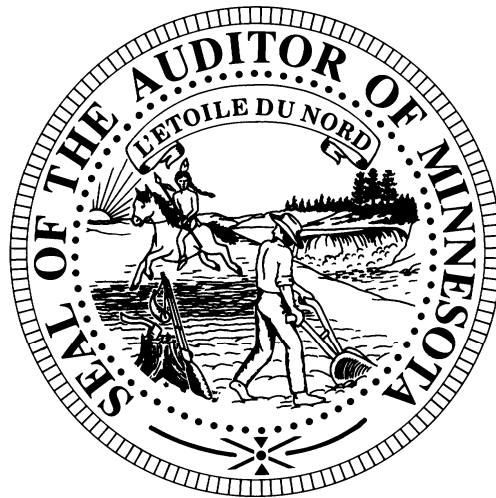


# STATE OF MINNESOTA

## Office of the State Auditor



**Rebecca Otto**  
**State Auditor**

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

YEAR ENDED DECEMBER 31, 2015

## **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 150 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 700 public pension funds; and

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

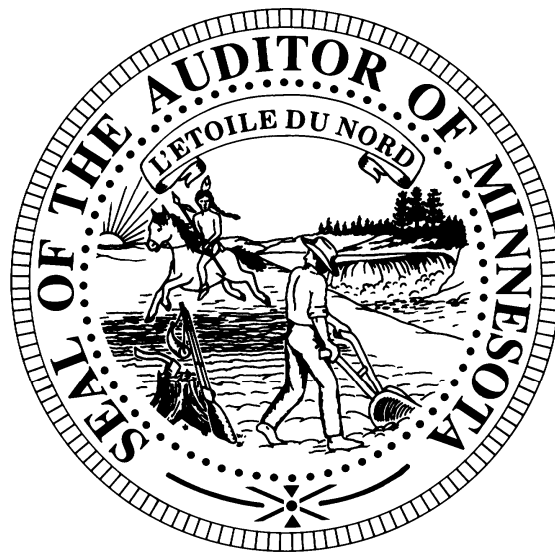
The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employees Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

**Year Ended December 31, 2015**



**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**

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**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

**ORGANIZATION  
DECEMBER 31, 2015**

			<u>Term Expires</u>
<b>Elected</b>			
<b>Commissioners</b>			
Chair	Rick Goutermont	Lake County	January 2017
Vice Chair	Richard Brenner	Carlton County	January 2017
Board Member	Gary Gamble	Cook County	January 2019
Board Member	Wade Pavleck	Koochiching County	January 2019
Board Member	Jeremy Hurd	Lake County	January 2019
Board Member	Frank Jewell	St. Louis County	January 2017
Board Member	Keith Nelson	St. Louis County	January 2019
Board Member	Pete Stauber	St. Louis County	January 2017
<b>Appointed</b>			
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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SAINT PAUL, MN 55103-2139

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1-800-627-3529 (Relay Service)

### INDEPENDENT AUDITOR'S REPORT

Board of Commissioners  
Arrowhead Regional Corrections  
Duluth, Minnesota

#### **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, 2015, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from 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 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 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, 2015, 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.

### ***Emphasis of Matter - Change in Accounting Principle***

As discussed in Note 1.E. to the financial statements, in 2015 Arrowhead Regional Corrections adopted new accounting guidance by implementing the provisions of Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions*, as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, and GASB Statement No. 82, *Pension Issues*, which represents a change in accounting principles. Our opinion is not modified with respect to this matter.

### ***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 GASB, 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 Schedule of Intergovernmental Revenue 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.

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

December 5, 2016

*/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, 2015  
(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, 2015. Please read it in conjunction with the accompanying basic financial statements.

**FINANCIAL HIGHLIGHTS**

Total net position for Arrowhead Regional Corrections increased \$1.0 million to \$9.3 million.

Total fund balance for the Arrowhead Regional Corrections' General Fund was \$4.8 million at the end of 2015, a decrease of \$0.6 million from 2014.

Most of the fund balance, 98 percent, was committed or assigned by ARC for a specific purpose. Of this, 67 percent was committed towards retiree obligations and vesting sick leave to pay for employee sick leave reserve balances at retirement.

Arrowhead Regional Corrections' General Fund reported \$0.5 million expenditures in excess of revenues mainly due to the use of existing fund balance reserves to support renovation projects at Northeast Regional Corrections Center (NERCC).

**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, deferred outflows of resources, liabilities, and deferred inflows of resources using the full 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 it. Arrowhead Regional Corrections' net position--the difference between assets plus deferred outflows of resources and liabilities plus deferred inflows of resources--is 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. Arrowhead Regional Corrections' General Fund is considered to be 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 43.

**Supporting schedules:** The budgetary comparison schedule, notes to required supplementary information, and schedule of intergovernmental revenue are provided on pages 44 through 50.

### **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 and deferred outflows exceeded liabilities and deferred inflows by \$9.3 million.

By far the largest portion of Arrowhead Regional Corrections' net position is the 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	
	2015	2014
Current and other assets	\$ 5.7	\$ 8.6
Capital assets	15.9	13.6
Total Assets	\$ 21.6	\$ 22.2
Deferred pension outflows	\$ 1.5	\$ -
Other liabilities	\$ 0.8	\$ 2.7
Long-term liabilities outstanding	12.1	4.3
Total Liabilities	\$ 12.9	\$ 7.0
Deferred pension inflows	\$ 0.9	\$ -
Net Position		
Investment in capital assets	\$ 15.9	\$ 13.6
Unrestricted	(6.6)	1.6
Total Net Position, as reported	\$ 9.3	\$ 15.2
Change in accounting principle*		(6.9)
Total Net Position, as restated		\$ 8.3

\*This is the first year Arrowhead Regional Corrections implemented GASB Statements 68 and 71 (Note 1.E.). Arrowhead Regional Corrections had to make a prior year change in accounting principles to record its net pension liability and related deferred outflows of resources.

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

### **Governmental Activities**

In 2015, the total net position of Arrowhead Regional Corrections decreased by \$1.0 million to \$9.3 million after restatement of beginning net position for GASB Statements 68 and 71 (Note 1.E.). Arrowhead Regional Corrections continues to report positive balances in net position because total assets exceed total liabilities.

Current and other assets decreased by \$2.9 million in 2015 to \$5.7 million. The difference is a result of continued progress of the \$6.9 million capital renovation project (Note 5.E.) and other capital improvement projects at NERCC.

Total liabilities increased to \$12.8 million. Other liabilities, which consist of accounts payable, salaries payable, contracts payable, due to other governments, and unearned revenue, decreased \$1.9 million, and long-term liabilities outstanding increased by \$0.3 million. Arrowhead Regional Corrections implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*, and No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68* (Note 1.E.), which resulted in a restatement of beginning net position by \$6.9 million. This was required to recognize Arrowhead Regional Corrections' portion of PERA's unfunded liability, which was the main reason for the increase.

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	
	2015	2014
Revenues		
Program revenues		
Capital grants and contributions	\$ 0.6	\$ 6.0
Fees, charges, fines, and other	1.1	1.2
Operating grants and contributions	1.6	3.2
General revenues		
Community Corrections Act subsidy	4.9	3.9
Grants and contributions not restricted to specific programs	16.5	15.5
Miscellaneous and other	0.3	0.2
Total Revenues	<u>\$ 25.0</u>	<u>\$ 30.0</u>
Expenses		
Program expenses		
Administration	\$ 2.2	\$ 1.9
Court and field services	11.2	10.8
Northeast Regional Corrections Center (NERCC)	6.4	5.7
Arrowhead Juvenile Center (AJC)	4.2	4.1
Total Expenses	<u>\$ 24.0</u>	<u>\$ 22.5</u>
Increase (Decrease) in Net Position	\$ 1.0	\$ 7.5
Net Position, January 1 - restated*	<u>8.3*</u>	<u>7.7</u>
Net Position, December 31	<u>\$ 9.3</u>	<u>\$ 15.2</u>

\*Amount includes a prior period adjustment for a change in accounting principles.

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

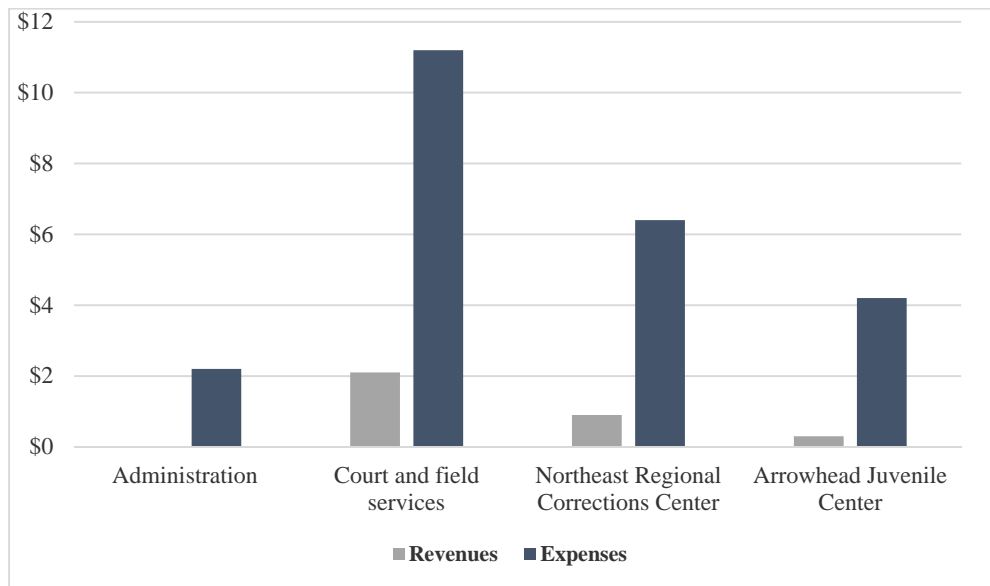
**Governmental Activities**

Revenues collected in 2015 by Arrowhead Regional Corrections totaled \$25.0 million, or \$5.0 million less than 2014.

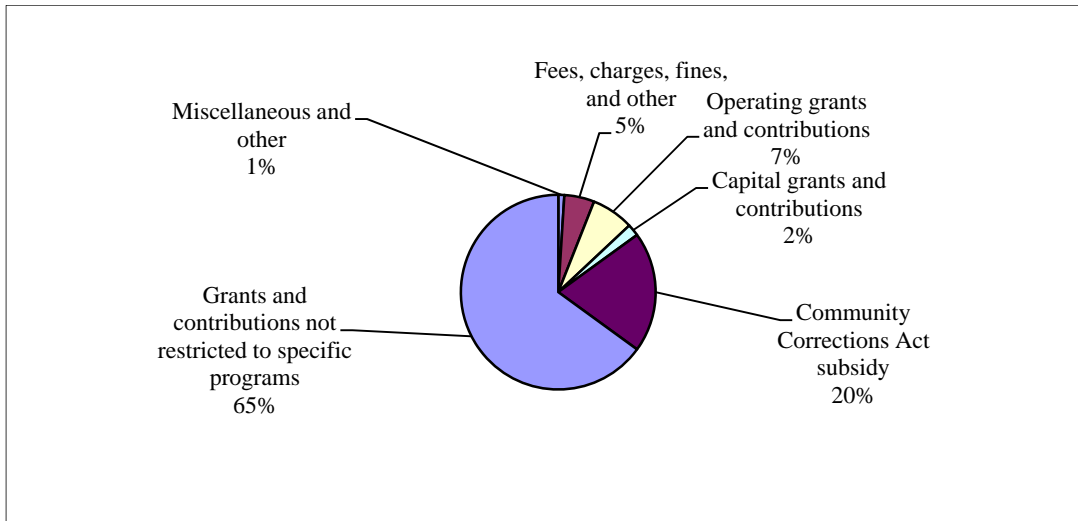
Member county contributions (general revenues) were \$16.4 million in 2015, \$15.3 million in 2014, \$14.8 million in 2013, \$13.7 million in 2012, \$12.0 million in 2011, and \$11.9 million in 2010.

Total expenses for 2015 were \$1.5 million more than 2014. Court and field services total expenses increased by \$0.4 million from 2014. NERCC's total expenses increased by \$0.7 million from 2014, while Arrowhead Juvenile Center's total expenses increased by only \$0.1 million. Administration expenses increased by \$0.3 million compared to 2014.

**Program Revenues and Expenses: Governmental Activities  
(Amounts in Millions)**



### 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, 2015, Arrowhead Regional Corrections' General Fund reported a fund balance of \$4.8 million, compared with \$5.4 million in 2014. County shares increased by \$1.1 million in 2015 so that ARC will no longer be using reserves to fund current year operations.

Expenditures for personnel services accounted for approximately 69 percent of Arrowhead Regional Corrections' total expenditures in 2015. Intergovernmental revenues (monies received from member counties and federal, state, and local grants) accounted for 95 percent of Arrowhead Regional Corrections' total revenues for the year.

### 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 contributions had an increase of \$1.1 million in 2015.



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

Total expenditures for Arrowhead Regional Corrections for 2015 were \$1.6 million under budget. The majority of the unspent budget monies were encumbered for capital improvements at the NERCC.

Total revenues for 2015 were \$0.2 million more than the final budget. Intergovernmental revenues came in \$0.2 million above the budget projections.

## **CAPITAL ASSETS AND DEBT ADMINISTRATION**

### **Capital Assets**

At year-end, Arrowhead Regional Corrections showed total capital assets of \$15.9 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	
	2015	2014
Construction in progress	\$ 7.8	\$ 6.3
Land	0.5	0.5
Buildings	7.1	6.4
Machinery, vehicles, furniture, and equipment	0.5	0.4
Totals	\$ 15.9	\$ 13.6

Total capital assets increased by \$2.3 million in 2015 mainly due to the \$7.5 million NERCC main building renovation project which was in progress during 2014 and 2015. Some of the purchases during the year included passenger vehicles, building and farm equipment, and system/structural improvements.

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 Arrowhead Regional Corrections Board set the 2016 budget at \$24.9 million, an increase of 0.6 percent from the 2015 budget. The main funding for this increased budget came from the county shares.

The average unemployment rate for the five member counties was 5.5 percent for 2015, while the average unemployment rate was 5.3 percent for the United States and 3.7 percent for the State of Minnesota.

The 2016 budget was passed on August 21, 2015, at a meeting of the Arrowhead Regional Corrections Board of Commissioners.

## **CONTACTING 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 North 5th Avenue West, Duluth, Minnesota 55802-1202.

## **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, 2015**

**Assets**

Cash and pooled investments	\$	2,215,662
Petty cash and change funds		4,995
Investments		1,986,096
Accounts receivable		61,563
Accrued interest receivable		3,394
Due from other governments		1,297,847
Inventories		111,601
Capital assets		
Non-depreciable		8,343,697
Depreciable - net of accumulated depreciation		7,571,184
		7,571,184
<b>Total Assets</b>	<b>\$</b>	<b>21,596,039</b>

**Deferred Outflows of Resources**

Deferred pension outflows	\$	1,517,984
---------------------------	----	-----------

**Liabilities**

Accounts payable	\$	325,396
Salaries payable		224,313
Contracts payable		22,493
Due to other governments		12,942
Unearned revenue - grants		188,988
Long-term liabilities		
Due within one year		1,222,831
Due in more than one year		3,179,660
Net pension liability		7,660,929
		7,660,929
<b>Total Liabilities</b>	<b>\$</b>	<b>12,837,552</b>

**Deferred Inflows of Resources**

Deferred pension inflows	\$	946,515
--------------------------	----	---------

**Net Position**

Investment in capital assets	\$	15,914,881
Unrestricted		(6,584,925)
		(6,584,925)
<b>Total Net Position</b>	<b>\$</b>	<b>9,329,956</b>

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

**EXHIBIT 2**

**STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED DECEMBER 31, 2015**

	<u>Expenses</u>	<u>Program Revenues</u>			<u>Net (Expense) Revenue and Change in Net Position</u>
		<u>Fees, Charges, Fines, and Other</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
<b><u>Functions/Programs</u></b>					
<b>Governmental activities</b>					
Administration	\$ 2,187,220	\$ -	\$ -	\$ -	\$ (2,187,220)
Court and field services	11,232,293	785,608	1,374,469	-	(9,072,216)
Northeast Regional Corrections Center	6,323,479	149,637	152,919	605,954	(5,414,969)
Arrowhead Juvenile Center	4,219,209	213,991	115,813	-	(3,889,405)
<b>Total Governmental Activities</b>	<b>\$ 23,962,201</b>	<b>\$ 1,149,236</b>	<b>\$ 1,643,201</b>	<b>\$ 605,954</b>	<b>\$ (20,563,810)</b>
<b>General Revenues</b>					
Community Corrections Act subsidy				\$ 4,888,889	
Grants and contributions not restricted to specific programs				16,479,192	
Unrestricted investment income				16,628	
Miscellaneous				236,239	
<b>Total general revenues</b>				<b>\$ 21,620,948</b>	
<b>Change in net position</b>				<b>\$ 1,057,138</b>	
<b>Net Position - Beginning, as restated (Note 1.E.)</b>				<b>8,272,818</b>	
<b>Net Position - Ending</b>				<b>\$ 9,329,956</b>	



**FUND FINANCIAL STATEMENTS**

**GOVERNMENTAL FUND**

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

**EXHIBIT 3**

**BALANCE SHEET  
GENERAL FUND  
DECEMBER 31, 2015**

**Assets**

Cash and pooled investments	\$	2,215,662
Petty cash and change funds		4,995
Investments		1,986,096
Accounts receivable		61,563
Accrued interest receivable		3,394
Due from other governments		1,297,847
Inventories		111,601
		111,601
<b>Total Assets</b>	<b>\$</b>	<b>5,681,158</b>

**Liabilities, Deferred Inflows of Resources,  
and Fund Balance**

**Liabilities**

Accounts payable	\$	325,396
Salaries payable		224,313
Contracts payable		22,493
Due to other governments		12,942
Unearned revenue - grants		188,988
		188,988
<b>Total Liabilities</b>	<b>\$</b>	<b>774,132</b>

**Deferred Inflows of Resources**

Unavailable revenue - grants	\$	70,780
		70,780

**Fund Balance**

**Nonspendable**

Inventories	\$	111,601
-------------	----	---------

**Committed to**

Retiree obligations		2,074,270
Vesting sick leave		1,105,390

**Assigned to**

Capital equipment		300,000
Capital improvements and emergency repairs		1,118,033
Health and welfare		351
Public safety innovation		126,601
		126,601

<b>Total Fund Balance</b>	<b>\$</b>	<b>4,836,246</b>
---------------------------	-----------	------------------

<b>Total Liabilities, Deferred Inflows of Resources, and Fund Balance</b>	<b>\$</b>	<b>5,681,158</b>
-------------------------------------------------------------------------------	-----------	------------------

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

**EXHIBIT 4**

**RECONCILIATION OF THE GENERAL FUND BALANCE SHEET TO  
THE GOVERNMENT-WIDE STATEMENT OF NET POSITION--GOVERNMENTAL ACTIVITIES  
DECEMBER 31, 2015**

<b>Fund balance - total governmental funds (Exhibit 3)</b>	<b>\$</b>	<b>4,836,246</b>
<p>Amounts reported for governmental activities in the statement of net position are different because:</p>		
<p>Capital assets, net of accumulated depreciation, used in governmental activities are not financial resources and, therefore, are not reported in the governmental fund.</p>		15,914,881
<p>Other long-term assets are not available to pay for current period expenditures and, therefore, are reported as deferred inflows of resources in the governmental fund.</p>		70,780
<p>Deferred outflows of resources and deferred inflows of resources are created as a result of various differences related to pensions that are not recognized in the General Fund.</p>		
Deferred pension outflows	\$ 1,517,984	
Deferred pension inflows	<u>(946,515)</u>	571,469
<p>Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the General Fund.</p>		
Compensated absences	\$ (4,402,491)	
Net pension liability	<u>(7,660,929)</u>	<u>(12,063,420)</u>
<b>Net Position of Governmental Activities (Exhibit 1)</b>		<b><u><u>\$ 9,329,956</u></u></b>

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

**EXHIBIT 5**

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE  
GENERAL FUND  
FOR THE YEAR ENDED DECEMBER 31, 2015**

<b>Revenues</b>	
Intergovernmental	\$ 24,077,559
Charges for services	1,149,236
Investment earnings	16,628
Miscellaneous	236,239
	<hr/>
<b>Total Revenues</b>	<b>\$ 25,479,662</b>
<b>Expenditures</b>	
<b>Current</b>	
Administration	\$ 2,163,605
Court and field services	11,023,000
Northeast Regional Corrections Center	6,053,902
Arrowhead Juvenile Center	4,097,383
<b>Capital outlay</b>	<hr/> 2,697,868
	<hr/>
<b>Total Expenditures</b>	<b>\$ 26,035,758</b>
<b>Net Change in Fund Balance</b>	<b>\$ (556,096)</b>
<b>Fund Balance - January 1</b>	<b>5,381,300</b>
<b>Increase (decrease) in inventories</b>	<hr/> 11,042
	<hr/>
<b>Fund Balance - December 31</b>	<b>\$ 4,836,246</b>

**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, 2015**

**Net change in fund balance - total governmental funds (Exhibit 5) \$ (556,096)**

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

In the funds, under the modified accrual basis, revenues not available for expenditure are deferred. In the statement of activities, those revenues are recognized when earned. The adjustment between the fund statements and the statement of activities is the increase or decrease in revenues deferred as unavailable.

Unavailable revenue - December 31	\$ 70,780	
Unavailable revenue - January 1	<u>(531,103)</u>	(460,323)

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 capital assets is reported; whereas, in the governmental funds, the proceeds from the disposal increase financial resources. Therefore, the change in net position differs from the change in fund balance by the net book value of the assets disposed of.

Expenditures for general capital assets	\$ 2,697,868	
Loss on the disposal of capital assets	(2,109)	
Current year depreciation	<u>(412,364)</u>	2,283,395

Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.

Change in compensated absences	\$ (59,955)	
Change in inventories	11,042	
Change in net pension liability, as restated	(265,682)	
Change in deferred pension outflows, as restated	1,051,272	
Change in deferred pension inflows	<u>(946,515)</u>	<u>(209,838)</u>

**Change in Net Position of Governmental Activities (Exhibit 2) \$ 1,057,138**

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS  
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2015**

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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, 2015. 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.

Jointly-Governed Organizations

Arrowhead Regional Corrections participates in jointly-governed organizations described in Note 5.G.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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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) 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**

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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 full 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, Deferred Outflows/Inflows of Resources, 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 and Prepaid Items

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.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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1. Summary of Significant Accounting Policies

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, 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.

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

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. The current portion of this liability is estimated based on the vacation balance at year-end. 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.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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1. Summary of Significant Accounting Policies

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity  
(Continued)

5. Unearned Revenue

Governmental funds and the government-wide financial statements report unearned revenue in connection with resources that have been received but not yet earned.

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 net position.

7. Pension Plan

For purposes of measuring the net pension liability, deferred outflows/inflows of resources, and pension expense, information about the fiduciary net position of the Public Employees Retirement Association (PERA) and additions to/deductions from PERA's fiduciary net position have been determined on the same basis as they are reported by PERA, except that PERA's fiscal year-end is June 30. For this purpose, plan contributions are recognized as of employer payroll paid dates and benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Plan investments are reported at fair value.

8. Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position reports a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents consumption of net position that applies to a future period(s) and will not be recognized as an outflow of resources (expenditure/expense) until then. Arrowhead Regional Corrections has one item, deferred pension outflows, which qualifies for reporting in this category. These outflows arise only under the full accrual basis of accounting and consist of pension plan contributions paid subsequent to the measurement date and also the differences between projected and actual earnings on pension plan investments and, accordingly, are reported only in the statement of net position.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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1. Summary of Significant Accounting Policies

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity

8. Deferred Outflows/Inflows of Resources (Continued)

In addition to liabilities, the statement of financial position reports a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. Arrowhead Regional Corrections has two types of deferred inflows. The governmental fund reports unavailable revenue which arises only under the modified accrual basis of accounting that qualifies for reporting in this category and is reported only in the governmental fund balance sheet. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available.

Arrowhead Regional Corrections also has deferred pension inflows. These inflows arise only under the full accrual basis of accounting and consist of differences between expected and actual pension plan economic experience and also pension plan changes in proportionate share and, accordingly, are reported only in the statement of net position.

9. Classification of Net Position

Net position in the government-wide statement of net position is classified in the following categories:

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 investment in capital assets.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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1. Summary of Significant Accounting Policies

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity  
(Continued)

10. 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 (resolution) 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 action (resolution) 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 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

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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1. Summary of Significant Accounting Policies

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position or Equity

10. Classification of Fund Balance (Continued)

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.

11. Use of Estimates

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

E. Change in Accounting Principle

During the year ended December 31, 2015, Arrowhead Regional Corrections adopted new accounting guidance by implementing the provisions of GASB Statements 68, 71, and 82. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*, requires governments providing defined benefit pensions to employees through pension plans administered through trusts to record their proportionate share of the net pension obligation as a liability on their financial statements along with related deferred outflows of resources, deferred inflows of resources, and pension expense. This statement also requires additional note disclosures and schedules in the required supplementary information.

GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, addresses an issue regarding amounts associated with contributions made to a pension plan after the measurement date of the net pension liability.

GASB Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, modifies the measure of payroll that is presented in the required supplementary information schedules.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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1. Summary of Significant Accounting Policies

E. Change in Accounting Principle (Continued)

GASB Statements 68 and 71 require Arrowhead Regional Corrections to report its proportionate share of the PERA total employers' unfunded pension liability. As a result, beginning net position has been restated to record Arrowhead Regional Corrections' net pension liability and related deferred outflows of resources.

	Governmental Activities
Net Position, January 1, 2015, as previously reported	\$ 15,201,353
Change in accounting principles	(6,928,535)
Net Position, January 1, 2015, as restated	\$ 8,272,818

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, 2015
Cash and pooled investments	\$ 2,215,662
Petty cash and change funds	4,995
Investments	1,986,096
Total	\$ 4,206,753

2. Capital Assets

Capital asset activity for the year ended December 31, 2015, was as follows:

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	\$ 476,534	\$ -	\$ -	\$ 476,534
Construction in progress	6,282,685	1,990,207	405,729	7,867,163
Total capital assets not depreciated	\$ 6,759,219	\$ 1,990,207	\$ 405,729	\$ 8,343,697
Capital assets depreciated				
Buildings	\$ 10,181,923	\$ 936,759	\$ -	\$ 11,118,682
Machinery, vehicles, furniture, and equipment	1,543,410	176,631	47,824	1,672,217
Total capital assets depreciated	\$ 11,725,333	\$ 1,113,390	\$ 47,824	\$ 12,790,899
Less: accumulated depreciation for				
Buildings	\$ 3,730,342	\$ 316,550	\$ -	\$ 4,046,892
Machinery, vehicles, furniture, and equipment	1,122,724	95,814	45,715	1,172,823
Total accumulated depreciation	\$ 4,853,066	\$ 412,364	\$ 45,715	\$ 5,219,715
Total capital assets depreciated, net	\$ 6,872,267	\$ 701,026	\$ 2,109	\$ 7,571,184
Total Capital Assets, Net	\$ 13,631,486	\$ 2,691,233	\$ 407,838	\$ 15,914,881



**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	\$	5,892
Court and field services		48,010
Northeast Regional Corrections Center		248,769
Arrowhead Juvenile Center		109,693
Total Depreciation Expense	\$	412,364

B. Liabilities

1. Operating Leases

Arrowhead Regional Corrections leases office space and office equipment under non-cancelable operating leases. Total costs for such leases were \$479,604 for the year ended December 31, 2015. The future minimum lease payments for these leases are as follows:

Year Ending December 31	Amount
2016	\$ 20,730
2017	3,827
2018	1,488
2019	316
2020	316
Total	\$ 26,677

2. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2015, was as follows:

Governmental Activities

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Compensated absences	\$ 4,342,536	\$ 1,218,599	\$ 1,158,644	\$ 4,402,491	\$ 1,222,831

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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2. Detailed Notes on All Funds

B. Liabilities (Continued)

3. 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.

3. Defined Benefit 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. PERA's defined benefit pension plans are tax qualified plans under Section 401(a) of the Internal Revenue Code.

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. The Basic Plan was closed to new members in 1967. All new members must participate in the Coordinated Plan, for which benefits vest after five years of credited service.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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3. Defined Benefit Pension Plans

A. Plan Description (Continued)

Local government employees of a county-administered facility who are responsible for the direct security, custody, and control of the county correctional facility and its inmates are covered by the Public Employees Correctional Fund. For members hired after June 30, 2010, benefits vest on a graduated schedule starting with 50 percent after 5 years and increasing 10 percent for each year of service until fully vested after 10 years.

B. Benefits Provided

PERA provides retirement benefits as well as disability benefits to members and benefits to survivors upon death of eligible members. Benefit provisions are established by state statute and can be modified only by the state legislature. Benefit increases are provided to benefit recipients each January. Increases are related to the funding ratio of the plan. Benefit recipients receive a future annual 1.0 percent post-retirement benefit increase. If the funding ratio reaches 90 percent for two consecutive years, the benefit increase will revert to 2.5 percent. If, after reverting to a 2.5 percent benefit increase, the funding ratio declines to less than 80 percent for one year or less than 85 percent for two consecutive years, the benefit increase will decrease to 1.0 percent.

The benefit provisions stated in the following paragraph 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 their public service.

Benefits are based on a member's highest average salary for any five successive years of allowable service, age, and years of credit at termination of service. Two methods are used to compute benefits for General Employees Retirement Fund Coordinated and Basic Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Basic Plan member is 2.2 percent of average salary for each of the first ten years of service and 2.7 percent for each remaining year. The annuity accrual rate for a Coordinated Plan member is 1.2 percent of average salary for each of the first ten years of service and 1.7 percent for each remaining year. Under Method 2, the annuity accrual rate is 2.7 percent of average salary for Basic Plan

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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3. Defined Benefit Pension Plans

B. Benefits Provided (Continued)

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 General Employees Retirement Fund members hired prior to July 1, 1989, a full annuity is available when age plus years of service equal 90, and normal retirement age is 65. For members hired on or after July 1, 1989, normal retirement age is the age for unreduced Social Security benefits capped at 66. For Public Employees Correctional Fund members who were hired prior to July 1, 1989, a full annuity is available when age plus years of service equal 90, and normal retirement age is 55. Disability benefits are available for vested members and are based on years of service and average high-five salary.

C. Contributions

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. General Employees Retirement Fund Basic Plan members and Coordinated Plan members were required to contribute 9.10 percent and 6.50 percent, respectively, of their annual covered salary in 2015.

Public Employees Correctional Fund members were required to contribute 5.83 percent of their annual covered salary in 2015.

In 2015, Arrowhead Regional Corrections was required to contribute the following percentages of annual covered salary:

General Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	7.50
Public Employees Correctional Fund	8.75

The General Employees Retirement Fund Coordinated Plan member and employer contribution rates each reflect a 0.25 percent increase from 2014.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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3. Defined Benefit Pension Plans

C. Contributions (Continued)

Arrowhead Regional Corrections' contributions for the year ended December 31, 2015, to the pension plans were:

General Employees Retirement Fund	\$ 656,183
Public Employees Correctional Fund	377,145

The contributions are equal to the contractually required contributions as set by state statute.

D. Pension Costs

General Employees Retirement Fund

At December 31, 2015, Arrowhead Regional Corrections reported a liability of \$7,317,717 for its proportionate share of the General Employees Retirement Fund's net pension liability. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. Arrowhead Regional Corrections' proportion of the net pension liability was based on Arrowhead Regional Corrections' contributions received by PERA during the measurement period for employer payroll paid dates from July 1, 2014, through June 30, 2015, relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2015, Arrowhead Regional Corrections' proportion was 0.1412 percent. It was 0.1538 percent measured as of June 30, 2014. Arrowhead Regional Corrections recognized pension expense of \$825,122 for its proportionate share of the General Employees Retirement Fund's pension expense.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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3. Defined Benefit Pension Plans

D. Pension Costs

General Employees Retirement Fund (Continued)

Arrowhead Regional Corrections reported its proportionate share of the General Employees Retirement Fund's deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual economic experience	\$ -	\$ 368,937
Difference between projected and actual investment earnings	692,734	-
Changes in proportion	-	443,913
Contributions paid to PERA subsequent to the measurement date	343,661	-
Total	\$ 1,036,395	\$ 812,850

The \$343,661 reported as deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2016. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended December 31	Pension Expense Amount
2016	\$ (97,767)
2017	(97,767)
2018	(97,767)
2019	173,185

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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3. Defined Benefit Pension Plans

D. Pension Costs (Continued)

Public Employees Correctional Fund

At December 31, 2015, Arrowhead Regional Corrections reported a liability of \$343,212 for its proportionate share of the Public Employees Correctional Fund's net pension liability. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. Arrowhead Regional Corrections' proportion of the net pension liability was based on Arrowhead Regional Corrections' contributions received by PERA during the measurement period for employer payroll paid dates from July 1, 2014, through June 30, 2015, relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2015, Arrowhead Regional Corrections' proportion was 2.22 percent. It was 2.26 percent measured as of June 30, 2014. Arrowhead Regional Corrections recognized pension expense of \$369,137 for its proportionate share of the Public Employees Correctional Fund's pension expense.

Arrowhead Regional Corrections reported its proportionate share of the Public Employees Correctional Fund's deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual economic experience	\$ -	\$ 131,402
Difference between projected and actual investment earnings	286,096	-
Changes in proportion	-	2,263
Contributions paid to PERA subsequent to the measurement date	<u>195,493</u>	<u>-</u>
Total	<u>\$ 481,589</u>	<u>\$ 133,665</u>

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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3. Defined Benefit Pension Plans

D. Pension Costs

Public Employees Correctional Fund (Continued)

The \$195,493 reported as deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2016. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

<u>Year Ended December 31</u>	<u>Pension Expense Amount</u>
2016	\$ 26,969
2017	26,969
2018	26,969
2019	71,524

Total Pension Expense

The total pension expense for all plans recognized by Arrowhead Regional Corrections for the year ended December 31, 2015, was \$1,194,259.

E. Actuarial Assumptions

The total pension liability in the June 30, 2015, actuarial valuation was determined using the individual entry age normal actuarial cost method and the following additional actuarial assumptions:

Inflation	2.75 percent per year
Active member payroll growth	3.50 percent per year
Investment rate of return	7.90 percent



**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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3. Defined Benefit Pension Plans

E. Actuarial Assumptions (Continued)

Salary increases were based on a service-related table. Mortality rates for active members, retirees, survivors, and disabilitants were based on RP-2000 tables for males or females, as appropriate, with slight adjustments. For the General Employees Retirement Fund, cost of living benefit increases for retirees are assumed to be 1.0 percent effective every January 1 through 2035 and 2037, respectively, and 2.5 percent thereafter. Cost of living benefit increases for retirees are assumed to be 2.5 percent for all years for the Public Employees Correctional Fund.

Actuarial assumptions used in the June 30, 2015, valuation were based on the results of actuarial experience studies. The experience study in the General Employees Retirement Fund was for the period July 1, 2004, through June 30, 2008, with an update of economic assumptions in 2014. The experience study for the Public Employees Correctional Fund was for the period July 1, 2006, through June 30, 2011.

In 2015, an updated experience study was done for PERA's General Employees Retirement Fund for the six-year period ending June 30, 2014, which would result in a larger pension liability. However, PERA will not implement the changes in assumptions until its June 30, 2016, estimate of pension liability.

The long-term expected rate of return on pension plan investments is 7.9 percent. The State Board of Investment, which manages the investments of PERA, prepares an analysis of the reasonableness of the long-term expected rate of return on a regular basis using a building-block method in which best-estimate ranges of expected future rates of return are developed for each major asset class. These ranges are combined to produce an expected long-term rate of return by weighting the expected future rates of return by the target asset allocation percentages. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Domestic stocks	45%	5.50%
International stocks	15	6.00
Bonds	18	1.45
Alternative assets	20	6.40
Cash	2	0.50

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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3. Defined Benefit Pension Plans (Continued)

F. Discount Rate

The discount rate used to measure the total pension liability was 7.9 percent. The discount rate did not change since the prior measurement date. The projection of cash flows used to determine the discount rate assumed that employee and employer contributions will be made at the rate specified in statute. Based on that assumption, each of the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

G. Pension Liability Sensitivity

The following presents Arrowhead Regional Corrections' proportionate share of the net pension liability calculated using the discount rate disclosed in the preceding paragraph, as well as what Arrowhead Regional Corrections' proportionate share of the net pension liability would be if it were calculated using a discount rate 1.0 percentage point lower or 1.0 percentage point higher than the current discount rate:

	1% Decrease in Discount Rate (6.9%)	Discount Rate (7.9%)	1% Increase in Discount Rate (8.9%)
Proportionate share of the General Employees Retirement Fund net pension liability	\$ 11,506,052	\$ 7,317,717	\$ 3,858,795
Public Employees Correctional Fund net pension liability (asset)	2,390,185	343,212	(1,295,192)

H. Pension Plan Fiduciary Net Position

Detailed information about the pension plan's fiduciary net position is available in a separately issued PERA financial report that includes financial statements and required supplementary information. That report may be obtained on the internet at [www.mnpera.org](http://www.mnpera.org); by writing to PERA at 60 Empire Drive, Suite 200, St. Paul, Minnesota 55103-2088; or by calling (651) 296-7460 or 1-800-652-9026.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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4. Other Postemployment Benefits

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 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.

Starting in 2014, St. Louis County elected to report Arrowhead Regional Corrections' liability for other postemployment benefits in its Comprehensive Annual Financial Report (CAFR). St. Louis County believes that ultimately, as the largest contributor to Arrowhead Regional Corrections, it would be responsible for fulfilling any obligations for postemployment benefits in the event that Arrowhead Regional Corrections was unable to. Consequently, a liability for other postemployment benefits is not reported on Arrowhead Regional Corrections' financial statements.

5. Summary of Significant Contingencies and Other Items

A. 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 CAFR.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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

B. Contingent Liabilities

Amounts received or receivable from grant agencies are subject to audit and adjustment by grantor agencies, principally the federal government. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of the expenditures that may be disallowed by the grantor cannot be determined at this time, although Arrowhead Regional Corrections expects such amounts, if any, to be immaterial.

C. Claims and Litigation

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

D. 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	10.63
Cook County	1.18
Koochiching County	1.80
Lake County	2.28
St. Louis County	<u>84.11</u>
Total	<u>100.00</u>

Member contributions towards operations for the current year totaled \$16,837,397, or 70 percent, of the total intergovernmental revenue received.

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 2015 totaled \$4,888,889, or 20 percent, of total intergovernmental revenue.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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

E. 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 was a 150-bed minimum-security facility which had significant deferred maintenance and several life safety and code issues which needed to be addressed. The Project was 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 allowed the NERCC to accommodate a greater population of pre-trial and post-conviction inmates from county jails.

The Board of Commissioners had received and approved a guaranteed maximum price for the Project of \$6,000,000 in 2014. The Board of Commissioners approved an additional \$500,000 at its June 19, 2015, Board meeting to cover additional costs related to architectural services. Four change orders were approved in 2015 to address unexpected costs related to the Project, for a net increase of \$396,428. The Project was completed in 2015.

The original cost of the Project was distributed proportionally to the member counties based on their average usage of the NERCC over a five-year period. On January 6, 2014, St. Louis County issued \$5,470,000 in General Obligation Capital Improvement Bonds, Series 2014A, to finance its share of the Project (87.6 percent), with the remainder of the \$6,000,000 cost being borne by the four other member counties. Additional amounts over the original \$6,000,000 were funded through the usage of fund balance assigned for capital improvements and emergency repairs. Capital outlays for the Project totaled \$1,862,237 during 2015 and totaled \$4,954,066 in 2014. Total capital outlays on the Project totaled \$6,816,303.

F. Trust Fund

Not shown on Arrowhead Regional Corrections' balance sheet as of December 31, 2015, are funds held in trust for residents or for their benefit. The account balance at December 31, 2015, is as follows:

Northeast Regional Corrections Center Residents' Trust Fund	<u>\$ 24,612</u>
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**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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

G. 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,
- North Shore Collaborative,
- Northern St. Louis County Drug Court,
- St. Louis County Drug Court, and
- Carlton County Drug Court.

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.

Drug Courts are collaborations between the courts, probation, law enforcement, treatment providers, and community partners that work to reduce recidivism of offenders who are chemically dependent. In lieu of incarceration, specialty courts use a treatment-based approach coupled with intensive supervision and judicial oversight to help chemically-dependent offenders maintain sobriety. The offenders enter the specialty courts for at least a year, during which time they are expected to complete treatment and remain accountable to probation through providing random urinalysis tests and complying with random home visits. Arrowhead Regional Corrections provides probation services for the Drug Courts.

Sentencing to Service

Arrowhead Regional Corrections, in conjunction with other local governments, participates in the State of Minnesota's Sentencing to Service (STS) program. STS is a project of the State Department of Administration's Strive Toward Excellence in Performance (STEP) program. STEP's goal is a statewide effort to make positive improvements in public services. It gives the courts an alternative to jail or fines for the nonviolent offenders who can work on a variety of community or state projects. Private

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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5. Summary of Significant Contingencies and Other Items

G. Jointly-Governed Organizations

Sentencing to Service (Continued)

funding, funds from various foundations and initiative funds, as well as the Minnesota Departments of Corrections and Natural Resources, provide the funds needed to operate the STS program. Although Arrowhead Regional Corrections has no operational or financial control over the STS program, Arrowhead Regional Corrections budgets for a percentage of this program. STS crews supervised by Department of Corrections' staff provide community work services at work sites in both Carlton and St. Louis Counties.

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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, 2015**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
<b>Revenues</b>				
Intergovernmental	\$ 24,969,560	\$ 23,809,600	\$ 24,077,559	\$ 267,959
Charges for services	1,289,115	1,289,075	1,149,236	(139,839)
Investment earnings	15,000	15,000	16,628	1,628
Miscellaneous	171,000	171,000	236,239	65,239
<b>Total Revenues</b>	<b>\$ 26,444,675</b>	<b>\$ 25,284,675</b>	<b>\$ 25,479,662</b>	<b>\$ 194,987</b>
<b>Expenditures</b>				
<b>Current</b>				
<b>Administration</b>				
Administrative support services	\$ 1,624,468	\$ 1,727,008	\$ 1,611,606	\$ 115,402
Research and evaluation	244,556	244,301	211,932	32,369
Staff development	105,185	117,769	117,369	400
Arrowhead Council of Churches	26,469	26,469	26,469	-
Women offenders program	200,000	200,000	196,229	3,771
<b>Total administration</b>	<b>\$ 2,200,678</b>	<b>\$ 2,315,547</b>	<b>\$ 2,163,605</b>	<b>\$ 151,942</b>
<b>Court and field services</b>				
Probation	\$ 11,705,176	\$ 9,964,740	\$ 9,787,744	\$ 176,996
St. Louis County data processing charges	269,781	260,684	260,684	-
Intensive supervision program	555,412	390,969	390,969	-
Short-term consequences	183,110	182,812	185,027	(2,215)
Sentencing to service	235,000	238,674	238,674	-
Correctional fees	168,137	168,128	159,902	8,226
<b>Total court and field services</b>	<b>\$ 13,116,616</b>	<b>\$ 11,206,007</b>	<b>\$ 11,023,000</b>	<b>\$ 183,007</b>
<b>Northeast Regional Corrections Center</b>				
Administration	\$ 5,889,771	\$ 6,050,556	\$ 5,630,854	\$ 419,702
Special education	220,624	220,328	225,503	(5,175)
Basic education	164,386	164,132	154,379	9,753
Vocational education	54,934	54,850	43,166	11,684
<b>Total Northeast Regional Corrections Center</b>	<b>\$ 6,329,715</b>	<b>\$ 6,489,866</b>	<b>\$ 6,053,902</b>	<b>\$ 435,964</b>
<b>Arrowhead Juvenile Center</b>				
Administration	\$ 4,158,072	\$ 4,145,571	\$ 4,097,383	\$ 48,188

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

***EXHIBIT A-1  
(Continued)***

**BUDGETARY COMPARISON SCHEDULE  
GENERAL FUND  
FOR THE YEAR ENDED DECEMBER 31, 2015**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
<b>Expenditures (Continued)</b>				
<b>Capital outlay</b>				
Administration	\$ 170,300	\$ 116,112	\$ 8,375	\$ 107,737
Court and field services	64,170	64,170	50,104	14,066
Northeast Regional Corrections Center	2,204,658	3,232,514	2,608,544	623,970
Arrowhead Juvenile Center	88,380	65,380	30,845	34,535
<b>Total capital outlay</b>	<b>\$ 2,527,508</b>	<b>\$ 3,478,176</b>	<b>\$ 2,697,868</b>	<b>\$ 780,308</b>
<b>Total Expenditures</b>	<b>\$ 28,332,589</b>	<b>\$ 27,635,167</b>	<b>\$ 26,035,758</b>	<b>\$ 1,599,409</b>
<b>Net Change in Fund Balance</b>	<b>\$ (1,887,914)</b>	<b>\$ (2,350,492)</b>	<b>\$ (556,096)</b>	<b>\$ 1,794,396</b>
<b>Fund Balance - January 1</b>	<b>5,381,300</b>	<b>5,381,300</b>	<b>5,381,300</b>	<b>-</b>
<b>Increase (decrease) in inventories</b>	<b>-</b>	<b>-</b>	<b>11,042</b>	<b>11,042</b>
<b>Fund Balance - December 31</b>	<b>\$ 3,493,386</b>	<b>\$ 3,030,808</b>	<b>\$ 4,836,246</b>	<b>\$ 1,805,438</b>

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

*EXHIBIT A-2*

**SCHEDULE OF PROPORTIONATE SHARE OF NET PENSION LIABILITY  
PERA GENERAL EMPLOYEES RETIREMENT FUND  
DECEMBER 31, 2015**

Measurement Date	Employer's Proportion of the Net Pension Liability (Asset)	Employer's Proportionate Share of the Net Pension Liability (Asset) (a)	Covered Payroll (b)	Employer's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of Covered Payroll (a/b)	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
2015	0.1412%	\$ 7,317,717	\$ 8,298,257	88.18%	78.19%

This schedule is intended to show information for ten years. Additional years will be displayed as they become available. The measurement date for each year is June 30.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

*EXHIBIT A-3*

**SCHEDULE OF CONTRIBUTIONS  
PERA GENERAL EMPLOYEES RETIREMENT FUND  
DECEMBER 31, 2015**

Year Ending	Statutorily Required Contributions (a)	Actual Contributions in Relation to Statutorily Required Contributions (b)	Contribution (Deficiency) Excess (b-a)	Covered Payroll (c)	Actual Contributions as a Percentage of Covered Payroll (b/c)
2015	\$ 656,183	\$ 656,183	-	\$ 8,749,107	7.50%

This schedule is intended to show information for ten years. Additional years will be displayed as they become available. Arrowhead Regional Corrections' year-end is December 31.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

*EXHIBIT A-4*

**SCHEDULE OF PROPORTIONATE SHARE OF NET PENSION LIABILITY  
PERA PUBLIC EMPLOYEES CORRECTIONAL FUND  
DECEMBER 31, 2015**

<b>Measurement Date</b>	<b>Employer's Proportion of the Net Pension Liability (Asset)</b>	<b>Employer's Proportionate Share of the Net Pension Liability (Asset) (a)</b>	<b>Covered Payroll (b)</b>	<b>Employer's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of Covered Payroll (a/b)</b>	<b>Plan Fiduciary Net Position as a Percentage of the Total Pension Liability</b>
2015	2.22%	\$ 343,212	\$ 3,986,802	8.61%	96.95%

This schedule is intended to show information for ten years. Additional years will be displayed as they become available. The measurement date for each year is June 30.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

*EXHIBIT A-5*

**SCHEDULE OF CONTRIBUTIONS  
PERA PUBLIC EMPLOYEES CORRECTIONAL FUND  
DECEMBER 31, 2015**

<b>Year Ending</b>	<b>Statutorily Required Contributions (a)</b>	<b>Actual Contributions in Relation to Statutorily Required Contributions (b)</b>	<b>Contribution (Deficiency) Excess (b-a)</b>	<b>Covered Payroll (c)</b>	<b>Actual Contributions as a Percentage of Covered Payroll (b/c)</b>
2015	\$ 377,145	\$ 377,145	\$ -	\$ 4,310,229	8.75%

This schedule is intended to show information for ten years. Additional years will be displayed as they become available. Arrowhead Regional Corrections' year-end is December 31.

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

**NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION  
FOR THE YEAR ENDED DECEMBER 31, 2015**

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Budgetary Data

The Board of Commissioners of Arrowhead Regional Corrections 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 \$198,392 encumbered at the end of December 31, 2015, with \$121,976 allocated for capital improvements at the Northeast Regional Corrections Center.

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**SUPPLEMENTARY INFORMATION**

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**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

***EXHIBIT B-1***

**SCHEDULE OF INTERGOVERNMENTAL REVENUE  
FOR THE YEAR ENDED DECEMBER 31, 2015**

<b>Shared Revenue</b>	
<b>State</b>	
PERA rate reimbursement	<u>\$ 51,928</u>
<b>Membership Contributions</b>	
<b>Shared operations</b>	
Carlton County	\$ 1,760,097
Cook County	198,158
Koochiching County	302,802
Lake County	384,260
St. Louis County	<u>13,766,147</u>
<b>Total shared operations</b>	<u>\$ 16,411,464</u>
<b>Drug court support</b>	
Carlton County	\$ 30,001
St. Louis County	<u>395,932</u>
<b>Total drug court support</b>	<u>\$ 425,933</u>
<b>Total membership contributions</b>	<u>\$ 16,837,397</u>
<b>Grants</b>	
<b>State</b>	
<b>Minnesota State Arts Board</b>	<u>\$ 5,775</u>
<b>Minnesota Department of Education</b>	<u>\$ 93,967</u>
<b>Minnesota Department of Corrections</b>	
Court and field services	
Caseload/workload reductions grant	\$ 210,825
Intensive supervision grant	341,148
Sex offender grant	153,778
Felony caseload reductions grant	10,192
Challenge incarceration program	100,597
Remote electronic monitoring	<u>15,324</u>
<b>Total court and field services</b>	<u>\$ 831,864</u>

**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

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

**SCHEDULE OF INTERGOVERNMENTAL REVENUE  
FOR THE YEAR ENDED DECEMBER 31, 2015**

**Grants**

**State**

**Minnesota Department of Corrections (Continued)**

Northeast Regional Corrections Center

State bonding funds

\$ 1,000,000

Sex offender grant

12,500

**Total Northeast Regional Corrections Center**

**\$ 1,012,500**

Arrowhead Juvenile Center

Sex offender grant

**\$ 60,500**

Community Corrections Act subsidy

**\$ 4,888,889**

**Total Minnesota Department of Corrections**

**\$ 6,793,753**

**Minnesota Department of Public Safety**

**\$ 26,400**

**Total state grants**

**\$ 6,919,895**

**Federal**

Department of

Agriculture

\$ 49,538

Transportation

136,988

Education

7,588

**Total federal grants**

**\$ 194,114**

**Other Grants**

Local

\$ 16,700

North St. Louis County Family Services Collaborative

Detention Assessment Team

57,525

**Total other grants**

**\$ 74,225**

**Total state, federal, and other grants**

**\$ 7,188,234**

**Total Intergovernmental Revenue**

**\$ 24,077,559**



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**ARROWHEAD REGIONAL CORRECTIONS  
DULUTH, MINNESOTA**

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS  
FOR THE YEAR ENDED DECEMBER 31, 2015**

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

**PREVIOUSLY REPORTED ITEM NOT RESOLVED**

Finding 1996-002

**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 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. Management has identified departments where inadequate segregation of duties exist. Management has determined that, given limited resources, it is not feasible to achieve the desired level of segregation of duties in these departments.

**Recommendation:** We recommend that the Board and management be aware of the lack of segregation of duties in the accounting functions and, where possible, continue to implement oversight procedures to ensure that the internal control policies and procedures are implemented to the extent possible.

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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### COMMUNICATION OF SIGNIFICANT DEFICIENCIES AND/OR MATERIAL WEAKNESSES IN INTERNAL CONTROL OVER FINANCIAL REPORTING AND OTHER MATTERS

Board of Commissioners  
Arrowhead Regional Corrections  
Duluth, Minnesota

We have audited, in accordance with the auditing standards generally accepted in the United States of America, the financial statements of the governmental activities and the General Fund of Arrowhead Regional Corrections as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise Arrowhead Regional Corrections' basic financial statements, and have issued our report thereon dated December 5, 2016.

#### **Internal Control Over Financial Reporting**

In planning and performing our audit of Arrowhead Regional Corrections' basic financial statements, we considered Arrowhead Regional Corrections' internal control over financial reporting (internal control) as a basis for designing 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 Arrowhead Regional Corrections' internal control. Accordingly, we do not express an opinion on the effectiveness of Arrowhead Regional Corrections' internal control.

A deficiency in internal control 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, such that there is a reasonable possibility that a material misstatement of Arrowhead Regional Corrections' financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. Our audit was also not designed to identify deficiencies in internal control that might be significant deficiencies. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A significant deficiency is reported in the Schedule of Findings and Recommendations as item 1996-002.

### **Other Matters**

Arrowhead Regional Corrections' written response to the internal control finding identified in our audit has been included in the Schedule of Findings and Recommendations. We did not audit Arrowhead Regional Corrections' response and, accordingly, we express no opinion on it.

This communication is intended solely for the information and use of the Board of Commissioners, management, and others within Arrowhead Regional Corrections, and is not intended to be, and should not be, used by anyone other than those specified parties.

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

December 5, 2016



REBECCA OTTO  
STATE AUDITOR

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### INDEPENDENT AUDITOR'S REPORT ON MINNESOTA LEGAL COMPLIANCE

Board of Commissioners  
Arrowhead Regional Corrections  
Duluth, Minnesota

We have audited, in accordance with auditing standards generally accepted in the United States of America, 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, 2015, and the related notes to the financial statements, which collectively comprise Arrowhead Regional Corrections' basic financial statements and have issued our report thereon dated December 5, 2016.

The *Minnesota Legal Compliance Audit Guide for Other 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, claims and disbursements, miscellaneous provisions, and tax increment financing. Our audit considered all of the listed categories, except that we did not test for compliance with the provisions for tax increment financing because Arrowhead Regional Corrections administers no tax increment financing districts. The provisions for deposits and investments and for claims and disbursements were tested in conjunction with our audit of St. Louis County, the fiscal agent for Arrowhead Regional Corrections.

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 Other 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 Arrowhead Regional Corrections' noncompliance with the above referenced provisions.

This report is intended solely for the information and use of the Board of Commissioners and management of Arrowhead Regional Corrections and the State Auditor and is not intended to be, and should not be, used by anyone other than those specified parties.

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

December 5, 2016