59,712 | 59,067 |
| Totals | \$ 76,649 | \$ 71,817 | \$ 2,181 | \$ 2,272 | \$ 78,830 | \$ 74,089 |

The County's fiscal-year 2007 capital budget calls for it to spend another \$11.3 million for capital projects, \$650 thousand for improvements at the Silver Bay Arena, and \$10.7 million for road construction. The road construction will be funded by state-aid construction funds.

Debt

At year-end, the County had \$8,439,749 in bonds and notes outstanding versus \$9,227,350 last year--a decrease of 8 percent--as shown in Table 5. Capital leases payable increased by \$2,185,963 because the County entered into a lease purchase agreement with The Lake Bank in the amount of \$2.2 million for the acquisition of 6,000 acres of land.

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

| | Governmental Activities | | Business-Type Activities | | Totals | |
|--------------------------|-------------------------|------------------|--------------------------|---------------|------------------|------------------|
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| General obligation bonds | \$ 7,870 | \$ 8,485 | \$ - | \$ - | \$ 7,870 | \$ 8,485 |
| Notes payable | 570 | 743 | - | - | 570 | 743 |
| Capital leases | 2,230 | 44 | 5 | 7 | 2,235 | 51 |
| Compensated absences | 1,253 | 1,119 | 105 | 102 | 1,358 | 1,221 |
| Total | <u>\$ 11,923</u> | <u>\$ 10,391</u> | <u>\$ 110</u> | <u>\$ 109</u> | <u>\$ 12,033</u> | <u>\$ 10,500</u> |

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

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

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The County's elected and appointed officials considered many factors when setting the fiscal-year 2007 budget, tax rates, and fees that will be charged for the business-type activities.

- County General Fund expenditures for 2007 are budgeted to increase 6.3 percent over 2006.
- Property tax levies have increased 11.9 percent for 2007.

CONTACTING LAKE COUNTY'S FINANCIAL MANAGEMENT

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

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BASIC FINANCIAL STATEMENTS

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 1

**STATEMENT OF NET ASSETS
DECEMBER 31, 2006**

| | Primary Government | | | Discretely Presented Component Unit |
|--|----------------------------|-----------------------------|----------------------|--|
| | Governmental Activities | Business-Type Activities | Total | |
| Assets | | | | |
| Cash and pooled investments | \$ 12,778,767 | \$ 294,676 | \$ 13,073,443 | \$ 321,328 |
| Receivables - net | 5,826,645 | 376,357 | 6,203,002 | 202,841 |
| Due from component unit | 887,928 | - | 887,928 | - |
| Due from primary government | - | - | - | 5,525 |
| Inventories | 345,170 | 16,467 | 361,637 | - |
| Prepaid items | - | 68,699 | 68,699 | - |
| Restricted assets | | | | |
| Cash and pooled investments | - | 3,758 | 3,758 | 82,691 |
| Deferred charges | 72,993 | - | 72,993 | - |
| Capital assets | | | | |
| Non-depreciable capital assets | 3,898,859 | 15,000 | 3,913,859 | 28,601 |
| Depreciable capital assets - net of accumulated depreciation | 72,750,021 | 2,166,166 | 74,916,187 | 2,324,757 |
| Total Assets | \$ 96,560,383 | \$ 2,941,123 | \$ 99,501,506 | \$ 2,965,743 |
| Liabilities | | | | |
| Accounts payable and other current liabilities | \$ 891,666 | \$ 156,578 | \$ 1,048,244 | \$ 17,829 |
| Accrued interest payable | 128,997 | - | 128,997 | 6,494 |
| Due to component unit | 5,525 | - | 5,525 | - |
| Due to primary government | - | - | - | 887,928 |
| Unearned revenue | 40,000 | - | 40,000 | 200 |
| Payable from restricted assets | | | | |
| Due to residents | - | 3,758 | 3,758 | - |
| Customer deposits payable | - | - | - | 13,493 |
| Long-term liabilities | | | | |
| Due within one year | 1,580,662 | 38,678 | 1,619,340 | 32,000 |
| Due in more than one year | 10,341,780 | 70,942 | 10,412,722 | 938,690 |
| Total Liabilities | \$ 12,988,630 | \$ 269,956 | \$ 13,258,586 | \$ 1,896,634 |
| Net Assets | | | | |
| Invested in capital assets - net of related debt | \$ 69,884,820 | \$ 2,176,479 | \$ 72,061,299 | \$ 1,227,668 |
| Restricted for | | | | |
| General government | 190,860 | - | 190,860 | - |
| Public safety | 29,642 | - | 29,642 | - |
| Highways and streets | 2,059,986 | - | 2,059,986 | - |
| Human services | 67,531 | - | 67,531 | - |
| Conservation of natural resources | 286,094 | - | 286,094 | - |
| Debt service | 519,617 | - | 519,617 | 69,198 |
| Unrestricted | 10,533,203 | 494,688 | 11,027,891 | (227,757) |
| Total Net Assets | \$ 83,571,753 | \$ 2,671,167 | \$ 86,242,920 | \$ 1,069,109 |

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

Page 11

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | <u>Expenses</u> | <u>Fees, Charges, Fines, and Other</u> | <u>Program Revenues Operating Grants and Contributions</u> |
|--------------------------------------|----------------------|--|--|
| Functions/Programs | | | |
| Primary Government | | | |
| Governmental activities | | | |
| General government | \$ 3,983,318 | \$ 649,107 | \$ 1,156,442 |
| Public safety | 3,106,623 | 163,104 | 598,293 |
| Highways and streets | 4,847,473 | 277,384 | 2,951,901 |
| Sanitation | 341,370 | 116,503 | - |
| Human services | 3,853,788 | 126,250 | 1,993,725 |
| Health | 418,470 | 147,141 | 114,208 |
| Culture and recreation | 629,287 | - | 300,887 |
| Conservation of natural resources | 978,304 | 313,866 | 226,967 |
| Economic development | 47,593 | 17,664 | - |
| Interest | 341,248 | - | - |
| Total governmental activities | \$ 18,547,474 | \$ 1,811,019 | \$ 7,342,423 |
| Business-type activities | | | |
| Nursing home | 3,275,361 | 3,036,154 | 132,222 |
| Total Primary Government | \$ 21,822,835 | \$ 4,847,173 | \$ 7,474,645 |
| Component unit | | | |
| Housing and Redevelopment Authority | \$ 791,117 | \$ 170,544 | \$ - |

General Revenues

Property taxes
Mortgage registry and deed tax
Payments in lieu of tax
Tax increments
Taxes - other
Grants and contributions not restricted to specific programs
Intergovernmental
Unrestricted investment earnings
Gain on sale of capital assets
Miscellaneous
Transfers

Total general revenues

Change in net assets

Net Assets - Beginning - Restated

Net Assets - Ending

EXHIBIT 2

| Capital Grants and Contributions | Net (Expense) Revenue and Changes in Net Assets | | | Discretely Presented Component Unit |
|--|---|---|-----------------------|---|
| | Governmental Activities | Primary Government Business-Type Activities | Total | |
| \$ - | \$ (2,177,769) | \$ - | \$ (2,177,769) | |
| - | (2,345,226) | - | (2,345,226) | |
| 1,937,180 | 318,992 | - | 318,992 | |
| - | (224,867) | - | (224,867) | |
| - | (1,733,813) | - | (1,733,813) | |
| - | (157,121) | - | (157,121) | |
| - | (328,400) | - | (328,400) | |
| - | (437,471) | - | (437,471) | |
| - | (29,929) | - | (29,929) | |
| - | (341,248) | - | (341,248) | |
| \$ 1,937,180 | \$ (7,456,852) | \$ - | \$ (7,456,852) | |
| - | - | (106,985) | (106,985) | |
| \$ 1,937,180 | \$ (7,456,852) | \$ (106,985) | \$ (7,563,837) | |
| \$ - | | | | \$ (620,573) |
| | \$ 5,214,152 | \$ - | \$ 5,214,152 | \$ - |
| | 23,037 | - | 23,037 | - |
| | 493,944 | - | 493,944 | - |
| | 184,042 | - | 184,042 | 254,325 |
| | 1,180,801 | - | 1,180,801 | - |
| | 2,098,256 | 231 | 2,098,487 | - |
| | - | - | - | 166,296 |
| | 646,438 | 6,539 | 652,977 | 3,817 |
| | - | 1,600 | 1,600 | 42,940 |
| | 150,261 | 47 | 150,308 | 15,231 |
| | 71,460 | (71,460) | - | - |
| | \$ 10,062,391 | \$ (63,043) | \$ 9,999,348 | \$ 482,609 |
| | \$ 2,605,539 | \$ (170,028) | \$ 2,435,511 | \$ (137,964) |
| | 80,966,214 | 2,841,195 | 83,807,409 | 1,207,073 |
| | \$ 83,571,753 | \$ 2,671,167 | \$ 86,242,920 | \$ 1,069,109 |

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FUND FINANCIAL STATEMENTS

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GOVERNMENTAL FUNDS

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2006**

| | General | Road and Bridge |
|------------------------------------|---------------------|----------------------------|
| <u>Assets</u> | | |
| Cash and pooled investments | \$ 4,281,739 | \$ 3,214,099 |
| Escheat cash | 38,290 | - |
| Petty cash and change funds | 1,300 | 1,000 |
| Undistributed cash in agency funds | 114,798 | 38,721 |
| Taxes receivable | | |
| Prior | 113,183 | 43,353 |
| Accounts receivable | 493,181 | 57,123 |
| Accrued interest receivable | 45,586 | - |
| Loans receivable | 163,851 | - |
| Due from other funds | 150,526 | 81,964 |
| Due from other governments | 1,033,280 | 2,505,855 |
| Due from component unit | - | - |
| Inventories | - | 345,170 |
| Leases receivable | 175,000 | - |
| | \$ 6,610,734 | \$ 6,287,285 |
| Total Assets | \$ 6,610,734 | \$ 6,287,285 |

EXHIBIT 3

| Human Services | Forfeited Tax | Resource Development | Other Governmental Funds | Total Governmental Funds |
|-----------------------|----------------------|-----------------------------|---------------------------------|---------------------------------|
| \$ 2,952,859 | \$ 299,200 | \$ 400,964 | \$ 1,361,131 | \$ 12,509,992 |
| - | - | - | - | 38,290 |
| 1,000 | 50 | - | - | 3,350 |
| 55,567 | - | - | 18,049 | 227,135 |
| - | - | - | - | - |
| 60,558 | - | - | 15,151 | 232,245 |
| 18,626 | 532,370 | - | - | 1,101,300 |
| - | - | - | - | 45,586 |
| - | - | - | 364,600 | 528,451 |
| - | 15 | 104,157 | 39,431 | 376,093 |
| 204,928 | - | - | - | 3,744,063 |
| - | - | - | 887,928 | 887,928 |
| - | - | - | - | 345,170 |
| - | - | - | - | 175,000 |
| \$ 3,293,538 | \$ 831,635 | \$ 505,121 | \$ 2,686,290 | \$ 20,214,603 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2006**

| | General | Road and Bridge |
|--|---------------------|----------------------------|
| <u>Liabilities and Fund Balance</u> | | |
| Liabilities | | |
| Accounts payable | \$ 82,523 | \$ 91,103 |
| Escheat property payable | 38,290 | - |
| Salaries payable | 191,212 | 67,336 |
| Contracts payable | - | 79,952 |
| Due to other funds | 105,010 | 15 |
| Due to other governments | 29,688 | 3,022 |
| Due to component units | - | - |
| Deferred revenue - unavailable | 226,715 | 2,139,828 |
| Deferred revenue - unearned | 40,000 | - |
| | \$ 713,438 | \$ 2,381,256 |
| Fund Balances | | |
| Reserved for | | |
| Inventories | \$ - | \$ 345,170 |
| Capital projects | - | 2,296,888 |
| Election equipment | 35,626 | - |
| Loans receivable | 163,851 | - |
| Law library | 53,423 | - |
| Sheriff's contingency | 3,709 | - |
| Sheriff's forfeited property | 25,933 | - |
| Recorder's technology fund | 68,654 | - |
| County property recorder's fee | 68,783 | - |
| Debt service | - | 519,617 |
| Region III fund | - | - |
| Title III forests | 286,094 | - |
| Retired employees | 2,902 | - |
| Unreserved | | |
| Designated for future expenditures | - | - |
| Designated for retired employees | - | 18,150 |
| Designated for capital equipment | - | 119,000 |
| Designated for buildings and grounds | - | 320,000 |
| Designated for computer network | - | 8,000 |
| Designated for gravel pit restoration | - | 180,307 |
| Undesignated | 5,188,321 | 98,897 |
| Unreserved, reported in nonmajor | | |
| Special revenue funds | - | - |
| Debt service fund | - | - |
| | \$ 5,897,296 | \$ 3,906,029 |
| Total Liabilities and Fund Balances | \$ 6,610,734 | \$ 6,287,285 |

EXHIBIT 3
(Continued)

| <u>Human Services</u> | <u>Forfeited Tax</u> | <u>Resource Development</u> | <u>Other Governmental Funds</u> | <u>Total Governmental Funds</u> |
|---------------------------|--------------------------|---------------------------------|---|---|
| \$ 98,310 | \$ 3,767 | \$ - | \$ - | \$ 275,703 |
| - | - | - | - | 38,290 |
| 65,934 | 14,331 | - | - | 338,813 |
| - | - | - | 25,703 | 105,655 |
| 44,438 | 104,157 | 15,000 | 107,473 | 376,093 |
| 46,843 | 550 | - | 53,102 | 133,205 |
| - | - | - | 5,525 | 5,525 |
| 52,882 | 475,142 | - | 306,775 | 3,201,342 |
| - | - | - | - | 40,000 |
| \$ 308,407 | \$ 597,947 | \$ 15,000 | \$ 498,578 | \$ 4,514,626 |
| | | | | |
| \$ - | \$ - | \$ - | \$ - | \$ 345,170 |
| - | - | - | - | 2,296,888 |
| - | - | - | - | 35,626 |
| - | - | - | 69,600 | 233,451 |
| - | - | - | - | 53,423 |
| - | - | - | - | 3,709 |
| - | - | - | - | 25,933 |
| - | - | - | - | 68,654 |
| - | - | - | - | 68,783 |
| - | - | - | - | 519,617 |
| 67,531 | - | - | - | 67,531 |
| - | - | - | - | 286,094 |
| - | - | - | - | 2,902 |
| - | - | - | - | - |
| 1,000,000 | - | - | - | 1,000,000 |
| - | - | - | - | 18,150 |
| - | - | - | - | 119,000 |
| - | - | - | - | 320,000 |
| - | - | - | - | 8,000 |
| - | - | - | - | 180,307 |
| 1,917,600 | 233,688 | 490,121 | - | 7,928,627 |
| - | - | - | 1,067,435 | 1,067,435 |
| - | - | - | 1,050,677 | 1,050,677 |
| \$ 2,985,131 | \$ 233,688 | \$ 490,121 | \$ 2,187,712 | \$ 15,699,977 |
| \$ 3,293,538 | \$ 831,635 | \$ 505,121 | \$ 2,686,290 | \$ 20,214,603 |

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 4

**RECONCILIATION OF GOVERNMENTAL FUNDS BALANCE SHEET TO
THE GOVERNMENT-WIDE STATEMENT OF NET ASSETS--GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2006**

| | | |
|--|----------------|--------------------------|
| Fund balances - total governmental funds (Exhibit 3) | \$ | 15,699,977 |
| Amounts reported for governmental activities in the statement of net assets are different because: | | |
| Capital assets, net of accumulated depreciation, used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds. | | 76,648,880 |
| Other long-term assets are not available to pay for current period expenditures and, therefore, are deferred in the governmental funds. | | 3,201,342 |
| Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the governmental funds. | | |
| General obligation bonds | \$ (7,870,000) | |
| Notes payable | (569,749) | |
| Capital lease payable | (2,229,924) | |
| Compensated absences | (1,252,769) | |
| Accrued interest payable | (128,997) | |
| Deferred debt issuance charges | 72,993 | |
| | (11,978,446) | (11,978,446) |
| Net assets of governmental activities (Exhibit 1) | \$ | <u>83,571,753</u> |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | General | Road and Bridge |
|--|---------------------|----------------------------|
| Revenues | | |
| Taxes | \$ 3,421,081 | \$ 1,197,678 |
| Licenses and permits | 29,927 | - |
| Intergovernmental | 3,395,849 | 3,710,423 |
| Charges for services | 557,811 | 274,051 |
| Fines and forfeits | 2,836 | - |
| Gifts and contributions | 14,837 | - |
| Interest on investments | 430,202 | 136,489 |
| Miscellaneous | 353,581 | 20,965 |
| | \$ 8,206,124 | \$ 5,339,606 |
| Expenditures | | |
| Current | | |
| General government | \$ 4,024,444 | \$ - |
| Public safety | 2,920,971 | - |
| Highways and streets | - | 5,549,487 |
| Sanitation | 319,230 | - |
| Human services | - | - |
| Health | - | - |
| Culture and recreation | 1,276,162 | - |
| Conservation of natural resources | 188,748 | - |
| Economic development | 47,593 | - |
| Capital outlay | - | - |
| Intergovernmental | - | - |
| Debt service | | |
| Principal | 21,553 | 14,037 |
| Interest | - | 96,287 |
| Bond issuance costs | - | - |
| Miscellaneous | - | 402 |
| | \$ 8,798,701 | \$ 5,660,213 |
| Excess of Revenues Over (Under) Expenditures | \$ (592,577) | \$ (320,607) |
| Other Financing Sources (Uses) | | |
| Transfers in | \$ 71,460 | \$ 150,000 |
| Proceeds from capital lease | - | - |
| Transfers out | (604) | - |
| | \$ 70,856 | \$ 150,000 |
| Net Change in Fund Balances | \$ (521,721) | \$ (170,607) |
| Fund Balances - January 1 | 6,419,017 | 4,147,724 |
| Increase (decrease) in reserved for inventories | - | (71,088) |
| | \$ 5,897,296 | \$ 3,906,029 |
| Fund Balances - December 31 | \$ 5,897,296 | \$ 3,906,029 |

EXHIBIT 5

| Human Services | Forfeited Tax | Resource Development | Other Governmental Funds | Total Governmental Funds |
|-----------------------|----------------------|-----------------------------|---------------------------------|---------------------------------|
| \$ 1,312,990 | \$ - | \$ - | \$ 626,753 | \$ 6,558,502 |
| - | 1,601 | - | 83 | 31,611 |
| 2,644,382 | 23,724 | 80,225 | 295,344 | 10,149,947 |
| 124,833 | 20,588 | - | - | 977,283 |
| - | - | - | - | 2,836 |
| - | - | - | - | 14,837 |
| - | - | - | 79,747 | 646,438 |
| 148,558 | 727,472 | - | 208,119 | 1,458,695 |
| \$ 4,230,763 | \$ 773,385 | \$ 80,225 | \$ 1,210,046 | \$ 19,840,149 |
| \$ - | \$ - | \$ - | \$ 6,366 | \$ 4,030,810 |
| - | - | - | 63,502 | 2,984,473 |
| - | - | - | - | 5,549,487 |
| - | - | - | - | 319,230 |
| 3,804,748 | - | - | - | 3,804,748 |
| 404,154 | - | - | - | 404,154 |
| - | - | - | - | 1,276,162 |
| - | 728,148 | 11,891 | - | 928,787 |
| - | - | - | - | 47,593 |
| - | 13,928 | 2,221,501 | 1,252,222 | 3,487,651 |
| - | - | - | 156,530 | 156,530 |
| - | - | 151,048 | 470,000 | 656,638 |
| - | - | 29,854 | 152,590 | 278,731 |
| - | - | - | 402 | 402 |
| - | - | - | 5,035 | 5,437 |
| \$ 4,208,902 | \$ 742,076 | \$ 2,414,294 | \$ 2,106,647 | \$ 23,930,833 |
| \$ 21,861 | \$ 31,309 | \$ (2,334,069) | \$ (896,601) | \$ (4,090,684) |
| \$ - | \$ - | \$ 104,157 | \$ 604 | \$ 326,221 |
| - | - | 2,200,000 | - | 2,200,000 |
| - | (104,157) | - | (150,000) | (254,761) |
| \$ - | \$ (104,157) | \$ 2,304,157 | \$ (149,396) | \$ 2,271,460 |
| \$ 21,861 | \$ (72,848) | \$ (29,912) | \$ (1,045,997) | \$ (1,819,224) |
| 2,963,270 | 306,536 | 520,033 | 3,233,709 | 17,590,289 |
| - | - | - | - | (71,088) |
| \$ 2,985,131 | \$ 233,688 | \$ 490,121 | \$ 2,187,712 | \$ 15,699,977 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 6

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE
GOVERNMENT-WIDE STATEMENT OF ACTIVITIES--GOVERNMENTAL ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2006**

Net change in fund balances - total governmental funds (Exhibit 5) \$ (1,819,224)

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

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

| | | | |
|--------------------------------|----|-------------|-----------|
| Deferred revenue - December 31 | \$ | 3,201,342 | |
| Deferred revenue - January 1 | | (1,959,938) | 1,241,404 |

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.

| | | | |
|--|----|-------------|-----------|
| Expenditures for general capital assets and infrastructure | \$ | 7,217,231 | |
| Current year depreciation | | (2,334,693) | 4,882,538 |

In the statement of activities, only the gain or loss on the disposal of capital assets is reported; whereas, in the governmental funds, the proceeds from the disposal increase financial resources. Therefore, the change in net assets differs from the change in fund balance by the book value of the capital assets disposed of. (51,105)

Debt issuance proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. Debt repayment is an expenditure in the funds, but a reduction of a liability in the government-wide statements.

| | | | |
|---------------|--|--|-------------|
| Debt issued | | | |
| Capital lease | | | (2,200,000) |

| | | | |
|--------------------------|----|---------|---------|
| Principal repayments | | | |
| General obligation bonds | \$ | 615,000 | |
| Notes payable | | 172,601 | |
| Capital lease | | 14,037 | 801,638 |

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

| | | | |
|--|----|-----------|-----------|
| Change in accrued interest payable | \$ | (29,380) | |
| Change in deferred bond issuance costs | | (15,768) | |
| Change in compensated absences | | (133,476) | |
| Change in inventories | | (71,088) | (249,712) |

Change in net assets of governmental activities (Exhibit 2) \$ 2,605,539

PROPRIETARY FUND

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 7

**STATEMENT OF FUND NET ASSETS
PROPRIETARY FUND
SEPTEMBER 30, 2006**

| | <u>Nursing Home Enterprise Fund</u> |
|---|---|
| <u>Assets</u> | |
| Current assets | |
| Cash and cash equivalents | \$ 294,176 |
| Petty cash and change funds | 500 |
| Accounts receivable - net | 376,357 |
| Inventories | 16,467 |
| Prepaid items | 68,699 |
| Restricted cash, cash equivalents, and investments | |
| Resident trust funds | 3,758 |
| | 3,758 |
| Total current assets | \$ 759,957 |
| Noncurrent assets | |
| Capital assets | \$ 4,233,939 |
| Less: accumulated depreciation | (2,052,773) |
| | 2,181,166 |
| Capital assets - net of accumulated depreciation | \$ 2,181,166 |
| Total Assets | \$ 2,941,123 |
| <u>Liabilities</u> | |
| Current liabilities | |
| Accounts payable | \$ 56,354 |
| Salaries payable | 39,156 |
| Accrued vacation payable | 61,068 |
| Compensated absences payable - current | 36,476 |
| Capital leases payable - current | 2,202 |
| | 195,256 |
| Total current liabilities | \$ 195,256 |
| Current liabilities payable from restricted assets | |
| Due to residents | \$ 3,758 |
| | 3,758 |
| Noncurrent liabilities | |
| Compensated absences payable - long-term | \$ 68,457 |
| Capital leases payable - long-term | 2,485 |
| | 70,942 |
| Total noncurrent liabilities | \$ 70,942 |
| Total Liabilities | \$ 269,956 |
| <u>Net Assets</u> | |
| Invested in capital assets - net of related debt | \$ 2,176,479 |
| Unrestricted | 494,688 |
| | 2,671,167 |
| Total Net Assets | \$ 2,671,167 |

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

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 8

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUND
FOR THE YEAR ENDED SEPTEMBER 30, 2006**

| | <u>Nursing Home Enterprise Fund</u> |
|---|--|
| Operating Revenues | |
| Patient services revenues | \$ 2,934,517 |
| Ancillary and other services | 69,337 |
| Miscellaneous | <u>32,300</u> |
| Total Operating Revenues | \$ 3,036,154 |
| Operating Expenses | |
| Nursing services | \$ 1,219,214 |
| Other care-related | 96,732 |
| Other services and charges | 39,518 |
| Dietary | 346,193 |
| Laundry | 55,455 |
| Housekeeping | 63,372 |
| Plant operations | 227,161 |
| Other property and related costs | 180,538 |
| Administration | 361,598 |
| Employee benefits | 559,873 |
| Depreciation | <u>125,129</u> |
| Total Operating Expenses | \$ 3,274,783 |
| Operating income | \$ (238,629) |
| Nonoperating revenues (expenses) | |
| Contributions and donations | \$ 231 |
| Miscellaneous revenue | 47 |
| Interest expense | (578) |
| Utility refund | 132,222 |
| Nursing Home payment adjustment | 6,539 |
| Gain on disposal of capital assets | <u>1,600</u> |
| Total Nonoperating Revenues (Expenses) | \$ 140,061 |
| Income (Loss) Before Contributions and Transfers | \$ (98,568) |
| Transfers out | <u>(71,460)</u> |
| Change in Net Assets | \$ (170,028) |
| Net Assets - October 1 | <u>2,841,195</u> |
| Net Assets - September 30 | <u><u>2,671,167</u></u> |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 9

**STATEMENT OF CASH FLOWS
PROPRIETARY FUND
FOR THE YEAR ENDED SEPTEMBER 30, 2006
Increase (Decrease) in Cash and Cash Equivalents**

| | <u>Nursing Home Enterprise Fund</u> |
|--|---|
| Cash Flows from Operating Activities | |
| Cash received from customers | \$ 3,193,360 |
| Cash received from miscellaneous sources | 278 |
| Cash paid to suppliers | (900,140) |
| Cash paid to employees | <u>(2,267,547)</u> |
| Net cash provided by (used in) operating activities | \$ 25,951 |
| Cash Flows from Noncapital Financing Activities | |
| Nursing Home payment adjustment received | \$ 6,539 |
| Cash Flows from Capital and Related Financing Activities | |
| Principal payments on capital lease | \$ (1,993) |
| Gain on disposal of capital assets | 1,600 |
| Payment to General Fund for prior year construction costs | (71,460) |
| Interest expense | (578) |
| Acquisition of capital assets | <u>(34,190)</u> |
| Net cash provided by (used in) capital and related financing activities | \$ (106,621) |
| Net Increase (Decrease) in Cash and Cash Equivalents | \$ (74,131) |
| Cash and Cash Equivalents - October 1 | <u>368,807</u> |
| Cash and Cash Equivalents at September 30 | <u>\$ 294,676</u> |
| Reconciliation of operating income (loss) to net cash provided by (used in) operating activities | |
| Operating income (loss) | \$ (238,629) |
| Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities | |
| Depreciation | \$ 125,129 |
| Miscellaneous nonoperating revenue | 278 |
| Changes in assets and liabilities | |
| (Increase) decrease in receivables | 157,206 |
| (Increase) decrease in inventories | 1,266 |
| (Increase) decrease in prepaid items | (35,731) |
| Increase (decrease) in accounts payable | 7,348 |
| Increase (decrease) in salaries payable | 2,756 |
| Increase (decrease) in compensated absences | 2,457 |
| Increase (decrease) in accrued vacation payable | <u>3,871</u> |
| Total adjustments | \$ 264,580 |
| Net cash provided by (used in) operating activities | <u>\$ 25,951</u> |

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

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FIDUCIARY FUNDS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 10

**FIDUCIARY FUNDS
STATEMENT OF FIDUCIARY NET ASSETS
DECEMBER 31, 2006**

| | <u>Agency</u> |
|-----------------------------|-------------------|
| <u>Assets</u> | |
| Cash and pooled investments | <u>\$ 796,570</u> |
| <u>Liabilities</u> | |
| Accounts payable | \$ 336,356 |
| Taxes collected in advance | 5,329 |
| Due to other governments | 367,795 |
| Customer deposits - current | <u>87,090</u> |
| Total Liabilities | <u>\$ 796,570</u> |

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2006**

1. Summary of Significant Accounting Policies

The County's financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as of and for the year ended December 31, 2006. 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 (FASB) issued through November 30, 1989, (when applicable) that do not conflict with or contradict GASB pronouncements. Although the County has the option to apply FASB pronouncements issued after that date to its Nursing Home Enterprise Fund, the County has chosen not to do so. The more significant accounting policies established in GAAP and used by the County are discussed below.

A. Financial Reporting Entity

Lake County was established March 1, 1866, and is an organized county having the powers, duties, and privileges granted counties by Minn. Stat. ch. 373. The Lake County Nursing Home was established pursuant to Minn. Stat. §§ 376.55-.60. As required by accounting principles generally accepted in the United States of America, these financial statements present Lake County (primary government) and its component unit for which the County is financially accountable. The County is governed by a five-member Board of Commissioners elected from districts within the County. The Board is organized with a chair and vice chair elected at the annual meeting in January of each year.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

A. Financial Reporting Entity (Continued)

Discretely Presented Component Unit

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

| <u>Component Unit</u> | <u>Component Unit Included in Reporting Entity Because</u> | <u>Separate Financial Statements</u> |
|---|---|---|
| Lake County Housing and Redevelopment Authority (HRA) | County appoints members, and HRA is a potential financial burden. | Lake County HRA P. O. Box 340 609 First Avenue Two Harbors, Minnesota 55616-0340 |

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

Joint Ventures

The County participates in several joint ventures described in Note 4.D. The County also participates in jointly-governed organizations described in Note 4.E.

B. Basic Financial Statements

1. Government-Wide Statements

The government-wide financial statements (the statement of net assets and the statement of activities) display information about the primary government and its component unit. These statements include the financial activities of the overall County government, except for fiduciary activities. Eliminations have been made to minimize the double counting of internal activities. Governmental activities, which normally are supported by taxes and intergovernmental revenue, are reported separately from business-type activities, which rely to a significant extent on fees and charges to external parties for support.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basic Financial Statements

1. Government-Wide Statements (Continued)

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

The statement of activities demonstrates the degree to which the direct expenses of each function of the County's governmental activities and different business-type activities are offset by program revenue. Direct expenses are those clearly identifiable with a specific function or activity. Program revenues include: (1) fees, fines, and charges paid by the recipients of goods, services, or privileges provided by a given function or activity; and (2) grants and contributions restricted to meeting the operational or capital requirements of a particular function or activity. Revenue not classified as program revenue, including all taxes, are presented as general revenue.

2. Fund Financial Statements

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basic Financial Statements

2. Fund Financial Statements (Continued)

The County reports the following major governmental funds:

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

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

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

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

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

The County reports the following major enterprise fund:

The Nursing Home Enterprise Fund is used to account for the operations of the County nursing home.

Additionally, the County reports the following fund type:

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

C. Measurement Focus and Basis of Accounting

The government-wide and proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Shared revenues are generally recognized in the period the appropriation goes into effect. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Lake County considers all revenue as available if collected within 90 days after the end of the current period. Property and other taxes, licenses, and interest are all considered susceptible to accrual. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, compensated absences, and claims and judgments, which are recognized as expenditures to the extent that they have matured. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

Proprietary fund operating revenue, such as charges for services, result from exchange transactions associated with the principle activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenue, such as contributions and donations, result from nonexchange transactions or incidental activities.

When both restricted and unrestricted resources are available for use, it is the County's policy to use restricted resources first and then unrestricted resources as needed.

D. Assets, Liabilities, and Net Assets or Equity

1. Cash and Cash Equivalents

The County has defined cash and cash equivalents to include cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition. Additionally, each fund's equity in the County's investment pool is treated as a cash equivalent because the funds can deposit or effectively withdraw cash at any time without prior notice or penalty.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

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

2. Deposits and Investments

The cash balances of substantially all funds are pooled and invested by the County Auditor/Treasurer for the purpose of increasing earnings through investment activities. Pooled and fund investments are reported at their fair value at December 31, 2006, based on market prices. Pursuant to Minn. Stat. § 385.07, investment earnings on cash and pooled investments are credited to the General Fund. Other funds received investment earnings based on other state statutes, grant agreements, contracts, and bond covenants. Pooled investment earnings for 2006 were \$646,438.

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

3. Receivables and Payables

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

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

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

3. Receivables and Payables (Continued)

Loans receivable consist of outstanding loans to other governmental entities to finance improvements, loans to individuals for shoreline erosion projects, and loans to individuals for economic development.

4. Inventories and Prepaid Items

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

Inventories in the Nursing Home Enterprise Fund are valued at cost on a first-in, first-out method and consist of nursing home supplies held for consumption. Inventoried items are recorded as an expense when used.

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

5. Restricted Assets

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

6. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets (for example, roads, bridges, and similar items), are reported in the applicable governmental or business-type activities column in the government-wide financial

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

6. Capital Assets (Continued)

statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair 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.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed. During the current period, the County did not have any capitalized interest.

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

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

7. Compensated Absences

The liability for compensated absences reported in the financial statements consists of unpaid, accumulated annual and sick leave balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. Compensated absences are accrued when incurred in the

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

7. Compensated Absences (Continued)

government-wide, and proprietary fund financial statements. A liability for these amounts is reported in the governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

Lake County's employees participate in a post-retirement health savings plan administered by the Minnesota State Retirement System. At retirement, depending on the employee's years of service, he or she is issued a lump sum payout of either 10 or 20 percent of the vested sick leave as well as 2 to 3 years of insurance coverage. The lump sum payouts are paid directly into the post-retirement health savings plan.

8. Deferred Revenue

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

9. Long-Term Obligations

In the government-wide financial statements, and proprietary fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of the debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

9. Long-Term Obligations (Continued)

discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

10. Fund Equity

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

11. 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.

E. Prior Period Restatement

On Exhibit 2, the prior year's net assets for the Housing and Redevelopment Authority discretely presented component unit have been restated as follows:

| | |
|---|---------------------|
| Net Assets - Beginning | \$ 907,073 |
| Add: Jail bonds should have been eliminated in prior year to prevent double reporting | <u>300,000</u> |
| Net Assets - Beginning, Restated | <u>\$ 1,207,073</u> |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

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

| | |
|--|----------------------|
| Primary government | |
| Cash and pooled investments | \$ 13,073,443 |
| Restricted cash and pooled investments | 3,758 |
| Component unit | |
| Cash and pooled investments | 321,328 |
| Restricted cash and pooled investments | 82,691 |
| Fiduciary funds | |
| Cash and pooled investments | <u>796,570</u> |
| Total Cash and Investments | <u>\$ 14,277,790</u> |

a. Deposits

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

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

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a financial institution failure, the County's deposits may not be returned to it. The County does not have a deposit policy for custodial credit risk. As of December 31, 2006, the primary government's bank balances of \$1,310,466 were not exposed to custodial credit risk.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

a. Deposits

Custodial Credit Risk (Continued)

The Lake County Housing and Redevelopment Authority component unit's book balance of \$404,019 was exposed to custodial credit risk as follows:

| | |
|--|------------------|
| Uninsured and uncollateralized Component unit | <u>\$ 64,061</u> |
|--|------------------|

b. Investments

Minn. Stat. §§ 118A.04 and 118A.05 generally authorize the following types of investments as available to the County:

- (1) securities which are direct obligations or are guaranteed or insured issues of the United States, its agencies, its instrumentalities, or organizations created by an act of Congress, except mortgage-backed securities defined as "high risk" by Minn. Stat. § 118A.04, subd. 6;
- (2) mutual funds through shares of registered investment companies provided the mutual fund receives certain ratings depending on its investments;
- (3) general obligations of the State of Minnesota and its municipalities, and in certain state agency and local obligations of Minnesota and other states provided such obligations have certain specified bond ratings by a national bond rating service;
- (4) bankers' acceptances of United States banks;
- (5) commercial paper issued by United States corporations or their Canadian subsidiaries that is rated in the highest quality category by two nationally recognized rating agencies and matures in 270 days or less; and

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

b. Investments (Continued)

- (6) with certain restrictions, in repurchase agreements, securities lending agreements, joint powers investment trusts, and guaranteed investment contracts.

Interest Rate Risk

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

Credit Risk

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

Custodial Credit Risk

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities in the possession of an outside party. The County does not have an investment policy for custodial credit risk. All of Lake County's investments in negotiable certificates of deposit and government securities are held by the counterparty to the

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

b. Investments

Custodial Credit Risk (Continued)

transactions and, therefore, are subject to custodial credit risk. A portion of these investments are insured by SIPC insurance or excess SIPC insurance and are not subject to custodial credit risk.

| | | |
|------------------------------------|----|-----------|
| Negotiable certificates of deposit | | |
| Insured | \$ | 287,572 |
| Government securities | | |
| Insured | | 3,576,947 |
| Uninsured, held by counterparty | | 3,069,795 |

Concentration of Credit Risk

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

The following table presents the County's deposit and investment balances at December 31, 2006, and information relating to potential investment risks:

| Investment Type | Credit Risk | | Concentration Risk | Interest Rate Risk | Carrying (Fair) Value |
|--|---------------|---------------|----------------------|--------------------|-----------------------|
| | Credit Rating | Rating Agency | Over 5% of Portfolio | Maturity Date | |
| U.S. government agency securities | | | | | |
| Federal National Mortgage Association Collateralized Mortgage Obligation | N/R | N/A | | 9/25/08 | \$ 4,424 |
| Federal National Mortgage Association Note | AAA | Moody's | | 6/14/10 | 199,500 |
| Federal National Mortgage Association Note | N/R | N/A | | 2/1/19 | 306,687 |
| Total Federal National Mortgage Association | | | <5% | | \$ 510,611 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments (Continued)

| Investment Type | Credit Risk | | Concentration Risk Over 5% of Portfolio | Interest Rate Risk Maturity Date | Carrying (Fair) Value |
|---|---------------|---------------|---|-------------------------------------|-----------------------|
| | Credit Rating | Rating Agency | | | |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 12/29/06 | \$ 299,100 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 3/30/07 | 99,375 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 4/30/07 | 99,344 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 5/4/07 | 114,246 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 5/11/07 | 497,030 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 6/18/07 | 247,577 |
| Federal Home Loan Bank Bonds | AAA | S&P | | 9/17/07 | 246,763 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 11/9/07 | 148,191 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 11/28/07 | 199,438 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 11/28/07 | 246,562 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 2/25/08 | 322,416 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 3/13/08 | 299,157 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 7/22/08 | 197,250 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 8/13/08 | 122,561 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 9/29/08 | 245,548 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 11/3/08 | 249,766 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 12/26/08 | 193,688 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 8/27/09 | 493,440 |
| Federal Home Loan Bank Bonds | AAA | S&P | | 10/15/09 | 121,913 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 12/29/09 | 250,000 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 11/22/10 | 146,429 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 5/1/13 | 244,613 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 6/12/13 | 193,502 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 6/19/13 | 290,628 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 7/24/13 | 241,565 |
| Federal Home Loan Bank Bonds | AAA | Moody's | | 6/26/18 | 296,064 |
| Total Federal Home Loan Bank Bonds | | | 45.2% | | \$ 6,106,166 |
| Government National Mortgage Association Note | N/R | N/A | <5% | 2/15/19 | \$ 29,965 |
| Investment pools/mutual funds | | | | | |
| MAGIC Fund | N/R | N/A | 47.2% | N/A | \$ 6,371,021 |
| Wells Fargo Government Money Market | N/R | N/A | N/A | N/A | 202,408 |
| Total investment pools/mutual funds | | | | | \$ 6,573,429 |
| Negotiable certificates of deposit | | | | | |
| LaSalle Bank Midwest | N/A | N/A | <5% | 3/7/07 | \$ 96,109 |
| Huntington National Bank | N/A | N/A | <5% | 1/9/13 | 95,984 |
| Waypoint Bank | N/A | N/A | <5% | 7/8/13 | 95,479 |
| Total negotiable certificates of deposit | | | | | \$ 287,572 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments (Continued)

| Investment Type | Credit Risk | | Concentration | Interest | Carrying (Fair) Value |
|-------------------------------|------------------|------------------|---------------------------------|-------------------------------|-----------------------------|
| | Credit Rating | Rating Agency | Risk Over 5% of Portfolio | Rate Risk Maturity Date | |
| Total Investments | | | | | \$ 13,507,743 |
| Deposits - primary government | | | | | 320,130 |
| Deposits - component unit | | | | | 404,019 |
| Petty cash | | | | | 3,850 |
| Resident trust funds | | | | | 3,758 |
| Escheat Cash | | | | | 38,290 |
| Total Cash and Investments | | | | | <u>\$ 14,277,790</u> |

N/A - Not Applicable; N/R - Not Rated

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

S&P - Standard & Poor's

2. Receivables

Receivables as of December 31, 2006, for the County's governmental activities and business-type activities are as follows:

| | Total Receivables | Amounts Not Scheduled for Collection During the Subsequent Year |
|-------------------------------|----------------------|--|
| Governmental Activities | | |
| Taxes | \$ 232,245 | \$ - |
| Due from other governments | 3,744,063 | - |
| Accounts | 1,101,300 | 5,320 |
| Interest | 45,586 | - |
| Loans receivable | 528,451 | 330,342 |
| Leases receivable | 175,000 | - |
| Total Governmental Activities | <u>\$ 5,826,645</u> | <u>\$ 335,662</u> |
| Business-Type Activities | | |
| Accounts | <u>\$ 376,357</u> | <u>\$ -</u> |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets (Continued)

3. Capital Assets

Capital asset activity for the year ended December 31, 2006, was as follows:

Governmental Activities

| | Beginning Balance | Increase | Decrease | Ending Balance |
|--|----------------------|--------------|--------------|-------------------|
| Capital assets not depreciated | | | | |
| Land | \$ 1,650,859 | \$ 2,298,000 | \$ 50,000 | \$ 3,898,859 |
| Construction in progress | 3,153,070 | 1,201,211 | 4,354,281 | - |
| Total capital assets not depreciated | \$ 4,803,929 | \$ 3,499,211 | \$ 4,404,281 | \$ 3,898,859 |
| Capital assets depreciated | | | | |
| Buildings | \$ 9,033,803 | \$ 5,117,616 | \$ - | \$ 14,151,419 |
| Improvements other than buildings | 362,539 | - | - | 362,539 |
| Machinery, furniture, and equipment | 6,879,956 | 890,031 | 84,460 | 7,685,527 |
| Infrastructure | 71,078,895 | 2,064,654 | - | 73,143,549 |
| Total capital assets depreciated | \$ 87,355,193 | \$ 8,072,301 | \$ 84,460 | \$ 95,343,034 |
| Less: accumulated depreciation for | | | | |
| Buildings | \$ 3,024,208 | \$ 323,539 | \$ - | \$ 3,347,747 |
| Improvements other than buildings | 241,133 | 10,049 | - | 251,182 |
| Machinery, furniture, and equipment | 5,064,782 | 581,209 | 83,355 | 5,562,636 |
| Infrastructure | 12,011,552 | 1,419,896 | - | 13,431,448 |
| Total accumulated depreciation | \$ 20,341,675 | \$ 2,334,693 | \$ 83,355 | \$ 22,593,013 |
| Total capital assets depreciated, net | \$ 67,013,518 | \$ 5,737,608 | \$ 1,105 | \$ 72,750,021 |
| Governmental Activities Capital Assets, Net | \$ 71,817,447 | \$ 9,236,819 | \$ 4,405,386 | \$ 76,648,880 |

Business-Type Activities

| | Beginning Balance | Increase | Decrease | Ending Balance |
|-------------------------------------|----------------------|-----------|----------|-------------------|
| Capital assets not depreciated | | | | |
| Land | \$ 15,000 | \$ - | \$ - | \$ 15,000 |
| Capital assets depreciated | | | | |
| Land improvements | \$ 91,983 | \$ - | \$ - | \$ 91,983 |
| Buildings | 3,502,827 | 10,850 | - | 3,513,677 |
| Machinery, furniture, and equipment | 591,939 | 23,340 | 2,000 | 613,279 |
| Total capital assets depreciated | \$ 4,186,749 | \$ 34,190 | \$ 2,000 | \$ 4,218,939 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

3. Capital Assets

Business-Type Activities (Continued)

| | <u>Beginning Balance</u> | <u>Increase</u> | <u>Decrease</u> | <u>Ending Balance</u> |
|---------------------------------------|------------------------------|--------------------|-----------------|---------------------------|
| Less: accumulated depreciation for | | | | |
| Land improvements | \$ 74,313 | \$ 2,852 | \$ - | \$ 77,165 |
| Buildings | 1,376,849 | 91,470 | - | 1,468,319 |
| Machinery, furniture, and equipment | 478,482 | 30,807 | 2,000 | 507,289 |
| | <u>\$ 1,929,644</u> | <u>\$ 125,129</u> | <u>\$ 2,000</u> | <u>\$ 2,052,773</u> |
| Total accumulated depreciation | | | | |
| Total capital assets depreciated, net | <u>\$ 2,257,105</u> | <u>\$ (90,939)</u> | <u>\$ -</u> | <u>\$ 2,166,166</u> |
| Business-Type Activities | | | | |
| Capital Assets, Net | <u>\$ 2,272,105</u> | <u>\$ (90,939)</u> | <u>\$ -</u> | <u>\$ 2,181,166</u> |

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

| | |
|---|---------------------|
| Governmental Activities | |
| General government | \$ 202,628 |
| Public safety | 192,659 |
| Highways and streets, including depreciation of infrastructure assets | 1,703,204 |
| Human services | 97,502 |
| Sanitation | 5,048 |
| Culture and recreation | 106,065 |
| Conservation of natural resources | 27,587 |
| | <u>2,334,693</u> |
| Total Depreciation Expense - Governmental Activities | <u>\$ 2,334,693</u> |
| Business-Type Activities | |
| Nursing home | <u>\$ 125,129</u> |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds (Continued)

B. Interfund Receivables, Payables, and Transfers

The composition of interfund balances as of December 31, 2006, is as follows:

1. Due To/From Other Funds

| <u>Receivable Fund</u> | <u>Payable Fund</u> | <u>Amount</u> | <u>Purpose</u> |
|-------------------------------|----------------------|-------------------|--------------------------------|
| General | Debt Service | \$ 106,088 | Temporary loan |
| | Human Services | 44,438 | Reimbursement for services |
| Total Due to General Fund | | <u>\$ 150,526</u> | |
| Road and Bridge | General | \$ 66,964 | Reimbursement for services |
| | Resource Development | 15,000 | Grant received in wrong fund |
| Total Due to Road and Bridge | | <u>\$ 81,964</u> | |
| Debt Service | General | \$ 38,046 | Rent charged to wrong fund |
| Forfeited Tax | Road and Bridge | \$ 15 | Pit reforestation |
| Capital Improvements | Debt Service | \$ 1,385 | Expenses charged to wrong fund |
| Resource Development | Forfeited Tax | \$ 104,157 | Apportionment of net proceeds |
| Total Due To/From Other Funds | | <u>\$ 376,093</u> | |

2. Due To/From Primary Government and Component Units

| <u>Receivable Entity</u> | <u>Payable Entity</u> | <u>Amount</u> | <u>Purpose</u> |
|--|--|-------------------|--|
| Component Unit - Lake County Housing and Redevelopment Authority | Primary Government - Debt Service Fund | <u>\$ 5,525</u> | Bond administration fees |
| Primary Government - Debt Service | Component Unit - Lake County Housing and Redevelopment Authority | <u>\$ 887,928</u> | Shortfalls in tax increment collections funded by primary government |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

B. Interfund Receivables, Payables, and Transfers (Continued)

3. Interfund Transfers

Interfund transfers for the year ended December 31, 2006, consisted of the following:

| | | |
|---|-------------------|----------------------------------|
| Transfers to General Fund from other funds Nursing Home Enterprise Fund | \$ 71,460 | Payment on construction cost |
| Transfers to Road and Bridge Fund from other governmental funds Capital Projects Fund | 150,000 | Payment on joint garage facility |
| Transfers to Capital Projects Fund from General Fund | 604 | Payment on HVAC project |
| Transfers to Resource Development Fund from other governmental funds Forfeited Tax Fund | <u>104,157</u> | Distribute net proceeds |
| Total Interfund Transfers | <u>\$ 326,221</u> | |

C. Liabilities

1. Payables

Payables at December 31, 2006, were as follows:

| | <u>Governmental Activities</u> | <u>Business-Type Activities</u> |
|--------------------------|------------------------------------|-------------------------------------|
| Accounts payable | \$ 275,703 | \$ 56,354 |
| Escheat property payable | 38,290 | - |
| Salaries payable | 338,813 | 39,156 |
| Accrued vacation payable | - | 61,068 |
| Contracts payable | 105,655 | - |
| Due to other governments | <u>133,205</u> | <u>-</u> |
| Total Payables | <u>\$ 891,666</u> | <u>\$ 156,578</u> |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities (Continued)

2. Leases

Business Type Activities

Capital Leases

In January 2003, the Lake County Nursing Home entered into a lease agreement to finance a copier. The lease runs for five years with interest at ten percent and monthly payments of \$214. At lease expiration, the copier will become the Nursing Home's property and, as such, it has been recorded as a capital asset. At September 30, 2006, the copier was valued at \$11,000. There is \$6,600 of accumulated depreciation through September 30, 2006.

The present value of the future minimum lease payments is shown below:

| Year Ending September 30 | | |
|---|----|-------|
| 2007 | \$ | 2,571 |
| 2008 | | 2,571 |
| Total minimum lease payments | \$ | 5,142 |
| Less: amount representing interest | | (455) |
| Present Value of Minimum Lease Payments | \$ | 4,687 |
| Current portion | \$ | 2,202 |
| Long-term portion | | 2,485 |
| Total | \$ | 4,687 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities (Continued)

3. Long-Term Debt

Governmental Activities

| Type of Indebtedness | Final Maturity | Installment Amounts | Interest Rate (%) | Original Issue Amount | Outstanding Balance December 31, 2006 |
|---|-------------------|--------------------------|-------------------------|-----------------------------|--|
| General obligation bonds | | | | | |
| G.O. Jail Lease Revenue Bonds, Series 1996A | 2007 | \$95,000 - \$155,000* | 4.00 - 5.10 | \$ 1,245,000 | \$ 155,000 |
| G.O. Taxable Tax Increment Refunding Bonds, Series 2003A | 2007 | \$80,000 - \$85,000 | 2.50 - 3.50 | 250,000 | 85,000 |
| G.O. Refunding Bonds, Series 2003B | 2009 | \$130,000 - \$150,000 | 2.50 - 3.00 | 700,000 | 435,000 |
| G.O. Tax Increment Refunding Bonds, Series 2003C | 2009 | \$250,000 - \$275,000 | 2.75 - 4.00 | 1,045,000 | 795,000 |
| G.O. Capital Improvement Bonds, Series 2005A | 2019 | \$155,000 - \$310,000 | 3.375 - 3.80 | 3,200,000 | 3,200,000 |
| G.O. State-Aid Highway Bonds, Series 2005B | 2013 | \$455,000 - \$460,000 | 3.25 - 3.50 | 3,200,000 | 3,200,000 |
| Total General Obligation Bonds | | | | <u>\$ 9,640,000</u> | <u>\$ 7,870,000</u> |
| Other long-term debt | | | | | |
| General obligation revenue Note | 2012 | \$20,304 - \$24,286 | 2.00 | \$ 222,422 | \$ 138,725 |
| Promissory note | 2008 | \$100,000 | 6.00 | 500,000 | 200,000 |
| Promissory note (Allete) | 2010 | \$58,915 | 5.00 | 282,072 | 231,024 |
| Capital Lease | 2021 | \$146,667 | 5.375 | 2,200,000 | 2,200,000 |
| Capital Lease | 2008 | \$15,942 | 4.25 | 73,356 | 29,924 |
| Total Other Long-Term Debt | | | | <u>\$ 3,277,850</u> | <u>\$ 2,799,673</u> |

*Paid by Lake County HRA (See Note 4.F.)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities

3. Long-Term Debt (Continued)

Business-Type Activities - Lake County Nursing Home

| Type of Indebtedness | Final Maturity | Installment Amounts | Interest Rate (%) | Original Issue Amount | Outstanding Balance September 30, 2006 |
|----------------------|----------------|---------------------|-------------------|-----------------------|--|
| Capital Lease | 2008 | \$2,571 | 10.00 | \$ 11,000 | \$ 4,687 |

4. Debt Service Requirements

Debt service requirements at December 31, 2006, were as follows:

Governmental Activities

| Year Ending December 31 | General Obligation Bonds | | Other Long-Term Debt | |
|----------------------------|--------------------------|---------------------|----------------------|---------------------|
| | Principal | Interest | Principal | Interest |
| 2007 | \$ 1,250,000 | \$ 253,694 | \$ 336,898 | \$ 145,156 |
| 2008 | 1,080,000 | 214,306 | 340,654 | 127,712 |
| 2009 | 1,100,000 | 177,247 | 228,641 | 111,736 |
| 2010 | 675,000 | 146,458 | 232,055 | 100,329 |
| 2011 | 685,000 | 122,888 | 170,475 | 88,764 |
| 2012 - 2016 | 2,185,000 | 318,560 | 757,620 | 315,698 |
| 2017 - 2019 | 895,000 | 51,668 | 733,330 | 118,250 |
| Total | <u>\$ 7,870,000</u> | <u>\$ 1,284,821</u> | <u>\$ 2,799,673</u> | <u>\$ 1,007,645</u> |

Business-Type Activities - Lake County Nursing Home

| Year Ending September 30 | Capital Leases | |
|-----------------------------|-----------------|---------------|
| | Principal | Interest |
| 2007 | \$ 2,202 | \$ 369 |
| 2008 | 2,485 | 86 |
| Total | <u>\$ 4,687</u> | <u>\$ 455</u> |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities (Continued)

5. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2006, was as follows:

Governmental Activities

| | Beginning Balance | Additions | Deductions | Ending Balance | Due Within One Year |
|--|----------------------|---------------------|---------------------|----------------------|------------------------|
| General obligation bonds | \$ 8,485,000 | \$ - | \$ 615,000 | \$ 7,870,000 | \$ 1,250,000 |
| Notes payable | 742,350 | - | 172,601 | 569,749 | 169,350 |
| Total bonds and notes payable | \$ 9,227,350 | \$ - | \$ 787,601 | \$ 8,439,749 | \$ 1,419,350 |
| Capital lease payable | 43,961 | 2,200,000 | 14,037 | 2,229,924 | 161,312 |
| Compensated absences | 1,119,293 | 851,958 | 718,482 | 1,252,769 | - |
| Governmental Activities Long-Term Liabilities | <u>\$ 10,390,604</u> | <u>\$ 3,051,958</u> | <u>\$ 1,520,120</u> | <u>\$ 11,922,442</u> | <u>\$ 1,580,662</u> |

Business-Type Activities - Lake County Nursing Home

| | Beginning Balance | Additions | Deductions | Ending Balance | Due Within One Year |
|---|----------------------|-----------------|-----------------|-------------------|------------------------|
| Capital lease payable | \$ 6,680 | \$ - | \$ 1,993 | \$ 4,687 | \$ 2,202 |
| Compensated absences | 102,476 | 2,457 | - | 104,933 | 36,476 |
| Business-Type Activities Long-Term Liabilities | <u>\$ 109,156</u> | <u>\$ 2,457</u> | <u>\$ 1,993</u> | <u>\$ 109,620</u> | <u>\$ 38,678</u> |

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Defined Benefit Plan

Plan Description

All full-time and certain part-time employees of Lake County are covered by defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). The PERA administers the Public Employees Retirement Fund, the Public Employees Police and Fire 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. All police officers, firefighters, and peace officers who qualify for membership by statute are covered by the Public Employees Police and Fire Fund. Members who are employed in a county correctional institution and have direct contact with inmates are covered by the Public Employees Correctional Fund.

The 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 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 Police and Fire Fund members, the annuity accrual rate is 3.0 percent of average salary for each year of service. For Public Employees Correctional Fund members, the annuity accrual rate is 1.9 percent of average salary for each year of service.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Defined Benefit Plan

Plan Description (Continued)

For all Public Employees Retirement Fund members whose annuity is calculated using Method 1, and for all Public Employees Police and Fire Fund and Public Employees Correctional Fund members, a full annuity is available when age plus years of service equal 90. 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.

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

Funding Policy

Pension benefits are funded from member and employee 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. The County 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 5.50 percent, respectively, of their annual covered salary in 2006. Contribution rates in the Coordinated Plan increased in 2007 to 5.75 percent. Public Employees Police and Fire Fund members were required to contribute 7.00 percent of their annual covered salary in 2006. That rate increased to 7.80 percent in 2007. Public Employees Correctional Fund members are required to contribute 5.83 percent of their annual covered salary.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Defined Benefit Plan

Funding Policy (Continued)

The County is required to contribute the following percentages of annual covered payroll in 2006 and 2007:

| | 2006 | 2007 |
|---------------------------------------|--------|--------|
| Public Employees Retirement Fund | | |
| Basic Plan members | 11.78% | 11.78% |
| Coordinated Plan members | 6.00 | 6.25 |
| Public Employees Police and Fire Fund | 10.50 | 11.70 |
| Public Employees Correctional Fund | 8.75 | 8.75 |

The County's contributions for the years ending December 31, 2006, 2005, and 2004, for the Public Employees Retirement Fund, the Public Employees Police and Fire Fund, and the Public Employees Correctional Fund were:

| | Public Employees Retirement Fund | Public Employees Police and Fire Fund | Public Employees Correctional Fund |
|------|---|--|---|
| 2006 | \$ 370,507 | \$ 94,744 | \$ 36,401 |
| 2005 | 328,600 | 83,198 | 32,825 |
| 2004 | 321,277 | 78,239 | 31,523 |

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

B. Defined Contribution Plan

The Public Employees Defined Contribution Plan is a multiple-employer deferred compensation plan for local government officials, except elected county sheriffs. The plan is established and administered in accordance with Minn. Stat. ch. 353D. The plan is a tax qualified plan under Section 401(a) of the Internal Revenue Code, and all contributions by or on behalf of employees are tax-deferred until time of withdrawal.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

B. Defined Contribution Plan (Continued)

Plan benefits depend solely on amounts contributed to the plan plus investment earnings, less administrative expenses. Minn. Stat. § 353D.03 specifies the employee and employer contribution rates for those qualified personnel who elect to participate. An eligible elected official who decides to participate contributes five percent of salary, which is matched by the employer.

No vesting period is required to receive benefits in the Defined Contribution Plan. At the time of retirement or termination, the market value of the member's account is distributed to the member or another qualified plan.

The County's contributions for the years ending December 31, 2006, 2005, and 2004, were \$5,864, \$5,541, and \$5,190, respectively, equal to the contractually required contributions for each year as set by state statute.

4. Summary of Significant Contingencies and Other Items

A. Risk Management

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

The Workers' Compensation Division of MCIT is self-sustaining based on the contributions charged, so that total contributions plus compounded earnings on these contributions will equal the amount needed to satisfy claims liabilities and other expenses. MCIT participates in the Workers' Compensation Reinsurance Association

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

A. Risk Management (Continued)

with coverage at \$390,000 per claim in 2006 and \$400,000 in 2007. Should the MCIT Workers' Compensation Division liabilities exceed assets, MCIT may assess the County in a method and amount to be determined by MCIT.

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

The North East Service Cooperative (NESC) is a joint powers entity which sponsors a plan to provide group employee health benefits to its participating members. All members pool premiums and losses; however, a particular member may receive increases or decreases depending on a good or bad year of claims experience. Premiums are determined annually by the NESC and are based partially on the experience of the County and partially on the experience of the group. The NESC solicits proposals from carriers and negotiates the contracts. Beginning in 2005, the County retained the risk of loss for the first \$1,000 of claims under single coverage and the first \$2,000 of claims under family coverage for each employee. The County has contracted with Hanratty and Associates to administer the County's health claims for which the risk has been retained by the County. Claims are recognized as they are paid. The amount of claims incurred at the balance sheet date, which have not been accrued in the financial statements is immaterial.

| | Year Ended December 31 | |
|---|------------------------|-----------|
| | 2006 | 2005 |
| Unpaid claims, beginning of fiscal year | \$ - | \$ - |
| Incurred claims (including IBNRs) | 332,402 | 209,829 |
| Claims payments | (332,402) | (209,829) |
| Unpaid Claims, End of Fiscal Year | \$ - | \$ - |

The County retains the risk of loss from claims related to employee dental. The County has contracted with Delta Dental to administer the County's dental claims. The County provides dental coverage to permanent full-time employees based on negotiated union

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

A. Risk Management (Continued)

contracts to cover a portion of the dental claims. Claims are recognized as they are paid. The amount of claims incurred at the balance sheet date, which have not been accrued in the financial statements is immaterial.

| | Year Ended December 31 | |
|---|------------------------|-----------|
| | 2006 | 2005 |
| Unpaid claims, beginning of fiscal year | \$ - | \$ - |
| Incurred claims (including IBNRs) | 115,407 | 112,267 |
| Claims payments | (115,407) | (112,267) |
| Unpaid Claims, End of Fiscal Year | \$ - | \$ - |

B. Contingent Liabilities

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

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

C. Other Commitments

Lake County has entered into a joint powers agreement with the Town of Silver Creek to assist the Town in financing a wastewater collection, treatment, and disposal system in the Castle Danger area. The County has agreed to contribute \$65,586 per year through the year 2017 to help finance this project. The total amount to be contributed is \$1,035,000, of which \$353,516 has been paid through December 31, 2006. The outstanding commitment at December 31, 2006, is \$681,484. The agreement may be terminated by the mutual agreement of the two parties. This amount has not been recorded as a liability in Lake County's financial statements.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

C. Other Commitments (Continued)

Lake County has entered into an agreement with the Township of Crystal Bay to provide \$60,000 of funding to the Township to help build a new community center. The funding is to be provided in four annual installments of \$15,000. Payments of \$15,000 were made in 2005 and 2006; therefore, the outstanding balance of the commitment is \$30,000 at December 31, 2006. The money is to be returned to the County if no building is completed within five years. This amount has not been recorded as a liability in Lake County's financial statements.

D. Joint Ventures

Arrowhead Regional Corrections

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

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

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

Arrowhead Regional Corrections is financed through state grants and contributions from the participating counties. During 2005 (the most recent information available), County contributions were in the following proportion:

| | |
|--------------------|----------------|
| Carlton County | 9.38% |
| Cook County | 1.44% |
| Koochiching County | 1.96% |
| Lake County | 2.19% |
| St. Louis County | <u>85.03%</u> |
| Total | <u>100.00%</u> |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Arrowhead Regional Corrections (Continued)

Below is a summary of the financial information from Arrowhead Regional Corrections' government-wide statements for December 31, 2005:

| | |
|----------------------|---------------|
| Total Assets | \$ 11,657,200 |
| Total Liabilities | 5,384,127 |
| Total Net Assets | 6,273,073 |
| Total Revenues | 18,420,835 |
| Total Expenses | 17,920,160 |
| Change in Net Assets | 500,675 |

Lake County provided \$219,834 in funding during 2006. Separate financial information can be obtained from:

Arrowhead Regional Corrections
St. Louis County Courthouse
100 North 5th Avenue West
Room 319
Duluth, Minnesota 55802

Community Health Services Board

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

The Community Health Services Board is composed of nine members. The Carlton, Cook, and Lake County Boards of Commissioners each appoint two members; the St. Louis County Board of Commissioners appoints three members. Financing is obtained through federal and state grants. Lake County provided no funding to this organization in 2006.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Community Health Services Board (Continued)

At December 31, 2005 (the most recent information available), the Community Health Services Board's summary of financial information was:

| | | |
|------------------------|----|-----------|
| Total Assets | \$ | 566,542 |
| Total Liabilities | | 453,372 |
| Total Net Assets | | 113,170 |
| Total Revenues/Sources | | 3,286,432 |
| Total Expenses/Uses | | 3,262,257 |
| Change in Net Assets | | 24,175 |

Separate financial information can be obtained from:

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

Northeast Minnesota Office of Job Training

Aitkin, Carlton, Cook, Itasca, Koochiching, Lake, and St. Louis Counties (excluding the City of Duluth) entered into a joint powers agreement pursuant to Minn. Stat. § 471.59 for the purpose of developing and implementing a private and public job training program. The United States Congress, through the Job Training Partnership Act of 1982, authorized states to establish "service delivery areas" to provide programs to achieve full employment through the use of grants. The counties identified above are defined as such a service delivery area, and the Northeast Minnesota Office of Job Training is designated as the grant recipient and administrator for such service delivery area. Lake County is not a funding mechanism for this organization.

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Northeast Minnesota Office of Job Training (Continued)

A summary of the financial information of Northeast Minnesota Office of Job Training's Government-Wide Statements for June 30, 2006, was:

| | |
|------------------------|--------------|
| Total Assets | \$ 2,749,976 |
| Total Liabilities | 1,182,416 |
| Total Net Assets | 1,567,560 |
| Total Revenues/Sources | 4,940,929 |
| Total Expenses/Uses | 4,915,961 |
| Change in Net Assets | 24,968 |

Separate financial information can be obtained from:

Northeast Minnesota Office of Job Training
820 North Ninth Street
Suite 210
Virginia, Minnesota 55792

Minnesota Counties Information Systems

The County entered into a joint powers agreement, pursuant to Minn. Stat. § 471.59, creating and operating Minnesota Counties Information Systems (MCIS). MCIS operates and maintains data processing facilities and management information systems for the benefit of members of this agreement.

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

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Minnesota Counties Information Systems (Continued)

A summary of the financial information of MCIS at December 31, 2004 (the most recent information available), was:

| | | |
|----------------------|----|-----------|
| Total Assets | \$ | 630,562 |
| Total Liabilities | | 240,172 |
| Total Net Assets | | 390,390 |
| Total Revenues | | 2,193,747 |
| Total Expenses | | 2,114,231 |
| Change in Net Assets | | 79,516 |

Separate financial information can be obtained from:

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

Northern Counties Land Use Board

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

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Northern Counties Land Use Board (Continued)

A summary of the financial statements at December 31, 2004 (the most recent available information), is shown below:

| | | |
|----------------------|----|--------|
| Total Assets | \$ | 27,283 |
| Total Liabilities | | 5,243 |
| Total Net Assets | | 22,040 |
| Total Revenues | | 51,250 |
| Total Expenses | | 42,956 |
| Change in Net Assets | | 8,294 |

The County contributed \$2,500 during 2006 to the Northern Counties Land Use Board.

Separate financial information can be obtained from:

Northern Counties Land Use Board
Room 607 Government Services Center
320 West Second Street
Duluth, Minnesota 55802

North Shore Collaborative

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

Control of the North Shore Collaborative is vested in a Board of Directors. Lake County has three members on the Board. Financing is provided by state and federal grants, appropriations from Collaborative members, and miscellaneous revenues. Lake

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

North Shore Collaborative (Continued)

County is the fiscal agent for the Collaborative and handles all of the financial transactions for the organization. Financial information for the Collaborative for the fiscal year ended December 31, 2006, is as follows:

| | | |
|-------------|----|---------|
| Assets | \$ | 336,356 |
| Liabilities | \$ | 336,356 |

E. Jointly-Governed Organizations

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

The North Shore Management Board provides Lake Superior Shoreline planning for Cook, Lake, and St. Louis Counties; the Cities of Beaver Bay, Grand Marais, Silver Bay, and Two Harbors; and the Towns of Duluth and Lakewood. The County provided \$2,500 in funding to the North Shore Management Board for 2006.

The St. Louis and Lake Counties Regional Railroad Authority operates a tourism train within the counties. Lake County did not provide any funding to the Regional Railroad Authority in 2006.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

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

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

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

Jail Bonds

The Lake County HRA is a discretely presented component unit of Lake County. During 1996, the HRA issued \$1,245,000 in General Obligation Jail Lease Revenue Bonds, with \$155,000 outstanding at December 31, 2006. The bonds were issued to finance the jail portion of the County Law Enforcement Center. The jail is owned by the HRA and is leased to Lake County. The County makes lease payments in the amounts necessary to make the bond principal and interest payments each year. When all of the bonds have been paid off, the title to the jail will pass to the County. Because the debt is essentially an obligation of the County, it is shown as County debt in the County's government-wide financial statements. It is also shown as debt in the separately issued financial statements of the Lake County HRA because the HRA issued the bonds. The debt is eliminated from the HRA Component Unit column on the County's financial statements to eliminate double reporting of the debt.

SEGOG Property

In June 2005, the County entered into agreement with the HRA to sell 70 acres of land to the HRA for \$250,000. The property will be used for housing development to meet the County's housing needs and to assist in fostering economic development in the County. The purchase price of \$250,000 will be paid to the County as individual lots are sold in the development. This agreement has not been finalized as of December 31, 2006, and no cash payments have been made.

Purchase of Rental Property

In April 2006, the County purchased the Two Harbors duplex rental property from the HRA for \$88,000.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

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

Tax Increment Shortfalls

The HRA tax increment revenues have not been sufficient to cover bond payments on the Cove Point and Superior Shores tax increment bonds. Lake County has made the bond payments on these bond issues; however, the Lake County HRA remains obligated to Lake County for these shortfalls. A receivable has been set up on the County's financial statements in the amount of \$887,928.

G. Tax-Forfeited Land

The County manages approximately 151,000 acres of state-owned, tax-forfeited land. This land generates revenues primarily from recreational land leases and land and timber sales. Land management costs, including forestry costs such as site preparation, seedlings, tree planting, and logging roads, are accounted for as current operating expenditures. Revenues in excess of expenditures are distributed to the County and cities, towns, and school districts within the County according to state statute.

H. Excess of Expenditures Over Appropriations

For the year ended December 31, 2006, expenditures exceeded appropriations in the following funds:

| | | |
|---|----|-----------|
| General Fund | \$ | 804,377 |
| Resource Development Special Revenue Fund | \$ | 2,155,525 |

5. Component Unit Disclosures

A. Summary of Significant Accounting Policies

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

A. Summary of Significant Accounting Policies (Continued)

Reporting Entity

The Lake County Housing and Redevelopment Authority was established June 13, 1984, and became active in 1986, having all the powers and duties of a County housing and redevelopment authority under the provisions of Minn. Stat. §§ 469.001 to 469.047. The Authority is governed by a five-member Board, appointed by the Lake County Board of Commissioners. The Board is organized with a chair, vice chair, and a secretary-treasurer, elected annually. At year-end December 31, 2006, there are five Board members.

Basis of Presentation

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

The Authority reports the following major governmental fund:

The General Fund is the Authority's primary operating fund. It accounts for all financial resources of the general government not accounted for in other funds.

The Authority reports the following major enterprise fund:

The Silverpointe Enterprise Fund is used to account for the operations of a 25-unit senior housing facility in Silver Bay, Minnesota. The facility is owned by the Authority and was built to provide quality and affordable housing for senior citizens in Lake County. Silverpointe is operated similar to a business enterprise. The intent of the Authority is that the cost of providing housing services to the general public, on a continuing basis, is financed or recovered primarily through user charges.

Measurement Focus and Basis of Accounting

The government-wide and proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred,

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

A. Summary of Significant Accounting Policies

Measurement Focus and Basis of Accounting (Continued)

regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. The Lake County Housing and Redevelopment Authority considers all revenues as available if collected within 90 days after the end of the current period. Property and other taxes, licenses, and interest are all considered to be susceptible to accrual.

Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, and claims and judgments, which are recognized as expenditures to the extent that they have matured. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first and then unrestricted resources as needed.

Cash and Cash Equivalents

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

Receivables and Payables

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

A. Summary of Significant Accounting Policies

Receivables and Payables (Continued)

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

Restricted Assets

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

Capital Assets

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

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

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

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

A. Summary of Significant Accounting Policies (Continued)

Long-Term Obligations

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

B. Detailed Notes on All Funds

Assets

Deposits and Investments

a. Deposits

The Authority's total cash and cash equivalents are reported as follows:

| | |
|---|-----------------------|
| Government-wide statement of net assets | |
| Governmental activities | |
| Cash | \$ 257,521 |
| Business-type activities | |
| Cash | 63,807 |
| Restricted assets | |
| Debt service | 69,198 |
| Customer deposits | <u>13,493</u> |
| Total Cash | <u>\$ 404,019</u> |

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

Authorized collateral includes treasury bills, notes and bonds; issues of U.S. government agencies; general obligations rated "A" or better, revenue obligations rated "AA" or better; irrevocable standby letters of credit issued by the Federal Home Loan Bank; and certificates of deposit. Minnesota

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

B. Detailed Notes on All Funds

Assets

Deposits and Investments

a. Deposits (Continued)

statutes require that securities pledged as collateral be held in safekeeping in a restricted account at the Federal Reserve Bank or in an account at a trust department of a commercial bank or other financial institution that is not owned or controlled by the financial institution furnishing the collateral.

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a financial institution failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of December 31, 2006, \$64,061 of the Authority's book balance of \$404,019 was exposed to custodial credit risk. These deposits are held in a trust account by the property manager of the Authority's rental units. The trust accounts are in the property manager's name and hold funds for multiple properties managed by the company. The account balances of each property are tracked internally by the property manager. Although the accounts are covered by FDIC insurance, it is not possible to determine the amount of FDIC coverage that is available to cover each property's individual balances.

| | |
|--------------------------------|------------------|
| Uninsured and uncollateralized | <u>\$ 64,061</u> |
|--------------------------------|------------------|

b. Investments

Minn. Stat. §§ 118A.04 and 118A.05 generally authorize the following types of investments as available to the Authority:

- (1) securities which are direct obligations or are guaranteed or insured issues of the United States, its agencies, its instrumentalities, or organizations created by an act of Congress, except mortgage-backed securities defined as "high risk" by Minn. Stat. § 118A.04, subd. 6;

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

B. Detailed Notes on All Funds

Assets

Deposits and Investments

b. Investments (Continued)

- (2) mutual funds through shares of registered investment companies provided the mutual fund receives certain ratings depending on its investments;
- (3) general obligations of the State of Minnesota and its municipalities, and in certain state agency and local obligations of Minnesota and other states provided such obligations have certain specified bond ratings by a national bond rating service;
- (4) bankers' acceptances of United States banks;
- (5) commercial paper issued by United States corporations or their Canadian subsidiaries that is rated in the highest quality category by two nationally recognized rating agencies and matures in 270 days or less; and
- (6) with certain restrictions, in repurchase agreements, securities lending agreements, joint powers investment trusts, and guaranteed investment contracts.

As of, and during the year ended, December 31, 2006, the Authority did not own any investments that required disclosure regarding interest rate risk, credit risk, custodial credit risk, or concentration of credit risk.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

B. Detailed Notes on All Funds

Assets (Continued)

Receivables

Receivables as of December 31, 2006, year-end for the Authority's governmental activities are as follows:

| | Total Receivables | Amounts Not Scheduled for Collection During the Subsequent Year |
|-------------------------------|----------------------|--|
| Governmental Activities | | |
| Taxes | \$ 6,955 | \$ - |
| Accounts receivable | 139,665 | - |
| Accrued interest | 715 | - |
| Due from Lake County | 5,525 | - |
| Loans receivable | 55,000 | - |
| Total Governmental Activities | \$ 207,860 | \$ - |

Loan Receivable

The Authority has a \$55,000 loan receivable from North Shore Business Enterprise Center, Inc., an unrelated non-profit organization. The loan is without interest. Annual principal payments of \$28,000 and \$27,000 are due on September 1, 2006 and September 1, 2007, respectively. The payment, which was due in 2006, has not been paid.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

B. Detailed Notes on All Funds

Assets (Continued)

Capital Assets

Capital asset activity for the year ended December 31, 2006, was as follows:

Governmental Activities

| | Beginning Balance | Increase | Decrease | Ending Balance |
|--|----------------------|-------------|-----------|-------------------|
| Capital assets not depreciated | | | | |
| Land | \$ 39,904 | \$ - | \$ 11,303 | \$ 28,601 |
| Capital assets depreciated | | | | |
| Buildings and structures | \$ 1,239,670 | \$ - | \$ 45,210 | \$ 1,194,460 |
| Less: accumulated depreciation for Buildings and structures | 279,303 | 30,765 | 11,453 | 298,615 |
| Total capital assets depreciated, net | \$ 960,367 | \$ (30,765) | \$ 33,757 | \$ 895,845 |
| Governmental Activities Capital Assets, Net | \$ 1,000,271 | \$ (30,765) | \$ 45,060 | \$ 924,446 |

Business-Type Activities

| | Beginning Balance | Increase | Decrease | Ending Balance |
|--|----------------------|-------------|----------|-------------------|
| Capital assets depreciated | | | | |
| Buildings and structures | \$ 1,879,117 | \$ - | \$ - | \$ 1,879,117 |
| Equipment | 3,911 | - | - | 3,911 |
| Total capital assets depreciated | \$ 1,883,028 | \$ - | \$ - | \$ 1,883,028 |
| Less: accumulated depreciation for Buildings and structures | \$ 403,227 | \$ 46,978 | \$ - | \$ 450,205 |
| Equipment | 3,911 | - | - | 3,911 |
| Total accumulated depreciation | \$ 407,138 | \$ 46,978 | \$ - | \$ 454,116 |
| Business-Type Activities Capital Assets, Net | \$ 1,475,890 | \$ (46,978) | \$ - | \$ 1,428,912 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

B. Detailed Notes on All Funds

Assets

Capital Assets (Continued)

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

| | |
|--------------------------------|------------------|
| Governmental Activities | |
| Urban and economic development | <u>\$ 30,765</u> |
| | |
| Business-Type Activities | |
| Senior housing | <u>\$ 46,978</u> |

Interfund Receivables, Payables, and Transfers

The composition of interfund balances as of December 31, 2006, is as follows:

Due To/From Other Funds

| Receivable Fund | Payable Fund | Amount |
|-----------------|------------------------------|------------------|
| General Fund | Silverpointe Enterprise Fund | <u>\$ 16,420</u> |

The General Fund pays for insurance and accounting expenses. A portion of the expense is then reimbursed by the Silverpointe Enterprise Fund. The amount payable at year-end is the insurance allocation for the years 2004-2006 and the accounting allocation for 2006.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

B. Detailed Notes on All Funds (Continued)

Liabilities

Long-Term Debt

Governmental Activities

| <u>Type of Indebtedness</u> | <u>Final Maturity</u> | <u>Installment Amounts</u> | <u>Interest Rate (%)</u> | <u>Original Issue Amount</u> | <u>Outstanding Balance December 31, 2006</u> |
|--|-----------------------|----------------------------|--------------------------|------------------------------|--|
| 1996 General Obligation Jail Lease Revenue Bonds | 2007 | \$95,000 - \$155,000 | 4.00 to 5.10 | \$ 1,245,000 | \$ 155,000 |

Business-Type Activities

| <u>Type of Indebtedness</u> | <u>Final Maturity</u> | <u>Installment Amounts</u> | <u>Interest Rate (%)</u> | <u>Original Issue Amount</u> | <u>Outstanding Balance December 31, 2006</u> |
|--|-----------------------|----------------------------|--------------------------|------------------------------|--|
| 1996 General Obligation Senior Housing Bonds | 2027 | Varies | 3.92 | \$ 1,160,642 | \$ 970,690 |

Debt Service Requirements

Debt service requirements at December 31, 2006, were as follows:

Governmental Activities

| <u>Year Ending December 31</u> | <u>Revenue Bonds</u> | |
|--------------------------------|----------------------|-----------------|
| | <u>Principal</u> | <u>Interest</u> |
| 2007 | \$ 155,000 | \$ 3,953 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

B. Detailed Notes on All Funds

Liabilities (Continued)

Business-Type Activities

| Year Ending December 31 | Revenue Bonds | |
|----------------------------|-------------------|-------------------|
| | Principal | Interest |
| 2007 | \$ 32,000 | \$ 37,485 |
| 2008 | 32,978 | 36,220 |
| 2009 | 34,294 | 34,903 |
| 2010 | 35,663 | 33,535 |
| 2011 | 37,087 | 32,111 |
| 2012 - 2016 | 208,853 | 137,136 |
| 2017 - 2021 | 253,995 | 91,994 |
| 2022 - 2026 | 308,892 | 37,096 |
| 2027 | 26,928 | 258 |
| Totals | <u>\$ 970,690</u> | <u>\$ 440,738</u> |

Changes in Long-Term Liabilities

Governmental Activities

| | Beginning Balance | Additions | Deductions | Ending Balance | Due Within One Year |
|-------------------------|----------------------|-----------|------------|-------------------|------------------------|
| Bonds payable | | | | | |
| General Obligation Jail | | | | | |
| Lease Revenue Bonds | \$ 300,000 | \$ - | \$ 145,000 | \$ 155,000 | \$ 155,000 |

Business-Type Activities

| | Beginning Balance | Additions | Deductions | Ending Balance | Due Within One Year |
|----------------------|----------------------|-----------|------------|-------------------|------------------------|
| Bonds payable | | | | | |
| General Obligation | | | | | |
| Senior Housing Bonds | \$ 1,000,035 | \$ - | \$ 29,345 | \$ 970,690 | \$ 32,000 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

B. Detailed Notes on All Funds

Liabilities (Continued)

Tax Increment Financing Districts

The Authority administers the following tax increment financing districts established pursuant to Minn. Stat. §§ 469.174-469.1791.

| | |
|-------------------|------------------------------------|
| District Number 2 | Blue Water/Superior Shores Project |
| District Number 3 | Cove Point Project |
| District Number 4 | Incubator Building Project |

The Bonds outstanding for District Nos. 2 and 3 are general obligation bonds issued by Lake County and are included in the Lake County financial statements. The bonds do not constitute a debt of the Authority. The County collects and pays the debt service payments pursuant to the amended Tax Increment Pledge Agreement, and the Authority recognizes the tax increment revenues and tax increment distributions to Lake County in its financial statements.

Risk Management

The Authority is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; injuries to employees; or natural disasters. To manage these risks, the Authority has joined the Minnesota Counties Insurance Trust (MCIT). The Authority retains risk for the deductible portions of the insurance policies. The amounts of these deductibles are considered immaterial to the financial statements. There were no significant reductions in insurance from the prior year. The amount of settlements did not exceed insurance coverage for the past three fiscal years.

C. Summary Disclosure of Significant Contingencies

Tax Increment Assistance

The Lake County Housing and Redevelopment Authority is committed to provide tax increment assistance pursuant to the Northshore Business Enterprise Center development agreement. The assistance is provided in the form of an annual tax rebate to the developer. The annual tax rebate is contingent upon payment of annual property

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

C. Summary Disclosure of Significant Contingencies

Tax Increment Assistance (Continued)

taxes by the developer. The assistance for the project is limited in amount based on both the scope of the project and the life of the tax increment district. The tax increment assistance does not result in debt proceeds and does not meet the definition of debt.

Conduit Debt Obligation

The Lake County Housing and Redevelopment Authority has issued the Health Care Facilities Revenue Bonds, series 2000, originally issued for \$5,000,000 in May 2000, and refinanced in October 2003, for \$4,108,000, to provide financial assistance to First Plan of Minnesota to construct two medical clinics. The bonds are secured by the property financed through a loan agreement and are payable solely from the revenues of First Plan of Minnesota. Neither the Authority nor the state is obligated in any manner for repayment of the bonds. Accordingly, the bonds are not reported as a liability in the Authority's financial statements.

Financial Condition

The Authority's expenses, including required payments to Lake County pursuant to bond obligations exceed current tax increment financing and other revenues. This continuing condition has resulted in a deficit balance of unrestricted net assets. Under current agreements and regulations, it appears the financial condition of the Authority will continue to deteriorate. The Authority's Board is looking into ways to improve its financial condition, including working with other similarly situated parties and the Minnesota Legislature to amend tax increment laws. The Authority is also in discussion with Lake County regarding its current obligations and the availability of alternative revenue sources.

The ability of the Authority to continue as a going concern is dependent on its ability to generate additional revenues and/or limit its current debt obligations to provide sufficient net cash flow to fund its daily and long-term obligations. The financial statements do not include any adjustments that might be necessary if the Authority is unable to continue as a going concern.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures (Continued)

D. Related Party Transactions

The Lake County Housing and Redevelopment Authority related party transactions are described in detail in Note 4.F.

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REQUIRED SUPPLEMENTARY INFORMATION

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 1

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | <u>Budgeted Amounts</u> | | <u>Actual Amounts</u> | <u>Variance with Final Budget</u> |
|---------------------------------|-------------------------|---------------------|---------------------------|---------------------------------------|
| | <u>Original</u> | <u>Final</u> | | |
| Revenues | | | | |
| Taxes | \$ 4,047,578 | \$ 4,047,578 | \$ 3,421,081 | \$ (626,497) |
| Licenses and permits | 88,055 | 88,055 | 29,927 | (58,128) |
| Intergovernmental | 2,225,800 | 2,225,800 | 3,395,849 | 1,170,049 |
| Charges for services | 512,465 | 512,465 | 557,811 | 45,346 |
| Fines and forfeits | 2,000 | 2,000 | 2,836 | 836 |
| Gifts and contributions | 7,000 | 7,000 | 14,837 | 7,837 |
| Investment earnings | 340,000 | 340,000 | 430,202 | 90,202 |
| Miscellaneous | 136,179 | 136,179 | 353,581 | 217,402 |
| Total Revenues | \$ 7,359,077 | \$ 7,359,077 | \$ 8,206,124 | \$ 847,047 |
| Expenditures | | | | |
| Current | | | | |
| General government | | | | |
| Commissioners | \$ 370,060 | \$ 458,060 | \$ 427,560 | \$ 30,500 |
| Courts | 24,099 | 24,099 | 36,379 | (12,280) |
| Law library | 25,000 | 25,000 | 25,942 | (942) |
| County administration | 72,169 | 72,169 | 71,229 | 940 |
| County auditor | 531,527 | 531,527 | 451,775 | 79,752 |
| County assessor | 428,417 | 428,417 | 412,385 | 16,032 |
| Elections | 197,115 | 197,115 | 173,382 | 23,733 |
| Accounting and auditing | 49,200 | 49,200 | 73,470 | (24,270) |
| Data processing | 794,048 | 794,048 | 716,562 | 77,486 |
| Personnel | 122,038 | 122,038 | 131,217 | (9,179) |
| Attorney | 349,905 | 353,783 | 379,302 | (25,519) |
| Recorder | 237,581 | 237,581 | 215,741 | 21,840 |
| Planning and zoning | 219,686 | 219,686 | 228,503 | (8,817) |
| Buildings and plant | 612,386 | 612,386 | 598,146 | 14,240 |
| Veterans service officer | 61,876 | 61,876 | 58,348 | 3,528 |
| Training | 5,000 | 5,000 | 151 | 4,849 |
| Motor pool | 20,302 | 20,302 | 24,352 | (4,050) |
| Total general government | \$ 4,120,409 | \$ 4,212,287 | \$ 4,024,444 | \$ 187,843 |
| Public safety | | | | |
| Sheriff | \$ 1,477,511 | \$ 1,477,511 | \$ 1,622,440 | \$ (144,929) |
| Boat and water safety | - | - | 21,809 | (21,809) |
| Ambulance | 44,562 | 44,562 | 43,361 | 1,201 |
| Emergency services | 99,498 | 99,498 | 99,708 | (210) |
| Coroner | 20,000 | 20,000 | 31,093 | (11,093) |
| County jail | 751,720 | 751,720 | 683,148 | 68,572 |
| Community corrections | 238,013 | 238,013 | 223,902 | 14,111 |
| Sentence to serve | 61,283 | 61,283 | 58,378 | 2,905 |
| Civil defense | 71,389 | 71,389 | 86,002 | (14,613) |
| Other public safety | 36,470 | 36,470 | 51,130 | (14,660) |
| Total public safety | \$ 2,800,446 | \$ 2,800,446 | \$ 2,920,971 | \$ (120,525) |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 1
(Continued)

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | Budgeted Amounts | | Actual Amounts | Variance with Final Budget |
|---|---------------------|---------------------|---------------------|-------------------------------|
| | Original | Final | | |
| Expenditures | | | | |
| Current (Continued) | | | | |
| Sanitation | | | | |
| Solid waste | \$ 176,348 | \$ 176,348 | \$ 176,918 | \$ (570) |
| Recycling | 155,469 | 155,469 | 130,938 | 24,531 |
| Hazardous waste | 20,900 | 20,900 | 11,374 | 9,526 |
| Total sanitation | \$ 352,717 | \$ 352,717 | \$ 319,230 | \$ 33,487 |
| Culture and recreation | | | | |
| Historical society | \$ 28,000 | \$ 28,000 | \$ 28,000 | \$ - |
| Arenas | 164,434 | 180,011 | 880,657 | (700,646) |
| Humane society | 3,500 | 3,500 | 3,500 | - |
| Memorial Day observance | 750 | 750 | 750 | - |
| Recreation board | 128,605 | 129,067 | 127,996 | 1,071 |
| Knife River Marina | - | - | 2,992 | (2,992) |
| Trails | - | - | 164,296 | (164,296) |
| County/Regional library | 67,971 | 67,971 | 67,971 | - |
| Total culture and recreation | \$ 393,260 | \$ 409,299 | \$ 1,276,162 | \$ (866,863) |
| Conservation of natural resources | | | | |
| Cooperative extension | \$ 92,238 | \$ 92,238 | \$ 90,480 | \$ 1,758 |
| Soil and water conservation | 35,771 | 35,771 | 37,659 | (1,888) |
| Agricultural society/County fair | 14,939 | 14,939 | 17,283 | (2,344) |
| Water planning | 23,326 | 23,326 | 23,326 | - |
| Wetland challenge | 5,000 | 5,000 | 5,000 | - |
| Other | - | - | 15,000 | (15,000) |
| Total conservation of natural resources | \$ 171,274 | \$ 171,274 | \$ 188,748 | \$ (17,474) |
| Economic development | | | | |
| Information centers | \$ 14,051 | \$ 20,301 | \$ 19,593 | \$ 708 |
| Airports | 28,000 | 28,000 | 28,000 | - |
| Total economic development | \$ 42,051 | \$ 48,301 | \$ 47,593 | \$ 708 |
| Debt service | | | | |
| Principal | \$ - | \$ - | \$ 21,553 | \$ (21,553) |
| Total Expenditures | \$ 7,880,157 | \$ 7,994,324 | \$ 8,798,701 | \$ (804,377) |
| Excess of Revenues Over (Under) Expenditures | \$ (521,080) | \$ (635,247) | \$ (592,577) | \$ 42,670 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 1
(Continued)

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | <u>Budgeted Amounts</u> | | <u>Actual Amounts</u> | <u>Variance with Final Budget</u> |
|---|-------------------------|---------------------|---------------------------|---------------------------------------|
| | <u>Original</u> | <u>Final</u> | | |
| Other Financing Sources (Uses) | | | | |
| Transfers in | \$ - | \$ - | \$ 71,460 | \$ 71,460 |
| Transfers out | (132,465) | (132,465) | (604) | 131,861 |
| Total Other Financing Sources (Uses) | \$ (132,465) | \$ (132,465) | \$ 70,856 | \$ 203,321 |
| Net Change in Fund Balance | \$ (653,545) | \$ (767,712) | \$ (521,721) | \$ 245,991 |
| Fund Balance - January 1 | 6,419,017 | 6,419,017 | 6,419,017 | - |
| Fund Balance - December 31 | \$ 5,765,472 | \$ 5,651,305 | \$ 5,897,296 | \$ 245,991 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 2

**BUDGETARY COMPARISON SCHEDULE
ROAD AND BRIDGE SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | Budgeted Amounts | | Actual Amounts | Variance with Final Budget |
|--|----------------------|----------------------|---------------------|-------------------------------|
| | Original | Final | | |
| Revenues | | | | |
| Taxes | \$ 1,448,892 | \$ 1,448,892 | \$ 1,197,678 | \$ (251,214) |
| Intergovernmental | 9,369,818 | 9,369,818 | 3,710,423 | (5,659,395) |
| Charges for services | 135,000 | 135,000 | 274,051 | 139,051 |
| Investment earnings | - | - | 136,489 | 136,489 |
| Miscellaneous | 10,000 | 10,000 | 20,965 | 10,965 |
| Total Revenues | \$ 10,963,710 | \$ 10,963,710 | \$ 5,339,606 | \$ (5,624,104) |
| Expenditures | | | | |
| Current | | | | |
| Highways and streets | | | | |
| Administration | \$ 310,757 | \$ 310,757 | \$ 314,347 | \$ (3,590) |
| Maintenance | 1,888,737 | 1,888,737 | 2,068,679 | (179,942) |
| Construction | 7,144,553 | 7,144,553 | 2,184,809 | 4,959,744 |
| Equipment maintenance and shop | 917,572 | 917,572 | 981,652 | (64,080) |
| Total highways and streets | \$ 10,261,619 | \$ 10,261,619 | \$ 5,549,487 | \$ 4,712,132 |
| Debt service | | | | |
| Principal | \$ - | \$ - | \$ 14,037 | \$ (14,037) |
| Interest | 98,253 | 98,253 | 96,287 | 1,966 |
| Administrative (fiscal) charges | - | - | 402 | (402) |
| Total debt service | \$ 98,253 | \$ 98,253 | \$ 110,726 | \$ (12,473) |
| Total Expenditures | \$ 10,359,872 | \$ 10,359,872 | \$ 5,660,213 | \$ 4,699,659 |
| Excess of Revenues Over (Under) Expenditures | \$ 603,838 | \$ 603,838 | \$ (320,607) | \$ (924,445) |
| Other Financing Sources (Uses) | | | | |
| Transfers in | 40,000 | 40,000 | 150,000 | 110,000 |
| Net Change in Fund Balance | \$ 643,838 | \$ 643,838 | \$ (170,607) | \$ (814,445) |
| Fund Balance - January 1 | 4,147,724 | 4,147,724 | 4,147,724 | - |
| Increase (decrease) in reserved for inventories | - | - | (71,088) | (71,088) |
| Fund Balance - December 31 | \$ 4,791,562 | \$ 4,791,562 | \$ 3,906,029 | \$ (885,533) |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 3

**BUDGETARY COMPARISON SCHEDULE
HUMAN SERVICES SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | Budgeted Amounts | | Actual Amounts | Variance with Final Budget |
|-----------------------------------|---------------------|---------------------|---------------------|-------------------------------|
| | Original | Final | | |
| Revenues | | | | |
| Taxes | \$ 1,636,559 | \$ 1,636,559 | \$ 1,312,990 | \$ (323,569) |
| Intergovernmental | 2,094,486 | 2,402,388 | 2,644,382 | 241,994 |
| Charges for services | 75,600 | 75,600 | 124,833 | 49,233 |
| Miscellaneous | 53,250 | 53,250 | 148,558 | 95,308 |
| Total Revenues | \$ 3,859,895 | \$ 4,167,797 | \$ 4,230,763 | \$ 62,966 |
| Expenditures | | | | |
| Current | | | | |
| Human services | | | | |
| Income maintenance | \$ 832,740 | \$ 907,740 | \$ 807,987 | \$ 99,753 |
| Social services | 2,669,515 | 3,102,417 | 2,996,761 | 105,656 |
| Total human services | \$ 3,502,255 | \$ 4,010,157 | \$ 3,804,748 | \$ 205,409 |
| Health | | | | |
| Nursing service | \$ 47,988 | \$ 47,988 | \$ 38,115 | \$ 9,873 |
| Transportation | 83,983 | 83,983 | 11,481 | 72,502 |
| Environmental health | - | - | 83,984 | (83,984) |
| Mental health | - | - | 38,245 | (38,245) |
| Health education | 225,669 | 225,669 | 232,329 | (6,660) |
| Total health | \$ 357,640 | \$ 357,640 | \$ 404,154 | \$ (46,514) |
| Total Expenditures | \$ 3,859,895 | \$ 4,367,797 | \$ 4,208,902 | \$ 158,895 |
| Net Change in Fund Balance | \$ - | \$ (200,000) | \$ 21,861 | \$ 221,861 |
| Fund Balance - January 1 | 2,963,270 | 2,963,270 | 2,963,270 | - |
| Fund Balance - December 31 | \$ 2,963,270 | \$ 2,763,270 | \$ 2,985,131 | \$ 221,861 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 4

**BUDGETARY COMPARISON SCHEDULES
FORFEITED TAX SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | <u>Budgeted Amounts</u> | | <u>Actual Amounts</u> | <u>Variance with Final Budget</u> |
|---|-------------------------|--------------------|---------------------------|---------------------------------------|
| | <u>Original</u> | <u>Final</u> | | |
| Revenues | | | | |
| Licenses and permits | \$ 575 | \$ 575 | \$ 1,601 | \$ 1,026 |
| Intergovernmental | 22,241 | 22,241 | 23,724 | 1,483 |
| Charges for services | 52,000 | 52,000 | 20,588 | (31,412) |
| Miscellaneous | 704,400 | 704,400 | 727,472 | 23,072 |
| Total Revenues | \$ 779,216 | \$ 779,216 | \$ 773,385 | \$ (5,831) |
| Expenditures | | | | |
| Current | | | | |
| Conservation of natural resources | | | | |
| Land use | \$ 745,617 | \$ 745,617 | \$ 728,148 | \$ 17,469 |
| Capital outlay | | | | |
| Conservation of natural resources | 48,000 | 48,000 | 13,928 | 34,072 |
| Total Expenditures | \$ 793,617 | \$ 793,617 | \$ 742,076 | \$ 51,541 |
| Excess of Revenues Over (Under) Expenditures | \$ (14,401) | \$ (14,401) | \$ 31,309 | \$ 45,710 |
| Other Financing Sources (Uses) | | | | |
| Transfers in | \$ 70,000 | \$ 70,000 | \$ - | \$ (70,000) |
| Transfers out | - | - | (104,157) | (104,157) |
| Total Other Financing Sources (Uses) | \$ 70,000 | \$ 70,000 | \$ (104,157) | \$ (174,157) |
| Net Change in Fund Balance | \$ 55,599 | \$ 55,599 | \$ (72,848) | \$ (128,447) |
| Fund Balance - January 1 | 306,536 | 306,536 | 306,536 | - |
| Fund Balance - December 31 | \$ 362,135 | \$ 362,135 | \$ 233,688 | \$ (128,447) |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 5

**BUDGETARY COMPARISON SCHEDULE
RESOURCE DEVELOPMENT SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | Budgeted Amounts | | Actual Amounts | Variance with Final Budget |
|---|---------------------|---------------------|-----------------------|-------------------------------|
| | Original | Final | | |
| Revenues | | | | |
| Intergovernmental | \$ 75,000 | \$ 75,000 | \$ 80,225 | \$ 5,225 |
| Expenditures | | | | |
| Current | | | | |
| Conservation of natural resources | | | | |
| Forestry | \$ 70,000 | \$ 70,000 | \$ 9,011 | \$ 60,989 |
| Other | - | - | 2,880 | (2,880) |
| Capital outlay | | | | |
| Conservation of natural resources | - | - | 2,221,501 | (2,221,501) |
| Debt service | | | | |
| Principal | 158,915 | 158,915 | 151,048 | 7,867 |
| Interest | 29,854 | 29,854 | 29,854 | - |
| Total Expenditures | \$ 258,769 | \$ 258,769 | \$ 2,414,294 | \$ (2,155,525) |
| Excess of Revenues Over (Under) Expenditures | \$ (183,769) | \$ (183,769) | \$ (2,334,069) | \$ (2,150,300) |
| Other Financing Sources (Uses) | | | | |
| Transfers in | \$ - | \$ - | \$ 104,157 | \$ 104,157 |
| Proceeds from capital lease | - | - | 2,200,000 | 2,200,000 |
| Total Other Financing Sources (Uses) | \$ - | \$ - | \$ 2,304,157 | \$ 2,304,157 |
| Net Change in Fund Balance | \$ (183,769) | \$ (183,769) | \$ (29,912) | \$ 153,857 |
| Fund Balance - January 1 | 520,033 | 520,033 | 520,033 | - |
| Fund Balance - December 31 | \$ 336,264 | \$ 336,264 | \$ 490,121 | \$ 153,857 |

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED DECEMBER 31, 2006**

1. Budgetary Information

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

In July of each year, all departments and agencies submit requests for appropriations to the County Auditor/Treasurer so that a budget can be prepared. Before September 15, the proposed budget is presented to the County Board for review. A final budget is adopted by the Board and certified to the Auditor/Treasurer by December 28.

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

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

2. Excess of Expenditures Over Appropriations

For the year ended December 31, 2006, expenditures exceeded appropriations in the following funds:

| | |
|---|------------|
| General Fund | \$ 804,377 |
| Resource Development Special Revenue Fund | 2,155,525 |

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SUPPLEMENTARY INFORMATION

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

NONMAJOR GOVERNMENTAL FUNDS

The Economic Development Special Revenue Fund is used to account for intergovernmental revenue used to finance various economic development projects.

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

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

The Capital Improvements Capital Projects Fund is used to account for financial resources used for the construction of a new human services building.

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Statement 1

**COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
DECEMBER 31, 2006**

| | Special Revenue (Statement 3) | Debt Service | Capital Projects | Total Nonmajor Governmental Funds |
|---|--|-------------------------|-----------------------------|--|
| <u>Assets</u> | | | | |
| Cash and pooled investments | \$ 202,344 | \$ 219,695 | \$ 939,092 | \$ 1,361,131 |
| Undistributed cash in agency funds | 2,880 | 15,169 | - | 18,049 |
| Taxes receivable | | | | |
| Prior | 2,511 | 12,640 | - | 15,151 |
| Due from other funds | - | 38,046 | 1,385 | 39,431 |
| Due from component unit | - | 887,928 | - | 887,928 |
| Loans receivable | 69,600 | 295,000 | - | 364,600 |
| | \$ 277,335 | \$ 1,468,478 | \$ 940,477 | \$ 2,686,290 |
| <u>Liabilities and Fund Balances</u> | | | | |
| Liabilities | | | | |
| Contracts payable | \$ - | \$ - | \$ 25,703 | \$ 25,703 |
| Due to other funds | - | 107,473 | - | 107,473 |
| Due to other governments | 53,102 | - | - | 53,102 |
| Due to component unit | - | 5,525 | - | 5,525 |
| Deferred revenue - unavailable | 1,972 | 304,803 | - | 306,775 |
| | \$ 55,074 | \$ 417,801 | \$ 25,703 | \$ 498,578 |
| Fund Balances | | | | |
| Reserved for loans receivable | \$ 69,600 | \$ - | \$ - | \$ 69,600 |
| Unreserved | | | | |
| Designated for debt service | - | 1,050,677 | - | 1,050,677 |
| Undesignated | 152,661 | - | 914,774 | 1,067,435 |
| | \$ 222,261 | \$ 1,050,677 | \$ 914,774 | \$ 2,187,712 |
| Total Liabilities and Fund Balances | \$ 277,335 | \$ 1,468,478 | \$ 940,477 | \$ 2,686,290 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Statement 2

**COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
NONMAJOR GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | Special Revenue (Statement 4) | Debt Service | Capital Projects | Total Nonmajor Governmental Funds |
|---|-------------------------------------|---------------------|-----------------------|--|
| Revenues | | | | |
| Taxes | \$ 73,967 | \$ 552,786 | \$ - | \$ 626,753 |
| Licenses and permits | 83 | - | - | 83 |
| Intergovernmental | 14,460 | 280,884 | - | 295,344 |
| Investment earnings | - | 79,747 | - | 79,747 |
| Miscellaneous | 17,664 | 190,455 | - | 208,119 |
| Total Revenues | \$ 106,174 | \$ 1,103,872 | \$ - | \$ 1,210,046 |
| Expenditures | | | | |
| Current | | | | |
| General government | \$ 6,366 | \$ - | \$ - | \$ 6,366 |
| Public safety | 63,502 | - | - | 63,502 |
| Intergovernmental | - | 156,530 | - | 156,530 |
| Capital outlay | - | - | 1,252,222 | 1,252,222 |
| Debt service | | | | |
| Principal | - | 470,000 | - | 470,000 |
| Interest | - | 152,590 | - | 152,590 |
| Bond issuance costs | - | 402 | - | 402 |
| Administrative (fiscal) charges | - | 5,035 | - | 5,035 |
| Total Expenditures | \$ 69,868 | \$ 784,557 | \$ 1,252,222 | \$ 2,106,647 |
| Excess of Revenues Over (Under) Expenditures | \$ 36,306 | \$ 319,315 | \$ (1,252,222) | \$ (896,601) |
| Other Financing Sources (Uses) | | | | |
| Transfers in | \$ - | \$ - | \$ 604 | \$ 604 |
| Transfers out | - | - | (150,000) | (150,000) |
| Total Other Financing Sources (Uses) | \$ - | \$ - | \$ (149,396) | \$ (149,396) |
| Net Change in Fund Balance | \$ 36,306 | \$ 319,315 | \$ (1,401,618) | \$ (1,045,997) |
| Fund Balance - January 1 | 185,955 | 731,362 | 2,316,392 | 3,233,709 |
| Fund Balance - December 31 | \$ 222,261 | \$ 1,050,677 | \$ 914,774 | \$ 2,187,712 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Statement 3

**COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS
DECEMBER 31, 2006**

| | Economic Development | Unorganized Townships | Total |
|---|---------------------------------|----------------------------------|-------------------|
| <u>Assets</u> | | | |
| Cash and pooled investments | \$ 42,488 | \$ 159,856 | \$ 202,344 |
| Undistributed cash in agency funds | - | 2,880 | 2,880 |
| Taxes receivable | | | |
| Prior | - | 2,511 | 2,511 |
| Loans receivable | 69,600 | - | 69,600 |
| Total Assets | \$ 112,088 | \$ 165,247 | \$ 277,335 |
| <u>Liabilities and Fund Balances</u> | | | |
| Liabilities | | | |
| Due to other governments | \$ - | \$ 53,102 | \$ 53,102 |
| Deferred revenue - unavailable | - | 1,972 | 1,972 |
| Total Liabilities | \$ - | \$ 55,074 | \$ 55,074 |
| Fund Balances | | | |
| Reserved for loans receivable | \$ 69,600 | \$ - | \$ 69,600 |
| Undesignated | 42,488 | 110,173 | 152,661 |
| Total Fund Balances | \$ 112,088 | \$ 110,173 | \$ 222,261 |
| Total Liabilities and Fund Balances | \$ 112,088 | \$ 165,247 | \$ 277,335 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Statement 4

**COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | Economic Development | Unorganized Townships | Total |
|-----------------------------------|---------------------------------|----------------------------------|-------------------|
| Revenues | | | |
| Taxes | \$ - | \$ 73,967 | \$ 73,967 |
| Licenses and permits | - | 83 | 83 |
| Intergovernmental | - | 14,460 | 14,460 |
| Miscellaneous | 17,664 | - | 17,664 |
| | \$ 17,664 | \$ 88,510 | \$ 106,174 |
| Expenditures | | | |
| Current | | | |
| General government | \$ - | \$ 6,366 | \$ 6,366 |
| Public safety | - | 63,502 | 63,502 |
| | \$ - | \$ 69,868 | \$ 69,868 |
| Net Change in Fund Balance | \$ 17,664 | \$ 18,642 | \$ 36,306 |
| Fund Balance - January 1 | 94,424 | 91,531 | 185,955 |
| Fund Balance - December 31 | \$ 112,088 | \$ 110,173 | \$ 222,261 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 6

**BUDGETARY COMPARISON SCHEDULE
ECONOMIC DEVELOPMENT SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | <u>Budgeted Amounts</u> | | <u>Actual Amounts</u> | <u>Variance with Final Budget</u> |
|-----------------------------------|-------------------------|-------------------|---------------------------|---------------------------------------|
| | <u>Original</u> | <u>Final</u> | | |
| Revenues | | | | |
| Miscellaneous | \$ 6,492 | \$ 6,492 | \$ 17,664 | \$ 11,172 |
| Net Change in Fund Balance | \$ 6,492 | \$ 6,492 | \$ 17,664 | \$ 11,172 |
| Fund Balance - January 1 | 94,424 | 94,424 | 94,424 | - |
| Fund Balance - December 31 | <u>\$ 100,916</u> | <u>\$ 100,916</u> | <u>\$ 112,088</u> | <u>\$ 11,172</u> |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 7

**BUDGETARY COMPARISON SCHEDULE
UNORGANIZED TOWNSHIPS SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | Budgeted Amounts | | Actual Amounts | Variance with Final Budget |
|-----------------------------------|-------------------|-------------------|-------------------|-------------------------------|
| | Original | Final | | |
| Revenues | | | | |
| Taxes | \$ 87,405 | \$ 87,405 | \$ 73,967 | \$ (13,438) |
| Licenses and permits | 195 | 195 | 83 | (112) |
| Intergovernmental | - | - | 14,460 | 14,460 |
| Total Revenues | \$ 87,600 | \$ 87,600 | \$ 88,510 | \$ 910 |
| Expenditures | | | | |
| Current | | | | |
| General government | | | | |
| Elections | \$ 6,300 | \$ 6,300 | \$ 6,366 | \$ (66) |
| Public safety | | | | |
| Emergency services | 82,500 | 82,500 | 63,502 | 18,998 |
| Total Expenditures | \$ 88,800 | \$ 88,800 | \$ 69,868 | \$ 18,932 |
| Net Change in Fund Balance | \$ (1,200) | \$ (1,200) | \$ 18,642 | \$ 19,842 |
| Fund Balance - January 1 | 91,531 | 91,531 | 91,531 | - |
| Fund Balance - December 31 | \$ 90,331 | \$ 90,331 | \$ 110,173 | \$ 19,842 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 8

**BUDGETARY COMPARISON SCHEDULE
DEBT SERVICE FUND
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | Budgeted Amounts | | Actual Amounts | Variance with Final Budget |
|-----------------------------------|---------------------|---------------------|---------------------|-------------------------------|
| | Original | Final | | |
| Revenues | | | | |
| Taxes | \$ 703,444 | \$ 703,444 | \$ 552,786 | \$ (150,658) |
| Intergovernmental | 132,465 | 132,465 | 280,884 | 148,419 |
| Investment earnings | 2,000 | 2,000 | 79,747 | 77,747 |
| Miscellaneous | 191,415 | 191,415 | 190,455 | (960) |
| Total Revenues | \$ 1,029,324 | \$ 1,029,324 | \$ 1,103,872 | \$ 74,548 |
| Expenditures | | | | |
| Intergovernmental | | | | |
| General government | \$ 156,530 | \$ 156,530 | \$ 156,530 | \$ - |
| Debt service | | | | |
| Principal | 470,000 | 470,000 | 470,000 | - |
| Interest | 156,773 | 156,773 | 152,590 | 4,183 |
| Bond issuance costs | - | - | 402 | (402) |
| Administrative (fiscal) charges | 5,000 | 5,000 | 5,035 | (35) |
| Total Expenditures | \$ 788,303 | \$ 788,303 | \$ 784,557 | \$ 3,746 |
| Net Change in Fund Balance | \$ 241,021 | \$ 241,021 | \$ 319,315 | \$ 78,294 |
| Fund Balance - January 1 | 731,362 | 731,362 | 731,362 | - |
| Fund Balance - December 31 | \$ 972,383 | \$ 972,383 | \$ 1,050,677 | \$ 78,294 |

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FIDUCIARY FUNDS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Statement 5

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | Balance January 1 | Additions | Deductions | Balance December 31 |
|---|----------------------|----------------------|----------------------|------------------------|
| <u>CITIES, TOWNS AND OTHER GOVERNMENTS</u> | | | | |
| <u>Assets</u> | | | | |
| Cash and pooled investments | \$ 144,975 | \$ 7,848,646 | \$ 7,991,806 | \$ 1,815 |
| <u>Liabilities</u> | | | | |
| Due to other governments | \$ 144,975 | \$ 7,848,646 | \$ 7,991,806 | \$ 1,815 |
| <u>TAXES AND PENALTIES</u> | | | | |
| <u>Assets</u> | | | | |
| Cash and pooled investments | \$ 301,354 | \$ 12,647,160 | \$ 12,654,468 | \$ 294,046 |
| <u>Liabilities</u> | | | | |
| Taxes collected in advance | \$ 11,148 | \$ 5,329 | \$ 11,148 | \$ 5,329 |
| Due to other governments | 290,206 | 12,641,831 | 12,643,320 | 288,717 |
| Total Liabilities | \$ 301,354 | \$ 12,647,160 | \$ 12,654,468 | \$ 294,046 |
| <u>STATE</u> | | | | |
| <u>Assets</u> | | | | |
| Cash and pooled investments | \$ 38,320 | \$ 366,369 | \$ 327,426 | \$ 77,263 |
| <u>Liabilities</u> | | | | |
| Due to other governments | \$ 38,320 | \$ 366,369 | \$ 327,426 | \$ 77,263 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

*Statement 5
(Continued)*

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2006**

| | Balance January 1 | Additions | Deductions | Balance December 31 |
|---|----------------------|----------------------|----------------------|------------------------|
| <u>SEWER SYSTEM DEPOSITS</u> | | | | |
| <u>Assets</u> | | | | |
| Cash and pooled investments | \$ 74,965 | \$ 24,625 | \$ 12,500 | \$ 87,090 |
| <u>Liabilities</u> | | | | |
| Customer deposits - current | \$ 74,965 | \$ 24,625 | \$ 12,500 | \$ 87,090 |
| <u>NORTH SHORE COLLABORATIVE</u> | | | | |
| <u>Assets</u> | | | | |
| Cash and pooled investments | \$ 436,402 | \$ 159,796 | \$ 259,842 | \$ 336,356 |
| <u>Liabilities</u> | | | | |
| Accounts payable | \$ 436,402 | \$ 159,796 | \$ 259,842 | \$ 336,356 |
| <u>TOTAL ALL AGENCY FUNDS</u> | | | | |
| <u>Assets</u> | | | | |
| Cash and pooled investments | \$ 996,016 | \$ 21,046,596 | \$ 21,246,042 | \$ 796,570 |
| <u>Liabilities</u> | | | | |
| Accounts payable | \$ 436,402 | \$ 159,796 | \$ 259,842 | \$ 336,356 |
| Taxes collected in advance | 11,148 | 5,329 | 11,148 | 5,329 |
| Due to other governments | 473,501 | 20,856,846 | 20,962,552 | 367,795 |
| Customer deposits - current | 74,965 | 24,625 | 12,500 | 87,090 |
| Total Liabilities | \$ 996,016 | \$ 21,046,596 | \$ 21,246,042 | \$ 796,570 |

OTHER SCHEDULE

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 9

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Shared Revenue

State

| | | |
|-------------------------|----|-----------|
| Highway users tax | \$ | 1,843,122 |
| County program aid | | 632,632 |
| PERA rate reimbursement | | 24,475 |
| Disparity reduction aid | | 165,581 |
| Police aid | | 74,559 |
| Taconite credit | | 595,580 |
| Enhanced 911 | | 83,603 |
| Market value credit aid | | 490,380 |
| | | 490,380 |

Total Shared Revenue **\$ 3,909,932**

Reimbursement for Services

State

| | | |
|--|----|---------|
| Minnesota Department of Human Services | \$ | 786,079 |
| | | 786,079 |

Payments

State

| | | |
|---------------------------|----|---------|
| Payments in lieu of taxes | \$ | 493,944 |
|---------------------------|----|---------|

Local

| | | |
|-------|--|---------|
| Other | | 189,608 |
| | | 189,608 |

Total Payments **\$ 683,552**

Grants

State

| | | |
|------------------------------------|----|-----------|
| Minnesota Department of | | |
| Public Safety | \$ | 38,026 |
| Transportation | | 466,357 |
| Health | | 67,450 |
| Natural Resources | | 246,932 |
| Human Services | | 1,080,795 |
| Water and Soil Resources Board | | 96,675 |
| Office of Environmental Assistance | | 122,698 |
| Miscellaneous boards | | 4,703 |
| | | 4,703 |

Total State **\$ 2,123,636**

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 9
(Continued)

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Grants (Continued)

Federal

| | |
|---------------------------------|--------------|
| Department of | |
| Agriculture | \$ 1,136,872 |
| Commerce | 68,000 |
| Interior | 147,181 |
| Justice | 15,883 |
| Transportation | 852,566 |
| Health and Human Services | 220,595 |
| Homeland Security | 16,518 |
| Environmental Protection Agency | 9,133 |
| Elections Assistance Commission | 180,000 |

Total Federal **\$ 2,646,748**

Total State and Federal Grants **\$ 4,770,384**

Total Intergovernmental Revenue **\$ 10,149,947**

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 10

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2006**

I. SUMMARY OF AUDITOR'S RESULTS

- A. Our report expresses unqualified opinions on the basic financial statements of Lake County.
- B. Significant deficiencies in internal control were disclosed by the audit of financial statements of Lake 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*." One of the significant deficiencies is a material weakness.
- C. No instances of noncompliance material to the financial statements of Lake County were disclosed during the audit.
- D. No matters involving internal control over compliance relating to the audit of the major federal award programs 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 programs for Lake County expresses an unqualified opinion.
- F. No findings were disclosed that are required to be reported by Section 510(a) of Office of Management and Budget (OMB) Circular A-133.
- G. The major programs are:

| | |
|-----------------------------------|--------------|
| Highway Planning and Construction | CFDA #20.205 |
| Help America Vote Act | CFDA #90.401 |
- H. The threshold for distinguishing between Types A and B programs was \$300,000.
- I. Lake County was 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

96-11 Segregation of Duties

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. The following duties should be segregated if possible:

- Someone independent of the cash collection and receipting function and the cash disbursement function should prepare bank reconciliations. If this is not possible, someone independent of these functions should review the bank reconciliations.
- Individuals who collect and receipt cash should not also:
 - post cash receipts to the general ledger system,
 - process cash disbursements,
 - maintain the general ledger,
 - make bank deposits,
 - make wire transfers,
 - make general journal entries, or
 - prepare billings.
- Individuals who process vouchers for payments should not also:
 - print or sign checks or
 - make journal entries.

Lake County does not segregate the duties of cash collection and receipting from posting receipts to the general ledger system, processing cash disbursements, or making bank deposits. Also, the same person who processes cash disbursements has the ability to print and sign checks. In addition, bank reconciliations are prepared by the same person who performs most of the cash disbursement functions and also does some cash receipting. At the department level, many of these functions are also not segregated.

We recommend the County Board segregate these functions as much as possible. If it is not possible to segregate these duties, Lake County management should be aware of the lack of segregation of the accounting functions and implement oversight procedures to ensure that the internal control policies and procedures are being performed by staff. One possible oversight procedure is to distribute detailed monthly revenue and expenditure reports to department heads and require them to affirm they have reviewed the reports and concur with the revenues and expenditures reported for their department.

Client's Response:

The Auditor/Treasurer will review these functions with staff and reassign various duties when possible.

03-2 Capital Assets

For financial reporting and asset management purposes, the County is required to keep records of its capital assets, including infrastructure. The County maintains its capital asset records on a separate capital asset software system called Assetkeeper. Capital asset additions and deletions are entered into this system, and depreciation is calculated by the system. Capital asset policies utilized by the County in maintaining the capital asset system have not been formally approved by the County Board. A capital assets policy should be adopted which defines the County's accounting policies over capital assets, such as capitalization thresholds, useful lives, and depreciation methods.

The County also does not have policies and procedures in place to identify capital asset additions and deletions for entry into Assetkeeper. County staff generally identify capital asset additions by reviewing capital expenditure accounts at year-end and determining which assets to capitalize. There is no procedure in place to identify asset disposals. The Assetkeeper system will need to be maintained on a current basis. Procedures should be established on how purchases and disposals of capital assets will be identified by department heads and how the information will be transmitted to the person responsible for maintaining the Assetkeeper system. Also, a physical inventory of capital assets has not been done since the capital asset records were initially established in 2003.

We recommend the County Board establish a capital assets policy to define the accounting policies for capital assets. The policy should establish procedures to identify capital asset additions and deletions. Department heads should report capital asset additions and deletions to the person maintaining Assetkeeper at least 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 inventoried at least once every five years. Some critical capital assets may need to be inventoried more frequently.

Client's Response:

The Board will attempt to develop policies and procedures for capital assets and discuss the process of doing a physical inventory.

03-4 Preparation of Financial Statements

The County is required to prepare financial statements in accordance with generally accepted accounting principles (GAAP). The preparation of the financial statements is the responsibility of the County's management. Financial statement preparation in accordance with GAAP requires internal controls over both: (1) recording, processing, and summarizing accounting data (maintaining internal books and records); and (2) preparing and reporting appropriate government-wide and fund financial statements, including the related notes to the financial statements.

As is the case with many small and medium-sized entities, the County has 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. Accordingly, the County's ability to prepare financial statements in accordance with GAAP is based, at least in part, on its reliance on its external auditors, who cannot by definition be considered part of the government's internal control. This condition was caused by the County's decision that it is more cost effective to have its auditors prepare its annual basic financial statements than to incur the time and expense of obtaining the necessary training and expertise required to prepare the financial statements internally. As a result of this condition, the government lacks internal control over the preparation of financial statements in accordance with GAAP.

We recommend the County obtain the training and expertise to internally prepare its annual financial statements in accordance with GAAP. If the County still intends to have the staff of the Office of the State Auditor assist in preparation then, at a minimum, they must identify and train individuals to obtain the expertise that can sufficiently review, understand, and approve the County's financial statements, including notes. As an alternative, the County could consider hiring an outside consultant to assist in preparing its basic financial statements.

Client's Response:

The County has just established a new position of financial coordinator in the Auditor/Treasurer's Office. It is intended that this position will work with the State Auditor's Office to prepare financial statements.

05-1 Duplicate Check Numbers

During our prior year disbursement testing, we noted that County Auditor/Treasurer's staff issued checks using check numbers that had been previously issued. This occurred on numerous occasions and involved duplication of hundreds of check numbers. During our current audit, we still noted at least one occasion where duplicate check numbers were issued.

Duplicate check numbers make reconciling the bank account very difficult. Bank reconciliation is a key internal control in environments where segregation of duties is limited.

We recommend the County Auditor/Treasurer develop procedures for staff to follow when issuing checks that will ensure that duplicate check numbers are not issued. The computer system should produce a warning when checks are about to be run if the check numbers have been previously issued. This warning should be evaluated before overriding that control.

Client's Response:

The County Auditor/Treasurer has reviewed this matter with staff and has stressed the importance of not issuing checks with duplicate numbers.

ITEMS ARISING THIS YEAR

06-1 Journal Entries

Lake County limits access to the journal entry function on the Integrated Financial System (IFS) to select County employees. At the time of our review, 11 County employees had access to this function. Most journal entries are made by the Financial Coordinator and the Human Services Accountant. The journal entries made by these employees are not reviewed or approved by anyone else.

The ability to make journal entries on the IFS general ledger system is a powerful function. It allows those employees with access to the journal entry function to make changes to the general ledger system. To prevent abuse of this function, it should be limited to those employees who have a logical need for this access. Also needed is a procedure for review and approval of the journal entries made.

We recommend the County Auditor/Treasurer review the access to the journal entry function to determine if there is a logical need for that access for all employees who have access. We also recommend a procedure be established to require review and approval of journal entries by someone other than the person making the journal entries. This person should obtain an understanding of the journal entry and its purpose before approval. The approval could be documented by signature on a journal entry form or a printed copy of the journal entry made. Supporting documentation or sufficient explanation should be attached to or included on the journal entry to explain why the journal entry is being made and who is making the journal entry. Journal entries should be filed in a manner that allows for their review should questions arise. A report should be generated from the IFS system that lists all journal entries made. The person charged with review and approval of journal entries should periodically review this report. Review of this report would be to ensure that no journal entries have been made which have not been submitted for review and approval.

Client's Response:

The County Auditor/Treasurer will review, with the Human Service Director, who has authority to make journal entries in IFS. They will also attempt to develop procedures to review journal entries.

06-2 Budgeting

The Lake County Board has adopted resolutions which establish the legal level of budgetary control and the budgetary basis; however, there has been no comprehensive budget policy adopted by the County Board. A formal written budget policy should include policies such as:

- which funds require budgets,
- the legal level of control,
- when budgets can be modified by management and when budget modifications require Board approval,

- the budgetary basis on which the budget is adopted, and
- the procedures for monitoring the budget.

After the budget is adopted by the County Board, it is entered into the IFS by the Lake County Auditor/Treasurer. Budget amendments are generally initiated by the Auditor/Treasurer when he receives information that expenditures have been approved that were previously unbudgeted. At that time, he will send a budget resolution to the County Board. These amendments are usually for capital outlay expenditures. The County Auditor/Treasurer enters approved budget amendments into the IFS.

Lake County does not have a budget policy that addresses when the budget should be amended or which budget changes should be brought before the Board and which budget changes can be made by management without Board approval. The County Board should adopt a policy and then approve budget amendments as required by their policy. Approved budget amendments should be entered to the IFS. Budget amendments allowed to be made by management under the policy should be tracked on budget amendment forms and should be entered into the IFS by a person independent of the budgeting process.

Lake County distributes semi-annual budget to actual reports to County department heads. However, the extent to which department heads review these reports is not known.

During the year, the County department heads should monitor the departmental budgets for which they are responsible. Monthly budget to actual reports should be distributed to each department head. Department heads should indicate their review of these reports by signature on the reports. The County Board should also monitor budgets periodically.

We recommend the County Board adopt a budget policy that includes the elements recommended above. After adoption, someone independent of the budget process should enter the original budget and budget amendments to the IFS. If required by the budget policy, the County Board should approve budget amendments. Management should properly document budget amendments that do not require County Board approval. Department heads and the County Board should monitor budgets on an ongoing basis. Reviewers should indicate their review of budget to actual reports by signing off on them.

Client's Response:

The County Board has discussed methods to better control and monitor budgets. The Board is looking at developing policies and processes to review current budgets.

06-3 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. Statement on Auditing Standards (SAS) No. 112 states that one control deficiency that shall be regarded as at least a significant deficiency is identification by the auditor of a material misstatement in the financial statements that was not initially identified by the entity's internal controls, even if management subsequently corrects the misstatement.

During our audit, we proposed numerous adjustments that resulted in significant changes to the County's financial statements. The County provides cash basis financial statements and prepares some of the modified accrual information necessary to adjust the cash basis financial statements to the modified accrual basis. However, County staff do not have the time nor the governmental accounting expertise to prepare all of the information necessary to provide accurate financial statements. Therefore, audit adjustments were necessary to record additional receivables and payables found during audit, record the fair value adjustment for cash and pooled investments, adjust fund balance reserves, adjust state-aid highway allotments, adjust timber receivables for uncollectible amounts, allocate unallocated revenues and expenditures, record capital leases, and to make reclassification entries as necessary. Audit adjustments were also necessary to adjust modified accrual financial statements to the accrual basis for the government-wide financial statements.

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

Client's Response:

It is the County's expectation the Financial Coordinator will be able to fulfill these recommendations.

06-4 Accounting Policies and Procedures Manual

The County does not have a current and comprehensive accounting policies and procedures manual. All governments should document their accounting policies and procedures. Although other methods might suffice, this documentation is traditionally in the form of an accounting policies and procedures manual. This manual should document the accounting policies and procedures which make up the County's internal control system.

An accounting policies and procedures manual will enhance employees' understanding of their role and function in the internal control system, establish responsibilities, provide guidance for employees, improve efficiency and consistency of transaction processing, and improve compliance with established policies. It can also help to prevent deterioration of key elements in the County's internal control system and can help to avoid circumvention of County policies.

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

Client's Response:

The Auditor/Treasurer will attempt to assemble information for the County Board to review on this issue.

06-5 Computer Risk Management

Lake County has internal controls in place for its computer system. As part of these internal controls, the County has developed policies on emergency recovery procedures, data backup procedures, password controls, and acceptable uses of technology resources. However, the policies have not been updated on an ongoing basis; and the County has no formal procedures to identify and manage risks associated with its computer system.

Risk management begins with a risk assessment of a county's computer system to identify those risks that could negatively influence computer operations. Internal controls should be implemented to reduce the identified risks. Internal controls implemented

should be documented in a well-maintained policies and procedures manual, which should be communicated to the County's staff. Staffs' adherence to these policies and procedures should be monitored. Because computer systems are ever changing, the County should include in its plan periodic reassessment of risk to ensure existing internal controls are still effective.

We recommend the County Board develop a plan to ensure that internal controls are in place to reduce the risk associated with the County's computer systems.

Client's Response:

The County Board will consult and review with department heads the current computer system internal controls.

06-6 New Vendors

Lake County does not have any procedures for determining if new vendors have been added to the accounts payable system or if the new vendors added are legitimate vendors.

The ability to set up new vendors on the accounts payable system should be limited to those individuals with a logical need for this function. In addition, periodically, a report listing active vendors should be printed and reviewed by someone independent of the accounts payable system. That person should document the review by signing off on the report.

Also, when invoices are submitted for vendors that have not previously done business with the County, some procedures should be required to verify whether the vendor is legitimate. Procedures could include looking up the vendor in the phone book or on the internet or requiring the company to send information about their business. Periodically, the vendor listing should be reviewed for old, unused vendors and those vendors should be removed from the system.

Client's Response:

The Auditor/Treasurer will consult with the Human Services Director and attempt to review current procedures and develop new procedures if necessary.

06-7 Payroll

In Lake County, authorization for payroll changes such as new hires, promotions, and step increases, is initiated in the personnel office. Notification of the changes to be made is sent to the payroll department. In the payroll department, the financial coordinator inputs the changes into the master file of the payroll system and subsequently checks payroll edit reports to make sure the changes went into the system properly.

After the financial coordinator clears the payroll edit reports, she runs the final payroll reports and payroll checks. No one independent of the payroll function reviews the checks or payroll reports to determine that all payments were made to actual employees and the hours worked appear to be correct. The financial coordinator also has the ability to make journal entries on the general ledger.

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

Client's Response:

The Auditor/Treasurer will review this recommendation. With recent position changes within the office, it may be possible for an independent staff member to review the payroll edits before final payroll processing.

06-8 Service Organization

Under the County's health insurance plan, Lake County is self insured for the first \$1,000 of claims under single coverage and the first \$2,000 of claims under family coverage for each employee. The County has contracted with a claims administrator to process the health insurance claims for which the County is responsible. The claims administrator processes the claims on behalf of the County and, as such, is operating as a service organization for the County.

A service organization should have an internal control system in place to assure that all claims paid on the County's behalf are, in fact, claims which are properly chargeable to Lake County. Many service organizations obtain an audit which covers the internal controls over the transactions it processes for other organizations. This is commonly

called an SAS 70 audit. The County's claims administrator has not obtained a service organization (SAS 70) audit covering its internal controls, nor has the organization provided any substantive information about its internal control procedures which would allow the County to evaluate whether its controls are adequate. Because of federal privacy regulations, the claims administrator is not able to provide the County with the names of the individuals for which the claims are being paid. This limits the amount of compensating controls the County can establish for determining whether the claims paid are proper. The total claims paid by the claims administrator in 2006 were approximately \$332,000.

We recommend the County Board take action to determine that the claims administrator has an adequate internal control structure in place to assure the County that its funds are being properly spent.

Client's Response

The County Board is currently looking at replacing the current health insurance plans and the current claims administrator would be replaced. The Auditor/Treasurer has been aware of this control flaw since 2005 and has expressed his concerns to the County Board.

06-9 Inventory

The Road and Bridge inventory at Lake County is on a perpetual inventory system. Inventory purchases are entered to the inventory system from vendor invoices, and usage slips are used to enter usage into the system. However, the perpetual inventory system has not been updated on a monthly basis. At the time of our audit, Lake County was five months behind in updating the perpetual inventory system.

Access to inventory is generally limited to two garage mechanics who are in charge of inventory distribution. However, inventory is not locked up; and sometimes access to inventory is uncontrolled when the garage mechanics are not present.

We recommend the County update the perpetual inventory system on a monthly basis for purchases and usage to better control management of inventory stock. Access to inventory should be limited, if possible. When one person is in charge of issuing inventory, usage is more likely to be recorded, and the perpetual inventory system will be more accurate.

Client's Response:

The Lake County Road and Bridge Department is aware of the inventory situation. The ability to update inventory on a current basis and the ability to have a more controlled inventory area are not feasible given the current level of staffing and facilities.

06-10 SSIS Segregation of Duties

In October 2006, the Lake County Human Services Department implemented the Minnesota Department of Human Services (DHS) newly-issued Social Service Information System Fiscal Payment (SSIS) software module. The County uses this module to pay vendors providing services to the various social service programs.

The software allows the County's SSIS system administrator flexibility in assigning staff access to the software. One basic objective of internal control is to provide for segregation of incompatible duties so that no single individual could establish a vendor, authorize a transaction, record the transaction, and obtain custody of the asset resulting from the transaction. The size of a department and the number of staff sometimes limit the application of adequate segregation of duties. County management must perform a risk assessment to determine if incompatible access exists that affects the internal control over the SSIS system. When it is not possible to limit an employee's incompatible access, mitigating controls should be implemented, such as independent review, to ensure that transactions are authorized and appropriate.

Lake County management has not performed a risk assessment to determine if incompatible access exists since initially assigning staff access to the SSIS system.

We recommend that Lake County management review staff's access to the SSIS system and identify those with incompatible or inappropriate access. If assigning incompatible access is unavoidable, management should develop appropriate mitigating controls to minimize the risk of undetected errors or fraud.

Client's Response:

In response to the audit recommendation, Lake County Human Services recently performed a risk assessment and evaluated the assigned roles based on recommended roles from the Department of Human Services. We have determined that incompatible access does not exist regarding assigned staff access to the SSIS system. Lake County Human Services does not have a single individual that could establish a vendor, authorize a transaction, record a transaction, and obtain custody of the asset resulting from the transaction.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

None.

IV. OTHER FINDINGS AND RECOMMENDATIONS

A. MINNESOTA LEGAL COMPLIANCE

ITEM ARISING THIS YEAR

06-11 Publishing of Financial Statements

Lake County did not publish its 2005 financial statements in the designated newspaper as required by Minn. Stat. § 375.17. Minn. Stat. § 375.17 requires that the County publish its financial statements or its summary in a duly qualified legal newspaper in the County.

We recommend the County Auditor/Treasurer publish the financial statements annually as required by Minn. Stat. § 375.17.

Client's Response:

The Auditor/Treasurer will publish the financial statements.

PREVIOUSLY REPORTED ITEM RESOLVED

Bidding (04-1)

In 2005, the County Board purchased an ambulance for the Lake County Ambulance Service. The County did not advertise for bids for this purchase as required by Minn. Stat. §§ 471.345 and 375.21.

Resolution

In the current audit, all contracts tested for bidding requirements were properly advertised for sealed bids.

B. MANAGEMENT PRACTICES

PREVIOUSLY REPORTED ITEM NOT RESOLVED

96-16 Purchasing Policy

The County Board has not adopted a formal purchasing policy establishing procedures regarding the County's purchasing function. A purchasing policy would help staff responsible for purchasing to know what guidelines need to be followed.

We recommend the County Board adopt a formal purchasing policy.

Client's Response:

The Board will attempt to develop and adopt a formal purchasing policy.

C. OTHER ITEM FOR CONSIDERATION

Other Postemployment Benefits (OPEB)

The Governmental Accounting Standards Board (GASB) recently issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes financial reporting for OPEB plans, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which governs employer accounting and financial reporting for OPEB. These standards, similar to what GASB Statements 25 and 27 did for government employee pension benefits and plans, provide the accounting and reporting standards for the various other postemployment benefits 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 statements, accounting for OPEB is now similar to the accounting used by governments for pension plans.

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

- determine if the 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 wait until legislation is enacted authorizing the creation of an OPEB trust and establishing an applicable investment standard; 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.

If applicable for Lake County, GASB Statements No. 43 and No. 45 would be implemented for the years ended December 31, 2007 and 2008, respectively.

OTHER REQUIRED REPORTS

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

Board of County Commissioners
Lake County

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lake County as of and for the year ended December 31, 2006, and have issued our report thereon dated September 28, 2007. The financial statements include the Nursing Home Enterprise Fund as of and for the year ended September 30, 2006. 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 Lake County's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in 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 96-11, 03-2, 03-4, 05-1, and 06-1 through 06-10 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 the 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, of the significant deficiencies described above, we consider item 06-3 to be a material weakness.

Compliance and Other Matters

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

Minnesota Legal Compliance

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for 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, Lake County complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Questioned Costs as item 06-11.

Also included in the Schedule of Findings and Questioned Costs is a management practices comment and an other item for consideration. We believe this recommendation and information to be of benefit to Lake County and are reporting it for that purpose.

Lake County's written responses to the significant deficiencies, material weakness, legal compliance, and management practices findings identified in our audit have not been subjected to any auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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

/s/Rebecca Otto

/s/Greg Hierlinger

REBECCA OTTO
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

September 28, 2007

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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
Lake County

Compliance

We have audited the compliance of Lake 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 each of its major federal programs for the year ended December 31, 2006. Lake County's major federal programs are identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the County's management. Our responsibility is to express an opinion on the County's compliance based on our audit.

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

In our opinion, Lake County complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended December 31, 2006.

Internal Control Over Compliance

The management of Lake County is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the County's internal control over compliance with requirements that could have a direct and material effect on a major federal program 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 Lake 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 business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lake County as of and for the year ended December 31, 2006, and have issued our report thereon dated September 28, 2007. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise 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 and others within the County, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

September 28, 2007

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 11

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2006**

| Federal Grantor Pass-Through Agency Grant Program Title | Pass-Through Grant Numbers | Federal CFDA Number | Expenditures |
|---|--|------------------------------------|---------------------|
| U.S. Department of Agriculture | | | |
| Direct | | | |
| U.S. Forest Service Cooperative Agreement | | R9-9-95-35B | \$ 27,000 |
| Passed Through Carlton, Cook, Lake, and St. Louis Community Health Board | | | |
| Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) | | 10.557 | 29,708 |
| Passed Through Minnesota Department of Human Services | | | |
| Matching Grant for Food Stamp Program | | 10.561 | 3,233 |
| Passed Through Minnesota Department of Finance | | | |
| National Forest Lands - 25% Payments to States | | 10.665 | 189,681 |
| National Forest Lands - 3/4 of 1% | | 10.668 | 887,250 |
| | | | <u>1,136,872</u> |
| Total U.S. Department of Agriculture | | | |
| | | | <u>\$ 1,136,872</u> |
| U.S. Department of Commerce | | | |
| Passed Through Minnesota Department of Natural Resources | | | |
| Coastal Zone Management Administration Award | 306-A-06-07 | 11.419 | <u>\$ 68,000</u> |
| U.S. Department of the Interior | | | |
| Direct | | | |
| Payments in Lieu of Taxes | | 15.226 | <u>\$ 147,181</u> |
| U.S. Department of Justice | | | |
| Passed Through Minnesota Department of Public Safety | | | |
| Crime Victim Assistance Grant | CVS-00066/9900-1615 | 16.575 | \$ 15,343 |
| Enforcing Underage Drinking Laws | | 16.727 | 540 |
| | | | <u>15,883</u> |
| Total U.S. Department of Justice | | | |
| | | | <u>\$ 15,883</u> |
| U.S. Department of Transportation | | | |
| Passed Through Minnesota Department of Natural Resources | | | |
| Boating Safety Financial Assistance | | 20.005 | \$ 9,590 |
| Passed Through Minnesota Department of Transportation | | | |
| Highway Planning and Construction | SP-38-596-01 SP-38-596-02 SP-38-595-02 | 20.205 | 876,200 |
| Passed Through Minnesota Department of Public Safety | | | |
| State and Community Highway Safety | | 20.600 | 6,889 |
| Alcohol Traffic Safety and Drunk Driving Prevention Incentive Grant | | 20.601 | 2,400 |
| Safety Incentive Grants for the Use of Seatbelts | | 20.604 | 1,217 |
| | | | <u>896,296</u> |
| Total U.S. Department of Transportation | | | |
| | | | <u>\$ 896,296</u> |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

***Schedule 11
(Continued)***

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2006**

| Federal Grantor Pass-Through Agency Grant Program Title | Pass-Through Grant Numbers | Federal CFDA Number | Expenditures |
|---|---------------------------------------|------------------------------------|---------------------|
| U.S. Environmental Protection Agency | | | |
| Passed Through Minnesota Department of Health State Indoor Radon Grants | | 66.032 | \$ 1,133 |
| Passed Through Minnesota Pollution Control Agency Beach Monitoring and Program Implementation Grants | | 66.472 | 3,000 |
| Surveys, Studies, Investigations, and Special Purpose Grants | | 66.606 | 2,000 |
| Total U.S. Environmental Protection Agency | | | \$ 6,133 |
| Election Assistance Commission | | | |
| Passed Through Minnesota Secretary of State Help America Vote Act Grant | A86599 | 90.401 | \$ 148,992 |
| U.S. Department of Health and Human Services | | | |
| Passed Through Carlton, Cook, Lake, and St. Louis Community Health Board | | | |
| Center for Disease Control and Prevention - Bioterrorism Grant | | 93.283 | \$ 12,898 |
| Maternal and Child Health | | 93.994 | 9,940 |
| Passed Through Minnesota Department of Human Services Promoting Safe and Stable Families | | 93.556 | 6,486 |
| Temporary Assistance for Needy Families | | 93.558 | 59,123 |
| Child Care and Development Block Grant | | 93.575 | 4,772 |
| Child Welfare Services | | 93.645 | 83 |
| Foster Care - Title IV-E | | 93.658 | 19,817 |
| Social Services Block Grant Title XX | | 93.667 | 102,116 |
| Support for Emancipation and Living Functionally | | 93.674 | 3,352 |
| Community Mental Health Block Grant | | 93.958 | 2,008 |
| Total U.S. Department of Health and Human Services | | | \$ 220,595 |
| U.S. Department of Homeland Security | | | |
| Passed Through Minnesota Department of Public Safety State Domestic Preparedness Equipment Support Program | 2000-9902 | 97.004 | \$ 6,479 |
| Homeland Security Grant Program | 2006-566 | 97.067 | 10,039 |
| Total U.S. Department of Homeland Security | | | \$ 16,518 |
| Total Federal Awards | | | \$ 2,656,470 |

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 11
(Continued)

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2006**

Notes to Schedule of Expenditures of Federal Awards

1. The Schedule of Expenditures of Federal Awards presents the activity of federal award programs expended by Lake County. The County's reporting entity is defined in Note 1 to the financial statements.
2. The expenditures on this schedule are on the modified accrual basis of accounting. Due to timing differences in revenue recognition under the modified accrual basis, expenditures on this schedule do not equal federal revenues reported in the financial statements. In 2006, \$3,000 of prior year federal expenditures were recognized as revenues in the financial statements, and \$43,730 of current year federal expenditures were not recognized as revenues because they were not received within the period of availability. In 2006, there is also \$31,008 more reported in the federal revenues in the financial statements due to unspent grant funds.
3. Pass-through numbers are presented for grants for which they have been assigned.