

STATE OF MINNESOTA

Office of the State Auditor



**Rebecca Otto
State Auditor**

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

FOR THE YEAR ENDED DECEMBER 31, 2007

Description of the Office of the State Auditor

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

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

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

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

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

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

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

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

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

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

For the Year Ended December 31, 2007



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

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

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TWO HARBORS, MINNESOTA**

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

ORGANIZATION
DECEMBER 31, 2007

			<u>Term Expires</u>
Elected			
Commissioner	Thomas Clifford	District 1	January 2009
Commissioner	Derrick Goutermont	District 2	January 2011
Commissioner	Scott Larson	District 3	January 2009
Commissioner	Paul Bergman	District 4	January 2011
Commissioner	Lenore Johnson	District 5	January 2009
Attorney	Russell H. Conrow		January 2011
Auditor/Treasurer	Steven R. McMahon		January 2011
Recorder	Erica Koski		January 2011
Sheriff	Carey Johnson		January 2011
Appointed			
Assessor	Bruce Giddings		December 2008
Examiner of Titles	David Adams (St. Louis County)		Indefinite
Health Officer	Harold B. Leppink, M.D.		Indefinite
Highway Engineer	Alan Goodman		May 2008
Veterans Service Officer	George Scheidt		September 2008
Clerk of the Board	Wilma Rahn		Indefinite
Human Services			
Board Members	Thomas Clifford		January 2009
	Derrick Goutermont		January 2011
	Scott Larson		January 2009
	Paul Bergman		January 2011
	Lenore Johnson		January 2009
	Kathy Goedel		Indefinite
	Christine Johnson		Indefinite
Director	Dennis Henkel		Indefinite
Nursing Home			
Board Members	Thomas Clifford		December 2009
	Derrick Goutermont		December 2011
	Scott Larson		December 2009
	Paul Bergman		December 2011
	Lenore Johnson		December 2009
	Kathy Goedel		Indefinite
	Deade Johnson		Indefinite
Administrator	Susan Johnson		Indefinite

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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INDEPENDENT AUDITOR'S REPORT

Board of County Commissioners
Lake County

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lake County, Minnesota, as of and for the year ended December 31, 2007, including the Nursing Home Enterprise Fund as of and for the year ended September 30, 2007, which collectively comprise the County's basic financial statements. These financial statements are the responsibility of Lake County's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lake County as of December 31, 2007, including the Nursing Home Enterprise Fund at September 30, 2007, and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis and the required supplementary information listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required 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 financial statements that collectively comprise Lake County's basic financial statements. The supplementary information and other schedule listed in the table of contents are presented for purposes of additional analysis and are 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 1, 2008, on our consideration of Lake County's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

December 1, 2008

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

MANAGEMENT'S DISCUSSION AND ANALYSIS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2007
(Unaudited)**

Lake County's Management's Discussion and Analysis (MD&A) provides an overview of the County's financial activities for the fiscal year ended December 31, 2007. 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 County's financial statements.

FINANCIAL HIGHLIGHTS

- Governmental activities' total net assets are \$90,489,486, of which \$77,782,607 is invested in capital assets, net of related debt, and \$2,949,175 is restricted to specific purposes.
- Business-type activities have total net assets of \$2,166,823. Invested in capital assets, net of related debt, represents \$2,114,086 of the total.
- Lake County's net assets increased by \$5,517,544 for the year ended December 31, 2007. Of the increase, \$6,021,888 was an increase in the governmental activities' net assets; and \$504,344 represented a decrease in business-type activities' net assets. The Lake County Housing and Redevelopment Authority is shown as a "Discretely Presented Component Unit." The net assets of the County's discretely presented component unit decreased by \$143,008.
- The net cost of governmental activities was \$4,763,598 for the current fiscal year. The net cost was funded by general revenues and other items totaling \$10,785,486.
- Governmental funds' fund balances decreased by \$3,355,582.

OVERVIEW OF THE FINANCIAL STATEMENTS

This MD&A is intended to serve as an introduction to the basic financial statements. Lake County's basic financial statements consist of three parts: government-wide financial statements, fund financial statements, and notes to the financial statements. The MD&A (this section) and certain budgetary comparison schedules are required to accompany the basic financial statements and, therefore, are included as required supplementary information.

There are two government-wide financial statements. The Statement of Net Assets and the Statement of Activities provide information about the activities of the County as a whole and present a longer-term view of the County's finances. Fund financial statements report the County's operations in more detail than the government-wide statements by providing information about the County's most significant funds. For governmental activities, these statements tell how these services were financed in the short-term as well as what remains for future spending. The remaining statements provide financial information about activities for which the County acts solely as a trustee or agent for the benefit of those outside of the government.

Government-Wide Financial Statements--The Statement of Net Assets and the Statement of Activities

The statement of net assets and the statement of activities report information about the County as a whole and about its activities in a way that helps the reader determine whether the County's financial condition has improved or declined as a result of the year's activities. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the County's net assets and changes in them. You can think of the County's net assets--the difference between assets and liabilities--as one way to measure the County's financial health, or financial position. Over time, increases or decreases in the County's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors however, such as changes in the County's property tax base and the condition of County roads, to assess the overall health of the County.

In the statement of net assets and the statement of activities, we divide the County into three kinds of activities:

- Governmental activities--Most of the County's basic services are reported here, including general government, public safety, highways and streets, sanitation, human services, health, culture and recreation, conservation of natural resources, and economic development. Property taxes and state and federal grants finance most of these activities.
- Business-type activities--The County charges a fee to customers to help it cover all or most of the cost of services it provides. The County's nursing home activities are reported here.
- Component unit--The County includes another separate legal entity in its report. The entity, the Lake County Housing and Redevelopment Authority, is presented in a separate column. Although legally separate, this "component unit" is important because the County is financially accountable for it.

The government-wide financial statements can be found in Exhibits 1 and 2.

Fund Financial Statements

The fund financial statements provide detailed information about the most significant funds--not the County as a whole. Some funds are required to be established by state law and by bond covenants. However, the County Board establishes some funds to help it control and manage money for a particular purpose or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money. The County's two kinds of funds--governmental and proprietary--use different accounting methods.

- Governmental funds--Most of the County's basic services are reported in governmental funds, which focus on how money flows in and out of those funds and the balances left at year-end that are available for spending. These funds 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. The governmental fund statements provide a detailed short-term view of the County's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the County's programs. We describe the relationship (or differences) between governmental activities (reported in the statement of net assets and the statement of activities) and governmental funds in a reconciliation in a statement following each governmental fund financial statement.

The basic financial statements for governmental funds can be found in Exhibits 3 through 6.

- Proprietary funds--When the County charges customers for the services it provides--whether to outside customers or to other units of the County--these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the statement of net assets and the statement of activities. In fact, the County's proprietary funds are substantially the same as the business-type activities we report in the government-wide statements but provide more detail and additional information, such as cash flows, for proprietary funds.

Proprietary fund financial statements may be found in Exhibits 7 through 9.

Reporting the County's Fiduciary Responsibilities

The County is the trustee, or fiduciary, over assets that can be used only for the trust beneficiaries, based on the trust arrangement. All of the County's fiduciary activities are reported in a separate Statement of Fiduciary Net Assets. We exclude these activities from the County's other financial statements because the County cannot use these assets to finance its operations. The County is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

The fiduciary funds financial statement is Exhibit 10.

LAKE COUNTY AS A WHOLE

Our analysis below focuses on the net assets (Table 1) and changes in net assets (Table 2) of the County's governmental and business-type activities.

Table 1
Net Assets
(in Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2007	2006 (Restated)	2007	2006	2007	2006 (Restated)
Current and other assets	\$ 16,861	\$ 19,911	\$ 371	\$ 760	\$ 17,232	\$ 20,671
Capital assets	85,749	77,546	2,117	2,181	87,866	79,727
Total Assets	\$ 102,610	\$ 97,457	\$ 2,488	\$ 2,941	\$ 105,098	\$ 100,398
Long-term debt outstanding	\$ 9,016	\$ 10,342	\$ 79	\$ 71	\$ 9,095	\$ 10,413
Other liabilities	3,105	2,647	242	199	3,347	2,846
Total Liabilities	\$ 12,121	\$ 12,989	\$ 321	\$ 270	\$ 12,442	\$ 13,259
Net Assets						
Invested in capital assets, net of debt	\$ 77,782	\$ 70,782	\$ 2,114	\$ 2,176	\$ 79,896	\$ 72,958
Restricted	2,949	3,154	-	-	2,949	3,154
Unrestricted	9,758	10,532	53	495	9,811	11,027
Total Net Assets	\$ 90,489	\$ 84,468	\$ 2,167	\$ 2,671	\$ 92,656	\$ 87,139

Table 2
Changes in Net Assets
(in Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2007	2006 (Restated)	2007	2006	2007	2006 (Restated)
Revenues						
Program revenues						
Fees, fines, charges, and other	\$ 2,786	\$ 1,811	\$ 2,564	\$ 3,036	\$ 5,350	\$ 4,847
Operating grants and contributions	5,664	7,342	-	132	5,664	7,474
Capital grants and contributions	7,835	1,937	-	-	7,835	1,937
General revenues						
Property taxes	6,136	5,214	-	-	6,136	5,214
Other taxes	1,933	1,882	-	-	1,933	1,882
Unrestricted grants and contributions	1,891	2,098	-	2	1,891	2,100
Investment earnings	655	646	7	6	662	652
Miscellaneous	171	222	6	(71)	177	151
Total Revenues	\$ 27,071	\$ 21,152	\$ 2,577	\$ 3,105	\$ 29,648	\$ 24,257

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2007	2006 (Restated)	2007	2006	2007	2006 (Restated)
Expenses						
General government	\$ 3,808	\$ 3,983	\$ -	\$ -	\$ 3,808	\$ 3,983
Public safety	3,546	3,107	-	-	3,546	3,107
Culture and recreation	788	629	-	-	788	629
Highways and streets	7,229	4,848	-	-	7,229	4,848
Human services	3,592	3,854	3,081	3,275	6,673	7,129
Health	457	418	-	-	457	418
Sanitation	283	341	-	-	283	341
Conservation of natural resources	890	978	-	-	890	978
Economic development	48	48	-	-	48	48
Interest	409	341	-	-	409	341
Total Expenses	\$ 21,050	\$ 18,547	\$ 3,081	\$ 3,275	\$ 24,131	\$ 21,822
Increase (Decrease) in Net Assets	\$ 6,021	\$ 2,605	\$ (504)	\$ (170)	\$ 5,517	\$ 2,435
Net Assets, January 1 (restated)	84,468	81,863	2,671	2,841	87,139	84,704
Net Assets, December 31	<u>\$ 90,489</u>	<u>\$ 84,468</u>	<u>\$ 2,167</u>	<u>\$ 2,671</u>	<u>\$ 92,656</u>	<u>\$ 87,139</u>

Governmental Activities

The cost of all governmental activities this year was \$21,048,880. However, as shown in the Statement of Activities, the amount that our taxpayers ultimately financed for these activities through County taxes and other general revenues was only \$4,763,598, because some of the cost was paid by those who directly benefited from the programs (\$2,785,955) or by other governments and organizations that subsidized certain programs with grants and contributions (\$13,499,327).

Table 3 presents the cost of each of the County's five largest program functions, as well as each function's net cost (total cost, less revenues generated by the activities). The net cost shows the financial burden that was placed on the County's taxpayers by each of these functions.

Table 3
Governmental Activities
(in Thousands)

	Total Cost of Services		Net Cost of Services	
	2007	2006	2007	2006
Highways and streets	\$ 7,229	\$ 4,847	\$ (2,705)	\$ (319)
General government	3,808	3,983	1,897	2,178
Human services	3,592	3,854	1,655	1,734
Public safety	3,546	3,107	2,725	2,345
Conservation of natural resources	890	978	(125)	437
All others	1,985	1,778	1,317	1,082
Total	\$ 21,050	\$ 18,547	\$ 4,764	\$ 7,457

General Fund Budgetary Highlights

Over the course of the year, the County Board reviews the County's General Fund budget and may make budget amendments. These budget amendments fall into three categories: new information changing original budget estimations, greater than anticipated revenues or costs, and final agreement reached on employee contracts.

In the General Fund, the actual charges to appropriations (expenditures) were \$575,964 greater than the final budget amounts. Unbudgeted expenditures were almost totally in the public safety area and included expenditures of reserved 9-1-1 grant funds.

Resources available for appropriation were also above the final budgeted amount by \$1,099,676. Greater than expected collections in intergovernmental revenue, interest earnings, public safety grants, and miscellaneous revenues exceeded budgeted amounts.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of 2007, the County had \$87,866,000 invested in a broad range of capital assets, including land, buildings, highways and streets, and equipment. (See Table 4 below.)

Table 4
Capital Assets at Year-End
(Net of Depreciation, in Thousands)

	Governmental Activities		Business-Type Activities		Totals	
	2007	2006 (Restated)	2007	2006	2007	2006 (Restated)
Land	\$ 3,899	\$ 3,899	\$ 15	\$ 15	\$ 3,914	\$ 3,914
Buildings and improvements	12,218	11,811	1,984	2,060	14,202	13,871
Machinery, vehicles, furniture, and equipment	1,986	2,123	118	106	2,104	2,229
Infrastructure	67,646	59,713	-	-	67,646	59,713
Totals	\$ 85,749	\$ 77,546	\$ 2,117	\$ 2,181	\$ 87,866	\$ 79,727

The County's fiscal year 2008 capital budget calls for it to spend another \$4.3 million for capital projects, \$207 thousand for miscellaneous improvements at various buildings, and \$4.1 million for road construction. The road construction will be funded by state-aid construction funds.

Debt

At year-end, the County had \$7,014,163 in bonds and notes outstanding versus \$8,439,749 last year--a decrease of 16 percent--as shown in Table 5. Capital leases payable decreased by \$127,141.

Table 5
Outstanding Debt, at Year-End
(in Thousands)

	Governmental Activities		Business-Type Activities		Totals	
	2007	2006	2007	2006	2007	2006
General obligation bonds	\$ 6,620	\$ 7,870	\$ -	\$ -	\$ 6,620	\$ 7,870
Notes payable	394	570	-	-	394	570
Capital leases	2,103	2,230	3	5	2,106	2,235
Compensated absences	1,346	1,253	112	105	1,458	1,358
Total	<u>\$ 10,463</u>	<u>\$ 11,923</u>	<u>\$ 115</u>	<u>\$ 110</u>	<u>\$ 10,578</u>	<u>\$ 12,033</u>

The state limits the amount of net debt that the County can issue to two percent of the market value of all taxable property in the County. The County's outstanding net debt is below this state-imposed limit.

Other obligations include accrued vacation pay and sick leave payable. More detailed information about the County's long-term liabilities is presented in the notes to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The County's elected and appointed officials considered many factors when setting the fiscal year 2008 budget, tax rates, and fees that will be charged for the business-type activities.

- County General Fund expenditures for 2008 are budgeted to decrease 4.2 percent over 2007.
- Property tax levies have increased 7.0 percent for 2008 and include a loss of \$91,000 in state aid for property tax reduction.

CONTACTING LAKE COUNTY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the County's finances and to show the County's accountability for the money it receives. If you have questions about this report, or need additional financial information, contact the County Auditor/Treasurer Steven McMahon, Lake County Courthouse, 601 - 3rd Avenue, Two Harbors, Minnesota 55616.

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BASIC FINANCIAL STATEMENTS

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 1

**STATEMENT OF NET ASSETS
DECEMBER 31, 2007**

	Primary Government			Housing and Redevelopment Authority Component Unit
	Governmental Activities	Business-Type Activities	Total	
<u>Assets</u>				
Cash and pooled investments	\$ 9,130,875	\$ 45,493	\$ 9,176,368	\$ 276,570
Receivables - net	6,416,872	241,942	6,658,814	171,213
Due from component unit	951,470	-	951,470	-
Due from primary government	-	-	-	5,912
Inventories	283,233	13,240	296,473	-
Prepaid items	19,309	64,055	83,364	-
Restricted assets				
Cash and pooled investments	-	6,404	6,404	82,837
Deferred charges	59,262	-	59,262	-
Capital assets				
Non-depreciable capital assets	3,898,859	15,000	3,913,859	-
Depreciable capital assets - net of accumulated depreciation	81,850,544	2,101,571	83,952,115	1,381,934
Total Assets	\$ 102,610,424	\$ 2,487,705	\$ 105,098,129	\$ 1,918,466
<u>Liabilities</u>				
Accounts payable and other current liabilities	\$ 1,530,412	\$ 199,950	\$ 1,730,362	\$ 4,066
Accrued interest payable	122,005	-	122,005	2,700
Due to component unit	5,912	-	5,912	-
Due to primary government	-	-	-	951,470
Unearned revenue	-	-	-	134
Payable from restricted assets				
Due to residents	-	6,404	6,404	-
Customer deposits payable	-	-	-	13,639
Long-term liabilities				
Due within one year	1,446,949	35,288	1,482,237	28,000
Due in more than one year	9,015,660	79,240	9,094,900	913,508
Total Liabilities	\$ 12,120,938	\$ 320,882	\$ 12,441,820	\$ 1,913,517

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

***EXHIBIT 1
(Continued)***

**STATEMENT OF NET ASSETS
DECEMBER 31, 2007**

	Primary Government			Housing and Redevelopment Authority Component Unit
	Governmental Activities	Business-Type Activities	Total	
<u>Net Assets</u>				
Invested in capital assets - net of related debt	\$ 77,782,607	\$ 2,114,086	\$ 79,896,693	\$ 440,426
Restricted for				
General government	254,044	-	254,044	-
Public safety	168,911	-	168,911	-
Highways and streets	1,606,389	-	1,606,389	-
Human services	72,335	-	72,335	-
Conservation of natural resources	335,475	-	335,475	-
Debt service	512,021	-	512,021	69,198
Unrestricted	9,757,704	52,737	9,810,441	(504,675)
Total Net Assets	\$ 90,489,486	\$ 2,166,823	\$ 92,656,309	\$ 4,949

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Expenses</u>	<u>Fees, Charges, Fines, and Other</u>	<u>Program Revenues Operating Grants and Contributions</u>
<u>Functions/Programs</u>			
Primary government			
Governmental activities			
General government	\$ 3,808,295	\$ 751,411	\$ 1,159,784
Public safety	3,545,609	251,745	569,100
Highways and streets	7,229,315	460,911	1,638,005
Sanitation	282,655	114,208	-
Human services	3,591,643	131,040	1,806,099
Health	457,208	128,491	211,070
Culture and recreation	787,691	25,840	180,610
Conservation of natural resources	889,884	914,950	99,496
Economic development	47,340	7,359	-
Interest	409,240	-	-
Total governmental activities	\$ 21,048,880	\$ 2,785,955	\$ 5,664,164
Business-type activities			
Nursing Home	3,080,650	2,564,044	-
Total Primary Government	\$ 24,129,530	\$ 5,349,999	\$ 5,664,164
Component unit			
Housing and Redevelopment Authority	\$ 544,232	\$ 173,827	\$ -

General Revenues

Property taxes
Mortgage registry and deed tax
Payments in lieu of tax
Tax increments
Taxes - other
Grants and contributions not restricted to specific programs
Intergovernmental
Unrestricted investment earnings
Miscellaneous

Total general revenues

Change in net assets

Net Assets - Beginning, Restated (Note 1.E.)

Net Assets - Ending

EXHIBIT 2

Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets			Discretely Presented Component Unit
	Governmental Activities	Primary Government Business-Type Activities	Total	
\$ -	\$ (1,897,100)	\$ -	\$ (1,897,100)	
-	(2,724,764)	-	(2,724,764)	
7,835,163	2,704,764	-	2,704,764	
-	(168,447)	-	(168,447)	
-	(1,654,504)	-	(1,654,504)	
-	(117,647)	-	(117,647)	
-	(581,241)	-	(581,241)	
-	124,562	-	124,562	
-	(39,981)	-	(39,981)	
-	(409,240)	-	(409,240)	
\$ 7,835,163	\$ (4,763,598)	\$ -	\$ (4,763,598)	
-	-	(516,606)	(516,606)	
\$ 7,835,163	\$ (4,763,598)	\$ (516,606)	\$ (5,280,204)	
\$ -				\$ (370,405)
	\$ 6,136,324	\$ -	\$ 6,136,324	\$ -
	14,207	-	14,207	-
	512,216	-	512,216	-
	223,891	-	223,891	205,018
	1,182,359	-	1,182,359	-
	1,890,691	-	1,890,691	-
	-	-	-	4,250
	654,981	6,539	661,520	10,626
	170,817	5,723	176,540	7,503
	\$ 10,785,486	\$ 12,262	\$ 10,797,748	\$ 227,397
	\$ 6,021,888	\$ (504,344)	\$ 5,517,544	\$ (143,008)
	84,467,598	2,671,167	87,138,765	147,957
	\$ 90,489,486	\$ 2,166,823	\$ 92,656,309	\$ 4,949

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FUND FINANCIAL STATEMENTS

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GOVERNMENTAL FUNDS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 3

**BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2007**

	<u>General</u>	<u>Road and Bridge</u>	<u>Human Services</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<u>Assets</u>					
Cash and pooled investments	\$ 4,082,156	\$ 601,238	\$ 3,045,721	\$ 1,033,996	\$ 8,763,111
Escheat cash	36,538	-	-	-	36,538
Petty cash and change funds	1,300	1,000	1,000	50	3,350
Undistributed cash in agency funds	177,091	56,519	79,491	14,775	327,876
Taxes receivable					
Prior	149,811	51,404	75,958	14,411	291,584
Accounts receivable	512,837	321,435	38,799	441,275	1,314,346
Accrued interest receivable	50,378	-	-	-	50,378
Loans receivable	123,827	-	-	213,166	336,993
Due from other funds	140,887	68,292	12	1	209,192
Due from other governments	1,030,745	2,868,284	335,463	14,079	4,248,571
Due from component unit	-	-	-	951,470	951,470
Prepaid expense	-	-	19,309	-	19,309
Inventories	-	283,233	-	-	283,233
Leases receivable	175,000	-	-	-	175,000
Total Assets	<u>\$ 6,480,570</u>	<u>\$ 4,251,405</u>	<u>\$ 3,595,753</u>	<u>\$ 2,683,223</u>	<u>\$ 17,010,951</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**EXHIBIT 3
(Continued)**

**BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2007**

	<u>General</u>	<u>Road and Bridge</u>	<u>Human Services</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<u>Liabilities and Fund Balances</u>					
Liabilities					
Accounts payable	\$ 107,538	\$ 427,384	\$ 117,805	\$ 2,607	\$ 655,334
Escheat payable	36,538	-	-	-	36,538
Salaries payable	191,828	88,220	73,211	15,405	368,664
Contracts payable	-	311,101	-	-	311,101
Due to other funds	66,269	1	20,733	122,189	209,192
Due to other governments	39,290	7,610	9,791	102,084	158,775
Due to component unit	-	-	-	5,912	5,912
Deferred revenue - unavailable	294,375	1,981,792	64,567	580,306	2,921,040
Total Liabilities	\$ 735,838	\$ 2,816,108	\$ 286,107	\$ 828,503	\$ 4,666,556
Fund Balances					
Reserved for					
Inventories	\$ -	\$ 283,233	\$ -	\$ -	\$ 283,233
Capital projects	-	198,411	-	-	198,411
Election equipment	33,542	-	-	-	33,542
Loans receivable	123,827	-	-	63,166	186,993
Law library	44,843	-	-	-	44,843
Sheriff's contingency	4,760	-	-	-	4,760
Sheriff's forfeited property	77,360	-	-	-	77,360
Recorder's technology fund	104,049	-	-	-	104,049
Recorder's compliance fund	105,152	-	-	-	105,152
Enhanced 911	86,791	-	-	-	86,791
Debt service	-	512,021	-	-	512,021
Region III fund	-	-	72,335	-	72,335
Title III forests	335,475	-	-	-	335,475
Unreserved					
Designated for future expenditures	-	-	1,000,000	-	1,000,000
Designated for rescue squad	13,217	-	-	-	13,217
Designated for retired employees	-	73,851	-	-	73,851
Designated for capital equipment	-	101,000	-	-	101,000
Designated for computer network	-	18,000	-	-	18,000
Designated for gravel pit restoration	-	221,837	-	-	221,837
Undesignated	4,815,716	26,944	2,237,311	-	7,079,971
Unreserved, reported in nonmajor					
Special revenue funds	-	-	-	894,624	894,624
Debt service fund	-	-	-	896,930	896,930
Total Fund Balances	\$ 5,744,732	\$ 1,435,297	\$ 3,309,646	\$ 1,854,720	\$ 12,344,395
Total Liabilities and Fund Balances	\$ 6,480,570	\$ 4,251,405	\$ 3,595,753	\$ 2,683,223	\$ 17,010,951

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

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 4

**RECONCILIATION OF GOVERNMENTAL FUNDS BALANCE SHEET TO
THE GOVERNMENT-WIDE STATEMENT OF NET ASSETS--GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2007**

Fund balances - total governmental funds (Exhibit 3)		\$	12,344,395
Amounts reported for governmental activities in the statement of net assets are different because:			
Capital assets, net of accumulated depreciation, used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.			85,749,403
Other long-term assets are not available to pay for current period expenditures and, therefore, are deferred in the governmental funds.			2,921,040
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the governmental funds.			
General obligation bonds	\$	(6,620,000)	
Notes payable		(394,163)	
Capital leases payable		(2,102,783)	
Compensated absences		(1,345,663)	
Accrued interest payable		(122,005)	
Deferred debt issuance charges		59,262	
		<u> </u>	<u>(10,525,352)</u>
Net Assets of Governmental Activities (Exhibit 1)			<u><u>\$ 90,489,486</u></u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 5

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>General</u>	<u>Road and Bridge</u>	<u>Human Services</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Revenues					
Taxes	\$ 4,162,668	\$ 1,291,336	\$ 1,540,205	\$ 517,106	\$ 7,511,315
Licenses and permits	27,984	-	-	867	28,851
Intergovernmental	3,198,583	10,092,910	2,506,756	266,564	16,064,813
Charges for services	581,313	451,638	152,129	267,078	1,452,158
Fines and forfeits	63,075	-	-	-	63,075
Gifts and contributions	330	-	-	-	330
Investment earnings	555,073	64,065	-	35,843	654,981
Miscellaneous	492,155	11,190	107,402	986,675	1,597,422
Total Revenues	\$ 9,081,181	\$ 11,911,139	\$ 4,306,492	\$ 2,074,133	\$ 27,372,945
Expenditures					
Current					
General government	\$ 3,674,024	\$ -	\$ -	\$ -	\$ 3,674,024
Public safety	3,486,018	-	-	106,489	3,592,507
Highways and streets	-	14,907,596	-	-	14,907,596
Sanitation	301,829	-	-	-	301,829
Human services	-	-	3,528,289	-	3,528,289
Health	-	-	453,688	-	453,688
Culture and recreation	1,321,533	-	-	-	1,321,533
Conservation of natural resources	181,517	-	-	679,715	861,232
Economic development	47,340	-	-	-	47,340
Intergovernmental	-	-	-	23,324	23,324
Debt service					
Principal	21,986	489,498	-	1,090,267	1,601,751
Interest	-	102,305	-	295,180	397,485
Miscellaneous	-	403	-	4,613	5,016
Total Expenditures	\$ 9,034,247	\$ 15,499,802	\$ 3,981,977	\$ 2,199,588	\$ 30,715,614
Excess of Revenues Over (Under)					
Expenditures	\$ 46,934	\$ (3,588,663)	\$ 324,515	\$ (125,455)	\$ (3,342,669)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

*EXHIBIT 5
(Continued)*

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>General</u>	<u>Road and Bridge</u>	<u>Human Services</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Other Financing Sources (Uses)					
Transfers in	\$ 16,101	\$ 1,130,844	\$ -	\$ 518,573	\$ 1,665,518
Capital lease purchase	-	49,024	-	-	49,024
Transfers out	(215,599)	-	-	(1,449,919)	(1,665,518)
Total Other Financing Sources (Uses)	\$ (199,498)	\$ 1,179,868	\$ -	\$ (931,346)	\$ 49,024
Net Change in Fund Balances	\$ (152,564)	\$ (2,408,795)	\$ 324,515	\$ (1,056,801)	\$ (3,293,645)
Fund Balances - January 1	5,897,296	3,906,029	2,985,131	2,911,521	15,699,977
Increase (decrease) in reserved for inventories	-	(61,937)	-	-	(61,937)
Fund Balances - December 31	\$ 5,744,732	\$ 1,435,297	\$ 3,309,646	\$ 1,854,720	\$ 12,344,395

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 6

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE
GOVERNMENT-WIDE STATEMENT OF ACTIVITIES--GOVERNMENTAL ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2007**

Net change in fund balances - total governmental funds (Exhibit 5) \$ (3,293,645)

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

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

Deferred revenue - December 31	\$ 2,921,040	
Deferred revenue - January 1	<u>(3,201,342)</u>	(280,302)

Governmental funds report capital outlay as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the statement of activities, only the gain or loss on the disposal of capital assets is reported; whereas, in the governmental funds, the proceeds from the sale increase financial resources. Therefore, the change in net assets differs from the change in fund balance by the net book value of the assets sold.

Expenditures for general capital assets and infrastructure	\$ 10,764,332	
Net book value of assets sold	(37,566)	
Current year depreciation	<u>(2,522,088)</u>	8,204,678

Debt issuance proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. Debt repayment is an expenditure in the funds, but a reduction of a liability in the statement of net assets.

Debt issued		
Capital lease		(49,024)

Principal repayments		
General obligation bonds	\$ 1,250,000	
Notes payable	175,586	
Capital lease	<u>176,165</u>	1,601,751

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

Change in accrued interest payable	\$ 6,992	
Change in deferred bond issuance costs	(13,731)	
Change in compensated absences	(92,894)	
Change in inventories	<u>(61,937)</u>	<u>(161,570)</u>

Change in Net Assets of Governmental Activities (Exhibit 2) \$ 6,021,888

PROPRIETARY FUND

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 7

**STATEMENT OF FUND NET ASSETS
PROPRIETARY FUND
SEPTEMBER 30, 2007**

	Nursing Home Enterprise Fund
<u>Assets</u>	
Current assets	
Cash and cash equivalents	\$ 44,993
Petty cash and change funds	500
Accounts receivable - net	241,942
Inventories	13,240
Prepaid items	64,055
Restricted cash, cash equivalents, and investments	
Resident trust funds	6,404
Total current assets	\$ 371,134
Noncurrent assets	
Capital assets	\$ 4,291,670
Less: accumulated depreciation	(2,175,099)
Capital assets - net of accumulated depreciation	\$ 2,116,571
Total Assets	\$ 2,487,705
<u>Liabilities</u>	
Current liabilities	
Accounts payable	\$ 106,245
Salaries payable	41,179
Accrued vacation payable	52,526
Compensated absences payable - current	32,804
Capital leases payable - current	2,484
Total current liabilities	\$ 235,238
Current liabilities payable from restricted assets	
Due to residents	6,404
Noncurrent liabilities	
Compensated absences payable - long-term	79,240
Total Liabilities	\$ 320,882
<u>Net Assets</u>	
Invested in capital assets - net of related debt	\$ 2,114,086
Unrestricted	52,737
Total Net Assets	\$ 2,166,823

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 8

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUND
FOR THE YEAR ENDED SEPTEMBER 30, 2007**

	Nursing Home Enterprise Fund
Operating Revenues	
Patient services revenues	\$ 2,418,447
Ancillary and other services	96,805
Miscellaneous	48,792
	<u>48,792</u>
Total Operating Revenues	\$ 2,564,044
Operating Expenses	
Nursing services	\$ 1,129,208
Other care-related	96,698
Other services and charges	60,686
Dietary	329,812
Laundry	53,828
Housekeeping	61,438
Plant operations	152,702
Other property and related costs	177,944
Administration	425,049
Employee benefits	470,590
Depreciation	122,326
	<u>122,326</u>
Total Operating Expenses	\$ 3,080,281
Operating Income (Loss)	\$ (516,237)
Nonoperating Revenues (Expenses)	
Miscellaneous revenue	\$ 5,723
Interest expense	(369)
Nursing Home payment adjustment	6,539
	<u>6,539</u>
Total Nonoperating Revenues (Expenses)	\$ 11,893
Change in Net Assets	\$ (504,344)
Net Assets - October 1	2,671,167
Net Assets - September 30	\$ 2,166,823

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 9

**STATEMENT OF CASH FLOWS
PROPRIETARY FUND
FOR THE YEAR ENDED SEPTEMBER 30, 2007**

	Nursing Home Enterprise Fund
Cash Flows from Operating Activities	
Cash received from customers	\$ 2,566,237
Cash received from miscellaneous sources	5,723
Cash paid to suppliers	(843,702)
Cash payments to employees	(2,055,899)
	\$ (327,641)
Cash Flows from Noncapital Financing Activities	
Nursing Home payment adjustment received	\$ 6,539
Utility refund received	132,222
	\$ 138,761
Cash Flows from Capital and Related Financing Activities	
Principal payments on capital lease	\$ (2,202)
Interest expense	(369)
Acquisition of capital assets	(57,732)
	\$ (60,303)
Net Increase (Decrease) in Cash and Cash Equivalents	\$ (249,183)
Cash and Cash Equivalents - October 1	294,676
Cash and Cash Equivalents - September 30	\$ 45,493
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities	
Operating income (loss)	\$ (516,237)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities	
Depreciation	\$ 122,326
Miscellaneous nonoperating revenue	5,723
Changes in assets and liabilities	
(Increase) decrease in receivables	2,193
(Increase) decrease in inventories	3,227
(Increase) decrease in prepaid items	4,644
Increase (decrease) in accounts payable	49,891
Increase (decrease) in salaries payable	2,023
Increase (decrease) in compensated absences	(8,542)
Increase (decrease) in vacations payable	7,111
	\$ 188,596
Net Cash Provided by (Used in) Operating Activities	\$ (327,641)

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

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FIDUCIARY FUNDS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 10

**FIDUCIARY FUNDS
STATEMENT OF FIDUCIARY NET ASSETS
DECEMBER 31, 2007**

	<u>Agency</u>
<u>Assets</u>	
Cash and pooled investments	<u>\$ 708,676</u>
<u>Liabilities</u>	
Accounts payable	\$ 253,554
Taxes collected in advance	15,123
Due to other governments	388,259
Customer deposits - current	<u>51,740</u>
Total Liabilities	<u>\$ 708,676</u>

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2007**

1. Summary of Significant Accounting Policies

The County's financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as of and for the year ended December 31, 2007. 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 (FASB) issued through November 30, 1989, (when applicable) that do not conflict with or contradict GASB pronouncements. Although the County has the option to apply FASB pronouncements issued after that date to its Nursing Home Enterprise Fund, the County has chosen not to do so. The more significant accounting policies established in GAAP and used by the County are discussed below.

A. Financial Reporting Entity

Lake County was established March 1, 1866, and is an organized county having the powers, duties, and privileges granted counties by Minn. Stat. ch. 373. The Lake County Nursing Home was established pursuant to Minn. Stat. §§ 376.55-.60. As required by accounting principles generally accepted in the United States of America, these financial statements present Lake County (primary government) and its component unit for which the County is financially accountable. The County is governed by a five-member Board of Commissioners elected from districts within the County. The Board is organized with a chair and vice chair elected at the annual meeting in January of each year.

Discretely Presented Component Unit

While part of the reporting entity, the discretely presented component unit is presented in a separate column in the government-wide financial statements to emphasize that it is legally separate from the County. The following component unit of Lake County is discretely presented:

<u>Component Unit</u>	<u>Component Unit Included in Reporting Entity Because</u>	<u>Separate Financial Statements</u>
Lake County Housing and Redevelopment Authority	County appoints members, and Authority is a potential financial burden.	Lake County Housing and Redevelopment Authority P. O. Box 340 609 First Avenue Two Harbors, Minnesota 55616-0340

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

A. Financial Reporting Entity

Discretely Presented Component Unit (Continued)

The Lake County Housing and Redevelopment Authority is governed by a five-member Board appointed by the Lake County Board of Commissioners. The Lake County HRA has all of the powers and duties of a county housing and redevelopment authority under the provisions of Minn. Stat. §§ 469.001-.047.

Joint Ventures

The County participates in several joint ventures described in Note 4.D. The County also participates in jointly-governed organizations described in Note 4.E.

B. Basic Financial Statements

1. Government-Wide Statements

The government-wide financial statements (the statement of net assets and the statement of activities) display information about the primary government and its component unit. These statements include the financial activities of the overall County government, except for fiduciary activities. Eliminations have been made to minimize the double counting of internal activities. Governmental activities, which normally are supported by taxes and intergovernmental revenue, are reported separately from business-type activities, which rely to a significant extent on fees and charges to external parties for support.

In the government-wide statement of net assets, both the governmental and business-type activities columns: (a) are presented on a consolidated basis by column; and (b) are reported on a full accrual, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations. The County's net assets are reported in three parts: (1) invested in capital assets, net of related debt; (2) restricted net assets; and (3) unrestricted net assets. The County first utilizes restricted resources to finance qualifying activities.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basic Financial Statements

1. Government-Wide Statements (Continued)

The statement of activities demonstrates the degree to which the direct expenses of each function of the County's governmental activities and different business-type activities are offset by program revenue. Direct expenses are those clearly identifiable with a specific function or activity. Program revenues include: (1) fees, fines, and charges paid by the recipients of goods, services, or privileges provided by a given function or activity; and (2) grants and contributions restricted to meeting the operational or capital requirements of a particular function or activity. Revenue not classified as program revenue, including all taxes, are presented as general revenue.

2. Fund Financial Statements

The fund financial statements provide information about the County's funds, including its fiduciary funds. Separate statements for each fund category--governmental, proprietary, and fiduciary--are presented. The emphasis of governmental and proprietary fund financial statements is on major individual governmental and enterprise funds, with each displayed as separate columns in the fund financial statements. All remaining governmental and enterprise funds are aggregated and reported as nonmajor funds.

The County reports the following major governmental funds:

The General Fund is the County's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The Road and Bridge Special Revenue Fund is used to account for revenues and expenditures of the County Highway Department, which is responsible for the construction and maintenance of roads, bridges, and other projects affecting County roadways.

The Human Services Special Revenue Fund is used to account for economic assistance and community social services programs.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basic Financial Statements

2. Fund Financial Statements (Continued)

The County reports the following major enterprise fund:

The Nursing Home Enterprise Fund is used to account for the operations of the County Nursing Home.

Additionally, the County reports the following fund type:

Agency funds are custodial in nature and do not present results of operations or have a measurement focus. These funds account for assets that the County holds for others in an agent capacity.

C. Measurement Focus and Basis of Accounting

The government-wide and proprietary 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. Property taxes are recognized as revenue in the year for which they are levied. Shared revenues are generally recognized in the period the appropriation goes into effect. 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. Lake County considers all revenue as available if collected within 90 days after the end of the current period, except for taxes, which have a 60-day accrual period. Property and other taxes, licenses, and interest are all 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 general long-term debt and acquisitions under capital leases are reported as other financing sources.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

C. Measurement Focus and Basis of Accounting (Continued)

Proprietary fund operating revenue, such as charges for services, result from exchange transactions associated with the principle activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenue, such as contributions and donations, result from nonexchange transactions or incidental activities.

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

D. Assets, Liabilities, and Net Assets or Equity

1. Cash and Cash Equivalents

The County has defined cash and cash equivalents to include cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition. Additionally, each fund's equity in the County's investment pool is treated as a cash equivalent because the funds can deposit or effectively withdraw cash at any time without prior notice or penalty.

2. Deposits and Investments

The cash balances of substantially all funds are pooled and invested by the County Auditor/Treasurer for the purpose of increasing earnings through investment activities. Pooled and fund investments are reported at their fair value at December 31, 2007, based on market prices. Pursuant to Minn. Stat. § 385.07, investment earnings on cash and pooled investments are credited to the General Fund. Other funds received investment earnings based on other state statutes, grant agreements, contracts, and bond covenants. Pooled investment earnings for 2007 were \$654,981.

Lake County 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 (SEC), but does operate in a manner consistent with Rule 2a-7 prescribed by the SEC pursuant to the

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

2. Deposits and Investments (Continued)

Investment Company Act of 1940 (17 C.F.R. § 270.2a-7). Therefore, the fair value of the County's position in the pool is the same as the value of the pool shares.

3. Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year is referred to as either "due to/from other funds" (the current portion of interfund loans) or "advances to/from other funds" (the noncurrent portion of interfund loans).

All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

Property taxes are levied as of January 1 on property values assessed as of the same date. The tax levy notice is mailed in March with the first half payment due May 15 and the second half payment due October 15. Unpaid taxes at December 31 become liens on the respective property and are classified in the financial statements as delinquent taxes receivable.

Loans receivable consist of outstanding loans to other governmental entities to finance improvements, loans to individuals for shoreline erosion projects, and loans to individuals for economic development.

4. Inventories and Prepaid Items

The Road and Bridge Special Revenue Fund inventory is valued at cost using the average cost method and consists of expendable supplies and parts held for consumption and sand and gravel stockpiles. Inventories in governmental funds are recorded as expenditures when purchased rather than when consumed. Inventories in proprietary funds and at the government-wide level are recorded as expenses when consumed.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

4. Inventories and Prepaid Items (Continued)

Inventories in the Nursing Home Enterprise Fund are valued at cost on a first-in, first-out method and consist of nursing home supplies held for consumption. Inventoried items are recorded as an expense when used.

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

5. Restricted Assets

Certain funds of the County are classified as restricted assets on the statement of net assets because the restriction is either imposed by law through constitutional provisions or enabling legislation or imposed externally by creditors, grantors, contributors, or laws or regulations of other governments. Therefore, their use is limited by applicable laws and regulations.

6. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets (for example, roads, bridges, and similar items), are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. 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.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed. During the current period, the County did not have any capitalized interest.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

6. Capital Assets (Continued)

Property, plant, and equipment of the primary government, as well as the component unit, are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings	5 - 50
Improvements other than buildings	8 - 20
Public domain infrastructure	50 - 75
Furniture, equipment, and vehicles	5 - 20

7. Compensated Absences

The liability for compensated absences reported in the 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 government-wide and proprietary 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.

Lake County's employees participate in a post-retirement health savings plan administered by the Minnesota State Retirement System. At retirement, depending on the employee's years of service, he or she is issued a lump sum payout of either 10 or 20 percent of the vested sick leave as well as two to three years of insurance coverage. The lump sum payouts are paid directly into the post-retirement health savings plan.

8. Deferred Revenue

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

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

9. Long-Term Obligations

In the government-wide and proprietary fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of the debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources, while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

10. Fund Equity

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

11. Use of Estimates

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

E. Prior Period Restatement

In 2007, it was determined that the original cost of the jail, less accumulated depreciation, should have been accounted for as part of Lake County's capital assets rather than the Housing and Redevelopment Authority's capital assets.

On Exhibit 2, the prior year's net assets for the governmental activities have been restated as follows:

Net Assets - Beginning	\$	83,571,753
Restatement		
Jail - original cost, less accumulated depreciation		895,845
Net Assets - Beginning, Restated	\$	84,467,598

In 2007, the Lake County Housing and Redevelopment Authority was carrying \$28,601 in capitalized expenditures regarding a post office relocation study relating to land that was sold in 2005. These capitalized expenditures were removed from the Authority's financial statements and are shown as a prior period restatement of capital assets and beginning net assets.

On Exhibit 2, the prior year's net assets for the Housing and Redevelopment Authority discretely presented component unit have been restated as follows:

Net Assets - Beginning	\$	1,069,109
Restatement		
Remove capitalized expenditures related to land previously sold		(28,601)
Jail - original cost, less accumulated depreciation		(895,845)
Accrued interest payable on Jail Lease Revenue Bonds		3,294
Net Assets - Beginning, Restated	\$	147,957

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

The County's total cash and investments are reported as follows:

Primary government	
Cash and pooled investments	\$ 9,176,368
Restricted cash and pooled investments	6,404
Component unit	
Cash and pooled investments	276,570
Restricted cash and pooled investments	82,837
Fiduciary funds	
Cash and pooled investments	<u>708,676</u>
 Total Cash and Investments	 <u>\$ 10,250,855</u>

a. Deposits

Minn. Stat. §§ 118A.02 and 118A.04 authorize the County to designate a depository for public funds and to invest in certificates of deposit. Minn. Stat. § 118A.03 requires that all County 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 that is not owned or controlled by the financial institution furnishing the collateral.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

a. Deposits (Continued)

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a financial institution failure, the County's deposits may not be returned to it. The County does not have a deposit policy for custodial credit risk. As of December 31, 2007, the primary government's bank balances of \$800,990 were not exposed to custodial credit risk.

The Lake County Housing and Redevelopment Authority component unit's book balance of \$359,407 was exposed to custodial credit risk as follows:

Uninsured and uncollateralized Component unit	<u>\$ 61,382</u>
--	------------------

b. Investments

Minn. Stat. §§ 118A.04 and 118A.05 generally authorize the following types of investments as available to the County:

- (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;

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

b. Investments (Continued)

- (4) bankers' acceptances of United States banks;
- (5) commercial paper issued by United States corporations or their Canadian subsidiaries that is rated in the highest quality category by two nationally recognized rating agencies and matures in 270 days or less; and
- (6) with certain restrictions, in repurchase agreements, securities lending agreements, joint powers investment trusts, and guaranteed investment contracts.

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 County 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 an investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. It is the County's 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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

b. Investments

Custodial Credit Risk (Continued)

outside party. The County does not have an investment policy for custodial credit risk. All of Lake County's investments in negotiable certificates of deposit and government securities are held by the counterparty to the transactions and, therefore, are subject to custodial credit risk. A portion of these investments are insured by Securities Investor Protection Corporation (SIPC) insurance or excess SIPC insurance and are not subject to custodial credit risk.

Negotiable certificates of deposit			
Insured	\$		1,443,344
Government securities			
Insured			1,670,721
Uninsured, held by counterparty			1,670,809

Concentration of Credit Risk

The concentration of credit risk is the risk of loss that may be caused by the County's investment in a single issuer. It is the policy of the County to diversify investments to avoid risk and, also, for cash-flow purposes.

The following table presents the County's deposit and investment balances at December 31, 2007, and information relating to potential investment risks:

Investment Type	Credit Risk		Concentration Risk	Interest Rate Risk	Carrying (Fair) Value
	Credit Rating	Rating Agency	Over 5% of Portfolio	Maturity Date	
U.S. government agency securities					
Federal National Mortgage Association Collateralized Mortgage Obligation	N/R	N/A		09/25/2008	\$ 1,286
Federal National Mortgage Association Note	AAA	Moody's		02/22/2012	200,500
Federal National Mortgage Association Note	N/R	N/A		02/01/2019	234,674
Total Federal National Mortgage Association			<5%		\$ 436,460

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments (Continued)

Investment Type	Credit Risk		Concentration Risk Over 5% of Portfolio	Interest Rate Risk Maturity Date	Carrying (Fair) Value
	Credit Rating	Rating Agency			
Federal Home Loan Bank Bonds	AAA	Moody's		07/22/2008	\$ 200,000
Federal Home Loan Bank Bonds	AAA	Moody's		09/29/2008	249,532
Federal Home Loan Bank Bonds	AAA	Moody's		12/26/2008	198,688
Federal Home Loan Bank Bonds	AAA	Moody's		08/27/2009	500,470
Federal Home Loan Bank Bonds	AAA	S&P		10/15/2009	125,489
Federal Home Loan Bank Bonds	AAA	Moody's		07/10/2012	200,070
Federal Home Loan Bank Bonds	AAA	Moody's		11/22/2010	151,203
Federal Home Loan Bank Bonds	AAA	Moody's		05/01/2013	255,697
Federal Home Loan Bank Bonds	AAA	Moody's		06/15/2010	254,845
Federal Home Loan Bank Bonds	AAA	Moody's		06/19/2013	185,612
Federal Home Loan Bank Bonds	AAA	Moody's		07/24/2013	252,650
Federal Home Loan Bank Bonds	AAA	Moody's		06/27/2014	302,625
Total Federal Home Loan Bank Bonds			31.0%		\$ 2,876,881
Government National Mortgage Association Note	N/R	N/A	<5%	02/15/2019	\$ 28,189
Investment pools/mutual funds					
MAGIC Fund	N/R	N/A	46.1%	N/A	\$ 4,272,774
Wells Fargo Government Money Market	N/R	N/A	<5%	N/A	211,769
Total investment pools/mutual funds					\$ 4,484,543
Negotiable certificates of deposit					
LaSalle Bank Midwest	N/A	N/A	<5%	03/07/2008	\$ 97,475
Huntington National Bank	N/A	N/A	<5%	01/09/2013	95,999
Waypoint Bank	N/A	N/A	<5%	07/08/2013	95,733
Seattle Savings Bank	N/A	N/A	<5%	02/13/2008	97,000
National Bank of SC	N/A	N/A	<5%	02/16/2008	97,000
PrivateBank & TC	N/A	N/A	<5%	02/29/2008	95,000
National Bank	N/A	N/A	<5%	03/07/2008	95,085
Washington Mutual Bank	N/A	N/A	<5%	03/28/2008	97,000
Midfirst Bank	N/A	N/A	<5%	05/14/2008	97,000
Imperial Cap Bank	N/A	N/A	<5%	06/12/2008	97,000
GMAC Bank	N/A	N/A	<5%	06/12/2008	97,000
Discover Bank	N/A	N/A	<5%	09/15/2008	96,000
E Trade Bank	N/A	N/A	<5%	09/19/2008	96,000
Horizon Bank	N/A	N/A	<5%	05/20/2010	95,026
Professional Business	N/A	N/A	<5%	05/20/2010	95,026
Total negotiable certificates of deposit					\$ 1,443,344

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments (Continued)

Investment Type	Credit Risk		Concentration Risk Over 5% of Portfolio	Interest Rate Risk Maturity Date	Carrying (Fair) Value
	Credit Rating	Rating Agency			
Total investments					\$ 9,269,417
Deposits - primary government					575,239
Deposits - component unit					359,407
Petty cash					3,850
Resident trust funds					6,404
Escheat cash					36,538
Total Cash and Investments					<u>\$ 10,250,855</u>

N/A - Not Applicable; N/R - Not Rated
 <5% - Concentration is less than 5% of investments
 S&P - Standard & Poor's

2. Receivables

Receivables as of December 31, 2007, for the County's governmental activities and business-type activities are as follows:

	Total Receivables	Amounts Not Scheduled for Collection During the Subsequent Year
Governmental Activities		
Taxes	\$ 291,584	\$ -
Due from other governments	4,248,571	-
Accounts	1,314,346	480
Interest	50,378	-
Loans receivable	336,993	145,852
Leases receivable	175,000	-
Total Governmental Activities	<u>\$ 6,416,872</u>	<u>\$ 146,332</u>
Business-Type Activities		
Accounts	<u>\$ 241,942</u>	<u>\$ -</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets (Continued)

3. Capital Assets

Capital asset activity for the year ended December 31, 2007, was as follows:

Governmental Activities

	Beginning Balance (Restated)	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	\$ 3,898,859	\$ -	\$ -	\$ 3,898,859
Capital assets depreciated				
Buildings	\$ 15,345,878	\$ 751,905	\$ -	\$ 16,097,783
Improvements other than buildings	362,539	98,939	-	461,478
Machinery, furniture, and equipment	7,685,527	387,331	163,444	7,909,414
Infrastructure	73,143,549	9,526,157	-	82,669,706
Total capital assets depreciated	\$ 96,537,493	\$ 10,764,332	\$ 163,444	\$ 107,138,381
Less: accumulated depreciation for				
Buildings	\$ 3,646,362	\$ 424,567	\$ -	\$ 4,070,929
Improvements other than buildings	251,182	18,632	-	269,814
Machinery, furniture, and equipment	5,562,636	486,450	125,878	5,923,208
Infrastructure	13,431,448	1,592,438	-	15,023,886
Total accumulated depreciation	\$ 22,891,628	\$ 2,522,087	\$ 125,878	\$ 25,287,837
Total capital assets depreciated, net	\$ 73,645,865	\$ 8,242,245	\$ 37,566	\$ 81,850,544
Governmental Activities Capital Assets, Net	\$ 77,544,724	\$ 8,242,245	\$ 37,566	\$ 85,749,403

Business-Type Activities

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	\$ 15,000	\$ -	\$ -	\$ 15,000
Capital assets depreciated				
Land improvements	\$ 91,983	\$ -	\$ -	\$ 91,983
Buildings	3,513,677	17,866	-	3,531,543
Machinery, furniture, and equipment	613,279	43,942	4,077	653,144
Total capital assets depreciated	\$ 4,218,939	\$ 61,808	\$ 4,077	\$ 4,276,670

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

3. Capital Assets

Business-Type Activities (Continued)

	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
Less: accumulated depreciation for				
Land improvements	\$ 77,165	\$ 2,852	\$ -	\$ 80,017
Buildings	1,468,319	91,785	-	1,560,104
Machinery, furniture, and equipment	<u>507,289</u>	<u>27,689</u>	<u>-</u>	<u>534,978</u>
Total accumulated depreciation	<u>\$ 2,052,773</u>	<u>\$ 122,326</u>	<u>\$ -</u>	<u>\$ 2,175,099</u>
Total capital assets depreciated, net	<u>\$ 2,166,166</u>	<u>\$ (60,518)</u>	<u>\$ 4,077</u>	<u>\$ 2,101,571</u>
Business-Type Activities				
Capital Assets, Net	<u>\$ 2,181,166</u>	<u>\$ (60,518)</u>	<u>\$ 4,077</u>	<u>\$ 2,116,571</u>

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental Activities	
General government	\$ 231,270
Public safety	145,819
Highways and streets, including depreciation of infrastructure assets	1,832,237
Human services	98,016
Sanitation	5,726
Culture and recreation	182,833
Conservation of natural resources	<u>26,186</u>
Total Depreciation Expense - Governmental Activities	<u>\$ 2,522,087</u>
Business-Type Activities	
Nursing home	<u>\$ 122,326</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds (Continued)

B. Interfund Receivables, Payables, and Transfers

1. Due To/From Other Funds

The composition of interfund balances as of December 31, 2007, is as follows:

Receivable Fund	Payable Fund	Amount	Purpose
General	Debt Service	\$ 122,189	Temporary loan, transfer of remaining fund balance
	Human Services	18,698	Reimbursement for services
Total due to General Fund		<u>\$ 140,887</u>	
Road and Bridge	General	\$ 66,257	Reimbursement for services
	Human Services	2,035	Reimbursement for services
Total due to Road and Bridge Fund		<u>\$ 68,292</u>	
Human Services	General	\$ 12	Reimbursement of expenses
Forfeited Tax	Road and Bridge	\$ 1	Pit reforestation
Total Due To/From Other Funds		<u>\$ 209,192</u>	

2. Due To/From Primary Government and Component Units

Receivable Entity	Payable Entity	Amount	Purpose
Component Unit - Lake County Housing and Redevelopment Authority	Primary Government - Debt Service Fund	<u>\$ 5,912</u>	Bond administration fees
Primary Government - Debt Service	Component Unit - Lake County Housing and Redevelopment Authority	<u>\$ 951,470</u>	Shortfalls in tax increment collections funded by primary government

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

B. Interfund Receivables, Payables, and Transfers (Continued)

3. Interfund Transfers

Interfund transfers for the year ended December 31, 2007, consisted of the following:

Transfers to General Fund from Debt Service Fund	\$ 16,101	Remaining fund balance
Transfers to Road and Bridge Fund from General Fund	\$ 125,096	Reimbursement for services and for expenditures made on the arena parking lot
Capital Projects Fund	1,005,748	Payment on joint garage facility and local road improvements
Total transfers to Road and Bridge Fund	<u>\$ 1,130,844</u>	
Transfers to Forfeited Tax Fund from Resource Development Fund	\$ 10,987	Transfer of coastal zone grant
Transfers to Capital Projects Fund from General Fund	\$ 90,503	Provide funding
Debt Service Fund	471	Expense charged to wrong fund
Total transfers to Capital Projects Fund	<u>\$ 90,974</u>	
Transfers to Resource Development Fund from Forfeited Tax Fund	\$ 416,612	Distribute net proceeds
Total Interfund Transfers	<u>\$ 1,665,518</u>	

C. Liabilities

1. Payables

Payables at December 31, 2007, were as follows:

	Governmental Activities	Business-Type Activities
Accounts payable	\$ 655,334	\$ 106,245
Escheat property payable	36,538	-
Salaries payable	368,664	41,179
Accrued vacation payable	-	52,526
Contracts payable	311,101	-
Due to other governments	158,775	-
Total Payables	<u>\$ 1,530,412</u>	<u>\$ 199,950</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities (Continued)

2. Leases

Business-Type Activities

Capital Leases

In January 2003, the Lake County Nursing Home entered into a lease agreement to finance a copier. The lease runs for five years with interest at ten percent and monthly payments of \$214. At lease expiration, the copier will become the Nursing Home's property and, as such, it has been recorded as a capital asset. At September 30, 2007, the copier was valued at \$11,000. There is \$8,800 of accumulated depreciation through September 30, 2007.

See Notes 3.C.3. and 3.C.4. for information on the lease payable and debt service requirements.

3. Long-Term Debt

Governmental Activities

Type of Indebtedness	Final Maturity	Installment Amounts	Interest Rate (%)	Original Issue Amount	Outstanding Balance December 31, 2007
General obligation bonds					
G.O. Refunding Bonds, Series 2003B	2009	\$130,000 - \$150,000	2.50 - 3.00	\$ 700,000	\$ 295,000
G.O. Tax Increment Refunding Bonds, Series 2003C	2009	\$250,000 - \$275,000	2.75 - 4.00	1,045,000	540,000
G.O. Capital Improvement Bonds, Series 2005A	2019	\$155,000 - \$310,000	3.375 - 3.80	3,200,000	3,045,000
G.O. State-Aid Highway Bonds, Series 2005B	2013	\$455,000 - \$460,000	3.25 - 3.50	3,200,000	2,740,000
Total General Obligation Bonds				<u>\$ 8,145,000</u>	<u>\$ 6,620,000</u>
Other long-term debt					
General obligation revenue note	2012	\$20,304 - \$24,286	2.00	\$ 222,422	\$ 116,739
Promissory note	2008	\$100,000	6.00	500,000	100,000
Promissory note (Allete)	2010	\$58,915	5.00	282,072	177,424
Capital lease	2021	\$146,667	5.375	2,200,000	2,053,333
Capital lease	2008	\$15,942	4.25	73,356	15,279
Capital lease	2009	\$27,686	6.25	49,024	34,171
Total Other Long-Term Debt				<u>\$ 3,326,874</u>	<u>\$ 2,496,946</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities

3. Long-Term Debt (Continued)

Business-Type Activities - Lake County Nursing Home

Type of Indebtedness	Final Maturity	Installment Amounts	Interest Rate (%)	Original Issue Amount	Outstanding Balance September 30, 2007
Capital lease	2008	\$2,571	10.00	\$ 11,000	\$ 2,484

4. Debt Service Requirements

Debt service requirements at December 31, 2007, were as follows:

Governmental Activities

Year Ending December 31	General Obligation Bonds		Other Long-Term Debt	
	Principal	Interest	Principal	Interest
2008	\$ 1,080,000	\$ 214,306	\$ 366,949	\$ 129,103
2009	1,100,000	177,247	236,517	111,829
2010	675,000	146,458	232,055	100,329
2011	685,000	122,888	170,475	88,764
2012	690,000	99,048	170,952	79,198
2013 - 2017	1,780,000	247,886	733,335	275,917
2018 - 2021	610,000	23,295	586,663	78,833
Total	\$ 6,620,000	\$ 1,031,128	\$ 2,496,946	\$ 863,973

Business-Type Activities - Lake County Nursing Home

Year Ending September 30	Capital Leases	
	Principal	Interest
2008	\$ 2,484	\$ 87

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities (Continued)

5. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2007, was as follows:

Governmental Activities

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
General obligation bonds	\$ 7,870,000	\$ -	\$ 1,250,000	\$ 6,620,000	\$ 1,080,000
Notes payable	569,749	-	175,586	394,163	178,708
Total bonds and notes payable	\$ 8,439,749	\$ -	\$ 1,425,586	\$ 7,014,163	\$ 1,258,708
Capital lease payable	2,229,924	49,024	176,165	2,102,783	188,241
Compensated absences	1,252,769	797,825	704,931	1,345,663	-
Governmental Activities Long-Term Liabilities	<u>\$ 11,922,442</u>	<u>\$ 846,849</u>	<u>\$ 2,306,682</u>	<u>\$ 10,462,609</u>	<u>\$ 1,446,949</u>

Business-Type Activities - Lake County Nursing Home

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Capital lease payable	\$ 4,687	\$ -	\$ 2,203	\$ 2,484	\$ 2,484
Compensated absences	104,933	7,111	-	112,044	32,804
Business-Type Activities Long-Term Liabilities	<u>\$ 109,620</u>	<u>\$ 7,111</u>	<u>\$ 2,203</u>	<u>\$ 114,528</u>	<u>\$ 35,288</u>

The County has covenanted to provide ongoing disclosure of certain annual financial information and operating data with respect to the County, including audited financial statements of the County.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Defined Benefit Plan

Plan Description

All full-time and certain part-time employees of Lake County are covered by defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the Public Employees Retirement Fund, the Public Employees Police and Fire Fund, and the Local Government Correctional Service Retirement Fund (the Public Employees Correctional Fund), which are cost-sharing, multiple-employer retirement plans. These plans are established and administered in accordance with Minn. Stat. chs. 353 and 356.

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. All police officers, firefighters, and peace officers who qualify for membership by statute are covered by the Public Employees Police and Fire Fund. Members who are employed in a county correctional institution as a correctional guard or officer, a joint jailer/dispatcher, or as a supervisor of correctional guards or officers or of joint jailer/dispatchers and are directly responsible for the direct security, custody, and control of the county correctional institution and its inmates, are covered by the Public Employees Correctional Fund.

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 defined retirement benefits are based on a member's highest average salary for any five successive years of allowable service, age, and years of credit at termination of service.

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Defined Benefit Plan

Plan Description (Continued)

Fire Fund members, the annuity accrual rate is 3.0 percent of average salary for each year of service. For Public Employees Correctional Fund members, the annuity accrual rate is 1.9 percent of average salary for each year of service.

For all Public Employees Retirement Fund members hired prior to July 1, 1989, whose annuity is calculated using Method 1, and for all Public Employees Police and Fire Fund and Public Employees Correctional Fund members, a full annuity is available when age plus years of service equal 90. A reduced retirement annuity is also available to eligible members seeking early retirement.

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, the Public Employees Police and Fire Fund, and the Public Employees Correctional Fund. That report may be obtained on the internet at www.mnpera.org; by writing to PERA at 60 Empire Drive, Suite 200, Saint Paul, Minnesota 55103-2088; or by calling 651-296-7460 or 1-800-652-9026.

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. The County makes annual contributions to the pension plans equal to the amount required by state statutes. Public Employees Retirement Fund Basic Plan members and Coordinated Plan members were required to contribute 9.10 and 5.75 percent, respectively, of their annual covered salary in 2007. Contribution rates in the Coordinated Plan increased in 2008 to 6.00 percent. Public Employees Police and Fire Fund members were required to contribute 7.80 percent of their annual covered salary in 2007. That rate increased to 8.60 percent in 2008. Public Employees Correctional Fund members are required to contribute 5.83 percent of their annual covered salary.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Defined Benefit Plan

Funding Policy (Continued)

The County is required to contribute the following percentages of annual covered payroll in 2007 and 2008:

	2007	2008
Public Employees Retirement Fund		
Basic Plan members	11.78%	11.78%
Coordinated Plan members	6.25	6.50
Public Employees Police and Fire Fund	11.70	12.90
Public Employees Correctional Fund	8.75	8.75

The County's contributions for the years ending December 31, 2007, 2006, and 2005, for the Public Employees Retirement Fund, the Public Employees Police and Fire Fund, and the Public Employees Correctional Fund were:

	2007	2006	2005
Public Employees Retirement Fund	\$ 396,937	\$ 370,507	\$ 328,600
Public Employees Police and Fire Fund	115,311	94,744	83,198
Public Employees Correctional Fund	44,581	36,401	32,825

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

B. Defined Contribution Plan

Three County Commissioners are covered by the Public Employees Defined Contribution Plan, a multiple-employer, deferred compensation plan administered by PERA in accordance with Minn. Stat. ch. 353D. The plan is a tax qualified plan under Section 401(a) of the Internal Revenue Code, and all contributions by or on behalf of employees are tax-deferred until time of withdrawal.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

B. Defined Contribution Plan (Continued)

Plan benefits depend solely on amounts contributed to the plan plus investment earnings, less administrative expenses. Minn. Stat. § 353D.03 specifies the employee and employer contribution rates for those qualified personnel who elect to participate. An eligible elected official who decides to participate contributes five percent of salary, which is matched by the employer. Employees may elect to make member contributions in an amount not to exceed the employer share. Employee and employer contributions are combined and used to purchase shares in one or more of the seven accounts of the Minnesota Supplemental Investment Fund. For administering the plan, PERA receives 2.00 percent of employer contributions and 0.25 percent of the assets in each member account annually.

Total contributions by dollar amount and percentage of covered payroll made by the County during the year ended December 31, 2007, were:

	<u>Employee</u>	<u>Employer</u>
Contribution amount	\$8,567	\$8,567
Percentage of covered payroll	5%	5%

Required contribution rates were 5.00 percent.

4. Summary of Significant Contingencies and Other Items

A. Risk Management

The County 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. To manage its workers' compensation and property and casualty risks, the County has entered into a joint powers agreement with other Minnesota counties to form the Minnesota Counties Insurance Trust (MCIT). The County is a member of both the MCIT Workers' Compensation and Property and Casualty Divisions. The County self-insures for employee dental coverage and participates in a health insurance pool for employee health coverage. For other risks, the County carries commercial insurance. The County retains risk for the deductible portions of the insurance policies. The amounts of these deductibles are considered immaterial to the financial statements. There were no significant reductions in insurance from the prior year. The amount of settlements did not exceed insurance coverage for the past three fiscal years.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

A. Risk Management (Continued)

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 \$400,000 per claim in 2007 and \$410,000 in 2008. Should the MCIT Workers' Compensation Division liabilities exceed assets, MCIT may assess the County in a method and amount to be determined by MCIT.

The Property and Casualty Division of MCIT is self-sustaining, and the County 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 County in a method and amount to be determined by MCIT.

The North East Service Cooperative (NESC) is a joint powers entity which sponsors a plan to provide group employee health benefits to its participating members. All members pool premiums and losses; however, a particular member may receive increases or decreases depending on a good or bad year of claims experience. Premiums are determined annually by the NESC and are based partially on the experience of the County and partially on the experience of the group. The NESC solicits proposals from carriers and negotiates the contracts. Beginning in 2005, the County retained the risk of loss for the first \$1,000 of claims under single coverage and the first \$2,000 of claims under family coverage for each employee. The County has contracted with Hanratty and Associates to administer the County's health claims for which the risk has been retained by the County. Claims are recognized as they are paid. The amount of claims incurred at the balance sheet date which have not been accrued in the financial statements is immaterial.

	Year Ended December 31	
	2007	2006
Unpaid claims, beginning of fiscal year	\$ -	\$ -
Incurred claims (including IBNRs)	307,382	332,402
Claims payments	(307,382)	(332,402)
Unpaid Claims, End of Fiscal Year	\$ -	\$ -

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

A. Risk Management (Continued)

The County retains the risk of loss from claims related to employee dental. The County has contracted with Delta Dental to administer the County's dental claims. The County provides dental coverage to permanent full-time employees based on negotiated union contracts to cover a portion of the dental claims. Claims are recognized as they are paid. The amount of claims incurred at the balance sheet date which have not been accrued in the financial statements is immaterial.

	Year Ended December 31	
	2007	2006
Unpaid claims, beginning of fiscal year	\$ -	\$ -
Incurred claims (including IBNRs)	109,648	115,407
Claims payments	(109,648)	(115,407)
Unpaid Claims, End of Fiscal Year	\$ -	\$ -

B. Contingent Liabilities

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

The County is a defendant in various lawsuits. Although the outcome of these lawsuits is not presently determinable, in the opinion of the County Attorney, the resolution of these matters will not have a material adverse effect on the financial condition of the government.

C. Other Commitments

Lake County has entered into a joint powers agreement with the Town of Silver Creek to assist the Town in financing a wastewater collection, treatment, and disposal system in the Castle Danger area. The County has agreed to contribute \$65,586 per year through the year 2017 to help finance this project. The total amount to be contributed is

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

C. Other Commitments (Continued)

\$1,035,000, of which \$419,102 has been paid through December 31, 2007. The outstanding commitment at December 31, 2007, is \$615,898. The agreement may be terminated by the mutual agreement of the two parties. This amount has not been recorded as a liability in Lake County's financial statements.

Lake County has entered into an agreement with the Township of Crystal Bay to provide \$60,000 of funding to the Township to help build a new community center. The funding is to be provided in four annual installments of \$15,000. The total amount that has been paid through December 31, 2007, is \$45,000; therefore, the outstanding balance of the commitment is \$15,000 at December 31, 2007. The money is to be returned to the County if no building is completed within five years. This amount has not been recorded as a liability in Lake County's financial statements.

D. Joint Ventures

Arrowhead Regional Corrections

The County, in a joint powers agreement pursuant to Minn. Stat. § 471.59, participates with Carlton, Cook, Koochiching, and St. Louis Counties in the Arrowhead Regional Corrections Board, which was established pursuant to the Community Corrections Act, Minn. Stat. §§ 401.01-.16.

The Arrowhead Regional Corrections Board comprises three major divisions: juvenile institutional services, adult institutional services, and court and field services. These divisions are composed of the five participating counties' probation departments, the Arrowhead Juvenile Detention Center, and the Northeast Regional Corrections Center.

Arrowhead Regional Corrections is governed by an eight-member Board, composed of one member appointed from each of the participating counties' Boards of Commissioners, except for St. Louis County, which has three members from its Board. In addition, the right to have an additional member is annually rotated among Carlton, Cook, Koochiching, and Lake Counties.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Arrowhead Regional Corrections (Continued)

Arrowhead Regional Corrections is financed through state grants and contributions from the participating counties. During 2006 (the most recent information available), County contributions were in the following proportion:

Carlton County	9.38%
Cook County	1.44
Koochiching County	1.96
Lake County	2.19
St. Louis County	<u>85.03</u>
Total	<u>100.00</u>

Below is a summary of the financial information from Arrowhead Regional Corrections' government-wide statements for December 31, 2006:

Total Assets	\$ 12,013,685
Total Liabilities	5,550,953
Total Net Assets	6,462,732
Total Revenues	19,396,875
Total Expenses	19,207,216
Change in Net Assets	189,659

Lake County provided \$290,936 in funding during 2007. Separate financial information can be obtained from:

Arrowhead Regional Corrections
St. Louis County Courthouse
100 North 5th Avenue West
Room 319
Duluth, Minnesota 55802

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures (Continued)

Community Health Board

Carlton, Cook, Lake, and St. Louis Counties entered into a joint powers agreement creating and operating the Carlton, Cook, Lake, and St. Louis County Community Health Board. This agreement was entered into January 1, 1977, and is established pursuant to Minn. Stat. § 471.59.

The Community Health Board is composed of nine members. The Carlton, Cook, and Lake County Boards of Commissioners each appoint two members; the St. Louis County Board of Commissioners appoints three members. Financing is obtained through federal and state grants. Lake County provided no funding to this organization in 2007.

At December 31, 2007, the Community Health Board's summary of financial information was:

Total Assets	\$ 1,311,645
Total Liabilities	1,154,632
Total Net Assets	157,013
Total Revenues	3,742,318
Total Expenses	3,716,572
Change in Net Assets	25,746

Separate financial information can be obtained from:

Carlton, Cook, Lake, and St. Louis Counties
Community Health Board
404 West Superior Street, Suite 220
Duluth, Minnesota 55802

Northeast Minnesota Office of Job Training

Aitkin, Carlton, Cook, Itasca, Koochiching, Lake, and St. Louis Counties (excluding the City of Duluth) entered into a joint powers agreement pursuant to Minn. Stat. § 471.59 for the purpose of developing and implementing a private and public job training program. The United States Congress, through the Job Training Partnership Act of 1982, authorized states to establish "service delivery areas" to provide programs

**LAKE COUNTY
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4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Northeast Minnesota Office of Job Training (Continued)

to achieve full employment through the use of grants. The counties identified above are defined as such a service delivery area, and the Northeast Minnesota Office of Job Training is designated as the grant recipient and administrator for such service delivery area. Lake County is not a funding mechanism for this organization.

The governing body is composed of seven members, one from the Board of Commissioners of each of the participating counties.

A summary of the financial information of Northeast Minnesota Office of Job Training's government-wide statements for June 30, 2007, was:

Total Assets	\$	2,992,962
Total Liabilities		1,487,634
Total Net Assets		1,505,328
Total Revenues		5,373,069
Total Expenses		5,435,301
Change in Net Assets		(62,232)

Separate financial information can be obtained from:

Northeast Minnesota Office of Job Training
820 North Ninth Street
Suite 210
Virginia, Minnesota 55792

Minnesota Counties Information Systems

The County entered into a joint powers agreement, pursuant to Minn. Stat. § 471.59, creating and operating Minnesota Counties Information Systems (MCIS). MCIS operates and maintains data processing facilities and management information systems for the benefit of members of this agreement.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Minnesota Counties Information Systems (Continued)

MCIS is governed by a 13-member board. Each participating county appoints a member. Financing is obtained through user charges to the members. Cass County is the fiscal agent for MCIS.

Each county's share of the assets and liabilities cannot be accurately determined since it will depend on the number of counties that are members when the agreement is dissolved.

A summary of the financial information of MCIS at December 31, 2006 (the most recent information available), was:

Total Assets	\$	785,330
Total Liabilities		202,814
Total Net Assets		582,516
Total Revenues		2,387,269
Total Expenses		2,195,143
Change in Net Assets		192,126

Separate financial information can be obtained from:

Minnesota Counties Information Systems
413 Southeast 7th Avenue
Grand Rapids, Minnesota 55744

Northern Counties Land Use Board

The Northern Counties Land Use Board was established through a joint powers agreement, pursuant to Minn. Stat. § 471.59, for the purpose of helping to formulate land use plans for the protection, sustainable use, and development of lands and natural resources.

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TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Northern Counties Land Use Board (Continued)

The joint powers are Cook, Koochiching, Lake, Lake of the Woods, Marshall, Pennington, Roseau, and St. Louis Counties. Three elected County Commissioners from St. Louis County and two from each of the other counties make up the membership of the Board. St. Louis County handles all of the financial transactions for this organization through its Northern Counties Land Use Board Agency Fund.

A summary of the financial statements at December 31, 2006 (the most recent information available), is shown below:

Total Assets	\$	75,537
Total Liabilities		20,061
Total Net Assets		55,476
Total Revenues		23,750
Total Expenses		7,780
Change in Net Assets		15,970

The County made no contributions in 2007 to the Northern Counties Land Use Board.

Separate financial information can be obtained from:

Northern Counties Land Use Board
Room 607 Government Services Center
320 West Second Street
Duluth, Minnesota 55802

North Shore Collaborative

The North Shore Collaborative was established in 1995 pursuant to Minn. Stat. § 124D.23. The Collaborative includes Lake County, Cook County, Independent School District 381, Independent School District 166, and the Grand Portage Reservation. The purpose of the Collaborative is to form a coalition of agencies, schools, and communities along the North Shore that will systematically address the mental health and other needs of the whole person for all children and youth, ensure their graduation from high school, and assist them in becoming healthy, happy, productive citizens.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

North Shore Collaborative (Continued)

Control of the North Shore Collaborative is vested in a Board of Directors. Lake County has three members on the Board. Financing is provided by state and federal grants, appropriations from Collaborative members, and miscellaneous revenues. Lake County is the fiscal agent for the Collaborative and handles all of the financial transactions for the organization. Financial information for the Collaborative for the fiscal year ended December 31, 2007, is as follows:

Assets	\$ 253,554
	<u> </u>
Liabilities	\$ 253,554
	<u> </u>

Arrowhead Health Alliance

Carlton, Cook, Koochiching, and Lake Counties entered into a joint powers agreement, pursuant to Minn. Stat. §§ 471.59 and 256B.692, for the purpose of organizing, governing, planning, and administering a county-based purchasing entity to participate in prepaid healthcare programs through the Minnesota Department of Human Services and the federal Centers for Medicare and Medicaid Services.

Control of the Arrowhead Health Alliance is vested in a Board of Directors composed of one representative from each of the member counties. Carlton County is the fiscal agent for the Arrowhead Health Alliance.

Lake County contributed \$78,697 in start-up funds to the Arrowhead Health Alliance in 2007.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

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

E. Jointly-Governed Organizations

Lake County, in conjunction with other local governments, has formed joint powers boards to provide a variety of services. The County appoints at least one member to the following organizations:

The North Shore Management Board provides Lake Superior Shoreline planning for Cook, Lake, and St. Louis Counties; the Cities of Beaver Bay, Grand Marais, Silver Bay, and Two Harbors; and the Towns of Duluth and Lakewood. The County provided \$2,500 in funding to the North Shore Management Board for 2007.

The St. Louis and Lake Counties Regional Railroad Authority operates a tourism train within the counties. Lake County did not provide any funding to the Regional Railroad Authority in 2007.

F. Related-Party Transactions - Lake County Housing and Redevelopment Authority

The Lake County Housing and Redevelopment Authority is a discretely presented component unit of Lake County. The following are related-party transactions:

SEGOG Property

In June 2005, the County entered into agreement with the Authority to sell 70 acres of land to the Authority for \$250,000. The property will be used for housing development to meet the County's housing needs and to assist in fostering economic development in the County. The purchase price of \$250,000 will be paid to the County as individual lots are sold in the development. This agreement has not been finalized as of December 31, 2007, and no cash payments have been made.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

F. Related-Party Transactions - Lake County Housing and Redevelopment Authority
(Continued)

Tax Increment Shortfalls

The Authority's tax increment revenues have not been sufficient to cover bond payments on the Cove Point and Superior Shores tax increment bonds. Lake County has made the bond payments on these bond issues; however, the Lake County Housing and Redevelopment Authority remains obligated to Lake County for these shortfalls. A receivable has been set up on the County's financial statements in the amount of \$951,470.

G. Tax-Forfeited Land

The County manages approximately 151,000 acres of state-owned, tax-forfeited land. This land generates revenues primarily from recreational land leases and land and timber sales. Land management costs, including forestry costs such as site preparation, seedlings, tree planting, and logging roads, are accounted for as current operating expenditures.

H. Excess of Expenditures Over Appropriations

For the year ended December 31, 2007, expenditures exceeded appropriations in the following funds:

General Fund	\$	575,964
Road and Bridge Special Revenue Fund		781,576
Resource Development Special Revenue Fund		87,919
Unorganized Townships Special Revenue Fund		34,489
Debt Service Fund		22,587

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

A. Summary of Significant Accounting Policies

In addition to those identified in Note 1, the County's discretely presented component unit, the Lake County Housing and Redevelopment Authority, has the following significant accounting policies.

Reporting Entity

The Lake County Housing and Redevelopment Authority was established June 13, 1984, and became active in 1986, having all the powers and duties of a County housing and redevelopment authority under the provisions of Minn. Stat. §§ 469.001 to 469.047. The Authority is governed by a five-member Board, appointed by the Lake County Board of Commissioners. The Board is organized with a chair, vice chair, secretary, and treasurer, elected annually.

Basis of Presentation

The Lake County Housing and Redevelopment Authority prepares separate financial statements.

The Authority reports a major governmental fund, the General Fund, and a major enterprise fund, the Silverpointe Enterprise Fund.

Measurement Focus and Basis of Accounting

The government-wide and proprietary 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. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

**LAKE COUNTY
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5. Component Unit Disclosures

A. Summary of Significant Accounting Policies

Measurement Focus and Basis of Accounting (Continued)

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. The Lake County Housing and Redevelopment Authority considers all revenues as available if collected within 90 days after the end of the current period, except for taxes, which have a 60-day accrual period. Property and other taxes, licenses, and interest are all considered to be susceptible to accrual.

Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, and claims and judgments, which are recognized as expenditures to the extent that they have matured. Proceeds of general 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 Authority's policy to use restricted resources first and then unrestricted resources as needed.

Cash and Cash Equivalents

The Authority's cash and cash equivalents consist of savings and checking accounts, cash on hand, and certificates of deposit, and do not include restricted accounts.

Receivables and Payables

All outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

A. Summary of Significant Accounting Policies

Receivables and Payables (Continued)

Property taxes, including property taxes captured as tax increment, are levied as of January 1 on property values assessed as of the same date. The tax levy notice is mailed in March with the first half payment due May 15 and the second half payment due October 15. The Authority approved an annual levy for operating purposes. Property taxes, including tax increment, are collected by Lake County. Unpaid taxes at December 31 become liens on the respective property and are classified in the financial statements as taxes receivable.

Restricted Assets

Certain funds of the Authority are classified as restricted assets on the statement of net assets because the restriction is either imposed by law through constitutional provisions or enabling legislation or imposed externally by creditors, grantors, contributors, or laws or regulations of other governments. Therefore, their use is limited by applicable laws and regulations.

Capital Assets

Capital assets, which include land, buildings and structures, and equipment, are reported in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$1,000 and have an expected life of at least five years. Such assets are recorded at historical cost.

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.

Buildings and structures and equipment of the Authority are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings and structures	25 - 40
Equipment	7

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

A. Summary of Significant Accounting Policies (Continued)

Long-Term Obligations

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

B. Detailed Notes on All Funds

1. Assets

Deposits and Investments

a. Deposits

The Authority's total cash and cash equivalents are reported as follows:

Government-wide statement of net assets	
Cash	\$ 276,570
Restricted cash and pooled investments	<u>82,837</u>
Total Cash	<u>\$ 359,407</u>

Minn. Stat. §§ 118A.02 and 118A.04 authorize the Authority to designate a depository for public funds and to invest in certificates of deposit. Minn. Stat. § 118A.03 requires that all Authority 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 that is not owned or controlled by the financial institution furnishing the collateral.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

B. Detailed Notes on All Funds

1. Assets

Deposits and Investments

a. Deposits (Continued)

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a financial institution failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of December 31, 2007, \$61,382 of the Authority's book balance of \$359,407 was exposed to custodial credit risk. These deposits are held in a trust account by the property manager of the Authority's rental units. The trust accounts are in the property manager's name and hold funds for multiple properties managed by the company. The account balances of each property are tracked internally by the property manager. Although the accounts are covered by FDIC insurance, it is not possible to determine the amount of FDIC coverage that is available to cover each property's individual balances.

Uninsured and uncollateralized	\$ <u>61,382</u>
--------------------------------	------------------

b. Investments

Minn. Stat. §§ 118A.04 and 118A.05 generally authorize the same types of investments as available to the Authority as are available to the County and are detailed in Note 2.A.1.b.

As of, and during the year ended, December 31, 2007, the Authority did not own any investments that required disclosure regarding interest rate risk, credit risk, custodial credit risk, or concentration of credit risk.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

B. Detailed Notes on All Funds

1. Assets (Continued)

Receivables

Receivables as of December 31, 2007, for the Authority's activities are as follows:

	Total Receivables	Amounts Not Scheduled for Collection During the Subsequent Year
Taxes	\$ 6,521	\$ -
Accounts receivable	119,495	-
Accrued interest	2,235	-
Loans receivable	42,962	-
Total Governmental Activities	\$ 171,213	\$ -

Loan Receivable

The Authority has a \$42,962 loan receivable from North Shore Business Enterprise Center, Inc., an unrelated non-profit organization. The loan is without interest. Annual principal payments of \$28,000 and \$27,000 are due on September 1, 2006, and September 1, 2007, respectively. However, no payment was received in 2006, and only \$12,038 was received in 2007.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

B. Detailed Notes on All Funds

1. Assets (Continued)

Capital Assets

Business-Type Activities

	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
Capital assets depreciated				
Buildings and structures	\$ 1,879,117	\$ -	\$ -	\$ 1,879,117
Equipment	3,911	-	-	3,911
	<u>\$ 1,883,028</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,883,028</u>
Less: accumulated depreciation for				
Buildings and structures	\$ 450,205	\$ 46,978	\$ -	\$ 497,183
Equipment	3,911	-	-	3,911
	<u>\$ 454,116</u>	<u>\$ 46,978</u>	<u>\$ -</u>	<u>\$ 501,094</u>
Business-Type Activities Capital Assets, Net	<u>\$ 1,428,912</u>	<u>\$ (46,978)</u>	<u>\$ -</u>	<u>\$ 1,381,934</u>

Depreciation expense was charged to functions/programs of the Authority as follows:

Business-Type Activities	
Senior housing	<u>\$ 46,978</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

B. Detailed Notes on All Funds (Continued)

2. Liabilities

Long-Term Debt

Business-Type Activities

<u>Type of Indebtedness</u>	<u>Final Maturity</u>	<u>Installment Amounts</u>	<u>Interest Rate (%)</u>	<u>Original Issue Amount</u>	<u>Outstanding Balance December 31, 2007</u>
1996 General Obligation Senior Housing Bonds	2028	Varies	3.92	\$ 1,160,642	\$ 941,508

Debt Service Requirements

Debt service requirements at December 31, 2007, were as follows:

Business-Type Activities

<u>Year Ending December 31</u>	<u>Revenue Bonds</u>	
	<u>Principal</u>	<u>Interest</u>
2008	\$ 28,000	\$ 46,443
2009	29,272	45,018
2010	30,769	43,521
2011	32,343	41,947
2012	33,998	40,292
2013 - 2017	197,931	173,518
2018 - 2022	254,016	117,433
2023 - 2027	325,994	45,455
2028	9,185	52
Totals	\$ 941,508	\$ 553,679

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

B. Detailed Notes on All Funds

2. Liabilities (Continued)

Changes in Long-Term Liabilities

Business-Type Activities

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds payable					
General Obligation					
Senior Housing Bonds	\$ 970,690	\$ -	\$ 29,182	\$ 941,508	\$ 28,000

Tax Increment Financing Districts

The Authority administers the following tax increment financing districts established pursuant to Minn. Stat. §§ 469.174 to 469.1791.

District Number 2	Blue Water/Superior Shores Project
District Number 3	Cove Point Project
District Number 4	Incubator Building Project

The bonds outstanding for District Nos. 2 and 3 are general obligation bonds issued by Lake County and are included in the Lake County financial statements. The bonds do not constitute a debt of the Authority. The County collects and pays the debt service payments pursuant to the amended Tax Increment Pledge Agreement, and the Authority recognizes the tax increment revenues and tax increment distributions to Lake County in its financial statements.

In 2007, the Housing and Redevelopment Authority decertified the tax increment financing District Number 3 - Cove Point Project and District Number 4 - Incubator Building Project.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures (Continued)

C. Risk Management

The Authority is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; or natural disasters. To manage these risks, the Authority has joined the Minnesota Counties Insurance Trust (MCIT). The Authority retains risk for the deductible portions of the insurance policies. The amounts of these deductibles are considered immaterial to the financial statements. There were no significant reductions in insurance from the prior year. The amount of settlements did not exceed insurance coverage for the past three fiscal years.

D. Summary Disclosure of Significant Contingencies

Tax Increment Assistance

The Lake County Housing and Redevelopment Authority is committed to provide tax increment assistance pursuant to the Northshore Business Enterprise Center development agreement. The assistance is provided in the form of an annual tax rebate to the developer. The annual tax rebate is contingent upon payment of annual property taxes by the developer. The assistance for the project is limited in amount based on both the scope of the project and the life of the tax increment district. The tax increment assistance does not result in debt proceeds and does not meet the definition of debt.

Conduit Debt Obligation

The Lake County Housing and Redevelopment Authority has issued the Health Care Facilities Revenue Bonds, Series 2000, originally issued for \$5,000,000 in May 2000, and refinanced in October 2003, for \$4,108,000, to provide financial assistance to First Plan of Minnesota to construct two medical clinics. The bonds are secured by the property financed through a loan agreement and are payable solely from the revenues of First Plan of Minnesota. Neither the Authority nor the state is obligated in any manner for repayment of the bonds. Accordingly, the bonds are not reported as a liability in the Authority's financial statements.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

D. Summary Disclosure of Significant Contingencies (Continued)

Financial Condition

The Authority's expenses, including required payments to Lake County pursuant to bond obligations, exceed current tax increment financing and other revenues. This continuing condition has resulted in a deficit balance of unrestricted net assets. Under current agreements and regulations, it appears the financial condition of the Authority will continue to deteriorate. The Authority's Board is looking into ways to improve its financial condition, including working with other similarly situated parties and the Minnesota Legislature to amend tax increment laws. The Authority is also in discussion with Lake County regarding its current obligations and the availability of alternative revenue sources.

The ability of the Authority to continue as a going concern is dependent on its ability to generate additional revenues and/or limit its current debt obligations to provide sufficient net cash flow to fund its daily and long-term obligations. The financial statements do not include any adjustments that might be necessary if the Authority is unable to continue as a going concern.

E. Related-Party Transactions

The Lake County Housing and Redevelopment Authority related-party transactions are described in detail in Note 4.F.

F. Subsequent Events

In 2008, the Lake County Housing and Redevelopment Authority entered into a joint powers agreement with Cook County/Grand Marais Joint Economic Development Authority pursuant to Minn. Stat. § 471.59 for the purpose of preserving the existing housing market, encouraging new housing construction, and providing housing opportunities to the residents of Lake and Cook Counties. The power of each party will be exercised jointly under this agreement with the assistance of a housing coordinator to be retained by both parties.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

F. Subsequent Events (Continued)

In 2008, Lake County was awarded a \$671,576 United States Department of Housing and Urban Development federal grant under the Community Development Block Grant program through the Minnesota Department of Employment and Economic Development to be administered by the Lake County Housing and Redevelopment Authority. The funds are to be used for the rehabilitation of homes in Lake and Cook Counties. Lake County also expects to receive an additional \$553,436 in other funds to aid in the rehabilitation of these homes.

REQUIRED SUPPLEMENTARY INFORMATION

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 1

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 4,881,694	\$ 4,881,694	\$ 4,162,668	\$ (719,026)
Licenses and permits	23,055	23,055	27,984	4,929
Intergovernmental	2,160,164	2,160,164	3,198,583	1,038,419
Charges for services	461,920	461,920	581,313	119,393
Fines and forfeits	1,500	1,500	63,075	61,575
Gifts and contributions	-	-	330	330
Investment earnings	343,000	343,000	555,073	212,073
Miscellaneous	110,172	110,172	492,155	381,983
Total Revenues	<u>\$ 7,981,505</u>	<u>\$ 7,981,505</u>	<u>\$ 9,081,181</u>	<u>\$ 1,099,676</u>
Expenditures				
Current				
General government				
Commissioners	\$ 380,971	\$ 380,971	\$ 362,769	\$ 18,202
Courts	26,599	26,599	23,318	3,281
Law library	25,000	25,000	24,822	178
County administration		76,936	78,160	(1,224)
County auditor	487,146	487,146	483,380	3,766
County assessor	430,598	430,598	405,944	24,654
Elections	1,000	1,000	10,151	(9,151)
Accounting and auditing	55,000	55,000	72,352	(17,352)
Data processing	609,976	609,976	562,024	47,952
Personnel	132,128	132,128	168,382	(36,254)
Attorney	382,584	382,584	367,749	14,835
Recorder	230,417	230,417	219,122	11,295
Planning and zoning	251,614	251,614	218,909	32,705
Buildings and plant	635,760	635,760	565,812	69,948
Veterans service officer	61,473	61,473	61,111	362
Training	5,000	5,000	1,783	3,217
Motor pool	58,318	58,318	48,236	10,082
Total general government	<u>\$ 3,773,584</u>	<u>\$ 3,850,520</u>	<u>\$ 3,674,024</u>	<u>\$ 176,496</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

***Schedule 1
(Continued)***

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Expenditures				
Current (Continued)				
Public safety				
Sheriff	\$ 1,657,443	\$ 1,657,443	\$ 1,768,491	\$ (111,048)
Ambulance	43,533	43,533	41,382	2,151
Emergency services	112,219	112,219	111,655	564
Coroner	20,000	20,000	12,106	7,894
County jail	751,820	751,820	852,065	(100,245)
Community corrections	293,961	293,961	294,294	(333)
Sentence to serve	63,522	63,522	64,203	(681)
Emergency management	76,260	76,260	83,269	(7,009)
Civil defense	-	-	1,111	(1,111)
Other public safety	35,870	35,870	257,442	(221,572)
Total public safety	\$ 3,054,628	\$ 3,054,628	\$ 3,486,018	\$ (431,390)
Sanitation				
Solid waste	\$ 114,916	\$ 114,916	\$ 129,252	\$ (14,336)
Recycling	143,006	143,006	125,705	17,301
Hazardous waste	46,600	46,600	46,872	(272)
Total sanitation	\$ 304,522	\$ 304,522	\$ 301,829	\$ 2,693
Culture and recreation				
Historical society	\$ 28,000	\$ 28,000	\$ 28,000	\$ -
Arenas	790,096	790,096	859,596	(69,500)
Humane society	3,500	3,500	3,500	-
Memorial Day observance	750	750	300	450
Recreation board	130,105	130,105	130,094	11
Trails	-	-	225,275	(225,275)
County/regional library	74,768	74,768	74,768	-
Total culture and recreation	\$ 1,027,219	\$ 1,027,219	\$ 1,321,533	\$ (294,314)
Conservation of natural resources				
County extension	\$ 96,600	\$ 96,600	\$ 93,647	\$ 2,953
Soil and water conservation	35,963	35,963	36,585	(622)
Agricultural society/County fair	17,350	17,350	20,042	(2,692)
Water planning	23,631	23,631	23,631	-
Wetland challenge	5,000	5,000	5,000	-
Other	-	-	2,612	(2,612)
Total conservation of natural resources	\$ 178,544	\$ 178,544	\$ 181,517	\$ (2,973)

The notes to the required supplementary information are an integral part of this schedule.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 1
(Continued)

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Expenditures				
Current (Continued)				
Economic development				
Information centers	\$ 14,850	\$ 14,850	\$ 19,340	\$ (4,490)
Airports	28,000	28,000	28,000	-
Total economic development	\$ 42,850	\$ 42,850	\$ 47,340	\$ (4,490)
Debt service				
Principal	\$ -	\$ -	\$ 21,986	\$ (21,986)
Total Expenditures	\$ 8,381,347	\$ 8,458,283	\$ 9,034,247	\$ (575,964)
Excess of Revenues Over (Under)				
Expenditures	\$ (399,842)	\$ (476,778)	\$ 46,934	\$ 523,712
Other Financing Sources (Uses)				
Transfers in	\$ -	\$ -	\$ 16,101	\$ 16,101
Transfers out	178,222	178,222	(215,599)	(393,821)
Total Other Financing Sources (Uses)	\$ 178,222	\$ 178,222	\$ (199,498)	\$ (377,720)
Net Change in Fund Balance	\$ (221,620)	\$ (298,556)	\$ (152,564)	\$ 145,992
Fund Balance - January 1	5,897,296	5,897,296	5,897,296	-
Fund Balance - December 31	\$ 5,675,676	\$ 5,598,740	\$ 5,744,732	\$ 145,992

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 2

**BUDGETARY COMPARISON SCHEDULE
ROAD AND BRIDGE SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 1,524,456	\$ 1,524,456	\$ 1,291,336	\$ (233,120)
Intergovernmental	9,282,567	9,282,567	10,092,910	810,343
Charges for services	125,000	125,000	451,638	326,638
Investment earnings	57,665	57,665	64,065	6,400
Miscellaneous	37,500	37,500	11,190	(26,310)
Total Revenues	\$ 11,027,188	\$ 11,027,188	\$ 11,911,139	\$ 883,951
Expenditures				
Current				
Highways and streets				
Administration	\$ 316,247	\$ 316,247	\$ 353,199	\$ (36,952)
Maintenance	1,481,784	1,481,784	1,988,575	(506,791)
Construction	11,262,629	11,262,629	11,539,637	(277,008)
Equipment maintenance and shop	1,097,856	1,097,856	1,026,185	71,671
Total highways and streets	\$ 14,158,516	\$ 14,158,516	\$ 14,907,596	\$ (749,080)
Debt service				
Principal	\$ 460,000	\$ 460,000	\$ 489,498	\$ (29,498)
Interest	99,710	99,710	102,305	(2,595)
Administrative (fiscal) charges	-	-	403	(403)
Total debt service	\$ 559,710	\$ 559,710	\$ 592,206	\$ (32,496)
Total Expenditures	\$ 14,718,226	\$ 14,718,226	\$ 15,499,802	\$ (781,576)
Excess of Revenues Over (Under) Expenditures	\$ (3,691,038)	\$ (3,691,038)	\$ (3,588,663)	\$ 102,375
Other Financing Sources (Uses)				
Transfers in	\$ 1,750,000	\$ 1,750,000	\$ 1,130,844	\$ (619,156)
Capital lease purchase	-	-	49,024	49,024
Total Other Financing Sources (Uses)	\$ 1,750,000	\$ 1,750,000	\$ 1,179,868	\$ (570,132)
Net Change in Fund Balance	\$ (1,941,038)	\$ (1,941,038)	\$ (2,408,795)	\$ (467,757)
Fund Balance - January 1	3,906,029	3,906,029	3,906,029	-
Increase (decrease) in reserved for inventories	-	-	(61,937)	(61,937)
Fund Balance - December 31	\$ 1,964,991	\$ 1,964,991	\$ 1,435,297	\$ (529,694)

The notes to the required supplementary information are an integral part of this schedule.

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 3

**BUDGETARY COMPARISON SCHEDULE
HUMAN SERVICES SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 1,863,278	\$ 1,863,278	\$ 1,540,205	\$ (323,073)
Intergovernmental	2,115,961	2,115,961	2,506,756	390,795
Charges for services	91,546	91,546	152,129	60,583
Miscellaneous	21,250	21,250	107,402	86,152
Total Revenues	<u>\$ 4,092,035</u>	<u>\$ 4,092,035</u>	<u>\$ 4,306,492</u>	<u>\$ 214,457</u>
Expenditures				
Current				
Human services				
Income maintenance	\$ 846,827	\$ 846,827	\$ 868,991	\$ (22,164)
Social services	2,870,068	2,870,068	2,659,298	210,770
Total human services	<u>\$ 3,716,895</u>	<u>\$ 3,716,895</u>	<u>\$ 3,528,289</u>	<u>\$ 188,606</u>
Health				
Nursing service	\$ 49,818	\$ 49,818	\$ 52,763	\$ (2,945)
Transportation		7,379	16,949	(9,570)
Environmental health	82,160	82,160	85,639	(3,479)
Mental health	-	-	17,792	(17,792)
Health education	235,783	235,783	280,545	(44,762)
Total health	<u>\$ 367,761</u>	<u>\$ 375,140</u>	<u>\$ 453,688</u>	<u>\$ (78,548)</u>
Total Expenditures	<u>\$ 4,084,656</u>	<u>\$ 4,092,035</u>	<u>\$ 3,981,977</u>	<u>\$ 110,058</u>
Net Change in Fund Balance	<u>\$ 7,379</u>	<u>\$ -</u>	<u>\$ 324,515</u>	<u>\$ 324,515</u>
Fund Balance - January 1	<u>2,985,131</u>	<u>2,985,131</u>	<u>2,985,131</u>	<u>-</u>
Fund Balance - December 31	<u>\$ 2,992,510</u>	<u>\$ 2,985,131</u>	<u>\$ 3,309,646</u>	<u>\$ 324,515</u>

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED DECEMBER 31, 2007**

1. Budgetary Information

Annual budgets are adopted on a basis consistent with generally accepted accounting principles for all governmental funds. All annual appropriations lapse at fiscal year-end.

In July of each year, all departments and agencies submit requests for appropriations to the County Auditor/Treasurer so that a budget can be prepared. Before September 15, the proposed budget is presented to the County Board for review. A final budget is adopted by the Board and certified to the Auditor/Treasurer by December 28.

The appropriated budget is prepared by fund, function, and department. The County's department heads may make transfers of appropriations within a department with County Board approval. Transfers of appropriations between departments also require approval of the County Board. The legal level of budgetary control (the level at which expenditures may not legally exceed appropriations) is the fund level.

Encumbrance accounting is employed in governmental funds. Encumbrances (for example, purchase orders or contracts) outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be reapportioned and honored during the subsequent year.

2. Excess of Expenditures Over Appropriations

For the year ended December 31, 2007, expenditures exceeded appropriations in the following funds:

General Fund	\$	575,964
Road and Bridge Special Revenue Fund		781,576

SUPPLEMENTARY INFORMATION

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

NONMAJOR GOVERNMENTAL FUNDS

The Resource Development Special Revenue Fund is used to account for intergovernmental revenue used for resource development, forest management, game and fish habitat improvement, and recreational development and maintenance of County-administered natural resources land.

The Economic Development Special Revenue Fund is used to account for intergovernmental revenue used to finance various economic development projects.

The Unorganized Townships Special Revenue Fund is used to account for the activities of Unorganized Townships 1 and 2 related to fire protection and election services. Activities related to road maintenance in the unorganized townships are accounted for in the County's Road and Bridge Special Revenue Fund.

The Forfeited Tax Special Revenue Fund is used to account for revenues from the sale or lease of lands forfeited to the State of Minnesota and for revenues dedicated for use in memorial forests and various land and timber development projects.

The Debt Service Fund is used to account for the accumulation of resources for and the payment of principal, interest, and related costs of general long-term debt.

The Capital Improvements Capital Projects Fund is used to account for financial resources used for the construction of a new human services building and for county road projects. These projects were completed in 2007 and the fund was closed out.

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Statement 1

**COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
DECEMBER 31, 2007**

	Special Revenue (Statement 3)	Debt Service	Total
<u>Assets</u>			
Cash and pooled investments	\$ 973,816	\$ 60,180	\$ 1,033,996
Petty cash and change funds	50	-	50
Undistributed cash in agency funds	3,356	11,419	14,775
Taxes receivable			
Prior	2,113	12,298	14,411
Accounts receivable	441,275	-	441,275
Due from other funds	1	-	1
Due from other governments	14,079	-	14,079
Due from component unit	-	951,470	951,470
Loans receivable	63,166	150,000	213,166
	\$ 1,497,856	\$ 1,185,367	\$ 2,683,223
 <u>Liabilities and Fund Balances</u>			
Liabilities			
Accounts payable	\$ 2,607	\$ -	\$ 2,607
Salaries payable	15,405	-	15,405
Due to other funds	-	122,189	122,189
Due to other governments	102,084	-	102,084
Due to component unit	-	5,912	5,912
Deferred revenue - unavailable	419,970	160,336	580,306
	\$ 540,066	\$ 288,437	\$ 828,503
 Fund Balances			
Reserved for loans receivable	\$ 63,166	\$ -	\$ 63,166
Unreserved			
Designated for debt service	-	896,930	896,930
Undesignated	894,624	-	894,624
	\$ 957,790	\$ 896,930	\$ 1,854,720
Total Fund Balances	\$ 957,790	\$ 896,930	\$ 1,854,720
 Total Liabilities and Fund Balances	\$ 1,497,856	\$ 1,185,367	\$ 2,683,223

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Statement 2

**COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
NONMAJOR GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2007**

	Special Revenue (Statement 4)	Debt Service	Capital Projects	Total
Revenues				
Taxes	\$ 63,936	\$ 453,170	\$ -	\$ 517,106
Licenses and permits	867	-	-	867
Intergovernmental	145,062	121,502	-	266,564
Charges for services	267,078	-	-	267,078
Investment earnings	-	35,843	-	35,843
Miscellaneous	762,442	224,233	-	986,675
	\$ 1,239,385	\$ 834,748	\$ -	\$ 2,074,133
Expenditures				
Current				
Public safety	\$ 106,489	\$ -	\$ -	\$ 106,489
Conservation of natural resources	679,715	-	-	679,715
Intergovernmental	-	23,324	-	23,324
Debt service				
Principal	300,267	790,000	-	1,090,267
Interest	141,194	153,986	-	295,180
Administrative (fiscal) charges	-	4,613	-	4,613
	\$ 1,227,665	\$ 971,923	\$ -	\$ 2,199,588
Excess of Revenues Over (Under) Expenditures	\$ 11,720	\$ (137,175)	\$ -	\$ (125,455)
Other Financing Sources (Uses)				
Transfers in	\$ 427,599	\$ -	\$ 90,974	\$ 518,573
Transfers out	(427,599)	(16,572)	(1,005,748)	(1,449,919)
	\$ -	\$ (16,572)	\$ (914,774)	\$ (931,346)
Net Change in Fund Balance	\$ 11,720	\$ (153,747)	\$ (914,774)	\$ (1,056,801)
Fund Balance - January 1	946,070	1,050,677	914,774	2,911,521
Fund Balance - December 31	\$ 957,790	\$ 896,930	\$ -	\$ 1,854,720

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Statement 3

**COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS
DECEMBER 31, 2007**

	<u>Resource Development</u>	<u>Economic Development</u>	<u>Unorganized Townships</u>	<u>Forfeited Tax</u>	<u>Total</u>
<u>Assets</u>					
Cash and pooled investments	\$ 520,714	\$ 56,281	\$ 170,787	\$ 226,034	\$ 973,816
Petty cash and change funds	-	-	-	50	50
Undistributed cash in agency funds	-	-	3,356	-	3,356
Taxes receivable					
Prior	-	-	2,113	-	2,113
Accounts receivable	-	-	-	441,275	441,275
Due from other funds	-	-	-	1	1
Due from other governments	-	-	-	14,079	14,079
Loans receivable	-	63,166	-	-	63,166
Total Assets	<u>\$ 520,714</u>	<u>\$ 119,447</u>	<u>\$ 176,256</u>	<u>\$ 681,439</u>	<u>\$ 1,497,856</u>
<u>Liabilities and Fund Balances</u>					
Liabilities					
Accounts payable	\$ -	\$ -	\$ -	\$ 2,607	\$ 2,607
Salaries payable	-	-	-	15,405	15,405
Due to other governments	-	-	96,089	5,995	102,084
Deferred revenue - unavailable	-	-	1,536	418,434	419,970
Total Liabilities	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 97,625</u>	<u>\$ 442,441</u>	<u>\$ 540,066</u>
Fund Balances					
Reserved for loans receivable	\$ -	\$ 63,166	\$ -	\$ -	\$ 63,166
Unreserved					
Undesignated	520,714	56,281	78,631	238,998	894,624
Total Fund Balances	<u>\$ 520,714</u>	<u>\$ 119,447</u>	<u>\$ 78,631</u>	<u>\$ 238,998</u>	<u>\$ 957,790</u>
Total Liabilities and Fund Balances	<u>\$ 520,714</u>	<u>\$ 119,447</u>	<u>\$ 176,256</u>	<u>\$ 681,439</u>	<u>\$ 1,497,856</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Statement 4

**COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Resource Development</u>	<u>Economic Development</u>	<u>Unorganized Townships</u>	<u>Forfeited Tax</u>	<u>Total</u>
Revenues					
Taxes	\$ -	\$ -	\$ 63,936	\$ -	\$ 63,936
Licenses and permits	-	-	75	792	867
Intergovernmental	96,415	-	10,936	37,711	145,062
Charges for services	-	-	-	267,078	267,078
Miscellaneous	-	7,359	-	755,083	762,442
Total Revenues	\$ 96,415	\$ 7,359	\$ 74,947	\$ 1,060,664	\$ 1,239,385
Expenditures					
Current					
Public safety	\$ -	\$ -	\$ 106,489	\$ -	\$ 106,489
Conservation of natural resources	29,986	-	-	649,729	679,715
Debt service					
Principal	300,267	-	-	-	300,267
Interest	141,194	-	-	-	141,194
Total Expenditures	\$ 471,447	\$ -	\$ 106,489	\$ 649,729	\$ 1,227,665
Excess of Revenues Over (Under) Expenditures	\$ (375,032)	\$ 7,359	\$ (31,542)	\$ 410,935	\$ 11,720
Other Financing Sources (Uses)					
Transfers in	\$ 416,612	\$ -	\$ -	\$ 10,987	\$ 427,599
Transfers out	(10,987)	-	-	(416,612)	(427,599)
Total Other Financing Sources (Uses)	\$ 405,625	\$ -	\$ -	\$ (405,625)	\$ -
Net Change in Fund Balance	\$ 30,593	\$ 7,359	\$ (31,542)	\$ 5,310	\$ 11,720
Fund Balance - January 1	490,121	112,088	110,173	233,688	946,070
Fund Balance - December 31	\$ 520,714	\$ 119,447	\$ 78,631	\$ 238,998	\$ 957,790

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 4

**BUDGETARY COMPARISON SCHEDULE
RESOURCE DEVELOPMENT SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Intergovernmental	\$ 80,000	\$ 80,000	\$ 96,415	\$ 16,415
Expenditures				
Current				
Conservation of natural resources				
Forestry	\$ 203,000	\$ 203,000	\$ 29,986	\$ 173,014
Debt service				
Principal	158,915	158,915	300,267	(141,352)
Interest	21,613	21,613	141,194	(119,581)
Total Expenditures	<u>\$ 383,528</u>	<u>\$ 383,528</u>	<u>\$ 471,447</u>	<u>\$ (87,919)</u>
Excess of Revenues Over (Under)				
Expenditures	<u>\$ (303,528)</u>	<u>\$ (303,528)</u>	<u>\$ (375,032)</u>	<u>\$ (71,504)</u>
Other Financing Sources (Uses)				
Transfers in	\$ -	\$ -	\$ 416,612	\$ 416,612
Transfers out	-	-	(10,987)	(10,987)
Total Other Financing Sources (Uses)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 405,625</u>	<u>\$ 405,625</u>
Net Change in Fund Balance	\$ (303,528)	\$ (303,528)	\$ 30,593	\$ 334,121
Fund Balance - January 1	<u>490,121</u>	<u>490,121</u>	<u>490,121</u>	<u>-</u>
Fund Balance - December 31	<u>\$ 186,593</u>	<u>\$ 186,593</u>	<u>\$ 520,714</u>	<u>\$ 334,121</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 5

**BUDGETARY COMPARISON SCHEDULE
ECONOMIC DEVELOPMENT SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Miscellaneous	\$ 13,392	\$ 13,392	\$ 7,359	\$ (6,033)
Net Change in Fund Balance	\$ 13,392	\$ 13,392	\$ 7,359	\$ (6,033)
Fund Balance - January 1	<u>112,088</u>	<u>112,088</u>	<u>112,088</u>	-
Fund Balance - December 31	<u><u>\$ 125,480</u></u>	<u><u>\$ 125,480</u></u>	<u><u>\$ 119,447</u></u>	<u><u>\$ (6,033)</u></u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 6

**BUDGETARY COMPARISON SCHEDULE
UNORGANIZED TOWNSHIPS SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 74,490	\$ 74,490	\$ 63,936	\$ (10,554)
Licenses and permits	95	95	75	(20)
Intergovernmental	-	-	10,936	10,936
	<hr/>	<hr/>	<hr/>	<hr/>
Total Revenues	\$ 74,585	\$ 74,585	\$ 74,947	\$ 362
Expenditures				
Current				
Public safety				
Emergency services	72,000	72,000	106,489	(34,489)
	<hr/>	<hr/>	<hr/>	<hr/>
Net Change in Fund Balance	\$ 2,585	\$ 2,585	\$ (31,542)	\$ (34,127)
Fund Balance - January 1	110,173	110,173	110,173	-
	<hr/>	<hr/>	<hr/>	<hr/>
Fund Balance - December 31	<u>\$ 112,758</u>	<u>\$ 112,758</u>	<u>\$ 78,631</u>	<u>\$ (34,127)</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 7

**BUDGETARY COMPARISON SCHEDULE
FORFEITED TAX SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Licenses and permits	\$ 1,075	\$ 1,075	\$ 792	\$ (283)
Intergovernmental	22,241	22,241	37,711	15,470
Charges for services	150,000	150,000	267,078	117,078
Miscellaneous	1,454,400	1,454,400	755,083	(699,317)
Total Revenues	\$ 1,627,716	\$ 1,627,716	\$ 1,060,664	\$ (567,052)
Expenditures				
Current				
Conservation of natural resources				
Land use	779,275	779,275	649,729	129,546
Excess of Revenues Over (Under)				
Expenditures	\$ 848,441	\$ 848,441	\$ 410,935	\$ (437,506)
Other Financing Sources (Uses)				
Transfers in	\$ 70,000	\$ 70,000	\$ 10,987	\$ (59,013)
Transfers out	-	-	(416,612)	(416,612)
Total Other Financing Sources (Uses)	\$ 70,000	\$ 70,000	\$ (405,625)	\$ (475,625)
Net Change in Fund Balance	\$ 918,441	\$ 918,441	\$ 5,310	\$ (913,131)
Fund Balance - January 1	233,688	233,688	233,688	-
Fund Balance - December 31	\$ 1,152,129	\$ 1,152,129	\$ 238,998	\$ (913,131)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 8

**BUDGETARY COMPARISON SCHEDULE
DEBT SERVICE FUND
FOR THE YEAR ENDED DECEMBER 31, 2007**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Taxes	\$ 453,642	\$ 453,642	\$ 453,170	\$ (472)
Intergovernmental	178,222	178,222	121,502	(56,720)
Investment earnings	3,000	3,000	35,843	32,843
Miscellaneous	224,047	224,047	224,233	186
Total Revenues	<u>\$ 858,911</u>	<u>\$ 858,911</u>	<u>\$ 834,748</u>	<u>\$ (24,163)</u>
Expenditures				
Intergovernmental				
General government	\$ -	\$ -	\$ 23,324	\$ (23,324)
Debt service				
Principal	790,000	790,000	790,000	-
Interest	153,986	153,986	153,986	-
Administrative (fiscal) charges	5,350	5,350	4,613	737
Total Expenditures	<u>\$ 949,336</u>	<u>\$ 949,336</u>	<u>\$ 971,923</u>	<u>\$ (22,587)</u>
Excess of Revenues Over (Under)				
Expenditures	\$ (90,425)	\$ (90,425)	\$ (137,175)	\$ (46,750)
Other Financing Sources (Uses)				
Transfers out	-	-	(16,572)	(16,572)
Net Change in Fund Balance	\$ (90,425)	\$ (90,425)	\$ (153,747)	\$ (63,322)
Fund Balance - January 1	<u>1,050,677</u>	<u>1,050,677</u>	<u>1,050,677</u>	<u>-</u>
Fund Balance - December 31	<u>\$ 960,252</u>	<u>\$ 960,252</u>	<u>\$ 896,930</u>	<u>\$ (63,322)</u>

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FIDUCIARY FUNDS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Statement 5

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2007**

	Balance January 1	Additions	Deductions	Balance December 31
<u>CITIES, TOWNS, AND OTHER GOVERNMENTS</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 1,815	\$ 8,761,249	\$ 8,762,946	\$ 118
<u>Liabilities</u>				
Due to other governments	\$ 1,815	\$ 8,761,249	\$ 8,762,946	\$ 118
 <u>TAXES AND PENALTIES</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 294,046	\$ 14,482,122	\$ 14,398,857	\$ 377,311
<u>Liabilities</u>				
Taxes collected in advance	\$ 5,329	\$ 15,123	\$ 5,329	\$ 15,123
Due to other governments	288,717	14,466,999	14,393,528	362,188
Total Liabilities	\$ 294,046	\$ 14,482,122	\$ 14,398,857	\$ 377,311
 <u>STATE</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 77,263	\$ 240,686	\$ 291,996	\$ 25,953
<u>Liabilities</u>				
Due to other governments	\$ 77,263	\$ 240,686	\$ 291,996	\$ 25,953

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

*Statement 5
(Continued)*

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2007**

	Balance January 1	Additions	Deductions	Balance December 31
<u>SEWER SYSTEM DEPOSITS</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 87,090	\$ 5,850	\$ 41,200	\$ 51,740
<u>Liabilities</u>				
Customer deposits - current	\$ 87,090	\$ 5,850	\$ 41,200	\$ 51,740
 <u>NORTH SHORE COLLABORATIVE</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 336,356	\$ 153,398	\$ 236,200	\$ 253,554
<u>Liabilities</u>				
Accounts payable	\$ 336,356	\$ 153,398	\$ 236,200	\$ 253,554
 <u>TOTAL ALL AGENCY FUNDS</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 796,570	\$ 23,643,305	\$ 23,731,199	\$ 708,676
<u>Liabilities</u>				
Accounts payable	\$ 336,356	\$ 153,398	\$ 236,200	\$ 253,554
Taxes collected in advance	5,329	15,123	5,329	15,123
Due to other governments	367,795	23,468,934	23,448,470	388,259
Customer deposits - current	87,090	5,850	41,200	51,740
Total Liabilities	\$ 796,570	\$ 23,643,305	\$ 23,731,199	\$ 708,676

OTHER SCHEDULE

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 9

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2007**

Shared Revenue

State

Highway users tax	\$	5,306,175
County program aid		515,209
PERA rate reimbursement		24,475
Disparity reduction aid		164,927
Police aid		92,725
Taconite credit		602,969
Enhanced 911		76,704
Market value credit		479,073

Total Shared Revenue **\$ 7,262,257**

Reimbursement for Services

State

Minnesota Department of Human Services	\$	773,529
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Payments

State

Payments in lieu of taxes	\$	512,216
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Local

Other		104,038
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Total Payments **\$ 616,254**

Grants

State

Minnesota Department of Public Safety	\$	155,848
Transportation		81,783
Health		103,005
Natural Resources		239,274
Human Services		925,864
Office of Environmental Assistance		52,039
Veterans Affairs		2,800
Miscellaneous boards		6,030

Total State **\$ 1,566,643**

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 9
(Continued)

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2007**

Grants (Continued)

Federal

Department of	
Agriculture	\$ 1,145,356
Commerce	62,566
Interior	145,887
Transportation	4,211,324
Health and Human Services	235,033
Homeland Security	39,157
Environmental Protection Agency	<u>6,807</u>

Total Federal **\$ 5,846,130**

Total State and Federal Grants **\$ 7,412,773**

Total Intergovernmental Revenue **\$ 16,064,813**

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 10

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2007

I. SUMMARY OF AUDITOR'S RESULTS

- A. Our report expresses unqualified opinions on the basic financial statements of Lake County.
- B. Significant deficiencies in internal control were disclosed by the audit of financial statements of Lake County 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*." One of the significant deficiencies is a material weakness.
- C. No instances of noncompliance material to the financial statements of Lake County 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 Lake County expresses an unqualified opinion.
- F. No findings were disclosed that are required to be reported by Section 510(a) of Office of Management and Budget (OMB) Circular A-133.
- G. The major program is:
 - Highway Planning and Construction
 - CFDA #20.205
- H. The threshold for distinguishing between Types A and B programs was \$300,000.
- I. Lake County was not determined to be a low-risk auditee.

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

96-11 Segregation of Duties

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, or
 - prepare billings.
- Individuals who process vouchers for payments should not also:
 - print or sign checks or
 - make journal entries.

Lake County does not segregate the duties of cash collection and receipting from posting receipts to the general ledger system, maintaining the general ledger, making journal entries, processing cash disbursements, or making bank deposits. Also, the same person who processes cash disbursements has the ability to print and sign checks. In addition, bank reconciliations are prepared by the same person who performs most of the cash disbursement functions and also does some cash receipting. At the department level, many of these functions are also not segregated.

We recommend the County Board segregate these functions as much as possible. If it is not possible to segregate these duties, Lake County management should be aware of the lack of segregation of the accounting functions and implement oversight procedures to ensure that the internal control policies and procedures are being performed by staff. One possible oversight procedure is to distribute detailed monthly revenue and expenditure reports to department heads and require them to affirm they have reviewed the reports and concur with the revenues and expenditures reported for their department.

Client's Response:

Auditor/Treasurer will review these functions with staff and reassign when possible. The Auditor/Treasurer will also look at other possible oversight procedures to ensure internal control policies and procedures are being performed.

03-2 Capital Assets

The County maintains its capital asset records on a capital asset software system called Assetkeeper. Capital asset additions and deletions are entered into this system, and depreciation is calculated by the system. Capital asset policies utilized by the County in maintaining the capital asset system have not been formally approved by the County Board. A capital assets policy should be adopted which defines the County's accounting policies over capital assets, such as capitalization thresholds, useful lives, and depreciation methods. The policy should also include the procedures to be used to identify capital asset additions and deletions.

A physical inventory of capital assets has not been done since the capital asset records were initially established in 2003.

We recommend the County Board establish a capital assets policy to define the accounting policies for capital assets. The policy should also establish procedures to identify capital asset additions and deletions. Department heads should report capital asset additions and deletions to the person maintaining Assetkeeper at least annually. Also, 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 inventoried at least once every five years. Some critical capital assets may need to be inventoried more frequently.

Client's Response:

The Board will attempt to develop policies and procedures for capital assets and discuss the process of doing a physical inventory.

03-4 Preparation of Financial Statements

The County 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 County's 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, the County 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 County's 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 County's 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. As a result of this condition, the government lacks internal control over the preparation of financial statements in accordance with GAAP.

We recommend the County obtain the training and expertise to internally prepare its annual financial statements in accordance with GAAP. If County management intends to have staff from the Office of the State Auditor assist in preparation then, at a minimum, they must identify and train individuals to obtain the expertise that can sufficiently review, understand, and approve the County's financial statements, including notes.

Client's Response:

The County will continue to have the financial coordinator work with the State Auditor's Office on preparing financial statements.

06-1 Journal Entries

Lake County limits access to the journal entry function on the Integrated Financial System (IFS) to select County employees. At the time of our review, eight County employees had access to this function. Most journal entries are made by the Financial Coordinator and the Human Services Accountant. The journal entries made by these employees are not reviewed or approved by anyone else.

The ability to make journal entries on the IFS general ledger system is a powerful function. It allows those employees with access to the journal entry function to make changes to the general ledger system. To prevent abuse of this function, it should be limited to those employees who have a logical need for this access. Also needed is a procedure for review and approval of the journal entries made.

We recommend the County Auditor/Treasurer review the access to the journal entry function to determine if there is a logical need for that access for all employees who have access. 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 IFS 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 be to ensure that no journal entries have been made which have not been submitted for review and approval.

Client's Response:

The County Auditor/Treasurer will review, with the Human Service Director, who has authority to make journal entries in the IFS. After determining who has authority they will review who has the need for the authority for journal entries. Also, an attempt will be made to develop procedures to review journal entries.

06-2 Budgeting

The Lake County Board has adopted a formal written budget policy which includes policies on when budget amendments must go before the County Board for approval and when they may be submitted to the County Auditor/Treasurer only. However, there have been no procedures or forms developed to implement the new budget policy and to communicate the budget amendment requests to either the County Board or the County Auditor/Treasurer. Also, the budget policy does not address how the budget will be monitored and who will monitor it.

We noted several instances in the current audit where the County Board approved budget amendments in the Board minutes but they were not entered into the IFS system.

We recommend that procedures and forms be developed to implement the new budget policy. Budget amendments should be tracked on budget amendment forms which should be approved by either the County Board or the County Auditor/Treasurer in accordance with the policy. Approved budget amendments should be entered to the IFS system by a person independent of the budgeting process.

The budget policy should be revised to include budget monitoring procedures. These procedures could include department head review of monthly budget to actual reports, County Board review of periodic budget to actual reports, or County Budget Officer review of budget to actual reports. Reviewers should indicate their review of budget to actual reports by signing off on them.

Client's Response:

The Board has developed a budget policy. The Board is currently working on forms and procedures to implement the budget policy. The Board is also working on revising the budget policy to include budget monitoring procedures.

06-3 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. Statement on Auditing Standards No. 112 states that one control deficiency that shall be regarded as at least a significant deficiency is identification by the auditor of a material misstatement in the financial statements that was not initially identified by the entity's internal controls, even if management subsequently corrects the misstatement.

During our audit, we proposed numerous adjustments that resulted in significant changes to the County's financial statements. The County provides cash basis financial statements and prepares some of the modified accrual information necessary to adjust the cash basis financial statements to the modified accrual basis. However, County staff do not have the time nor the governmental accounting expertise to prepare all of the information necessary to provide accurate financial statements. Therefore, audit adjustments were necessary to record additional receivables and payables found during the audit, record the fair value adjustment for cash and pooled investments, adjust fund balance reserves, adjust state-aid highway allotments, allocate unallocated revenues and expenditures, record capital leases, and to make reclassification entries as necessary. Audit adjustments were also necessary to adjust modified accrual financial statements to the accrual basis for the government-wide financial statements.

We recommend that County staff review the trial balances and journal entries in detail to ensure they have an understanding of all audit adjustments made so that, in future audits, this information can be prepared by the County.

Client's Response:

It is still the County's expectation that the financial coordinator will be able to fulfill these recommendations in time.

06-4 Accounting Policies and Procedures Manual

The County 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 County's 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 County's internal control system and can help to avoid circumvention of County policies.

We recommend the County 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 County 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:

The Auditor/Treasurer will attempt to assemble information for the County Board to review.

06-5 Computer Risk Management

Lake County has internal controls in place for its computer system. As part of these internal controls, the County has developed policies on emergency recovery procedures, data backup procedures, password controls, and acceptable uses of technology resources. However, the policies have not been updated on an ongoing basis; and the County has no formal procedures to identify and manage risks associated with its computer system.

Risk management begins with a risk assessment of a county's computer system to identify those risks that could negatively influence computer operations. Internal controls should be implemented to reduce the identified risks. Internal controls implemented should be documented in a well-maintained policies and procedures manual, which should be communicated to the County's staff. Staff adherence to these policies and procedures should be monitored. Because computer systems are ever changing, the County should include in its plan periodic reassessment of risk to ensure existing internal controls are still effective.

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

Client's Response:

The County will work with the Information Systems Department to identify risks that could negatively influence computer operations. A plan, along with appropriate policies, will be put together after the risk assessment is complete.

06-6 New Vendors

Lake County 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 listing active vendors should be printed and 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 that have not previously done business with the County, 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 their business. Periodically, the vendor listing should be reviewed for old, unused vendors and those vendors should be removed from the system.

Client's Response:

The Auditor/Treasurer will consult with the Human Services Director and attempt to review current procedures and develop new procedures if necessary.

06-7 Payroll

In Lake County, authorization for payroll changes such as new hires, promotions, and step increases, is initiated in the personnel office. Notification of the changes to be made is sent to the payroll department. In the payroll department, the payroll clerk inputs the changes into the master file of the payroll system and subsequently checks payroll edit reports to make sure the changes went into the system properly.

After the payroll clerk clears the payroll edit reports, she runs the final payroll reports and payroll checks. No one independent of the payroll function reviews the checks or payroll reports to determine that all payments were made to actual employees and the hours worked appear to be correct.

We recommend that someone independent of the payroll processing function review the payroll edit reports to make sure all changes made to the payroll system master file were authorized. This independent person should also review the final payroll reports and check to verify all employees paid are actual employees and the hours worked appear to be correct. The functions of generating and signing payroll checks should be segregated from the payroll processing function, if possible.

Client's Response:

The Auditor/Treasurer will continue to work at using current staff to have someone independent to review the payroll edits before final payroll processing.

ITEM ARISING THIS YEAR

07-1 **Approval of Time Sheets**

During our current audit, we noted that supervisors and certain employees who do not have immediate supervisors are approving their own time sheets. Approval of time sheets is an important internal control which helps to ensure that the time worked is reported accurately and reliably.

We recommend that each time sheet contain two attestations of the hours worked. One attestation should be by the employee and the other should be by the employee's supervisor or other appropriate person.

Client's Response:

The County will look at implementing a policy that requires two attestations for each time sheet.

PREVIOUSLY REPORTED ITEMS RESOLVED

Duplicate Check Numbers (05-1)

During our previous audits, we noted several occasions where County Auditor/Treasurer's staff issued checks using check numbers that had been previously issued. Duplicate check numbers make reconciling the bank account very difficult. Bank reconciliation is a key internal control in environments where segregation of duties is limited.

Resolution

We noted no further instances of duplicate check numbers being issued in our current audit.

Budgeting (06-2)

The Lake County Board did not have a comprehensive budget policy addressing which funds were required to be budgeted, the legal level of control, when budgets could be modified by management and when Board approval was required, and the budgetary basis on which the budget was adopted.

Resolution

In January 2008, the County Board adopted a budget policy that includes the elements recommended above.

Service Organization (06-8)

The County has contracted with a claims administrator to process the self-insured portion of health insurance claims for which the County is responsible. The claims administrator processes the claims on behalf of the County and, as such, is operating as a service organization for the County. The service organization which processes the County's claims has not had a service organization audit (SAS 70) covering the internal controls over the transactions it process for other organizations, nor has the organization provided any substantive information about its internal control procedures which would allow the County to evaluate whether its controls are adequate to assure the County that its funds are being properly spent.

Resolution

The County has terminated its contract with this service organization in 2008.

Inventory (06-9)

The Road and Bridge perpetual inventory system was five months behind in being updated for purchases and usage of inventory at the time of our last audit. Inventory is not locked up, and sometimes access to inventory is uncontrolled when the garage mechanics are not present.

Resolution

During our current audit, we found the perpetual inventory system to be up to date. Access to inventory is generally limited to two garage mechanics in charge of inventory distribution. Although inventory is not locked up, physical counts have not revealed any material variances between the physical counts and the perpetual inventory.

SSIS Segregation of Duties (06-10)

Lake County management had not performed a risk assessment to determine if any of their staff had incompatible access within the Minnesota Department of Human Services (DHS) Social Service Information System Fiscal Payment (SSIS) software module since initially assigning staff access to the SSIS system.

Resolution

The Lake County Human Services Department performed a risk assessment to determine if any employees had incompatible access. They determined that there was no single individual who could establish a vendor, authorize a transaction, record a transaction, and obtain custody of the asset resulting from the transaction.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

None.

IV. OTHER FINDINGS AND RECOMMENDATIONS

A. MINNESOTA LEGAL COMPLIANCE

ITEMS ARISING THIS YEAR

07-2 Safekeeping of Investments

Minn. Stat. § 118A.06 requires that all investments be held in safekeeping with:

- a federal reserve bank;
- any bank authorized under the laws of the United States or any state to exercise corporate trust powers including, but not limited to, the bank from which the investment is purchased;
- a primary reporting dealer in United States government securities to the Federal Reserve Bank of New York; or
- a securities broker-dealer having its principal executive office in Minnesota licensed under chapter 80A, or an affiliate of it, and regulated by the Securities and Exchange Commission.

Lake County has on hand at December 31, 2007, government securities and negotiable certificates of deposit totaling \$2,614,065 which were purchased through Wachovia Securities and government securities totaling \$2,170,809 purchased through Morgan Keegan. Neither of these firms are primary reporting dealers nor have their principal executive offices in Minnesota. The investments were purchased in book entry form and are tracked by the Depository Trust Corporation. However, for purposes of custody, the securities are “held” by the party who controls their movement, which in this case is the brokerage firm. Therefore, we do not believe that these investments are being safekept in accordance with Minn. Stat. § 118A.06.

We recommend the County Auditor/Treasurer comply with the requirements of Minn. Stat. § 118A.06. Investments can only be held by brokerage firms that are primary reporting dealers or have their principal offices in Minnesota. If investments are purchased through these dealers, they must be held at a bank rather than at the brokerage firm.

Client's Response:

The Auditor/Treasurer will take the steps necessary to comply with Minnesota statutes.

07-3

Bidding

The Lake County Board entered into a contract totaling \$98,748 to purchase four Ford Expeditions. This contract was formally bid as required by Minn. Stat. § 471.345, subd. 3, which required all contracts expected to exceed \$50,000 to be solicited by public notice and let on sealed bids. However, the contract was not awarded to the lowest bidder as required by Minn. Stat. § 375.21, subd. 1. The contract was awarded to a local vendor because the price was only slightly higher.

We recommend the County comply with Minn. Stat. § 375.21, subd. 1, and award contracts to the lowest responsible bidder.

Client's Response:

The County will comply with Minnesota statutes.

PREVIOUSLY REPORTED ITEM RESOLVED

Publishing of Financial Statements (06-11)

Lake County did not publish its 2005 financial statements in the designated newspaper as required by Minn. Stat. § 375.17.

Resolution

Lake County published its 2006 financial statements in the designated newspaper as required by Minn. Stat. § 375.17.

B. MANAGEMENT PRACTICES

PREVIOUSLY REPORTED ITEM RESOLVED

Purchasing Policy (96-16)

The County Board had not adopted a formal purchasing policy establishing procedures regarding the County's purchasing function.

Resolution

The Lake County Board adopted a purchasing policy in July 2008.

C. OTHER ITEM FOR CONSIDERATION

Other Postemployment Benefits (OPEB)

The Governmental Accounting Standards Board (GASB) issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which governs employer accounting and financial reporting for OPEB. This standard, similar to what GASB Statement 27 did for government employee pension benefits and plans, provides 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 statement, accounting for OPEB is now similar to the accounting used by governments for pension plans.

Schedule 10
(Continued)

This year, the legislature enacted a new law, Minn. Stat. § 471.6175, intended to help local governments address their OPEB liability in at least three important ways:

- it allows governments to create both irrevocable and revocable OPEB trusts;
- it authorizes the use of a different list of permissible investments for both irrevocable and revocable OPEB trusts; and
- it also permits governments to invest OPEB trust assets with the State Board of Investment, bank trust departments, and certain insurance companies.

Some of the issues that the Lake County Board will need to address in order to comply with GASB Statement 45 are:

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

GASB Statement 45 would be applicable to Lake County for the year ended December 31, 2008.

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

Board of County Commissioners
Lake County

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lake County as of and for the year ended December 31, 2007, which collectively comprise the County's basic financial statements, and have issued our report thereon dated December 1, 2008. The financial statements include the Nursing Home Enterprise Fund as of and for the year ended September 30, 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 Lake County's 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 County's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the County's 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 County's 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 County's financial statements that is more than inconsequential will not be prevented or detected by the County's internal control. We considered the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 96-11, 03-2, 03-4, 06-1 through 06-07, and 07-1 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 the County's 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 item 06-3 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Lake County's 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, Lake County complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Questioned Costs as items 07-2 and 07-3.

Also included in the Schedule of Findings and Questioned Costs is an other item for consideration. We believe this information to be of benefit to Lake County, and are reporting it for that purpose.

Lake County's written responses to the significant deficiencies, material weakness, and legal compliance findings identified in our audit have been included in the Schedule of Findings and Questioned Costs. We did not audit the County's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Board of County Commissioners, management, others within Lake County, 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

/s/Greg Hierlinger

REBECCA OTTO
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

December 1, 2008

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

Board of County Commissioners
Lake County

Compliance

We have audited the compliance of Lake County 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, 2007. Lake County's 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 County's management. Our responsibility is to express an opinion on the County's 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 Lake County's 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 County's compliance with those requirements.

In our opinion, Lake County 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, 2007.

Internal Control Over Compliance

The management of Lake County 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 County's 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 County's 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 County's 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 County's 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 Lake County's 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 business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lake County as of and for the year ended December 31, 2007, which collectively comprise the County's basic financial statements, and have issued our report thereon dated December 1, 2008. Our audit was performed for the purpose of forming opinions on the

County's 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 Board of County Commissioners, management and others within the County, 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

December 1, 2008

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 11

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2007**

Federal Grantor Pass-Through Agency Grant Program Title	Pass-Through Grant Numbers	Federal CFDA Number	Expenditures
U.S. Department of Agriculture			
Direct			
U.S. Forest Service Cooperative Agreement		R9-9-95-35B	\$ 27,000
Passed Through Carlton, Cook, Lake, and St. Louis Community Health Board			
Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)		10.557	36,808
Passed Through Minnesota Department of Human Services			
Matching Grant for Food Stamp Program		10.561	5,005
Passed Through Minnesota Department of Finance			
National Forest Lands - 25% Payments to States		10.665	189,293
National Forest Lands - 3/4 of 1%		10.668	887,250
Total U.S. Department of Agriculture			\$ 1,145,356
U.S. Department of Commerce			
Passed Through Minnesota Department of Natural Resources			
Coastal Zone Management Administration Award	306A-10-06 306A-05-08	11.419	\$ 62,566
U.S. Department of the Interior			
Direct			
Payments in Lieu of Taxes		15.226	\$ 145,887
U.S. Department of Transportation			
Passed Through Minnesota Department of Transportation			
Highway Planning and Construction	SP-38-596-01 SP-38-596-02 SP-38-060-01 SP-38-602-23 SP-38-602-25 SP-38-604-13 SP-38-605-09	20.205	\$ 4,446,786
U.S. Environmental Protection Agency			
Passed Through Minnesota Department of Health			
State Indoor Radon Grants		66.032	\$ 1,807
Passed Through Minnesota Pollution Control Agency			
Nonpoint Source Implementation Grants		66.460	2,000
Beach Monitoring and Program Implementation Grants		66.472	3,000
Total U.S. Environmental Protection Agency			\$ 6,807

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**Schedule 11
(Continued)**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2007**

Federal Grantor Pass-Through Agency Grant Program Title	Pass-Through Grant Numbers	Federal CFDA Number	Expenditures
U.S. Department of Health and Human Services			
Passed Through Carlton, Cook, Lake, and St. Louis Community Health Board			
Alzheimer's Disease Demonstration Grants to the States		93.051	\$ 750
Center for Disease Control and Prevention - Bioterrorism Grant		93.283	8,755
Maternal and Child Health Services Block Grant		93.994	9,940
Passed Through Minnesota Department of Human Services			
Substance Abuse and Mental Health Services		93.243	40,000
Promoting Safe and Stable Families		93.556	5,167
Temporary Assistance for Needy Families		93.558	45,690
Child Care and Development Block Grant		93.575	3,959
Foster Care - Title IV-E		93.658	17,735
Social Services Block Grant Title XX		93.667	102,115
Support for Emancipation and Living Functionally		93.674	922
Total U.S. Department of Health and Human Services			\$ 235,033
U.S. Department of Homeland Security			
Passed Through Minnesota Department of Public Safety			
Boating Safety Financial Assistance		97.012	\$ 8,405
Emergency Management Performance Grant	2007-EMPG-00532	97.042	10,076
Homeland Security Grant Program	2005-SHSP-00465	97.067	20,676
Total U.S. Department of Homeland Security			\$ 39,157
Total Federal Awards			\$ 6,081,592

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 Lake County. The County's 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. Due to timing differences in revenue recognition under the modified accrual basis, expenditures on this schedule may not equal federal revenues reported in the financial statements. In 2007, \$43,730 of prior year federal expenditures were recognized as revenue in the financial statements, and \$279,192 of current year federal expenditures were not recognized as revenues because they were not received within the period of availability.
3. Pass-through grant numbers are presented for grants for which they have been assigned.