STATE OF MINNESOTA
Office of the State Auditor

Rebecca Otto
State Auditor

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

YEAR ENDED DECEMBER 31, 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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ST. LOUIS AND LAKE COUNTIES
REGIONAL RAILROAD AUTHORITY
EVELETH, MINNESOTA

Year Ended December 31, 2012

Audit Practice Division
Office of the State Auditor
State of Minnesota

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

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Introductory Section

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

ORGANIZATION
DECEMBER 31, 2012

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

Executive Director
Robert Manzoline

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Financial Section

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STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

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INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and the General Fund of the St. Louis and Lake Counties Regional Railroad Authority, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Authority'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 Authority'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 Authority'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 and the General Fund of the St. Louis and Lake Counties Regional Railroad Authority as of December 31, 2012, and the respective changes in financial position thereof and the budgetary comparison of the General Fund for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Management has omitted the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the 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. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 24, 2014, on our consideration of the St. Louis and Lake Counties Regional Railroad Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the St. Louis and Lake Counties Regional Railroad Authority's internal control over financial reporting and compliance.

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

March 24, 2014

BASIC FINANCIAL STATEMENTS

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

EXHIBIT 1

GENERAL FUND BALANCE SHEET AND
GOVERNMENTAL ACTIVITIES - STATEMENT OF NET POSITION
WITH ADJUSTMENTS TO CONVERT MODIFIED TO FULL ACCRUAL
DECEMBER 31, 2012

	General Fund	Adjustments	Governmental Activities
Assets			
Cash and pooled investments	$ 2,425,133	$ -	$ 2,425,133
Accounts receivable	16,123	-	16,123
Taxes receivable - delinquent	90,795	-	90,795
Due from other governments	303,781	-	303,781
Capital assets			
Non-depreciable	-	4,397,899	4,397,899
Depreciable - net of accumulated depreciation	-	8,316,405	8,316,405
Total Assets	**$ 2,835,832**	**$ 12,714,304**	**$ 15,550,136**
Liabilities and Fund Balance/Net Position			
Liabilities			
Current liabilities			
Accounts payable	$ 200,502	$ -	$ 200,502
Salaries payable	9,040	-	9,040
Due to other governments	24,082	-	24,082
Deferred revenue - unavailable	249,101	(249,101)	-
Deferred revenue - unearned	24,885	-	24,885
Noncurrent liabilities			
Compensated absences payable - due within one year	-	19,480	19,480
Compensated absences payable - long-term	-	79,059	79,059
Total Liabilities	**$ 507,610**	**$ (150,562)**	**$ 357,048**
Fund Balance			
Assigned			
Compensated absences	$ 79,059	$ (79,059)	
Future trail maintenance	371,690	(371,690)	
Lakefront Line Railroad Bridge Replacement	407,000	(407,000)	
Unassigned	1,470,473	(1,470,473)	
Total Fund Balance	**$ 2,328,222**	**$ (2,328,222)**	
Net Position			
Net investment in capital assets		$ 12,714,304	$ 12,714,304
Unrestricted		2,478,784	2,478,784
Total Net Position		**$ 15,193,088**	**$ 15,193,088**
Total Liabilities and Fund Balance/Net Position	**$ 2,835,832**	**$ 12,714,304**	**$ 15,550,136**

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

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

EXHIBIT 1
(Continued)

GENERAL FUND BALANCE SHEET AND
GOVERNMENTAL ACTIVITIES - STATEMENT OF NET POSITION
WITH ADJUSTMENTS TO CONVERT MODIFIED TO FULL ACCRUAL
DECEMBER 31, 2012

Reconciliation of the General Fund Balance to Net Position		
Fund Balance - General Fund	**$**	**2,328,222**
Capital assets, net of accumulated depreciation, used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.		12,714,304
Other long-term assets are not available to pay for the current period expenditures and, therefore, are deferred in the governmental funds.		249,101
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the governmental funds.		(98,539)
Net Position - Governmental Activities	**$**	**15,193,088**

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

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

EXHIBIT 2

GENERAL FUND STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE AND GOVERNMENTAL ACTIVITIES - STATEMENT OF ACTIVITIES WITH ADJUSTMENTS TO CONVERT MODIFIED TO FULL ACCRUAL FOR THE YEAR ENDED DECEMBER 31, 2012

	General Fund	Adjustments	Governmental Activities
Revenues			
Taxes	$ 1,244,247	$ (816)	$ 1,243,431
Intergovernmental	911,212	22,752	933,964
Charges for services	9,280	-	9,280
Miscellaneous	221,920	-	221,920
Capital contributions	-	267,253	267,253
Total Revenues	**$ 2,386,659**	**$ 289,189**	**$ 2,675,848**
Expenditures/Expenses			
Current			
Economic development			
Administration	$ 1,671,277	$ 51,384	$ 1,722,661
Depreciation	-	220,429	220,429
Capital outlay	326,136	(326,136)	-
Total Expenditures/Expenses	**$ 1,997,413**	**$ (54,323)**	**$ 1,943,090**
Net Change in Fund Balance/Net Position	**$ 389,246**	**$ 343,512**	**$ 732,758**
Fund Balance/Net Position - January 1	**1,938,976**	**12,521,354**	**14,460,330**
Fund Balance/Net Position - December 31	**$ 2,328,222**	**$ 12,864,866**	**$ 15,193,088**

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

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

EXHIBIT 2
(Continued)

GENERAL FUND STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE AND GOVERNMENTAL ACTIVITIES - STATEMENT OF ACTIVITIES WITH ADJUSTMENTS TO CONVERT MODIFIED TO FULL ACCRUAL FOR THE YEAR ENDED DECEMBER 31, 2012

Reconciliation of the Statement of General Fund Revenues, Expenditures, and Changes in Fund Balance to the Statement of Activities of Governmental Activities		
Net Change in Fund Balance		**$ 389,246**
In the General Fund, under the modified accrual basis, receivables not available for expenditures are deferred. In the Statement of Activities, those revenues are recognized when earned. The adjustment to revenues between the General Fund and the governmental activities is the increase or decrease in revenues deferred as unavailable.		
Deferred revenue - December 31	$ 249,101	
Deferred revenue - January 1	(227,165)	21,936
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. Also, in the statement of activities, only the gain or loss on the disposal of assets is reported; whereas, in the governmental fund, the proceeds from the sale increase financial resources. Therefore, the change in net position differs from the change in fund balance by the net book value of the assets sold.		
Expenditures for general capital assets and infrastructure	$ 326,136	
Net book value of assets disposed of	(2,000)	
Capital contributions	267,253	
Current year depreciation	(220,429)	370,960
Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.		
Changes in compensated absences		(49,384)
Change in Net Position of Governmental Activities		**$ 732,758**

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

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

EXHIBIT 3

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
BUDGETARY COMPARISON
FOR THE YEAR ENDED DECEMBER 31, 2012

	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget
Revenues				
Taxes	**$ 1,470,211**	**$ 1,470,211**	**$ 1,244,247**	**$ (225,964)**
Intergovernmental				
Federal				
Disaster Grants - Public Assistance				
(Presidentially Declared Disasters)	$ -	$ -	$ 220,744	$ 220,744
Payments in lieu of taxes	-	-	8	8
Highway Planning and Construction	-	5,000	-	(5,000)
State				
Department of Public Safety	394,782	394,782	-	(394,782)
Department of Transportation	-	272,436	-	(272,436)
LCMR	287,470	287,470	66,223	(221,247)
Iron Range Resources and				
Rehabilitation Board	221,380	221,380	230,000	8,620
Market value credit	-	-	1,687	1,687
Taconite credit	-	-	51,878	51,878
State PERA	-	-	1,417	1,417
State 30% rental	-	-	8	8
Disparity reduction credit	-	-	30,332	30,332
Local				
Other local grants	51,000	91,638	228,915	137,277
Reimbursement for administrative services				
Minneapolis-Duluth/Superior				
Passenger Rail Alliance	80,000	80,000	80,000	-
Total intergovernmental	**$ 1,034,632**	**$ 1,352,706**	**$ 911,212**	**$ (441,494)**
Charges for services	**$ -**	**$ -**	**$ 9,280**	**$ 9,280**
Miscellaneous	**$ 49,701**	**$ 49,701**	**$ 221,920**	**$ 172,219**
Total Revenues	**$ 2,554,544**	**$ 2,872,618**	**$ 2,386,659**	**$ (485,959)**
Expenditures				
Current				
Economic development	$ 2,838,181	$ 2,617,506	$ 1,671,277	$ (946,229)
Capital outlay	-	498,111	326,136	(171,975)
Total Expenditures	**$ 2,838,181**	**$ 3,115,617**	**$ 1,997,413**	**$ (1,118,204)**
Net Change in Fund Balance	**$ (283,637)**	**$ (242,999)**	**$ 389,246**	**$ 632,245**
Fund Balance - January 1	**1,938,976**	**1,938,976**	**1,938,976**	**-**
Fund Balance - December 31	**$ 1,655,339**	**$ 1,695,977**	**$ 2,328,222**	**$ 632,245**

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

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1. Summary of Significant Accounting Policies

The St. Louis and Lake Counties Regional Railroad Authority's financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as of and for the year ended December 31, 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 St. Louis and Lake Counties Regional Railroad Authority are discussed below.

A. Financial Reporting Entity

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

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

B. Basic Financial Statements

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

1. Summary of Significant Accounting Policies

B. Basic Financial Statements (Continued)

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

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

C. Measurement Focus and Basis of Accounting

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

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. The Authority considers all revenues except for tax revenue as available if collected within 90 days after the end of the current period. Tax revenue is considered available if collected within 60 days after the end of the current period. Charges for services and interest are considered susceptible to accrual. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on long-term debt, compensated absences, and claims and judgments, which are recognized as expenditures to the extent that they have matured. Proceeds of long-term debt and acquisitions under capital leases, if any, are reported as other financing sources.

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

1. Summary of Significant Accounting Policies (Continued)

D. Budgetary Data

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

E. Assets, Liabilities, and Net Position or Equity

1. Taxes Receivable

Taxes receivable consist of uncollected taxes payable in the years 2006 to 2012. Taxes receivable are offset by deferred revenue for the amount not collected within 60 days of December 31 to indicate they are not available to pay current expenditures. No provision has been made for an estimated uncollectible amount.

2. Capital Assets

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

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

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

1. Summary of Significant Accounting Policies

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

3. Classification of Fund Balances

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

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

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

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

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

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

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

1. Summary of Significant Accounting Policies

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

4. Classification of Net Position

Net position in government-wide 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.

5. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Detailed Notes

A. Assets

1. Deposits and Investments

The Authority is authorized by Minn. Stat. §§ 118A.02 and 118A.04 to deposit its cash and to invest in certificates of deposit in financial institutions designated by the St. Louis County Board of Commissioners and the Authority's board.

2. Detailed Notes

A. Assets

1. Deposits and Investments (Continued)

Minnesota statutes require that all Authority deposits be covered by insurance, surety bond, or collateral. The Authority may invest in the types of securities authorized by Minn. Stat. §§ 118A.04-.05.

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

2. Receivables

Receivables as of December 31, 2012, for the St. Louis and Lake Counties Regional Railroad Authority's governmental activities are as follows:

Due from other governments	$	303,781
Taxes receivable		90,795
Accounts		16,123
Total Receivables	$	410,699

3. Capital Assets

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

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	$ 126,211	$ 40,000	$ -	$ 166,211
Construction in progress	3,678,299	553,389	-	4,231,688
Total capital assets not depreciated	$ 3,804,510	$ 593,389	$ -	$ 4,397,899

2. Detailed Notes

A. Assets

3. Capital Assets (Continued)

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets depreciated				
Infrastructure	$ 10,941,934	$ -	$ -	$ 10,941,934
Machinery, furniture, and equipment	157,702	-	8,000	149,702
Total capital assets depreciated	$ 11,099,636	$ -	$ 8,000	$ 11,091,636
Less: accumulated depreciation for				
Infrastructure	$ 2,499,351	$ 212,675	$ -	$ 2,712,026
Machinery, furniture, and equipment	61,451	7,754	6,000	63,205
Total accumulated depreciation	$ 2,560,802	$ 220,429	$ 6,000	$ 2,775,231
Total capital assets depreciated, net	$ 8,538,834	$ (220,429)	$ 2,000	$ 8,316,405
Total Capital Assets, Net	$ 12,343,344	$ 372,960	$ 2,000	$ 12,714,304

Depreciation expense was charged to functions/programs as follows:

Governmental Activities	
Economic development	$ 220,429

B. Liabilities

1. Payables

Payables at December 31, 2012, for the St. Louis and Lake Counties Regional Railroad Authority's governmental activities are as follows:

Accounts	$ 200,502
Salaries	9,040
Due to other governments	24,082
Total Payables	$ 233,624

2. Detailed Notes

B. Liabilities (Continued)

2. Deferred Revenue

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

3. Compensated Absences

The liability for compensated absences reported in the financial statements consists of unpaid, accumulated annual vacation and sick leave balances. The liability has been calculated using the vesting method, in which leave amounts for employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. Compensated absences are accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in the governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

The following is a summary of the changes in long-term compensated absences payable for the year ended December 31, 2012:

Payable - January 1	$	49,155
Net increase (decrease)		49,384
Payable - December 31	$	98,539

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

2. Detailed Notes

B. Liabilities

3. Compensated Absences (Continued)

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

4. Risk Management

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

3. Pension Plans

A. Plan Description

All full-time and certain part-time employees of the St. Louis and Lake Counties Regional Railroad Authority are covered by defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the General Employees Retirement Fund, which is a cost-sharing, multiple-employer retirement plan. The plan is established and administered in accordance with Minn. Stat. chs. 353 and 356.

3. Pension Plans

A. Plan Description (Continued)

General Employees Retirement Fund members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security, and Basic Plan members are not. All new members must participate in the Coordinated Plan.

PERA provides retirement benefits as well as disability benefits to members and benefits to survivors upon death of eligible members. Benefits are established by state statute and vest after three years of credited service (five years for those first eligible for membership after June 30, 2010). Defined retirement benefits are based on a member's average yearly salary for the five highest-paid consecutive years of allowable service, age, and years of credit at termination of service.

Two methods are used to compute benefits for Coordinated and Basic Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Basic Plan member is 2.2 percent of average salary for each of the first ten years of service and 2.7 percent for each year thereafter. For a Coordinated Plan member, the annuity accrual rate is 1.2 percent of average salary for each of the first ten years and 1.7 percent for each successive year. Using Method 2, the annuity accrual rate is 2.7 percent of average salary for Basic Plan members and 1.7 percent for Coordinated Plan members for each year of service.

For General Employees Retirement Fund members whose annuity is calculated using Method 1, a full annuity is available when age plus years of service equal 90. Normal retirement age is 65 for members hired prior to July 1, 1989, and is the age for unreduced Social Security benefits capped at age 66 for Coordinated Plan members hired on or after July 1, 1989. A reduced retirement annuity is also available to eligible members seeking early retirement.

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

3. Pension Plans

A. Plan Description (Continued)

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

B. Funding Policy

Pension benefits are funded from member and employer contributions and income from the investment of fund assets. Rates for employer and employee contributions are set by Minn. Stat. ch. 353. These statutes are established and amended by the State Legislature. The St. Louis and Lake Counties Regional Railroad Authority makes annual contributions to the pension plans equal to the amount required by state statutes.

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

The St. Louis and Lake Counties Regional Railroad Authority 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	7.00

The St. Louis and Lake Counties Regional Railroad Authority’s contributions for the years ending December 31, 2012, 2011, and 2010, for the General Employees Retirement Fund were:

2012	2011	2010
$ 13,678	$ 13,587	$ 13,027

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

4. Related Organizations

Minneapolis-Duluth/Superior Passenger Rail Alliance

The St. Louis and Lake Counties Regional Railroad Authority, along with several other governmental entities, formed the Minneapolis-Duluth/Superior Passenger Rail Alliance on February 1, 2008, under a Joint Powers Agreement in accordance with Minn. Stat. §§ 471.59, 398A.04, and 398A.06. Its purpose is to collaboratively discuss, study, plan for, promote, and facilitate the development of intercity passenger rail transportation between the Twin Cities Metropolitan and Twin Ports areas. The Alliance is governed by a nine-member Board of Directors composed of one elected official selected by each party represented in the Alliance. Each member of the Alliance contributes funds to the Alliance for use in funding its operations. The Authority contributed $61,750 and $76,000 to the Alliance in 2012 and 2011, respectively.

The Minneapolis-Duluth/Superior Passenger Rail Alliance does not have any employees of its own. The St. Louis and Lake Counties Regional Railroad Authority contracted with the Alliance to administer its day-to-day activities. In return for services provided, the Alliance reimbursed the Authority $80,000 in 2012 and 2011.

Management and Compliance Section

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

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

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

03-1 Internal Control/Segregation of Duties

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

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

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

Effect: Inadequate segregation of duties could adversely affect the Authority's ability to detect and correct or prevent misstatements in a timely manner by personnel in the normal course of performing their assigned functions.

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

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

Client's Response:

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

11-1 Audit Adjustments and Reclassifications

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

Condition: During our audit, we identified adjustments that resulted in a material change to the Authority's government-wide financial statements.

Context: The inability to identify and correct material adjustments in the Authority's financial statements increases the likelihood that the financial statements would not be fairly presented.

Effect: Audit adjustments were made to decrease liabilities on the government-wide financial statements to reflect the recognition of revenue related to a receivable received outside of the period of availability and to adjust for the over accrual of compensated absences.

Cause: St. Louis County is the Authority's fiscal agent. The Authority is reported in the County's general ledger as an agency fund. As part of the year-end closing process, a receivable related to a state disaster relief grant was not reported. Vesting sick leave as recorded in the general ledger did not agree with calculations performed in accordance with employee contracts.

Recommendation: We recommend that the Authority and its fiscal agent review significant receipts received after year-end to ensure that all significant receivables are recorded in the appropriate accounting period. We also recommend that the Authority and its fiscal agent revise its calculation of compensated absences to reflect the terms of contracts between the Authority and its employees.

Client's Response

We will review and better communicate significant receivables particularly those associated with grant reimbursements.

The Authority adopted a compensated absences policy in August of 2012 and since that time, all Authority employee contracts have been amended to conform to the new policy. Employee contracts are now the same as far as compensated absence terms and calculations which should alleviate this problem.

11-2 Fund Balance Reporting

Criteria: Governments are required to classify and report amounts in the appropriate fund balance classifications by applying their accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to have been spent.

Condition: In 2012, the Authority's Board of Directors reclassified $407,000 of unassigned fund balance to be assigned for future Lakefront Line Railroad Bridge Replacement. This assignment of fund balance was not reflected in the Authority's general ledger. Also, we noted that expenditures related to trail maintenance were not recorded as reducing the fund balance assigned for future trail maintenance.

Context: Board actions and financial activity affecting fund balance must be accurately reported in a timely manner to the Authority's fiscal agent, St. Louis County, to be correctly reported in the Authority's general ledger.

Effect: A material audit adjustments was required to increase assigned fund balance and decrease unassigned fund balance to reflect the Board of Directors' intended use of funds for the replacement of railroad bridges along the Lakefront Line. An additional adjustment, though not material, was made to properly reflect the 2012 activity in the fund balance assigned for future trail maintenance.

Cause: Changes in fund balance were not properly communicated to the Authority's fiscal agent, and the Authority's internal controls did not detect the omission.

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

Client's Response:

The procedure for communicating changes to fund balances will be an email communication from the Authority to the Authority's fiscal agent advising/directing changes followed by an email response from Authority's fiscal agent confirming changes.

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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 Directors
St. Louis and Lake Counties
Regional Railroad Authority

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 and the General Fund of the St. Louis and Lake Counties Regional Railroad Authority as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated March 24, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the St. Louis and Lake Counties Regional Railroad Authority's internal control over financial reporting to determine the 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 Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be 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 Recommendations**,** we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and a significant deficiency.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Authority's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Recommendations as items 11-1 and 11-2 to be a material weaknesses.

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 deficiency described in the accompanying Schedule of Findings and Recommendations as item 03-1 to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the St. Louis and Lake Counties Regional Railroad Authority's financial statements are free from 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 six categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, and miscellaneous provisions. Our audit considered all of the listed categories, except that we did not test for compliance with the provisions for public indebtedness because the Authority does not have any outstanding debt. Deposits and investments and claims and disbursements were tested in conjunction with our audit of St. Louis County.

In connection with our audit, nothing came to our attention that caused us to believe that the St. Louis and Lake Counties Regional Railroad Authority 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 Authority's noncompliance with the above referenced provisions.

Other Matters

The St. Louis and Lake Counties Regional Railroad Authority's responses to the internal control findings identified in our audit have been included in the Schedule of Findings and Recommendations. The Authority'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 results of that testing, and not to provide an opinion on the effectiveness of the Authority'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 Authority's internal control over financial reporting and compliance. Accordingly, this communication is not suitable for any other purpose.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

March 24, 2014