STATE OF MINNESOTA

Office of the State Auditor

Rebecca Otto
State Auditor

ST. LOUIS AND LAKE COUNTIES
REGIONAL RAILROAD AUTHORITY
EVELETH, MINNESOTA

YEAR ENDED DECEMBER 31, 2011

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.

Office of the State Auditor
525 Park Street, Suite 500
Saint Paul, Minnesota 55103
(651) 296-2551
state.auditor@osa.state.mn.us
www.auditor.state.mn.us

This document can be made available in alternative formats upon request. Call 651-296-2551 [voice] or 1-800-627-3529 [relay service] for assistance; or visit the Office of the State Auditor's web site: www.auditor.state.mn.us.

ST. LOUIS AND LAKE COUNTIES
REGIONAL RAILROAD AUTHORITY
EVELETH, MINNESOTA

Year Ended December 31, 2011

Audit Practice Division
Office of the State Auditor
State of Minnesota

This page was left blank intentionally.

ST. LOUIS AND LAKE COUNTIES
REGIONAL RAILROAD AUTHORITY
EVELETH, MINNESOTA

TABLE OF CONTENTS

This page was left blank intentionally.

Introductory Section

This page was left blank intentionally.

ST. LOUIS AND LAKE COUNTIES
REGIONAL RAILROAD AUTHORITY
EVELETH, MINNESOTA

ORGANIZATION
DECEMBER 31, 2011

Board	Representing
Steve Raukar, Chair	St. Louis County
Chris Dahlberg, Alternate	St. Louis County
Keith Nelson	St. Louis County
Steve O'Neil, Alternate	St. Louis County
Peg Sweeney	St. Louis County
Paul Bergman, Secretary/Treasurer	Lake County
Rick Goutermont, Vice Chair	Lake County
Rich Sve, Alternate	Lake County

Executive Director

Robert Manzoline

This page was left blank intentionally.

Financial Section

This page was left blank intentionally.

STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

SUITE 500
525 PARK STREET
SAINT PAUL, MN 55103-2139

REBECCA OTTO
STATE AUDITOR

(651) 296-2551 (Voice)
(651) 296-4755 (Fax)
state.auditor@state.mn.us (E-mail)
1-800-627-3529 (Relay Service)

INDEPENDENT AUDITOR'S REPORT

Board of Directors
St. Louis and Lake Counties
Regional Railroad Authority

We have audited the accompanying financial statements of the governmental activities and the General Fund of the St. Louis and Lake Counties Regional Railroad Authority as of and for the year ended December 31, 2011, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the General Fund of the St. Louis and Lake Counties Regional Railroad Authority as of December 31, 2011, and the respective changes in financial position thereof and the budgetary comparison of the General Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, during the year ended December 31, 2011, the Authority adopted Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. GASB Statement 54 provides clearer fund balance classifications that can be more consistently applied and clarifies existing governmental fund type definitions.

Management has omitted the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the GASB, who consider it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 3, 2013, on our consideration of the St. Louis and Lake Counties Regional Railroad Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

May 3, 2013

BASIC FINANCIAL STATEMENTS

This page was left blank intentionally.

ST. LOUIS AND LAKE COUNTIES
REGIONAL RAILROAD AUTHORITY
EVELETH, MINNESOTA

EXHIBIT 1

GENERAL FUND BALANCE SHEET AND
GOVERNMENTAL ACTIVITIES - STATEMENT OF NET ASSETS
WITH ADJUSTMENTS TO CONVERT MODIFIED TO FULL ACCRUAL
DECEMBER 31, 2011

	General Fund	Adjustments	Governmental Activities
Assets			
Cash and pooled investments	$ 2,033,051	$ -	$ 2,033,051
Accounts receivable	26,663	-	26,663
Taxes receivable - delinquent	90,842	-	90,842
Due from other governments	205,853	-	205,853
Capital assets			
Non-depreciable	-	3,804,510	3,804,510
Depreciable - net of accumulated depreciation	-	8,538,834	8,538,834
Total Assets	**$ 2,356,409**	**$ 12,343,344**	**$ 14,699,753**
Liabilities and Fund Balance/Net Assets			
Liabilities			
Current liabilities			
Accounts payable	$ 108,846	$ -	$ 108,846
Salaries payable	8,186	-	8,186
Due to other governments	32,598	-	32,598
Deferred revenue - unavailable	227,165	(227,165)	-
Deferred revenue - unearned	40,638	-	40,638
Noncurrent liabilities			
Compensated absences payable - due within one year	-	5,551	5,551
Compensated absences payable - long-term	-	43,604	43,604
Total Liabilities	**$ 417,433**	**$ (178,010)**	**$ 239,423**
Fund Balance			
Assigned			
Compensated absences	$ 43,604	$ (43,604)	
Future trail maintenance	354,539	(354,539)	
Unassigned	1,540,833	(1,540,833)	
Total Fund Balance	**$ 1,938,976**	**$ (1,938,976)**	
Net Assets			
Invested in capital assets		$ 12,343,344	$ 12,343,344
Unrestricted		2,116,986	2,116,986
Total Net Assets		**$ 14,460,330**	**$ 14,460,330**
Total Liabilities and Fund Balance/Net Assets	**$ 2,356,409**	**$ 12,343,344**	**$ 14,699,753**

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

ST. LOUIS AND LAKE COUNTIES
REGIONAL RAILROAD AUTHORITY
EVELETH, MINNESOTA

EXHIBIT 1
(Continued)

GENERAL FUND BALANCE SHEET AND
GOVERNMENTAL ACTIVITIES - STATEMENT OF NET ASSETS
WITH ADJUSTMENTS TO CONVERT MODIFIED TO FULL ACCRUAL
DECEMBER 31, 2011

Reconciliation of the General Fund Balance to Net Assets	
Fund Balance - General Fund	**$ 1,938,976**
Capital assets, net of accumulated depreciation, used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.	12,343,344
Other long-term assets are not available to pay for the current period expenditures and, therefore, are deferred in the governmental funds.	227,165
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the governmental funds.	(49,155)
Net Assets - Governmental Activities	**$ 14,460,330**

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

ST. LOUIS AND LAKE COUNTIES
REGIONAL RAILROAD AUTHORITY
EVELETH, MINNESOTA

EXHIBIT 2

**GENERAL FUND STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
AND GOVERNMENTAL ACTIVITIES - STATEMENT OF ACTIVITIES
WITH ADJUSTMENTS TO CONVERT MODIFIED TO FULL ACCRUAL
FOR THE YEAR ENDED DECEMBER 31, 2011**

	General Fund	Adjustments	Governmental Activities
Revenues			
Taxes	$ 1,158,250	$ 6,423	$ 1,164,673
Intergovernmental	848,412	(307,592)	540,820
Charges for services	14,340	-	14,340
Miscellaneous	160,418	-	160,418
Capital contributions	-	785,456	785,456
Total Revenues	**$ 2,181,420**	**$ 484,287**	**$ 2,665,707**
Expenditures/Expenses			
Current			
Economic development			
Administration	$ 1,491,425	$ (457,974)	$ 1,033,451
Depreciation	-	203,902	203,902
Capital outlay	16,743	-	16,743
Total Expenditures/Expenses	**$ 1,508,168**	**$ (254,072)**	**$ 1,254,096**
Net Change in Fund Balance/Net Assets	**$ 673,252**	**$ 738,359**	**$ 1,411,611**
Fund Balance/Net Assets - January 1	**1,265,724**	**11,782,995**	**13,048,719**
Fund Balance/Net Assets - December 31	**$ 1,938,976**	**$ 12,521,354**	**$ 14,460,330**

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

ST. LOUIS AND LAKE COUNTIES
REGIONAL RAILROAD AUTHORITY
EVELETH, MINNESOTA

EXHIBIT 2
(Continued)

GENERAL FUND STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE AND GOVERNMENTAL ACTIVITIES - STATEMENT OF ACTIVITIES WITH ADJUSTMENTS TO CONVERT MODIFIED TO FULL ACCRUAL FOR THE YEAR ENDED DECEMBER 31, 2011

Reconciliation of the Statement of General Fund Revenues, Expenditures, and Changes in Fund Balance to the Statement of Activities of Governmental Activities		
Net Change in Fund Balance		**$ 673,252**
In the General Fund, under the modified accrual basis, receivables not available for expenditures are deferred. In the Statement of Activities, those revenues are recognized when earned. The adjustment to revenues between the General Fund and the governmental activities is the increase or decrease in revenues deferred as unavailable.		
Deferred revenue - December 31	$ 227,165	
Deferred revenue - January 1	(528,334)	(301,169)
Governmental funds report capital outlay as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.		
Expenditures for general capital assets and infrastructure	$ 446,219	
Capital contributions	785,456	
Current year depreciation	(203,902)	1,027,773
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.		
Changes in compensated absences		11,755
Change in Net Assets of Governmental Activities		**$ 1,411,611**

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

ST. LOUIS AND LAKE COUNTIES
REGIONAL RAILROAD AUTHORITY
EVELETH, MINNESOTA

EXHIBIT 3

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
BUDGETARY COMPARISON
FOR THE YEAR ENDED DECEMBER 31, 2011

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget
Revenues				
Taxes	**$ 1,369,549**	**$ 1,369,549**	**$ 1,158,250**	**$ (211,299)**
Intergovernmental				
Federal				
Payments in lieu of taxes	$ -	$ -	$ 9	$ 9
State				
LCMR	-	$ -	378,414	378,414
Market value credit	100,662	100,662	100,662	-
Taconite credit	-	-	55,269	55,269
State PERA	-	-	1,233	1,233
Mobile home taconite credit	-	-	776	776
State 30% rental	-	-	2	2
Disparity reduction credit	-	-	25,061	25,061
Local				
Other local grants	49,200	49,200	206,986	157,786
Reimbursement for administrative services				
Minneapolis-Duluth/Superior Passenger Rail Alliance	97,000	97,000	80,000	(17,000)
Total intergovernmental	**$ 246,862**	**$ 246,862**	**$ 848,412**	**$ 601,550**
Charges for services	**$ 37,500**	**$ 37,500**	**$ 14,340**	**$ (23,160)**
Miscellaneous	**$ 50,201**	**$ 50,201**	**$ 160,418**	**$ 110,217**
Total Revenues	**$ 1,704,112**	**$ 1,704,112**	**$ 2,181,420**	**$ 477,308**
Expenditures				
Current				
Economic development	$ 2,083,912	$ 2,083,912	$ 1,491,425	$ (592,487)
Capital outlay	-	-	16,743	16,743
Total Expenditures	**$ 2,083,912**	**$ 2,083,912**	**$ 1,508,168**	**$ (575,744)**
Net Change in Fund Balance	**$ (379,800)**	**$ (379,800)**	**$ 673,252**	**$ 1,053,052**
Fund Balance - January 1	**1,265,724**	**1,265,724**	**1,265,724**	**-**
Fund Balance - December 31	**$ 885,924**	**$ 885,924**	**$ 1,938,976**	**$ 1,053,052**

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

This page was left blank intentionally.

1. Summary of Significant Accounting Policies

The St. Louis and Lake Counties Regional Railroad Authority's financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as of and for the year ended December 31, 2011. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (statements and interpretations). Governments are also required to follow the pronouncements of the Financial Accounting Standards Board issued through November 30, 1989, (when applicable) that do not conflict with or contradict GASB pronouncements. The more significant accounting policies established in GAAP and used by the St. Louis and Lake Counties Regional Railroad Authority are discussed below.

A. Financial Reporting Entity

The St. Louis and Lake Counties Regional Railroad Authority was established July 14, 1986, under the Regional Railroad Authorities Act, Minn. Stat. §§ 398A.01 to 398A.09. It is governed by a Board composed of three members from the St. Louis County Board of Commissioners and two members from the Lake County Board of Commissioners. Both counties also appoint an alternate member. Its purpose is to operate a scenic tourist excursion railway in Northeastern Minnesota and create a paved multi-purpose trail along abandoned rail lines, where possible, which will enable users to access one community from another. The Board is organized with a chair, vice chair, and secretary-treasurer elected each year.

St. Louis County, as fiscal agent, reports the transactions of the Authority in an agency fund on its annual financial statements.

B. Basic Financial Statements

Basic financial statements include information on the Authority's activities as a whole and information on the individual fund of the Authority. These separate presentations are reported in different columns on Exhibits 1 and 2. Each of the exhibits starts with a column of information based on activities of the General Fund and reconciles it to a column that reports the "governmental activities" of the Authority as a whole.

1. Summary of Significant Accounting Policies

B. Basic Financial Statements (Continued)

The governmental activities columns are reported on the full accrual, economic resources basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations. The Authority's net assets are reported in two parts: invested in capital assets and unrestricted net assets. The Statement of Activities demonstrates the degree to which the expenses of the Authority are offset by revenues.

The Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balance for the General Fund are presented on the modified accrual basis and report current financial resources.

C. Measurement Focus and Basis of Accounting

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

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 Authority considers all revenues except for tax revenue as available if collected within 90 days after the end of the current period. Tax revenue is considered available if collected within 60 days after the end of the current period. Charges for services and interest are considered susceptible to accrual. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on long-term debt, compensated absences, and claims and judgments, which are recognized as expenditures to the extent that they have matured. Proceeds of long-term debt and acquisitions under capital leases, if any, 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.

1. Summary of Significant Accounting Policies (Continued)

D. Budgetary Data

The Authority adopts estimated revenue and expenditure budgets for the General Fund on a basis consistent with generally accepted accounting principles. The budget can be amended during the year by the Authority's Board.

E. Assets, Liabilities, and Net Assets or Equity

1. Taxes Receivable

Taxes receivable consist of uncollected taxes payable in the years 2003 to 2011. Taxes receivable are offset by deferred revenue for the amount not collected within 60 days of December 31 to indicate they are not available to pay current expenditures. No provision has been made for an estimated uncollectible amount.

2. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets (for example, paved trails, bridges, sidewalks, and similar items), are reported in the governmental activities column in the government-wide financial statements. Capital assets are defined by the Authority as assets with an initial, individual cost of more than $5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized.

Property, plant, and equipment of the St. Louis and Lake Counties Regional Railroad Authority are depreciated using the straight-line method over the following estimated useful lives:

Assets	Years
Infrastructure	20 - 40
Machinery, furniture, and equipment	3 - 20

1. Summary of Significant Accounting Policies

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

3. Fund Equity

In 2011, the Authority implemented the requirements of Statement No. 54 of the Governmental Accounting Standards Board, *Fund Balance Reporting and Governmental Fund Type Definitions*. The statement requires retroactive restatement of fund balance for the reclassifications made to conform to this statement. Total fund balance did not change. Fund balance is now classified as:

Non-spendable - amounts that cannot be spent because they are not in spendable form, or are legally or contractually required to be maintained intact. The "not in spendable form" criterion includes items that are not expected to be converted to cash.

Restricted - amounts with constraints placed on the use of resources either externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or is imposed by law through constitutional provisions or enabling legislation.

Committed - amounts that can be used only for the specific purposes imposed by formal action (ordinance or resolution) of the Authority's board. Those committed amounts cannot be used for any other purpose unless the Board removes or changes the specified use by taking the same type of actions (ordinance or resolution) it employed to previously commit these amounts.

Assigned - amounts the Authority's Board intends to use for specific purposes that do not meet the criteria to be classified as restricted or committed. In the General Fund, assigned amounts represent intended uses established by the Board.

Unassigned - the residual classification for the General Fund, it includes all spendable amounts not contained in the other fund balance classifications.

1. Summary of Significant Accounting Policies

E. Assets, Liabilities, and Net Assets or Equity

3. Fund Equity (Continued)

The Authority applies restricted resources first when expenditures are incurred for purposes for which either restricted or unrestricted (committed, assigned, and unassigned) amounts are available. Similarly, within unrestricted fund balance, committed amounts are reduced first followed by assigned, and then unassigned amounts when expenditures are incurred for purposes for which amounts in any of the unrestricted fund balance classifications could be used.

4. 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. Detailed Notes

A. Assets

1. Deposits and Investments

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

The Authority deposits all its cash with its fiscal agent, St. Louis County. Additional disclosures, as required by GASB Statement No. 40, *Deposits and Investment Risk Disclosure*; and Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools,* are disclosed in the St. Louis County Comprehensive Annual Financial Report.

2. Detailed Notes

A. Assets (Continued)

2. Receivables

Receivables as of December 31, 2011, for the St. Louis and Lake Counties Regional Railroad Authority's governmental activities are as follows:

Due from other governments	$	205,853
Taxes receivable		90,842
Accounts		26,663
Total Receivables	$	323,358

3. Capital Assets

Governmental capital asset activity for the year ended December 31, 2011, was as follows:

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	$ 126,211	$ -	$ -	$ 126,211
Construction in progress	3,089,115	821,755	232,571	3,678,299
Total capital assets not depreciated	$ 3,215,326	$ 821,755	$ 232,571	$ 3,804,510
Capital assets depreciated				
Infrastructure	$ 10,316,186	$ 625,748	$ -	$ 10,941,934
Machinery, furniture, and equipment	140,959	16,743	-	157,702
Total capital assets depreciated	$ 10,457,145	$ 642,491	$ -	$ 11,099,636
Less: accumulated depreciation for				
Infrastructure	$ 2,301,014	$ 198,337	$ -	$ 2,499,351
Machinery, furniture, and equipment	55,886	5,565	-	61,451
Total accumulated depreciation	$ 2,356,900	$ 203,902	$ -	$ 2,560,802
Total capital assets depreciated, net	$ 8,100,245	$ 438,589	$ -	$ 8,538,834
Total Capital Assets, Net	$ 11,315,571	$ 1,260,344	$ 232,571	$ 12,343,344

2. Detailed Notes

A. Assets

3. Capital Assets (Continued)

Depreciation expense was charged to functions/programs as follows:

Governmental Activities		
Economic development	$	203,902

B. Liabilities

1. Payables

Payables at December 31, 2011, for the St. Louis and Lake Counties Regional Railroad Authority's governmental activities are as follows:

Accounts	$	108,846
Salaries		8,186
Due to other governments		32,598
Total Payables	$	149,630

2. Deferred Revenue

St. Louis and Lake Counties Regional Railroad Authority's fund and the government-wide financial statements defer revenue for resources that have been received but not yet earned. The governmental fund also reports deferred revenue in connection with receivables for revenues not considered to be available to liquidate liabilities of the current period.

3. Compensated Absences

The liability for compensated absences reported in the financial statements consists of unpaid, accumulated annual vacation and sick leave balances. The liability has been calculated using the vesting method, in which leave amounts for employees who currently are eligible to receive termination payments and other

2. Detailed Notes

B. Liabilities

3. Compensated Absences (Continued)

employees who are expected to become eligible in the future to receive such payments upon termination are included. Compensated absences are accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in the governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

The following is a summary of the changes in long-term compensated absences payable for the year ended December 31, 2011:

Payable - January 1	$	60,910
Net increase (decrease)		(11,755)
Payable - December 31	$	49,155

Under the St. Louis and Lake Counties Regional Railroad Authority's labor agreements, its employees are granted vacation and sick leave in varying amounts based on length of service. Vacation leave accrual is 5 to 20 days per year. Sick leave accrual is 13 to 16.25 days per year.

Unused, accumulated vacation is paid to employees upon termination. The current portion of unused vacation is recognized as a current liability in the government-wide Statement of Net Assets. Vested sick leave is paid to employees at retirement or is used for the payment of employees' health insurance coverage during their retirement. The vested sick leave and unvested sick leave likely to become vested (vesting sick leave) are estimated using the vesting method prescribed by GASB Statement 16. Both vested and vesting amounts are recognized in the government-wide financial statements as liabilities, but not in the governmental fund.

2. Detailed Notes

B. Liabilities (Continued)

4. Risk Management

The St. Louis and Lake Counties Regional Railroad Authority is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; injuries to employees; or natural disasters. The Authority maintains commercial insurance policies to address these risks of loss, either by purchasing the policies directly from commercial insurers or by contractual commitments from third parties to name the Authority as an additional insured on policies of commercial liability insurance maintained by the contracting parties. There were no significant reductions in insurance coverage from the previous year. There were no settlements in excess of insurance for any of the past three fiscal years.

3. Pension Plans

A. Plan Description

All full-time and certain part-time employees of the St. Louis and Lake Counties Regional Railroad Authority are covered by defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the General Employees Retirement Fund, which is a cost-sharing, multiple-employer retirement plan. The plan is 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.

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 (five years for those first eligible for membership after June 30, 2010). Defined retirement benefits are based on a member’s average yearly salary for the five highest-paid consecutive years of allowable service, age, and years of credit at termination of service.

3. Pension Plans

A. Plan Description (Continued)

Two methods are used to compute benefits for Coordinated and Basic Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Basic Plan member is 2.2 percent of average salary for each of the first ten years of service and 2.7 percent for each year thereafter. For a Coordinated Plan member, the annuity accrual rate is 1.2 percent of average salary for each of the first ten years and 1.7 percent for each successive year. Using 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 General Employees Retirement Fund members whose annuity is calculated using Method 1, a full annuity is available when age plus years of service equal 90. Normal retirement age is 65 for members hired prior to July 1, 1989, and is the age for unreduced Social Security benefits capped at age 66 for Coordinated Plan members hired on or after July 1, 1989. 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. 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.

B. 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 St. Louis and Lake Counties Regional Railroad Authority makes annual contributions to the pension plans equal to the amount required by state statutes.

3. Pension Plans

B. Funding Policy (Continued)

General Employees Retirement Fund Basic Plan members and Coordinated Plan members are required to contribute 9.10 and 6.25 percent, respectively, of their annual covered salary.

The Authority is required to contribute the following percentages of annual covered payroll in 2011:

General Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	7.00

The Authority's contributions for the years ending December 31, 2011, 2010, and 2009, for the General Employees Retirement Fund were:

2011	2010	2009
$ 13,587	$ 13,027	$ 10,760

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

4. Related Organizations

Minneapolis-Duluth/Superior Passenger Rail Alliance

The St. Louis and Lake Counties Regional Railroad Authority, along with several other governmental entities, formed the Minneapolis-Duluth/Superior Passenger Rail Alliance on February 1, 2008, under a Joint Powers Agreement in accordance with Minn. Stat. §§ 471.59, 398A.04, and 398A.06. Its purpose is to collaboratively discuss, study, plan for, promote, and facilitate the development of intercity passenger rail transportation between the Twin Cities Metropolitan and Twin Ports areas. The Alliance is governed by a ten-member Board of Directors composed of one elected official selected by each party represented in the Alliance. Each member of the Alliance contributes funds to the Alliance for use in funding its operations. The Authority contributed $76,000 and $96,000 to the Alliance in 2011 and 2010, respectively.

4. Related Organizations

Minneapolis-Duluth/Superior Passenger Rail Alliance (Continued)

The Minneapolis-Duluth/Superior Passenger Rail Alliance does not have any employees of its own. The St. Louis and Lake Counties Regional Railroad Authority contracted with the Alliance to administer its day to day activities. In return for services provided, the Alliance reimbursed the Authority $80,000 and $88,000 in 2011 and 2010, respectively, for services provided.

5. Subsequent Event

June 30, 2012, Flooding

Flooding on June 30, 2012, caused damage to the Lakefront Line Railroad and to the Mesabi Trail amounting to an estimated total repair cost of $425,820. Most repairs have been completed with the exception of repairs to the Mesabi Trail at mile post 72, which are still ongoing. FEMA is expected to provide reimbursement for approximately 60 percent of the cost of repairs with $220,744 provided so far. The State of Minnesota has also indicated that it may contribute to the cost of repairs that are not paid for by FEMA.

Management and Compliance Section

This page was left blank intentionally.

SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2011

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

03-1 Internal Control/Segregation of Duties

Criteria: Management is responsible for establishing and maintaining internal control. This responsibility includes the internal control over the various accounting cycles, the fair presentation of the financial statements and related notes, and the accuracy and completeness of all financial records and related information. Also, management is responsible for controls over the period-end financial reporting process, including controls over procedures used to enter transaction totals into the general ledger; initiate, authorize, record, and process journal entries into the general ledger; and record recurring and nonrecurring adjustments to the financial statements. Adequate segregation of duties is a key internal control in an organization's accounting system and in meeting management's financial reporting responsibilities.

Condition: The limited number of staff results in lack of segregation of accounting functions necessary to insure adequate internal accounting control.

Context: It is not unusual for an organization the size of the St. Louis and Lake Counties Regional Railroad Authority to be limited in the internal control that management can design and implement into the organization.

Effect: Inadequate segregation of duties results in a weakness in the Authority's internal controls over its accounting functions and the financial reporting process which may affect the ability of the Authority to detect and correct or prevent misstatements in a timely manner by staff in the normal course of performing their assigned functions.

Cause: The size and structure of the St. Louis and Lake Counties Regional Railroad Authority limit the internal control that management can design and implement into the organization.

Recommendation: Management should be aware that segregation of duties is not adequate from an internal control point of view. We recommend the Board of Directors be mindful that limited staffing causes inherent risks in safeguarding the Authority's assets and the proper reporting of its financial activity. We recommend the Board of Directors continue to implement oversight procedures and monitor those procedures to determine if they are still effective internal controls.

Client's Response:

Management is aware of internal control responsibility, and the Board of Directors is aware that staff limitations are not adequate for the Authority's accounting system. Management has recommended, and the Board of Directors has approved, continuation of agreements with the St. Louis County Auditor's Office and the State of Minnesota Office of the Auditor for accounting, financial statements, and recording services.

11-1 Audit Adjustments and Reclassifications

Criteria: 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 there is a reasonable probability that a material misstatement of the Authority's financial statements will not be prevented, or detected and corrected, on a timely basis.

Condition: During our audit, we identified material adjustments that resulted in significant changes to the Authority's financial statements. Material adjustments were required to recognize additional construction in progress and infrastructure expenditures and to correctly record contributed capital in the government-wide financial statements of the Authority.

Context: St. Louis County is the Authority's fiscal agent. The Authority is reported in the County's general ledger as an agency fund. The County employs a capital asset management system, and capital transactions incurred by the Authority must be coded to the correct object code in order to be reported correctly.

Effect: An inability to identify and correct material adjustments to the Authority's financial statements is an indication of a material weakness in the financial reporting process.

Cause: Capital-related expenditures and contributed capital are not being correctly reported to and/or recorded by the fiscal agent in the accounting records of the Authority.

Recommendation: We recommend the Authority develop procedures to ensure that capital assets, including construction in progress and infrastructure, and capital contributions are correctly coded to object and source for proper classification in the fiscal agent's accounting records. Detailed schedules should be maintained identifying construction activities, related capital expenditures, and funding sources that support amounts reported in the Authority's financial statements as capital transactions. Authority management should periodically review fiscal agent financial reports to ensure accuracy.

Client's Response

Management will make adjustments to capital asset recording particularly with projects under construction. Construction(s) in progress will be capitalized for those projects that carry over from one calendar year into the next calendar year.

11-2 Fund Balance Reporting

Criteria: Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* requires components of fund balance to be reported as non-spendable, restricted, committed, assigned, and unassigned. In the implementation year, beginning fund balances are required to be restated to the new classifications and all subsequent activity reported under those categories.

Condition: During the year ended December 31, 2011, the Authority implemented GASB Statement 54. The Authority reported $134,419 in compensated absences as committed fund balance in its general ledger at year-end; however, the Authority's governing Board had not taken action before year-end to commit any portion of fund balance. Additionally, although a Board resolution had authorized $75,000 of the Authority's fund balance to be assigned to future trail maintenance, only $50,000 was recorded in the general ledger.

Context: In order to commit funds, an entity's governing board must take action before fiscal year-end in the form of a resolution or ordinance. The resolution or ordinance must identify the purpose for which funds are to be committed, an estimate of the resources committed, and the conditions under which funds may be released. Only Board action may release funds once committed. Additionally, Board actions and other financial activity needs to be accurately reported to the Authority's fiscal agent, St. Louis County, in a timely manner in order to be correctly reported in the Authority's general ledger.

Effect: A component of the Authority's fund balance was not correctly reported in its general ledger in accordance with the requirements of GASB Statement 54. This resulted in an audit reclassification of committed fund balance to assigned fund balance. Also, an audit adjust was required to correct assigned year-end fund balance for future trail maintenance.

Cause: The Authority erred in classifying the components of fund balance required under GASB Statement 54 and in the determination of the proper valuation of the future trail maintenance fund balance account.

Recommendation: We recommend the Authority develop procedures to ensure that financial transactions affecting fund balance are properly classified in the Authority's general ledger in accordance with the requirements of GASB Statement 54. We also recommend that the Authority review the account balances in its general ledger periodically to ensure the fiscal agent has properly recorded all financial activity to date.

Client's Response:

Management has worked with the St. Louis County Auditor's Office to put into place a coding system that will identify expenditures and financial transactions dedicated for future trail maintenance funds. This procedure was enacted January 2012.

PREVIOUSLY REPORTED ITEMS RESOLVED

Capital Asset Records (09-1)

Capital asset records were not being adequately maintained to account for capital-related transactions including construction in progress and infrastructure.

Resolution

In 2011, the Authority had prepared schedules for capital-related transactions.

Designated Fund Balance Account Records (10-1)

Expenditures were not properly coded, resulting in incorrect amounts charged against the designated for future trail maintenance fund balance account.

Resolution

The implementation of GASB Statement 54 resulted in new classifications for the components of fund balance. The future trail maintenance account was reviewed as part of the implementation of the new fund balance classifications, and account balances adjusted as necessary to conform to the requirements of GASB Statement 54.

REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

SUITE 500
525 PARK STREET
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)
(651) 296-4755 (Fax)
state.auditor@state.mn.us (E-mail)
1-800-627-3529 (Relay Service)

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 Directors
St. Louis and Lake Counties
Regional Railroad Authority

We have audited the financial statements of the governmental activities and the General Fund of the St. Louis and Lake Counties Regional Railroad Authority as of and for the year ended December 31, 2011, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated May 3, 2013. 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

Management of the St. Louis and Lake Counties Regional Railroad Authority is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the St. Louis and Lake Counties Regional Railroad Authority'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 Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the 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 Recommendations, 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 Authority's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency described in the accompanying Schedule of Findings and Recommendations as item 11-1 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 Recommendations as items 03-1 and 11-2 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the St. Louis and Lake Counties Regional Railroad Authority 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 six categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, and miscellaneous provisions. Our study included all of the listed categories, except we did not test for the following: public indebtedness, because the Authority did not issue any debt; deposits and investments and claims and disbursements, because they are tested in conjunction with the audit of St. Louis County.

The results of our tests indicate that for the items tested, the St. Louis and Lake Counties Regional Railroad Authority complied with the material terms and conditions of applicable legal provisions.

The St. Louis and Lake Counties Regional Railroad Authority's written responses to the internal control findings identified in our audit have been included in the Schedule of Findings and Recommendations**.** We did not audit the Authority's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Board of Directors, management, and others within the St. Louis and Lake Counties Regional Railroad Authority and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto	*/s/Greg Hierlinger*
REBECCA OTTO STATE AUDITOR	GREG HIERLINGER, CPA DEPUTY STATE AUDITOR

May 3, 2013