

# STATE OF MINNESOTA

## Office of the State Auditor



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

---

**LINCOLN, LYON, & MURRAY**  
**HUMAN SERVICES**  
**MARSHALL, MINNESOTA**

FOR THE YEAR ENDED DECEMBER 31, 2006

## **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** - 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  
525 Park Street, Suite 500  
Saint Paul, Minnesota 55103  
(651) 296-2551  
state.auditor@state.mn.us  
www.auditor.state.mn.us

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](http://www.auditor.state.mn.us).

**LINCOLN, LYON, & MURRAY  
HUMAN SERVICES  
MARSHALL, MINNESOTA**

**For the Year Ended December 31, 2006**



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

This page was left blank intentionally.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

TABLE OF CONTENTS

	Reference	Page
<b>Introductory Section</b>		
Organization		1
<b>Financial Section</b>		
Independent Auditor's Report		2
Management's Discussion and Analysis		4
Basic Financial Statements		
General Fund Balance Sheet and Governmental Activities - Statement of Net Assets	Exhibit 1	10
General Fund Statement of Revenues, Expenditures, and Changes in Fund Balance and Governmental Activities - Statement of Activities	Exhibit 2	12
Statement of Revenues, Expenditures, and Changes in Fund Balance--Budgetary Comparison	Exhibit 3	13
Fiduciary Fund		
Statement of Fiduciary Net Assets - Agency Fund	Exhibit 4	14
Notes to the Financial Statements		15
Supplementary Information		
Statement of Changes in Assets and Liabilities - Agency Fund	Statement 1	30
Supporting Schedule		
Schedule of Intergovernmental Revenue	Schedule 1	31
<b>Management and Compliance Section</b>		
Schedule of Findings and Questioned Costs	Schedule 2	32
Other Required Reports		
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>		48
Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133		51
Schedule of Expenditures of Federal Awards	Schedule 3	54

This page was left blank intentionally.



This page was left blank intentionally.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

ORGANIZATION  
2006

Board	County	Term Expires
Chair		
Robert Fenske	Lyon	December 31, 2006
Vice Chair		
Steve Ritter	Lyon	December 31, 2008
Secretary		
Ann Svendsen	Lincoln	July 5, 2008
Members		
Deane Sagmoe	Lincoln	December 31, 2008
Joan Jagt	Lincoln	December 31, 2008
Carmen Marben	Lyon	July 5, 2008
Gail Byers	Murray	July 5, 2008
Kevin Vickerman	Murray	December 31, 2006
Lyle Onken	Murray	December 31, 2006
Lincoln, Lyon, & Murray Human Services Board		
Attorney		
William J. Toulouse		Indefinite
Director		
Christopher Sorensen		Indefinite
Accounting Officers		
Steve Glaeser/Nancy Walker (Effective April 24, 2006)		Indefinite
Troy Knakmuhs		Indefinite
Lori Johnson		Indefinite
Mary Hauschild		Indefinite
Harvey Witt/Karyn Groenewoldt (Effective April 10, 2006)		Indefinite

This page was left blank intentionally.



This page was left blank intentionally.



REBECCA OTTO  
STATE AUDITOR

# STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

SUITE 500  
525 PARK STREET  
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)  
(651) 296-4755 (Fax)  
state.auditor@state.mn.us (E-mail)  
1-800-627-3529 (Relay Service)

## INDEPENDENT AUDITOR'S REPORT

Board of Commissioners  
Lincoln, Lyon, & Murray Human Services

We have audited the financial statements of the governmental activities, the major fund, and the remaining fund information of Lincoln, Lyon, & Murray Human Services as of and for the year ended December 31, 2006, which collectively comprise the Human Services basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Human Services 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; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and 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 basic financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, the major fund, and the remaining fund information of Lincoln, Lyon, & Murray Human Services as of December 31, 2006, and the changes in financial position thereof and the General Fund budgetary comparison for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming opinions on the basic financial statements of the Lincoln, Lyon, & Murray Human Services. The statement and schedule listed as supplementary information and as a supporting schedule in the table of contents are presented for the purpose of additional analysis and are not a required part of the basic financial statements of the Human Services. The supplemental and supporting information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented 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 August 9, 2007, on our consideration of Lincoln, Lyon, & Murray Human Services 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

August 9, 2007

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

This page was left blank intentionally.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
DECEMBER 31, 2006  
(Unaudited)**

Lincoln, Lyon, & Murray Human Services' Management's Discussion and Analysis (MD&A) provides an overview of the Human Services' financial activities for the fiscal year ended December 31, 2006. Since this information is designed to focus on the current year's activities, resulting changes, and currently known facts, it should be read in conjunction with the Human Services' financial statements (beginning with Exhibit 1).

**FINANCIAL REPORTING ENTITY**

Lincoln, Lyon, & Murray Human Services was formed pursuant to Minn. Stat. § 393.01, subd. 7, (joint powers agreement), by Lincoln, Lyon, and Murray Counties. The Human Services began official operation on July 1, 1974, and performs Board and welfare functions. Local financing is provided by the three member counties on the basis of each county's welfare expenditures in 1973. Percentages are:

Lincoln County	-	20.90 percent
Lyon County	-	54.77 percent
Murray County	-	24.33 percent

**FINANCIAL HIGHLIGHTS**

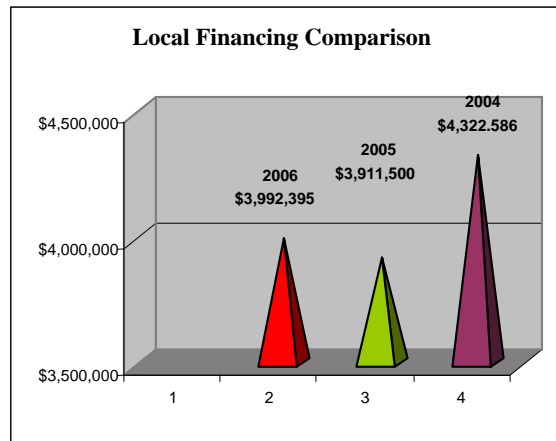
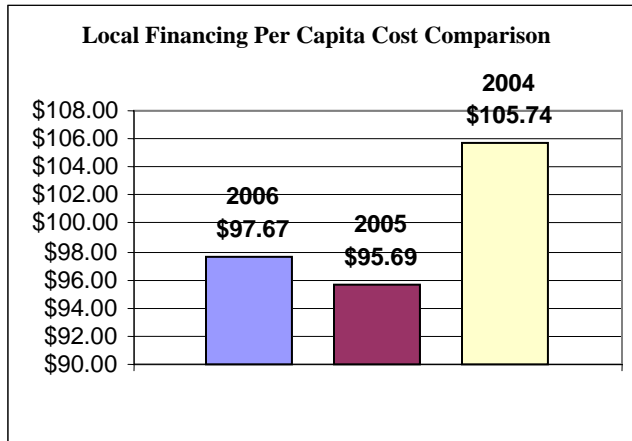
Governmental activities' total net assets are \$3,374,957, of which \$111,634 is invested in capital assets (Exhibit 1). Governmental activities' total net assets decreased by \$1,545,328. Most of the decrease was due to the decrease in funding from the state, overspending in both income maintenance and social services, and no increase in the tax levy.

Local financing for the Human Services in the year 2006 was \$3,992,395, which was 44.3 percent of intergovernmental revenue. Comparing 2006 with 2005 and 2004, the following tables show local financing costs and per capita cost decreased from 2004 to 2005 and increased slightly from 2005 to 2006.

**Schedule of Local Financing Revenue (Schedule 1)**

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Payments from participating counties	<u>\$ 3,992,395</u>	<u>\$ 3,911,500</u>	<u>\$ 4,322,586</u>

Population of all three counties is 40,878.



Since 2004, intergovernmental revenue has decreased and then recovered somewhat. From 2004 to 2005, intergovernmental revenue decreased by \$383,221; from 2005 to 2006, it increased by \$220,026. However, since 2004, investment earnings have increased as relative to interest rates and the economy. From 2004 to 2005, investment earnings increased by \$43,986; from 2005 to 2006, it increased by \$23,393.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This MD&A is intended to serve as an introduction to the basic financial statements. Lincoln, Lyon, & Murray Human Services’ basic financial statements consist of two statements that combine government-wide financial statements and fund financial statements, a budgetary comparison statement, a statement of changes in assets and liabilities for the agency fund, and notes to the financial statements. The MD&A (this section) is required to accompany the basic financial statements and, therefore, is included as required supplementary information.

The first column of each of the first two statements presents governmental fund data. These columns focus on how money flows in and out and the balances left at year-end available for spending. They are reported using an accounting method called modified accrual accounting. This method measures cash and all other financial assets that can be readily converted to cash. These columns provide a detailed short-term view of the Human Services’ general government operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the Human Services’ programs. We reconcile the relationship (or differences) between governmental funds and governmental activities (reported in the third column) in the center column of each statement.

The third column in each statement presents the governmental activities’ statement of net assets and the statement of activities, which provide information about the activities of the Human Services as a whole and present a longer-term view of the Human Services’ finances. These

columns 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. Over time, increases or decreases in the Human Services' net assets are one indicator of whether its financial health is improving or deteriorating.

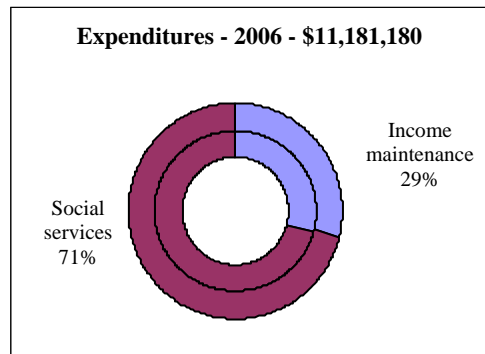
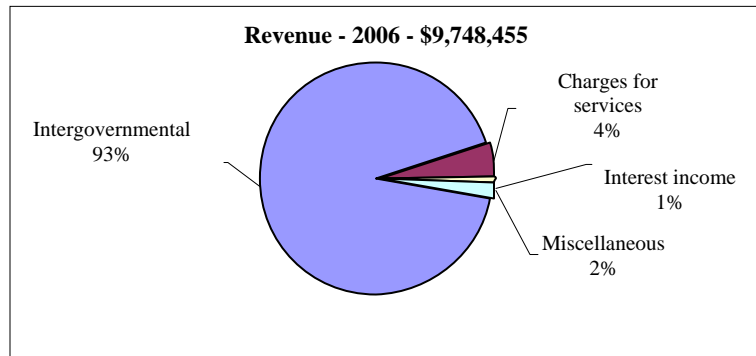
## Governmental Activities

Comparative statements of net assets and activities illustrate the changes from 2005 to 2006:

	<u>2006</u>	<u>2005</u>	<u>Percent Change</u>
<b>Assets</b>			
Current assets	\$ 4,357,909	\$ 5,907,613	(26.2)
Capital assets, net of depreciation	<u>111,634</u>	<u>176,783</u>	(36.9)
Total Assets	<u>\$ 4,469,543</u>	<u>\$ 6,084,396</u>	(26.5)
<b>Liabilities</b>			
Current liabilities	\$ 630,502	\$ 747,481	(15.6)
Long-term liabilities	<u>464,084</u>	<u>416,630</u>	11.4
Total Liabilities	<u>\$ 1,094,586</u>	<u>\$ 1,164,111</u>	(6.0)
<b>Net Assets</b>			
Invested in capital assets	\$ 111,634	\$ 176,783	(36.9)
Unrestricted	<u>3,263,323</u>	<u>4,743,502</u>	(31.2)
Total Net Assets	<u>\$ 3,374,957</u>	<u>\$ 4,920,285</u>	(31.4)
<b>Revenues</b>			
Intergovernmental	\$ 9,010,229	\$ 9,230,255	(2.4)
Charges for services	428,212	175,475	144.0
Investment earnings	117,915	94,522	24.7
Miscellaneous	<u>192,099</u>	<u>488,878</u>	(60.7)
Total Revenues	\$ 9,748,455	\$ 9,989,130	(2.4)
Expenses	<u>11,293,783</u>	<u>10,613,010</u>	6.4
Change in Net Assets	\$ (1,545,328)	\$ (623,880)	(147.7)
Net Assets - January 1	<u>4,920,285</u>	<u>5,544,165</u>	(11.3)
Net Assets - December 31	<u>\$ 3,374,957</u>	<u>\$ 4,920,285</u>	(31.4)

## Governmental Fund

Revenues for the Human Services' General Fund decreased 2.41 percent (\$240,675) from the prior year, while total expenditures increased by 5.22 percent (\$554,398) from the prior year. This results in a 27.77 percent decrease in fund balance in the year ended December 31, 2006.



As shown in the Statement of Activities on Exhibit 2, the amount that was received through intergovernmental revenue was 93 percent of the total revenue received. See graph for breakout of intergovernmental revenue.

### General Fund - 2006

Revenues	Amount
Intergovernmental	\$ 9,010,229
Charges for services	428,212
Interest on investments	117,915
Miscellaneous	192,099
<b>Total Revenues</b>	<b>\$ 9,748,455</b>

### General Fund Budgetary Highlights

Over the course of the year, the original to final budget totals stayed the same. Budgeted revenue exceeded actual revenue by \$292,178. The 2006 Federal Budget Reconciliation Act, passed on February 1, 2006, provided for many changes affecting the Human Services in the area of federal revenues. Targeted Case Management (TCM) funding, currently a source of revenue for child welfare, children and adult mental health, and vulnerable adults, was largely reduced in 2006. These targeted funds represented approximately \$525,000 in budgeted revenue

for 2006. The Human Services received \$180,698 less than budgeted in this area. Additionally, case management funding for waived services (developmental disabled, elderly, etc.) was also reduced by approximately \$187,000.

Actual expenditures exceeded budgeted by \$921,060. Nondiscretionary expenditures in the areas of adult mental health hold order costs, County share for “poor relief” or institutional care, and children’s mental health residential treatment center costs were the contributing factors to this overage.

## CAPITAL ASSETS AND DEBT ADMINISTRATION

### Capital Assets

The Human Services’ investment in capital assets for its governmental activities for the year ended December 31, 2006, is \$111,634 (net of accumulated depreciation). This investment in capital assets includes office furniture and equipment and automotive equipment. There was a decrease in the Human Services’ investment in capital assets for the current fiscal year of 36.85 percent. Overall, the Human Services has been holding onto capital assets longer and replacing at a slower rate due to decreased funding and revenues.

Capital asset activity for the year ended December 31, 2006, was as follows:

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets depreciated				
Office furniture and equipment	\$ 227,911	\$ -	\$ -	\$ 227,911
Automotive equipment	<u>225,403</u>	<u>13,630</u>	<u>18,179</u>	<u>220,854</u>
Total capital assets depreciated	<u>\$ 453,314</u>	<u>\$ 13,630</u>	<u>\$ 18,179</u>	<u>\$ 448,765</u>
Less: accumulated depreciation for				
Office furniture and equipment	\$ 136,012	\$ 40,110	\$ -	\$ 176,122
Automotive equipment	<u>140,519</u>	<u>38,669</u>	<u>18,179</u>	<u>161,009</u>
Total accumulated depreciation	<u>\$ 276,531</u>	<u>\$ 78,779</u>	<u>\$ 18,179</u>	<u>\$ 337,131</u>
Total Capital Assets Depreciated, Net	<u><u>\$ 176,783</u></u>	<u><u>\$ (65,149)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 111,634</u></u>

Depreciation expense was charged to income maintenance and social services programs for the year ended December 31, 2006.

Information on the Human Services’ capital assets can be found in the notes to the financial statements.

## Long-Term Liabilities

The Human Services long-term liabilities consist of compensated absences at December 31, 2006, as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Compensated absences	<u>\$ 416,630</u>	<u>\$ 47,454</u>	<u>\$ -</u>	<u>\$ 464,084</u>	<u>\$ 49,286</u>

## ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

Lincoln, Lyon, & Murray Human Services has included the use of \$114,228 of cash balance for the 2007 budget year. The 2007 Lincoln, Lyon, & Murray Human Services budget also reflects a reduction in overall spending from 2006 of approximately \$401,698.

The most recent legislative session for the State of Minnesota includes sparse revenue enhancements for counties that address revenue losses (on a short-term basis) created by the federal government budgetary reductions. These temporary adjustments highlight what has been almost five years of budgetary reductions for local county human services agencies. We anticipate that, given the current funding priorities, most of the emphasis for service development will be focused upon maintaining the "safety net" of services for our most vulnerable community members.

## CONTACTING THE HUMAN SERVICES FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of Lincoln, Lyon, & Murray Human Services financial statements. Additional questions or further explanation of this report can be obtained by contacting Christopher J. Sorensen, Director of Lincoln, Lyon, & Murray Human Services, 607 West Main Street, Marshall, Minnesota 56258.

## **BASIC FINANCIAL STATEMENTS**

This page was left blank intentionally.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

**EXHIBIT 1**

**GENERAL FUND BALANCE SHEET AND  
GOVERNMENTAL ACTIVITIES - STATEMENT OF NET ASSETS  
WITH ADJUSTMENTS TO CONVERT MODIFIED TO FULL ACCRUAL  
DECEMBER 31, 2006**

	<b>General Fund</b>	<b>Reconciliation</b>	<b>Governmental Activities</b>
<b><u>Assets</u></b>			
Current assets			
Cash and pooled investments	\$ 3,448,295	\$ -	\$ 3,448,295
Petty cash and change funds	540	-	540
Accounts receivable	13,385	-	13,385
Accrued interest receivable	10,254	-	10,254
Due from other governments	885,435	-	885,435
Capital assets			
Depreciable - net	-	111,634	111,634
<b>Total Assets</b>	<b>\$ 4,357,909</b>	<b>\$ 111,634</b>	<b>\$ 4,469,543</b>
<b><u>Liabilities</u></b>			
Current liabilities			
Accounts payable	\$ 272,955	\$ -	\$ 272,955
Salaries payable	234,643	-	234,643
Due to other governments	122,904	-	122,904
Long-term liabilities			
Due within one year	-	49,286	49,286
Due in more than one year	-	414,798	414,798
<b>Total Liabilities</b>	<b>\$ 630,502</b>	<b>\$ 464,084</b>	<b>\$ 1,094,586</b>
<b><u>Fund Balance/Net Assets</u></b>			
<b>Fund Balance</b>			
Reserved for unspent grant monies	\$ 23,408		
Unreserved, undesignated	3,703,999		
<b>Total Fund Balance</b>	<b>\$ 3,727,407</b>	<b>\$ (3,727,407)</b>	
<b>Total Liabilities and Fund Balance</b>	<b>\$ 4,357,909</b>		
<b>Net Assets</b>			
Invested in capital assets		\$ 111,634	\$ 111,634
Unrestricted		3,263,323	3,263,323
<b>Total Net Assets</b>		<b>\$ 3,374,957</b>	<b>\$ 3,374,957</b>

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

***EXHIBIT 1***  
***(Continued)***

**GENERAL FUND BALANCE SHEET AND  
GOVERNMENTAL ACTIVITIES - STATEMENT OF NET ASSETS  
WITH ADJUSTMENTS TO CONVERT MODIFIED TO FULL ACCRUAL  
DECEMBER 31, 2006**

	<b>General Fund</b>	<b>Reconciliation</b>	<b>Governmental Activities</b>
<b>Reconciliation of the General Fund Balance to Net Assets</b>			
Fund Balance - General Fund			\$ 3,727,407
Capital assets are reported on the Statement of Net Assets but not on the Fund Balance Sheet.			111,634
Long-term liabilities are reported on the Statement of Net Assets but not on the Fund Balance Sheet.			(464,084)
<b>Net Assets - Governmental Activities</b>			<b>\$ 3,374,957</b>

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

**EXHIBIT 2**

**GENERAL FUND STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE  
AND GOVERNMENTAL ACTIVITIES - STATEMENT OF ACTIVITIES  
WITH ADJUSTMENTS TO CONVERT MODIFIED TO FULL ACCRUAL  
FOR THE YEAR ENDED DECEMBER 31, 2006**

	<b>General Fund</b>	<b>Reconciliation</b>	<b>Governmental Activities</b>
<b>Revenues</b>			
Intergovernmental	\$ 9,010,229	\$ -	\$ 9,010,229
Charges for services	428,212	-	428,212
Investment earnings	117,915	-	117,915
Miscellaneous	192,099	-	192,099
	<b>\$ 9,748,455</b>	<b>\$ -</b>	<b>\$ 9,748,455</b>
<b>Expenditures/Expenses</b>			
<b>Current</b>			
<b>Human services</b>			
Income maintenance	\$ 3,258,486	\$ 45,042	\$ 3,303,528
Social services	7,922,694	67,561	7,990,255
	<b>\$ 11,181,180</b>	<b>\$ 112,603</b>	<b>\$ 11,293,783</b>
<b>Net Change in Fund Balance/Net Assets</b>	<b>\$ (1,432,725)</b>	<b>\$ (112,603)</b>	<b>\$ (1,545,328)</b>
<b>Fund Balance/Net Assets - January 1</b>	<b>5,160,132</b>	<b>(239,847)</b>	<b>4,920,285</b>
<b>Fund Balance/Net Assets - December 31</b>	<b>\$ 3,727,407</b>	<b>\$ (352,450)</b>	<b>\$ 3,374,957</b>

**Reconciliation of the Statement of General Fund Revenues, Expenditures, and Changes in Fund Balance to the Statement of Activities - Governmental Activities**

**Net Change in Fund Balance** **\$ (1,432,725)**

Governmental funds report capital outlays 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.

Capital outlay expenditures	\$ 13,630	
Current year depreciation expense	(78,779)	(65,149)

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.

(Increase) decrease in compensated absences payable		(47,454)
---	--	----------

**Change in Net Assets of Governmental Activities** **\$ (1,545,328)**

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

**EXHIBIT 3**

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE  
BUDGETARY COMPARISON  
FOR THE YEAR ENDED DECEMBER 31, 2006**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
<b>Revenues</b>				
Intergovernmental	\$ 9,316,633	\$ 9,316,633	\$ 9,010,229	\$ (306,404)
Charges for services	231,500	231,500	428,212	196,712
Interest on investments	107,000	107,000	117,915	10,915
Miscellaneous	385,500	385,500	192,099	(193,401)
<b>Total Revenues</b>	<b>\$ 10,040,633</b>	<b>\$ 10,040,633</b>	<b>\$ 9,748,455</b>	<b>\$ (292,178)</b>
<b>Expenditures</b>				
<b>Current</b>				
<b>Human services</b>				
Income maintenance	\$ 2,812,100	\$ 2,812,100	\$ 3,258,486	\$ (446,386)
Social services	7,448,020	7,448,020	7,922,694	(474,674)
<b>Total Expenditures</b>	<b>\$ 10,260,120</b>	<b>\$ 10,260,120</b>	<b>\$ 11,181,180</b>	<b>\$ (921,060)</b>
<b>Net Change in Fund Balance</b>	<b>\$ (219,487)</b>	<b>\$ (219,487)</b>	<b>\$ (1,432,725)</b>	<b>\$ (1,213,238)</b>
<b>Fund Balance - January 1</b>	<b>5,160,132</b>	<b>5,160,132</b>	<b>5,160,132</b>	<b>-</b>
<b>Fund Balance - December 31</b>	<b>\$ 4,940,645</b>	<b>\$ 4,940,645</b>	<b>\$ 3,727,407</b>	<b>\$ (1,213,238)</b>

**FIDUCIARY FUND**

This page was left blank intentionally.

LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA

*EXHIBIT 4*

STATEMENT OF FIDUCIARY NET ASSETS  
AGENCY FUND  
DECEMBER 31, 2006

Assets

Cash and pooled investments	<u>\$ 58,677</u>
-----------------------------	------------------

Liabilities

Due to other governments	<u>\$ 58,677</u>
--------------------------	------------------

This page was left blank intentionally.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS  
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2006**

---

---

1. Summary of Significant Accounting Policies

Lincoln, Lyon, & Murray Human Services' financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as of and for the year ended December 31, 2006. 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 the Human Services are discussed below.

A. Financial Reporting Entity

Lincoln, Lyon, & Murray Human Services was formed pursuant to Minn. Stat. § 393.01, subd. 7, by Lincoln, Lyon, and Murray Counties. The Human Services began official operation on July 1, 1974, and performs welfare functions formerly performed by the individual counties. Local financing is provided by the three member counties on the basis of each county's welfare expenditures in 1973. Percentages are:

Lincoln County	20.90%
Lyon County	54.77
Murray County	24.33

Lincoln, Lyon, & Murray Human Services is governed by two County Commissioners from each of the participating counties, who are chosen by their respective county boards, and one lay person from each participating county. In 1999, the Human Services changed its name from the Region VIII North Welfare Board.

Lincoln, Lyon, & Murray Human Services is an independent joint venture and is not included in any of the member counties' reporting entities.

Joint Ventures

Lincoln, Lyon, & Murray Human Services participates in a joint venture which is described in Note 6.B.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

---

1. Summary of Significant Accounting Policies (Continued)

B. Basic Financial Statements

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

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

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

Additionally, the Human Services reports a fiduciary fund type, which is excluded from the governmental activities. The Agency Fund is custodial in nature and does not present result of operations or have a measurement focus. This fund accounts for assets that the Human Services holds for the Collaborative in an agent capacity.

C. Measurement Focus and Basis of Accounting

The governmental activities and fiduciary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. 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. Lincoln, Lyon, & Murray Human Services considers all revenues as available if collected within

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

---

1. Summary of Significant Accounting Policies

C. Measurement Focus and Basis of Accounting (Continued)

60 days after the end of the current period. Charges for services and interest are considered susceptible to accrual. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general 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 the Human Services' policy to use restricted resources first and then unrestricted resources as needed.

D. Assets, Liabilities, and Net Assets or Equity

1. Deposits and Investments

Deposits and investments are reported at their fair value at December 31, 2006, based on market prices.

Under the direction of the Investment Committee and the Board, most cash transactions are administered by the Lyon County Auditor/Treasurer.

Lincoln, Lyon, & Murray Human Services invests in an external investment pool, the Minnesota Association of Governments Investing for Counties (MAGIC) Fund, which is created under a joint powers agreement pursuant to Minn. Stat. § 471.59. The MAGIC Fund is not registered with the Securities and Exchange Commission, but does operate in a manner consistent with Rule 2a7 of the Investment Company Act of 1940. Therefore, the fair value of Lincoln, Lyon, & Murray Human Services' position in the pool is the same as the value of the pool shares.

2. Receivables

The financial statements for the Human Services contain no allowance for uncollectible accounts. Uncollectible amounts due for receivables are recognized as bad debts at the time information becomes available that indicates the uncollectibility of the particular receivable. These amounts are not considered to be material in relation to the financial position or operations of the fund.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

---

---

1. Summary of Significant Accounting Policies

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

3. Capital Assets

Capital assets, which include office furniture and equipment and automotive equipment, are reported in the governmental activities column in the Statement of Net Assets. Capital assets are defined as assets with an initial, individual cost of more than \$1,500 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.

Office furniture and equipment and automotive equipment are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Office furniture and equipment	3 to 10
Automotive equipment	5

4. Compensated Absences

The liability for compensated absences reported in financial statements consists of unpaid, accumulated annual and sick leave balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. Compensated absences are accrued when incurred in the fund 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.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

---

1. Summary of Significant Accounting Policies

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

5. Deferred Revenue

Governmental funds and the government-wide statements defer revenue recognition in connection with 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 Liabilities

Long-term liabilities are not reported in the fund. The General Fund reports only liabilities expected to be financed with available, spendable financial resources. The Statement of Net Assets reports long-term liabilities of the governmental activities.

7. Fund Equity

The fund financial statements 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. The Human Services reported no designations for the year ended December 31, 2006.

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.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

---

2. Stewardship, Compliance, and Accountability

Excess of Expenditures Over Budget

Fund	Expenditures	Budget	Excess
General	\$ 11,181,180	\$ 10,260,120	\$ 921,060

3. Detailed Notes

A. Assets

1. Deposits and Investments

Deposits

Minn. Stat. §§ 118A.02 and 118A.04 authorize Lincoln, Lyon, & Murray Human Services to designate a depository for public funds and to invest in certificates of deposit. Minn. Stat. § 118A.03 requires that all Human Services' deposits be protected by insurance, surety bond, or collateral. The market value of collateral pledged shall be at least ten percent more than the amount on deposit plus accrued interest at the close of the financial institution's banking day not covered by insurance or bonds.

Authorized collateral includes treasury bills, notes, and bonds; issues of U.S. government agencies; general obligations rated "A" or better, revenue obligations rated "AA" or better; irrevocable standby letters of credit issued by the Federal Home Loan Bank; and certificates of deposit. Minnesota statutes require that securities pledged as collateral be held in safekeeping in a restricted account at the Federal Reserve Bank or in an account at a trust department of a commercial bank or other financial institution not owned or controlled by the financial institution furnishing the collateral.

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a financial institution failure, the Human Services' deposits may not be returned to it. The Human Services does not have a policy for custodial credit risk. As of December 31, 2006, the Human Services' deposits were not exposed to custodial credit risk.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

---

3. Detailed Notes

A. Assets

1. Deposits and Investments (Continued)

Investments

Minn. Stat. §§ 118A.04 and 118A.05 generally authorize the following types of investments as available to Lincoln, Lyon, & Murray Human Services:

- (1) securities which are direct obligations or are guaranteed or insured issues of the United States, its agencies, its instrumentalities, or organizations created by an act of Congress, except mortgage-backed securities defined as “high risk” by Minn. Stat. § 118A.04, subd. 6;
- (2) mutual funds through shares of registered investment companies provided the mutual fund receives certain ratings depending on its investments;
- (3) general obligations of the State of Minnesota and its municipalities, and in certain state agency and local obligations of Minnesota and other states provided such obligations have certain specified bond ratings by a national bond rating service;
- (4) bankers’ acceptances of United States banks;
- (5) commercial paper issued by United States corporations or their Canadian subsidiaries rated in the highest quality category by two nationally recognized rating agencies and maturing in 270 days or less; and
- (6) with certain restrictions, in repurchase agreements, securities lending agreements, joint powers investment trusts, and guaranteed investment contracts.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

---

3. Detailed Notes

A. Assets

1. Deposits and Investments

Investments (Continued)

Interest Rate Risk

Interest rate risk is the risk that changes in the market interest rates will adversely affect the fair value of an investment. The Human Services minimizes its exposure to interest rate risk by investing in both short-term and long-term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. It is the Human Services' policy to invest only in securities that meet the ratings requirements set by state statute.

Custodial Credit Risk

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities in the possession of an outside party.

Concentration of Credit Risk

The concentration of credit risk is the risk of loss that may be caused by the Human Services' investment in a single issuer. The Human Services does not have a policy that addresses this risk but currently invests only in certificates of deposit and the MAGIC Fund external investment pool.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

3. Detailed Notes

A. Assets

1. Deposits and Investments (Continued)

At December 31, 2006, the Human Services had the following deposits and investments.

Petty cash and change funds	\$ 540
Cash in bank	1,464,640
MAGIC Fund	1,392,332
Certificates of deposit	650,000
Total Cash and Investments	\$ 3,507,512

As reported in the financial statements:

Governmental activities	
Cash and pooled investments	\$ 3,448,295
Petty cash and change funds	540
Agency Fund	
Cash and pooled investments	58,677
Total	\$ 3,507,512

2. Receivables

The Human Services did not have any receivables scheduled to be collected beyond one year as of December 31, 2006.

3. Capital Assets

Capital asset activity for the year ended December 31, 2006, was as follows:

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets depreciated				
Office furniture and equipment	\$ 227,911	\$ -	\$ -	\$ 227,911
Automotive equipment	225,403	13,630	18,179	220,854
Total capital assets depreciated	\$ 453,314	\$ 13,630	\$ 18,179	\$ 448,765

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

---

3. Detailed Notes

A. Assets

3. Capital Assets (Continued)

	Beginning Balance	Increase	Decrease	Ending Balance
Less: accumulated depreciation for				
Office furniture and equipment	\$ 136,012	\$ 40,110	\$ -	\$ 176,122
Automotive equipment	140,519	38,669	18,179	161,009
Total accumulated depreciation	\$ 276,531	\$ 78,779	\$ 18,179	\$ 337,131
Total Capital Assets				
Depreciated, Net	\$ 176,783	\$ (65,149)	\$ -	\$ 111,634

Depreciation expense was charged to income maintenance and social services programs for the year ended December 31, 2006.

B. Liabilities

1. Retired Employee Health Insurance Benefits

The Human Services pays the health and dental insurance for qualified employees who retire between the ages of 55 and 65, have worked for the Human Services for at least 15 years, and are receiving a disability benefit or Public Employees Retirement Association of Minnesota (PERA) annuity, or who have met age and service requirements necessary to receive a PERA annuity. These employees are entitled to receive four percent per year of service toward the employee's health and dental insurance premium. The coverage shall discontinue at age 65 and/or when they become Medicare eligible, or until they obtain work in which insurance benefits are available to them as an individual at no cost.

The Human Services' contributions for the year ended December 31, 2006, were for ten employees, for a total of \$60,228. The Human Services records the expenditures for retired employees' health and dental insurance benefits in the year paid and does not accrue a liability for future benefits.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

---

3. Detailed Notes

B. Liabilities (Continued)

2. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2006, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Compensated absences	\$ 416,630	\$ 47,454	\$ -	\$ 464,084	\$ 49,286

4. Pension Plans

A. Plan Description

All full-time and certain part-time employees of Lincoln, Lyon, & Murray Human Services are covered by defined benefit plans administered by PERA. PERA administers the Public Employees Retirement Fund, which is a cost-sharing, multiple-employer retirement plan. The plan is established and administered in accordance with Minn. Stat. chs. 353 and 356.

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.

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

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

---

4. Pension Plans

A. Plan Description (Continued)

first ten years of service and 1.7 percent for each successive year. Using Method 2, the annuity accrual rate is 2.7 percent of average salary for Basic Plan members and 1.7 percent for Coordinated Plan members for each year of service.

For Public Employees Retirement Fund members whose annuity is calculated using Method 1, 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.

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

PERA issues a publicly available financial report that includes financial statements and required supplementary information for the Public Employees Retirement Fund. 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, 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. The Human Services 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 are required to contribute 9.10 and 5.50 percent, respectively, of their annual covered salary in 2006. Contribution rates in the Coordinated Plan increased in 2007 to 5.75 percent. The Human Services is required to contribute the following percentages of annual covered payroll:

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

---

4. Pension Plans

B. Funding Policy (Continued)

In 2006	
Public Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	6.00
In 2007	
Public Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	6.25

The Human Services' contributions for the years ending December 31, 2006, 2005, and 2004, were \$218,324, \$197,630, and \$190,578, respectively, equal to the contractually required contributions for each year as set by state statute.

5. Risk Management

Lincoln, Lyon, & Murray Human Services is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; injuries to employees; or natural disasters. The Human Services has entered into a joint powers agreement with Minnesota counties to form the Minnesota Counties Insurance Trust (MCIT). For all other risk, the Human Services carries commercial insurance. There were no significant reductions in insurance from the prior year. The amount of settlements did not exceed insurance coverage for each of the past three fiscal years.

The Workers' Compensation Division of MCIT is self-sustaining based on the contributions charged, so that total contributions plus compounded earnings on these contributions will equal the amount needed to satisfy claims liabilities and other expenses.

MCIT participates in the Workers' Compensation Reinsurance Association with coverage at \$390,000 per claim in 2006 and \$400,000 per claim in 2007. Should the MCIT Workers' Compensation Division liabilities exceed assets, MCIT may assess the Human Services in a method and amount to be determined by MCIT.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

---

5. Risk Management (Continued)

The Property and Casualty Division of MCIT is self-sustaining, and the Human Services pays an annual premium to cover current and future losses. MCIT carries reinsurance for its property lines to protect against catastrophic losses. Should the MCIT Property and Casualty Division liabilities exceed assets, MCIT may assess the Human Services in a method and amount to be determined by MCIT.

6. 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 Lincoln, Lyon, & Murray Human Services expects such amounts, if any, to be immaterial.

Lincoln, Lyon, & Murray Human Services is a defendant in various lawsuits. Although the outcome of these lawsuits is not presently determinable, in the opinion of the Human Services' attorney, the resolution of these matters will not have a material adverse effect on the financial condition of the government.

B. Joint Venture

Southwestern Minnesota Adult Mental Health Consortium Board

In November 1997, Lincoln, Lyon, & Murray Human Services entered into a joint powers agreement with several counties creating and operating the Southwestern Minnesota Adult Mental Health Consortium Board under the authority of Minn. Stat. § 471.59. The Consortium Board is headquartered in Windom, Minnesota, where Cottonwood County acts as fiscal host.

The Consortium Board shall take actions and enter into such agreements as may be necessary to plan and develop within the Consortium Board's geographic jurisdiction a system of care that will serve the needs of adults with serious and persistent mental illness. The governing board is composed of one board member from each of the participating counties. Financing is provided by state proceeds or appropriations for the development of the system of care.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

---

6. Summary of Significant Contingencies and Other Items

B. Joint Venture

Southwestern Minnesota Adult Mental Health Consortium Board (Continued)

The following is a summary of the Consortium Board's annual financial report for the year ended December 31, 2005 (the latest information available):

Total assets	\$ 1,148,132
Total liabilities	497,546
Total net assets	650,586
Total revenues	1,960,287
Total expenditures	1,671,076
Net change in net assets	289,211

The Consortium Board reported no long-term obligations at December 31, 2005.

A complete financial report of the Southwestern Minnesota Adult Mental Health Consortium Board can be obtained at Cottonwood County Family Services Agency, Windom, Minnesota 56101.

This page was left blank intentionally.

**SUPPLEMENTARY INFORMATION**

This page was left blank intentionally.

LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA

*Statement 1*

STATEMENT OF CHANGES IN ASSETS AND LIABILITIES  
AGENCY FUND  
FOR THE YEAR ENDED DECEMBER 31, 2006

	<u>Balance January 1</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance December 31</u>
<b><u>COLLABORATIVE</u></b>				
<b><u>Assets</u></b>				
Cash and pooled investments	<u>\$ -</u>	<u>\$ 166,094</u>	<u>\$ 107,417</u>	<u>\$ 58,677</u>
<b><u>Liabilities</u></b>				
Due to other governments	<u>\$ -</u>	<u>\$ 166,094</u>	<u>\$ 107,417</u>	<u>\$ 58,677</u>

This page was left blank intentionally.

**SUPPORTING SCHEDULE**

This page was left blank intentionally.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

**Schedule 1**

**SCHEDULE OF INTERGOVERNMENTAL REVENUE  
FOR THE YEAR ENDED DECEMBER 31, 2006**

<b>Shared Revenue</b>	
Payments from participating counties	<u>\$ 3,992,395</u>
<b>Reimbursement for Services</b>	
<b>State</b>	
Minnesota Department of Human Services	<u>\$ 2,329,133</u>
<b>Payments</b>	
<b>Local</b>	
McKnight	<u>\$ 39,512</u>
<b>Grants</b>	
<b>State</b>	
Minnesota Department of Human Services	<u>\$ 1,866,358</u>
<b>Federal</b>	
Department of	
Agriculture	\$ 9,610
Health and Human Services	<u>773,221</u>
<b>Total Federal</b>	<u>\$ 782,831</u>
<b>Total State and Federal Grants</b>	<u>\$ 2,649,189</u>
<b>Total Intergovernmental Revenue</b>	<u><u>\$ 9,010,229</u></u>

This page was left blank intentionally.



This page was left blank intentionally.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

*Schedule 2*

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED DECEMBER 31, 2006**

**I. SUMMARY OF AUDITOR'S RESULTS**

- A. Our report expresses an unqualified opinion on the basic financial statements of Lincoln, Lyon, & Murray Human Services.
- B. Significant deficiencies in internal control were disclosed by the audit of financial statements of Lincoln, Lyon, & Murray Human Services and are reported in the "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*." Some of the significant deficiencies are material weaknesses.
- C. No instances of noncompliance material to the financial statements of Lincoln, Lyon, & Murray Human Services were disclosed during the audit.
- D. No matters involving internal control over compliance relating to the audit of the major federal award program were reported in the "Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133."
- E. The Auditor's Report on Compliance for the major federal award program for Lincoln, Lyon, & Murray Human Services expresses an unqualified opinion.
- F. No findings were disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133.
- G. The major program was:
  - Social Services Block Grant Title XX
  - CFDA #93.667
- H. The threshold for distinguishing between Types A and B programs was \$300,000.
- I. Lincoln, Lyon, & Murray Human Services was determined to be a low-risk auditee.

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

INTERNAL CONTROL

ITEMS ARISING THIS YEAR

06-1 Internal Accounting Controls - Segregation of Duties

Due to the limited number of office personnel within Lincoln, Lyon, & Murray Human Services, segregation of the accounting functions necessary to ensure adequate internal accounting control is not always possible. Lincoln, Lyon, & Murray Human Services does not segregate the duties of cash receipting and disbursing from one accounting technician. Also, the same person has the ability to make journal entries and maintain the general ledger.

One basic objective of internal control is to provide for segregation of incompatible duties. In other words, responsibilities should be separated among employees so that a single employee is not able to authorize a transaction, record the transaction in accounts, and be responsible for custody of the asset resulting from the transaction. The following duties should be segregated if possible:

- Someone independent of the cash collection and receipting function and the cash disbursement function should prepare bank reconciliations. If this is not possible, someone independent of these functions should review the bank reconciliations.
- Individuals who collect and receipt cash should not also:
  - post cash receipts to the general ledger system,
  - process cash disbursements,
  - maintain the general ledger,
  - make bank deposits,
  - make wire transfers,
  - make general journal entries, and
  - prepare billings.
- Individuals who process invoices for payments should not also:
  - print or sign checks and
  - make journal entries.

We recommend that Human Services management segregate these duties within the accounting functions as much as possible by limiting access to accounting programs commensurate to the employees' duties and job responsibilities. If it is not possible to segregate these duties, management should be aware of the lack of segregation of duties and implement oversight procedures to ensure the integrity and reliability of the financial information in the accounting system. One possible oversight procedure would be to include the distribution of the detailed monthly revenue and expenditure reports to the Human Services Board members for their review and approval.

Client's Response:

*We will further segregate duties in the accounting department so that a single employee is not able to authorize a transaction, record the transaction in accounts, and be responsible for custody of the assets resulting from the transaction.*

06-2 Budgeting Procedures

Human Services adopts a summarized budget for the General Fund. Approval of the revenues and expenditures budget was not documented in the Board minutes. As a result, the detail of estimated revenue sources for the fund and the budgeted expenditures by fund, function, and department are not always clearly documented. In addition, the Board has not developed and adopted a budget policy for management's administration of the budget.

Before audit adjustments to the budget, Human Services had recorded the use of excess reserves as a revenue item which materially misstated the unaudited budgetary comparison schedule.

We recommend the Human Services Board adopt and record in its minutes the budget by major revenue source and estimated expenditures by function and department for its operational fund. After adoption, someone independent of the budget process should enter the original budget and budget amendments to the general ledger. In addition, we also recommend that the Board develop and adopt budget policies and procedures to include the following elements:

- the legal level of control,
- when budgets can be modified by management and when budget modifications require Board approval,
- the budgetary basis on which the budget is adopted, and
- procedures for monitoring the budget.

Client's Response:

*We will establish a formal budget policy as suggested above. In 2007, we have already demonstrated some of the proposed changes.*

06-3 Antifraud Programs and Controls

Responses of management and staff regarding the risks of fraud and how Lincoln, Lyon, & Murray Human Services addresses those risks indicate deficiencies in antifraud programs and controls. The written responses of the five individuals sampled show the following deficiencies:

- one individual (Board Chair) responded with a “?” as to how management communicates to employees the importance of ethical behavior;
- one individual (an accounting technician) stated, “the Board and the state auditors monitor the accounting staff . . .” relating to how programs or controls to address identified fraud risk are monitored; and,
- three individuals (Director, Assistant Director, and Administrative Assistant) refer to a situation where one employee over-estimated budgeted revenues from 2003 through 2006, which reduced actual fund balance of the Human Services and was not noticed until the employee retired from service.

The Committee of Sponsoring Organizations (COSO) of the Treadway Commission's Internal Control – Integrated Framework specifies five components of an effective antifraud program: (1) performing fraud risk assessments, (2) creating a control environment, (3) designing and implementing antifraud control activities, (4) sharing information and communication, and (5) monitoring activities.

Human Services should communicate its philosophy on antifraud programs and controls throughout the organization. This should help ensure that employees understand the antifraud activities in place, know what is expected of them, and realize the organization takes fraud risks and prevention very seriously. All levels of the organization should have involvement in these communications and, if appropriate, communications should also be made to external parties (including clients, suppliers, and agents).

The Office of the State Auditor (OSA) is an external, independent audit organization. Relying on the OSA's expertise and knowledge to identify fraud risks is not permissible as the OSA is not part of the organization's internal control system.

A control deficiency 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 misstatements on a timely basis. A budget policy should be adopted that describes the budget approval process. Management and the Board should review the detailed budget information to help ensure proper amounts are approved by the Board and to find errors in a timely manner.

We recommend Human Services improve internal controls over antifraud programs and controls. The controls should address all five components of an effective antifraud program according to the COSO framework. We encourage Human Services to not only obtain the training and expertise to implement a program that prevents, deters, and detects fraud, but also to monitor and test the controls in place to evaluate whether the controls are operating effectively and in the intended manner.

Client's Response:

*We will establish protocol of notice and obligations to LLMHS staff and Board members that illustrate antifraud programs and controls.*

06-4 Preparation of Financial Statements

Human Services is required to prepare financial statements in accordance with generally accepted accounting principles (GAAP). The preparation of the financial statements is the responsibility of the Human Services' management. Financial statement preparation in accordance with GAAP requires internal controls over both: (1) recording, processing, and summarizing accounting data (maintaining internal books and records) and (2) preparing and reporting appropriate government-wide and fund financial statements, including the related notes to the financial statements.

As is the case with many small and medium-sized entities, Human Services has relied on its independent external auditors to assist in the preparation of the basic financial statements, including notes to the financial statements, as part of its external financial reporting process. Accordingly, the Human Services' ability to prepare financial statements in accordance with GAAP is based, at least in part, on its reliance on its external auditors, who cannot by definition be considered part of the government's internal control. This condition was caused by the Human Services' decision that it is more cost-effective to have its auditors prepare its annual basic financial statements than to incur the time and expense of obtaining the necessary training and expertise required to prepare the financial statements internally.

We recommend the Human Services obtain the training and expertise to internally prepare its annual financial statements in accordance with GAAP. If the Human Services still intends to have the State Auditor's staff assist in preparation then, at a minimum, they must identify and train individuals to obtain the expertise so that they can sufficiently review, understand and approve the financial statements, including notes. As an alternative, the Human Services could consider hiring an outside consultant to assist in preparing its basic financial statements.

Client's Response:

*We will consider available options and will comply.*

06-5 Access to the Computer Systems - Passwords

Control over computer passwords needs to be strengthened. The Human Services uses a minimum password length of only five characters, and sets no limitations on passwords such as requiring a number, not allowing adjacent characters, or not allowing multiple repeated strokes of the same key. Weak control over access to the computer systems increases the risk of access to the system by unauthorized individuals.

We recommend that management strengthen access controls to the information system by changing employee passwords on a regular basis and using strong password systems which include longer and more randomized characters. Also, we recommend that the Human Services review access for all users to ensure that their access is commensurate with their job duties and responsibilities.

Client's Response:

*We are currently working on this area with our IT supervisor and will strengthen password requirements.*

06-6 Accounting Policies and Procedures Manual

The Human Services does not have a current and comprehensive accounting policies and procedures manual. All governments should document their accounting policies and procedures. Although other methods might suffice, this documentation is traditionally in the form of an accounting policies and procedures manual. This manual should document the accounting policies and procedures which make up the Human Services' internal control system.

An accounting policies and procedures manual will enhance employees' understanding of their role and function in the internal control system, establish responsibilities, provide guidance for employees, improve efficiency and consistency of transaction processing, and improve compliance with established policies. It can also help to prevent deterioration of key elements in the Human Services' internal control system and can help to avoid circumvention of Human Services policies.

We recommend the Human Services establish an accounting policies and procedures manual. The accounting policies and procedures manual should be prepared by appropriate levels of management and be approved by the Board to emphasize its importance and authority. The documentation should describe procedures as they are intended to be performed, indicate which employees are to perform which procedures, and explain the design and purpose of control-related procedures to increase employee understanding and support for controls.

Client's Response:

*We will develop a current and comprehensive accounting policy and procedure manual that will enhance employees' understanding of their role and function in the internal control system, establish responsibilities, provide guidance for employees, improve efficiency and consistency of transaction process, and improve compliance with established policies.*

06-7 Capital Assets Policies and Procedures

For financial reporting and asset management purposes, Human Services is required to keep records of its capital assets, including infrastructure. Human Services maintains its capital asset records on a separate software system. Capital asset additions and deletions are entered into this system, and depreciation is calculated by the system. Capital asset policies utilized by Human Services in maintaining the capital asset system have not been formally approved. A capital assets policy should be adopted which defines the Human Services' accounting policies over capital assets, such as capitalization thresholds, useful lives, and depreciation methods.

The Human Services is carrying a significant amount of fully depreciated assets. Typically, a capital asset still in use should not be considered fully depreciated. For significant assets, the estimated useful lives assigned to capital assets should be reconsidered. At the time of re-determination, the estimated useful life of an asset includes both the years the asset has been in service and the estimated number of years of service remaining.

We recommend Human Services establish a capital assets policy to define the Human Services' accounting policies over capital assets. The Board should also establish policies and procedures to identify capital asset additions and deletions. We recommend a physical inventory of capital assets be performed periodically. This physical inventory can be rotated so that a portion of the capital assets is inventoried each year. Each asset should be counted at least once every four years. Some critical capital assets may need more frequent accounting.

Client's Response:

*We will develop a comprehensive Capital Assets policy and reassess the useful life of our fully depreciated assets.*

06-8 Computer Risk Management

The Human Services has not developed a formal plan to identify and manage risks associated with its computer system.

Risk management begins with a risk assessment of the computer system to identify those risks that could negatively influence computer operations. Internal controls should be implemented to reduce the identified risks. Those controls should be documented in a well-maintained policies and procedures manual, which should be communicated to the

Human Services' staff. Staff adherence to these policies and procedures should be monitored. Because computer systems are ever-changing, the Human Services should include in its plan periodic reassessment of risk to ensure existing internal controls are still effective.

We recommend the Human Services Board develop a plan to ensure that internal controls are in place to reduce the risk associated with the Human Services' computer systems.

Client's Response:

*We are currently reviewing profiles of staff with access to IFS and will be adjusting profiles to be "job required."*

06-9 Adding New Vendors to the Accounting System

The Human Services does not have any procedures for determining if new vendors have been added to the accounts payable system or if the new vendors added are legitimate vendors.

The ability to set up new vendors on the accounts payable system should be limited to those individuals with a logical need for this function. In addition, periodically, a report called "Vendors Added List By Number" should be printed and should be reviewed by someone independent of the accounts payable system. That person should document the review by signing off on the report.

Also, when invoices are submitted for vendors who have not previously done business with the Human Services, some procedures should be required to verify whether the vendor is legitimate. Procedures could include looking up the vendor in the phone book or on the internet or requiring the company to send information about its business. Periodically, the vendor listing should be reviewed for old, unused vendors; and those vendors should be removed from the system.

Client's Response:

*This area will be addressed in our Accounting Policies and Procedures Manual, which will also include independent review.*

06-10 Accounting System Journal Entries

The Human Services limits access to the accounting system journal entry function to select employees. Most journal entries are made by the Administrative Assistant and one of the Accounting Technicians. The journal entries made to the accounting system are not reviewed or approved by anyone.

The ability to make journal entries on the accounting system is a powerful function because it allows those employees to make changes to the system. To prevent abuse of this function, access should be limited to those employees whose job duties require them to have this access.

We recommend that Human Services strengthen control over the journal entries by determining who has access to the journal entry function and determine whether there is a logical need for those employees to have access to this function. We also recommend a procedure be established to require review and approval of journal entries by someone other than the person making the journal entries. This person should obtain an understanding of the journal entry and its purpose before approval. The approval could be documented by signature on a journal entry form or a printed copy of the journal entry made. Supporting documentation or sufficient explanation should be attached to or included on the journal entry to explain why the journal entry is being made and who is making the journal entry. Journal entries should be filed in a manner that allows for their review should questions arise. A report should be generated from the accounting system that lists all journal entries made. The person charged with review and approval of journal entries should periodically review this report. Review of this report would ensure that no journal entries have been made that have not been submitted for review and approval.

Client's Response:

*We will add to the Accounting Policies and Procedures Manual and will comply.*

06-11 Audit Adjustments

A control deficiency 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 misstatements of the financial statements on a timely basis. One control deficiency that typically is considered significant is identification by the auditor of a material misstatement in the financial statements not initially identified by the entity's internal controls. During our audit, we proposed numerous adjustments that resulted in significant changes to the Human Services' financial statements. The adjustments

resulted from: management not sufficiently reviewing preliminary financial data relating to accruals; controls over calculating the proper amount of receivables did not detect an error, which resulted in the client understating receivables by \$293,554; errors made in recording transactions and with mapping of various account codes; and accounting staff not keeping current on accounting and financial reporting requirements. The inability to detect a material misstatement in the financial statement increases the likelihood that the financial statements could be not fairly presented.

We recommend that the Human Services review internal controls currently in place, then design and implement procedures to improve internal control over financial reporting to detect misstatements in the financial statements. The updated controls should include review of the balances and supporting documentation by a qualified individual to identify potential misstatements.

Client's Response:

*We will comply.*

06-12 Quarterly Fiscal Reports

When testing a sample of two fiscal reports for the third quarter of 2006, we noted that the amounts reported did not agree with the general ledger for either submission. Human Services under-reported various expenditures on the Social Services Expenditure and Grant Reconciliation (SEAGR) report for a net difference of \$29,836. Thirty of the 65 accounts reported on the SEAGR did not tie to what was found in the corresponding BRASS [Budgeting, Reporting, and Accounting for Social Services] codes in the general ledger. The Income Maintenance Expenditures Report for the third quarter also had differences.

The amounts submitted on fiscal reports to the Minnesota Department of Human Services (DHS) should be complete and accurate. All fiscal reports should be reviewed before submission to DHS.

We recommend that Lincoln, Lyon, & Murray Human Services contact DHS to check whether submitting corrected reports is possible. When completing fiscal reports in the future, review the information before submission to verify the amounts being reported are correct. Amounts in each BRASS code in the general ledger should tie to the corresponding code in the SEAGR report. If adjustments are made between accounts, the net effect on the SEAGR report should be zero.

Client's Response:

*Third quarter SEAGR will be redone, and we will work with DHS to request resubmission. Future reports will be reconciled by service code with the general ledger.*

**III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS**

None.

**IV. OTHER FINDINGS AND RECOMMENDATIONS**

A. MINNESOTA LEGAL COMPLIANCE

ITEMS ARISING THIS YEAR

06-13 Notice Required to Collect Collateral Upon Default by Bank

The depository pledge agreements between the Human Services and Wells Fargo and Bank of the West state that the Human Services is required to give notice of a failure, insolvency, or breach to the bank and wait at least three business days after the notice before the Human Services can collect the collateral from the custodian so the bank has time to cure the default.

Minn. Stat. § 118A.03, subd. 4, states, "The written assignment shall recite that, upon default, the financial institution shall release to the government entity on demand, free of exchange or any other charges, the collateral pledged."

We recommend that the Human Services' fiscal agent review this security agreement to ensure that it is consistent with the default language of Minn. Stat. § 118A.03, subd. 4, and that the required language is included.

Client's Response:

*We are working on this.*

06-14 Collateral Substitution - Depository Pledge Agreement

The depository pledge agreement between the Human Services and Bank of the West allows the bank to substitute eligible securities for any of the pledged collateral by providing the custodian with a substitution notice signed by an authorized representative of the bank.

Minn. Stat. § 118A.03, subd. 5, states:

“A financial institution may withdraw excess collateral or substitute other collateral after giving written notice to the governmental entity and receiving confirmation. The authority to return any delivered and assigned collateral rests with the governmental entity.”

The processes described by the bank do not meet this standard because they allow the financial institution to substitute collateral before it gives any notice to the governmental entity and receives approval.

We recommend that the Human Services’ fiscal agent review these procedural changes for compliance with Minn. Stat. § 118A.03, subd. 5.

Client’s Response:

*We will comply.*

06-15 Pledged Collateral Rating

Information was not on file with Human Services’ fiscal agent relating to the rating of some of the local government obligations pledged to Human Services by Bremer Bank.

Minn. Stat. § 118A.03, subd. 2, states that general obligation securities of any state or local government with taxing powers pledged as collateral shall be rated “A” or better by a national bond rating service. Ratings for the collateral pledged during the year should be checked and documented to ensure statutory compliance.

We recommend that the Human Services monitors its fiscal agent’s compliance with Minn. Stat. § 118A.03, subd. 2.

Client's Response:

*Done as of May 11, 2007.*

06-16 Depository Pledge Agreement

The Human Services does not have a depository pledge agreement for collateral pledged by Bremer Bank.

We recommend that the Human Services fiscal agent execute security agreements with all banks. The pledge agreement should be consistent with the language of Minn. Stat. § 118A.03.

Client's Response:

*We are working on this.*

06-17 Travel Claims/Disbursements

While reviewing travel claims, we noted that one hotel was paid twice for the same stay, and an un-itemized credit card receipt was used to support a hotel reimbursement.

Minn. Stat. § 471.38 provides that where claims can be itemized in the ordinary course of business, the board shall audit and allow the claim only after it has been reduced to writing in items. Minn. Stat. § 471.41 states that, "Every member of such board who shall audit and allow any claim required to be itemized, without the same having been first duly itemized and verified, shall be guilty of a gross misdemeanor."

We recommend that the Human Services follow Minn. Stat. § 471.38 and allow only claims to be paid that have the proper itemization, supporting documentation attached, and have been properly audited and verified by the officer authorized by law to audit and allow claims to be paid.

Client's Response:

*We will be amending our policy and will be training all staff regarding "itemized" receipts.*

B. OTHER ITEM FOR CONSIDERATION

Other Postemployment Benefits (OPEB)

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, similar to what Statements 25 and 27 did for government 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 Lincoln, Lyon, & Murray Human Services Board will need to address in order to comply with the statements are:

- determine if employees are provided OPEB;
- if OPEB are being provided, the Lincoln, Lyon, & Murray Human Services Board will have to determine whether it will advance fund the benefits or pay for them on a pay-as-you-go basis;

*Schedule 2*  
*(Continued)*

- if OPEB are being provided, and the Lincoln, Lyon, & Murray Human Services Board determines that the establishment of a trust is desirable in order to fund the OPEB, the Lincoln, Lyon, & Murray Human Services 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 Lincoln, Lyon, & Murray Human Services Board will have to decide whether to hire an actuary.

If applicable for Lincoln, Lyon, & Murray Human Services, GASB Statements 43 and 45 would be implemented for the years ended December 31, 2007 and 2008, respectively.

## **OTHER REQUIRED REPORTS**

This page was left blank intentionally.



REBECCA OTTO  
STATE AUDITOR

# STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

SUITE 500  
525 PARK STREET  
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)  
(651) 296-4755 (Fax)  
state.auditor@state.mn.us (E-mail)  
1-800-627-3529 (Relay Service)

## **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***

Board of Commissioners  
Lincoln, Lyon, & Murray Human Services

We have audited the financial statements of the governmental activities, the major fund, and the remaining fund information of Lincoln, Lyon, & Murray Human Services as of and for the year ended December 31, 2006, and have issued our report thereon dated August 9, 2007. 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 Lincoln, Lyon, & Murray Human Services' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Human Services' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Human Services' internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph of this section and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Human Services' ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Human Services' financial statements that is more than inconsequential will not be prevented or detected by the Human Services' internal control. We considered the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 06-1 through 06-12 to be significant deficiencies in internal control over financial reporting

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Lincoln, Lyon, & Murray Human Services' internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 06-1 through 06-4, 06-6, 06-7, and 06-9 through 06-12 to be material weaknesses.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether Lincoln, Lyon, & Murray Human Services' 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, Human Services complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Questioned Costs as items 06-13 through 06-17.

Also included in the Schedule of Findings and Questioned Costs is an other item for consideration. We believe this recommendation and information to be of benefit to the Human Services, and it is reported for that purpose.

Lincoln, Lyon, & Murray Human Services written responses to the significant deficiencies, material weaknesses, and legal compliance findings identified in our audit have not been subjected to any auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of Lincoln, Lyon, & Murray Human Services, management, others within the Human Services, and federal awarding agencies and pass-through entities 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

August 9, 2007

This page was left blank intentionally.



REBECCA OTTO  
STATE AUDITOR

# STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

SUITE 500  
525 PARK STREET  
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)  
(651) 296-4755 (Fax)  
state.auditor@state.mn.us (E-mail)  
1-800-627-3529 (Relay Service)

## REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of Commissioners  
Lincoln, Lyon, & Murray Human Services

### Compliance

We have audited the compliance of Lincoln, Lyon, & Murray Human Services with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended December 31, 2006. Lincoln, Lyon, & Murray Human Services major federal program is identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Human Services' management. Our responsibility is to express an opinion on the Human Services compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Lincoln, Lyon, & Murray Human Services compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Human Services' compliance with those requirements.

In our opinion, Lincoln, Lyon & Murray Human Services complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2006.

#### Internal Control Over Compliance

The management of Lincoln, Lyon, & Murray Human Services is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Human Services internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Human Services internal control over compliance.

A control deficiency in internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Human Services ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the Human Services internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by Human Services internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

#### Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the major fund, and the remaining fund information of Lincoln, Lyon, & Murray Human Services as of and for the year ended December 31, 2006, and have issued our report thereon dated August 9, 2007. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the Human Services' basic financial statements. The accompanying Schedule of

Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information 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.

This report is intended solely for the information and use of the Lincoln, Lyon & Murray Human Services, management, others within the Human Services, and federal awarding agencies and pass-through entities 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

August 9, 2007

This page was left blank intentionally.

**LINCOLN, LYON, & MURRAY HUMAN SERVICES  
MARSHALL, MINNESOTA**

Schedule 3

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED DECEMBER 31, 2006**

<b>Federal Grantor Pass-Through Agency Grant Program Title</b>	<b>Federal CFDA Number</b>	<b>Expenditures</b>
<b>U.S. Department of Agriculture</b>		
Passed Through Minnesota Department of Human Services State Administrative Matching Grants for Food Stamp Program	10.561	<b>\$ 9,610</b>
<b>U.S. Department of Health and Human Services</b>		
Passed Through Minnesota Department of Human Services Promoting Safe and Stable Families	93.556	\$ 103,084
Temporary Assistance for Needy Families (TANF)	93.558	209,895
Child Care and Development Block Grant	93.575	21,992
Child Welfare Services - State Grants	93.645	12,219
Foster Care - Title IV-E	93.658	120,331
Social Services Block Grant - Title XX	93.667	284,148
Chafee Foster Care Independence Program	93.674	8,846
Block Grants for Community Mental Health Services	93.958	12,706
<b>Total U.S. Department of Health and Human Services</b>		<b>\$ 773,221</b>
<b>Total Federal Awards</b>		<b>\$ 782,831</b>

Notes to Schedule of Expenditures of Federal Awards

1. The Schedule of Expenditures of Federal Awards presents the activity of federal award programs expended by Lincoln, Lyon, & Murray Human Services. The Human Services' reporting entity is defined in Note 1 to the financial statements.
2. The expenditures on this schedule are on the modified accrual basis of accounting.
3. During 2006, Lincoln, Lyon, & Murray Human Services did not pass any federal money to subrecipients.
4. Pass-through grant numbers were not assigned by the pass-through agencies.