STATE OF MINNESOTA

Office of the State Auditor

Rebecca Otto
State Auditor

LAKE COUNTY
TWO HARBORS, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2012

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, 2012

Audit Practice Division
Office of the State Auditor
State of Minnesota

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LAKE COUNTY
TWO HARBORS, MINNESOTA

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Introductory Section

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LAKE COUNTY
TWO HARBORS, MINNESOTA

ORGANIZATION
DECEMBER 31, 2012

			Term Expires
Elected			
Commissioner	Thomas Clifford	District 1	January 2013
Commissioner	Derrick Goutermont	District 2	January 2017
Commissioner	Brad Jones	District 3	January 2017
Commissioner	Paul Bergman	District 4	January 2015
Commissioner	Rich Sve	District 5	January 2017
Attorney	Laura M. Auron		January 2015
Auditor/Treasurer	Steven R. McMahon		January 2015
Recorder	Erica Koski		January 2015
Sheriff	Carey Johnson		January 2015
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 2016
Veterans Service Officer	Nazareth V. Sando		September 2015
Clerk of the Board	Laurel Buchanan		Indefinite
County Administrator	Matthew Huddleston		Indefinite
Human Services			
Board Members	Thomas Clifford		January 2013
	Derrick Goutermont		January 2017
	Brad Jones		January 2017
	Paul Bergman		January 2015
	Rich Sve		January 2017
	Kathy Goedel		Indefinite
	Christine Johnson		Indefinite
Director	Vickie Thompson		Indefinite

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Financial Section

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STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

REBECCA OTTO
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INDEPENDENT AUDITOR'S REPORT

Board of County Commissioners
Lake County

Report on the Financial Statements

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, 2012, and the related notes to the financial statements, which collectively comprise the County's basic financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the County's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the County’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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, 2012, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, 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.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Lake County’s basic financial statements. The supplementary information as listed in the table of contents 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. Such 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 as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated September 25, 2013, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Lake County's internal control over financial reporting and compliance.

Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (SEFA) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information 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. The 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 SEFA is fairly stated in all material respects in relation to the basic financial statements as a whole.

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

September 25, 2013

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MANAGEMENT'S DISCUSSION AND ANALYSIS

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LAKE COUNTY
TWO HARBORS, MINNESOTA

MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2012
(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, 2012. 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 have a total net position of $106,655,011, of which $89,217,867 is the net investment in capital assets and $2,071,890 is restricted to specific purposes.

- Business-type activities have a total net position of $131,933. Net investment in capital assets represents $2,081,300 of the total.

- Lake County's net position increased by $3,568,581 for the year ended December 31, 2012. The Lake County Housing and Redevelopment Authority is shown as the "Discretely Presented Component Unit." The net position of the County's discretely presented component unit increased by $331,847.

- The net cost of governmental activities was $8,420,475 for the current fiscal year. The net cost was funded by general revenues and other items totaling $11,857,123.

- Governmental funds' fund balances increased by $1,565,796.

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 - Other Postemployment Benefits 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 position 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 Position and the Statement of Activities

The statement of net position 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 position and changes in them. You can think of the County's net position--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 position 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 position 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 broadband 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--All 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 position 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 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 position 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 position. 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 position (Table 1) and changes in net position (Table 2) of the County's governmental activities.

Table 1
Net Position
(in Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2012	2011	2012	2011	2012	2011
Current and other assets	$ 22,061	$ 19,963	$ (1,323)	$ -	$ 20,738	$ 19,963
Capital assets	92,812	91,746	8,269	-	101,081	91,746
Total Assets	$ 114,873	$ 111,709	$ 6,946	$ -	$ 121,819	$ 111,709
Long-term debt outstanding	$ 4,492	$ 5,151	$ 5,905	$ -	$ 10,397	$ 5,151
Other liabilities	3,726	3,340	909	-	4,635	3,340
Total Liabilities	$ 8,218	$ 8,491	$ 6,814	$ -	$ 15,032	$ 8,491
Net Position						
Net investment in capital assets	$ 89,218	$ 87,290	$ 2,081	$ -	$ 91,299	$ 87,290
Restricted	2,072	1,817	-	-	2,072	1,817
Unrestricted	15,365	14,111	(1,949)	-	13,416	14,111
Total Net Position	$ 106,655	$ 103,218	$ 132	$ -	$ 106,787	$ 103,218

Table 2
Changes in Net Position
(in Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2012	2011	2012	2011	2012	2011
Revenues						
Program revenues						
Fees, fines, charges, and other	$ 1,908	$ 1,944	$ -	$ -	$ 1,908	$ 1,944
Operating grants and contributions	11,997	11,078	-	-	11,997	11,078
Capital grants and contributions	3,647	2,776	1,015	-	4,662	2,776
General revenues						
Property taxes	7,795	7,455	-	-	7,795	7,455
Other taxes	2,052	2,056	-	-	2,052	2,056
Unrestricted grants and contributions	967	1,606	-	-	967	1,606
Investment earnings	75	146	-	-	75	146
Gain on sale of capital asset	1	17	-	-	1	17
Miscellaneous	228	168	7	-	235	168
Transfers	739	-	(739)	-	-	-
Total Revenues	$ 29,409	$ 27,246	$ 283	$ -	$ 29,692	$ 27,246

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2012	2011	2012	2011	2012	2011
Expenses						
General government	$ 4,428	$ 4,405	$ -	$ -	$ 4,428	$ 4,405
Public safety	4,580	4,353	-	-	4,580	4,353
Highways and streets	8,015	6,935	-	-	8,015	6,935
Sanitation	327	270	-	-	327	270
Human services	3,033	2,705	-	-	3,033	2,705
Health	2,535	3,223	-	-	2,535	3,223
Culture and recreation	938	899	-	-	938	899
Conservation of natural resources	1,443	1,118	-	-	1,443	1,118
Economic development	530	1,232	151	-	681	1,232
Interest	143	218	-	-	143	218
Total Expenses	$ 25,972	$ 25,358	$ 151	$ -	$ 26,123	$ 25,358
Increase (Decrease) in Net Position	$ 3,437	$ 1,888	$ 132	$ -	$ 3,569	$ 1,888
Net Position, January 1	103,218	101,330	-	-	103,218	101,330
Net Position, December 31	$ 106,655	$ 103,218	$ 132	$ -	$ 106,787	$ 103,218

Lake County's business-type activities is the broadband project that started in 2012. This is primarily funded by capital grants and contributions, which included a Broadband Initiatives Program Grant of $1,015,368 and a Broadband Initiatives Program Loan of $6,217,524.

The increase in highways and streets expenses can be attributed to the amounts spent for the 2012 flood. These expenses were offset by operating grants and contributions received from the Federal Emergency Management Agency (FEMA).

Governmental Activities

The cost of all governmental activities this year was $25,972,252. 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 $8,420,475, because some of the cost was paid by those who directly benefited from the programs ($1,908,219) or by other governments and organizations that subsidized certain programs with grants and contributions ($15,643,558). 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			
	2012		2011		2012		2011	
General government	$	4,428	$	4,405	$	941	$	880
Public safety		4,580		4,353		2,932		2,686
Highways and streets		8,015		6,935		1,082		2,595
Human services		3,033		2,705		1,887		1,121
Health		2,535		3,223		(178)		427
All others		3,381		3,737		1,756		1,851
Total	$	25,972	$	25,358	$	8,420	$	9,560

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 in 2012.

In the General Fund, the actual charges to appropriations (expenditures) were $679,259 greater than the final budget amounts. Unbudgeted expenditures included $304,979 of unbudgeted trail expenditures, $278,535 of unbudgeted small cities development program expenditures and $405,494 of unbudgeted emergency management expenditures.

Resources available for appropriation were also above the final budgeted amount by $1,238,478. This was primarily due to greater than expected collections in intergovernmental revenues.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of 2012, the County had $101,080,950 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	
	2012	2011	2012	2011	2012	2011
Land	$ 4,021	$ 3,990	$ -	$ -	$ 4,021	$ 3,990
Construction in progress	-	-	8,269	-	8,269	-
Buildings and improvements	10,491	10,939	-	-	10,491	10,939
Machinery, vehicles, furniture, and equipment	2,603	2,854	-	-	2,603	2,854
Infrastructure	75,697	73,964	-	-	75,697	73,964
Totals	$ 92,812	$ 91,747	$ 8,269	$ -	$ 101,081	$ 91,747

The County's fiscal year 2013 capital budget calls for it to spend another $163,300 for miscellaneous improvements at various buildings, $344,000 on vehicles for various departments, $824,657 on equipment for various departments and $1,050,000 for road construction. The road construction will be funded by state-aid construction funds.

Debt

At year-end, the County had $2,390,000 in bonds and notes outstanding versus $3,104,285 last year--a decrease of 23 percent--as shown in Table 5. Capital leases payable decreased by $172,335. The Rural Utilities Service Broadband Loan on the business-type activities portion has a balance of $6,215,855.

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

	Governmental Activities		Business-Type Activities		Totals	
	2012	2011	2012	2011	2012	2011
General obligation bonds	$ 2,390	$ 3,080	$ -	$ -	$ 2,390	$ 3,080
Notes payable	-	24	-	-	-	24
Capital leases	1,408	1,581	-	-	1,408	1,581
Loans payable	-	-	6,216	-	6,216	-
Compensated absences	1,319	1,174	-	-	1,319	1,174
Net other postemployment benefits	248	179	-	-	248	179
Total	$ 5,365	$ 6,038	$ 6,216	$ -	$ 11,581	$ 6,038

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 2013 budget and tax rates.

- County General Fund expenditures for 2013 are budgeted to increase three percent over 2012.

- Property tax levies did not increase for 2013.

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.

BASIC FINANCIAL STATEMENTS

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT 1

STATEMENT OF POSITION
DECEMBER 31, 2012

	Primary Government			Housing and Redevelopment Authority
	Governmental Activities	**Business-type Activities**	**Total**	**Component Unit**
Assets				
Cash and pooled investments	$ 13,560,412	$ -	$ 13,560,412	$ 539,313
Cash with management company for operations	-	-	-	89,208
Receivables - net	6,368,190	50,092	6,418,282	146,732
Due from component unit	212,013	-	212,013	-
Internal balances	1,373,069	(1,373,069)	-	-
Inventories	522,103	-	522,103	-
Prepaid items	13,096	-	13,096	-
Restricted assets				
Cash and pooled investments	-	-	-	69,258
Cash with management company for security deposits	-	-	-	14,246
Deferred charges	12,108	-	12,108	28,000
Capital assets				
Non-depreciable capital assets	4,021,386	8,268,823	12,290,209	-
Depreciable capital assets - net of accumulated depreciation	88,790,741	-	88,790,741	1,147,845
Total Assets	**$ 114,873,118**	**$ 6,945,846**	**$ 121,818,964**	**$ 2,034,602**
Liabilities				
Accounts payable and other current liabilities	$ 1,546,385	$ 598,058	$ 2,144,443	$ 36,013
Accrued interest payable	45,198	-	45,198	14,556
Advance from other governments	1,261,298	-	1,261,298	-
Due to primary government	-	-	-	212,013
Unearned revenue	-	-	-	240
Payable from restricted assets				
Security deposits payable	-	-	-	14,246
Long-term liabilities				
Due within one year	873,314	311,040	1,184,354	30,000
Due in more than one year	4,491,912	5,904,815	10,396,727	818,763
Total Liabilities	**$ 8,218,107**	**$ 6,813,913**	**$ 15,032,020**	**$ 1,125,831**

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

EXHIBIT 1
(Continued)

STATEMENT OF POSITION
DECEMBER 31, 2012

	Primary Government			Housing and Redevelopment Authority Component Unit
	Governmental Activities	Business-type Activities	Total	
Net Position				
Net investment in capital assets	$ 89,217,867	$ 2,081,300	$ 91,299,167	$ 299,082
Restricted for				
General government	383,362	-	383,362	-
Public safety	459,023	-	459,023	-
Highways and streets	134,053	-	134,053	-
Conservation of natural resources	44,166	-	44,166	-
Debt service	1,051,286	-	1,051,286	69,258
Operations	-	-	-	89,208
Unrestricted	15,365,254	(1,949,367)	13,415,887	451,223
Total Net Position	**$ 106,655,011**	**$ 131,933**	**$ 106,786,944**	**$ 908,771**

LAKE COUNTY
TWO HARBORS, MINNESOTA

STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2012

		Program Revenues	
	Expenses	Fees, Charges, Fines, and Other	Operating Grants and Contributions
Functions/Programs			
Primary government			
Governmental activities			
General government	$ 4,428,101	$ 554,369	$ 2,932,288
Public safety	4,579,528	21,657	1,625,370
Highways and streets	8,014,945	564,727	2,726,867
Sanitation	326,795	44,739	438
Human services	3,033,226	100,928	1,044,837
Health	2,535,303	236,236	2,477,155
Culture and recreation	937,825	-	358,481
Conservation of natural resources	1,443,188	385,057	358,153
Economic development	530,503	506	473,252
Interest	142,838	-	-
Total governmental activities	**$ 25,972,252**	**$ 1,908,219**	**$ 11,996,841**
Business-type activities			
Broadband	151,382	-	-
Total Primary Government	**$ 26,123,634**	**$ 1,908,219**	**$ 11,996,841**
Component unit			
Housing and Redevelopment Authority	**$ 272,298**	**$ 182,325**	**$ -**

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
Administrative fees
Unrestricted investment earnings
Gain on sale of capital assets
Miscellaneous
Transfers

Total general revenues and transfers

Change in net position

Net Position - Beginning

Net Position - Ending

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

EXHIBIT 2

Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Position — Primary Government: Governmental Activities	Business-type Activities	Total	Discretely Presented Component Unit
$ -	$ (941,444)	$ -	$ (941,444)	
-	(2,932,501)	-	(2,932,501)	
3,641,767	(1,081,584)	-	(1,081,584)	
-	(281,618)	-	(281,618)	
-	(1,887,461)	-	(1,887,461)	
-	178,088	-	178,088	
-	(579,344)	-	(579,344)	
4,950	(695,028)	-	(695,028)	
-	(56,745)	-	(56,745)	
-	(142,838)	-	(142,838)	
$ 3,646,717	**$ (8,420,475)**	**$ -**	**$ (8,420,475)**	
1,015,368	-	863,986	-	
$ 4,662,085	**$ (8,420,475)**	**$ 863,986**	**$ (7,556,489)**	
$ -				**$ (89,973)**
	$ 7,794,561	$ -	$ 7,794,561	$ 111,822
	9,835	-	9,835	-
	759,947	-	759,947	-
	188,300	-	188,300	201,666
	1,093,913	-	1,093,913	-
	967,246	-	967,246	7,897
	-	-	-	91,400
	74,423	-	74,423	798
	1,496	-	1,496	-
	228,348	7,001	235,349	8,237
	739,054	(739,054)	-	-
	$ **11,857,123**	$ **(732,053)**	$ **11,125,070**	$ **421,820**
	$ 3,436,648	**$ 131,933**	**$ 3,568,581**	**$ 331,847**
	103,218,363	**-**	**103,218,363**	**576,924**
	$ 106,655,011	**$ 131,933**	**$ 106,786,944**	**$ 908,771**

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FUND FINANCIAL STATEMENTS

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GOVERNMENTAL FUNDS

LAKE COUNTY
TWO HARBORS, MINNESOTA

BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2012

	General	Road and Bridge
Assets		
Cash and pooled investments	$ 6,534,278	$ -
Escheat cash	36,538	-
Petty cash and change funds	1,350	1,000
Undistributed cash in agency funds	241,732	74,867
Taxes receivable - prior	297,329	97,477
Accounts receivable	16,563	138,453
Accrued interest receivable	14,184	-
Loans receivable	68,143	-
Due from other funds	1,976,360	118,706
Due from other governments	2,790,895	1,025,287
Due from component unit	-	-
Prepaid expense	-	-
Inventories	-	522,103
Leases receivable	375,000	-
Total Assets	**$ 12,352,372**	**$ 1,977,893**

Human Services		Forfeited Tax		Nonmajor Funds		Total	
$	5,886,773	$	-	$	658,196	$	13,079,247
	-		-		-		36,538
	1,000		50		-		3,400
	106,271		-		18,357		441,227
	146,213		-		28,889		569,908
	16,717		552,004		-		723,737
	-		-		-		14,184
	-		-		-		68,143
	-		50,338		-		2,145,404
	446,575		248,764		105,697		4,617,218
	-		-		212,013		212,013
	13,096		-		-		13,096
	-		-		-		522,103
	-		-		-		375,000
$	**6,616,645**	**$**	**851,156**	**$**	**1,023,152**	**$**	**22,821,218**

LAKE COUNTY
TWO HARBORS, MINNESOTA

BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2012

	General	Road and Bridge
Liabilities and Fund Balances		
Liabilities		
Accounts payable	$ 97,053	$ 106,884
Escheat payable	36,538	-
Salaries payable	145,251	56,377
Contracts payable	-	477,506
Due to other funds	115,469	164,461
Due to other governments	47,645	62,904
Deferred revenue - unavailable	820,423	409,380
Advances from other governments	-	1,261,298
Total Liabilities	**$ 1,262,379**	**$ 2,538,810**
Fund Balances		
Nonspendable		
Loans receivables	$ 10,000	$ -
Inventories	-	522,103
Restricted for		
Law library	13,860	-
Recorder's technology equipment	229,457	-
Enhanced 911	390,197	-
County property recorder's fee	140,045	-
Law and prosecutorial equipment	64,109	-
Election equipment	22,018	-
Sheriff's contingency fund	4,717	-
Title III forest	44,166	-
Debt service	-	466,854
Capital projects	-	203,662
Committed to		
Broadband project	3,500,000	-
Rescue squad capital expenditures	25,019	-
Out-of-home placement costs	-	-
Forestry road grant	-	-
Unorganized townships		
Emergency services	-	-
Assigned to		
Resource development	-	-
Human services	-	-
Unassigned	6,646,405	(1,753,536)
Total Fund Balances	**$ 11,089,993**	**$ (560,917)**
Total Liabilities and Fund Balances	**$ 12,352,372**	**$ 1,977,893**

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

EXHIBIT 3
(Continued)

Human Services	Forfeited Tax	Nonmajor Funds	Total
$ 157,506	$ 147,085	$ 3,114	$ 511,642
-	-	-	36,538
40,980	8,141	-	250,749
-	-	-	477,506
15,443	365,849	111,113	772,335
42,747	-	116,654	269,950
129,998	424,394	26,088	1,810,283
-	-	-	1,261,298
$ 386,674	**$ 945,469**	**$ 256,969**	**$ 5,390,301**
$ -	$ -	$ -	$ 10,000
-	-	-	522,103
-	-	-	13,860
-	-	-	229,457
-	-	-	390,197
-	-	-	140,045
-	-	-	64,109
-	-	-	22,018
-	-	-	4,717
-	-	-	44,166
-	-	584,432	1,051,286
-	-	-	203,662
-	-	-	3,500,000
-	-	-	25,019
1,000,000	-	-	1,000,000
-	1,739	-	1,739
-	-	79,168	79,168
-	-	102,583	102,583
5,229,971	-	-	5,229,971
-	(96,052)	-	4,796,817
$ 6,229,971	**$ (94,313)**	**$ 766,183**	**$ 17,430,917**
$ 6,616,645	**$ 851,156**	**$ 1,023,152**	**$ 22,821,218**

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EXHIBIT 4

RECONCILIATION OF GOVERNMENTAL FUNDS BALANCE SHEET TO THE GOVERNMENT-WIDE STATEMENT OF NET POSITION--GOVERNMENTAL ACTIVITIES DECEMBER 31, 2012

Fund balances - total governmental funds (Exhibit 3)		**$ 17,430,917**
Amounts reported for governmental activities in the statement of net position are different because:		
Capital assets, net of accumulated depreciation, used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.		92,812,127
Other long-term assets are not available to pay for current period expenditures and, therefore, are deferred in the governmental funds.		1,810,283
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the governmental funds.		
General obligation bonds	$ (2,390,000)	
Capital leases payable	(1,407,922)	
Compensated absences	(1,319,601)	
Net other postemployment benefits payable	(247,703)	
Accrued interest payable	(45,198)	
Deferred debt issuance charges	12,108	(5,398,316)
Net Position of Governmental Activities (Exhibit 1)		**$ 106,655,011**

LAKE COUNTY
TWO HARBORS, MINNESOTA

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2012

	General	Road and Bridge
Revenues		
Taxes	$ 4,818,860	$ 1,742,074
Licenses and permits	12,330	-
Intergovernmental	5,589,701	7,062,634
Charges for services	348,854	557,270
Fines and forfeits	2,319	-
Investment earnings	74,126	151
Miscellaneous	370,967	7,457
Total Revenues	**$ 11,217,157**	**$ 9,369,586**
Expenditures		
Current		
General government	$ 4,228,020	$ -
Public safety	4,222,318	-
Highways and streets	-	9,759,892
Sanitation	316,191	-
Human services	-	-
Health	-	-
Culture and recreation	760,112	-
Conservation of natural resources	208,538	-
Economic development	342,113	-
Capital outlay		
Conservation of natural resources	-	-
Debt service		
Principal	24,285	480,668
Interest	-	27,482
Administrative (fiscal) charges	-	402
Total Expenditures	**$ 10,101,577**	**$ 10,268,444**
Excess of Revenues Over (Under) Expenditures	**$ 1,115,580**	**$ (898,858)**
Other Financing Sources (Uses)		
Transfers in	$ 5,025	$ 9,767
Transfers out	(200,129)	-
Total Other Financing Sources (Uses)	**$ (195,104)**	**$ 9,767**
Net Change in Fund Balances	**$ 920,476**	**$ (889,091)**
Fund Balances - January 1	**10,169,517**	**161,032**
Increase (decrease) in inventories	**-**	**167,142**
Fund Balances - December 31	**$ 11,089,993**	**$ (560,917)**

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

Human Services	Forfeited Tax	Nonmajor Funds	Total
$ 1,950,626	$ -	$ 542,395	$ 9,053,955
-	570	150	13,050
3,737,184	303,444	344,135	17,037,098
268,263	53,749	-	1,228,136
-	-	-	2,319
-	-	146	74,423
68,901	615,242	74,347	1,136,914
$ 6,024,974	**$ 973,005**	**$ 961,173**	**$ 28,545,895**
$ -	$ -	$ 6,145	$ 4,234,165
-	-	127,554	4,349,872
-	-	-	9,759,892
-	-	-	316,191
2,903,889	-	-	2,903,889
2,531,180	-	-	2,531,180
-	-	4,015	764,127
-	1,051,900	174,766	1,435,204
-	-	188,390	530,503
-	22,670	-	22,670
-	-	381,667	886,620
-	-	123,696	151,178
-	-	402	804
$ 5,435,069	**$ 1,074,570**	**$ 1,006,635**	**$ 27,886,295**
$ 589,905	**$ (101,565)**	**$ (45,462)**	**$ 659,600**
$ -	$ -	$ 929,416	$ 944,208
-	-	(5,025)	(205,154)
$ -	**$ -**	**$ 924,391**	**$ 739,054**
$ 589,905	**$ (101,565)**	**$ 878,929**	**$ 1,398,654**
5,640,066	**7,252**	**(112,746)**	**15,865,121**
-	**-**	**-**	**167,142**
$ 6,229,971	**$ (94,313)**	**$ 766,183**	**$ 17,430,917**

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, 2012

Net change in fund balances - total governmental funds (Exhibit 5)		**$ 1,398,654**
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	$ 1,810,283	
Deferred revenue - January 1	(1,686,632)	123,651
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	$ 4,405,332	
Current year depreciation	(3,339,742)	1,065,590
Debt issuances provide current financial resources to governmental funds, but increase long-term liabilities in the statement of net position. Debt repayment is an expenditure in funds, but a reduction of a liability in the statement of net position.		
Principal repayments		
General obligation bonds	$ 690,000	
Notes payable	24,285	
Capital lease	172,335	886,620
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	$ 17,436	
Change in deferred bond issuance costs	(8,293)	
Change in compensated absences	(145,900)	
Change in other postemployment benefits	(68,252)	
Change in inventories	167,142	(37,867)
Change in Net Position of Governmental Activities (Exhibit 2)		**$ 3,436,648**

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

PROPRIETARY FUND

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LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT 7

STATEMENT OF NET POSITION
PROPRIETARY FUND
DECEMBER 31, 2012

Assets		Broadband
Current assets		
Accounts receivable	$	2,845
Due from other governments		47,247
Total current assets	**$**	**50,092**
Capital assets - net		8,268,823
Total Assets	**$**	**8,318,915**
Liabilities		
Current liabilities		
Accounts payable	$	213,216
Contracts payable		383,903
Due to other governments		939
Due to other funds		1,373,069
Loans payable - current		311,040
Total current liabilities	**$**	**2,282,167**
Noncurrent liabilities		
Loans payable - noncurrent		5,904,815
Total Liabilities	**$**	**8,186,982**
Net Position		
Net investment in capital assets	$	2,081,300
Unrestricted		(1,949,367)
Total Net Position	**$**	**131,933**

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

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT 8

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
PROPRIETARY FUND
FOR THE YEAR ENDED DECEMBER 31, 2012

		Broadband
Nonoperating Revenues (Expenses)		
Broadband Initiatives Program	$	1,015,368
Miscellaneous revenue		7,001
Miscellaneous expense		(92,802)
Interest expense		(58,580)
Total Nonoperating Revenues (Expenses)	**$**	**870,987**
Transfers out		(739,054)
Change in Net Position	**$**	**131,933**
Net Position - January 1		-
Net Position - December 31	**$**	**131,933**

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

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT 9

STATEMENT OF CASH FLOWS
PROPRIETARY FUND
FOR THE YEAR ENDED DECEMBER 31, 2012

		Broadband
Cash Flows from Capital and Related Financing Activities		
Acquisition of capital assets	$	(7,785,321)
Grant proceeds		1,097,210
Proceeds from loan		6,217,524
Advance		591,300
Miscellaneous revenue		4,006
Professional services		(64,470)
Principal paid on loan		(1,669)
Interest paid on loan		(58,580)
Net cash provided by (used in) capital and related financing activities	**$**	-
Net Increase (Decrease) in Cash and Cash Equivalents	**$**	-
Cash and Cash Equivalents at January 1		-
Cash and Cash Equivalents at December 31	**$**	-

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 POSITION
DECEMBER 31, 2012

		Agency
Assets		
Cash and pooled investments	**$**	**786,956**
Liabilities		
Accounts payable	$	200,164
Taxes collected in advance		3,606
Due to other governments		539,476
Customer deposits - current		43,710
Total Liabilities	**$**	**786,956**

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

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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, 2012. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (statements and interpretations). 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. 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:

Component Unit	Component Unit Included in Reporting Entity Because	Separate Financial Statements
Lake County Housing and Redevelopment Authority	The 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

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 position 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 revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges to external parties.

In the government-wide statement of net position, the governmental and business-type activities column: (a) is presented on a consolidated basis by column; and (b) is 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 position is reported in three parts: (1) net investment in capital assets; (2) restricted net position; and (3) unrestricted net position. The County first utilizes restricted resources to finance qualifying activities.

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 and 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 funds are aggregated and reported as nonmajor funds.

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

         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 accounted for in another fund.

            The Road and Bridge Special Revenue Fund is used to account for property tax and intergovernmental 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.

1. Summary of Significant Accounting Policies

   B. Basic Financial Statements

      2. Fund Financial Statements (Continued)

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

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

The County reports the following major proprietary fund:

The Broadband Enterprise Fund is used to account for the operations of the broadband system. Activities necessary to provide broadband services are accounted for in this fund including the financial resources to be used for the acquisition and construction of the major capital assets relating to the County's broadband system.

Additionally, the County reports the following fund types:

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 Broadband Capital Projects Fund is used to account for financial resources to be used for the acquisition or construction of major capital assets relating to the County's broadband system. This fund was closed in 2012.

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.

1. Summary of Significant Accounting Policies (Continued)

C. Measurement Focus and Basis of Accounting

The government-wide and proprietary and fiduciary 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 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 County's policy to use restricted resources first and then unrestricted resources as needed.

D. Assets, Liabilities, and Net Position 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.

1. Summary of Significant Accounting Policies

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

2. Deposits and Investments

The cash balances of substantially all funds are pooled and invested by the County Auditor/Treasurer for the purpose of increasing earnings through investment activities. Pooled and fund investments are reported at their fair value at December 31, 2012, 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 2012 were $74,423.

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). The investment in the pool is measured at the net asset value per share provided by the pool.

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 the 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.

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Position or Equity

3. Receivables and Payables (Continued)

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

4. Inventories and Prepaid Items

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

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 position 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 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.

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Position 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.

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:

Assets	Years
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 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.

1. Summary of Significant Accounting Policies

   D. Assets, Liabilities, and Net Position 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 postretirement health savings plan.

      8. Deferred Revenue

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

      9. Long-Term Obligations

         In the government-wide financial statements and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the governmental activities, business-type activities, or proprietary fund type statement of net position. 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.

1. Summary of Significant Accounting Policies

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

10. Classification of Net Position

Net position in government-wide statements and in the proprietary fund type statements is classified in the following categories:

Net investment in capital assets - the amount of net position representing capital assets net of accumulated depreciation and reduced by outstanding debt attributed to the acquisition, construction, or improvement of the assets.

Restricted net position - the amount of net position for which external restrictions have been imposed by creditors, grantors, contributors, or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.

Unrestricted net position - the amount of net position that does not meet the definition of restricted or net investment in capital assets.

11. Classification of Fund Balances

Fund balance is divided into five classifications based primarily on the extent to which the County is bound to observe constraints imposed upon the use of the resources in the governmental funds. The classifications are as follows:

Nonspendable - amounts that cannot be spent because they are not in spendable form, such as fund balance associated with inventories, prepaids, or permanent funds.

Restricted - amounts that are restricted by external parties such as creditors or imposed by grants, law or legislation.

Committed - amounts that can be used only for the specific purposes determined by a formal action of Lake County's highest level of decision-making authority, which is the Lake County Board of Commissioners. Fund balance commitments are established, modified, or rescinded by County Board action through a Board resolution.

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Position or Equity

11. Classification of Fund Balances (Continued)

Assigned - amounts intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the General Fund, assigned fund balance represents the remaining amount of fund balance that is not restricted or committed.

Unassigned - the residual classification for the General Fund and includes all spendable amounts not contained in the other fund balance classifications. In other governmental funds, the unassigned classification is used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted or committed.

The County 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.

12. 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

A. Deficit Fund Equity

Road and Bridge Special Revenue Fund

At December 31, 2012, the Road and Bridge Special Revenue Fund had a deficit fund balance of $560,917. This deficit will be made up with future tax levies and other revenue sources.

Forfeited Tax Special Revenue Fund

At December 31, 2012, the Forfeited Tax Special Revenue Fund had a deficit fund balance of $94,313. This deficit will be made up with future tax levies and other revenue sources.

B. Excess of Expenditures Over Appropriations

For the year ended December 31, 2012, expenditures exceeded appropriations in the following funds:

	Final Budget	Expenditures	Excess
General Fund	$ 9,422,318	$ 10,101,577	$ 679,259
Special Revenue Funds			
Road and Bridge	7,837,904	10,268,444	2,430,540
Forfeited Tax	596,561	1,074,570	478,009
Resource Development	194,334	373,756	179,422
Unorganized Townships	120,800	133,699	12,899
Debt Service Fund	310,798	499,180	188,382

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	$	13,560,412
Component unit		
Cash and pooled investments		539,313
Cash with management company for operations		89,208
Restricted cash and pooled investments		69,258
Restricted cash with management company for security deposits		14,246
Fiduciary funds		
Cash and pooled investments		786,956
Total Cash and Investments	$	15,059,393

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.

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, 2012, the primary government's bank balances of $1,363,009 were not exposed to custodial credit risk.

The Lake County Housing and Redevelopment Authority component unit does not have a deposit policy for custodial credit risk other than complying with the requirements of Minnesota statutes. As of December 31, 2012, the Authority's deposits were not exposed to custodial credit risk.

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;

(4) bankers' acceptances of United States banks;

3. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

b. Investments (Continued)

(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.

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.

3. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments (Continued)

The following table presents the County's deposit and investment balances at December 31, 2012, and information relating to potential investment risks:

Investment Type	Credit Risk: Credit Rating	Credit Risk: Rating Agency	Concentration Risk: Over 5% of Portfolio	Interest Rate Risk: Maturity Date	Carrying (Fair) Value
U.S. government agency securities					
Federal National Mortgage Association	N/R	N/A	<5%	02/01/2019	$ 47,210
Federal Home Loan Bank Bonds	Aaa	Moody's		07/18/2022	$ 1,000,260
Federal Home Loan Bank Bonds	Aaa	Moody's		09/28/2022	249,140
Federal Home Loan Bank Bonds	Aaa	Moody's		10/18/2022	500,070
Federal Home Loan Bank Bonds	Aaa	Moody's		11/15/2022	500,210
Federal Home Loan Bank Bonds	AA+	S&P		12/28/2022	300,426
Total Federal Home Loan Bank Bonds			18.7%		$ 2,550,106
Government National Mortgage Association Note	N/R	N/A	<5%	02/15/2019	$ 4,004
Federal Home Loan Mortgage Corporation	Aaa	Moody's	7.4%	03/21/2022	$ 1,002,850
Total U.S. government agency securities					$ 3,604,170
Investment pools/mutual funds					
MAGIC Fund	N/R	N/A	71.9%	N/A	$ 9,791,058
Wells Fargo Government Money Market	Aaa	Moody's	<5%	N/A	215,509
Total investment pools/mutual funds					$ 10,006,567
Total investments					$ 13,610,737
Deposits - primary government					696,693
Deposits - component unit					712,025
Petty cash and change funds					3,400
Escheat cash					36,538
Total Cash and Investments					$ 15,059,393

N/A - Not Applicable
N/R - Not Rated
<5% - Concentration is less than 5% of investments

3. Detailed Notes on All Funds

A. Assets (Continued)

2. Receivables

Receivables as of December 31, 2012, for the County's governmental and business-type activities are as follows:

	Total Receivables	Amounts Not Scheduled for Collection During the Subsequent Year
Governmental Activities		
Taxes	$ 569,908	$ -
Due from other governments	4,617,218	-
Accounts	723,737	-
Interest	14,184	-
Loans receivable	68,143	58,270
Leases receivable	375,000	-
Total Governmental Activities	$ 6,368,190	$ 58,270
Business-Type Activities		
Accounts	$ 2,845	$ -
Due from other governments	47,247	-
Total Business-Type Activities	$ 50,092	$ -

3. Detailed Notes on All Funds

A. Assets (Continued)

3. Capital Assets

Capital asset activity for the year ended December 31, 2012, was as follows:

Governmental Activities

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	$ 3,990,362	$ 31,024	$ -	$ 4,021,386
Capital assets depreciated				
Buildings	$ 16,376,308	$ -	$ -	$ 16,376,308
Improvements other than buildings	675,523	941	-	676,464
Machinery, furniture, and equipment	10,994,025	725,887	70,461	11,649,451
Infrastructure	96,066,459	3,647,480	-	99,713,939
Total capital assets depreciated	$ 124,112,315	$ 4,374,308	$ 70,461	$ 128,416,162
Less: accumulated depreciation for				
Buildings	$ 5,745,265	$ 417,696	$ -	$ 6,162,961
Improvements other than buildings	367,658	31,159	-	398,817
Machinery, furniture, and equipment	8,140,309	976,768	70,461	9,046,616
Infrastructure	22,102,908	1,914,119	-	24,017,027
Total accumulated depreciation	$ 36,356,140	$ 3,339,742	$ 70,461	$ 39,625,421
Total capital assets depreciated, net	$ 87,756,175	$ 1,034,566	$ -	$ 88,790,741
Governmental Activities Capital Assets, Net	$ 91,746,537	$ 1,065,590	$ -	$ 92,812,127

Business-Type Activities

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Construction in progress	$ -	$ 8,268,823	$ -	$ 8,268,823

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	$	218,163
Public safety		498,619
Highways and streets, including depreciation of infrastructure assets		2,306,015
Human services		97,815
Sanitation		14,614
Culture and recreation		180,105
Conservation of natural resources		24,411
Total Depreciation Expense - Governmental Activities	$	3,339,742

B. Interfund Receivables, Payables, and Transfers

1. Due To/From Other Funds

The composition of interfund balances as of December 31, 2012, is as follows:

Receivable Fund	Payable Fund	Amount	Purpose
General	Human Services	$ 15,443	Reimbursement for services
	Road and Bridge	114,123	Deficit cash balance
	Forfeited Tax	362,612	Deficit cash balance
	Other governmental funds	111,113	Temporary loan
	Broadband Enterprise Fund	1,373,069	Deficit cash balance
Total due to General Fund		$ 1,976,360	
Road and Bridge	General	$ 115,469	Reimbursement for services
	Forfeited Tax	3,237	Reimbursement for services
Total due to Road and Bridge		$ 118,706	
Forfeited Tax	Road and Bridge	$ 50,338	Pit royalty
Total Due To/From Other Funds		$ 2,145,404	

3. Detailed Notes on All Funds

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

2. Due To/From Primary Government and Component Units

Receivable Entity	Payable Entity	Amount	Purpose
Primary Government - Debt Service	Component Unit - Lake County Housing and Redevelopment Authority	$ 212,013	Shortfalls in tax increment collections funded by primary government

3. Interfund Transfers

Interfund transfers for the year ended December 31, 2012, consisted of the following:

Transfers to Other Governmental Funds from General Fund	$ 190,362	Eliminate deficit cash
Transfers to Road and Bridge Special Revenue Fund from General Fund	9,767	Reimbursement for services
Transfer to General Fund from Other Governmental Funds	5,025	Reimbursement for services
Transfer to Other Governmental Funds from the Broadband Enterprise Fund	739,054	Close the Broadband Capital Projects Fund
Total Transfers	$ 944,208	

3. Detailed Notes on All Funds (Continued)

C. Liabilities

1. Payables

Payables at December 31, 2012, were as follows:

	Governmental Activities	Business-Type Activities
Accounts payable	$ 511,642	$ 213,216
Escheat property payable	36,538	-
Salaries payable	250,749	-
Contracts payable	477,506	383,903
Due to other governments	269,950	939
Total Payables	$ 1,546,385	$ 598,058

2. Long-Term Debt

Governmental Activities

Types of Indebtedness	Final Maturity	Installment Amounts	Interest Rate (%)	Original Issue Amount	Outstanding Balance December 31, 2012
General Obligation Bonds					
G.O. Capital Improvement Bonds, Series 2005A	2019	$155,000- $310,000	3.375 - 3.8	$ 3,200,000	$ 1,935,000
G.O. State Aid Highway Bonds, Series 2005B	2013	$455,000- $460,000	3.25 - 3.50	3,200,000	455,000
Total General Obligation Bonds				$ 6,400,000	$ 2,390,000
Other Long Term Debt					
Capital lease	2021	$146,667	3.25- 5.375	$ 2,200,000	$ 1,319,999
Capital lease	2016	$4,893- $28,719	3.75	134,259	87,923
Total Other Long-Term Debt				$ 2,334,259	$ 1,407,922

3. Detailed Notes on All Funds

C. Liabilities

2. Long-Term Debt (Continued)

Business-Type Activities

Types of Indebtedness	Final Maturity	Installment Amounts	Interest Rate (%)	Original Issue Amount	Outstanding Balance December 31, 2012
Rural Utilities Service Broadband Loans	2029	$295,935 - $435,666	2.0154 - 2.4076	$ 6,217,524	$ 6,215,855

3. Debt Service Requirements

Debt service requirements at December 31, 2012, were as follows:

Governmental Activities

Year Ending December 31	General Obligation Bonds		Other Long Term Debt	
	Principal	Interest	Principal	Interest
2013	$ 700,000	$ 74,710	$ 173,314	$ 45,743
2014	255,000	57,748	174,331	39,959
2015	265,000	48,388	175,386	34,137
2016	275,000	38,668	151,560	28,623
2017	285,000	28,374	146,667	23,833
2018-2022	610,000	23,295	586,664	47,667
Total	$ 2,390,000	$ 271,183	$ 1,407,922	$ 219,962

3. Detailed Notes on All Funds

C. Liabilities

3. Debt Service Requirements (Continued)

Business-Type Activities

Year Ending December 31	Rural Utilities Service Broadband Loans Principal	Rural Utilities Service Broadband Loans Interest
2013	$ 311,040	$ 136,620
2014	318,101	129,559
2015	325,321	122,339
2016	332,710	114,950
2017	340,262	107,398
2018-2022	1,820,831	417,469
2023-2027	2,037,317	200,983
2028-2029	730,273	14,499
Total	$ 6,215,855	$ 1,243,817

4. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2012, was as follows:

Governmental Activities

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
General obligation bonds	$ 3,080,000	$ -	$ 690,000	$ 2,390,000	$ 700,000
Notes payable	24,285	-	24,285	-	-
Total bonds and notes payable	$ 3,104,285	$ -	$ 714,285	$ 2,390,000	$ 700,000
Capital lease payable	1,580,257	-	172,335	1,407,922	173,314
Compensated absences	1,173,701	791,069	645,169	1,319,601	-
Net other postemployment benefits	179,451	96,095	27,843	247,703	-
Governmental Activity Long-Term Liabilities	$ 6,037,694	$ 887,164	$ 1,559,632	$ 5,365,226	$ 873,314

3. Detailed Notes on All Funds

C. Liabilities

4. Changes in Long-Term Liabilities (Continued)

Business-Type Activities

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Broadband Loans	$ -	$ 6,217,524	$ 1,669	$ 6,215,855	$ 311,040

4. 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

4. Pension Plans

A. Defined Benefit Plan

Plan Description (Continued)

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. 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.

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 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.

4. Pension Plans

A. Defined Benefit Plan

Plan Description (Continued)

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.

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 6.25 percent, respectively, of their annual covered salary. Public Employees Police and Fire Fund members are required to contribute 9.60 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 2012:

General Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	7.25
Public Employees Police and Fire Fund	14.40
Public Employees Correctional Fund	8.75

4. Pension Plans

A. Defined Benefit Plan

Funding Policy (Continued)

The County's contributions for the years ending December 31, 2012, 2011, and 2010, for the General Employees Retirement Fund, the Public Employees Police and Fire Fund, and the Public Employees Correctional Fund were:

	2012	2011	2010
General Employees Retirement Fund	$ 379,607	$ 372,065	$ 480,493
Public Employees Police and Fire Fund	157,623	158,741	166,913
Public Employees Correctional Fund	44,745	44,979	45,371

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

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.

4. Pension Plans

B. Defined Contribution Plan (Continued)

Total contributions by dollar amount and percentage of covered payroll made by the County during the year ended December 31, 2012, were:

	Employee	Employer
Contribution amount	$ 6,891	$ 6,891
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 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, 2012, there was one retiree using 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, 2012, five 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.

5. Postemployment Benefits

A. Plan Description and Funding Policy (Continued)

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 funding excess) over a period not to exceed 30 years. The following table shows the components of the County’s annual OPEB cost for 2012, the amount actually contributed to the plan, and changes in the County’s net OPEB obligation:

ARC	$	98,739
Interest on net OPEB obligation		8,075
Adjustment to ARC		(10,719)
Annual OPEB cost	$	96,095
Contributions during the year		(27,843)
Increase in net OPEB obligation	$	68,252
Net OPEB - Beginning of Year		179,451
Net OPEB - End of Year	$	247,703

The County’s annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2012, 2011, and 2010 were as follows:

	2012		2011		2010	
Percentage of annual OPEB cost contributed		29.0%		46.0%		50.1%
Annual OPEB cost	$	96,095	$	96,696	$	85,266
Employer contributions		(27,843)		(44,458)		(42,704)
Net Increase in Net OPEB Obligation	$	68,252	$	52,238	$	42,562

5. Postemployment Benefits (Continued)

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.

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.

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 care plan. Funding is provided through pre-tax contributions from Lake County on employee health care elections.

6. Postemployment Health Care Plans

B. VEBA Plan (Continued)

In 2012, the maximum County contribution for active employees is $1,690 for employees with single coverage and $3,250 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 care 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.

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 $460,000 in 2012 and $470,000 in 2013. 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	
	2012	2011
Unpaid claims, beginning of fiscal year	$ -	$ -
Incurred claims (including incurred but not reported)	90,487	92,709
Claims payments	(90,487)	(92,709)
Unpaid Claims, End of Fiscal Year	$ -	$ -

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 $747,032 has been paid through December 31, 2012. The outstanding commitment at December 31, 2012, is $287,968. 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.

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 appointed by 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 2011 (the most recent information available), county contributions were in the following proportion:

Carlton County	9.25%
Cook County	1.13
Koochiching County	1.82
Lake County	2.22
St. Louis County	85.58
Total	100.00%

Following is a summary of the financial information from Arrowhead Regional Corrections' government-wide statements for December 31, 2011 (the most recent information available):

Total Assets	$ 11,583,872
Total Liabilities	5,480,324
Total Net Assets	6,103,548
Total Revenues	20,207,852
Total Expenses	21,169,166
Change in Net Assets	(961,314)

Lake County provided $333,197 in funding during 2012. Separate financial information can be obtained from:

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

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 2012.

At December 31, 2011 (the most recent available), the Community Health Board's summary of financial information was:

Total Assets	$ 1,188,582
Total Liabilities	940,509
Total Net Assets	248,073
Total Revenues	6,073,622
Total Expenses	6,031,081
Change in Net Assets	42,541

Separate financial information can be obtained from:

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

Northeast Minnesota Office of Job Training

Aitkin, Carlton, Cook, Itasca, Koochiching, Lake, and St. Louis Counties (excluding the City of Duluth) entered into a joint powers agreement pursuant to Minn. Stat. § 471.59 for the purpose of developing and implementing a private and public job training program. The United States Congress, through the Job Training Partnership Act of 1982, authorized states to establish "service delivery areas" to provide programs

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Northeast Minnesota Office of Job Training (Continued)

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, 2012, was:

Total Assets	$ 3,244,642
Total Liabilities	1,805,858
Total Net Assets	1,438,784
Total Revenues	5,300,003
Total Expenses	5,236,622
Change in Net Assets	63,381

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

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.

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Minnesota Counties Information Systems (Continued)

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, 2010 (the most recent information available), was:

Total Assets	$ 1,527,727
Total Liabilities	349,605
Total Net Assets	1,178,122
Total Revenues	2,984,785
Total Expenses	2,591,311
Change in Net Assets	393,474

Separate financial information can be obtained from:

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

Northern Counties Land Use Coordinating Board

The Northern Counties Land Use Coordinating 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, 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.

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Northern Counties Land Use Coordinating Board (Continued)

A summary of the financial statements at December 31, 2012, is shown below:

Total Assets	$ 127,231
Total Liabilities	794
Total Fund Balance	126,437
Total Revenues	16,500
Total Expenditures	6,704
Change in Fund Balance	9,796

Lake County made contributions of $2,000 in 2012 to the Northern Counties Land Use Coordinating Board.

Separate financial information can be obtained from:

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

North Shore Collaborative

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

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures

North Shore Collaborative (Continued)

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, 2012, is as follows:

Total Assets	$ 200,164
Total Liabilities	$ 200,164

Arrowhead Health Alliance

Carlton, Cook, Koochiching, St. Louis 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. Lake County contributed $14,990 in funding in 2012.

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.

7. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Northeast Minnesota Regional Radio Board (Continued)

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 $286 in funding in 2012.

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. Lake County contributed $5,000 in funding in 2012.

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 2012.

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, 2012, 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 $212,013.

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.

8. Subsequent Events

On April 9, 2013, the County Board of Commissioners awarded a contract to Rohl Networks, LP for the construction of an outside plant relating to the Broadband Initiative Grant Program in the amount of $20,036,269.

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.

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.

9. Component Unit Disclosures

A. Summary of Significant Accounting Policies

Measurement Focus and Basis of Accounting (Continued)

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. 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.

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."

9. Component Unit Disclosures

A. Summary of Significant Accounting Policies

Receivables and Payables (Continued)

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

Restricted Assets

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

Capital Assets

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

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

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

Assets	Years
Buildings and structures	25 - 40
Equipment	7

9. Component Unit Disclosures

A. Summary of Significant Accounting Policies (Continued)

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 position.

B. Detailed Notes on All Funds

1. Assets

Deposits and Investments

a. Deposits

The Authority's total deposits are reported as follows:

Government-wide statement of net position		
Cash and pooled investments	$	539,313
Cash with management company for operations		89,208
Restricted cash and pooled investments		69,258
Restricted cash with management company for security deposits		14,246
Total Cash	$	712,025

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 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.

9. Component Unit Disclosures

   B. Detailed Notes on All Funds

      1. Assets

         Deposits and Investments

         a. Deposits (Continued)

            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 other than complying with the requirements of Minnesota statutes. As of December 31, 2012, the Authority's deposits were not exposed to custodial credit risk.

         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, 2012, the Authority did not own any investments that required disclosure regarding interest rate risk, credit risk, custodial credit risk, or concentration of credit risk.

9. Component Unit Disclosures

B. Detailed Notes on All Funds

1. Assets (Continued)

Loan Receivable

The Authority has a $10,714 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.

Capital Assets

Capital asset activity for the year ended December 31, 2012, was as follows:

Governmental Activities

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets depreciated				
Equipment	$ 1,866	$ -	$ -	$ 1,866
Less: accumulated depreciation for				
Equipment	801	267	-	1,068
Governmental Activities Capital Assets, Net	$ 1,065	$ (267)	$ -	$ 798

Business-Type Activities

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets depreciated				
Buildings and structures	$ 1,879,117	$ -	$ -	$ 1,879,117
Equipment	5,378	-	-	5,378
Total capital assets depreciated	$ 1,884,495	$ -	$ -	$ 1,884,495
Less: accumulated depreciation for				
Buildings and structures	$ 685,095	$ 46,975	$ -	$ 732,070
Equipment	5,378	-	-	5,378
Total accumulated depreciation	$ 690,473	$ 46,975	$ -	$ 737,448
Business-Type Activities Capital Assets, Net	$ 1,194,022	$ (46,975)	$ -	$ 1,147,047

9. Component Unit Disclosures

B. Detailed Notes on All Funds

1. Assets

Capital Assets (Continued)

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

Governmental Activities		
Urban and economic development	$	267

Business-Type Activities		
Senior housing	$	46,975

2. Liabilities

Long-Term Debt

Business-Type Activities

Type of Indebtedness	Final Maturity	Installment Amounts	Interest Rate (%)	Original Issue Amount	Outstanding Balance December 31, 2012
2012 General Obligation Senior Housing Bonds	2028	Varies	1.0 – 3.5	$ 860,000	$ 860,000

The Authority issued $860,000 of 2012 General Obligation Senior Housing Bonds to refund the outstanding maturities of the Silver Bay Housing Bonds of 1996.

9. Component Unit Disclosures

B. Detailed Notes on All Funds

2. Liabilities (Continued)

Debt Service Requirements

Debt service requirements at December 31, 2012, were as follows:

Business-Type Activities

Year Ending December 31	Revenue Bonds Principal	Revenue Bonds Interest
2013	$ 30,000	$ 24,763
2014	50,000	20,163
2015	50,000	19,538
2016	50,000	18,788
2017	55,000	17,863
2018-2022	280,000	71,375
2023-2027	310,000	31,931
2028	35,000	613
Totals	$ 860,000	$ 205,034

Changes in Long-Term Liabilities

Business-Type Activities

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Bonds payable					
1996 General Obligation Senior Housing Bonds	$ 823,374	$ -	$ 823,374	$ -	$ -
2012 General Obligation Senior Housing Bonds	-	860,000	-	860,000	30,000
Less: unamortized discount	-	(12,040)	(803)	(11,237)	-
Total Bonds Payable	$ 823,374	$ 847,960	$ 822,571	$ 848,763	$ 30,000

9. Component Unit Disclosures (Continued)

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.

Related-Party Transactions

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

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, 2012

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget
Revenues				
Taxes	$ 5,204,219	$ 5,204,219	$ 4,818,860	$ (385,359)
Licenses and permits	6,700	6,700	12,330	5,630
Intergovernmental	4,075,183	4,075,183	5,589,701	1,514,518
Charges for services	503,750	503,750	348,854	(154,896)
Fines and forfeits	1,500	1,500	2,319	819
Investment earnings	99,000	99,000	74,126	(24,874)
Miscellaneous	88,327	88,327	370,967	282,640
Total Revenues	**$ 9,978,679**	**$ 9,978,679**	**$ 11,217,157**	**$ 1,238,478**
Expenditures				
Current				
General government				
Commissioners	$ 408,332	$ 408,332	$ 460,271	$ (51,939)
Courts	39,500	39,500	55,577	(16,077)
Law library	24,000	24,000	11,621	12,379
County administration	199,191	199,191	175,685	23,506
County auditor	544,083	544,083	515,578	28,505
County assessor	399,185	399,185	425,172	(25,987)
Elections	24,971	24,971	30,375	(5,404)
Accounting and auditing	70,600	70,600	67,378	3,222
Data processing	759,402	759,402	594,002	165,400
Personnel	217,008	217,008	186,087	30,921
Attorney	384,030	384,030	378,619	5,411
Recorder	239,774	239,774	259,494	(19,720)
Planning and zoning	238,472	238,472	339,355	(100,883)
Buildings and plant	684,124	684,124	621,778	62,346
Veterans service officer	76,596	76,596	76,850	(254)
Training	4,500	4,500	470	4,030
Motor pool	37,548	37,548	26,581	10,967
Other general government	32,969	32,969	3,127	29,842
Total general government	**$ 4,384,285**	**$ 4,384,285**	**$ 4,228,020**	**$ 156,265**
Public safety				
Sheriff	$ 2,172,607	$ 2,172,607	$ 2,024,999	$ 147,608
Ambulance	43,531	43,531	43,183	348
Emergency services	224,129	224,129	150,534	73,595
Coroner	18,000	18,000	13,467	4,533
County jail	946,011	946,011	993,311	(47,300)
Community corrections	357,958	357,958	334,822	23,136
Sentence to serve	73,150	73,150	79,977	(6,827)
Emergency management	92,137	92,137	497,631	(405,494)
Other public safety	88,325	88,325	84,394	3,931
Total public safety	**$ 4,015,848**	**$ 4,015,848**	**$ 4,222,318**	**$ (206,470)**

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, 2012

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget
Expenditures				
Current (Continued)				
Sanitation				
Solid waste	$ 161,573	$ 161,573	$ 188,572	$ (26,999)
Recycling	145,096	145,096	109,774	35,322
Hazardous waste	32,000	32,000	17,845	14,155
Total sanitation	**$ 338,669**	**$ 338,669**	**$ 316,191**	**$ 22,478**
Culture and recreation				
Historical society	$ 35,000	$ 35,000	$ 35,000	$ -
Arenas	165,457	165,457	152,458	12,999
Humane Society	3,500	3,500	3,500	-
Memorial Day observance	3,000	3,000	3,000	-
Recreation board	138,875	138,875	138,875	-
Trails	-	-	304,979	(304,979)
County/regional library	122,300	122,300	122,300	-
Total culture and recreation	**$ 468,132**	**$ 468,132**	**$ 760,112**	**$ (291,980)**
Conservation of natural resources				
County extension	$ 60,313	$ 60,313	$ 59,145	$ 1,168
Soil and water conservation	63,258	63,258	102,929	(39,671)
Agricultural society/County fair	21,294	21,294	21,294	-
Water planning	18,886	18,886	20,170	(1,284)
Wetland challenge	5,000	5,000	5,000	-
Total conservation of natural resources	**$ 168,751**	**$ 168,751**	**$ 208,538**	**$ (39,787)**
Economic development				
Information centers	$ 18,633	$ 18,633	$ 15,578	$ 3,055
Airports	28,000	28,000	28,000	-
Housing and Redevelopment Authority	-	-	278,535	(278,535)
Other economic development	-	-	20,000	(20,000)
Total economic development	**$ 46,633**	**$ 46,633**	**$ 342,113**	**$ (295,480)**
Debt service				
Principal	$ -	$ -	$ 24,285	$ (24,285)
Total Expenditures	**$ 9,422,318**	**$ 9,422,318**	**$ 10,101,577**	**$ (679,259)**

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, 2012

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget
Excess of Revenues Over (Under) Expenditures	**$ 556,361**	**$ 556,361**	**$ 1,115,580**	**$ 559,219**
Other Financing Sources (Uses)				
Transfers in	$ -	$ -	$ 5,025	$ 5,025
Transfers out	(49,000)	(49,000)	(200,129)	(151,129)
Total Other Financing Sources (Uses)	**$ (49,000)**	**$ (49,000)**	**$ (195,104)**	**$ (146,104)**
Net Change in Fund Balance	**$ 507,361**	**$ 507,361**	**$ 920,476**	**$ 413,115**
Fund Balance - January 1	**10,169,517**	**10,169,517**	**10,169,517**	**-**
Fund Balance - December 31	**$ 10,676,878**	**$ 10,676,878**	**$ 11,089,993**	**$ 413,115**

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

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT A-2

BUDGETARY COMPARISON SCHEDULE
ROAD AND BRIDGE SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2012

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget
Revenues				
Taxes	$ 1,553,992	$ 1,553,992	$ 1,742,074	$ 188,082
Intergovernmental	5,980,971	5,980,971	7,062,634	1,081,663
Charges for services	267,500	267,500	557,270	289,770
Investment earnings	175	175	151	(24)
Miscellaneous	15,000	15,000	7,457	(7,543)
Total Revenues	**$ 7,817,638**	**$ 7,817,638**	**$ 9,369,586**	**$ 1,551,948**
Expenditures				
Current				
Highways and streets				
Administration	$ 353,050	$ 353,050	$ 882,295	$ (529,245)
Maintenance	2,354,025	2,354,025	2,765,675	(411,650)
Construction	3,723,777	3,723,777	5,118,830	(1,395,053)
Equipment maintenance and shop	927,982	927,982	993,092	(65,110)
Total highways and streets	**$ 7,358,834**	**$ 7,358,834**	**$ 9,759,892**	**$ (2,401,058)**
Debt service				
Principal	$ 455,000	$ 455,000	$ 480,668	$ (25,668)
Interest	23,660	23,660	27,482	(3,822)
Administrative (fiscal) charges	410	410	402	8
Total debt service	**$ 479,070**	**$ 479,070**	**$ 508,552**	**$ (29,482)**
Total Expenditures	**$ 7,837,904**	**$ 7,837,904**	**$ 10,268,444**	**$ (2,430,540)**
Excess of Revenues Over (Under) Expenditures	**$ (20,266)**	**$ (20,266)**	**$ (898,858)**	**$ (878,592)**
Other Financing Sources (Uses)				
Transfers in	40,000	40,000	9,767	(30,233)
Net Change in Fund Balance	**$ 19,734**	**$ 19,734**	**$ (889,091)**	**$ (908,825)**
Fund Balance - January 1	**161,032**	**161,032**	**161,032**	**-**
Increase (decrease) in inventories	**-**	**-**	**167,142**	**167,142**
Fund Balance - December 31	**$ 180,766**	**$ 180,766**	**$ (560,917)**	**$ (741,683)**

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

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT A-3

BUDGETARY COMPARISON SCHEDULE
HUMAN SERVICES SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2012

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget
Revenues				
Taxes	$ 2,130,838	$ 2,130,838	$ 1,950,626	$ (180,212)
Intergovernmental	4,080,394	4,080,394	3,737,184	(343,210)
Charges for services	164,500	164,500	268,263	103,763
Miscellaneous	20,015	20,015	68,901	48,886
Total Revenues	**$ 6,395,747**	**$ 6,395,747**	**$ 6,024,974**	**$ (370,773)**
Expenditures				
Current				
Human services				
Income maintenance	$ 940,803	$ 940,803	$ 812,901	$ 127,902
Social services	2,527,805	2,527,805	2,090,988	436,817
Total human services	**$ 3,468,608**	**$ 3,468,608**	**$ 2,903,889**	**$ 564,719**
Health				
Nursing service	$ 70,293	$ 70,293	$ 78,606	$ (8,313)
Transportation	9,732	9,732	10,379	(647)
Environmental health	97,703	97,703	80,618	17,085
Mental health	2,396,614	2,396,614	2,108,739	287,875
Health education	320,297	320,297	252,838	67,459
Total health	**$ 2,894,639**	**$ 2,894,639**	**$ 2,531,180**	**$ 363,459**
Total Expenditures	**$ 6,363,247**	**$ 6,363,247**	**$ 5,435,069**	**$ 928,178**
Net Change in Fund Balance	**$ 32,500**	**$ 32,500**	**$ 589,905**	**$ 557,405**
Fund Balance - January 1	**5,640,066**	**5,640,066**	**5,640,066**	**-**
Fund Balance - December 31	**$ 5,672,566**	**$ 5,672,566**	**$ 6,229,971**	**$ 557,405**

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

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT A-4

BUDGETARY COMPARISON SCHEDULE
FORFEITED TAX SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2012

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget
Revenues				
Licenses and permits	$ 1,216	$ 1,216	$ 570	$ (646)
Intergovernmental	1,241	1,241	303,444	302,203
Charges for services	25,000	25,000	53,749	28,749
Miscellaneous	582,975	582,975	615,242	32,267
Total Revenues	**$ 610,432**	**$ 610,432**	**$ 973,005**	**$ 362,573**
Expenditures				
Current				
Conservation of natural resources				
Land use	$ 573,561	$ 573,561	$ 1,051,900	$ (478,339)
Capital outlay				
Conservation of natural resources	23,000	23,000	22,670	330
Total Expenditures	**$ 596,561**	**$ 596,561**	**$ 1,074,570**	**$ (478,009)**
Net Change in Fund Balance	**$ 13,871**	**$ 13,871**	**$ (101,565)**	**$ (115,436)**
Fund Balance - January 1	**7,252**	**7,252**	**7,252**	**-**
Fund Balance - December 31	**$ 21,123**	**$ 21,123**	**$ (94,313)**	**$ (115,436)**

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

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT A-5

SCHEDULE OF FUNDING PROGRESS - OTHER POSTEMPLOYMENT BENEFITS
DECEMBER 31, 2012

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (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

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

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LAKE COUNTY
TWO HARBORS, MINNESOTA

NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED DECEMBER 31, 2012

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, 2012, expenditures exceeded appropriations in the following funds:

General Fund	$	679,259
Road and Bridge Special Revenue Fund		2,430,540
Forfeited Tax Special Revenue Fund		478,009

3. Schedule of Funding Progress - Other Postemployment Benefits

Beginning in 2008, Lake County implemented Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. Since the County has not irrevocably deposited funds in a trust for future health benefits, the actuarial value of the assets is zero. Currently, only two actuarial valuations are available. Future reports will provide additional trend analysis to meet the three-year valuation funded status requirement as the information becomes available.

See Note 5. in the notes to the financial statements for additional information regarding the County's other postemployment benefits.

SUPPLEMENTARY INFORMATION

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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 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 Broadband Capital Projects Fund is used to account for financial resources to be used for the acquisition or construction of major capital assets relating to the County's broadband system. This fund was closed in 2012.

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LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT B-1

COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
DECEMBER 31, 2012

	Special Revenue			
	Resource Development	**Unorganized Townships**	**Debt Service**	**Total**
Assets				
Cash and pooled investments	$ -	$ 190,032	$ 468,164	$ 658,196
Undistributed cash in agency funds	-	5,023	13,334	18,357
Taxes receivable				
Prior	-	6,377	22,512	28,889
Due from other governments	105,697	-	-	105,697
Due from component unit	-	-	212,013	212,013
Total Assets	**$ 105,697**	**$ 201,432**	**$ 716,023**	**$ 1,023,152**
Liabilities and Fund Balances				
Liabilities				
Accounts payable	$ 3,114	$ -	$ -	$ 3,114
Due to other funds	-	-	111,113	111,113
Due to other governments	-	116,654	-	116,654
Deferred revenue - unavailable	-	5,610	20,478	26,088
Total Liabilities	**$ 3,114**	**$ 122,264**	**$ 131,591**	**$ 256,969**
Fund Balances				
Restricted for debt service	$ -	$ -	$ 584,432	$ 584,432
Committed to unorganized townships emergency services	-	79,168	-	79,168
Assigned to resource development	102,583	-	-	102,583
Total Fund Balances	**$ 102,583**	**$ 79,168**	**$ 584,432**	**$ 766,183**
Total Liabilities and Fund Balances	**$ 105,697**	**$ 201,432**	**$ 716,023**	**$ 1,023,152**

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, 2012

	Special Revenue				
	Resource Development	Unorganized Townships	Debt Service	Broadband Capital Projects	Total
Revenues					
Taxes	$ -	$ 112,294	$ 430,101	$ -	$ 542,395
Licenses and permits	-	150	-	-	150
Intergovernmental	304,640	16,326	23,169	-	344,135
Investment earnings	-	-	146	-	146
Miscellaneous	4,015	-	70,332	-	74,347
Total Revenues	**$ 308,655**	**$ 128,770**	**$ 523,748**	**$ -**	**$ 961,173**
Expenditures					
Current					
General government	$ -	$ 6,145	$ -	$ -	$ 6,145
Public safety	-	127,554	-	-	127,554
Culture and recreation	4,015	-	-	-	4,015
Conservation of natural resources	174,766	-	-	-	174,766
Economic development	-	-	188,390	-	188,390
Debt service					
Principal	146,667	-	235,000	-	381,667
Interest	48,308	-	75,388	-	123,696
Administrative (fiscal) charges	-	-	402	-	402
Total Expenditures	**$ 373,756**	**$ 133,699**	**$ 499,180**	**$ -**	**$ 1,006,635**
Excess of Revenues Over (Under) Expenditures	**$ (65,101)**	**$ (4,929)**	**$ 24,568**	**$ -**	**$ (45,462)**
Other Financing Sources (Uses)					
Transfers in	$ 84,347	$ -	$ 106,015	$ 739,054	$ 929,416
Transfers out	-	-	(5,025)	-	(5,025)
Total Other Financing Sources (Uses)	**$ 84,347**	**$ -**	**$ 100,990**	**$ 739,054**	**$ 924,391**
Net Change in Fund Balance	**$ 19,246**	**$ (4,929)**	**$ 125,558**	**$ 739,054**	**$ 878,929**
Fund Balance - January 1	**83,337**	**84,097**	**458,874**	**(739,054)**	**(112,746)**
Fund Balance - December 31	**$ 102,583**	**$ 79,168**	**$ 584,432**	**$ -**	**$ 766,183**

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT B-3

BUDGETARY COMPARISON SCHEDULE
RESOURCE DEVELOPMENT SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2012

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget
Revenues				
Intergovernmental	$ -	$ -	$ 304,640	$ 304,640
Miscellaneous	100,000	100,000	4,015	(95,985)
Total Revenues	**$ 100,000**	**$ 100,000**	**$ 308,655**	**$ 208,655**
Expenditures				
Current				
Culture and recreation				
Trails	**$ -**	**$ -**	**$ 4,015**	**$ (4,015)**
Conservation of natural resources				
Forestry	$ -	$ -	$ 171,652	$ (171,652)
Other conservation	-	-	3,114	(3,114)
Total conservation of natural resources	**$ -**	**$ -**	**$ 174,766**	**$ (174,766)**
Debt service				
Principal	$ 146,667	$ 146,667	$ 146,667	$ -
Interest	47,667	47,667	48,308	(641)
Total debt service	**$ 194,334**	**$ 194,334**	**$ 194,975**	**$ (641)**
Total Expenditures	**$ 194,334**	**$ 194,334**	**$ 373,756**	**$ (179,422)**
Excess of Revenues Over (Under) Expenditures	**$ (94,334)**	**$ (94,334)**	**$ (65,101)**	**$ 29,233**
Other Financing Sources (Uses)				
Transfers in	-	-	84,347	84,347
Net Change in Fund Balance	**$ (94,334)**	**$ (94,334)**	**$ 19,246**	**$ 113,580**
Fund Balance - January 1	**83,337**	**83,337**	**83,337**	**-**
Fund Balance - December 31	**$ (10,997)**	**$ (10,997)**	**$ 102,583**	**$ 113,580**

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT B-4

BUDGETARY COMPARISON SCHEDULE
UNORGANIZED TOWNSHIPS SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2012

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget
Revenues				
Taxes	$ 120,555	$ 120,555	$ 112,294	$ (8,261)
Licenses and permits	38	38	150	112
Intergovernmental	-	-	16,326	16,326
Total Revenues	**$ 120,593**	**$ 120,593**	**$ 128,770**	**$ 8,177**
Expenditures				
Current				
General government				
Elections	$ 6,500	$ 6,500	$ 6,145	$ 355
Public safety				
Emergency services	114,300	114,300	127,554	(13,254)
Total Expenditures	**$ 120,800**	**$ 120,800**	**$ 133,699**	**$ (12,899)**
Net Change in Fund Balance	**$ (207)**	**$ (207)**	**$ (4,929)**	**$ (4,722)**
Fund Balance - January 1	**84,097**	**84,097**	**84,097**	**-**
Fund Balance - December 31	**$ 83,890**	**$ 83,890**	**$ 79,168**	**$ (4,722)**

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT B-5

BUDGETARY COMPARISON SCHEDULE
DEBT SERVICE FUND
FOR THE YEAR ENDED DECEMBER 31, 2012

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget
Revenues				
Taxes	$ 475,193	$ 475,193	$ 430,101	$ (45,092)
Intergovernmental	-	-	23,169	23,169
Investment earnings	145	145	146	1
Miscellaneous	70,337	70,337	70,332	(5)
Total Revenues	**$ 545,675**	**$ 545,675**	**$ 523,748**	**$ (21,927)**
Expenditures				
Current				
Economic development				
Housing and Redevelopment Authority	**$ -**	**$ -**	**$ 188,390**	**$ (188,390)**
Debt service				
Principal	$ 235,000	$ 235,000	$ 235,000	$ -
Interest	75,388	75,388	75,388	-
Administrative (fiscal) charges	410	410	402	8
Total debt service	**$ 310,798**	**$ 310,798**	**$ 310,790**	**$ 8**
Total Expenditures	**$ 310,798**	**$ 310,798**	**$ 499,180**	**$ (188,382)**
Excess of Revenues Over (Under) Expenditures	**$ 234,877**	**$ 234,877**	**$ 24,568**	**$ (210,309)**
Other Financing Sources (Uses)				
Transfers in	$ -	$ -	$ 106,015	$ 106,015
Transfers out	-	-	(5,025)	(5,025)
Total Other Financing Sources (Uses)	**$ -**	**$ -**	**$ 100,990**	**$ 100,990**
Net Change in Fund Balance	**$ 234,877**	**$ 234,877**	**$ 125,558**	**$ (109,319)**
Fund Balance - January 1	**458,874**	**458,874**	**458,874**	**-**
Fund Balance - December 31	**$ 693,751**	**$ 693,751**	**$ 584,432**	**$ (109,319)**

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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, 2012

	Balance January 1	Additions	Deductions	Balance December 31
CITIES, TOWNS, AND OTHER GOVERNMENTS				
Assets				
Cash and pooled investments	**$ 3,090**	**$ 12,197,958**	**$ 12,194,317**	**$ 6,731**
Liabilities				
Due to other governments	**$ 3,090**	**$ 12,197,958**	**$ 12,194,317**	**$ 6,731**
TAXES AND PENALTIES				
Assets				
Cash and pooled investments	$ **317,962**	**$ 19,328,287**	**$ 19,120,670**	**$ 525,579**
Liabilities				
Taxes collected in advance	$ 11,878	$ 3,606	$ 11,878	$ 3,606
Due to other governments	306,084	19,324,681	19,108,792	521,973
Total Liabilities	**$ 317,962**	**$ 19,328,287**	**$ 19,120,670**	**$ 525,579**
STATE				
Assets				
Cash and pooled investments	**$ 19,906**	**$ 170,562**	**$ 179,696**	**$ 10,772**
Liabilities				
Due to other governments	**$ 19,906**	**$ 170,562**	**$ 179,696**	**$ 10,772**

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, 2012

	Balance January 1	Additions	Deductions	Balance December 31
SEWER SYSTEM DEPOSITS				
Assets				
Cash and pooled investments	**$ 37,710**	**$ 18,000**	**$ 12,000**	**$ 43,710**
Liabilities				
Customer deposits - current	**$ 37,710**	**$ 18,000**	**$ 12,000**	**$ 43,710**
NORTH SHORE COLLABORATIVE				
Assets				
Cash and pooled investments	**$ 195,316**	**$ 83,078**	**$ 78,230**	**$ 200,164**
Liabilities				
Accounts payable	**$ 195,316**	**$ 83,078**	**$ 78,230**	**$ 200,164**
TOTAL ALL AGENCY FUNDS				
Assets				
Cash and pooled investments	**$ 573,984**	**$ 31,797,885**	**$ 31,584,913**	**$ 786,956**
Liabilities				
Accounts payable	$ 195,316	$ 83,078	$ 78,230	$ 200,164
Taxes collected in advance	11,878	3,606	11,878	3,606
Due to other governments	329,080	31,693,201	31,482,805	539,476
Customer deposits - current	37,710	18,000	12,000	43,710
Total Liabilities	**$ 573,984**	**$ 31,797,885**	**$ 31,584,913**	**$ 786,956**

OTHER SCHEDULES

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT D-1

SCHEDULE OF INTERGOVERNMENTAL REVENUE
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2012

Shared Revenue		
State		
Highway users tax	$	3,486,343
County program aid		120,153
PERA rate reimbursement		24,475
Disparity reduction aid		155,179
Police aid		110,033
Taconite credit		533,319
Enhanced 911		82,317
Market value credit		3,270
Total shared revenue	**$**	**4,515,089**
Reimbursement for Services		
State		
Minnesota Department of Human Services	**$**	**133,373**
Payments		
State		
Payments in lieu of taxes	$	759,947
Local		
Arrowhead Regional Development Commission		91,575
Local		130,850
Total payments	**$**	**982,372**
Grants		
State		
Minnesota Department of		
Public Safety	$	151,808
Health		108,767
Natural Resources		523,968
Pollution Control		52,350
Transportation		2,278
Human Services		2,570,041
Employment and Economic Security		65,956
Board of Water and Soil Resources		54,738
Office of Environmental Assistance		55,950
Total state	**$**	**3,585,856**

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT D-1
(Continued)

SCHEDULE OF INTERGOVERNMENTAL REVENUE
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2012

Grants (Continued)		
Federal		
Department of		
Agriculture	$	3,362,484
Housing and Urban Development		278,535
Interior		246,972
Transportation		2,675,455
Health and Human Services		727,768
Homeland Security		529,194
Total federal	**$**	**7,820,408**
Total state and federal grants	**$**	**11,406,264**
Total Intergovernmental Revenue	**$**	**17,037,098**

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT D-2

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2012

Federal Grantor Pass-Through Agency Grant Program Title	Contract Number/ 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		$ 13,500
U.S. Forest Service Cooperative Agreement - Pagami Creek	11-LE-11090903-022		162,333
U.S. Forest Service Cooperative Agreement - Aquatic Passages	11-PA-11090903-027		202,829
Broadband Initiatives Program Cluster			
Broadband Initiatives Program Grant - ARRA		10.787	1,075,345
(Total Broadband Initiatives Program 10.787 $7,168,963)			
Broadband Initiatives Program Loan - ARRA		10.787	6,093,618
(Total Broadband Initiatives Program 10.787 $7,168,963)			
Passed Through Carlton, Cook, Lake, and St. Louis Community Health Board			
Special Supplemental Nutrition Program for Women, Infants, and Children		10.557	51,243
Passed Through Minnesota Department of Human Services			
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program		10.561	64,750
Passed Through Minnesota Department of Natural Resources			
Cooperative Forestry Assistance		10.664	223,435
Passed Through Minnesota Management and Budget			
Schools and Roads - Grants to States		10.665	2,771,229
Total U.S. Department of Agriculture			**$ 10,658,282**
U.S. Department of Housing and Urban Development			
Passed Through Minnesota Department of Employment and Economic Development			
Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii	CDAP-10-0078-0-FY11	14.228	**$ 278,535**
U.S. Department of the Interior			
Direct			
Payments in Lieu of Taxes		15.226	**$ 246,972**
U.S. Department of Transportation			
Passed Through Minnesota Department of Transportation			
Highway Planning and Construction	SP-38-612-15 SP-38-602-32 SP-38-661-10 SP-38-607-13 SP-38-614-10 SP-38-661-09 SP-38-090-03 SP-38-090-06 SP-38-595-03	20.205	**$ 2,754,653**

The notes to the Schedule of Expenditures of Federal Awards are an integral part of this schedule.

LAKE COUNTY
TWO HARBORS, MINNESOTA

EXHIBIT D-2
(Continued)

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2012

Federal Grantor Pass-Through Agency Grant Program Title	Contract Number/ Pass-Through Grant Numbers	Federal CFDA Number	Expenditures
U.S. Department of Health and Human Services			
Passed Through Carlton, Cook, Lake, and St. Louis Community Health Board			
Public Health Emergency Preparedness		93.069	$ 13,997
Temporary Assistance for Needy Families Cluster			
Temporary Assistance for Needy Families		93.558	2,095
(Total Temporary Assistance for Needy Families 93.558 $65,522)			
Refugee and Entrant Assistance - State Administered Programs		93.566	189
Medical Assistance Program		93.778	10,469
(Total Medical Assistance Program 93.778 $278,611)			
Maternal and Child Health Services Block Grant to the States		93.994	10,132
Passed Through Minnesota Department of Human Services			
Promoting Safe and Stable Families		93.556	4,346
Temporary Assistance for Needy Families Cluster			
Temporary Assistance for Needy Families		93.558	63,427
(Total Temporary Assistance for Needy Families 93.558 $65,522)			
Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program - ARRA		93.714	4,115
Child Support Enforcement		93.563	206,144
Child Care and Development Block Grant		93.575	3,185
Stephanie Tubbs Jones Child Welfare Services Program		93.645	2,341
Foster Care - Title IV-E		93.658	36,746
Social Services Block Grant		93.667	100,920
Chafee Foster Care Independence Program		93.674	1,497
Children's Health Insurance Program		93.767	23
Medical Assistance Program		93.778	268,142
(Total Medical Assistance Program 93.778 $278,611)			
Total U.S. Department of Health and Human Services			**$ 727,768**
U.S. Department of Homeland Security			
Passed Through Minnesota Department of Natural Resources			
Boating Safety Financial Assistance		97.012	$ 30,270
Passed Through Minnesota Department of Public Safety			
Disaster Grants - Public Assistance (Presidentially Declared Disasters)		97.036	448,786
Hazard Mitigation Grant		97.039	16,548
Emergency Management Performance Grants	2011-EMPG-04341	97.042	31,797
Homeland Security Grant Program		97.067	1,793
Total U.S. Department of Homeland Security			**$ 529,194**
Total Federal Awards			**$ 15,195,404**

The notes to the Schedule of Expenditures of Federal Awards are an integral part of this schedule.

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2012

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, 2012. 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 position, 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. Clusters

Clusters of programs are groupings of closely related programs that share common compliance requirements. Total expenditures by cluster are:

Broadband Initiatives Program Cluster	$ 7,168,963
Temporary Assistance for Needy Families Cluster	69,637

5. Reconciliation to Schedule of Intergovernmental Revenue

Federal grant revenue per Schedule of Intergovernmental Revenue	$	7,820,408
Grants received more than 90 days after year-end, deferred in 2012		
Cooperative Forestry Assistance		126,835
Highway Planning and Construction		135,176
Deferred in 2011, recognized as revenue in 2012		
Highway Planning and Construction		(55,978)
Capital grants received in enterprise funds		
Broadband Initiatives Program Grant - ARRA		1,075,345
Broadband Initiatives Program Loan - ARRA		6,093,618
Expenditures Per Schedule of Expenditures of Federal Awards	$	15,195,404

6. Subrecipients

During 2012, the County did not pass any federal money to subrecipients.

7. 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.

Management and
Compliance Section

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LAKE COUNTY
TWO HARBORS, MINNESOTA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2012

I. SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: **Unmodified**

Internal control over financial reporting:

- Material weaknesses identified? **Yes**
- Significant deficiencies identified? **Yes**

Noncompliance material to the financial statements noted? **No**

Federal Awards

Internal control over major programs:

- Material weaknesses identified? **Yes**
- Significant deficiencies identified? **Yes**

Type of auditor's report issued on compliance for major programs: **Unmodified**

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133? **Yes**

The major programs are:

U.S. Forest Service Cooperative Agreement	10.R9-9-95-35B
U.S. Forest Service Cooperative Agreement - Pagami Creek	11-LE-11090903-022
U.S. Forest Service Cooperative Agreement - Aquatic Passages	11-PA-11090903-027
Broadband Initiatives Program Cluster	
Broadband Initiatives Program Grant - ARRA	CFDA #10.787
Broadband Initiatives Program Loan - ARRA	CFDA #10.787
Highway Planning and Construction	CFDA #20.205
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	CFDA #97.036

The threshold for distinguishing between Types A and B programs was $300,000.

Lake County qualified as a low-risk auditee? **No**

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

Criteria: A good system of internal control provides for an adequate segregation of duties so that no one individual handles a transaction from its inception to completion.

Condition: At Lake County, some individuals who collect and receipt cash can also post receipts to the general ledger system and make bank deposits. Also, an individual who maintains the general ledger, makes journal entries, and reconciles bank accounts also does some cash receipting. In addition, the same person who processes cash disbursements has the ability to print and sign checks. At the department level, many of these functions are also not segregated.

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

Effect: Inadequate segregation of duties could adversely affect the County's ability to detect misstatements in amounts that would be material in relation to the financial statements in a timely period by employees in the normal course of performing their assigned functions.

Cause: The County informed us that it does not have the economic resources needed to hire additional qualified accounting staff in order to segregate duties in every department.

Recommendation: We recommend that the County's elected officials and management be aware of the lack of segregation of duties of the accounting functions and, where possible, implement oversight procedures to ensure that the internal control policies and procedures are being implemented by staff to the extent possible.

Client's Response:

The County's management is aware of this condition. Limited staff prohibits the extensive segregation of duties that is desired. Occasional re-assignment of duties will be attempted in order to increase the segregation.

03-2 Capital Assets

Criteria: A capital assets policy should be adopted which defines the County's accounting policies over capital assets, such as capitalization thresholds, useful lives, and depreciation methods. A physical inventory should be taken of capital assets at least every five years.

Condition: The County Board has not adopted a capital asset policy. There has not been a physical inventory of capital assets since the records were first established in 2003.

Context: The County maintains its capital asset records on a capital asset software system. Additions and deletions are entered into this system and depreciation is calculated by the system. However, the capital asset policies utilized by the County in maintaining this system have not been formally approved by the County Board.

Effect: Without a written capitalization policy, the County may capitalize or depreciate assets inconsistently from year to year. Without a physical inventory of capital assets, it is possible that items that were disposed of will not be properly taken off inventory.

Cause: The County Board has not established or approved a capital asset policy, and no one has been assigned the responsibility of setting up a system to do a physical inventory of capital assets.

Recommendation: We recommend the County Board establish a capital asset policy to define the County's accounting policies over capital assets. The policy should also establish procedures to identify capital additions and deletions. Also, we recommend a physical inventory of capital assets be performed at least once every five years. This physical inventory can be rotated so that a portion of the capital assets is inventoried each year.

Client's Response:

The County intends to develop policies and procedures for capital assets and determine a process of doing a physical inventory as time permits.

06-2 Budgeting

Criteria: Written policies and procedures outline the specific authority and responsibilities of County personnel, providing for accountability. Budget policies should address how budgets will be monitored to provide for accountability over spending.

Condition: The County Board has adopted a formal budget policy which addresses when budget amendments must be approved by the County Board or County Auditor/Treasurer. However, the budget policy does not address how the budget will be monitored or who will monitor it.

Context: To be an effective financial management tool, a budget should be monitored to determine that departments are not overspending their budgets.

Effect: There is no formal process for monitoring the budget. This could result in over expenditure of budgets.

Cause: The County Board has not determined the procedures to be used for monitoring the budget and has not addressed this in the budget policy.

Recommendation: We recommend the budget policy be revised to include budget monitoring procedures. These procedures could include department head or County Budget Officer review of monthly 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 the amended policy will address monitoring procedures.

06-3 Audit Adjustments

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. Auditing standards define a material weakness as a deficiency, or combination of deficiencies, in internal control 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.

Condition: During our audit, we identified material adjustments that resulted in significant changes to the County's financial statements.

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

Effect: Audit adjustments were necessary to record additional receivables, additional deferred revenue, additional payables, a reduction in the amount due from component unit, the closure of the capital projects fund and the opening of the enterprise fund, additional construction in progress in the enterprise fund, and the elimination of non-revenue and non-expense accounts in the enterprise fund. Audit adjustments were also necessary to adjust the modified accrual financial statements to the accrual basis for the government-wide financial statements.

Cause: 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, the County staff do not have the time nor the technical expertise to ensure that all material adjustments have been made.

Recommendation: We recommend the 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 anticipated that the Financial Coordinator and the County Auditor will review the trial balances and journal entries.

06-4 Accounting Policies and Procedures Manual

Criteria: 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.

Condition: The County does not have a current and comprehensive accounting policies and procedures manual.

Context: This manual should be on hand to document the accounting policies and procedures which make up the County's internal control system. It can also help to prevent deterioration of key elements in the County's internal control system and help to avoid circumvention of County policies.

Effect: 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.

Cause: Lake County has various policies and procedures documents that have been adopted by the County Board. Some of these policies are accounting-related policies, and others are administrative in nature. The policies have not been integrated into a comprehensive accounting policies and procedures manual.

Recommendation: 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 County Auditor will attempt to draft a policy and procedures manual for the County Board's review and approval.

06-6 New Vendors

Criteria: Before being added to the accounts payable system, all new vendors should be verified as to their validity.

Condition: Lake County does not have any formal procedures for reviewing new vendors that have been added to the accounts payable system or for determining if they are legitimate vendors.

Context: There are generally a minimum of 5 to 10 new vendors added to the accounts payable system each year.

Effect: Without procedures to review and verify new vendors, ficticious vendors could be established.

Cause: Formal policies and procedures have never been established and approved to review new vendors created or to establish their validity.

Recommendation: We recommend the County Auditor develop written policies and procedures for staff to follow when setting up a new vendor that verifies the validity of the vendor, such as looking up the vendor in the phone book or on the internet or requiring the company to send information about its business. An active vendor's listing should be periodically reviewed by someone independent of the accounts payable processing function. That person should document the review by signing off on the report.

Client’s Response:

The County’s current policy is for the person responsible for creating a new vendor to check by internet and other sources that the vendor is legitimate. The Auditor does an occasional review of the new vendor list.

ITEM ARISING THIS YEAR

12-1 Network/Application Journal Entry Controls

Criteria: County management is responsible for the County's internal controls over information systems. This requires establishing security policies and performing assessments of existing controls to determine if established internal controls are still effective or if changes are needed to ensure County data is protected as prescribed by management.

Condition: Lake County has not performed an assessment of its existing controls over the journal entry function in the Integrated Financial System (IFS) to determine if controls are still effective.

Context: The IFS application is the general ledger for Lake County. Detailed receipt and disbursement transactions, as well as budget information, are maintained on the IFS application throughout the year. This information is used by management to monitor the resources available and make decisions based on the available resources. The information maintained within the IFS application is the key source of information used for the preparation of the County’s annual financial statements.

Effect: It is imperative that the County monitor its controls over the journal entry function to ensure only authorized employees have access to this function to prevent unauthorized adjustments to the County’s general ledger.

Cause: Lake County management has not performed an assessment of its controls over the journal entry function in IFS to determine whether only authorized employees have access to this function.

Recommendation: We recommend Lake County management review controls in place over the journal entry function that limit access to the IFS application to determine whether they are appropriate or if changes are needed to protect County data as prescribed by management.

Client’s Response:

The County will review the journal entry data function controls to make sure only authorized personnel have access to this function.

PREVIOUSLY REPORTED ITEMS RESOLVED

Payroll (06-7)
The County needed to establish procedures to provide additional oversight and monitoring of the payroll process to ensure the proper segregation of duties to the payroll function.

Resolution
In 2012, the County implemented oversight procedures to the payroll function. The Human Resources Administrator now reviews all payroll edit reports and the payroll listing before the processing of payroll.

Approval of Time Sheets (07-1)
The County needed to establish procedures to ensure all timesheets contained two attestations of the hours worked. One attestation should be made by the employee, and the other should be made by the employee's supervisor or other appropriate person.

Resolution
In 2012, the County implemented procedures to ensure that all timesheets contain two attestations; one attestation by the employee and the other by the employee's supervisor or appropriate person.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

PREVIOUSLY REPORTED ITEM NOT RESOLVED

11-1 Identification of Federal Awards

Programs	Pass-Through Agencies
U.S. Department of Agriculture	
Cooperative Forestry Assistance (CFDA No. 10.664)	Minnesota Department of Natural Resources
Broadband Initiatives Program Cluster	
Broadband Initiatives Program Grant - ARRA (CFDA No. 10.787)	
Broadband Initiatives Program Loan - ARRA (CFDA No. 10.787)	
U.S. Department of Transportation	
Highway Planning and Construction (CFDA No. 20.205)	Minnesota Department of Transportation
U.S. Department of Homeland Security	
Disaster Grants - Public Assistance (Presidentially Declared Disasters) (CFDA No. 97.036)	Minnesota Department of Public Safety

Criteria: The Office of Management and Budget's (OMB) Circular A-133**,** *Audits of States, Local Governments, and Non-Profit Organizations, Auditee Responsibilities* subpart C.300(a) and (d) requires, "The auditee shall identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received.

Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity. The auditee shall prepare appropriate financial statements, including the Schedule of Expenditures of Federal awards (SEFA) in accordance with subpart C.310."

Condition: Lake County did not properly identify federal expenditures on the SEFA for which there were federal funds expended.

Context: The SEFA prepared by Lake County did not correctly identify federal programs and amounts expended for the following more significant programs:

- The County under-reported expenditures for the Cooperative Forestry Assistance (CFDA No. 10.664) by $189,912.

- The County under-reported expenditures for the Broadband Initiatives Program Grant - ARRA (CFDA No. 10.787) and the Broadband Initiatives Program Loan – ARRA (CFDA No. 10.787) by $383,903.

- The County over-reported expenditures for the Highway Planning and Construction Grant (CFDA No. 20.205) by $82,847.

- The County under-reported expenditures for the Disaster Grants - Public Assistance (Presidentially Declared Disasters) (CFDA No. 97.036) by $102,374.

Effect: The inability to identify and accurately record federal financial assistance in the SEFA results in a deficiency in internal control over the SEFA preparation, and the reporting of federal financial assistance in accordance with OMB Circular A-133.

Cause: The County erred in its determination and classification of the actual amounts received and expended under these federal programs. The County's procedures and internal controls for identifying federal financial assistance for preparation of its SEFA are inadequate.

Recommendation: We recommend that County management develop a process for adequately identifying federal revenues and accumulating the information needed to prepare the SEFA. Those responsible for compiling the SEFA should understand the components of the SEFA and properly gather the correct information and maintain supporting documentation. For each federal award identified, the County should determine the correct program CFDA title and number, award number and year, federal grantor agency, pass-through agency, amount received and expended, and whether American Recovery and Reinvestment Act (ARRA) funding is involved. The County should also reconcile the SEFA amounts to the general ledger and financial statements.

Corrective Action Plan:

Name of Contact Person Responsible For Corrective Action:

Lake County Auditor, Steve McMahon

Corrective Action Planned:

The County will attempt to develop a process to identify federal revenues and accumulate the information needed to prepare the SEFA.

Anticipated Completion Date:

Third quarter of 2013

ITEMS ARISING THIS YEAR

12-2 Activities Allowed and Unallowed, Allowable Costs/Cost Principles

Program: U.S. Department of Agriculture's U.S. Forest Service Cooperative Agreements (Contract Nos. 10.R9-9-95-35B, 11-LE-11090903-022, and 11-PA-11090903-027)

Criteria: For grant programs funded on a reimbursement basis, federal compliance requires that claims for reimbursement be based upon paid invoices that are allowable under the grant. Documentation should be attached supporting allowable expenditures claimed. Reimbursement should only include the expenditures allowable under the grant agreement.

Condition: Lake County did not properly review all expenditures for allowability under the U.S. Forest Service Cooperative Agreements before submitting the expenditures to the grantor for reimbursement.

Questioned Costs: None.

Context: Lake County should have procedures in place to make sure all expenditures are allowable under the grant before reimbursement requests are submitted to the grantor.

Effect: Not all of the costs submitted to the grantor for reimbursement were allowable under the grant, which resulted in adjustments to the reimbursement requests.

Cause: Failure of Lake County to review the expenditures for allowability under the U.S. Forest Service Cooperative Agreements before submitting the reimbursement request to the grantor.

Recommendation: We recommend that all invoices be reviewed by the County for allowability under its grant agreements before the submission of a reimbursement request to the grantor. Reimbursement should not be requested until the County is sure all expenditures are allowable under the grant. Existing internal controls should be evaluated for effectiveness and written policies and procedures developed, where necessary, to ensure compliance with applicable federal requirements in accordance with OMB Circular A-133.

Corrective Action Plan:

Name of Contact Person Responsible for Corrective Action:

Lake County Administrator

Corrective Action Planned:

All invoices will be reviewed by the County for allowability under their grant agreements before submission for reimbursement to the grantor.

Anticipated Completion Date

Immediately

12-3 Reporting

Program: U.S. Department of Agriculture's U.S. Forest Service Cooperative Agreements (Contract Nos. 10.R9-9-95-35B, 11-LE-11090903-022, and 11-PA-11090903-027)

Criteria: Lake County is required to submit annual performance reports to the U.S. Forest Service Program Manager within 30 days after the completion of the reporting period as identified in the U.S. Forest Service Cooperative Agreements.

Condition: Lake County did not submit the annual performance reports for December 31, 2011, and December 31, 2012, as required by the U.S. Forest Service Cooperative Agreements.

Questioned Costs: None.

Context: Lake County did not submit the annual performance reports as required by the grant agreements. As the grantee, the County is responsible for compliance with all federal grant requirements, including those relating to submission of required performance reports to the U.S. Forest Service Program Manager.

Effect: The County did not submit the performance reports required by the grant agreements for reporting.

Cause: The County's authorized representative under the grant agreement was not aware that the performance reports were required under the U.S. Forest Service Cooperative Agreements.

Recommendation: We recommend that the County thoroughly review its grant agreements and develop procedures to ensure the County is in compliance with the requirements of the grant, including the submission of the required performance reports.

<u>Corrective Action Plan:</u>

<u>Name of Contact Person Responsible for Corrective Action:</u>

Lake County Administrator

<u>Corrective Action Planned:</u>

The County will attempt to thoroughly review grants and develop procedures to make sure the County is in compliance with all requirements.

<u>Anticipated Completion Date:</u>

Third quarter of 2013

12-4 <u>Davis-Bacon Act</u>

Program: U.S. Department of Agriculture's Broadband Initiatives Program Grant - ARRA (CFDA No. 10.787) and Broadband Initiatives Program Loan - ARRA (CFDA No. 10.787)

Criteria: The Davis-Bacon Act (23 U.S.C. 113) requires contractors and subcontractors performing work on federal contracts in excess of $2,000 pay their laborers and mechanics not less than the prevailing wage rates and fringe benefits listed in the contract's wage determination class. Each covered contractor and subcontractor must, on a weekly basis, provide a copy of the payrolls providing the information listed under recordkeeping for the preceding weekly payroll period. Each payroll submitted must be accompanied by a "Statement of Compliance." This must be completed within seven days after the regular pay date for the pay period.

The U.S. Department of Agriculture Rural Utilities Service entered into an agreement with the County which stated the County was responsible for all federal requirements involving Davis-Bacon Act wages and reporting.

Condition: Lake County does not have internal controls in place to determine if contractors are complying with the Davis-Bacon Act regarding the payment of prevailing wage rates. The County receives the certified payrolls but does maintain evidence that the certified payrolls were reviewed for compliance with the Davis-Bacon Act.

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Questioned Costs: None.

Context: Lake County contracted with Rohl Networks, LP which submitted weekly certified payroll reports to the County for review for compliance with the Davis-Bacon Act. The County did not document its review of compliance with the Davis-Bacon Act.

Effect: Lake County provided no evidence of review for compliance with the Davis-Bacon Act. There is no assurance that the County properly monitored that the wages paid by the contractor and subcontractor were in compliance with the Davis-Bacon Act.

Cause: Lake County staff do not have controls in place to document its review of the Davis-Bacon Act regarding the payment of prevailing wage rates.

Recommendation: We recommend that Lake County develop internal controls and written policies and procedures to ensure compliance with the requirements of the Davis-Bacon Act in accordance with OMB Circular A-133.

<u>Corrective Action Plan</u>:

<u>Name of Contact Person Responsible for Corrective Action</u>:

Lake County Administrator

<u>Corrective Action Planned</u>:

Lake County will develop internal controls to properly document the review of certified payrolls assuring compliance with the Davis-Bacon Act.

<u>Anticipated Completion Date</u>

Third quarter of 2013

12-5 Incomplete Documentation - Activities Allowed or Unallowed, Allowable Costs/Cost Principles, Reporting, and Special Tests and Provisions

Program: U.S. Department of Homeland Security's Disaster Grants - Public Assistance (Presidentially Declared Disasters) (CFDA #97.036)

Pass-Through Agency: Minnesota Department of Public Safety

Criteria: Each recipient of a federal grant award should maintain documentation supporting its compliance with federal grant requirements, including allowable activities undertaken during the grant period. The documentation should be available for auditors to review to determine if the auditee has complied with the terms of the grant program and the requirements of OMB Circular A-133.

Condition: The documentation for the Disaster Grants - Public Assistance (Presidentially Declared Disasters) was incomplete. The County was unable to identify the individual expenditures that were reimbursed under the grant. Due to the lack of documentation maintained by the County and the County's inability to identify the expenditures reimbursed under the grant, compliance with the requirements for activities allowed or unallowed, allowable costs/cost principles, reporting, and special tests and provisions could not be tested or determined.

Questioned Costs: None.

Context: In June 2012, Lake County experienced a substantial rainfall event that lead to severe flooding. The Federal Emergency Management Agency (FEMA) responded to Lake County to assist the County with flood recovery. As part of FEMA's assistance, FEMA worked with the County to prepare project worksheets to document the costs to repair the damage caused by the flood that is reimbursable under the Disaster Grants - Public Assistance (Presidentially Declared Disasters) Grant Program. Since the completion of the project worksheets by FEMA, the County's Road and Bridge Department has been unable to reconcile its expenditures to the project worksheets. As the grantee, the County is responsible for compliance with all federal grant requirements, including the maintenance of complete and accurate documentation of all grant related activities.

Effect: The County's Disaster Grants - Public Assistance (Presidentially Declared Disasters) Grant Program documentation does not contain evidence or support of compliance with the activities allowed or unallowed, allowable costs/cost principles, reporting and special tests and provisions compliance requirements.

Cause: The County's Highway Department has been unable to reconcile its expenditures to the project worksheets prepared by FEMA.

Recommendation: We recommend that the County work with FEMA to reconcile its expenditures to the project worksheets prepared by FEMA. The County should also gather and maintain all of the supporting documentation necessary to demonstrate its compliance with the requirements of this grant. Proper documentation is important since the County will need to submit all of the necessary documentation at the completion of the grant to close out the grant program and receive final payment on the grant.

Corrective Action Plan:

Name of Contact Person Responsible for Corrective Action:

Lake County Administrator

Corrective Action Planned:

All costs incurred by the County have been documented and were provided to the FEMA personnel. The FEMA personnel completed the Project Worksheets and submitted them for reimbursement. Only costs to return the roads/sites to their pre-flood condition are eligible.

Anticipated Completion Date:

The County is working with the Minnesota Department of Public Safety, Homeland Security, and Emergency Management to ensure that the P.4 Certificate is completed and all allowable costs are detailed and requested for final reimbursement.

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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*

Independent Auditor's Report

Board of County Commissioners
Lake County

We have audited, 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, 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, 2012, and the related notes to the financial statements, which collectively comprise the County's basic financial statements, and have issued our report thereon dated September 25, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Lake County's internal control over financial reporting to determine audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and, therefore, material weaknesses may exist that were not 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, 06-2, 06-4, 06-6, and 12-1 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

The *Minnesota Legal Compliance Audit Guide for Political Subdivisions*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65, 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.

In connection with our audit, nothing came to our attention that caused us to believe that Lake County failed to comply with the provisions of the *Minnesota Legal Compliance Audit Guide for Political Subdivisions.* However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the County's noncompliance with the above referenced provisions.

Other Matters

Lake County's responses to the internal control findings identified in our audit have been included in the Schedule of Findings and Questioned Costs. The County's responses were not subject to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting, compliance and the provisions of the *Minnesota Legal Compliance Audit Guide for Political Subdivisions* and the result of that testing, and not to provide an opinion on the effectiveness of the County's internal control over financial reporting or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the County's internal control over financial reporting and compliance. Accordingly, this communication is not suitable for any other purpose.

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

September 25, 2013

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REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE

Independent Auditor's Report

Board of County Commissioners
Lake County

Report on Compliance for Each Major Federal Program

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 the County's major federal programs for the year ended December 31, 2012. 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.

Management's Responsibility
Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its federal programs.

Auditor's Responsibility
Our responsibility is to express an opinion on compliance for each of Lake County's major federal programs based on our audit of the types of compliance requirements referred to above. 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 on compliance for each major federal program. However, our audit does not provide a legal determination of the County's compliance with those requirements.

Opinion on Each Major Federal Program

In our opinion, Lake County complied, in all material respects, with the types of compliance 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, 2012.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs, as items 12-2, 12-3, 12-4, and 12-5. Our opinion on each major federal program is not modified with respect to these matters.

Lake County's responses to the noncompliance findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs as Corrective Action Plans. Lake County's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

Report on Internal Control Over Compliance

Management of Lake County is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the County's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on compliance for each major federal program 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.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a deficiency in internal control over compliance that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

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. We consider the deficiency in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs, as item 11-1 to be a material weakness.

A significant deficiency in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit the attention of those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 12-2, 12-3, 12-4, and 12-5 to be significant deficiencies.

Lake County's responses to the internal control over compliance findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs as Corrective Action Plans. Lake County's responses were not subject to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

Purpose of This Report

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

/s/Rebecca Otto | */s/Greg Hierlinger*

REBECCA OTTO
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

September 25, 2013