

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

ARROWHEAD REGIONAL CORRECTIONS
DULUTH, 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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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

For the Year Ended December 31, 2012



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

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**ORGANIZATION
DECEMBER 31, 2012**

			<u>Term Expires</u>
Elected			
Commissioners			
Chair	Wade Pavleck	Koochiching County	January 2015
Vice Chair	Rick Goutermont	Lake County	January 2017
Board Member	Richard Brenner	Carlton County	January 2016
Board Member	Robert Olean	Carlton County	January 2015
Board Member	Janice Hall	Cook County	January 2014
Board Member	Keith Nelson	St. Louis County	January 2014
Board Member	Christopher Dahlberg	St. Louis County	January 2016
Board Member	Peg Sweeney	St. Louis County	January 2013
Appointed			
Executive Director	Kay Arola		Indefinite

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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INDEPENDENT AUDITOR'S REPORT

Board of Commissioners
Arrowhead Regional Corrections

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and the General Fund of Arrowhead Regional Corrections as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise Arrowhead Regional Corrections' 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 Arrowhead Regional Corrections' 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 Arrowhead Regional Corrections' 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 Arrowhead Regional Corrections as of December 31, 2012, and the respective changes in financial position 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 Arrowhead Regional Corrections' basic financial statements. The Schedule of Intergovernmental Revenue 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 our report dated January 16, 2014, on our consideration of Arrowhead Regional Corrections' 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 Arrowhead Regional Corrections' internal control over financial reporting and compliance.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

January 16, 2014

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

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MANAGEMENT'S DISCUSSION AND ANALYSIS

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2012
(Unaudited)**

Our Management's Discussion and Analysis (MD&A) of Arrowhead Regional Corrections' (ARC) financial performance provides an overview of the financial activities for the fiscal year ended December 31, 2012. Please read it in conjunction with the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

Total net position for Arrowhead Regional Corrections increased \$0.1 million to \$6.2 million.

Total fund balance for the Arrowhead Regional Corrections General Fund was \$4.8 million at the end of 2012, an increase of \$0.5 million from 2011.

Most of the fund balance, 96 percent, was committed or assigned by ARC for a specific purpose. Of these, 74 percent are made for retiree obligations and vesting sick leave, which are committed to pay for employee sick leave reserve balances at retirement. At year-end, ARC had \$64,039 of unassigned fund balance, which can be used at the discretion of the ARC Board.

The Arrowhead Regional Corrections General Fund reported \$0.5 million revenues in excess of expenditures mainly due to unspent personnel and operating budgets. The personnel budget had \$0.4 million unspent at year-end due to the time it takes to fill vacant positions.

OVERVIEW OF THE FINANCIAL STATEMENTS

This MD&A is intended to serve as an introduction to Arrowhead Regional Corrections' basic financial statements. The basic financial statements comprise three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report contains other supporting schedules in addition to the basic financial statements.

Government-wide financial statements: The Statement of Net Position and the Statement of Activities report information about Arrowhead Regional Corrections as a whole and about its 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 current year revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report Arrowhead Regional Corrections' net position and changes to them. Arrowhead Regional Corrections' net position--the difference between assets and liabilities--are one way to measure Arrowhead Regional Corrections' financial health, or financial position. Over time, increases or decreases in Arrowhead Regional Corrections' net position are one indicator of whether its financial health is improving or deteriorating. You will need to consider other non-financial factors, such as the condition of buildings and structures, to assess the overall health of Arrowhead Regional Corrections. The government-wide financial statements can be found on pages 13 and 14.

Fund financial statements: These statements provide detailed information about the General Fund, not Arrowhead Regional Corrections as a whole. The Arrowhead Regional Corrections General Fund is considered a governmental fund.

All of Arrowhead Regional Corrections' services are reported in the General Fund, which focuses on how money flows into and out of the fund, and any balance left at year-end is available for spending. This fund is reported using the modified accrual method of accounting, which measures cash and all other financial assets that can be readily converted to cash. The General Fund statements provide a detailed short-term view of Arrowhead Regional Corrections' operations and the basic services it provides. General Fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance Arrowhead Regional Corrections' programs. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Position and the Statement of Activities) and the General Fund in a reconciliation following each of the fund financial statements. The basic financial statements for the General Fund can be found on pages 15 through 18.

Notes to the financial statements: The notes provide additional information essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found on pages 19 through 37.

Supporting schedules: The budgetary comparison schedule, notes to required supplementary information, and schedule of intergovernmental revenue are provided on pages 38 through 44.

Government-Wide Financial Analysis

Net position may, over time, be a useful indicator of a government's financial position. In the case of Arrowhead Regional Corrections, assets exceeded liabilities by \$6.2 million.

By far the largest portion of Arrowhead Regional Corrections' net position is the net investment in capital assets. Because Arrowhead Regional Corrections uses these capital assets to provide services to participants, they are not available for future spending.

Table 1
Net Position
(in Millions)

	Governmental Activities	
	2012	2011
Current and other assets	\$ 6.0	\$ 5.3
Capital assets	<u>6.2</u>	<u>6.3</u>
Total Assets	<u>\$ 12.2</u>	<u>\$ 11.6</u>
Other liabilities	\$ 1.0	\$ 0.8
Long-term liabilities outstanding	<u>5.0</u>	<u>4.7</u>
Total Liabilities	<u>\$ 6.0</u>	<u>\$ 5.5</u>
Net Position		
Net investment in capital assets	\$ 6.2	\$ 6.3
Unrestricted	<u>-</u>	<u>(0.2)</u>
Total Net Position	<u>\$ 6.2</u>	<u>\$ 6.1</u>

The following analysis focuses on Arrowhead Regional Corrections' net position (Table 1).

Governmental Activities

The total net position of Arrowhead Regional Corrections increased \$0.1 million in 2012 to \$6.2 million. Arrowhead Regional Corrections continues to report positive balances in net position because total assets exceed total liabilities.

Current and other assets increased by \$0.7 million because cash and pooled investments increased by \$0.7 million. This increase in cash and pooled investments is primarily due to the underspending of the operating and personnel budgets in 2012.

Total liabilities increased slightly to \$6.0 million. Other liabilities, which consist of accounts payable, salaries payable, due to other governments, and unearned revenue, increased \$0.2 million, and long-term liabilities outstanding, which are 100 percent compensated absences, increased by \$0.2 million as well.

A detailed analysis of capital assets is presented in Table 3 under the heading Capital Assets and Debt Administration.

Table 2
Changes in Net Position
(in Millions)

	Governmental Activities	
	2012	2011
Revenues		
Program revenues		
Charges for services	\$ 1.3	\$ 1.1
Operating grants and contributions	2.8	3.1
General revenues		
Community corrections act subsidy	3.8	3.8
Grant and contributions not restricted to specific programs	13.7	12.0
Miscellaneous	0.3	0.2
Total Revenues	<u>\$ 21.9</u>	<u>\$ 20.2</u>
Expenses		
Program expenses		
Administration	\$ 2.0	\$ 2.0
Court and field services	9.9	9.7
Northeast Regional Corrections Center (NERCC)	5.7	5.3
Arrowhead Juvenile Center (AJC)	4.2	4.1
Total Expenses	<u>\$ 21.8</u>	<u>\$ 21.1</u>
Increase (Decrease) in Net Position	\$ 0.1	\$ (0.9)
Net Position, January 1	<u>6.1</u>	<u>7.0</u>
Net Position, December 31	<u>\$ 6.2</u>	<u>\$ 6.1</u>

The following analysis focuses on Arrowhead Regional Corrections changes in net position (Table 2).

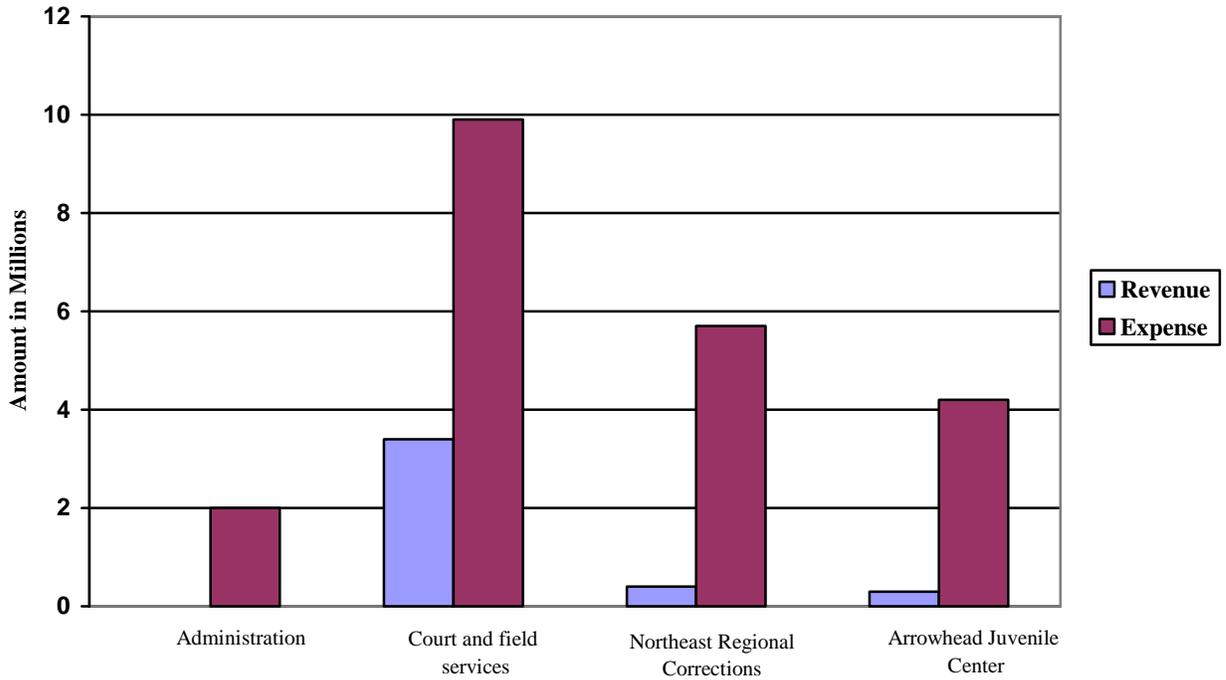
Governmental Activities

Revenues collected in 2012 by Arrowhead Regional Corrections totaled \$21.9 million, or \$1.7 million more than 2011.

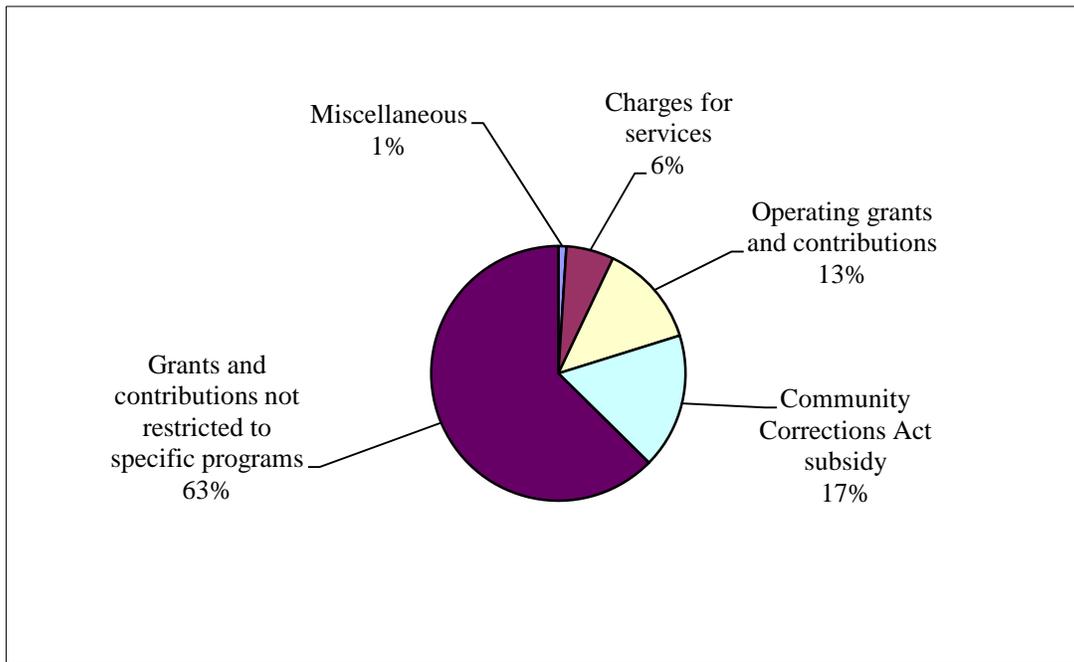
Member county contributions (general revenues) were \$13.7 million in 2012, \$12.0 million in 2011, \$11.9 million in 2010, \$12.9 million in 2009, and \$12.7 million in 2008. In both 2010 and 2011, ARC used over \$1.0 million in reserves to offset the County shares.

Total expenses for 2012 were \$0.7 million more than 2011. NERCC expenses increased by \$0.4 million compared to 2011, while Court and Field expenses increased by \$0.2 million in 2012.

Program Revenues and Expenses: Governmental Activities



Revenues by Source: Governmental Activities



Financial Analysis of the General Fund

As noted earlier, Arrowhead Regional Corrections uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

General Fund. The focus of Arrowhead Regional Corrections General Fund is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing Arrowhead Regional Corrections financing requirements. In particular, unassigned fund balance may serve as a useful measure of Arrowhead Regional Corrections' net resources available for spending at the end of the fiscal year.

As of December 31, 2012, Arrowhead Regional Corrections General Fund reported a fund balance of \$4.8 million, compared with \$4.3 million in 2011 and \$6.1 million in 2010. ARC has used reserves to offset County shares in both 2010 and 2011 which has resulted in the decline in fund balance. County shares increased by \$1.0 million in 2012 so that ARC will no longer be using reserves to fund current year operations.

Expenditures for personnel services accounted for approximately 75 percent of Arrowhead Regional Corrections total expenditures in 2012 and 2011. Intergovernmental revenues (monies received from member counties, state grants, and federal grants) accounted for 93 percent of Arrowhead Regional Corrections total revenues for the year. For 2012, actual revenues exceeded actual expenditures by \$0.5 million dollars.

General Fund Budgetary Highlights

Budgets can be amended during the year by the Arrowhead Regional Corrections Board. Budget revisions are reviewed by administration and submitted to the Board for approval.

The five member counties total contribution had an increase of \$1.7 million in 2012. In 2012, ARC did not use existing fund balance to offset county shares like they did in 2011.

During the year, the final revenue and expense budget both decreased from the original budget. The changes were due to grant budget adjustments that happened during the year.

Total expenditures for Arrowhead Regional Corrections for 2012 were \$1.4 million under budget. The majority of the unspent budget monies were in the personnel and operating budgets.

Total revenues for 2012 were \$0.3 million less than the final budget. Intergovernmental revenues and miscellaneous came in \$0.3 million short, while charges for services came in \$0.3 million above of the budget projections.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At year-end, Arrowhead Regional Corrections showed total capital assets of \$6.2 million. These amounts represent a broad range of capital assets, including land, buildings, machinery, vehicles, furniture, and equipment. Detail is presented immediately below in Table 3.

Table 3
Capital Assets at Year-End
(Net of Depreciation, in Millions)

	Governmental Activities	
	2012	2011
Construction in progress	\$ 0.1	\$ 0.2
Land	0.5	0.5
Buildings	5.4	5.4
Machinery, vehicles, furniture, and equipment	0.2	0.2
Totals	<u>\$ 6.2</u>	<u>\$ 6.3</u>

Total capital assets decreased by \$0.1 million in 2012 mainly due to the depreciation of the assets. Some of the purchases during the year included a 2013 Chevy Impala, LED lighting at NERCC, and a Fire Alarm Control panel at AJC.

Additional information on Arrowhead Regional Corrections capital assets can be found in the notes to the financial statements.

Debt Administration

At year-end, Arrowhead Regional Corrections did not have any bonded debt.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The ARC Board set the 2013 budget at \$22.5 million, an increase of three percent from the 2012 budget. The main funding for this increased budget came from the county shares. St. Louis County's share went up \$1.4 million in 2013.

St. Louis County had an average unemployment rate of 6.6 percent for 2012, while the average unemployment rate was 8.1 percent for the United States and 5.5 percent for the State of Minnesota.

Arrowhead Regional Corrections in 2010 authorized capital improvements at both AJC and NERCC with completion in 2012. Projects include roof replacement at both facilities and duct work at AJC. The capital improvements were paid for by using fund balance assigned for capital improvements.

The Arrowhead Regional Corrections' 2013 budget was passed at a Board meeting in late 2012.

CONTACTING THE ARROWHEAD REGIONAL CORRECTIONS FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of finances and to show Arrowhead Regional Corrections' accountability for the money it receives. If you have a question about this report or need information, contact the Arrowhead Regional Corrections Office at: 100 N. 5th Avenue West, Duluth, Minnesota 55802-1293.

BASIC FINANCIAL STATEMENTS

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 1

**STATEMENT OF NET POSITION
GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2012**

Assets

Cash and pooled investments	\$ 2,453,778
Petty cash and change funds	5,195
Investments	2,264,684
Accounts receivable	48,529
Due from other governments	1,124,636
Inventories	131,021
Capital assets	
Non-depreciable	555,997
Depreciable - net of accumulated depreciation	5,623,043
	<hr/>
Total Assets	\$ 12,206,883

Liabilities

Accounts payable	\$ 282,831
Salaries payable	673,843
Due to other governments	46,731
Unearned revenue	35,134
Long-term liabilities	
Due within one year	1,127,260
Due in more than one year	3,816,618
	<hr/>
Total Liabilities	\$ 5,982,417

Net Position

Net investment in capital assets	\$ 6,179,040
Unrestricted	45,426
	<hr/>
Total Net Position	\$ 6,224,466

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 2

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2012**

	Program Revenues				Net (Expense)
Expenses	Fees, Charges, Fines, and Other	Operating Grants and Contributions	Capital Grants and Contributions		Revenue and Change in Net Position
<u>Functions/Programs</u>					
Governmental activities					
Administration	\$ 2,011,297	\$ -	\$ 23,281	\$ -	\$ (1,988,016)
Court and Field Services	9,922,312	727,928	2,633,052	-	(6,561,332)
Northeast Regional Corrections Center	5,702,994	311,079	60,840	46,286	(5,284,789)
Arrowhead Juvenile Center	4,225,691	301,743	126,527	-	(3,797,421)
Total Governmental Activities	\$ 21,862,294	\$ 1,340,750	\$ 2,843,700	\$ 46,286	\$ (17,631,558)
General Revenues					
Community Corrections Act subsidy				\$ 3,798,768	
Grants and contributions not restricted to specific programs				13,683,319	
Unrestricted investment earnings				4,656	
Miscellaneous				265,733	
Total general revenues				\$ 17,752,476	
Change in net position					\$ 120,918
Net Position - Beginning					6,103,548
Net Position - Ending					\$ 6,224,466

FUND FINANCIAL STATEMENTS

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GOVERNMENTAL FUND

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 3

**BALANCE SHEET
GENERAL FUND
DECEMBER 31, 2012**

Assets

Cash and pooled investments	\$	2,453,778
Petty cash and change funds		5,195
Investments		2,264,684
Accounts receivable		48,529
Due from other governments		1,124,636
Inventories		131,021
		131,021
Total Assets	\$	6,027,843

Liabilities and Fund Balance

Liabilities

Accounts payable	\$	282,831
Salaries payable		673,843
Due to other governments		46,731
Deferred revenue - unavailable		209,296
Deferred revenue - unearned		35,134
		35,134
Total Liabilities	\$	1,247,835

Fund Balance

Nonspendable		
Inventories	\$	131,021
Committed to		
Retiree obligations		2,264,684
Vesting sick leave		1,119,642
Assigned to		
Capital improvements		194,533
Capital improvements and emergency repairs		1,000,000
Health and welfare		6,089
Unassigned		64,039
		64,039
Total Fund Balance	\$	4,780,008

Total Liabilities and Fund Balance	\$	6,027,843
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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 4

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

Fund balance - General Fund (Exhibit 3)	\$ 4,780,008
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 fund.	6,179,040
Other long-term assets are not available to pay for current period expenditures and, therefore, are deferred in the fund.	209,296
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the fund.	
Net other postemployment benefits liability	\$ (432,292)
Compensated absences	(4,511,586)
	<u>(4,943,878)</u>
Net Position of Governmental Activities (Exhibit 1)	<u>\$ 6,224,466</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 5

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

Revenues	
Intergovernmental	\$ 20,359,152
Charges for services	1,340,750
Investment earnings	4,656
Miscellaneous	265,733
	<hr/>
Total Revenues	\$ 21,970,291
Expenditures	
Current	
Administration	\$ 1,999,536
Court and field services	9,743,552
Northeast Regional Corrections Center	5,484,512
Arrowhead Juvenile Center	4,072,901
Capital outlay	135,990
	<hr/>
Total Expenditures	\$ 21,436,491
Net Change in Fund Balance	\$ 533,800
Fund Balance - January 1	4,272,273
Increase (decrease) in inventories	(26,065)
	<hr/>
Fund Balance - December 31	\$ 4,780,008
	<hr/> <hr/>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 6

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE OF THE GENERAL FUND TO THE
GOVERNMENT-WIDE STATEMENT OF ACTIVITIES - GOVERNMENTAL ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2012**

Net change in fund balance - General Fund (Exhibit 5) \$ 533,800

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

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

Deferred revenue - December 31	\$ 209,296	
Deferred revenue - January 1	(196,375)	12,921

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	\$ 135,990	
Net book value of assets disposed of	(9,312)	
Current year depreciation	(276,038)	(149,360)

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 the governmental fund.

Change in compensated absences	\$ (154,228)	
Change in other postemployment benefits	(96,150)	
Change in inventories	(26,065)	(276,443)

Change in Net Position of Governmental Activities (Exhibit 2) \$ 120,918

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2012**

1. Summary of Significant Accounting Policies

Arrowhead Regional Corrections' financial statements are prepared in accordance with generally accepted accounting principles (GAAP) 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 Arrowhead Regional Corrections are discussed below.

A. Financial Reporting Entity

Arrowhead Regional Corrections provides correctional services to the five counties of Northeastern Minnesota's Arrowhead region. Arrowhead Regional Corrections was established pursuant to the Community Corrections Act, Minn. Stat. §§ 401.01-.16, and a joint powers agreement, effective January 1, 1993, between Carlton, Cook, Koochiching, Lake, and St. Louis Counties, pursuant to Minn. Stat. § 471.59.

As required by accounting principles generally accepted in the United States of America, these financial statements present Arrowhead Regional Corrections (primary government). Arrowhead Regional Corrections is governed by an eight-member Board. One member is appointed from the Board of Commissioners of each participating county, except for St. Louis County, which has three members from its Board of County Commissioners. In addition, the right to have an additional member is annually rotated among Carlton, Cook, Koochiching, and Lake Counties. Except for the rotating Board member position, all Board members serve two-year terms. The Board is organized with a chair and vice chair elected at the annual meeting in January of each year.

St. Louis County reports the financial transactions of Arrowhead Regional Corrections in an agency fund on its annual financial statements.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

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. These statements include the financial activities of Arrowhead Regional Corrections. Eliminations have been made to minimize the double counting of internal activities.

The government-wide statement of net position is reported on a full accrual, economic resource basis, which recognizes long-term assets and receivables as well as long-term debt and obligations. Arrowhead Regional Corrections' net position is reported in two parts: (1) net investment in capital assets and (2) unrestricted net position. Arrowhead Regional Corrections first utilizes restricted resources to finance qualifying activities.

The statement of activities demonstrates the degree to which the direct expenses of each function of Arrowhead Regional Corrections' governmental activities are offset by program revenues. Direct expenses are those clearly identifiable with a specific function or activity. Program revenues include: (1) fees 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. Revenues not classified as program revenues are presented as general revenues. Arrowhead Regional Corrections does not allocate indirect expenses to functions within the financial statements.

2. Fund Financial Statements

The fund financial statements provide information about Arrowhead Regional Corrections' General Fund. The General Fund is Arrowhead Regional Corrections' primary operating fund. It accounts for all financial resources of the general government.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

C. Measurement Focus and Basis of Accounting

The government-wide 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. 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. Arrowhead Regional Corrections considers all revenues as available if collected within 60 days after the end of the current period. 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 are reported as other financing sources.

D. Assets, Liabilities, and Net Position or Equity

1. Cash and Pooled Investments

Arrowhead Regional Corrections' available cash balances are pooled and invested by St. Louis County in accordance with Minnesota statutes. The County's cash balances and investments are at fair value based on quoted market prices. Additional disclosures defining cash and pooled investments can be found in the St. Louis County Comprehensive Annual Financial Report.

2. Inventories

All inventories are valued at cost using the first in/first out method. Inventories in governmental funds are recorded as expenditures when purchased rather than when consumed. Inventories at the government-wide level are reported as expenses when consumed.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

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

3. Capital Assets

Capital assets, which include property, plant, and equipment, are reported in the governmental activities column in the government-wide financial statements. Capital assets are defined by Arrowhead Regional Corrections 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.

Capital assets, which include property, plant, and equipment, are reported in the governmental activities column in the government-wide financial statements. Capital assets are defined by Arrowhead Regional Corrections 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 Arrowhead Regional Corrections are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings	30
Building improvements	15
Furniture, equipment, and vehicles	3 - 12

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

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

4. 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 both employees who are currently 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.

5. Deferred Revenue

The General Fund 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 revenues not considered to be available to liquidate liabilities of the current period.

6. Long-Term Obligations

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

7. 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.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

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

8. Classification of Fund Balance

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

Nonspendable - 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 for which constraints have been 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 imposed by law through constitutional provisions or enabling legislation.

Committed - amounts that can be used only for the specific purposes imposed by formal action of the Board of Commissioners. 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 it employed to previously commit these amounts.

Assigned - amounts Arrowhead Regional Corrections 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 of Commissioners or the Executive Director who has been delegated that authority by Board resolution.

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Position or Equity

8. Classification of Fund Balance (Continued)

Arrowhead Regional Corrections 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.

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

Arrowhead Regional Corrections 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 Arrowhead Regional Corrections Board. The County invests the funds of Arrowhead Regional Corrections. By agreement, Arrowhead Regional Corrections retains the interest earned on investments purchased with funds designated for compensated absences. The County retains the interest from the remainder of the funds. Minnesota statutes require that all County deposits be covered by insurance, surety bond, or collateral.

Arrowhead Regional Corrections invests in the types of securities authorized by Minn. Stat. §§ 118A.04 and 118A.05.

Additional disclosures, as required by GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*; GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*; and GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, are disclosed on an entity-wide basis in the St. Louis County Comprehensive Annual Financial Report.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments (Continued)

The following is a summary of Arrowhead Regional Corrections' cash:

	December 31, 2012
Cash and pooled investments	\$ 2,453,778
Petty cash and change funds	5,195
Investments	2,264,684
Total	\$ 4,723,657

2. Capital Assets

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

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	\$ 476,534	\$ -	\$ -	\$ 476,534
Construction in progress	185,714	46,286	152,537	79,463
Total capital assets not depreciated	\$ 662,248	\$ 46,286	\$ 152,537	\$ 555,997
Capital assets depreciated				
Buildings	\$ 8,455,372	\$ 195,615	\$ -	\$ 8,650,987
Machinery, furniture, and equipment	1,190,105	46,626	16,932	1,219,799
Total capital assets depreciated	\$ 9,645,477	\$ 242,241	\$ 16,932	\$ 9,870,786
Less: accumulated depreciation for				
Buildings	\$ 3,023,119	\$ 213,352	\$ -	\$ 3,236,471
Machinery, furniture, and equipment	956,206	62,686	7,620	1,011,272
Total accumulated depreciation	\$ 3,979,325	\$ 276,038	\$ 7,620	\$ 4,247,743
Total capital assets depreciated, net	\$ 5,666,152	\$ (33,797)	\$ 9,312	\$ 5,623,043
Total Capital Assets, Net	\$ 6,328,400	\$ 12,489	\$ 161,849	\$ 6,179,040

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

2. Capital Assets (Continued)

Depreciation expense was charged to functions/programs of Arrowhead Regional Corrections as follows:

Administration	\$ 610
Court and Field Services	43,466
Northeast Regional Corrections Center	128,889
Arrowhead Juvenile Center	<u>103,073</u>
Total Depreciation Expense	<u>\$ 276,038</u>

3. Receivables

Receivables as of December 31, 2012, for Arrowhead Regional Corrections' governmental activities are as follows:

Due from other governments	\$ 1,124,636
Accounts	<u>48,529</u>
Total Receivables	<u>\$ 1,173,165</u>

B. Liabilities

1. Payables

Payables at December 31, 2012, were as follows:

Accounts	\$ 282,831
Salaries	673,843
Due to other governments	<u>46,731</u>
Total Payables	<u>\$ 1,003,405</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

B. Liabilities (Continued)

2. Leases

Operating Leases

Arrowhead Regional Corrections leases office space and office equipment under non-cancelable operating leases. Total costs for such leases were \$416,781 for the year ended December 31, 2012. The future minimum lease payments for these leases are as follows:

Year Ending December 31	Amount
2013	\$ 404,609
2014	404,609
2015	404,609
2016	404,609
2017	404,609
Total	\$ 2,023,045

3. Changes in Long-Term Liabilities

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

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Compensated absences	\$ 4,357,358	\$ 1,287,246	\$ 1,133,018	\$ 4,511,586	\$ 1,127,260
Net other postemployment benefits (Note 5)	336,142	218,890	122,740	432,292	-
Total Long-Term Liabilities	\$ 4,693,500	\$ 1,506,136	\$ 1,255,758	\$ 4,943,878	\$ 1,127,260

4. Deferred Compensation

Arrowhead Regional Corrections' employees participate in St. Louis County's deferred compensation plan.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

B. Liabilities (Continued)

5. Other Employee Benefits

Under Arrowhead Regional Corrections' personnel policies and union contracts, its employees are granted vacation and sick leave in varying amounts based upon length of service. Vacation leave accrual varies from 2.0 to 9.0 hours per biweekly pay period. Sick leave accrual is from 2.0 to 5.5 hours per biweekly pay period.

For employees who have been employed by Arrowhead Regional Corrections for at least five years and meet certain other requirements, the cash equivalent of their accrued sick leave and vacation will be placed into the employee's account with the Post-Retirement Health Care Savings Plan upon 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 statements as liabilities, but not in the governmental fund.

Unvested sick leave of \$1,385,465 (total accumulated sick leave less estimated amounts of vested and vesting sick leave) at December 31, 2012, is available to employees in the event of illness-related absences and is not reported in the financial statements.

6. Risk Management

Arrowhead Regional Corrections 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. Risk management is handled through a combination of purchased commercial insurance and participation in the St. Louis County self-insurance program. Arrowhead Regional Corrections did not have a loss exceeding the limits of insurance coverage for any of the past three years. There were no significant reductions in insurance from the prior year.

St. Louis County handles its self-insurance through three internal service funds. Additional disclosures as required by GASB Statement No. 10, *Accounting and Reporting for Risk Financing and Related Insurance Issues*, are disclosed on an entity-wide basis in the St. Louis County Comprehensive Annual Financial Report.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Plan Description

All full-time and certain part-time employees of Arrowhead Regional Corrections are covered by defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the General Employees Retirement 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).

Members who are employed in a county correctional institution as a correctional guard or officer, a joint jailer/dispatcher, or as a supervisor of correctional guards or officers or of joint jailer/dispatchers and are directly responsible for the direct security, custody, and control of the county correctional institution and its inmates, are covered by the Public Employees Correctional Fund. For members first eligible for membership after June 30, 2010, benefits vest on a graduated schedule starting with 50 percent after five years and increasing 10 percent for each year of service until fully vested after ten years. Members eligible for membership before July 1, 2010, are fully vested after three years of service.

PERA provides retirement benefits as well as disability benefits to members and benefits to survivors upon death of eligible members. Benefits are established by state statute. 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.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Plan Description (Continued)

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 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 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 Correctional Fund members, and either 65 or 66 (depending on date hired) for General Employees Retirement Fund members. A reduced retirement annuity is also available to eligible members seeking early retirement.

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

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Employee Retirement Systems and Pension Plans (Continued)

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. Arrowhead Regional Corrections 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 Correctional Fund members are required to contribute 5.83 percent of their annual covered salary.

Arrowhead Regional Corrections 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 Correctional Fund	8.75

Arrowhead Regional Corrections contributions for the years ending December 31, 2012, 2011, and 2010, for the General Employees Retirement Fund and the Public Employees Correctional Fund were:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
General Employees Retirement Fund	\$ 547,667	\$ 555,414	\$ 545,718
Public Employees Correctional Fund	326,595	323,900	321,572

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

A. 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 Arrowhead Regional Corrections expects such amounts, if any, to be immaterial.

B. Claims and Litigation

Arrowhead Regional Corrections, in connection with the normal conduct of its affairs, is involved in various claims, judgments, and litigation.

The County Attorney estimates that the potential claims against Arrowhead Regional Corrections that would not be covered by insurance will not have a material adverse effect on the financial condition of Arrowhead Regional Corrections.

C. Participation

The budget of Arrowhead Regional Corrections is financed through state grants and contributions from the participating counties. County contributions are shared in the following proportion:

	<u>Percent (%)</u>
Carlton County	8.63
Cook County	1.63
Koochiching County	1.45
Lake County	2.44
St. Louis County	<u>85.85</u>
Total	<u><u>100.00</u></u>

Member contributions for the current year totaled \$13,633,781, or 64 percent, of the total intergovernmental revenue received.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

C. Participation (Continued)

Of the various state grants available to Arrowhead Regional Corrections, the most significant is the grant authorized under the Community Corrections Act. Grant proceeds for 2012 totaled \$3,798,768, or 19 percent, of total intergovernmental revenue received.

D. Trust Fund

Not shown on Arrowhead Regional Corrections' balance sheet as of December 31, 2012, are funds held in trust for residents or for their benefit. The account balance at December 31, 2012, is as follows:

NERCC Residents' Trust Fund	\$ <u>27,858</u>
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E. Jointly-Governed Organizations

Arrowhead Regional Corrections, in conjunction with other governmental entities and various private organizations, formed the jointly-governed organizations listed below:

- Duluth Family Service Collaborative,
- Koochiching County Family Services Collaborative,
- North St. Louis County Family Services Collaborative, and
- North Shore Collaborative.

The Collaboratives were established to create opportunities to enhance family strengths and support through service coordination and access to informal communication. Arrowhead Regional Corrections has no operational or financial control over the Collaboratives. During the year, Arrowhead Regional Corrections had expenditures of \$500 related to the North Shore Collaborative.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

5. Other Postemployment Benefits

A. Plan Description and Funding Policy

Arrowhead Regional Corrections provides health insurance benefits for certain retired employees under a single-employer self-insured plan. Arrowhead Regional Corrections provides postemployment health care benefits in accordance with Minn. Stat. § 471.61, subd. 2b. Active employees who retire from Arrowhead Regional Corrections when eligible to receive a retirement benefit from PERA (or similar plan) and do not participate in any other health benefits program providing coverage similar to that herein described, will be eligible to continue coverage with respect to both themselves and their eligible dependent(s) under the Arrowhead Regional Corrections' health benefits program. The retiree must 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.

B. Annual OPEB Cost and Net OPEB Obligation

Arrowhead Regional Corrections' 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 liabilities (or funding excess) over a period not to exceed 30 years.

The following table shows the components of Arrowhead Regional Corrections' annual OPEB cost for 2012, the amount actually contributed to the plan, and changes in Arrowhead Regional Corrections' net OPEB obligation:

ARC	\$	224,494
Interest on net OPEB obligation		14,790
Adjustment to ARC		(20,394)

Annual OPEB cost	\$	218,890
Contributions during the year		(122,740)

Increase (decrease) in net OPEB obligation	\$	96,150
Net OPEB - Beginning of Year		336,142

Net OPEB - End of Year	\$	432,292

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

5. Other Postemployment Benefits

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

Arrowhead Regional Corrections' annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2010, 2011, and 2012 were as follows:

<u>Fiscal Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Employer Contribution</u>	<u>Percentage of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
December 31, 2010	\$ 230,626	\$ 92,064	39.92%	\$ 207,711
December 31, 2011	238,414	109,983	46.13	336,142
December 31, 2012	218,890	122,740	56.07	432,292

C. Funded Status and Funding Progress

The actuarial accrued liability for benefits at January 1, 2012, the most recent actuarial valuation date, is \$2,299,991. Arrowhead Regional Corrections 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 \$11,377,222. The ratio of the unfunded actuarially accrued liabilities to covered payroll is 20.22 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.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

5. Other Postemployment Benefits

C. Funded Status and Funding Progress (Continued)

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, 2012, actuarial valuation, the entry age normal actuarial cost method was used. The actuarial assumptions included a 4.4 percent discount rate, which is based on the estimated long-term investment yield on the general assets of Arrowhead Regional Corrections. The annual health care cost trend rate is initially flat, which is the actual increase in premiums from 2012 to 2013, then climbs to 7.40 percent in 2013, and is reduced incrementally to an ultimate rate of 5.0 percent after 17 years. The unfunded actuarial accrued liability is being amortized as a level dollar amount over 30 years.

6. Subsequent Event

Capital Renovation Project at Northeast Regional Corrections Center

In 2013, the Board of Arrowhead Regional Corrections approved a renovation and improvement project (the Project) for the Northeast Regional Corrections Center (NERCC). The NERCC facility is currently a 150-bed minimum security facility which has significant deferred maintenance and several life safety and code issues which need to be addressed. The Project is designed to address these life safety and code issues while also adding increased functionality at the NERCC facility by adding medium-security capacity, special management, intake, visiting and gathering areas, along with multi-use activity areas. These improvements will allow NERCC to accommodate a greater population of pretrial and post-conviction inmates from county jails.

The Board has received and approved a guaranteed maximum price for the Project of \$6,000,000. The cost of the Project will be distributed proportionally to the member counties based on their average usage of NERCC over a five year period. Based on this, St. Louis County is expected to provide \$5,253,000 (87.6 percent) of the funding, with the remainder of the cost borne by the other four member counties. St. Louis County will be funding its share of the Project through the issuance of general obligation bonds which is expected to occur in January 2014.

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REQUIRED SUPPLEMENTARY INFORMATION

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT A-1

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2012**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Intergovernmental	\$ 21,705,243	\$ 20,668,941	\$ 20,359,152	\$ (309,789)
Charges for services	1,015,600	1,058,800	1,340,750	281,950
Investment earnings	8,000	8,000	4,656	(3,344)
Miscellaneous	577,933	578,383	265,733	(312,650)
Total Revenues	<u>\$ 23,306,776</u>	<u>\$ 22,314,124</u>	<u>\$ 21,970,291</u>	<u>\$ (343,833)</u>
Expenditures				
Current				
Administration				
Administrative support services	\$ 1,473,517	\$ 1,572,627	\$ 1,507,922	\$ 64,705
Research and evaluation	195,474	195,474	173,255	22,219
Staff development	121,748	121,748	107,234	14,514
Arrowhead Council of Churches	26,469	26,469	26,469	-
Women offenders program	200,000	200,000	184,656	15,344
Total administration	<u>\$ 2,017,208</u>	<u>\$ 2,116,318</u>	<u>\$ 1,999,536</u>	<u>\$ 116,782</u>
Court and field services				
Probation	\$ 10,321,131	\$ 9,087,256	\$ 8,549,380	\$ 537,876
St. Louis County data processing charges	255,854	255,854	255,854	-
Intensive supervision program	566,495	375,288	375,288	-
Short-term consequences	181,064	200,564	194,208	6,356
Sentence to serve	233,612	233,612	202,632	30,980
Correctional fees	115,523	166,190	166,190	-
Total court and field services	<u>\$ 11,673,679</u>	<u>\$ 10,318,764</u>	<u>\$ 9,743,552</u>	<u>\$ 575,212</u>
Northeast Regional Corrections Center				
Administration	\$ 5,507,165	\$ 5,122,513	\$ 5,122,092	\$ 421
Special education	204,251	204,251	208,383	(4,132)
Basic education	152,572	152,572	153,757	(1,185)
Vocational education	56,459	56,459	280	56,179
Total Northeast Regional Corrections Center	<u>\$ 5,920,447</u>	<u>\$ 5,535,795</u>	<u>\$ 5,484,512</u>	<u>\$ 51,283</u>
Arrowhead Juvenile Center				
Administration	<u>\$ 4,100,890</u>	<u>\$ 4,073,340</u>	<u>\$ 4,072,901</u>	<u>\$ 439</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

*EXHIBIT A-1
(Continued)*

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2012**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Expenditures (Continued)				
Capital outlay				
Court and Field Services	\$ -	\$ -	\$ 19,362	\$ (19,362)
Arrowhead Juvenile Center	397,753	397,753	39,820	357,933
Northeast Regional Corrections Center	407,344	407,344	76,808	330,536
Total capital outlay	\$ 805,097	\$ 805,097	\$ 135,990	\$ 669,107
Total Expenditures	\$ 24,517,321	\$ 22,849,314	\$ 21,436,491	\$ 1,412,823
Net Change in Fund Balance	\$ (1,210,545)	\$ (535,190)	\$ 533,800	\$ 1,068,990
Fund Balance - January 1	4,272,273	4,272,273	4,272,273	-
Increase (decrease) in inventories	-	-	(26,065)	(26,065)
Fund Balance - December 31	\$ 3,061,728	\$ 3,737,083	\$ 4,780,008	\$ 1,042,925

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT A-2

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

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a/c))
January 1, 2008	\$ -	\$1,731,675	\$1,731,675	0.0%	\$11,245,904	15.40%
January 1, 2010	-	2,433,608	2,433,608	0.0	11,417,275	21.32
January 1, 2012	-	2,299,991	2,299,991	0.0	11,377,222	20.22

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

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

1. Budgetary Data

The Arrowhead Regional Corrections Board adopts annual revenue and expenditure budgets for the General Fund on a basis consistent with generally accepted accounting principles. The budget is subject to approval by member counties and the State of Minnesota.

On or before mid-June of each year, all divisions submit requests for appropriations to the Executive Director so that a budget can be prepared. Before September 15, the proposed budget is presented to the Board for review and approval.

The appropriated budget is prepared by each division of Arrowhead Regional Corrections. Department heads may make transfers of appropriations within a department. Transfers of appropriations between departments require Board approval. The legal level of budgetary control (the level at which expenditures may not legally exceed the budget) is at the divisional level.

Encumbrance accounting, under which commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary integration in the General Fund. Encumbrances (purchase orders and contracts) outstanding at year-end are reported as assignments of fund balances and provide authority for the carryover of appropriations to the subsequent year in order to complete these transactions. There were funds of \$77,128 encumbered at the end of December 31, 2011, with \$44,533 of that amount remaining at the end of December 31, 2012. These funds were encumbered towards paying for the capital improvement projects planned for 2012 at the Arrowhead Juvenile Center and the Northeast Regional Corrections Centers. The projects consisted of roof replacement at the Arrowhead Juvenile Center along with the remodeling of the shower room and installation of LED lighting at the Northeast Regional Corrections Center.

2. Other Postemployment Benefits

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Other Postemployment Benefits (Continued)

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

SUPPLEMENTARY INFORMATION

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT B-1

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2012**

Shared Revenue

State

PERA rate reimbursement	\$ <u>49,538</u>
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Membership Contributions

Shared operations

Carlton County	\$ 1,176,688
Cook County	221,988
Koochiching County	197,271
Lake County	333,197
St. Louis County	<u>11,704,637</u>

Total shared operations	\$ <u>13,633,781</u>
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Grants

State

Minnesota Department of Education	\$ <u>106,224</u>
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Minnesota Department of Corrections

Court and field services

Caseload/workload reductions grant	\$ 1,225,901
Intensive supervision grant	365,096
Sex offender grant	381,220
Felony caseload reductions grant	101,368
Challenge incarceration program	108,734
Remote electronic monitoring	<u>24,214</u>

Total court and field services	\$ 2,206,533
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Arrowhead Juvenile Center

Sex offender grant	60,950
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Community Corrections Act subsidy	<u>3,798,768</u>
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Total Minnesota Department of Corrections	\$ <u>6,066,251</u>
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Minnesota Department of Public Safety	<u>\$ 23,281</u>
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Total state grants	\$ <u>6,195,756</u>
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Federal

Department of

Agriculture	\$ 65,577
Justice	237,772
Education	<u>9,628</u>

Total federal grants	\$ <u>312,977</u>
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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

***EXHIBIT B-1
(Continued)***

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2012**

Grants (Continued)

Other Grants

Arrowhead Regional Arts Council	\$ 3,750
Duluth Superior Area Community Foundation	25,000
Lloyd K. Johnson Foundation	25,000
North St. Louis County Family Services Collaborative Detention Assessment Team	80,000
Northland Foundation	25,000
Otto Bremer Foundation	8,350
	<hr/>
Total other grants	\$ 167,100
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Total state, federal, and other grants	\$ 6,675,833
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Total Intergovernmental Revenue	\$ 20,359,152
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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, 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 ITEM NOT RESOLVED

96-2 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.

Condition: The limited number of staff results in a lack of segregation of duties necessary to ensure adequate internal accounting control.

Context: It is not unusual for an organization the size of Arrowhead Regional Corrections 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 Arrowhead Regional Corrections' ability to detect or prevent misstatements in a timely manner by personnel in the normal course of performing their assigned functions.

Cause: The size of Arrowhead Regional Corrections and its staffing limits 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 be mindful that limited staffing increases inherent risks in safeguarding Arrowhead Regional Corrections assets and the proper reporting of its financial activity. We recommend the Board continue to implement oversight procedures and monitor those procedures to determine if they are still effective internal controls.

Client's Response:

The Arrowhead Regional Corrections management team continues to be aware of the lack of segregation of accounting functions as a result of our limited number of office personnel. Internal control policies and procedures are reviewed and revised on a regular basis and will continue to be followed by employees.



REBECCA OTTO
STATE AUDITOR

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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 Commissioners
Arrowhead Regional Corrections

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 Arrowhead Regional Corrections as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Arrowhead Regional Corrections basic financial statements, and have issued our report thereon dated January 16, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Arrowhead Regional Corrections 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 Arrowhead Regional Corrections internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Arrowhead Regional Corrections internal control over financial reporting.

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 Arrowhead Regional Corrections financial statements will not be prevented, or detected and corrected, on a timely basis. 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 the attention of those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a deficiency in internal control over financial reporting, described in the accompanying Schedule of Findings and Recommendations as item 96-2, that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Arrowhead Regional Corrections 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.

In connection with our audit, nothing came to our attention that caused us to believe that Arrowhead Regional Corrections 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 Arrowhead Regional Corrections' noncompliance with the above referenced provisions.

Other Matters

Arrowhead Regional Corrections response to the internal control finding identified in our audit has been included in the Schedule of Findings and Recommendations. The Arrowhead Regional Corrections response was not subject to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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 Arrowhead Regional Corrections 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 Arrowhead Regional Corrections 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

January 16, 2014