

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

LAKE COUNTY
TWO HARBORS, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2010

Description of the Office of the State Auditor

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

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

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

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

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

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

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

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

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

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

For the Year Ended December 31, 2010



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

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

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TWO HARBORS, MINNESOTA**

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**ORGANIZATION
DECEMBER 31, 2010**

			<u>Term Expires</u>
Elected			
Commissioner	Thomas Clifford	District 1	January 2013
Commissioner	Derrick Goutermont	District 2	January 2011
Commissioner	Brad Jones	District 3	January 2013
Commissioner	Paul Bergman	District 4	January 2011
Commissioner	Rich Sve	District 5	January 2013
Attorney	Russell H. Conrow		January 2011
Auditor/Treasurer	Steven R. McMahon		January 2011
Recorder	Erica Koski		January 2011
Sheriff	Carey Johnson		January 2011
Appointed			
Assessor	Jack Renick		December 2012
Examiner of Titles	David Adams (St. Louis County)		Indefinite
Health Officer	Harold B. Leppink, M.D.		Indefinite
Highway Engineer	Alan Goodman		May 2012
Veterans Service Officer	George Scheidt		September 2012
Clerk of the Board	Laurel Buchanan		Indefinite
County Coordinator	Matthew Huddleston		Indefinite
Human Services			
Board Members	Thomas Clifford		January 2013
	Derrick Goutermont		January 2011
	Brad Jones		January 2013
	Paul Bergman		January 2011
	Rich Sve		January 2013
	Kathy Goedel		Indefinite
	Christine Johnson		Indefinite
Director	Vacant		Indefinite
Nursing Home			
Board Members	Thomas Clifford		December 2013
	Derrick Goutermont		December 2011
	Brad Jones		December 2013
	Paul Bergman		December 2011
	Rich Sve		December 2013
	Kathy Goedel		Indefinite
	Deade Johnson		Indefinite
Administrator	Susan Johnson		Indefinite

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

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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, 2010, including the Nursing Home Enterprise Fund as of and for the year ended September 30, 2010, which collectively comprise the County's basic financial statements as listed in the table of contents. 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; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. 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 respective 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, 2010, including the Nursing Home Enterprise Fund at September 30, 2010, 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.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Required Supplementary Information as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In accordance with auditing standards generally accepted in the United States of America, we have applied certain limited procedures to the required supplementary information, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Lake County's basic financial statements taken as a whole. The supplementary information, including the Schedule of Expenditures of Federal Awards required by OMB Circular A-133, is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. This information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 29, 2011, 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, 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 29, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2010
(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, 2010. 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 \$101,329,898, of which \$85,349,807 is invested in capital assets, net of related debt, and \$1,451,950 is restricted to specific purposes.
- Business-type activities have total net assets of \$2,319,213. Invested in capital assets, net of related debt, represents \$1,896,421 of the total.
- Lake County's net assets increased by \$4,102,006 for the year ended December 31, 2010. Of the increase, \$4,038,348 was an increase in the governmental activities' net assets, and \$63,658 represented an increase in business-type activities' net assets. The Lake County Housing and Redevelopment Authority is shown as a "Discretely Presented Component Unit." The net assets of the County's discretely presented component unit increased by \$255,188.
- The net cost of governmental activities was \$7,299,127 for the current fiscal year. The net cost was funded by general revenues and other items totaling \$11,337,475.
- Governmental funds' fund balances increased by \$960,692.

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), certain budgetary comparison schedules, and the schedule of funding progress 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. Further financial information for this component unit is available in separately issued and audited financial statements.

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 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		Total Primary Government	
	2010	2009	2010	2009	2010	2009
Current and other assets	\$ 19,565	\$ 17,651	\$ 755	\$ 615	\$ 20,320	\$ 18,266
Capital assets	90,680	88,951	1,913	2,015	92,593	90,966
Total Assets	\$ 110,245	\$ 106,602	\$ 2,668	\$ 2,630	\$ 112,913	\$ 109,232
Long-term debt outstanding	\$ 5,825	\$ 6,729	\$ 74	\$ 72	\$ 5,899	\$ 6,801
Other liabilities	3,090	2,581	275	302	3,365	2,883
Total Liabilities	\$ 8,915	\$ 9,310	\$ 349	\$ 374	\$ 9,264	\$ 9,684
Net Assets						
Invested in capital assets, net of debt	\$ 85,350	\$ 82,739	\$ 1,896	\$ 1,991	\$ 87,246	\$ 84,730
Restricted	1,452	1,503	-	-	1,452	1,503
Unrestricted	14,528	13,050	423	265	14,951	13,315
Total Net Assets	\$ 101,330	\$ 97,292	\$ 2,319	\$ 2,256	\$ 103,649	\$ 99,548

Table 2
Changes in Net Assets
(in Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2010	2009	2010	2009	2010	2009
Revenues						
Program revenues						
Fees, fines, charges, and other	\$ 2,444	\$ 1,964	\$ 3,851	\$ 3,560	\$ 6,295	\$ 5,524
Operating grants and contributions	10,341	10,712	-	-	10,341	10,712
Capital grants and contributions	4,244	2,508	-	-	4,244	2,508
General revenues						
Property taxes	7,480	7,384	-	-	7,480	7,384
Other taxes	1,873	2,070	-	-	1,873	2,070
Unrestricted grants and contributions	1,058	1,310	-	3	1,058	1,313
Investment earnings	52	151	-	-	52	151
Gain on sale of capital asset	622	8	-	-	622	8
Miscellaneous	252	170	-	22	252	192
Total Revenues	\$ 28,366	\$ 26,277	\$ 3,851	\$ 3,585	\$ 32,217	\$ 29,862

(Unaudited)

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	Governmental Activities		Business-Type Activities		Total Primary Government	
	2010	2009	2010	2009	2010	2009
Expenses						
General government	\$ 4,229	\$ 4,077	\$ -	\$ -	\$ 4,229	\$ 4,077
Public safety	4,187	3,228	-	-	4,187	3,228
Culture and recreation	1,033	845	-	-	1,033	845
Highways and streets	6,520	5,062	-	-	6,520	5,062
Human services	3,003	3,016	3,788	3,561	6,791	6,577
Health	3,046	3,050	-	-	3,046	3,050
Sanitation	276	316	-	-	276	316
Conservation of natural resources	1,140	1,080	-	-	1,140	1,080
Economic development	640	935	-	-	640	935
Interest	254	293	-	-	254	293
Total Expenses	\$ 24,328	\$ 21,902	\$ 3,788	\$ 3,561	\$ 28,116	\$ 25,463
Increase (Decrease) in Net Assets	\$ 4,038	\$ 4,375	\$ 63	\$ 24	\$ 4,101	\$ 4,399
Net Assets, January 1	97,292	92,917	2,256	2,232	99,548	95,149
Net Assets, December 31	\$ 101,330	\$ 97,292	\$ 2,319	\$ 2,256	\$ 103,649	\$ 99,548

Capital grants and contributions increased by \$1,735,739 primarily due to an increase in highway planning and construction grants.

Governmental Activities

The cost of all governmental activities this year was \$24,327,967. 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 \$7,299,127, because some of the cost was paid by those who directly benefited from the programs (\$2,444,086) or by other governments and organizations that subsidized certain programs with grants and contributions (\$14,584,754). 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	
	2010	2009	2010	2009
Highways and streets	\$ 6,520	\$ 5,062	\$ 352	\$ 853
General government	4,229	4,077	758	387
Public safety	4,187	3,228	2,968	2,013
Health	3,046	3,050	51	(194)
Human services	3,003	3,016	1,479	1,934
All others	3,343	3,469	1,691	1,725
Total	\$ 24,328	\$ 21,902	\$ 7,299	\$ 6,718

(Unaudited)

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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. The General Fund budget was not amended significantly in 2010.

In the General Fund, the actual charges to appropriations (expenditures) were \$962,555 greater than the final budget amounts. Unbudgeted expenditures included \$492,972 of unbudgeted federal grant expenditures, \$439,689 of unbudgeted trail expenditures, and \$234,996 of unbudgeted small cities development program expenditures.

Resources available for appropriation were also above the final budgeted amount by \$2,250,376. This was primarily due to greater than expected collections in intergovernmental revenues.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of 2010, the County had \$92,592,443 invested in a broad range of capital assets, including land, buildings, highways and streets, and equipment. (See Table 4.)

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

	Governmental Activities		Business-Type Activities		Totals	
	2010	2009	2010	2009	2010	2009
Land	\$ 3,990	\$ 3,915	\$ 15	\$ 15	\$ 4,005	\$ 3,930
Buildings and improvements	11,189	11,468	1,769	1,837	12,958	13,305
Machinery, vehicles, furniture, and equipment	2,098	2,080	129	163	2,227	2,243
Infrastructure	73,403	71,488	-	-	73,403	71,488
Totals	<u>\$ 90,680</u>	<u>\$ 88,951</u>	<u>\$ 1,913</u>	<u>\$ 2,015</u>	<u>\$ 92,593</u>	<u>\$ 90,966</u>

The County's fiscal year 2011 capital budget calls for it to spend another \$264 thousand for miscellaneous improvements at various buildings and \$872,000 for road construction. The road construction will be funded by state-aid construction funds.

Debt

At year-end, the County had \$3,949,091 in bonds and notes outstanding versus \$4,840,824 last year--a decrease of 18 percent--as shown in Table 5. Capital leases payable decreased by \$164,075.

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

	Governmental Activities		Business-Type Activities		Totals	
	2010	2009	2010	2009	2010	2009
General obligation bonds	\$ 3,765	\$ 4,440	\$ -	\$ -	\$ 3,765	\$ 4,440
Notes payable	184	401	-	-	184	401
Capital leases	1,633	1,796	5	7	1,638	1,803
Loans payable	-	-	11	17	11	17
Compensated absences	1,128	1,062	103	95	1,231	1,157
Net other postemployment benefits	127	85	-	-	127	85
Total	\$ 6,837	\$ 7,784	\$ 119	\$ 119	\$ 6,956	\$ 7,903

The state limits the amount of net debt that the County can issue to three 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, sick leave payable, and net other postemployment benefits. 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 2011 budget, tax rates, and fees that will be charged for the business-type activities.

- County General Fund expenditures for 2011 are budgeted to increase ten percent over 2010.
- Property tax levies did not increase for 2011.

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, 2010**

	Primary Government			Housing and Redevelopment Authority Component Unit
	Governmental Activities	Business-Type Activities	Total	
<u>Assets</u>				
Cash and pooled investments	\$ 12,532,817	\$ 363,165	\$ 12,895,982	\$ 357,815
Receivables - net	6,157,572	309,609	6,467,181	150,044
Due from component unit	596,232	-	596,232	-
Inventories	235,883	29,758	265,641	-
Prepaid items	13,096	46,264	59,360	-
Restricted assets				
Cash and pooled investments	-	6,674	6,674	83,405
Deferred charges	29,579	-	29,579	-
Capital assets				
Non-depreciable capital assets	3,990,362	15,000	4,005,362	-
Depreciable capital assets - net of accumulated depreciation	86,689,654	1,897,427	88,587,081	1,242,332
Total Assets	\$ 110,245,195	\$ 2,667,897	\$ 112,913,092	\$ 1,833,596
<u>Liabilities</u>				
Accounts payable and other current liabilities	\$ 1,410,541	\$ 222,989	\$ 1,633,530	\$ 17,672
Accrued interest payable	75,318	-	75,318	3,200
Advance from other governments	592,463	-	592,463	-
Due to primary government	-	-	-	596,232
Unearned revenue	-	-	-	202
Payable from restricted assets				
Due to residents	-	6,674	6,674	-
Customer deposits payable	-	-	-	14,207
Long-term liabilities				
Due within one year	1,012,322	45,503	1,057,825	32,350
Due in more than one year	5,824,653	73,518	5,898,171	822,670
Total Liabilities	\$ 8,915,297	\$ 348,684	\$ 9,263,981	\$ 1,486,533
<u>Net Assets</u>				
Invested in capital assets - net of related debt	\$ 85,349,807	\$ 1,896,421	\$ 87,246,228	\$ 387,312
Restricted for				
General government	348,583	-	348,583	-
Public safety	319,926	-	319,926	-
Highways and streets	48,845	-	48,845	-
Human services	93,991	-	93,991	-
Conservation of natural resources	157,476	-	157,476	-
Debt service	483,129	-	483,129	69,198
Unrestricted	14,528,141	422,792	14,950,933	(109,447)
Total Net Assets	\$ 101,329,898	\$ 2,319,213	\$ 103,649,111	\$ 347,063

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

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2010**

	Expenses	Fees, Charges, Fines, and Other	Program Revenues Operating Grants and Contributions
<u>Functions/Programs</u>			
Primary government			
Governmental activities			
General government	\$ 4,229,166	\$ 565,076	\$ 2,902,286
Public safety	4,186,649	165,472	1,053,062
Highways and streets	6,520,484	597,048	1,379,568
Sanitation	276,333	93,527	-
Human services	3,003,383	119,559	1,404,440
Health	3,045,493	193,072	2,800,973
Culture and recreation	1,032,610	160,070	404,314
Conservation of natural resources	1,140,191	524,457	82,885
Economic development	640,122	25,805	313,289
Interest	253,536	-	-
	\$ 24,327,967	\$ 2,444,086	\$ 10,340,817
Total governmental activities			
Business-type activities			
Nursing Home	3,787,222	3,850,880	-
	\$ 28,115,189	\$ 6,294,966	\$ 10,340,817
Total Primary Government			
Component unit			
Housing and Redevelopment Authority	\$ 299,484	\$ 191,343	\$ -
	\$ 299,484	\$ 191,343	\$ -

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
Unrestricted investment earnings
Gain on sale of capital assets
Miscellaneous

Total general revenues

Change in net assets

Net Assets - Beginning

Net Assets - Ending

EXHIBIT 2

Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets			Discretely Presented Component Unit
	Governmental Activities	Business-Type Activities	Total	
\$ 4,000	\$ (757,804)	\$ -	\$ (757,804)	
-	(2,968,115)	-	(2,968,115)	
4,192,035	(351,833)	-	(351,833)	
-	(182,806)	-	(182,806)	
-	(1,479,384)	-	(1,479,384)	
-	(51,448)	-	(51,448)	
-	(468,226)	-	(468,226)	
-	(532,849)	-	(532,849)	
47,902	(253,126)	-	(253,126)	
-	(253,536)	-	(253,536)	
\$ 4,243,937	\$ (7,299,127)	\$ -	\$ (7,299,127)	
-	-	63,658	63,658	
\$ 4,243,937	\$ (7,299,127)	\$ 63,658	\$ (7,235,469)	
\$ -				\$ (108,141)
	\$ 7,480,076	\$ -	\$ 7,480,076	\$ 102,634
	9,451	-	9,451	-
	555,125	-	555,125	-
	216,137	-	216,137	214,679
	1,092,426	-	1,092,426	-
	1,058,182	-	1,058,182	30,606
	51,993	-	51,993	3,779
	621,771	-	621,771	-
	252,314	-	252,314	11,631
	\$ 11,337,475	\$ -	\$ 11,337,475	\$ 363,329
	\$ 4,038,348	\$ 63,658	\$ 4,102,006	\$ 255,188
	97,291,550	2,255,555	99,547,105	91,875
	\$ 101,329,898	\$ 2,319,213	\$ 103,649,111	\$ 347,063

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FUND FINANCIAL STATEMENTS

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GOVERNMENTAL FUNDS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 3

**BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2010**

	<u>General</u>	<u>Road and Bridge</u>	<u>Human Services</u>	<u>Forfeited Tax</u>	<u>Nonmajor Funds</u>	<u>Total</u>
<u>Assets</u>						
Cash and pooled investments	\$ 6,082,694	\$ 1,384,825	\$ 4,587,751	\$ 18,969	\$ 158,286	\$ 12,232,525
Escheat cash	36,538	-	-	-	-	36,538
Petty cash and change funds	1,350	1,000	1,000	50	-	3,400
Undistributed cash in agency funds	146,273	37,466	60,948	-	15,667	260,354
Taxes receivable - prior	412,206	118,278	194,135	-	43,196	767,815
Accounts receivable	22,338	7,245	14,136	756,799	-	800,518
Accrued interest receivable	20,859	-	-	-	-	20,859
Loans receivable	125,689	-	-	-	23,666	149,355
Due from other funds	365,485	-	-	-	195,588	561,073
Due from other governments	2,818,619	675,939	573,135	-	56,332	4,124,025
Due from component unit	-	-	-	-	596,232	596,232
Prepaid expense	-	-	13,096	-	-	13,096
Inventories	-	235,883	-	-	-	235,883
Leases receivable	295,000	-	-	-	-	295,000
Total Assets	<u>\$ 10,327,051</u>	<u>\$ 2,460,636</u>	<u>\$ 5,444,201</u>	<u>\$ 775,818</u>	<u>\$ 1,088,967</u>	<u>\$ 20,096,673</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**EXHIBIT 3
(Continued)**

**BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2010**

	<u>General</u>	<u>Road and Bridge</u>	<u>Human Services</u>	<u>Forfeited Tax</u>	<u>Nonmajor Funds</u>	<u>Total</u>
<u>Liabilities and Fund Balances</u>						
Liabilities						
Accounts payable	\$ 175,794	\$ 63,119	\$ 96,113	\$ 3,470	\$ 30,156	\$ 368,652
Escheat payable	36,538	-	-	-	-	36,538
Salaries payable	122,367	41,584	38,725	7,419	-	210,095
Contracts payable	-	461,500	-	-	-	461,500
Due to other funds	136,713	-	14,051	58,875	351,434	561,073
Due to other governments	30,802	9,744	215,063	-	78,147	333,756
Deferred revenue - unavailable	748,480	276,802	179,001	666,481	87,208	1,957,972
Advances from other governments	-	592,463	-	-	-	592,463
Total Liabilities	\$ 1,250,694	\$ 1,445,212	\$ 542,953	\$ 736,245	\$ 546,945	\$ 4,522,049
Fund Balances						
Reserved for						
Inventories	\$ -	\$ 235,883	\$ -	\$ -	\$ -	\$ 235,883
Capital projects	-	203,192	-	-	-	203,192
Election equipment	27,804	-	-	-	-	27,804
Loans receivable	48,093	-	-	-	23,666	71,759
Law library	18,897	-	-	-	-	18,897
Sheriff's contingency	5,000	-	-	-	-	5,000
Sheriff's forfeited property	69,495	-	-	-	-	69,495
Recorder's technology fund	195,428	-	-	-	-	195,428
Recorder's compliance fund	134,258	-	-	-	-	134,258
Enhanced 911	245,431	-	-	-	-	245,431
Debt service	-	483,129	-	-	-	483,129
Region III fund	-	-	93,991	-	-	93,991
Title III forests	157,476	-	-	-	-	157,476
Retired employees	-	2,398	-	-	-	2,398
Unreserved						
Designated for future expenditures	-	-	1,000,000	-	-	1,000,000
Designated for rescue squad	25,019	-	-	-	-	25,019
Designated for capital equipment	-	90,822	-	-	-	90,822
Undesignated	8,149,456	-	3,807,257	39,573	-	11,996,286
Unreserved, reported in nonmajor						
Special revenue funds	-	-	-	-	192,264	192,264
Debt service fund	-	-	-	-	439,587	439,587
Capital projects fund	-	-	-	-	(113,495)	(113,495)
Total Fund Balances	\$ 9,076,357	\$ 1,015,424	\$ 4,901,248	\$ 39,573	\$ 542,022	\$ 15,574,624
Total Liabilities and Fund Balances	\$ 10,327,051	\$ 2,460,636	\$ 5,444,201	\$ 775,818	\$ 1,088,967	\$ 20,096,673

**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, 2010**

Fund balances - total governmental funds (Exhibit 3)		\$ 15,574,624
<p>Amounts reported for governmental activities in the statement of net assets are different because:</p>		
<p>Capital assets, net of accumulated depreciation, used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.</p>		90,680,016
<p>Other long-term assets are not available to pay for current period expenditures and, therefore, are deferred in the governmental funds.</p>		1,957,972
<p>Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the governmental funds.</p>		
General obligation bonds	\$ (3,765,000)	
Notes payable	(184,091)	
Capital leases payable	(1,632,403)	
Compensated absences	(1,128,268)	
Net other postemployment benefits payable	(127,213)	
Accrued interest payable	(75,318)	
Deferred debt issuance charges	29,579	
	(6,882,714)	(6,882,714)
Net Assets of Governmental Activities (Exhibit 1)		<u>\$ 101,329,898</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 5

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<u>General</u>	<u>Road and Bridge</u>	<u>Human Services</u>	<u>Forfeited Tax</u>	<u>Nonmajor Funds</u>	<u>Total</u>
Revenues						
Taxes	\$ 4,741,248	\$ 1,371,096	\$ 1,785,619	\$ -	\$ 666,439	\$ 8,564,402
Licenses and permits	12,023	-	-	942	38	13,003
Intergovernmental	5,328,276	6,024,076	4,389,373	28,176	289,615	16,059,516
Charges for services	546,232	592,849	232,592	5,824	-	1,377,497
Fines and forfeits	5,980	-	-	-	-	5,980
Investment earnings	51,485	214	-	-	294	51,993
Miscellaneous	496,749	18,724	80,039	605,324	97,321	1,298,157
Total Revenues	\$ 11,181,993	\$ 8,006,959	\$ 6,487,623	\$ 640,266	\$ 1,053,707	\$ 27,370,548
Expenditures						
Current						
General government	\$ 3,984,241	\$ -	\$ -	\$ -	\$ 6,247	\$ 3,990,488
Public safety	3,957,968	-	-	-	88,897	4,046,865
Highways and streets	-	8,337,623	-	-	-	8,337,623
Sanitation	264,994	-	-	-	-	264,994
Human services	-	-	2,924,061	-	-	2,924,061
Health	-	-	3,038,590	-	-	3,038,590
Culture and recreation	986,712	-	-	-	-	986,712
Conservation of natural resources	203,911	-	-	627,896	270,475	1,102,282
Economic development	282,509	-	-	-	244,118	526,627
Capital outlay	-	-	-	26,294	265,751	292,045
Debt service						
Principal	23,339	472,408	-	-	560,061	1,055,808
Interest	-	56,771	-	-	198,167	254,938
Miscellaneous	-	403	-	-	1,903	2,306
Total Expenditures	\$ 9,703,674	\$ 8,867,205	\$ 5,962,651	\$ 654,190	\$ 1,635,619	\$ 26,823,339
Excess of Revenues Over (Under) Expenditures	\$ 1,478,319	\$ (860,246)	\$ 524,972	\$ (13,924)	\$ (581,912)	\$ 547,209
Other Financing Sources (Uses)						
Transfers in	\$ -	\$ 709,628	\$ -	\$ -	\$ 136,713	\$ 846,341
Transfers out	(846,341)	-	-	-	-	(846,341)
Proceeds from sale of assets	597,925	-	-	-	-	597,925
Total Other Financing Sources (Uses)	\$ (248,416)	\$ 709,628	\$ -	\$ -	\$ 136,713	\$ 597,925
Net Change in Fund Balances	\$ 1,229,903	\$ (150,618)	\$ 524,972	\$ (13,924)	\$ (445,199)	\$ 1,145,134
Fund Balances - January 1	7,846,454	1,350,484	4,376,276	53,497	987,221	14,613,932
Increase (decrease) in reserved for inventories	-	(184,442)	-	-	-	(184,442)
Fund Balances - December 31	\$ 9,076,357	\$ 1,015,424	\$ 4,901,248	\$ 39,573	\$ 542,022	\$ 15,574,624

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

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**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, 2010**

Net change in fund balances - total governmental funds (Exhibit 5) \$ 1,145,134

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 revenue between the fund statements and the statement of activities is the increase or decrease in revenue deferred as unavailable.

Deferred revenue - December 31	\$ 1,957,972	
Deferred revenue - January 1	(1,560,130)	397,842

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. In the statement of activities, the gain or loss on the disposal of capital assets is reported; in the governmental funds, proceeds from the sale increase financial resources. The difference is the net book value of assets sold.

Expenditures for general capital assets and infrastructure	\$ 4,682,346	
Net book value of assets sold	(28,488)	
Current year depreciation	(2,924,652)	1,729,206

Debt issuances provide current financial resources to governmental funds, but increase long-term liabilities in the statement of net assets. Debt repayment is an expenditure in funds, but a reduction of a liability in the statement of net assets.

Principal repayments		
General obligation bonds	\$ 675,000	
Notes payable	216,733	
Capital lease	164,075	1,055,808

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	\$ 12,968	
Change in deferred bond issuance costs	(9,260)	
Change in compensated absences	(66,346)	
Change in other postemployment benefits	(42,562)	
Change in inventories	(184,442)	(289,642)

Change in Net Assets of Governmental Activities (Exhibit 2) \$ 4,038,348

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PROPRIETARY FUND

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 7

**STATEMENT OF FUND NET ASSETS
PROPRIETARY FUND
NURSING HOME ENTERPRISE FUND
SEPTEMBER 30, 2010**

Assets

Current assets

Cash and cash equivalents	\$	362,665
Petty cash and change funds		500
Accounts receivable - net		309,609
Inventories		29,758
Prepaid items		46,264
Restricted cash, cash equivalents, and investments		
Resident trust funds		6,674
		6,674

Total current assets

\$ 755,470

Noncurrent assets

Capital assets		
Nondepreciable	\$	15,000
Depreciable		4,482,358
Less: accumulated depreciation		(2,584,931)
		1,912,427

Total noncurrent assets

\$ 1,912,427

Total Assets

\$ 2,667,897

Liabilities

Current liabilities

Accounts payable	\$	78,508
Salaries payable		84,997
Accrued vacation payable		59,484
Compensated absences payable - current		37,570
Loans payable - current		5,688
Capital leases payable - current		2,245
		268,492

Total current liabilities

\$ 268,492

Current liabilities payable from restricted assets

Due to residents	\$	6,674
		6,674

Noncurrent liabilities

Compensated absences payable - long-term	\$	65,445
Loans payable - long-term		5,059
Capital leases payable - long-term		3,014
		73,518

Total noncurrent liabilities

\$ 73,518

Total Liabilities

\$ 348,684

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

***EXHIBIT 7
(Continued)***

**STATEMENT OF FUND NET ASSETS
PROPRIETARY FUND
NURSING HOME ENTERPRISE FUND
SEPTEMBER 30, 2010**

Net Assets

Invested in capital assets - net of related debt	\$ 1,896,421
Unrestricted	<u>422,792</u>
Total Net Assets	<u><u>\$ 2,319,213</u></u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 8

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUND
NURSING HOME ENTERPRISE FUND
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

Operating Revenues	
Patient services revenues	\$ 3,556,978
Ancillary and other services	203,026
Miscellaneous	90,776
	<hr/>
Total Operating Revenues	\$ 3,850,780
Operating Expenses	
Nursing services	\$ 1,413,561
Other care-related	111,773
Other services and charges	241,826
Dietary	459,281
Laundry	59,269
Housekeeping	63,530
Plant operations	163,418
Other property and related costs	182,912
Administration	413,028
Employee benefits	531,426
Depreciation	145,890
	<hr/>
Total Operating Expenses	\$ 3,785,914
Operating Income (Loss)	\$ 64,866
Nonoperating Revenues (Expenses)	
Contributions and donations	\$ 100
Interest expense	(1,308)
	<hr/>
Total Nonoperating Revenues (Expenses)	\$ (1,208)
Change in Net Assets	\$ 63,658
Net Assets - October 1	2,255,555
	<hr/>
Net Assets - September 30	\$ 2,319,213
	<hr/> <hr/>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 9

**STATEMENT OF CASH FLOWS
PROPRIETARY FUND
NURSING HOME ENTERPRISE FUND
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

Cash Flows from Operating Activities	
Cash received from customers	\$ 4,027,700
Cash paid to suppliers	(1,129,248)
Cash payments to employees	<u>(2,527,399)</u>
Net cash provided by (used in) operating activities	<u>\$ 371,053</u>
Cash Flows from Noncapital Financing Activities	
Cash received from contributions and donations	<u>\$ 100</u>
Cash Flows from Capital and Related Financing Activities	
Acquisition of capital assets	\$ (43,359)
Principal paid on capital lease	(2,107)
Interest paid on capital lease	(407)
Principal paid on loan	(5,821)
Interest paid on loan	<u>(901)</u>
Net cash provided by (used in) capital and related financing activities	<u>\$ (52,595)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	\$ 318,558
Cash and Cash Equivalents - October 1	<u>44,607</u>
Cash and Cash Equivalents - September 30	<u><u>\$ 363,165</u></u>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities	
Operating income (loss)	<u>\$ 64,866</u>
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities	
Depreciation	\$ 145,890
Changes in assets and liabilities	
(Increase) decrease in receivables	176,920
(Increase) decrease in inventories	(15,701)
(Increase) decrease in prepaid items	17,862
Increase (decrease) in accounts payable	(45,325)
Increase (decrease) in salaries payable	10,913
Increase (decrease) in compensated absences	8,119
Increase (decrease) in vacations payable	<u>7,509</u>
Total adjustments	<u>\$ 306,187</u>
Net Cash Provided by (Used in) Operating Activities	<u><u>\$ 371,053</u></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, 2010**

	<u>Agency</u>
<u>Assets</u>	
Cash and pooled investments	\$ <u><u>776,332</u></u>
<u>Liabilities</u>	
Accounts payable	\$ 424,351
Taxes collected in advance	7,445
Due to other governments	299,896
Customer deposits - current	<u>44,640</u>
Total Liabilities	\$ <u><u>776,332</u></u>

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2010

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, 2010. 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.

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	County appoints members, and the Authority is a potential financial burden.	Lake County Housing and Redevelopment Authority P. O. Box 103 Silver Bay, Minnesota 55614

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

A. Financial Reporting Entity

Discretely Presented Component Unit (Continued)

The Lake County Housing and Redevelopment Authority is governed by a five-member Board appointed by the Lake County Board of Commissioners. The Lake County Housing and Redevelopment Authority 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 7.D. The County also participates in jointly-governed organizations described in Note 7.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.

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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basic Financial Statements

1. Government-Wide Statements (Continued)

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.

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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basic Financial Statements

2. Fund Financial Statements (Continued)

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 projects.

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.

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. Revenues 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, except for taxes, which have a 60-day accrual 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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

C. Measurement Focus and Basis of Accounting (Continued)

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 revenues, 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 revenues, 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. Cash and cash equivalents do not include restricted accounts.

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, 2010, 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 2010 were \$51,993.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

2. Deposits and Investments (Continued)

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 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.

Loans receivable consist of outstanding loans to individuals for shoreline erosion projects and loans to individuals for economic development.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

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

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 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 value at the date of donation.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

6. Capital Assets (Continued)

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 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
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

7. Compensated Absences (Continued)

Lake County's employees (except for Highway Department employees) participate in a postretirement 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 two to three 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 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 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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

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

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.

2. Stewardship, Compliance, and Accountability

Excess of Expenditures Over Appropriations

For the year ended December 31, 2010, expenditures exceeded appropriations in the following funds:

	<u>Final Budget</u>	<u>Expenditures</u>	<u>Excess</u>
General Fund	\$ 8,741,119	\$ 9,703,674	\$ 962,555
Special Revenue Funds			
Road and Bridge	8,132,630	8,867,205	734,575
Forfeited Tax	613,255	654,190	40,935
Resource Development	307,734	575,127	267,393
Economic Development	-	29,481	29,481
Debt Service Fund	457,341	670,116	212,775

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. 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	\$ 12,895,982
Restricted cash and pooled investments	6,674
Component unit	
Cash and pooled investments	357,815
Restricted cash and pooled investments	83,405
Fiduciary funds	
Cash and pooled investments	<u>776,332</u>
 Total Cash and Investments	 <u>\$ 14,120,208</u>

a. Deposits

The County is authorized by Minn. Stat. §§ 118A.02 and 118A.04 to designate a depository for public funds and to invest in certificates of deposit. The County is required by Minn. Stat. § 118A.03 to protect all County deposits with insurance, surety bond, or collateral. The market value of collateral pledged shall be at least ten percent more than the amount on deposit 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 and 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 not owned or controlled by the financial institution furnishing the collateral.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

a. Deposits (Continued)

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, 2010, the primary government's bank balances of \$1,182,073 were not exposed to custodial credit risk.

The Lake County Housing and Redevelopment Authority component unit's book balance of \$441,220 was exposed to custodial credit risk as follows:

Uninsured and uncollateralized Component unit	<u>\$ 81,046</u>
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b. Investments

The County may invest in the following types of investments as authorized by Minn. Stat. §§ 118A.04 and 118A.05:

- (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;

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

b. Investments (Continued)

- (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.

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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

b. Investments (Continued)

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 transactions. These investments are covered by Securities Investor Protection Corporation (SIPC) insurance or excess SIPC insurance and are therefore, not subject to custodial credit risk.

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, 2010, and information relating to potential investment risks:

Investment Type	Credit Risk		Concentration Risk Over 5% of Portfolio	Interest Rate Risk Maturity Date	Carrying (Fair) Value
	Credit Rating	Rating Agency			
U.S. government agency securities					
Federal National Mortgage Association	Aaa	Moody's		09/21/2018	\$ 518,186
Federal National Mortgage Association	N/R	N/A		02/01/2019	119,967
Federal National Mortgage Association	Aaa	Moody's		04/05/2019	494,390
Total Federal National Mortgage Association			8.7%		\$ 1,132,543
Federal Home Loan Bank Bonds	Aaa	Moody's		12/14/2015	\$ 299,700
Federal Home Loan Bank Bonds	Aaa	Moody's		06/23/2017	398,180
Federal Home Loan Bank Bonds	Aaa	Moody's		09/13/2017	978,230
Federal Home Loan Bank Bonds	Aaa	Moody's		12/15/2020	299,223
Total Federal Home Loan Bank Bonds			15.2%		\$ 1,975,333

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. 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			
Government National Mortgage Association Note	N/R	N/A	<5%	02/15/2019	\$ 10,317
Federal Home Loan Mortgage Corporation	Aaa	Moody's	7.7%	09/07/2017	\$ 995,040
Investment pools/mutual funds					
MAGIC Fund	N/R	N/A	61.5%	N/A	\$ 8,006,817
Wells Fargo Government Money Market	Aaa	Moody's	<5%	N/A	215,502
Total investment pools/mutual funds					\$ 8,222,319
Negotiable certificates of deposit					
American Exp Bk FSB	N/A	N/A	<5%	04/15/2011	\$ 96,540
Discover Bank	N/A	N/A	<5%	04/15/2011	96,540
Citi Bank	N/A	N/A	<5%	04/21/2011	96,575
Sallie Mae Bank	N/A	N/A	<5%	05/13/2011	96,696
Midfirst Bank	N/A	N/A	<5%	05/20/2011	97,716
Washington Trust Bank	N/A	N/A	<5%	05/20/2011	97,728
GE Money Bank	N/A	N/A	<5%	07/11/2011	96,814
Total negotiable certificates of deposit					\$ 678,609
Total investments					\$ 13,014,161
Deposits - primary government					617,715
Deposits - component unit					441,220
Petty cash					3,900
Resident trust funds					6,674
Escheat cash					36,538
Total Cash and Investments					\$ 14,120,208

N/A - Not Applicable

N/R - Not Rated

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

A. Assets (Continued)

2. Receivables

Receivables as of December 31, 2010, 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	\$ 767,815	\$ -
Due from other governments	4,124,025	-
Accounts	800,518	-
Interest	20,859	-
Loans receivable	149,355	92,203
Leases receivable	295,000	-
Total Governmental Activities	\$ 6,157,572	\$ 92,203
Business-Type Activities		
Accounts	\$ 309,609	\$ -

3. Capital Assets

Capital asset activity for the year ended December 31, 2010, was as follows:

Governmental Activities

	Beginning Balance	Increase	Decrease	Reclassify	Ending Balance
Capital assets not depreciated					
Land	\$ 3,914,859	\$ 75,503	\$ -	\$ -	\$ 3,990,362
Capital assets depreciated					
Buildings	\$ 16,156,947	\$ 173,504	\$ -	\$ (16,931)	\$ 16,313,520
Improvements other than buildings	533,389	-	-	2,888	536,277
Machinery, furniture, and equipment	8,856,214	716,789	142,688	14,043	9,444,358
Infrastructure	89,945,281	3,716,550	-	-	93,661,831
Total capital assets depreciated	\$ 115,491,831	\$ 4,606,843	\$ 142,688	\$ -	\$ 119,955,986

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

A. Assets

3. Capital Assets

Governmental Activities (Continued)

	Beginning Balance	Increase	Decrease	Reclassify	Ending Balance
Less: accumulated depreciation for					
Buildings	\$ 4,919,751	\$ 416,086	\$ -	\$ (8,268)	\$ 5,327,569
Improvements other than buildings	302,775	23,460	-	6,940	333,175
Machinery, furniture, and equipment	6,776,398	682,588	114,200	1,328	7,346,114
Infrastructure	18,456,956	1,802,518	-	-	20,259,474
Total accumulated depreciation	\$ 30,455,880	\$ 2,924,652	\$ 114,200	\$ -	\$ 33,266,332
Total capital assets depreciated, net	\$ 85,035,951	\$ 1,682,191	\$ 28,488	\$ -	\$ 86,689,654
Governmental Activities Capital Assets, Net	<u>\$ 88,950,810</u>	<u>\$ 1,757,694</u>	<u>\$ 28,488</u>	<u>\$ -</u>	<u>\$ 90,680,016</u>

Business-Type Activities

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	\$ 15,000	\$ -	\$ -	\$ 15,000
Capital assets depreciated				
Land improvements	\$ 102,108	\$ -	\$ -	\$ 102,108
Buildings	3,569,954	37,357	-	3,607,311
Machinery, furniture, and equipment	766,937	6,002	-	772,939
Total capital assets depreciated	\$ 4,438,999	\$ 43,359	\$ -	\$ 4,482,358
Less: accumulated depreciation for				
Land improvements	\$ 86,226	\$ 3,527	\$ -	\$ 89,753
Buildings	1,748,720	102,429	-	1,851,149
Machinery, furniture, and equipment	604,095	39,934	-	644,029
Total accumulated depreciation	\$ 2,439,041	\$ 145,890	\$ -	\$ 2,584,931
Total capital assets depreciated, net	\$ 1,999,958	\$ (102,531)	\$ -	\$ 1,897,427
Business-Type Activities Capital Assets, Net	<u>\$ 2,014,958</u>	<u>\$ (102,531)</u>	<u>\$ -</u>	<u>\$ 1,912,427</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

A. Assets

3. Capital Assets (Continued)

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

Governmental Activities		
General government	\$	240,709
Public safety		249,683
Highways and streets, including depreciation of infrastructure assets		2,133,759
Human services		96,266
Sanitation		11,331
Culture and recreation		172,122
Conservation of natural resources		<u>20,782</u>
Total Depreciation Expense - Governmental Activities		<u>\$ 2,924,652</u>
Business-Type Activities		
Nursing Home	\$	<u>145,890</u>

B. Interfund Receivables, Payables, and Transfers

1. Due To/From Other Funds

The composition of interfund balances as of December 31, 2010, is as follows:

Receivable Fund	Payable Fund	Amount	Purpose
General	Human Services	\$ 14,051	Reimbursement for services Temporary loan, deficit cash balances
	Other Governmental Funds	<u>351,434</u>	
Total due to General Fund		<u>\$ 365,485</u>	
Other Governmental Funds	General	\$ 136,713	Transfer Title III funds for Clair Nelson Memorial Forest Lease payment Forfeited tax apportionment
	Forfeited Tax	<u>58,875</u>	
Total due to Other Governmental Funds		<u>\$ 195,588</u>	
Total Due To/From Other Funds		<u>\$ 561,073</u>	

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

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

2. Due To/From Primary Government and Component Units

<u>Receivable Entity</u>	<u>Payable Entity</u>	<u>Amount</u>	<u>Purpose</u>
Primary Government - Debt Service	Component Unit - Lake County Housing and Redevelopment Authority	\$ 596,232	Shortfalls in tax increment collections funded by primary government

3. Interfund Transfers

Interfund transfers for the year ended December 31, 2010, consisted of the following:

Transfers to Other Governmental Funds from General Fund	\$ 136,713	Distribute Title III funds Reimbursements for services and transfer of funds for capital asset purchases
Transfers to Road and Bridge Special Revenue Fund from General Fund	<u>709,628</u>	
Total Transfers	<u>\$ 846,341</u>	

C. Liabilities

1. Payables

Payables at December 31, 2010, were as follows:

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>
Accounts payable	\$ 368,652	\$ 78,508
Escheat property payable	36,538	-
Salaries payable	210,095	84,997
Accrued vacation payable	-	59,484
Contracts payable	461,500	-
Due to other governments	<u>333,756</u>	<u>-</u>
Total Payables	<u>\$ 1,410,541</u>	<u>\$ 222,989</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

C. Liabilities (Continued)

2. Capital Leases

Business-Type Activities

In January 2008, the Lake County Nursing Home entered into a lease agreement to finance a copier. The lease runs for five years with interest at 6.35 percent and monthly payments of \$210. At lease expiration, the copier will become the Nursing Home's property and, as such, it has been recorded as a capital asset. The copier is carried at a cost of \$10,748, less accumulated depreciation of \$4,961.

See Notes 3.C.3. and 3.C.4. for information on the lease payable and debt service requirements.

3. Long-Term Debt

Governmental Activities

Type of Indebtedness	Final Maturity	Installment Amounts	Interest Rate (%)	Original Issue Amount	Outstanding Balance December 31, 2010
General obligation bonds					
G.O. Capital Improvement Bonds, Series 2005A	2019	\$155,000 - \$310,000	3.375 - 3.80	\$ 3,200,000	\$ 2,400,000
G.O. State-Aid Highway Bonds, Series 2005B	2013	\$455,000 - \$460,000	3.25 - 3.50	3,200,000	1,365,000
Total General Obligation Bonds				<u>\$ 6,400,000</u>	<u>\$ 3,765,000</u>
Other long-term debt					
General obligation revenue note	2012	\$20,304 - \$24,286	2.00	\$ 222,422	\$ 48,093
Capital Equipment Note 2009A	2011	\$141,718 - \$141,913	3.90	400,000	135,998
Capital lease	2021	\$146,667	5.375	2,200,000	1,613,333
Capital lease	2011	\$7,500 - \$19,579	4.90	42,050	19,070
Total Other Long-Term Debt				<u>\$ 2,864,472</u>	<u>\$ 1,816,494</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

C. Liabilities

3. Long-Term Debt (Continued)

Business-Type Activities

Type of Indebtedness	Final Maturity	Installment Amounts	Interest Rate (%)	Original Issue Amount	Outstanding Balance September 30, 2010
Loans payable	2012	\$6,204	6.00	\$ 17,000	\$ 10,747
Capital lease	2013	\$2,520	6.35	10,748	5,259
Total Long-Term Debt				<u>\$ 27,748</u>	<u>\$ 16,006</u>

4. Debt Service Requirements

Debt service requirements at December 31, 2010, were as follows:

Governmental Activities

Year Ending December 31	General Obligation Bonds		Other Long-Term Debt	
	Principal	Interest	Principal	Interest
2011	\$ 685,000	\$ 122,887	\$ 325,543	\$ 94,672
2012	690,000	99,048	170,952	79,198
2013	700,000	74,710	146,667	70,950
2014	255,000	57,748	146,667	63,067
2015	265,000	48,388	146,667	55,183
2016 - 2020	1,170,000	90,336	733,335	157,667
2021	-	-	146,663	7,883
Total	<u>\$ 3,765,000</u>	<u>\$ 493,117</u>	<u>\$ 1,816,494</u>	<u>\$ 528,620</u>

Business-Type Activities

Year Ending September 30	Capital Leases		Loans Payable	
	Principal	Interest	Principal	Interest
2011	2,245	269	5,226	460
2012	2,392	123	5,521	166
2013	622	7	-	-
Total	<u>\$ 5,259</u>	<u>\$ 399</u>	<u>\$ 10,747</u>	<u>\$ 626</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Detailed Notes on All Funds

C. Liabilities (Continued)

5. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2010, was as follows:

Governmental Activities

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
General obligation bonds	\$ 4,440,000	\$ -	\$ 675,000	\$ 3,765,000	\$ 685,000
Notes payable	400,824	-	216,733	184,091	159,806
Total bonds and notes payable	\$ 4,840,824	\$ -	\$ 891,733	\$ 3,949,091	\$ 844,806
Capital lease payable	1,796,478	-	164,075	1,632,403	165,737
Compensated absences	1,061,922	653,194	586,848	1,128,268	1,779
Net other postemployment benefits	84,651	85,266	42,704	127,213	-
Governmental Activities Long-Term Liabilities	<u>\$ 7,783,875</u>	<u>\$ 738,460</u>	<u>\$ 1,685,360</u>	<u>\$ 6,836,975</u>	<u>\$ 1,012,322</u>

Business-Type Activities

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Capital lease payable	\$ 7,366	\$ -	\$ 2,107	\$ 5,259	\$ 2,245
Loans payable	16,568	-	5,821	10,747	5,688
Compensated absences	94,896	8,119	-	103,015	37,570
Business-Type Activities Long-Term Liabilities	<u>\$ 118,830</u>	<u>\$ 8,119</u>	<u>\$ 7,928</u>	<u>\$ 119,021</u>	<u>\$ 45,503</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**

4. 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). PERA administers the General Employees Retirement Fund, the Public Employees Police and Fire Fund, and the Local Government Correctional Service Retirement Fund (the Public Employees Correctional Fund), which are cost-sharing, multiple-employer retirement plans. These plans are established and administered in accordance with Minn. Stat. chs. 353 and 356.

General Employees Retirement Fund members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security, and Basic Plan members are not. All new members must participate in the Coordinated Plan, and benefits vest after three years of credited service (five years for those first eligible for membership after June 30, 2010). 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 as a correctional guard or officer, a joint jailer/dispatcher, or as a supervisor of correctional guards or officers or of joint jailer/dispatchers and are directly responsible for the direct security, custody, and control of the county correctional institution and its inmates, are covered by the Public Employees Correctional Fund. For members first eligible for membership after June 30, 2010, benefits vest on a graduated schedule starting with 50 percent after five years and increasing 10 percent for each year of service until fully vested after ten years. Members eligible for membership before July 1, 2010, are fully vested after three years of service.

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

Two methods are used to compute benefits for General Employees Retirement Fund Coordinated and Basic Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Basic Plan member is 2.2 percent of

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Employee Retirement Systems and Pension Plans

A. Defined Benefit Plan

Plan Description (Continued)

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.

For all General Employees Retirement Fund members hired prior to July 1, 1989, 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. Normal retirement age is 55 for Public Employees Police and Fire Fund members and Public Employees Correctional Fund members, and either 65 or 66 (depending on date hired) for General Employees Retirement Fund members. A reduced retirement annuity is also available to eligible members seeking early retirement.

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

PERA issues a publicly available financial report that includes financial statements and required supplementary information for the General 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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Employee Retirement Systems and Pension Plans

A. Defined Benefit Plan (Continued)

Funding Policy

Pension benefits are funded from member and employer contributions and income from the investment of fund assets. Rates for employer and employee contributions are set by Minn. Stat. ch. 353. These statutes are established and amended by the State Legislature. The County makes annual contributions to the pension plans equal to the amount required by state statutes. General Employees Retirement Fund Basic Plan members and Coordinated Plan members are required to contribute 9.10 and 6.00 percent, respectively, of their annual covered salary. Public Employees Police and Fire Fund members are required to contribute 9.40 percent. Public Employees Correctional Fund members are required to contribute 5.83 percent of their annual covered salary.

The County is required to contribute the following percentages of annual covered payroll in 2010:

General Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	7.00
Public Employees Police and Fire Fund	14.10
Public Employees Correctional Fund	8.75

The County's contributions for the years ending December 31, 2010, 2009, and 2008, for the General Employees Retirement Fund, the Public Employees Police and Fire Fund, and the Public Employees Correctional Fund were:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
General Employees Retirement Fund	\$ 480,493	\$ 456,644	\$ 414,745
Public Employees Police and Fire Fund	166,913	149,311	120,403
Public Employees Correctional Fund	45,371	43,115	41,819

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Employee Retirement Systems and Pension Plans (Continued)

B. Defined Contribution Plan

Four County Commissioners of Lake County are covered by the Public Employees Defined Contribution Plan, a multiple-employer, deferred compensation plan administered by PERA. The plan is established and administered in accordance with Minn. Stat. ch. 353D, which may be amended by the State Legislature. 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.

Plan benefits depend solely on amounts contributed to the plan plus investment earnings, less administrative expenses. For those qualified personnel who elect to participate, Minn. Stat. § 353D.03 specifies plan provisions, including the employee and employer contribution rates. An eligible elected official who decides to participate contributes 5.00 percent of salary, which is matched by the employer. Employees may elect to make member contributions in an amount not to exceed the employer share. Employee and employer contributions are combined and used to purchase shares in one or more of the seven accounts of the Minnesota Supplemental Investment Fund. For administering the plan, PERA receives 2.00 percent of employer contributions and 0.25 percent of the assets in each member account annually.

Total contributions by dollar amount and percentage of covered payroll made by the County during the year ended December 31, 2010, were:

	Employee	Employer
Contribution amount	\$ 11,249	\$ 11,249
Percentage of covered payroll	5%	5%

Required contribution rates were 5.00 percent.

5. Postemployment Benefits

A. Plan Description and Funding Policy

Lake County explicitly subsidizes the cost of retiree health insurance coverage for certain retired employees through a sick leave reserve program under a single-employer self-insured plan. Highway Department employees with at least 10 years of service who are eligible to receive a retirement benefit from PERA are eligible for up to 2 years of health insurance premiums paid by the County at the single rate. Highway

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Postemployment Benefits

A. Plan Description and Funding Policy (Continued)

Department employees with 20 or more years of service are eligible for up to 3 years of health insurance premiums. At retirement, each eligible employee's sick leave hours are converted to a dollar amount using the employee's hourly pay rate at retirement. The period of time for which the employee may receive the paid health insurance benefit is limited to the dollar value of the employee's accumulated sick leave at retirement. As of December 31, 2010, there were two retirees using their sick leave balances for insurance premiums.

Active employees who retire from the County when eligible to receive a retirement benefit from PERA, who do not qualify for the aforementioned benefits and do not participate in any other health benefits program providing similar coverage, will be eligible to continue coverage with respect to both themselves and their eligible dependents under the County's health benefits program. These retirees are required to pay 100 percent of the total premium cost. Since the premium is a blended rate determined on the entire active and retiree population, the retirees are receiving an implicit rate subsidy. As of December 31, 2010, 12 retirees were receiving health benefits from the County's health plan. The authority to provide these benefits is established in Minn. Stat. § 471.61, subd. 2a.

The cost of other postemployment benefits is funded on a "pay-as-you-go" method.

B. Annual OPEB Cost and Net OPEB Obligation

The County's annual other postemployment benefits (OPEB) cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial accrued liabilities (or

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Postemployment Benefits

B. Annual OPEB Cost and Net OPEB Obligation (Continued)

funding excess) over a period not to exceed 30 years. The following table shows the components of the County's annual OPEB cost for 2010, the amount actually contributed to the plan, and changes in the County's net OPEB obligation:

ARC	\$	86,583
Interest on net OPEB obligation		3,809
Adjustment to ARC		(5,126)
		(5,126)
Annual OPEB cost	\$	85,266
Contributions during the year		(42,704)
		(42,704)
Increase in net OPEB obligation	\$	42,562
Net OPEB - Beginning of Year		84,651
		84,651
Net OPEB - End of Year	\$	127,213
		127,213

The County's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2010, 2009, and 2008 were as follows:

	2010	2009	2008
Percentage of annual OPEB cost contributed	50.1%	80.4%	21.7%
Annual OPEB cost	\$ 85,266	\$ 85,937	\$ 86,583
Employer contributions	(42,704)	(69,085)	(18,784)
Net Increase in Net OPEB Obligation	\$ 42,562	\$ 16,852	\$ 67,799

C. Funded Status and Funding Progress

The actuarial accrued liability for benefits at January 1, 2011, the most recent actuarial date, is \$638,272. The County currently has no assets that have been irrevocably deposited in a trust for future health benefits; thus, the entire amount is unfunded. The covered payroll (annual payroll of active employees covered by the plan) is \$6,162,682. The ratio of the unfunded actuarially accrued liabilities (UAAL) to covered payroll is 10.4 percent.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Postemployment Benefits

C. Funded Status and Funding Progress (Continued)

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and health care cost trends. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The Schedule of Funding Progress - Other Postemployment Benefits, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan (as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques designed to reduce the effect of short-term volatility in actuarial accrued liabilities, consistent with the long-term perspective of the calculations.

In the January 1, 2011, actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 4.5 percent discount rate, which is based on the estimated long-term investment yield on the general assets of the County. The annual health care cost trend rate is 8.5 percent initially, reduced incrementally to an ultimate rate of 5.0 percent after 7 years. The unfunded actuarial accrued liability is being amortized as a level dollar amount on a closed basis over 30 years.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

6. Postemployment Health Care Plans

A. MSRS Health Care Savings Plan

All Lake County employees (except for Highway Department employees) are eligible to participate in a Health Care Savings Plan (HCSP) administered by the Minnesota State Retirement System (MSRS). The plan is authorized under Minn. Stat. § 352.98 and through an Internal Revenue Service (IRS) private letter ruling establishing the HCSP as a tax-exempt benefit as of July 29, 2002. The plan is open to any active public employees in Minnesota if they are covered under certain public service retirement plans.

Under the terms of the HCSP, employees are allowed to save money, tax-free, to use upon termination of employment to pay for eligible health care expenses. The IRS private letter ruling requires mandatory participation of all employees in each bargaining unit in order to gain tax-free benefits. Allowable amounts deposited into individual accounts must be negotiated by each individual bargaining unit and the employer. The plan must be written into the collective bargaining agreement or a Memo of Understanding. For those employees not covered by a bargaining unit, amounts to be deposited into individual accounts must be agreed to by the employer and included in a written personnel policy.

Under Lake County's plan, both unionized and non-represented employees are required to contribute, at retirement, a lump sum of 10 or 20 percent of their eligible unused sick time plus the value of 24 or 36 months of health insurance premiums into their HCSP account, depending on the years of service.

B. VEBA Plan

The Lake County Board of Commissioners approved a Voluntary Employees' Beneficiary Association (VEBA) plan for funding employee health benefits as authorized under Sections 501(c)(9) and 213(d) of the IRS code for members of the Sheriff's Deputy Union, Sheriff's Dispatchers/Corrections Union, Courthouse, Human Services, and for non-represented employees. The VEBA plan is a health reimbursement plan providing for individual employer funded accounts that can be used to help pay eligible medical expenses incurred by participating employees. The plan is used in combination with a high deductible health plan. Funding is provided through pre-tax contributions from Lake County on employee health care elections.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

6. Postemployment Health Care Plans

B. VEBA Plan (Continued)

In 2010, the maximum County contribution for active employees is \$780 for employees with single coverage and \$1,560 for employees with family coverage. Any balance remaining in an employee's account at year-end rolls over into the subsequent year. Upon retirement, any balance remaining in the VEBA account may be used to pay medical expenses.

Eligibility requirements include:

- be an active employee or retiree of a public entity,
- active employees must have a high deductible health plan, and
- be a member of a bargaining unit that has approved the VEBA plan.

7. 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 Intergovernmental 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.

**LAKE COUNTY
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7. Summary of Significant Contingencies and Other Items

A. Risk Management (Continued)

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 with coverage at \$450,000 in 2010 and 2011. 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.

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 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	
	2010	2009
Unpaid claims, beginning of fiscal year	\$ -	\$ -
Incurred claims (including incurred but not reported)	123,166	118,301
Claims payments	(123,166)	(118,301)
Unpaid Claims, End of Fiscal Year	\$ -	\$ -

**LAKE COUNTY
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7. Summary of Significant Contingencies and Other Items (Continued)

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 \$615,860 has been paid through December 31, 2010. The outstanding commitment at December 31, 2010, is \$419,140. 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.

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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Arrowhead Regional Corrections (Continued)

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 2009 (the most recent information available), County contributions were in the following proportion:

Carlton County	10.75%
Cook County	1.55
Koochiching County	1.93
Lake County	1.38
St. Louis County	<u>84.39</u>
Total	<u><u>100.00%</u></u>

Below is a summary of the financial information from Arrowhead Regional Corrections' government-wide statements for December 31, 2009 (the most recent information available):

Total Assets	\$ 13,994,960
Total Liabilities	5,630,836
Total Net Assets	8,364,124
Total Revenues	21,377,065
Total Expenses	20,956,591
Change in Net Assets	420,474

Lake County provided \$179,036 in funding during 2010. Separate financial information can be obtained from:

Arrowhead Regional Corrections
211 West Second Street, Suite 450
Duluth, Minnesota 55802

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures (Continued)

Community Health 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 Board. This agreement was entered into January 1, 1977, and is established pursuant to Minn. Stat. § 471.59.

The Community Health 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 2010.

At December 31, 2009 (the most recent information available), the Community Health Board's summary of financial information was:

Total Assets	\$	1,139,568
Total Liabilities		981,637
Total Net Assets		157,931
Total Revenues		4,242,424
Total Expenses		4,209,848
Change in Net Assets		32,576

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures (Continued)

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.

A summary of the financial information of the Northeast Minnesota Office of Job Training’s government-wide statements for June 30, 2010, was:

Total Assets	\$ 3,505,892
Total Liabilities	2,139,107
Total Net Assets	1,366,785
Total Revenues	7,896,886
Total Expenses	7,918,774
Change in Net Assets	(21,888)

Separate financial information can be obtained from:

Northeast Minnesota Office of Job Training
820 North Ninth Street, Suite 240
P. O. Box 1028
Virginia, Minnesota 55792

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures (Continued)

Minnesota Counties Information Systems

The Counties of Aitkin, Carlton, Cass, Chippewa, Cook, Crow Wing, Dodge, Itasca, Koochiching, Lac qui Parle, Lake, Sherburne, and St. Louis 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.

A summary of the financial information of MCIS at December 31, 2008 (the most recent information available), was:

Total Assets	\$ 1,007,784
Total Liabilities	256,583
Total Net Assets	751,201
Total Revenues	2,534,122
Total Expenses	2,365,437
Change in Net Assets	168,685

Separate financial information can be obtained from:

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures (Continued)

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 the Counties of Aitkin, Cook, Koochiching, Lake, Lake of the Woods, Marshall, Pennington, Roseau, and St. Louis. 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.

A summary of the financial statements at December 31, 2010, is shown below:

Total Assets	\$	108,124
Total Liabilities		800
Total Net Assets		107,324
Total Revenues		21,250
Total Expenditures		9,419
Change in Fund Balance		11,831

Lake County made contributions of \$2,500 in 2010 to the Northern Counties Land Use Board.

Separate financial information can be obtained from:

Northern Counties Land Use Board
St. Louis County Courthouse
100 N. 5th Avenue West, #214
Duluth, Minnesota 55802

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures (Continued)

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 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, 2010, is as follows:

Assets	<u>\$ 159,230</u>
Liabilities	<u>\$ 159,230</u>

Arrowhead Health Alliance

Carlton, Cook, Koochiching, and Lake Counties entered into a joint powers agreement, pursuant to Minn. Stat. §§ 471.59 and 256B.692, for the purpose of organizing, governing, planning, and administering a county-based purchasing entity to participate in prepaid health care programs through the Minnesota Department of Human Services and the federal Centers for Medicare and Medicaid Services.

Control of the Arrowhead Health Alliance is vested in a Board of Directors composed of one representative from each of the member counties. Carlton County is the fiscal agent for the Arrowhead Health Alliance.

Lake County contributed \$78,697 in start-up funds to the Arrowhead Health Alliance in 2007. The County has provided no further funding.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures (Continued)

Northeast Minnesota Regional Radio Board

The Northeast Minnesota Regional Radio Board was established through a joint powers agreement, pursuant to Minn. Stat. §§ 471.59 and 403.39, to provide for regional administration of enhancements to the Statewide Public Safety Radio and Communication System (ARMER) and to enhance and improve interoperable public safety communications.

The joint powers are the Counties of Aitkin, Carlton, Cass, Cook, Crow Wing, Itasca, Kanabec, Koochiching, Lake, Pine, and St. Louis and the Cities of Duluth, Hibbing, International Falls, and Virginia. Control of the Northeast Minnesota Regional Radio Board is vested in a Board of Directors composed of one County Commissioner from each of the member counties and one City Councilor from each of the member cities. In addition, there is one member from the Northeast Minnesota Regional Advisory Committee, one member from the Northeast Minnesota Regional Radio System User Committee, and one member from the Northeast Minnesota Owners and Operators Committee who are also voting members of the Board.

Itasca County is the fiscal agent for the Northeast Minnesota Regional Radio Board. Funding is provided by grants and contributions from participating members. Lake County contributed \$226 in funding in 2010.

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 2010.

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 2010.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. 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 is a discretely presented component unit of Lake County. The following are related-party transactions:

SEGOG Property

In June 2005, the County entered into an agreement with the Authority to sell 70 acres of land to the Authority 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, 2010, and no cash payments have been made.

Tax Increment Shortfalls

The Authority's 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 Housing and Redevelopment Authority remains obligated to Lake County for these shortfalls. A receivable has been set up on the County's financial statements in the amount of \$596,232.

G. Tax-Forfeited Land

The County manages approximately 150,000 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.

H. Sale of Nursing Home

Effective December 31, 2010, Lake County sold the Sunrise Nursing Home to Ecumen, a private company. The Sunrise Nursing Home's financial position and results of operations are included in these financial statements as of September 30, 2010. The activity of the Sunrise Nursing Home for the period of October 1, 2010, to December 31, 2010, are shown in an agency fund.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

7. Summary of Significant Contingencies and Other Items

H. Sale of Nursing Home (Continued)

On January 1, 2011, Lake County exercised an option to purchase the Sunrise Assisted Living Facility which was owned by Sunrise on Superior-GEAC, LLC. On March 2, 2011, this facility was also sold to Ecumen.

8. Subsequent Events

A. Broadband Network County Commitment

On February 8, 2011, the Lake County Board of Commissioners approved a resolution designating \$3,500,000 of County fund balances as a match for the construction and operation of the Lake County Broadband Network. Lake County was awarded a grant of \$9,955,359 and a loan of \$56,413,705 from the Rural Utility Service of the Department of Agriculture for the broadband project in September 2010. This County commitment is a required match for that grant/loan. The final grant agreement is still pending.

9. 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.

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-.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, secretary, and treasurer, elected annually.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

A. Summary of Significant Accounting Policies (Continued)

Basis of Presentation

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

The Authority reports a major governmental fund, the General Fund, and a major enterprise fund--the Silverpointe Enterprise Fund.

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, 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, except for taxes, which have a 60-day accrual 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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

A. Summary of Significant Accounting Policies (Continued)

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."

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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

A. Summary of Significant Accounting Policies

Capital Assets (Continued)

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

Assets	Years
Buildings and structures	25 - 40
Equipment	7

Long-Term Obligations

In the government-wide financial statements, and proprietary fund types in the 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.

B. Detailed Notes on All Funds

1. Assets

Deposits and Investments

a. Deposits

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

Government-wide statement of net assets	
Cash	\$ 357,815
Restricted cash and pooled investments	83,405
Total Cash	\$ 441,220

The Authority is authorized by Minn. Stat. §§ 118A.02 and 118A.04 to designate a depository for public funds and to invest in certificates of deposit. The Authority is required by Minn. Stat. § 118A.03 to protect Authority

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

B. Detailed Notes on All Funds

1. Assets

Deposits and Investments

a. Deposits (Continued)

deposits with insurance, surety bond, or collateral. The market value of collateral pledged shall be at least ten percent more than the amount on deposit 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 and 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 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, 2010, \$81,046 of the Authority's book balance of \$441,220 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 available to cover each property's individual balances.

Uninsured and uncollateralized	\$ <u>81,046</u>
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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

B. Detailed Notes on All Funds

1. Assets

Deposits and Investments (Continued)

b. Investments

The types of investments the Authority is authorized by Minn. Stat. §§ 118A.04 and 118A.05 are the same as are available to the County and are detailed in Note 3.A.1.b.

As of, and during the year ended December 31, 2010, the Authority did not own any investments that required disclosure regarding interest rate risk, credit risk, custodial credit risk, or concentration of credit risk.

Receivables

Receivables as of December 31, 2010, for the Authority's governmental activities are as follows:

	Total Receivables	Amounts Not Scheduled for Collection During the Subsequent Year
Taxes	\$ 14,791	\$ -
Accounts receivable	123,253	-
Loans receivable	12,000	11,000
Total Governmental Activities	<u>\$ 150,044</u>	<u>\$ 11,000</u>

Loan Receivable

The Authority has a \$12,000 loan receivable from the Town of Crystal Bay for the Finland Coop Roofing Project, an unrelated organization. The loan has an interest rate of three percent with annual payments of \$1,007 due on January 10 of each year.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

B. Detailed Notes on All Funds

1. Assets (Continued)

Capital Assets

Capital asset activity for the year ended December 31, 2010, was as follows:

Governmental Activities

	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
Capital assets depreciated				
Equipment	\$ 1,866	\$ -	\$ -	\$ 1,866
Less: accumulated depreciation for				
Equipment	<u>267</u>	<u>267</u>	<u>-</u>	<u>534</u>
Governmental Activities Capital Assets, Net	<u>\$ 1,599</u>	<u>\$ (267)</u>	<u>\$ -</u>	<u>\$ 1,332</u>

Business-Type Activities

	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
Capital assets depreciated				
Buildings and structures	\$ 1,879,117	\$ -	\$ -	\$ 1,879,117
Equipment	<u>3,911</u>	<u>1,467</u>	<u>-</u>	<u>5,378</u>
Total capital assets depreciated	<u>\$ 1,883,028</u>	<u>\$ 1,467</u>	<u>\$ -</u>	<u>\$ 1,884,495</u>
Less: accumulated depreciation for				
Buildings and structures	\$ 591,139	\$ 46,978	\$ -	\$ 638,117
Equipment	<u>3,911</u>	<u>1,467</u>	<u>-</u>	<u>5,378</u>
Total accumulated depreciation	<u>\$ 595,050</u>	<u>\$ 48,445</u>	<u>\$ -</u>	<u>\$ 643,495</u>
Business-Type Activities Capital Assets, Net	<u>\$ 1,287,978</u>	<u>\$ (46,978)</u>	<u>\$ -</u>	<u>\$ 1,241,000</u>

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

Governmental Activities	
Urban and economic development	<u>\$ 267</u>
Business-Type Activities	
Senior housing	<u>\$ 48,445</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

B. Detailed Notes on All Funds (Continued)

2. Liabilities

Long-Term Debt

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, 2010</u>
1996 General Obligation Senior Housing Bonds	2027	Varies	3.92	\$ 1,160,642	\$ 855,020

Debt Service Requirements

Debt service requirements at December 31, 2010, were as follows:

Business-Type Activities

<u>Year Ending December 31</u>	<u>Revenue Bonds</u>	
	<u>Principal</u>	<u>Interest</u>
2011	\$ 32,350	41,940
2012	33,218	41,071
2013	35,060	39,230
2014	36,879	37,411
2015	38,793	35,497
2016 - 2020	226,141	145,309
2021 - 2025	291,373	80,077
2026	161,206	3,158
Totals	\$ 855,020	\$ 423,693

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

B. Detailed Notes on All Funds

2. Liabilities (Continued)

Changes in Long-Term Liabilities

Business-Type Activities

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds payable					
General Obligation					
Senior Housing Bonds	\$ 885,592	\$ -	\$ 30,572	\$ 855,020	\$ 32,350

C. Summary of Significant Contingencies and Other Items

Tax Increment Financing Districts

The Authority administers the following tax increment financing district established pursuant to Minn. Stat. §§ 469.174-.1791.

District Number 2

Blue Water/Superior Shores Project

The bonds for District Number 2 were general obligation bonds issued by Lake County and paid off in 2009. The County is holding the tax increment district open in order to recover some of the shortfall between tax increment collections and debt service payments that accumulated over the years. 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; or natural disasters. To manage these risks, the Authority has joined the Minnesota Counties Intergovernmental 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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

9. Component Unit Disclosures

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

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. 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.

Related-Party Transactions

The Lake County Housing and Redevelopment Authority related-party transactions are described in detail in Note 7.F.

D. Joint Ventures

In 2008, the Lake County Housing and Development Authority entered into a joint powers agreement with Cook County/Grand Marais Joint Economic Development Authority pursuant to Minn. Stat. § 471.59 for the purpose of preserving the existing housing market, encouraging new housing construction, and providing housing opportunities to the residents of Lake and Cook Counties. The power of each party will be exercised jointly under this agreement with the assistance of a housing coordinator to be retained by both parties. The Lake County Housing and Redevelopment Authority is the fiscal agent and all the financial information is included as part of the Lake County Housing and Redevelopment Authority's financial statements.

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REQUIRED SUPPLEMENTARY INFORMATION

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT A-1

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Revenues				
Taxes	\$ 5,614,907	\$ 5,614,907	\$ 4,741,248	\$ (873,659)
Licenses and permits	7,500	7,500	12,023	4,523
Intergovernmental	2,410,589	2,410,589	5,328,276	2,917,687
Charges for services	493,020	493,020	546,232	53,212
Fines and forfeits	1,500	1,500	5,980	4,480
Investment earnings	351,000	351,000	51,485	(299,515)
Miscellaneous	53,101	53,101	496,749	443,648
Total Revenues	\$ 8,931,617	\$ 8,931,617	\$ 11,181,993	\$ 2,250,376
Expenditures				
Current				
General government				
Commissioners	\$ 414,147	\$ 414,147	\$ 375,238	\$ 38,909
Courts	30,500	30,500	23,316	7,184
Law library	24,000	24,000	16,736	7,264
County administration	197,840	197,840	178,476	19,364
County auditor	532,051	532,051	551,722	(19,671)
County assessor	395,356	395,356	398,440	(3,084)
Elections	25,105	25,105	27,960	(2,855)
Accounting and auditing	70,600	70,600	64,070	6,530
Data processing	553,308	553,308	501,347	51,961
Personnel	208,184	208,184	218,296	(10,112)
Attorney	393,041	393,041	377,478	15,563
Recorder	240,401	240,401	305,550	(65,149)
Planning and zoning	256,607	256,607	291,918	(35,311)
Buildings and plant	722,965	722,965	576,941	146,024
Veterans service officer	78,153	78,153	47,347	30,806
Training	4,500	4,500	835	3,665
Motor pool	27,873	27,873	22,271	5,602
Other general government	-	-	6,300	(6,300)
Total general government	\$ 4,174,631	\$ 4,174,631	\$ 3,984,241	\$ 190,390
Public safety				
Sheriff	\$ 1,964,799	\$ 1,964,799	\$ 2,037,383	\$ (72,584)
Ambulance	43,566	43,566	123,415	(79,849)
Emergency services	136,027	136,027	104,340	31,687
Coroner	18,000	18,000	10,550	7,450
County jail	910,601	910,601	932,963	(22,362)
Community corrections	203,797	203,797	178,575	25,222
Sentence to serve	73,549	73,549	68,491	5,058
Emergency management	59,792	59,792	168,598	(108,806)
Other public safety	54,865	54,865	333,653	(278,788)
Total public safety	\$ 3,464,996	\$ 3,464,996	\$ 3,957,968	\$ (492,972)

The notes to the required supplementary information are an integral part of this schedule.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

*EXHIBIT A-1
(Continued)*

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Expenditures				
Current (Continued)				
Sanitation				
Solid waste	\$ 119,707	\$ 119,707	\$ 134,225	\$ (14,518)
Recycling	133,641	133,641	120,281	13,360
Hazardous waste	26,000	26,000	10,488	15,512
Total sanitation	\$ 279,348	\$ 279,348	\$ 264,994	\$ 14,354
Culture and recreation				
Historical society	\$ 28,000	\$ 28,000	\$ 28,000	\$ -
Arenas	281,313	281,313	253,488	27,825
Humane society	3,500	3,500	3,500	-
Memorial Day observance	900	900	393	507
Recreation board	138,875	142,875	142,874	1
Trails	-	-	439,689	(439,689)
County/regional library	118,768	118,768	118,768	-
Total culture and recreation	\$ 571,356	\$ 575,356	\$ 986,712	\$ (411,356)
Conservation of natural resources				
County extension	\$ 102,013	\$ 102,013	\$ 100,955	\$ 1,058
Soil and water conservation	44,121	44,121	44,121	-
Agricultural society/County fair	24,324	24,324	24,260	64
Water planning	24,575	24,575	24,575	-
Wetland challenge	5,000	5,000	10,000	(5,000)
Total conservation of natural resources	\$ 200,033	\$ 200,033	\$ 203,911	\$ (3,878)
Economic development				
Information centers	\$ 18,755	\$ 18,755	\$ 19,513	\$ (758)
Airports	28,000	28,000	28,000	-
Housing and Redevelopment Authority	-	-	234,996	(234,996)
Total economic development	\$ 46,755	\$ 46,755	\$ 282,509	\$ (235,754)
Debt service				
Principal	\$ -	\$ -	\$ 23,339	\$ (23,339)
Total Expenditures	\$ 8,737,119	\$ 8,741,119	\$ 9,703,674	\$ (962,555)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

*EXHIBIT A-1
(Continued)*

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Excess of Revenues Over (Under) Expenditures	\$ 194,498	\$ 190,498	\$ 1,478,319	\$ 1,287,821
Other Financing Sources (Uses)				
Proceeds from sale of assets	\$ -	\$ -	\$ 597,925	\$ 597,925
Transfers out	(777,800)	(777,800)	(846,341)	(68,541)
Total Other Financing Sources (Uses)	<u>\$ (777,800)</u>	<u>\$ (777,800)</u>	<u>\$ (248,416)</u>	<u>\$ 529,384</u>
Net Change in Fund Balance	\$ (583,302)	\$ (587,302)	\$ 1,229,903	\$ 1,817,205
Fund Balance - January 1	<u>7,846,454</u>	<u>7,846,454</u>	<u>7,846,454</u>	<u>-</u>
Fund Balance - December 31	<u><u>\$ 7,263,152</u></u>	<u><u>\$ 7,259,152</u></u>	<u><u>\$ 9,076,357</u></u>	<u><u>\$ 1,817,205</u></u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT A-2

**BUDGETARY COMPARISON SCHEDULE
ROAD AND BRIDGE SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 1,257,653	\$ 1,257,653	\$ 1,371,096	\$ 113,443
Intergovernmental	6,043,379	6,043,379	6,024,076	(19,303)
Charges for services	63,000	63,000	592,849	529,849
Investment earnings	450	450	214	(236)
Miscellaneous	9,000	9,000	18,724	9,724
Total Revenues	\$ 7,373,482	\$ 7,373,482	\$ 8,006,959	\$ 633,477
Expenditures				
Current				
Highways and streets				
Administration	\$ 356,891	\$ 356,891	\$ 378,527	\$ (21,636)
Maintenance	2,278,864	2,278,864	2,284,329	(5,465)
Construction	4,071,741	4,071,741	4,764,524	(692,783)
Equipment maintenance and shop	915,084	915,084	910,243	4,841
Total highways and streets	\$ 7,622,580	\$ 7,622,580	\$ 8,337,623	\$ (715,043)
Debt service				
Principal	\$ 455,000	\$ 455,000	\$ 472,408	\$ (17,408)
Interest	54,600	54,600	56,771	(2,171)
Administrative (fiscal) charges	450	450	403	47
Total debt service	\$ 510,050	\$ 510,050	\$ 529,582	\$ (19,532)
Total Expenditures	\$ 8,132,630	\$ 8,132,630	\$ 8,867,205	\$ (734,575)
Excess of Revenues Over (Under) Expenditures	\$ (759,148)	\$ (759,148)	\$ (860,246)	\$ (101,098)
Other Financing Sources (Uses)				
Transfers in	690,000	690,000	709,628	19,628
Net Change in Fund Balance	\$ (69,148)	\$ (69,148)	\$ (150,618)	\$ (81,470)
Fund Balance - January 1	1,350,484	1,350,484	1,350,484	-
Increase (decrease) in reserved for inventories	-	-	(184,442)	(184,442)
Fund Balance - December 31	\$ 1,281,336	\$ 1,281,336	\$ 1,015,424	\$ (265,912)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT A-3

**BUDGETARY COMPARISON SCHEDULE
HUMAN SERVICES SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 2,106,912	\$ 2,106,912	\$ 1,785,619	\$ (321,293)
Intergovernmental	4,078,016	4,078,016	4,389,373	311,357
Charges for services	114,600	114,600	232,592	117,992
Miscellaneous	11,250	11,250	80,039	68,789
Total Revenues	<u>\$ 6,310,778</u>	<u>\$ 6,310,778</u>	<u>\$ 6,487,623</u>	<u>\$ 176,845</u>
Expenditures				
Current				
Human services				
Income maintenance	\$ 890,950	\$ 890,950	\$ 819,872	\$ 71,078
Social services	2,678,113	2,678,113	2,104,189	573,924
Total human services	<u>\$ 3,569,063</u>	<u>\$ 3,569,063</u>	<u>\$ 2,924,061</u>	<u>\$ 645,002</u>
Health				
Nursing service	\$ 63,260	\$ 63,260	\$ 99,505	\$ (36,245)
Transportation	8,139	8,139	3,597	4,542
Environmental health	100,897	100,897	96,262	4,635
Mental health	2,334,483	2,334,483	2,531,488	(197,005)
Health education	335,804	335,804	307,738	28,066
Total health	<u>\$ 2,842,583</u>	<u>\$ 2,842,583</u>	<u>\$ 3,038,590</u>	<u>\$ (196,007)</u>
Total Expenditures	<u>\$ 6,411,646</u>	<u>\$ 6,411,646</u>	<u>\$ 5,962,651</u>	<u>\$ 448,995</u>
Net Change in Fund Balance	<u>\$ (100,868)</u>	<u>\$ (100,868)</u>	<u>\$ 524,972</u>	<u>\$ 625,840</u>
Fund Balance - January 1	<u>4,376,276</u>	<u>4,376,276</u>	<u>4,376,276</u>	<u>-</u>
Fund Balance - December 31	<u>\$ 4,275,408</u>	<u>\$ 4,275,408</u>	<u>\$ 4,901,248</u>	<u>\$ 625,840</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT A-4

**BUDGETARY COMPARISON SCHEDULE
FORFEITED TAX SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<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	\$ 942	\$ 367
Intergovernmental	22,241	22,241	28,176	5,935
Charges for services	40,000	40,000	5,824	(34,176)
Miscellaneous	843,225	843,225	605,324	(237,901)
Total Revenues	\$ 906,041	\$ 906,041	\$ 640,266	\$ (265,775)
Expenditures				
Current				
Conservation of natural resources				
Land use	\$ 596,755	\$ 596,755	\$ 621,448	\$ (24,693)
Other conservation	-	-	6,448	(6,448)
Capital outlay				
Conservation of natural resources	16,500	16,500	26,294	(9,794)
Total Expenditures	\$ 613,255	\$ 613,255	\$ 654,190	\$ (40,935)
Net Change in Fund Balance	\$ 292,786	\$ 292,786	\$ (13,924)	\$ (306,710)
Fund Balance - January 1	53,497	53,497	53,497	-
Fund Balance - December 31	\$ 346,283	\$ 346,283	\$ 39,573	\$ (306,710)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT A-5

**SCHEDULE OF FUNDING PROGRESS - OTHER POSTEMPLOYMENT BENEFITS
DECEMBER 31, 2010**

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded Actuarial Accrued Liability (UAAL) (b - a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a)/c)
January 1, 2008	\$ -	\$ 618,083	\$ 618,083	0.00%	\$ 5,722,969	10.8%
January 1, 2011	-	638,272	638,272	0.00	6,162,682	10.4

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED DECEMBER 31, 2010**

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 30.

The appropriated budget is prepared by fund, function, and department. The County's department heads 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, 2010, expenditures exceeded appropriations in the following funds:

General Fund	\$	962,555
Road and Bridge Special Revenue Fund		734,575
Forfeited Tax Special Revenue Fund		40,935

3. Schedule of Funding Progress - Other Postemployment Benefits

Lake County currently has no assets that have been irrevocably deposited in a trust for future health benefits. Therefore, the actuarial value of assets is zero.

Lake County implemented Governmental Accounting Standards Board Statement 45 in the fiscal year ended December 31, 2008. Information for prior years is not available.

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SUPPLEMENTARY INFORMATION

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

NONMAJOR GOVERNMENTAL FUNDS

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 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 Projects Funds are used to account for financial resources to be used for the acquisition or construction of major capital assets.

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-1

**COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
DECEMBER 31, 2010**

	Special Revenue (Exhibit B-3)	Debt Service	Broadband Capital Projects	Total
<u>Assets</u>				
Cash and pooled investments	\$ 158,286	\$ -	\$ -	\$ 158,286
Undistributed cash in agency funds	3,911	11,756	-	15,667
Taxes receivable				
Prior	8,642	34,554	-	43,196
Due from other funds	195,588	-	-	195,588
Due from other governments	37,911	-	18,421	56,332
Due from component unit	-	596,232	-	596,232
Loans receivable	23,666	-	-	23,666
Total Assets	\$ 428,004	\$ 642,542	\$ 18,421	\$ 1,088,967
<u>Liabilities and Fund Balances</u>				
Liabilities				
Accounts payable	\$ -	\$ -	\$ 30,156	\$ 30,156
Due to other funds	96,775	171,320	83,339	351,434
Due to other governments	78,147	-	-	78,147
Deferred revenue - unavailable	37,152	31,635	18,421	87,208
Total Liabilities	\$ 212,074	\$ 202,955	\$ 131,916	\$ 546,945
Fund Balances				
Reserved for loans receivable	\$ 23,666	\$ -	\$ -	\$ 23,666
Designated for debt service	-	439,587	-	439,587
Unreserved				
Undesignated	192,264	-	(113,495)	78,769
Total Fund Balances	\$ 215,930	\$ 439,587	\$ (113,495)	\$ 542,022
Total Liabilities and Fund Balances	\$ 428,004	\$ 642,542	\$ 18,421	\$ 1,088,967

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-2

**COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
NONMAJOR GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<u>Special Revenue (Exhibit B-4)</u>	<u>Debt Service</u>	<u>Capital Projects (Exhibit B-5)</u>	<u>Total</u>
Revenues				
Taxes	\$ 103,829	\$ 562,610	\$ -	\$ 666,439
Licenses and permits	38	-	-	38
Intergovernmental	245,641	43,974	-	289,615
Investment earnings	-	294	-	294
Miscellaneous	25,805	70,374	1,142	97,321
Total Revenues	\$ 375,313	\$ 677,252	\$ 1,142	\$ 1,053,707
Expenditures				
Current				
General government	\$ 6,247	\$ -	\$ -	\$ 6,247
Public safety	88,897	-	-	88,897
Conservation of natural resources	270,475	-	-	270,475
Economic development	29,481	214,637	-	244,118
Capital outlay				
Public safety	-	-	152,256	152,256
Economic development	-	-	113,495	113,495
Debt service				
Principal	208,716	351,345	-	560,061
Interest	95,936	102,231	-	198,167
Administrative (fiscal) charges	-	1,903	-	1,903
Total Expenditures	\$ 699,752	\$ 670,116	\$ 265,751	\$ 1,635,619
Excess of Revenues Over (Under) Expenditures	\$ (324,439)	\$ 7,136	\$ (264,609)	\$ (581,912)
Other Financing Sources (Uses)				
Transfers in	\$ 136,713	\$ -	\$ -	\$ 136,713
Net Change in Fund Balance	\$ (187,726)	\$ 7,136	\$ (264,609)	\$ (445,199)
Fund Balance - January 1	403,656	432,451	151,114	987,221
Fund Balance - December 31	\$ 215,930	\$ 439,587	\$ (113,495)	\$ 542,022

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-3

**COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS
DECEMBER 31, 2010**

	<u>Resource Development</u>	<u>Economic Development</u>	<u>Unorganized Townships</u>	<u>Total</u>
<u>Assets</u>				
Cash and pooled investments	\$ -	\$ 16,621	\$ 141,665	\$ 158,286
Undistributed cash in agency funds	-	-	3,911	3,911
Taxes receivable				
Prior	-	-	8,642	8,642
Due from other funds	195,588	-	-	195,588
Due from other governments	8,430	29,481	-	37,911
Loans receivable	-	23,666	-	23,666
	<hr/>	<hr/>	<hr/>	<hr/>
Total Assets	\$ 204,018	\$ 69,768	\$ 154,218	\$ 428,004
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
<u>Liabilities and Fund Balances</u>				
Liabilities				
Due to other funds	\$ 96,775	\$ -	\$ -	\$ 96,775
Due to other governments	-	-	78,147	78,147
Deferred revenue - unavailable	-	29,481	7,671	37,152
	<hr/>	<hr/>	<hr/>	<hr/>
Total Liabilities	\$ 96,775	\$ 29,481	\$ 85,818	\$ 212,074
	<hr/>	<hr/>	<hr/>	<hr/>
Fund Balances				
Reserved for loans receivable	\$ -	\$ 23,666	\$ -	\$ 23,666
Unreserved				
Undesignated	107,243	16,621	68,400	192,264
	<hr/>	<hr/>	<hr/>	<hr/>
Total Fund Balances	\$ 107,243	\$ 40,287	\$ 68,400	\$ 215,930
	<hr/>	<hr/>	<hr/>	<hr/>
Total Liabilities and Fund Balances	\$ 204,018	\$ 69,768	\$ 154,218	\$ 428,004
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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-4

**COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<u>Resource Development</u>	<u>Economic Development</u>	<u>Unorganized Townships</u>	<u>Total</u>
Revenues				
Taxes	\$ -	\$ -	\$ 103,829	\$ 103,829
Licenses and permits	-	-	38	38
Intergovernmental	235,898	-	9,743	245,641
Miscellaneous	-	25,805	-	25,805
Total Revenues	\$ 235,898	\$ 25,805	\$ 113,610	\$ 375,313
Expenditures				
Current				
General government	\$ -	\$ -	\$ 6,247	\$ 6,247
Public safety	-	-	88,897	88,897
Conservation of natural resources	270,475	-	-	270,475
Economic development	-	29,481	-	29,481
Debt service				
Principal	208,716	-	-	208,716
Interest	95,936	-	-	95,936
Total Expenditures	\$ 575,127	\$ 29,481	\$ 95,144	\$ 699,752
Excess of Revenues Over (Under) Expenditures	\$ (339,229)	\$ (3,676)	\$ 18,466	\$ (324,439)
Other Financing Sources (Uses)				
Transfers in	136,713	-	-	136,713
Net Change in Fund Balance	\$ (202,516)	\$ (3,676)	\$ 18,466	\$ (187,726)
Fund Balance - January 1	309,759	43,963	49,934	403,656
Fund Balance - December 31	\$ 107,243	\$ 40,287	\$ 68,400	\$ 215,930

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-5

**COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
NONMAJOR GOVERNMENTAL FUNDS
CAPITAL PROJECTS FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2010**

	Capital Equipment Notes of 2009	Broadband Capital Projects	Total
Revenues			
Miscellaneous	\$ 1,142	\$ -	\$ 1,142
Expenditures			
Capital outlay			
Public safety	\$ 152,256	\$ -	\$ 152,256
Economic development	-	113,495	113,495
Total Expenditures	\$ 152,256	\$ 113,495	\$ 265,751
Excess of Revenues Over (Under) Expenditures	\$ (151,114)	\$ (113,495)	\$ (264,609)
Fund Balance - January 1	151,114	-	151,114
Fund Balance - December 31	\$ -	\$ (113,495)	\$ (113,495)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-6

**BUDGETARY COMPARISON SCHEDULE
DEBT SERVICE FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 610,420	\$ 610,420	\$ 562,610	\$ (47,810)
Intergovernmental	-	-	43,974	43,974
Investment earnings	1,200	1,200	294	(906)
Miscellaneous	70,472	70,472	70,374	(98)
Total Revenues	\$ 682,092	\$ 682,092	\$ 677,252	\$ (4,840)
Expenditures				
Current				
Economic development				
Housing and Redevelopment Authority	\$ -	\$ -	\$ 214,637	\$ (214,637)
Debt service				
Principal	353,333	353,333	351,345	1,988
Interest	102,258	102,258	102,231	27
Administrative (fiscal) charges	1,750	1,750	1,903	(153)
Total Expenditures	\$ 457,341	\$ 457,341	\$ 670,116	\$ (212,775)
Net Change in Fund Balance	\$ 224,751	\$ 224,751	\$ 7,136	\$ (217,615)
Fund Balance - January 1	432,451	432,451	432,451	-
Fund Balance - December 31	\$ 657,202	\$ 657,202	\$ 439,587	\$ (217,615)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-7

**BUDGETARY COMPARISON SCHEDULE
RESOURCE DEVELOPMENT SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Intergovernmental	\$ 100,000	\$ 100,000	\$ 235,898	\$ 135,898
Expenditures				
Current				
Conservation of natural resources				
Forestry	\$ -	\$ -	\$ 73,294	\$ (73,294)
Other conservation	-	-	197,181	(197,181)
Debt service				
Principal	208,716	208,716	208,716	-
Interest	99,018	99,018	95,936	3,082
Total Expenditures	\$ 307,734	\$ 307,734	\$ 575,127	\$ (267,393)
Excess of Revenues Over (Under) Expenditures	\$ (207,734)	\$ (207,734)	\$ (339,229)	\$ (131,495)
Other Financing Sources (Uses)				
Transfers in	-	-	136,713	136,713
Net Change in Fund Balance	\$ (207,734)	\$ (207,734)	\$ (202,516)	\$ 5,218
Fund Balance - January 1	309,759	309,759	309,759	-
Fund Balance - December 31	\$ 102,025	\$ 102,025	\$ 107,243	\$ 5,218

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-8

**BUDGETARY COMPARISON SCHEDULE
ECONOMIC DEVELOPMENT SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Miscellaneous	\$ 13,392	\$ 13,392	\$ 25,805	\$ 12,413
Expenditures				
Current				
Economic development				
Other economic development	-	-	29,481	(29,481)
Net Change in Fund Balance	\$ 13,392	\$ 13,392	\$ (3,676)	\$ (17,068)
Fund Balance - January 1	43,963	43,963	43,963	-
Fund Balance - December 31	\$ 57,355	\$ 57,355	\$ 40,287	\$ (17,068)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT B-9

**BUDGETARY COMPARISON SCHEDULE
UNORGANIZED TOWNSHIPS SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2010**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 120,540	\$ 120,540	\$ 103,829	\$ (16,711)
Licenses and permits	50	50	38	(12)
Intergovernmental	-	-	9,743	9,743
Total Revenues	\$ 120,590	\$ 120,590	\$ 113,610	\$ (6,980)
Expenditures				
Current				
General government				
Elections	\$ 6,600	\$ 6,600	\$ 6,247	\$ 353
Public safety				
Emergency services	114,300	114,300	88,897	25,403
Total Expenditures	\$ 120,900	\$ 120,900	\$ 95,144	\$ 25,403
Net Change in Fund Balance	\$ (310)	\$ (310)	\$ 18,466	\$ 18,776
Fund Balance - January 1	49,934	49,934	49,934	-
Fund Balance - December 31	\$ 49,624	\$ 49,624	\$ 68,400	\$ 18,776

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FIDUCIARY FUNDS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT C-1

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2010**

	Balance January 1	Additions	Deductions	Balance December 31
<u>CITIES, TOWNS, AND OTHER GOVERNMENTS</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 25,402	\$ 11,582,895	\$ 11,606,766	\$ 1,531
<u>Liabilities</u>				
Due to other governments	\$ 25,402	\$ 11,582,895	\$ 11,606,766	\$ 1,531
 <u>TAXES AND PENALTIES</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 394,524	\$ 17,997,020	\$ 18,115,735	\$ 275,809
<u>Liabilities</u>				
Taxes collected in advance	\$ 18,711	\$ 7,445	\$ 18,711	\$ 7,445
Due to other governments	375,813	17,989,575	18,097,024	268,364
Total Liabilities	\$ 394,524	\$ 17,997,020	\$ 18,115,735	\$ 275,809
 <u>STATE</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 18,504	\$ 216,977	\$ 205,480	\$ 30,001
<u>Liabilities</u>				
Due to other governments	\$ 18,504	\$ 216,977	\$ 205,480	\$ 30,001

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

*EXHIBIT C-1
(Continued)*

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2010**

	Balance January 1	Additions	Deductions	Balance December 31
<u>SEWER SYSTEM DEPOSITS</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 44,640	\$ 44,630	\$ 44,630	\$ 44,640
<u>Liabilities</u>				
Customer deposits - current	\$ 44,640	\$ 44,630	\$ 44,630	\$ 44,640
 <u>NORTH SHORE COLLABORATIVE</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 162,931	\$ 115,743	\$ 119,444	\$ 159,230
<u>Liabilities</u>				
Accounts payable	\$ 162,931	\$ 115,743	\$ 119,444	\$ 159,230
 <u>SUNRISE NURSING HOME</u>				
<u>Assets</u>				
Cash and pooled investments	\$ -	\$ 1,132,828	\$ 867,707	\$ 265,121
<u>Liabilities</u>				
Accounts payable	\$ -	\$ 1,132,828	\$ 867,707	\$ 265,121

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

*EXHIBIT C-1
(Continued)*

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2010**

	Balance January 1	Additions	Deductions	Balance December 31
<u>TOTAL ALL AGENCY FUNDS</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 646,001	\$ 31,090,093	\$ 30,959,762	\$ 776,332
<u>Liabilities</u>				
Accounts payable	\$ 162,931	\$ 1,248,571	\$ 987,151	\$ 424,351
Taxes collected in advance	18,711	7,445	18,711	7,445
Due to other governments	419,719	29,789,447	29,909,270	299,896
Customer deposits - current	44,640	44,630	44,630	44,640
Total Liabilities	\$ 646,001	\$ 31,090,093	\$ 30,959,762	\$ 776,332

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OTHER SCHEDULES

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT D-1

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2010**

Shared Revenue

State

Highway users tax	\$	3,504,089
County program aid		120,153
PERA rate reimbursement		24,475
Disparity reduction aid		155,178
Police aid		102,584
Taconite credit		547,269
Enhanced 911		83,677
Market value credit		195,779

Total shared revenue **\$ 4,733,204**

Reimbursement for Services

State

Minnesota Department of Human Services	\$	217,179
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Payments

State

Payments in lieu of taxes	\$	555,125
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Local

Region III funding from other counties		135,160
Arrowhead Regional Development Commission		95,333
Local		15,328

Total payments **\$ 800,946**

Grants

State

Minnesota Department of Public Safety	\$	40,736
Health		86,144
Natural Resources		296,352
Human Services		2,857,847
Employment and Economic Security		58,732
Board of Water and Soil Resources		140,623
Office of Environmental Assistance		55,950
Miscellaneous boards		5,377

Total state **\$ 3,541,761**

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

***EXHIBIT D-1
(Continued)***

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2010**

Grants (Continued)

Federal

Department of	
Agriculture	\$ 3,051,728
Interior	239,788
Housing and Urban Development	234,996
Transportation	2,126,219
Health and Human Services	823,431
Homeland Security	290,264

Total federal **\$ 6,766,426**

Total state and federal grants **\$ 10,308,187**

Total Intergovernmental Revenue **\$ 16,059,516**

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT D-2

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2010**

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		10.R9-9-95-35B	\$ 27,000
Capital Improvement and Maintenance - ARRA		10.687	24,318
Broadband Initiatives Program - ARRA		10.787	47,902
Passed Through Carlton, Cook, Lake, and St. Louis Community Health Board			
Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)		10.557	46,969
Passed Through Minnesota Department of Human Services			
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (SNAP) Cluster			
State Administrative Matching Grant for SNAP		10.561	113,219
State Administrative Matching Grant for SNAP - ARRA		10.561	1,752
Passed Through Minnesota Department of Natural Resources			
Cooperative Forestry Assistance		10.664	4,232
Passed Through Minnesota Department of Management and Budget			
Schools and Roads - Grants to State		10.665	<u>2,834,238</u>
Total U.S. Department of Agriculture			<u>\$ 3,099,630</u>
U.S. Department of Housing and Urban Development			
Passed Through Minnesota Department of Employment and Economic Development			
Community Development Block Grant - Small Cities Program	CDAP-07-0065-O-FY08 CDAP-09-0063-0-FY10	14.228	<u>\$ 234,996</u>
U.S. Department of the Interior			
Direct			
Payments in Lieu of Taxes		15.226	<u>\$ 239,788</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**EXHIBIT D-2
(Continued)**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2010**

Federal Grantor Pass-Through Agency Grant Program Title	Pass-Through Grant Numbers	Federal CFDA Number	Expenditures
U.S. Department of Transportation			
Highway Planning and Construction Cluster Passed Through Minnesota Department of Transportation	SP-38-606-08 SP-38-090-06		
Highway Planning and Construction	SP-38-620-03	20.205	\$ 2,159,499
Passed Through Minnesota Department of Natural Resources Recreational Trails Program	D119-07-S-1 0040-09-2C	20.219	80,000
Passed Through Minnesota Department of Public Safety Interagency Hazardous Materials Public Sector Training and Planning Grants	2010-HMEP-00508	20.703	<u>2,517</u>
Total U.S. Department of Transportation			<u>\$ 2,242,016</u>
U.S. Department of Health and Human Services			
Passed Through Carlton, Cook, Lake, and St. Louis Community Health Board Centers for Disease Control and Prevention - Investigations and Technical Assistance		93.283	\$ 60,896
Temporary Assistance for Needy Families		93.558	7,739
Immunization - ARRA		93.712	2,538
Maternal and Child Health Services Block Grant		93.994	4,773
Passed Through Minnesota Department of Human Services Promoting Safe and Stable Families		93.556	3,066
Temporary Assistance for Needy Families		93.558	93,833
IV-D Child Support Cluster			
IV-D Child Support		93.563	215,308
IV-D Child Support - ARRA		93.563	14,784
Refugee and Entrant Assistance - State-Administered Programs		93.566	146
Child Care Mandatory and Matching Funds		93.596	4,234
Foster Care - Title IV-E Cluster			
Foster Care - Title IV-E		93.658	18,984
Foster Care - Title IV-E - ARRA		93.658	6,634
Social Services Block Grant		93.667	101,352
Chafee Foster Care Independence Program		93.674	2,050
State Children's Insurance Program		93.767	168
Medical Assistance		93.778	282,926

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**EXHIBIT D-2
(Continued)**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2010**

Federal Grantor Pass-Through Agency Grant Program Title	Pass-Through Grant Numbers	Federal CFDA Number	Expenditures
U.S. Department of Health and Human Services (Continued)			
Passed Through Minnesota Secretary of State Voting Access for Individuals with Disabilities - Grants to States		93.617	<u>4,000</u>
Total U.S. Department of Health and Human Services			<u>\$ 823,431</u>
U.S. Department of Homeland Security			
Passed Through Minnesota Department of Natural Resources Boating Safety Financial Assistance		97.012	\$ 14,425
Passed Through Minnesota Department of Public Safety			
Emergency Management Performance Grant	2010-EMPG-00597 2009-EMPG-00420 2008-HSGP-00763 2009-OSGP-00283	97.042	34,153
Homeland Security Grant Program	2009-OSGP-00530	97.067	<u>241,686</u>
Total U.S. Department of Homeland Security			<u>\$ 290,264</u>
Total Federal Awards			<u>\$ 6,930,125</u>

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2010

1. Reporting Entity

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

2. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Lake County under programs of the federal government for the year ended December 31, 2010. The information in this schedule is presented in accordance with the requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the schedule presents only a selected portion of the operations of Lake County, it is not intended to and does not present the financial position, changes in net assets, or cash flows of Lake County.

3. Summary of Significant Accounting Policies

Expenditures reported on the schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through entity identifying numbers are presented where available.

4. Reconciliation to Schedule of Intergovernmental Revenue

Federal grant revenue per Schedule of Intergovernmental Revenue	\$ 6,766,426
Grants received more than 90 days after year-end, deferred in 2010	
Broadband Initiatives Program	47,902
Highway Planning and Construction	118,982
Deferred in 2009, recognized as revenue in 2010	
Highway Planning and Construction	(3,185)
Expenditures Per Schedule of Expenditures of Federal Awards	\$ 6,930,125

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. American Recovery and Reinvestment Act

The American Recovery and Reinvestment Act of 2009 (ARRA) requires recipients to clearly distinguish ARRA funds from non-ARRA funding. In the schedule, ARRA funds are denoted by the addition of ARRA to the program name.

6. Subrecipients

During 2010, the County did not pass any federal money to subrecipients.

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2010**

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 That Could Have a Direct and Material Effect on Each Major Program and on 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 in accordance with Section 510(a) of OMB Circular A-133.
- G. The major programs are:
 - Schools and Roads - Grants to States CFDA #10.665
 - Community Development Block Grant - Small Cities Program CFDA #14.228
 - Highway Planning and Construction Cluster
 - Highway Planning and Construction CFDA #20.205
 - Recreational Trails Program CFDA #20.219

- H. The threshold for distinguishing between Types A and B programs was \$300,000.
- I. Lake County was not determined to be a low-risk auditee.

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

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, maintaining the general ledger, making journal entries, 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 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:

Limited staff does not allow the desired segregation of duties. Occasional re-assignment of duties will be attempted in order to increase the review of various functions.

03-2 Capital Assets

The County maintains its capital asset records on a 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 asset policy should be adopted which defines the County's accounting policies over capital assets, such as capitalization thresholds, useful lives, and depreciation methods. The policy should also include the procedures to be used to identify capital asset additions and deletions.

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 asset policy to define the accounting policies for capital assets. The policy should also 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 County intends to develop policies and procedures for capital assets and determine a process of doing a physical inventory in 2012.

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 County management intends to have staff from the Office of the State Auditor assist in preparation then, at a minimum, it must identify and train individuals to obtain the expertise that can sufficiently review, understand, and approve the County's financial statements, including notes.

Client's Response:

The County has established a financial coordinator position in the auditor's office. This position will attend outside training that is available and continue to work with the State Auditor's Office to prepare financial statements.

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, seven County employees had access to this function. Most journal entries are made by the Financial Coordinator, the County Auditor/Treasurer, 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 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 will further scrutinize the need for 7 employees to hold this function and work to develop a form to use for review and approval of journal entries.

06-2 Budgeting

The Lake County Board has adopted a formal written budget policy that includes policies on when budget amendments must go before the County Board for approval and when they may be submitted to the County Auditor/Treasurer only. However, the budget policy does not address how the budget will be monitored and who will monitor it.

We recommend the budget policy be revised to include budget monitoring procedures. These procedures could include department head review of monthly budget to actual reports, County Board review of periodic budget to actual reports, or County Budget Officer review of budget to actual reports. Reviewers should indicate their review of budget to actual reports by signing off on them.

Client's Response:

The County intends to amend the budget policy and hopes to have the new policy in place for 2012. The amended policy will address monitoring procedures.

06-3 Audit Adjustments

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements of the financial statements on a timely basis. Statement on Auditing Standards 115 defines a material weakness as a deficiency, or combination of deficiencies, in internal control such that this is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

During our audit, we proposed 13 adjustments that were material 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, adjust state-aid highway allotments, reclassify deficit cash balances, and make reclassification entries to revenues and expenditures 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 that 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 will attempt to assemble information for the County Board to review on the issue.

06-6 New Vendors

Lake County does not have any formal 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 its 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 will review the 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 payroll clerk 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 payroll clerk 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.

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 should be segregated from the payroll processing function, if possible.

Client's Response:

The County will set up a process to have the Human Resources Department review payroll edits before final payroll processing and will also attempt to have the Auditor or Financial Coordinator review a final payroll report before processing.

07-1 Approval of Time Sheets

During our prior audit, we noted that supervisors and certain employees who do not have immediate supervisors are approving their own time sheets. Approval of time sheets is an important internal control which helps to ensure that the time worked is reported accurately and reliably.

We recommend that each time sheet contain two attestations of the hours worked. One attestation should be by the employee, and the other should be by the employee's supervisor or other appropriate person.

Client's Response:

The County will require all employees with a direct supervisor to have two attestations on their time sheet, and the County Coordinator will review and initial all Department Head Timesheets after payroll processing.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS RESOLVED

Expenditure Approval - Community Development Block Grant - CFDA #14.228 (09-1)

During our prior year audit of this program, we determined that the expenditure approval process was not well documented. We noted the Lake County Housing and Redevelopment Authority (LCHRA) Board Chair's approving signature on only 2 of 20 expenditure invoices that we reviewed during our audit. Also, the Board Chair's signature was on the Disbursement Request Forms which covered only 10 of the 20 expenditures we tested. Therefore, we could not conclude that expenditures were being properly approved prior to being paid. We recommended a policy and procedure be established identifying who should review and approve invoices paid under the grant and how this approval should be documented.

Resolution

After our prior audit recommendations, the LCHRA Board established a policy and procedure for reviewing and approving invoices and Disbursement Request Forms. We noted the Board chair's approving signature on all invoices and Disbursement Request Forms after the policy and procedure was established.

Supporting Documentation - Community Development Block Grant - CFDA #14.228 (09-2)

During our prior year review of expenditures under this grant, we noted that 2 of 20 expenditures we tested did not have adequate supporting documentation. Expenditures should be properly supported by documentation as to the purpose of the charge or what service was being performed for the grant, and the time period the charge was incurred. For grant expenditures relating to an independent contractor, the expenditure should be supported by a billing from the independent contractor. The amount of necessary detail required in the billing should be established in the contract.

Resolution

All expenditures we reviewed during the current year audit were properly supported.

IV. OTHER FINDINGS AND RECOMMENDATIONS

A. MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM NOT RESOLVED

09-3 Prompt Payment

In the current audit, 3 of the 15 expenditures we reviewed under the Small Cities Development Grant Program, were not paid within 35 days of receipt of the invoice as required by Minn. Stat. § 471.425, subd. 2. In the prior audit, 6 of the 20 expenditures we reviewed were not paid timely.

To ensure compliance with Minn. Stat. § 471.425, subd. 2, we recommend the Lake County Auditor/Treasurer and the Housing Coordinator who administers this grant review the payment process and determine what may be causing these payments to be delayed beyond 35 days.

Client's Response:

The Housing Authority has not renewed its contract with the former coordinator of these grants. It has entered into an agreement with Arrowhead Economic Opportunity Agency to administer the grants. It is anticipated that vendor claims will be promptly forwarded to the County for payment.

PREVIOUSLY REPORTED ITEMS RESOLVED

Safekeeping of Investments (07-2)

During our prior audit, we noted the County had investments with two broker-dealers that were not properly held in safekeeping in accordance with Minn. Stat. § 118A.06 as it was in effect at December 31, 2009.

Resolution

Effective in 2010, the Legislature changed the requirements of Minn. Stat. § 118A.06 to allow broker-dealers to hold investments to the extent they maintain insurance through the Securities Investor Protection Corporation (SIPC) or excess insurance coverage in an amount equal to or greater than the value of the securities held. The County's broker dealers have SIPC coverage and excess SIPC coverage and are therefore eligible to hold County investments to the extent of that coverage.

Vendor Gifts (09-4)

During our prior audit, we noted that the Lake County Sheriff's Department had received various gifts from a vendor when ordering departmental supplies. Accepting gifts from a vendor is generally banned under various Minnesota Statutes such as Minn. Stat. § 382.18, Minn. Stat. § 471.895, and Minn. Stat. § 471.87. Also, the Lake County Code of Conduct Policy generally prohibits public officials or employees of Lake County from accepting gifts or anything of value other than items of nominal value, from any person, firm, or corporation to which a contract or purchase order has been or may be awarded. In addition, the Lake County Purchasing Policy generally states that an elected official or an employee of Lake County should not have a direct or indirect financial interest in any contract or purchase order for goods or services used by the County.

Resolution

Our current year review indicated that the County Sheriff's Department did not receive any further vendor gifts from this vendor after April 2010. The former County Undersheriff retired in 2010, and the new Undersheriff does not use this vendor.

Bidding (09-5)

During our prior audit, we noted the County purchased a trail groomer for \$160,000 without advertising for bids as required by Minn. Stat. §§ 471.345 and 375.21, which require that contracts estimated to exceed \$100,000 be solicited by public notice and be awarded to the lowest responsible bidder.

Resolution

During our current audit, we did not find any instances where items were not formally bid when they were required to be.

B. OTHER ITEM FOR CONSIDERATION

GASB Statement 54

The Governmental Accounting Standards Board's (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, is effective for Lake County for the year ending December 31, 2011. The standard's objectives are to enhance the usefulness of fund balance information included in the financial report through clearer fund balance classifications that can be consistently applied and to clarify existing governmental fund type definitions.

Fund Balance Reporting

Statement 54 establishes new fund balance classifications based on constraints imposed on how resources can be spent. The existing components of fund balance are reserved, unreserved-designated, and unreserved-undesignated. Statement 54 replaces these components with nonspendable, restricted, committed, assigned, and unassigned as defined below:

- *Nonspendable* - amounts that cannot be spent because they are either not in spendable form (for example, inventory or prepaid items) or legally or contractually required to be maintained intact (such as the corpus of a permanent fund).
- *Restricted* - amounts that can be spent only for specific purposes stipulated by constitution, external resource providers, or through enabling legislation.
- *Committed* - amounts that can be used only for specific purposes determined by a formal action of a government's highest level of decision-making authority.
- *Assigned* - amounts a government intends to use for a specific purpose that do not meet the criteria to be classified as restricted or committed.
- *Unassigned* - spendable amounts not contained in the other classifications.

The County should begin the process for implementing the new fund balance classifications. A key step in successfully implementing the new fund balance requirements is to plan ahead. The County can start with the following steps:

- review the requirements of GASB Statement 54;
- review current fund balances and compare to the new classifications;
- reclassify January 1, 2011, fund balance using the new classifications;
- review/update/prepare a comprehensive fund balance policy;
- prepare appropriate Board resolutions to commit fund balance; and
- if the Board of County Commissioners intends to delegate authority to assign fund balance, prepare the resolutions delegating that authority.

Governmental Fund Type Definitions

The definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are clarified in the new standard. The new definition for a special revenue fund could have significant impact on the County's current fund classifications.

GASB Statement 54 provides a new and clearer description of when it is appropriate to account for an activity using a special revenue fund. Special revenue funds are used to report specific revenue sources restricted or committed to specified purposes other than debt service and capital projects, where the restricted or committed revenue sources comprise a substantial portion of the fund's resources, and are expected to continue to do so in the future. The standard does not define substantial portion; however, most recommendations are generally that the restricted or committed revenues should comprise at least 35 to 50 percent of total fund revenues. Under this definition, it is possible that some current special revenue funds will no longer meet the requirements for special revenue fund treatment. The County's management should review the County's special revenue funds to ensure these funds continue to warrant treatment as special revenue funds.

The County's management should perform the following steps prior to December 31, 2011:

- prepare a list of the County's special revenue funds;
- determine the sources of revenues for each of those funds;
- identify whether any of those revenues are restricted or committed;
- determine if these restricted or committed revenues represent a substantial portion of the fund's revenues and are expected to continue to be a substantial source of revenues;
 - if yes, the fund may continue to be classified as a special revenue fund;
 - if not, determine whether the County will combine that fund with the general fund or with a similar purpose special revenue fund that meets the new definition;
- code revenues in the general ledger by source constraints--restricted, committed, assigned, or unassigned; and
- determine if there needs to be a restatement of beginning fund balances.

Additional implementation steps could include: informing any component units that they also will need to meet the requirements; deciding on how fund balance will be presented in the financials, such as detailed vs. aggregate methods; and developing the potential note disclosures. Additional guidance on GASB Statement 54 can be found on the Office of the State Auditor's website at: http://www.auditor.state.mn.us/other/Statements/fundbalances_postGASB54_1012_statement.pdf.



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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, 2010, which collectively comprise the County's basic financial statements, and have issued our report thereon dated September 29, 2011. The financial statements include the Nursing Home Enterprise Fund as of and for the year ended September 30, 2010. 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 preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material

weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the County's financial statements will not be prevented or detected and corrected, on a timely basis. We considered the deficiency described in the accompanying Schedule of Findings and Questioned Costs as item 06-3 to be a material weakness.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 96-11, 03-2, 03-4, 06-1, 06-2, 06-4, 06-6, 06-7, and 07-1 to be significant deficiencies.

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 Political Subdivisions*, 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 Political Subdivisions* contains seven categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, miscellaneous provisions, and tax increment financing. Our study included all of the listed categories, except that the testing for compliance with tax increment financing was done with the audit of the Lake County Housing and Redevelopment Authority component unit.

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 09-3.

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

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

This report is intended solely for the information and use of the Board of County Commissioners, management, 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

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

September 29, 2011

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REBECCA OTTO
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REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of County Commissioners
Lake County

Compliance

We have audited Lake County's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2010. 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 could have a direct and material effect on each of its major federal programs for the year ended December 31, 2010.

Internal Control Over Compliance

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 to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, 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.

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

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

September 29, 2011