STATE OF MINNESOTA
Office of the State Auditor

Patricia Anderson
State Auditor

MANAGEMENT AND COMPLIANCE REPORT
FOR

ST. LOUIS COUNTY
DULUTH, MINNESOTA

YEAR ENDED DECEMBER 31, 2005

Description of the Office of the State Auditor

The Office of the State Auditor serves as a watchdog for Minnesota taxpayers by helping to ensure financial integrity, accountability, and cost-effectiveness in local governments throughout the state.

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 250 financial and compliance audits per year and has oversight responsibilities for over 4,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits for 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 over 700 public pension funds; and

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

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

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ST. LOUIS COUNTY
DULUTH, MINNESOTA

Year Ended December 31, 2005

Management and Compliance Report

Audit Practice Division
Office of the State Auditor
State of Minnesota

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ST. LOUIS COUNTY
DULUTH, MINNESOTA

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ST. LOUIS COUNTY
DULUTH, MINNESOTA

Schedule 1

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

I. SUMMARY OF AUDITOR'S RESULTS

A. Our report expresses an unqualified opinion on the basic financial statements of St. Louis County.

B. A reportable condition in internal control was disclosed by the audit of financial statements of St. Louis County and is 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.*" The reportable condition is not a material weakness.

C. No instances of noncompliance material to the financial statements of St. Louis County were disclosed during the audit.

D. No matters involving internal control over compliance relating to the audit of the major federal award programs 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 programs for St. Louis County expresses an unqualified opinion.

F. No findings were disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133.

G. The major programs are:

Community Development Block Grant	CFDA #14.218
Temporary Assistance for Needy Families (TANF)	CFDA #93.558
Social Services Block Grant	CFDA #93.667

H. The threshold for distinguishing between Types A and B programs was $524,751.

I. St. Louis 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 ITEM NOT RESOLVED

96-10 Departmental Internal Accounting Controls

Due to the limited number of office personnel within the various County departments, proper segregation of the accounting functions necessary to ensure adequate internal accounting control is not possible. Although this is not unusual in small departmental situations, management should constantly be aware of this condition and realize that the concentration of duties and responsibilities in a limited number of individuals is not desirable from an internal control point of view.

We recommend that County management be aware of the lack of segregation of the accounting functions and, if possible, implement oversight procedures to ensure that the internal control policies and procedures are being implemented by staff.

Client's Response:

The County Auditor's Office will contact the departments involved to assist them in implementing procedures that will help ensure segregation of duties where possible.

PREVIOUSLY REPORTED ITEMS RESOLVED

Social Services Fund Adjustments (04-1)
The Social Services Fund required extensive audit adjustments in order to properly present its operations at year-end.

Resolution
The Internal Auditor reviewed the Social Service Fund and made any necessary adjustments before closing of the fiscal year-end.

Minnesota Family Investment Program Reimbursement Loss (04-2)
Social Services failed to report all eligible Minnesota Family Investment Employment and Training Program (MFIP-ES) expenditures in its reimbursement reports during the 18-month fiscal allocation period beginning July 1, 2003, and ending December 31, 2004.

Resolution

The County submitted the unclaimed 2004 MFIP-ES expenditures during 2005 and received reimbursement from its 2005 allocation, which was underspent during 2005.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

None.

IV. OTHER FINDINGS AND RECOMMENDATIONS

A. MANAGEMENT PRACTICES

PREVIOUSLY REPORTED ITEM NOT RESOLVED

96-27 Management Information Systems (MIS) Department

Our review of the various MIS Department operations disclosed that its disaster recovery plan has some deficiencies. Items missing from the plan include: off-site storage of the written plan, specific recovery procedures, critical applications/user contingency report, and a formalized alternative site processing agreement. To effectively deal with a disaster affecting computer operations, the County must have a complete, detailed plan in place.

We recommend the MIS Director review the disaster recovery plan and expand it to address the noted deficiencies.

Client's Response:

The MIS Department is in the process of updating its Disaster Recovery Plan. Once completed, a copy of the plan will be placed in offsite storage in the Duluth Courthouse and in the MIS offices in the Northland Office Building in Virginia, Minnesota.

ITEMS ARISING THIS YEAR

05-1 Internal Audit Function

In 2003, the County Board established an internal auditor position. The formal St. Louis County organization chart has the internal auditor reporting to the County Auditor, an elected position. Informally, the internal auditor can report to either the County Auditor or the County Administrator who reports to the County Board.

Normally, internal auditors are responsible for providing analyses, evaluations, assurances, recommendations, and other information to the County Board, management, or to others with equivalent authority and responsibility. To fulfill this responsibility, internal auditors must maintain objectivity with respect to the activity being audited.

Generally accepted auditing standards state that if the external auditor decides that it would be efficient to use the internal auditor's work during the external audit, the external auditor should assess the internal auditor's competence and objectivity on the work used for the external audit.

The external auditor should consider the following factors when assessing the internal auditor's competence:

- educational level and professional experience;
- professional certification and continuing education;
- audit policies, programs, and procedures;
- supervision and review of internal auditor's activities;
- quality of working-paper documentation, reports, and recommendations; and
- evaluation of internal auditor's performance.

The external auditor should consider the following factors when assessing the internal auditor's objectivity:

- The organizational status of the internal auditor:

    - whether the internal auditor reports to an officer of sufficient status to ensure broad audit coverage and adequate consideration of, and action on, the findings and recommendations of the internal auditor;

    - whether the internal auditor has direct access and reports regularly to the County Board or an audit committee; and

    - whether the County Board or audit committee oversees employment decisions related to the internal auditor.

- Policies to maintain the internal auditor's objectivity about the areas audited include:

    - policies prohibiting an internal auditor from auditing areas where a conflict of interest may exist;

    - policies not allowing the internal auditor to assume any operational responsibilities;

    - policies prohibiting the internal auditor from auditing activities for which they had any authority or responsibility; and

    - policies not allowing the internal auditor to accept gifts or favors from others such as employees, clients, or business associates.

The County Board has not established the necessary resolutions, policies, and procedures that would document and allow for the assessment of the internal auditor's competence and objectivity.

If it is the intention of the County Board for the Office of the State Auditor, as external auditor, to rely on the internal auditor's work during our audit, we recommend that the County Board develop resolutions, policies, and procedures addressing the factors listed above. In addition, the County Board should approve all reports of the internal auditor as well as the annual internal audit work plan. The internal auditor should become a member of The Institute of Internal Auditors and follow its steps in establishing an internal audit function.

<u>Client's Response</u>:

Consistent with the framework of Minnesota statutes, the powers of a county as a body politic and corporate are exercised by the county board, an elected body. Minn. Stat. § 373.02. Counties are allowed the option of an appointed County Administrator appointed by the county board. Minn. Stat. § 375A.01, subd. 2(4). St. Louis County operates under this optional form of county government with the office of County Administrator pursuant to Minn. Stat. § 375A.06. The County Administrator reports to the County Board and serves at its pleasure. The office itself can be abolished at any time. County department heads report to and are supervised by the County Administrator. With the exception of statutory offices, they are at will employees.

Elected statutory officers are independent of both the County Board and County Administrator. This statutory framework is for the purpose of providing independence from the Board in the performance of the statutory duties of these offices. In St. Louis County, the offices of County Auditor and Treasurer have been consolidated pursuant to Minn. Stat. § 375A.10, subd. 2(c). The County Auditor has been elected County-wide across all commissioner districts to perform the functions of the Auditor and Treasurer pursuant to Minn. Stat. ch. 384 County Auditor and Minn. Stat. ch. 385 County Treasurer, and innumerable statutes that reference responsibilities for these two offices. The County Auditor and other elected statutory offices require an oath of office to faithfully discharge the duties of the office and a bond. The office is subject to removal for malfeasance, nonfeasance, or misfeasance of office pursuant to Minn. Stat. § 351.15. Numerous other statutes that pertain to misconduct of public officials apply to the elected statutory office of County Auditor and the duties that pertain to the County Treasurer's office.

In sum, the statutory scheme for the organizational structure of county government provides for independence of the County Auditor from the County Administrator, County Board, County departments, and County employees in performing the audit functions and treasurer functions that pertain to county government, including access to records and internal auditing.

In order to perform the function of auditing all county departments and activities, the St. Louis County Civil Service system has established a civil service classified position entitled internal auditor. This position reports to the County Auditor and is supervised by the County Auditor as the appointing authority for this position. The internal auditor performs under the general direction of the County Auditor in accordance with generally accepted accounting principles and standards. The *internal auditor is authorized full, unrestricted access to all County departments and agency functions, records, staff, and property. The internal auditor is responsible for planning, directing, and conducting independent and objective audits of all departments, agencies, offices, boards, activities, and subcontractors of the County. Its duties include reviewing financial and other internal control systems for compliance with policies, procedures and budgetary directives adopted by the St. Louis County Board, conducting performance effectiveness and efficiency audits, evaluating the reliability, accuracy and integrity of management and financial data records, reports, statements, conducting review studies or audits as requested by the County Auditor, County Board, or department heads, and supervising and reviewing the work of any assigned departmental staff.*

With respect to the statement that the County Board has not passed the resolutions, policies and procedures that would document and allow for the assessment of the internal auditor's competence and objectivity, St. Louis County disagrees. The Civil Service classified position of internal auditor requires a Bachelor's Degree in accounting and five (5) years professional experience conducting government audits, including federal programs with two years in a supervisor or audit management capacity. This is a minimum qualification. The internal auditor is also subject to the protections of the St. Louis County Civil Service Act and a collective bargaining agreement. Further, St. Louis County has adopted a Conflict of Interest Policy. The County will pursue additions to this policy to specifically address internal auditor conflicts, even though this policy now would cover such conflict.

The internal auditor has been provided the authority necessary to provide a complete, internal audit function and liaison with the external auditor of the State Auditor through the auspices of the County Auditor's statutory powers. With respect to conflict of interest circumstances in performing the internal audit function, the internal auditor may report any such issue to the County Auditor unless the issue involves a conflict with the County Auditor, in which case the matter will be resolved pursuant to St. Louis County's Conflict of Interest Policy.

05-2 <u>Chris Jensen Nursing Home Interfund Payable</u>

The County maintains a cash and investment pool available for use by all funds. An individual fund may overdraw its share of the pooled cash. The fund whose cash is overdrawn reports an interfund liability on the year-end balance sheet in the "Interfund Payable" account. An equivalent amount of another fund's position in the pool is reported as an interfund receivable in the "Interfund Receivable" account.

During 2002, the County transferred $1,221,122 to the Chris Jensen Nursing Home Enterprise Fund to eliminate the cash deficit.

Since 2002, the County Board has authorized loans rather than transfers of funds to the Nursing Home to cover its cash deficits. The balance of the loans outstanding from the General Fund to the Nursing Home is as follows:

December 31, 2003	$1,480,067
December 31, 2004	$2,690,659
December 31, 2005	$3,250,386

Generally accepted accounting principles (GAAP) state if repayment of a loan is not expected within a reasonable time, the interfund balances should be reduced, and the amount not expected to be repaid should be reported as a transfer from the fund that made the loan to the fund that received the loan. As reported above, the outstanding loan balance has increased each year. This indicates that the loans are not current or short-term in nature.

We recommend the County Board authorize a transfer from the General Fund to the Chris Jensen Nursing Home Enterprise Fund if the Nursing Home is unable to repay the loan.

Client's Response:

The St. Louis County Board last transferred $1,221,122 in authorized loans to the Chris Jensen facility at the end of 2002, eliminating its cash deficits.

Since that time the Board authorized loans of $1,480,067; $1,210,628; and $559,691 in years 2003, 2004 and 2005, respectively. In early 2005, Chris Jensen management brought forward an operating plan to increase revenues and reduce expenses in an effort to make the facility profitable and to cash flow. In fact, as changes were implemented, the facility was profitable on an operating basis for four of the last six months of 2005 (unaudited). Given this change in direction, the Board anticipated that the facility may be able to continue reducing the outstanding deficit into 2006. However, management reported to the Board in May 2006, that reduced and/or flat reimbursement levels by Medicare and Medicaid programs had returned the facility to cash deficit performance.

Management is continuing to pursue additional operational efficiencies and revenue enhancement programs. That notwithstanding and barring any major financial turn around of the facility, a recommendation will be made to the County Board that it authorize a permanent transfer of the deficit outstanding at 2006 year-end.

05-3 Infrastructure

The County uses a composite method of depreciating its infrastructure capital assets (roads, bridges, sidewalks, and similar items) over 25 years. The County removes infrastructure that has reached the end of its 25-year life from the capital assets as reported on its Statement of Net Assets.

Capital assets should not be written off until they are disposed of. Capital assets may be fully depreciated but still be in use. The composite method assumes that all assets are retired at the end of their useful lives. These assets should be removed from the base used to calculate the depreciation so that they are not depreciated beyond their book value. However, the capital assets should not be removed from the financial statements until they have been replaced or disposed of.

The County Highway Department annual report lists the number of miles that costs were charged to during the year. The County intended to use these miles to support that 25 years was an appropriate life expectancy. However, a road project from planning to completion could span multiple years resulting in the same mile of road being reported in different annual reports. Because a detailed analysis was not performed to determine how many times the same mile of road was reported, the County could not support that 25 years was a reasonable life expectancy. Based on the mileage reported, it would appear that the life expectancy is longer than 25 years. Other counties in Northeast Minnesota are using 50 years for roads and 75 years for bridges.

Depreciation is a method of allocating an asset's cost over its useful life. A periodic review of this useful life is necessary for depreciation to appropriately reflect that allocation. If this review indicates that actual useful life is significantly different from the estimated useful life, future depreciation should be adjusted prospectively.

The historical cost of a capital asset should include the cost of any subsequent additions or improvements, but exclude the costs of repairs. An addition or improvement, unlike a repair, either enhances a capital asset's functionality, effectiveness, or efficiency, or it extends a capital asset's expected useful life. For example, periodically resurfacing a road, (assuming that the road surface was not treated as a separate asset in its own right), would be treated as a repair (the cost would not be capitalized), whereas adding a new lane would constitute an addition (the cost would be capitalized).

The County uses the Highway Department annual report as the basis for the historical cost of infrastructure capital assets. However, a detailed analysis was not performed to determine whether the costs capitalized were additions and improvements or repairs.

We recommend the County Auditor review the life expectancy of the County's roads and bridges to determine the proper depreciation rate. The County Auditor should review the capital additions to infrastructure to ensure that the proper costs are added. The County's Capital Asset System Policy Manual should be updated for any changes.

<u>Client's Response</u>:

A recently completed detailed analysis of road construction miles from 1980 through 2004 showed that the County has completed approximately 1300 miles of road construction in 25 years. As a result the County will begin using 57 years as the estimated life expectancy for depreciating infrastructure. A review of the estimated life of infrastructure will be done yearly with future depreciation being adjusted prospectively.

The historical cost of infrastructure does come from Highway Department Annual Reports. Highway staff has confirmed to the Auditor's office that the expenditures from this report are for construction. Agency 200001 – Road Maintenance is used for all maintenance and repairs projects. The expenditures from agency 200001 are not included in the annual report. The Auditor's office therefore believes that the additions that have been made to its infrastructure are proper costs.

The County's Capital Asset System Policy Manual will be updated for all changes.

05-4 Medical Assistance Program Billings

The County pays cost-effective health insurance (CEHI) premiums and the cost of medical transportation services for eligible recipients under the Medical Assistance (MA) program. The County then requests reimbursement from the Minnesota Department of Human Services (DHS).

The County's year-end receivables balance for these programs has been increasing over the past several years. At year-end 2005, 2004, and 2003, the receivables balances were $1,610,024, $1,282,979, and $875,867, respectively. The receivables balance accumulates when the claims billed to the DHS are subsequently rejected or suspended due to various billing code errors, periods of ineligibility, or errors in client service plans. These claims need to be promptly corrected and re-billed in a timely manner as the DHS may eventually deny the claim, resulting in a loss of reimbursement to the County.

The County has stated that approximately $600,000 of the old receivables balance was collected during 2005. This leaves approximately $700,000 in claims from prior years that remain uncollected. The County does not have a receivable aging report for management to monitor the collections. It was unknown at the time of the audit whether DHS would disallow any of the outstanding receivables.

We recommend the Social Service Director review the current program procedures from the point of certifying the recipient, through delivery of service, and claiming and receipting of reimbursements in order to identify why the receivables are increasing. An aging receivable balance report should be developed to assist in the monitoring of the receivables. Monitoring of the receivables helps ensure that claims are not denied, resulting in the County having to use its own funds. Also, prompt reimbursements allow the County to invest these funds, which results in additional County revenues.

Client's Response:

As of December 31, 2005, receivables for Medical transportation were exceptionally high due to an error in the claiming process. The denied claims were corrected, resubmitted and collected. The result of this error was an increase of year-end MA Access (transportation) receivables of approximately $600,000. It is notable that outside of the 2006 recoupment of this 2005 error, 2006 receipts for MA programs are increased substantially in proportion to prior years. A process for tracking MA Access claims has been put in place to insure accurate and timely receipt of reimbursements to the County.

Another area of concern is reimbursement of County expenditures for MA Cost Effective Health Insurance (CEHI) paid on behalf of clients. In order to avoid loss of reimbursement due to DHS denial of claims, a number of steps have been taken. We have performed a review of program process from initial client application, qualification and authorization, payments, claiming and review. Accordingly, problem areas have been identified and corrective measures are being put in place.

- *A new Authorization form containing expanded information requirements and more restricted limitations is being developed. The result will be fewer denied claims due to missing or inaccurate information.*

- *A new policy regarding the length of term of provision of CEHI. This will provide a more frequent review (maximum of 6 months) of eligibility for this service, resulting in fewer claim denials due to expired insurance policies or undetected changes in client status.*

- *There is a new policy for Accounting Department review of the accuracy and completeness of all required data prior to initial payments or continuation of payments after semi-annual eligibility review.*

- *The Accounting Department is developing a new spreadsheet program which will integrate actual payments being made with the tracking of claims for DHS reimbursement and actual receipts. This will also provide an aging of unpaid claims, facilitating follow-up on any denied claims or inaccurate reimbursements.*

- *No expenditures will be made prior to receipt of an <u>approved</u> Referral for CEHI Review (DHS-2841-ENG) and until all required information is complete.*

- *A review of previously denied claims is being instituted in order to determine whether deficiencies can be corrected and reimbursement reclaimed.*

B. OTHER ITEM FOR CONSIDERATION

Other Postemployment Benefits (OPEB)

The Governmental Accounting Standards Board (GASB) recently issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* which establishes financial reporting for OPEB plans, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* which governs employer accounting and financial reporting for OPEB. These standards, like what GASB Statements 25 and 27 did for government employee pension benefits and plans, provide the accounting and reporting standards for the various other postemployment benefits many local governments offer to their employees. OPEBs can include many different benefits offered to retirees such as health, dental, life, and long-term care insurance coverage. Also, if retirees are included in an insurance plan and pay a rate similar to that paid for younger active employees, this implicit rate subsidy is considered an OPEB. In fact, local governments may be required to continue 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 statements, accounting for OPEB is now similar to the accounting used by governments for pension plans.

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

- determine if employees are provided OPEB;
- if OPEB are being provided, the 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 wait until legislation is enacted authorizing the creation of an OPEB trust and establishing an applicable investment standard; and
- in order to determine annual costs and liabilities that need to be recognized, the County Board will have to decide whether to hire an actuary.

If applicable for St. Louis County, GASB Statements 43 and 45 would be implemented for the years ended December 31, 2006 and 2007, respectively.

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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
St. Louis County

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of St. Louis County as of and for the year ended December 31, 2005, and have issued our report thereon dated May 12, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered St. Louis County's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the County's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying Schedule of Findings and Questioned Costs as item 96-10.

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether St. Louis 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, St. Louis County complied with the material terms and conditions of applicable legal provisions.

This report is intended solely for the information and use of the Board of County Commissioners, management, 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/Pat Anderson

PATRICIA ANDERSON
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

End of Fieldwork: May 12, 2006

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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
St. Louis County

Compliance

We have audited the compliance of St. Louis 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 each of its major federal programs for the year ended December 31, 2005. St. Louis County's major federal programs are 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 each of its major federal programs 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 St. Louis 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, St. Louis County complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended December 31, 2005.

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Internal Control Over Compliance

The management of St. Louis 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 and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of St. Louis County as of and for the year ended December 31, 2005, and have issued our report thereon dated May 12, 2006. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise St. Louis 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 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/Pat Anderson	*/s/Greg Hierlinger*
PATRICIA ANDERSON STATE AUDITOR	GREG HIERLINGER, CPA DEPUTY STATE AUDITOR

End of Fieldwork: May 12, 2006

ST. LOUIS COUNTY
DULUTH, MINNESOTA

Schedule 2

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2005

Federal Grantor Pass-Through Agency Grant Program Title	Pass-Through Grant Number	Federal CFDA Number	Expenditures	Passed Through to Subrecipients
U.S. Department of Agriculture				
Passed Through Carlton, Cook, Lake, and St. Louis Community Health Board				
Special Supplemental Nutrition Program for Women, Infants, and Children		10.557	$ 434,801	$ -
Passed Through Minnesota Department of Human Services				
State Administrative Matching Grants for Food Stamp Program		10.561	95,857	-
Passed Through Minnesota Department of Finance				
Schools and Roads - Grants to States		10.665	185,570	-
Superior National Forest Lands		10.668	510,649	-
Total U.S. Department of Agriculture			**$ 1,226,877**	**$ -**
U.S. Department of Commerce				
Passed Through Minnesota Department of Natural Resources				
Coastal Zone Management Administration		11.419	**$ 29,670**	**$ -**
U.S. Department of Housing and Urban Development				
Direct				
Community Development Block Grants - Entitlement Grants		14.218	$ 3,141,507	$ 2,450,000
Emergency Shelter Grants Program		14.231	100,397	-
HOME Investment Partnership Program		14.239	915,411	872,152
Total U.S. Department of Housing and Urban Development			**$ 4,157,315**	**$ 3,322,152**
U.S. Department of the Interior				
Direct				
Payments in Lieu of Taxes		15.226	**$ 675,481**	**$ -**
U.S. Department of Justice				
Direct				
Public Safety Partnership and Community Policing Grants		16.710	$ 8,217	$ -
Passed Through the City of Duluth				
Edward Byrne Memorial Justice Assistance Grant Program		16.738	7,560	-
Passed Through Minnesota Department of Public Safety				
Byrne Formula Grant Program		16.579	129,456	-
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	2000-9761	16.580	446,018	-
Bullet-Proof Vest Partnership Program		16.607	136	-
National Incident Based Reporting System		16.733	205,834	-
Total U.S. Department of Justice			**$ 797,221**	**$ -**

ST. LOUIS COUNTY
DULUTH, MINNESOTA

Schedule 2
(Continued)

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2005

Federal Grantor Pass-Through Agency Grant Program Title	Pass-Through Grant Number	Federal CFDA Number	Expenditures	Passed Through to Subrecipients
U.S. Department of Transportation				
Passed Through Minnesota Department of Transportation				
Highway Planning and Construction		20.205	$ 2,964,641	$ -
Passed Through Minnesota Department of Public Safety				
State and Community Highway Safety		20.600	26,048	-
Alcohol Trafffic Safety and Drunk Driving Prevention Incentive Grants		20.601	7,077	-
Safety Incentive Grants for Use of Seatbelts		20.604	2,465	-
Total U.S. Department of Transportation			**$ 3,000,231**	**$ -**
U.S. Environmental Protection Agency				
Passed Through Minnesota Department of Health				
State Indoor Radon Grants		66.032	**$ 6,964**	**$ -**
U.S. Department of Health and Human Services				
Passed Through Arrowhead Regional Development Commission				
Special Programs for the Aging - Title III - Nutrition Services		93.045	$ 108,749	$ -
Passed Through Minnesota Department of Human Services				
Projects for Assistance in Transition from Homelessness		93.150	61,881	-
Promoting Safe and Stable Families		93.556	267,545	-
Temporary Assistance for Needy Families (TANF)		93.558	3,667,336	-
Child Care and Development Block Grant		93.575	178,699	-
Child Care Mandatory and Matching Funds		93.596	113,150	-
Children's Justice Grants to States		93.643	2,040	-
Child Welfare Services - State Grants		93.645	21,491	-
Foster Care Title IV-E		93.658	308,255	-
Social Services Block Grant		93.667	1,818,533	-
Chafee Foster Care Independence Program		93.674	33,162	-
Block Grants for Community Mental Health Services		93.958	31,630	-
Block Grants for Prevention and Treatment of Substance Abuse Block Grant		93.959	105,592	-
Passed Through Minnesota Department of Health				
Cooperative Agreement for State-Based Comprehensive Breast/Cervical Cancer Early Detection Program		93.919	4,000	-
Passed Through Carlton, Cook, Lake, and St. Louis Community Health Board				
Immunization Grants		93.268	1,175	-
Centers for Disease Control and Prevention - Investigations and Technical Assistance	H12-A80408	93.283	314,880	-
Temporary Assistance for Needy Families (TANF)		93.558	176,564	-
Maternal and Child Health Services Block Grant to States		93.994	260,892	-
Total U.S. Department of Health and Human Services			**$ 7,475,574**	**$ -**

ST. LOUIS COUNTY
DULUTH, MINNESOTA

Schedule 2
(Continued)

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2005

Federal Grantor Pass-Through Agency Grant Program Title	Pass-Through Grant Number	Federal CFDA Number	Expenditures	Passed Through to Subrecipients
U.S. Department of Homeland Security				
Passed Through Minnesota Department of Natural Resources				
Boating Safety		97.012	$ 10,000	$ -
Passed Through Minnesota Department of Public Safety				
Homeland Security Grant Program	SHSP-00540	97.067	112,383	-
Total U.S. Department of Homeland Security			**$ 122,383**	**$ -**
Total Federal Awards			**$ 17,491,716**	**$ 3,322,152**

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 St. Louis County. The County's reporting entity is defined in Note 1 to the financial statements.

(2) The expenditures on this schedule are on the basis of accounting used by the individual funds of the County. Governmental funds use the modified accrual basis of accounting. Proprietary funds use the accrual basis.