

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2005

Description of the Office of the State Auditor

The mission of the State Auditor's Office is to oversee local government finances for Minnesota taxpayers by helping to ensure financial integrity and accountability in local governmental financial activities.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 160 financial and compliance audits per year and has oversight responsibilities for over 3,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits of local governments;

Government Information - collects and analyzes financial information for cities, towns, counties, and special districts;

Legal/Special Investigations - provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

Pension - monitors investment, financial, and actuarial reporting for approximately 730 public pension funds; and

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

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

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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 State Auditor's web site: www.auditor.state.mn.us.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

For the Year Ended December 31, 2005



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

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

ORGANIZATION
DECEMBER 31, 2005

			<u>Term Expires</u>
Elected			
Commissioners			
Chair	Peg Sweeney	St. Louis County	January 2008
Vice Chair	Richard Brenner	Carlton County	January 2006
Board Member	Janice Hall	Cook County	January 2007
Board Member	Fritz Sobanja	Cook County	January 2007
Board Member	Wade Pavleck	Koochiching County	January 2007
Board Member	Rick Goutermout	Lake County	January 2007
Board Member	Bill Kron	St. Louis County	January 2008
Board Member	Steve Raukar	St. Louis County	January 2006
Appointed			
Executive Director	Tom Roy		Indefinite

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

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INDEPENDENT AUDITOR'S REPORT

Arrowhead Regional Corrections
Duluth, Minnesota

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, 2005, which collectively comprise Arrowhead Regional Corrections' basic financial statements as listed in the table of contents. These financial statements are the responsibility of Arrowhead Regional Corrections' management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the General Fund of Arrowhead Regional Corrections as of December 31, 2005, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis and the required supplementary information are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures,

which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Arrowhead Regional Corrections' basic financial statements. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements of Arrowhead Regional Corrections. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 17, 2006, on our consideration of Arrowhead Regional Corrections' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

End of Fieldwork: November 17, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2005
(Unaudited)

Our Management's Discussion and Analysis (MD&A) of Arrowhead Regional Corrections' financial performance provides an overview of the financial activities for the fiscal year ended December 31, 2005. Please read it in conjunction with the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

- The total net assets of Arrowhead Regional Corrections increased by \$0.5 million, or 8.6 percent.
- Arrowhead Regional Corrections' General Fund reported a combined ending fund balance of \$3.7 million, an increase of \$0.2 million. Part of the fund balance, \$2.1 million, is reserved and not available for appropriation. The remaining \$1.6 million (unreserved fund balance) has been designated for specific uses. Arrowhead Regional Corrections has zero undesignated fund balance at the end of 2005, a decrease of \$0.5 million.
- The General Fund reported an excess of revenue over expenditures of \$0.2 million, a decrease of \$0.2 million.

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 Assets and the Statement of Activities report information about Arrowhead Regional Corrections as a whole and about its activities. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report Arrowhead Regional Corrections' net assets and changes to them. Net assets--the difference between assets and liabilities--is one way to measure Arrowhead Regional Corrections' financial health, or financial position. Over time, increases or decreases in Arrowhead Regional Corrections' net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial 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 12 and 13.

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 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 that 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 Assets and the Statement of Activities) and the General Fund in reconciliations following each of the fund financial statements. The basic financial statements for the General Fund can be found on pages 14 through 17.

Notes to the Financial Statements

The notes to the financial statements 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 18 through 31.

Supporting Schedules

The budgetary comparison schedule, notes to the required supplementary information, and the schedule of intergovernmental revenue are provided on pages 32 through 35.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net assets may, over time, be a useful indicator of a government's financial position. In the case of Arrowhead Regional Corrections, assets exceeded liabilities by \$6.3 million.

By far, the largest portion of Arrowhead Regional Corrections' net assets is the investment in capital assets (101.6 percent), which reflects Arrowhead Regional Corrections' 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
Arrowhead Regional Corrections
Net Assets
(in Millions)

	Governmental Activities	
	2005	2004 (Restated)
Current and other assets	\$ 5.3	\$ 4.1
Capital assets	6.4	6.6
Total Assets	\$ 11.7	\$ 10.7
Other liabilities	\$ 0.8	\$ 0.5
Long-term liabilities outstanding	4.6	4.4
Total Liabilities	\$ 5.4	\$ 4.9
Net Assets		
Invested in capital assets, net of debt	\$ 6.4	\$ 6.6
Unrestricted	(0.1)	(0.8)
Total Net Assets	\$ 6.3	\$ 5.8

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

Governmental Activities

Arrowhead Regional Corrections' net assets increased by \$0.5 million, or 8.6 percent, from \$5.8 million to \$6.3 million. Arrowhead Regional Corrections was not able to report positive balances in the two categories of net assets for 2005 and 2004 because current and other assets were exceeded by total liabilities. That difference was, however, reduced by \$0.7 million in 2005.

Current and other assets are primarily cash and pooled investments (80.4 percent, or \$4.2 million).

The long-term liabilities outstanding are 100 percent compensated absences. Other liabilities increased \$0.3 million due to increases in salaries payable and accounts payable. Other liabilities and long-term liabilities are detailed on the General Fund balance sheet under liabilities.

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

Table 2
Arrowhead Regional Corrections
Changes in Net Assets
(in Millions)

	Governmental Activities	
	2005	2004 (Restated)
Revenues		
Program revenues	\$ 0.9	\$ 0.6
Charges for services	2.3	2.3
Operating grants and contributions		
General revenues		
Community Corrections Act subsidy	3.8	3.8
Grant and contributions not restricted to specific programs	11.1	10.2
Miscellaneous	0.3	0.3
Total Revenues	\$ 18.4	\$ 17.2
Expenses		
Program expenses		
Administration	\$ 1.8	\$ 1.5
Court and field services	8.2	8.3
Northeast Regional Corrections Center	4.7	4.8
Arrowhead Juvenile Center	3.2	3.2
Total Expenses	\$ 17.9	\$ 17.8
Increase (Decrease) in Net Assets	\$ 0.5	\$ (0.6)
Net Assets, January 1, restated	5.8	6.4
Net Assets, December 31	<u>\$ 6.3</u>	<u>\$ 5.8</u>

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

Governmental Activities

Total revenues were \$1.2 million more in 2005 than in 2004, an increase of 7.0 percent.

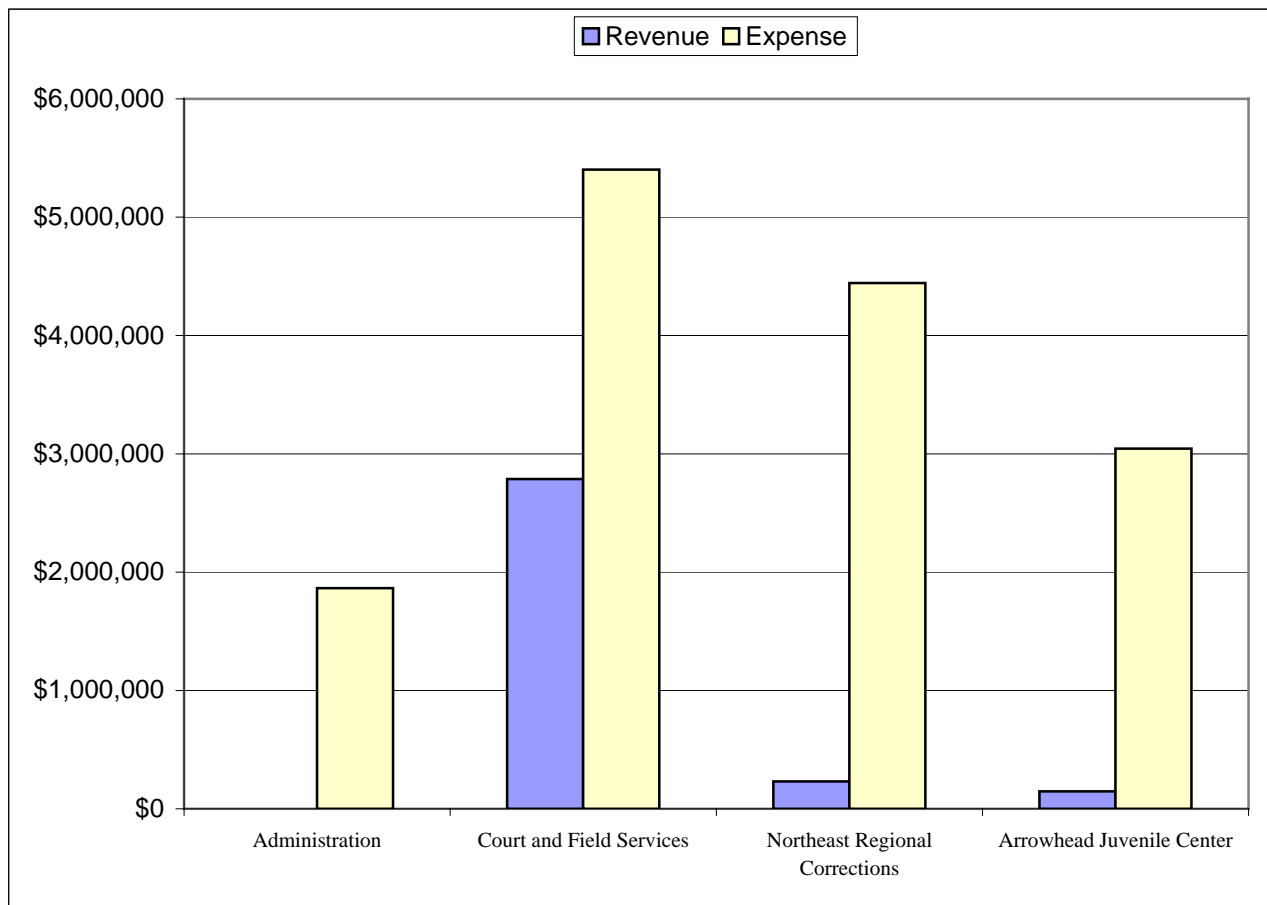
Program revenues increased by \$0.3 million in 2005. The total increase was from charges for services. Operating grants and contributions were from state and federal grants. The state and federal grants totaled \$2.3 million for both 2005 and 2004.

Arrowhead Regional Corrections received \$11.1 million in grants and contributions not restricted to specific programs. That was a \$0.9 million increase over 2004. These monies were contributed almost entirely by the five member counties. St. Louis County contributed 83.7 percent of the amount.

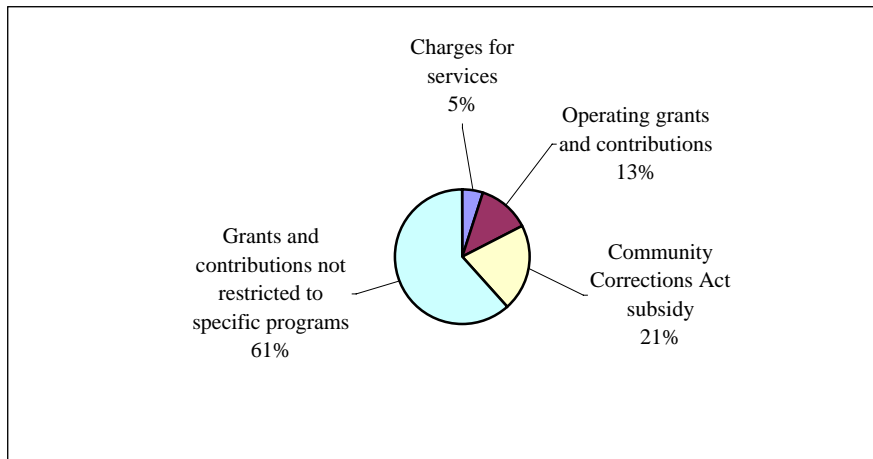
Total expenses increased in 2005 by \$0.1 million. Individual program expenses were fairly constant between the two years.

Court and field services accounted for 45.7 percent of all Arrowhead Regional Corrections' program expenses for 2005, down slightly from 2004.

Expenses and Program Revenues: Governmental Activities



Revenues by Source: Governmental Activities



Financial Analysis of the General Fund

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

General Fund. The focus of Arrowhead Regional Corrections' General Fund is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing Arrowhead Regional Corrections' financing requirements. In particular, unreserved 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, 2005, Arrowhead Regional Corrections' General Fund reported a fund balance of \$3.7 million, compared with \$3.5 million in 2004. Most of the combined fund balance, or \$1.6 million, was unreserved fund balance, which is available for spending at Arrowhead Regional Corrections' discretion. All of the \$1.6 million unreserved fund balance was designated. Designations reflect Arrowhead Regional Corrections' self-imposed limitations on otherwise available expendable resources. Designated for compensated absences of \$1.4 million is the largest designation. The remaining \$2.1 million is reserved. Fund balance is reserved because it is either unavailable for spending or legally restricted. Reserved for juvenile probation of \$1.8 million is the largest reserved fund balance.

Arrowhead Regional Corrections' fund balance increased \$0.2 million as a result of revenues exceeding expenditures.

General Fund Budgetary Highlights

Notable highlights were minimal in 2005. An area in which Arrowhead Regional Corrections continues to shine is in correctional fees. Every year since inception, collection rates have risen, and those funds support important correctional programming and positions.

Drug Court grants have funded and established a new Drug Court in Koochiching County. There seems to be an effort through the State Legislature to continue funding existing and already established Drug Courts. The Supreme Court in 2005 established a Drug Court working group and has identified it as a major initiative. Part of that initiative will be the necessity to fund the important correctional component of those Courts.

One of the challenges facing Arrowhead Regional Corrections and other local entities is providing local consequences for parole violators who have less than six months to serve. Formerly, the state returned all of those violators to state prisons, but now they are required to stay local. The per diem for those offenders is \$12 per day, and the actual cost of maintaining them is closer to \$50 per day.

Arrowhead Regional Corrections is a regional organization providing services to five counties in Northeastern Minnesota. Funding is provided through the Minnesota Department of Corrections through the Community Corrections Act subsidy, Carlton County, Cook County, Koochiching County, St. Louis County, and a number of federal and state grants.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At year-end, Arrowhead Regional Corrections showed total capital assets to be \$6.4 million. These amounts represent a broad range of capital assets, including land, buildings, machinery, and vehicles. Detail is presented in Table 3.

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

	Governmental Activities	
	2005	2004
Land	\$ 0.5	\$ 0.5
Buildings and improvements	5.8	6.0
Machinery, furniture, and equipment	0.1	0.1
Totals	\$ 6.4	\$ 6.6

The reduction in capital assets was due to depreciation expense far exceeding less than \$0.1 million of new purchases.

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 outstanding debt.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The economic factors of the Arrowhead Region continue to be depressed. Jobs that correctional clients can take advantage of to become productive citizens are not available.

Total population for the five Arrowhead Regional Corrections' counties, based on 2010 projections, is 272,290. St. Louis County's population continues to represent 76 percent of the total, while Cook County's population makes up 2 percent of the total, Carlton County contributes 13 percent, Koochiching County contributes 5 percent, and Lake County contributes 4 percent of the total Arrowhead Regional Corrections' population. These numbers have increased for all counties, except Koochiching County, from the 2000 to 2010 projections. Carlton, Cook, Lake, and St. Louis Counties show gains ranging from 1.5 percent for St. Louis County to 9.5 percent for Cook County. Koochiching County's population is projected to decrease 2.4 percent during the same period. The combined Arrowhead Regional Corrections' population increased by 1.9 percent from 2000 to the 2010 projection, while the overall state population increased by 4.9 percent.

The challenges of increased health care and energy costs will continue to affect our budget. The depressed economy will continue to impact criminal justice agencies statewide.

Federal funds that have traditionally been available through grants have been reduced or have become unavailable; hence new initiatives will be less likely. It is not expected that local County Boards will support those types of activities, and we will be lucky to maintain the status quo.

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 55802-1293.

BASIC FINANCIAL STATEMENTS

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 1

**STATEMENT OF NET ASSETS
DECEMBER 31, 2005**

	Governmental Activities
<u>Assets</u>	
Cash and pooled investments	\$ 4,201,789
Receivables - net	778,283
Inventories	99,762
Prepaid items	143,349
Capital assets	
Non-depreciable capital assets	454,123
Depreciable capital assets - net of accumulated depreciation	5,979,894
Total Assets	\$ 11,657,200
<u>Liabilities</u>	
Accounts payable and other current liabilities	\$ 794,575
Long-term liabilities	
Due in more than one year	4,589,552
Total Liabilities	\$ 5,384,127
<u>Net Assets</u>	
Invested in capital assets	\$ 6,434,017
Unrestricted	(160,944)
Total Net Assets	\$ 6,273,073

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 2

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2005**

	Program Revenues			Net (Expense) Revenue and Change in Net Assets
	Expenses	Fees, Charges, Fines, and Other	Operating Grants and Contributions	
<u>Functions/Programs</u>				
Governmental activities				
Administration	\$ 1,864,701	\$ -	\$ -	\$ (1,864,701)
Court and field services	8,188,581	659,755	2,126,634	(5,402,192)
Northeast Regional Corrections Center	4,675,287	153,546	77,987	(4,443,754)
Arrowhead Juvenile Center	3,191,591	52,834	94,475	(3,044,282)
Total governmental activities	\$ 17,920,160	\$ 866,135	\$ 2,299,096	\$ (14,754,929)
General Revenues				
Community Corrections Act subsidy				\$ 3,778,965
Grants and contributions not restricted to specific programs				11,158,582
Miscellaneous				318,057
Total general revenues				\$ 15,255,604
Change in net assets				\$ 500,675
Net Assets - Beginning (Restated, Note 1.D.)				5,772,398
Net Assets - Ending				\$ 6,273,073

FUND FINANCIAL STATEMENTS

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GOVERNMENTAL FUND

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 3

**BALANCE SHEET
GENERAL FUND
DECEMBER 31, 2005**

<u>Assets</u>	
Cash and pooled investments	\$ 4,178,832
Petty cash and change funds	22,957
Accounts receivable	26,366
Due from other governments	751,917
Inventories	99,762
Prepaid items	143,349
	\$ 5,223,183
Total Assets	\$ 5,223,183
<u>Liabilities and Fund Balance</u>	
Liabilities	
Accounts payable	\$ 336,384
Salaries payable	452,713
Due to other governments	5,478
Deferred revenue - unavailable	699,172
	\$ 1,493,747
Total Liabilities	\$ 1,493,747
Fund Balance	
Reserved for	
Inventories	\$ 99,762
Prepaid items	143,349
Health and welfare	125,788
Juvenile probation	1,776,969
Unreserved	
Designated for cash flow	160,572
Designated for petty cash funds	22,957
Designated for compensated absences	1,400,039
	\$ 3,729,436
Total Fund Balance	\$ 3,729,436
Total Liabilities and Fund Balance	\$ 5,223,183

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 4

**RECONCILIATION OF GENERAL FUND BALANCE SHEET TO
THE GOVERNMENT-WIDE STATEMENT OF NET ASSETS--GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2005**

Fund balance - total general fund (Exhibit 3)	\$ 3,729,436
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets, net of accumulated depreciation, used in governmental activities are not financial resources and, therefore, are not reported in the fund.	6,434,017
Other long-term assets are not available to pay for current period expenditures and, therefore, are deferred in the fund.	699,172
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the fund.	
Compensated absences	<u>(4,589,552)</u>
Net assets of governmental activities (Exhibit 1)	<u><u>\$ 6,273,073</u></u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

EXHIBIT 5

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2005**

Revenues	
Intergovernmental	\$ 16,564,928
Charges for services	866,135
Miscellaneous	318,057
	\$ 17,749,120
Expenditures	
Current	
Administration	\$ 1,821,402
Court and field services	8,100,177
Northeast Regional Corrections Center	4,446,936
Arrowhead Juvenile Center	3,084,654
Capital outlay	54,830
	\$ 17,507,999
Excess of Revenues Over (Under) Expenditures	\$ 241,121
Fund Balance - January 1	3,521,557
Increase (decrease) in reserved for inventories	(33,242)
	\$ 3,729,436
Fund Balance - December 31	\$ 3,729,436

**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, 2005**

Net change in fund balance - general fund (Exhibit 5) \$ 241,121

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

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

Deferred revenue - December 31	\$ 699,172	
Deferred revenue - January 1	(29,945)	669,227

Governmental funds report capital outlay as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

Expenditures for general capital assets	\$ 56,378	
Current year depreciation	(243,118)	(186,740)

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

Change in compensated absences	\$ (189,691)	
Change in inventories	(33,242)	(222,933)

Change in net assets of governmental activities (Exhibit 2) \$ 500,675

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2005**

1. Summary of Significant Accounting Policies

Arrowhead Regional Corrections' financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as of and for the year ended December 31, 2005. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (statements and interpretations). Governments are also required to follow the pronouncements of the Financial Accounting Standards Board issued through November 30, 1989, (when applicable) that do not conflict with or contradict GASB pronouncements. The more significant accounting policies established in GAAP and used by Arrowhead Regional Corrections are discussed below.

A. Financial Reporting Entity

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.

B. Basic Financial Statements

1. Government-Wide Statements

The government-wide financial statements (the statement of net assets 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.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basic Financial Statements

1. Government-Wide Statements (Continued)

The government-wide statement of net assets 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 assets are reported in two parts: (1) invested in capital assets and (2) unrestricted net assets. 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 that are 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.

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.

C. Measurement Focus and Basis of Accounting

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

C. Measurement Focus and Basis of Accounting (Continued)

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Arrowhead Regional Corrections considers all revenues to be 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.

When both restricted and unrestricted resources are available for use, it is Arrowhead Regional Corrections' policy to use restricted resources first and then unrestricted resources as needed.

D. Restatement

As of January 1, 2005, Arrowhead Regional Corrections changed the method of determining the liability for vested and vesting sick leave from the termination method to the vesting method of the governmental activities. This resulted in a restatement of net assets.

January 1, net assets, as previously reported	\$ 6,692,024
Restatement	<u>(919,626)</u>
January 1, net assets, as restated	<u>\$ 5,772,398</u>

E. Assets, Liabilities, and Net Assets 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.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

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

2. Inventories

All inventories are valued at cost using the first in/first out (FIFO) 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.

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 market 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 is depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings	30 - 70
Building improvements	10 - 20
Furniture, equipment, and vehicles	3 - 15

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies

E. Assets, Liabilities, and Net Assets or Equity

4. Compensated Absences (Continued)

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

5. Deferred Revenue

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

6. Long-Term Obligations

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

7. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts not available for appropriation or legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans subject to change.

8. Use of Estimates

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

Minn. Stat. §§ 118A.02 and 118A.04 authorize Arrowhead Regional Corrections 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, the County retains the interest earned. Minnesota statutes require that all County deposits be covered by insurance, surety bond, or collateral.

Minn. Stat. §§ 118A.04 and 118A.05 authorize the types of securities available to Arrowhead Regional Corrections for investment.

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.

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

	December 31, 2005
	<hr/>
Cash and pooled investments	\$ 4,178,832
Petty cash and change funds	22,957
	<hr/>
Total	\$ 4,201,789
	<hr/> <hr/>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets (Continued)

2. Receivables

Receivables as of December 31, 2005, for Arrowhead Regional Corrections' governmental activities are as follows:

Due from other governments	\$	751,917
Accounts		<u>26,366</u>
Total Receivables	\$	<u>778,283</u>

3. Capital Assets

Capital asset activity for the year ended December 31, 2005, was as follows:

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	\$ 454,123	\$ -	\$ -	\$ 454,123
Capital assets depreciated				
Buildings	\$ 7,776,422	\$ 1,547	\$ 12,898	\$ 7,765,071
Machinery, furniture, and equipment	<u>1,242,850</u>	<u>54,831</u>	<u>315,658</u>	<u>982,023</u>
Total capital assets depreciated	<u>\$ 9,019,272</u>	<u>\$ 56,378</u>	<u>\$ 328,556</u>	<u>\$ 8,747,094</u>
Less: accumulated depreciation for				
Buildings	\$ 1,806,885	\$ 180,651	\$ 12,898	\$ 1,974,638
Machinery, furniture, and equipment	<u>1,045,753</u>	<u>62,467</u>	<u>315,658</u>	<u>792,562</u>
Total accumulated depreciation	<u>\$ 2,852,638</u>	<u>\$ 243,118</u>	<u>\$ 328,556</u>	<u>\$ 2,767,200</u>
Total capital assets depreciated, net	<u>\$ 6,166,634</u>	<u>\$ (186,740)</u>	<u>\$ -</u>	<u>\$ 5,979,894</u>
Capital Assets, Net	<u>\$ 6,620,757</u>	<u>\$ (186,740)</u>	<u>\$ -</u>	<u>\$ 6,434,017</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

3. Capital Assets (Continued)

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

Administration	\$ 19,568
Court and Field Services	2,057
Northeast Regional Corrections Center	128,707
Arrowhead Juvenile Center	<u>92,786</u>
Total Depreciation Expense	<u>\$ 243,118</u>

B. Liabilities

1. Payables

Payables at December 31, 2005, were as follows:

Accounts	\$ 336,384
Salaries	452,713
Due to other governments	<u>5,478</u>
Total Payables	<u>\$ 794,575</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

B. Liabilities (Continued)

2. Leases

Operating Leases

Arrowhead Regional Corrections leases office space and office equipment under noncancelable operating leases. Total costs for such leases were \$161,226 for the year ended December 31, 2005. The future minimum lease payments for these leases are as follows:

Year Ending December 31	Amount
2006	\$ 161,298
2007	161,298
2008	161,298
2009	161,298
2010	161,298
Total	\$ 806,490

3. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2005, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Compensated absences (restated)	\$ 4,399,861	\$ 1,687,182	\$ 1,497,491	\$ 4,589,552	\$ -

Beginning compensated absences balance was restated for a change from the termination method to the vesting method for calculating the liability. The restatement amount for the governmental activities was \$919,626.

4. Deferred Compensation

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

2. Detailed Notes on All Funds

B. Liabilities (Continued)

5. Other Employee Benefits

Under Arrowhead Regional Corrections' personnel policies and union contracts, its employees are granted vacation and sick leave in varying amounts based upon length of service. Vacation leave accrual varies from two to nine hours per biweekly pay period. Sick leave accrual is from 2 to 5.5 hours per biweekly pay period.

Unused accumulated vacation is paid to employees. Vested sick leave is paid to employees at retirement or is used for payment of employees' health insurance coverage during their retirement. The current portion of unused vacation is recognized as a current liability in the government-wide Statement of Net Assets. The noncurrent unused vacation, vested sick leave, and unvested sick leave likely to become vested are recognized as a long-term liability in the government-wide Statement of Net Assets. Unvested sick leave of \$1,183,040 at December 31, 2005, is available to employees in the event of illness-related absences.

6. Risk Management

Arrowhead Regional Corrections is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; injuries to employees; or natural disasters. Risk management is handled through a combination of purchased commercial insurance and participation in the St. Louis County self-insurance program. Arrowhead Regional Corrections did not have a loss exceeding the limits of insurance coverage for any of the past three years. There were no significant reductions in insurance from the prior year.

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Plan Description

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

Public Employees Retirement Fund members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security, and Basic Plan members are not. All new members must participate in the Coordinated Plan. Members who are employed in a county correctional institution and have direct contact with inmates are covered by the Public Employees Correctional Fund.

The PERA provides retirement benefits as well as disability benefits to members and benefits to survivors upon death of eligible members. Benefits are established by state statute and vest after three years of credited service. The retirement 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 Coordinated and Basic Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Basic Plan member is 2.2 percent of average salary for each of the first ten years of service and 2.7 percent for each year thereafter. For a Coordinated Plan member, the annuity accrual rate is 1.2 percent of average salary for each of the first ten years and 1.7 percent for each successive year. Under Method 2, the annuity accrual rate is 2.7 percent of average salary for Basic Plan members and 1.7 percent for Coordinated Plan members for each year of service. For Public Employees Correctional Fund members, the annuity accrual rate is 1.9 percent of average salary for each year of service.

For all Public Employees Retirement Fund members whose annuity is calculated using Method 1 and Public Employees Correctional Fund members, a full annuity is available when age plus years of service equal 90. A reduced retirement annuity is also available to eligible members seeking early retirement.

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Plan Description (Continued)

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

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

B. Funding Policy

Pension benefits are funded from member and employer contributions and income from the investment of fund assets. Minn. Stat. ch. 353 sets the rates for employer and employee contributions. These statutes are established and amended by the State Legislature. Arrowhead Regional Corrections makes annual contributions to the pension plans equal to the amount required by state statutes. Public Employees Retirement Fund Basic Plan members and Coordinated Plan members were required to contribute 9.10 and 5.10 percent, respectively, of their annual covered salary in 2005. Contribution rates in the Coordinated Plan increased in 2006 to 5.50 percent. Public Employees Correctional Fund members are required to contribute 5.83 percent of their annual covered salary.

Arrowhead Regional Corrections is required to contribute the following percentages of annual covered payroll in 2005 and 2006:

	<u>2005</u>	<u>2006</u>
Public Employees Retirement Fund		
Basic Plan members	11.78%	11.78%
Coordinated Plan members	5.53	6.00
Public Employees Correctional Fund	8.75	8.75

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

B. Funding Policy (Continued)

Arrowhead Regional Corrections' contributions for the years ending December 31, 2005, 2004, and 2003, for the Public Employees Retirement Fund and the Public Employees Correctional Fund were:

	Public Employees Retirement Fund	Public Employees Correctional Fund
2005	\$ 394,793	\$ 228,257
2004	399,375	232,207
2003	401,602	234,474

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

4. Summary of Significant Contingencies and Other Items

A. Contingent Liabilities

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

B. Claims and Litigation

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

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

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

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

C. Participation

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

	<u>Percent (%)</u>
Carlton County	9.38
Cook County	1.44
Koochiching County	1.96
Lake County	2.19
St. Louis County	<u>85.03</u>
Totals	<u>100.00</u>

Member contributions for the current year totaled \$10,985,866, or 64 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 the year 2005 totaled \$3,778,965, or 22 percent of total intergovernmental revenue received.

D. 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

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.

REQUIRED SUPPLEMENTARY INFORMATION

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

Schedule 1

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2005**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Intergovernmental	\$ 17,573,498	\$ 17,573,498	\$ 16,564,928	\$ (1,008,570)
Charges for services	681,629	681,629	866,135	184,506
Miscellaneous	162,746	162,746	318,057	155,311
Total Revenues	\$ 18,417,873	\$ 18,417,873	\$ 17,749,120	\$ (668,753)
Expenditures				
Current				
Administration				
Administrative support services	\$ 1,724,735	\$ 1,724,735	\$ 1,267,083	\$ 457,652
Research and evaluation	180,209	180,209	190,033	(9,824)
Staff development	138,848	138,848	108,672	30,176
Arrowhead Council of Churches	24,924	24,924	24,924	-
Women offenders program	165,000	165,000	124,540	40,460
Use of institutions	100,000	100,000	106,150	(6,150)
Total administration	\$ 2,333,716	\$ 2,333,716	\$ 1,821,402	\$ 512,314
Court and field services				
Probation	\$ 7,778,222	\$ 7,978,222	\$ 7,445,260	\$ 532,962
St. Louis County data processing charges	115,975	115,975	105,975	10,000
Intensive day treatment program	-	-	156,410	(156,410)
Short-term consequences	112,424	112,424	93,653	18,771
Sentence to service	220,000	220,000	217,799	2,201
Juvenile restitution	-	-	92	(92)
Probation fees	62,500	62,500	80,988	(18,488)
Total court and field services	\$ 8,289,121	\$ 8,489,121	\$ 8,100,177	\$ 388,944
Northeast Regional Corrections Center				
Administration	\$ 4,266,915	\$ 4,266,915	\$ 4,066,578	\$ 200,337
Special education	173,901	173,901	139,986	33,915
Basic education	112,412	112,412	110,972	1,440
Vocational education	130,821	130,821	129,400	1,421
Total Northeast Regional Corrections Center	\$ 4,684,049	\$ 4,684,049	\$ 4,446,936	\$ 237,113
Arrowhead Juvenile Center				
Administration	\$ 3,111,592	\$ 3,140,642	\$ 3,084,654	\$ 55,988

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

Schedule 1
(Continued)

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2005**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Expenditures (Continued)				
Capital outlay				
Northeast Regional Corrections Center	\$ -	\$ -	\$ 36,007	\$ (36,007)
Arrowhead Juvenile Center	-	-	18,823	(18,823)
Total capital outlay	\$ -	\$ -	\$ 54,830	\$ (54,830)
Total Expenditures	\$ 18,418,478	\$ 18,647,528	\$ 17,507,999	\$ 1,139,529
Excess of Revenues Over (Under) Expenditures	\$ (605)	\$ (229,655)	\$ 241,121	\$ 470,776
Fund Balance - January 1	2,787,328	2,787,328	3,521,557	734,229
Increase (decrease) in reserved for inventories	-	-	(33,242)	(33,242)
Fund Balance - December 31	<u>\$ 2,786,723</u>	<u>\$ 2,557,673</u>	<u>\$ 3,729,436</u>	<u>\$ 1,171,763</u>

**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

**NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED DECEMBER 31, 2005**

Budgetary Data

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

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

The appropriated budget is prepared by each division of Arrowhead Regional Corrections. Department heads may make transfers of appropriations within a department. Transfers of appropriations between departments require Board approval. The legal level of budgetary control (the level at which expenditures may not legally exceed the budget) is at the divisional level. During the year, the Board made supplemental budgetary appropriations of \$229,050 to the expenditures in the General Fund.

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 reservations of fund balances and provide authority for the carryover of appropriations to the subsequent year in order to complete these transactions. There were no encumbrances reported at December 31, 2005.

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SUPPLEMENTARY INFORMATION

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

Schedule 2

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
FOR THE YEAR ENDED DECEMBER 31, 2005**

Shared Revenue	
State	
PERA rate reimbursement	\$ <u>62,634</u>
Member Contributions	
Shared operations	
Carlton County	\$ 1,030,932
Cook County	158,806
Koochiching County	214,404
Lake County	240,622
St. Louis County	9,341,102
Local contributions	<u>99,712</u>
Total shared operations	\$ <u>11,085,578</u>
Grants	
State	
Minnesota Department of Education	\$ <u>79,571</u>
Minnesota Department of Corrections	
Court and field services	
Caseload/workload reductions grant	\$ 746,792
Intensive supervision grant	103,626
Sex offender grant	256,638
Felony caseload reductions grant	76,770
Remote electronic monitoring	<u>10,103</u>
Total court and field services	\$ <u>1,193,929</u>
Arrowhead Juvenile Center	
Sex offender grant	\$ <u>35,970</u>
Community Corrections Act subsidy	\$ <u>3,778,965</u>
Total Minnesota Department of Corrections	\$ <u>5,008,864</u>
Total State Grants	\$ <u>5,088,435</u>
Federal	
Department of	
Agriculture	\$ 56,017
Justice	259,476
Education	<u>12,788</u>
Total Federal Grants	\$ <u>328,281</u>
Total State and Federal Grants	\$ <u>5,416,716</u>
Total Intergovernmental Revenue	\$ <u>16,564,928</u>

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**ARROWHEAD REGIONAL CORRECTIONS
DULUTH, MINNESOTA**

Schedule 3

SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2005

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEM NOT RESOLVED

96-2 Segregation of Duties

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

We recommend that Arrowhead Regional Corrections' management be aware of the lack of segregation of the accounting functions and enact oversight procedures to ensure that the internal control policies and procedures are being implemented by staff.

Client's Response:

Arrowhead Regional Corrections' management is aware of the lack of segregation of accounting functions as a result of our limited number of office personnel. Internal control policies and procedures will continue to be followed by Corrections' staff.

II. OTHER FINDINGS AND RECOMMENDATIONS

OTHER ITEM FOR CONSIDERATION

Other Postemployment Benefits

The Governmental Accounting Standards Board (GASB) recently issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes financial reporting for OPEB plans, and Statement No. 45,

Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, which governs employer accounting and financial reporting for OPEB. These standards, like what GASB Statements 25 and 27 did for governmental employee pension benefits and plans, provide the accounting and reporting standards for the various other postemployment benefits many local governments offer to their employees. OPEB can include many different benefits offered to retirees such as health, dental, life, and long-term care insurance coverage.

If retirees are included in an insurance plan and pay a rate similar to that paid for younger active employees, this implicit subsidy is considered OPEB. In fact, local governments may be required to continue medical insurance coverage pursuant to Minn. Stat. § 471.61, subd. 2b. This benefit is common when accumulated sick leave is used to pay for retiree medical insurance. Under the new GASB statements, accounting for OPEB is now similar to the accounting used by governments for pension plans.

Some of the issues that the Arrowhead Regional Corrections Board will need to address in order to comply with the statements are:

- determine if the employees are provided OPEB;
- if OPEB are being provided, the Board will have to decide whether it will advance fund the benefits or pay for them on a pay-as-you-go basis;
- if OPEB are being provided, and the County Board determines that the establishment of a trust is desirable in order to fund the OPEB, the County Board will have to wait until legislation is enacted authorizing the creation of an OPEB trust and establishing an applicable investment standard; and
- in order to determine annual costs and liabilities that need to be recognized, the Board will have to decide whether to hire an actuary.

If applicable for Arrowhead Regional Corrections, GASB Statements 43 and 45 would be implemented for the years ended December 31, 2006 and 2007, respectively.



REBECCA OTTO
STATE AUDITOR

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Arrowhead Regional Corrections Board
Duluth, Minnesota

We have audited the financial statements of the governmental activities and the General Fund of Arrowhead Regional Corrections as of and for the year ended December 31, 2005, and have issued our report thereon dated November 17, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Arrowhead Regional Corrections' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Arrowhead Regional Corrections' ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying Schedule of Findings and Recommendations as item 96-2.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the

financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition indicated above is not a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Arrowhead Regional Corrections' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Minnesota Legal Compliance

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* contains six categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, and miscellaneous provisions. Our study included all of the listed categories.

The results of our tests indicate that, for the items tested, Arrowhead Regional Corrections complied with the material terms and conditions of applicable legal provisions.

This report is intended solely for the information and use of the Arrowhead Regional Corrections Board and management 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

End of Fieldwork: November 17, 2006