

STATE OF MINNESOTA

Office of the State Auditor



Patricia Anderson
State Auditor

LAKE COUNTY
TWO HARBORS, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2004

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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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

For The Year Ended December 31, 2004



**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, 2004**

			<u>Term Expires</u>
Elected			
Commissioner	Clair Nelson	District 1	January 2005
Commissioner	Derrick Goutermont	District 2	January 2007
Commissioner	Larry Larson	District 3	January 2005
Commissioner	Willard Clark	District 4	January 2007
Commissioner	Lenore Johnson	District 5	January 2005
Attorney	Russell H. Conrow		January 2007
Auditor-Treasurer	Steven R. McMahon		January 2007
Recorder	Erica Koski		January 2007
Sheriff	Steve Peterson		January 2007
Appointed			
Assessor	Bruce Giddings		December 2004
Court Administrator	Larry J. Saur		Indefinite
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		Indefinite
Clerk of the Board	Wilma Rahn		Indefinite
Human Services			
Board Members	Clair Nelson		January 2005
	Derrick Goutermont		January 2007
	Larry Larson		January 2005
	Willard Clark		January 2007
	Lenore Johnson		January 2005
	Kathy Goedel		Indefinite
	Diane Johnson		Indefinite
Director	Dennis Henkel		Indefinite
Nursing Home			
Board Members	Clair Nelson		January 2005
	Derrick Goutermont		January 2007
	Larry Larson		January 2005
	Willard Clark		January 2007
	Lenore Johnson		January 2005
	Kathy Goedel		Indefinite
	Diane Johnson		Indefinite

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STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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PATRICIA ANDERSON
STATE AUDITOR

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, 2004, including the Nursing Home Enterprise Fund as of and for the year ended September 30, 2004, 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, 2004, including the Nursing Home Enterprise Fund at September 30, 2004, 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 budgetary comparison schedules for the General Fund, Road and Bridge Fund, Human Services Fund, and the Forfeited Tax Fund 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 introductory section and combining nonmajor fund financial statements and supplementary schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining nonmajor fund financial statements and supplementary schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 10, 2005, 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/Pat Anderson

/s/Greg Hierlinger

PATRICIA ANDERSON
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

End of Fieldwork: August 10, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2004
(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, 2004. 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 \$80,487,831, of which \$67,454,026 is invested in capital assets, net of related debt, and \$716,330 is restricted to specific purposes.
- Business-type activities have total net assets of \$2,751,005. Invested in capital assets, net of related debt represents \$2,373,951 of the total.
- Lake County's net assets decreased by \$621,700 for the year ended December 31, 2004. Of the decrease, \$695,182 was a decrease in the governmental activities' net assets, and \$73,482 represented the increase in business-type activities' net assets. The Lake County Housing and Redevelopment Authority (HRA) is shown as a "Discretely Presented Component Unit." The net assets of the County's discretely presented components unit decreased by \$219,000.
- The net cost of governmental activities was \$9,773,004 for the current fiscal year. The net cost was funded by general revenues and other items totaling \$9,077,822.
- Governmental funds' fund balances decreased by \$3,158,431.
- During the year, Lake County called its General Obligation Capital Improvement Bonds, Series 1995A, of \$ 395,000. The bonds called had maturity dates of 2005 through 2009.

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 statements.

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 governmental-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, which can only be used 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		Primary Government	
	2003	2004	2003	2004	2003	2004
Current and other assets	\$ 23,736	\$ 19,164	\$ 590	\$ 677	\$ 24,326	\$ 19,841
Capital assets	<u>65,235</u>	<u>67,911</u>	<u>2,450</u>	<u>2,382</u>	<u>67,685</u>	<u>70,293</u>
Total Assets	<u>\$ 88,971</u>	<u>\$ 87,075</u>	<u>\$ 3,040</u>	<u>\$ 3,059</u>	<u>\$ 92,011</u>	<u>\$ 90,134</u>
Long-term debt outstanding	\$ (5,723)	\$ (3,716)	\$ (80)	\$ (78)	\$ (5,803)	\$ (3,794)
Other liabilities	<u>(2,065)</u>	<u>(2,871)</u>	<u>(283)</u>	<u>(230)</u>	<u>(2,348)</u>	<u>(3,101)</u>
Total Liabilities	<u>\$ (7,788)</u>	<u>\$ (6,587)</u>	<u>\$ (363)</u>	<u>\$ (308)</u>	<u>\$ (8,151)</u>	<u>\$ (6,895)</u>
Net Assets						
Invested in capital assets, net of debt	\$ 64,769	\$ 67,454	\$ 2,440	\$ 2,374	\$ 67,209	\$ 69,828
Restricted	5,362	717	-	-	5,362	717
Unrestricted	<u>11,052</u>	<u>12,317</u>	<u>237</u>	<u>377</u>	<u>11,289</u>	<u>12,694</u>
Total Net Assets	<u>\$ 81,183</u>	<u>\$ 80,488</u>	<u>\$ 2,677</u>	<u>\$ 2,751</u>	<u>\$ 83,860</u>	<u>\$ 83,239</u>

TABLE 2
Changes in Net Assets
(In Thousands)

	Governmental Activities		Business-Type Activities		Primary Government	
	2003	2004	2003	2004	2003	2004
Revenues						
Program revenues						
Fees, fines, charges, and other	\$ 1,942	\$ 1,937	\$ 3,076	\$ 3,197	\$ 5,018	\$ 5,134
Operating grants and Contributions	6,185	5,900	-	3	6,185	5,903
Capital grants and Contributions	1,806	1,881	19	-	1,825	1,881
General revenues						
Property taxes	4,246	4,368	-	-	4,246	4,368
Other taxes	2,686	2,011	-	-	2,686	2,011
Unrestricted grants and contributions	2,067	2,131	1	-	2,068	2,131
Investment earnings	204	301	-	6	204	307
Miscellaneous	<u>292</u>	<u>267</u>	<u>38</u>	<u>1</u>	<u>330</u>	<u>268</u>
Total Revenues	<u>\$ 19,428</u>	<u>\$ 18,796</u>	<u>\$ 3,134</u>	<u>\$ 3,207</u>	<u>\$ 22,562</u>	<u>\$ 22,003</u>

(Unaudited)

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	Governmental Activities		Business-Type Activities		Primary Government	
	2003	2004	2003	2004	2003	2004
Expenses						
General government	\$ 3,900	\$ 3,641	\$ -	\$ -	\$ 3,900	\$ 3,641
Public safety	2,671	2,918	-	-	2,671	2,918
Culture and recreation	639	664	-	-	639	664
Highways and streets	3,228	6,845	-	-	3,228	6,845
Human services	3,692	3,721	3,013	3,133	6,705	6,854
Health	286	307	-	-	286	307
Sanitation	311	274	-	-	311	274
Conservation of natural resources	715	817	-	-	715	817
Economic development	83	59	-	-	83	59
Interest	258	245	-	-	258	245
Total Expenses	\$ 15,783	\$19,491	\$ 3,013	\$ 3,133	\$ 18,796	\$ 22,624
Increase (Decrease) in Net Assets	\$ 3,645	\$ (695)	\$ 121	\$ 74	\$ 3,766	\$ (621)
Net Assets, January 1	77,538	81,183	2,556	2,677	80,094	83,860
Net Assets, December 31	\$ 81,183	\$ 80,488	\$ 2,677	\$ 2,751	\$ 83,860	\$ 83,239

Governmental Activities

The cost of all governmental activities this year was \$19,490,549. However, as shown in the Statement of Activities, the amount that our taxpayers ultimately financed for these activities through County taxes was only \$9,773,004, because some of the cost was paid by those who directly benefited from the programs (\$1,936,692) or by other governments and organizations that subsidized certain programs with grants and contributions (\$7,780,853).

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

	Total Cost of Services		Net Cost of Services	
	2003	2004	2003	2004
Human services	\$ 3,692	\$ 3,721	\$ 1,244	\$ 1,426
Highways and streets	3,228	6,845	(568)	3,035
General government	3,900	3,641	2,290	2,059
Public safety	2,671	2,918	2,130	2,445
Conservation of natural resources	715	817	(398)	(413)
All others	1,577	1,549	1,152	1,221
Total	\$ 15,783	\$ 19,491	\$ 5,850	\$ 9,773

(Unaudited)

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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 \$382,776 greater than the final budget amounts. Unbudgeted expenditures included expenditures to a local sewer district for engineering studies.

Resources available for appropriation were also above the final budgeted amount. Greater than expected collections in intergovernmental revenues offset reductions in anticipated tax revenues and interest earnings.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of 2004, the County had \$70,293,876 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	
	2003	2004	2003	2004	2003	2004
Land	\$ 1,062	\$ 1,112	\$ 15	\$ 15	\$ 1,077	\$ 1,127
Buildings and improvements	6,553	6,507	2,305	2,231	8,858	8,738
Machinery, vehicles, furniture, and equipment	2,048	1,825	130	136	2,178	1,961
Infrastructure	<u>55,572</u>	<u>58,467</u>	<u>-</u>	<u>-</u>	<u>55,572</u>	<u>58,467</u>
Totals	<u>\$ 65,235</u>	<u>\$ 67,911</u>	<u>\$ 2,450</u>	<u>\$ 2,382</u>	<u>\$ 67,685</u>	<u>\$ 70,293</u>

The County's fiscal-year 2005 capital budget calls for it to spend another \$7.3 million for capital projects, \$3.0 million for a new health and human services building, and \$4.3 million for road construction. The road construction will be funded by state-aid construction funds, and the health and human services building will be funded by bonding and current fund balance.

Debt

At year-end, the County had \$4,211,406 in bonds and notes outstanding versus \$5,542,118 last year--a decrease of 24 percent--as shown in Table 5. The County called its Capital Improvement Refunding Bonds, Series 1995A, of \$395,000.

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

	<u>Governmental Activities</u>		<u>Business-Type Activities</u>		<u>Totals</u>	
	<u>2003</u>	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>	<u>2004</u>
General obligation bonds	\$ 4,840	\$ 3,630	\$ -	\$ -	\$ 4,840	\$ 3,630
Notes payable	702	581	-	-	702	581
Capital leases	-	58	10	8	10	66
Compensated absences	<u>1,116</u>	<u>1,127</u>	<u>99</u>	<u>99</u>	<u>1,215</u>	<u>1,226</u>
Totals	<u>\$ 6,658</u>	<u>\$ 5,396</u>	<u>\$ 109</u>	<u>\$ 107</u>	<u>\$ 6,767</u>	<u>\$ 5,503</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 \$10,740,000 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 2005 budget, tax rates, and fees that will be charged for the business-type activities.

- County General Fund expenditures for 2005 are budgeted to increase 5.4 percent over 2004.
- Property tax levies have increased 7.6 percent for 2005.

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

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 1

**STATEMENT OF NET ASSETS
DECEMBER 31, 2004**

	Primary Government			Discretely Presented Component Unit
	Governmental Activities	Business-Type Activities	Total	
Assets				
Cash and pooled investments	\$ 13,669,772	\$ 500	\$ 13,670,272	\$ 68,918
Receivables - net	4,397,863	602,268	5,000,131	281,891
Due from component unit	566,538	-	566,538	-
Due from primary government	-	-	-	2,538
Inventories	503,395	18,313	521,708	-
Prepaid items	-	48,381	48,381	-
Restricted assets				
Cash and pooled investments	-	7,213	7,213	78,817
Deferred charges	26,085	-	26,085	-
Capital assets				
Non-depreciable capital assets	1,112,269	-	1,112,269	208,629
Depreciable capital assets - net of accumulated depreciation	66,799,171	2,382,436	69,181,607	2,526,208
Total Assets	\$ 87,075,093	\$ 3,059,111	\$ 90,134,204	\$ 3,167,001
Liabilities				
Accounts payable and other current liabilities	\$ 989,603	\$ 193,708	\$ 1,183,311	\$ 25,254
Accrued interest payable	79,415	-	79,415	2,650
Due to component unit	2,538	-	2,538	-
Due to primary government	-	-	-	566,538
Unearned revenue	120,000	-	120,000	25
Payable from restricted assets				
Due to residents	-	7,213	7,213	-
Customer deposits payable	-	-	-	9,619
Long-term liabilities				
Due within one year	1,679,582	29,065	1,708,647	30,100
Due in more than one year	3,716,124	78,120	3,794,244	998,862
Total Liabilities	\$ 6,587,262	\$ 308,106	\$ 6,895,368	\$ 1,633,048
Net Assets				
Invested in capital assets - net of related debt	\$ 67,454,026	\$ 2,373,951	\$ 69,827,977	\$ 1,705,875
Restricted for				
General government	62,341	-	62,341	-
Public safety	16,160	-	16,160	-
Highways and streets	397,919	-	397,919	-
Human services	98,027	-	98,027	-
Conservation of natural resources	141,883	-	141,883	-
Debt service	-	-	-	69,198
Unrestricted	12,317,475	377,054	12,694,529	(241,120)
Total Net Assets	\$ 80,487,831	\$ 2,751,005	\$ 83,238,836	\$ 1,533,953

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2004**

	Expenses	Fees, Charges, Fines, and Other	Program Revenues Operating Grants and Contributions
Functions/Programs			
Primary Government			
Governmental activities			
General government	\$ 3,640,815	\$ 411,021	\$ 1,154,945
Public safety	2,917,792	110,752	361,548
Highways and streets	6,845,035	215,378	1,729,063
Sanitation	274,104	112,770	-
Human services	3,720,949	161,969	2,133,272
Health	306,932	51,588	157,853
Culture and recreation	663,998	164	3,000
Conservation of natural resources	817,030	870,782	359,931
Economic development	58,473	2,268	-
Interest	245,421	-	-
Total governmental activities	\$ 19,490,549	\$ 1,936,692	\$ 5,899,612
Business-type activities			
Nursing home	3,133,318	3,196,851	2,609
Total Primary Government	\$ 22,623,867	\$ 5,133,543	\$ 5,902,221
Component unit			
Housing and Redevelopment Authority	\$ 838,273	\$ 141,790	\$ -

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

Net Assets - Ending

EXHIBIT 2

Net (Expense) Revenue and Changes in Net Assets				
Capital Grants and Contributions	Primary Government			Discretely Presented Component Unit
	Governmental Activities	Business-Type Activities	Total	
\$ 15,654	\$ (2,059,195)	\$ -	\$ (2,059,195)	
-	(2,445,492)	-	(2,445,492)	
1,865,587	(3,035,007)	-	(3,035,007)	
-	(161,334)	-	(161,334)	
-	(1,425,708)	-	(1,425,708)	
-	(97,491)	-	(97,491)	
-	(660,834)	-	(660,834)	
-	413,683	-	413,683	
-	(56,205)	-	(56,205)	
-	(245,421)	-	(245,421)	
\$ 1,881,241	\$ (9,773,004)	\$ -	\$ (9,773,004)	
-	-	66,142	66,142	
\$ 1,881,241	\$ (9,773,004)	\$ 66,142	\$ (9,706,862)	
\$ -				\$ (696,483)
	\$ 4,368,216	\$ -	\$ 4,368,216	\$ -
	21,242	-	21,242	-
	415,819	-	415,819	-
	393,042	-	393,042	237,474
	1,180,580	-	1,180,580	-
	2,131,258	-	2,131,258	-
	-	-	-	160,255
	300,671	6,540	307,211	1,373
	266,994	800	267,794	78,381
	\$ 9,077,822	\$ 7,340	\$ 9,085,162	\$ 477,483
	\$ (695,182)	\$ 73,482	\$ (621,700)	\$ (219,000)
	81,183,013	2,677,523	83,860,536	1,752,953
	\$ 80,487,831	\$ 2,751,005	\$ 83,238,836	\$ 1,533,953

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FUND FINANCIAL STATEMENTS

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GOVERNMENTAL FUNDS

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2004**

	General	Road and Bridge
<u>Assets</u>		
Cash and pooled investments	\$ 5,411,715	\$ 1,008,660
Escheat cash	10,948	-
Petty cash and change funds	1,400	500
Undistributed cash in agency funds	86,312	27,745
Cash with escrow agent	-	-
Taxes receivable		
Prior	107,280	38,700
Accounts receivable	35,326	252,490
Accrued interest receivable	50,467	-
Loans receivable	248,376	-
Due from other funds	108,676	225
Due from other governments	572,822	987,685
Due from component unit	-	-
Inventories	-	503,395
Leases receivable	190,000	-
	\$ 6,823,322	\$ 2,819,400
Total Assets	\$ 6,823,322	\$ 2,819,400

EXHIBIT 3

Human Services	Forfeited Tax	Debt Service	Other Governmental Funds	Total Governmental Funds
\$ 4,848,173	\$ 118,627	\$ 234,765	\$ 865,060	\$ 12,487,000
-	-	-	-	10,948
1,000	50	-	-	2,950
39,081	-	7,116	2,259	162,513
-	-	1,006,361	-	1,006,361
57,273	-	10,654	1,840	215,747
24,701	723,102	-	-	1,035,619
-	-	-	-	50,467
-	-	570,000	90,151	908,527
-	148,933	-	-	257,834
436,996	-	-	-	1,997,503
-	-	566,538	-	566,538
-	-	-	-	503,395
-	-	-	-	190,000
<u>\$ 5,407,224</u>	<u>\$ 990,712</u>	<u>\$ 2,395,434</u>	<u>\$ 959,310</u>	<u>\$ 19,395,402</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2004**

	General	Road and Bridge
<u>Liabilities and Fund Balance</u>		
Liabilities		
Accounts payable	\$ 97,738	\$ 12,924
Escheat property payable	10,948	-
Salaries payable	151,968	66,405
Contracts payable	-	358,490
Due to other funds	-	148,933
Due to other governments	26,266	6,647
Due to component units	-	-
Deferred revenue - unavailable	135,798	432,766
Deferred revenue - unearned	120,000	-
	\$ 542,718	\$ 1,026,165
Fund Balances		
Reserved for		
Inventories	\$ -	\$ 503,395
Loans receivable	248,376	-
Law library	62,341	-
Sheriff's contingency	2,575	-
Sheriff's forfeited property	13,585	-
Region III fund	-	-
Title III forests	141,883	-
Retired employees	20,377	40,642
Unreserved		
Designated for debt service	-	-
Designated for future expenditures	-	-
Designated for capital equipment	-	217,600
Designated for buildings and grounds	-	20,000
Designated for computer network	-	34,800
Designated for gravel pit	-	137,747
Undesignated	5,791,467	839,051
Unreserved, reported in nonmajor special revenue funds	-	-
	\$ 6,280,604	\$ 1,793,235
Total Liabilities and Fund Balances	\$ 6,823,322	\$ 2,819,400

EXHIBIT 3
(Continued)

<u>Human Services</u>	<u>Forfeited Tax</u>	<u>Debt Service</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
\$ 100,211	\$ 5,327	\$ -	\$ -	\$ 216,200
-	-	-	-	10,948
53,903	10,732	-	-	283,008
-	-	-	-	358,490
2,813	-	106,088	-	257,834
26,735	154	-	61,155	120,957
-	-	2,538	-	2,538
47,943	658,939	577,234	754	1,853,434
-	-	-	-	120,000
\$ 231,605	\$ 675,152	\$ 685,860	\$ 61,909	\$ 3,223,409
\$ -	\$ -	\$ -	\$ -	\$ 503,395
-	-	-	90,151	338,527
-	-	-	-	62,341
-	-	-	-	2,575
-	-	-	-	13,585
98,027	-	-	-	98,027
-	-	-	-	141,883
-	-	-	-	61,019
-	-	1,709,574	-	1,709,574
3,500,000	-	-	-	3,500,000
-	-	-	-	217,600
-	-	-	-	20,000
-	-	-	-	34,800
-	-	-	-	137,747
1,577,592	315,560	-	-	8,523,670
-	-	-	807,250	807,250
\$ 5,175,619	\$ 315,560	\$ 1,709,574	\$ 897,401	\$ 16,171,993
\$ 5,407,224	\$ 990,712	\$ 2,395,434	\$ 959,310	\$ 19,395,402

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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, 2004**

Fund balances - total governmental funds (Exhibit 3)	\$	16,171,993
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.		67,911,440
Other long-term assets are not available to pay for current period expenditures and, therefore, are deferred in the governmental funds.		1,853,434
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	\$ (3,630,000)	
Notes payable	(581,406)	
Capital lease payable	(57,414)	
Compensated absences	(1,126,886)	
Accrued interest payable	(79,415)	
Deferred debt issuance charges	26,085	
	(5,449,036)	(5,449,036)
Net assets of governmental activities (Exhibit 1)	\$	<u>80,487,831</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2004**

	General	Road and Bridge
Revenues		
Taxes	\$ 3,245,722	\$ 1,010,375
Licenses and permits	24,332	-
Intergovernmental	3,173,552	5,594,536
Charges for services	412,846	211,210
Fines and forfeits	66,437	-
Gifts and contributions	18,382	-
Interest on investments	290,574	-
Miscellaneous	310,798	4,168
	\$ 7,542,643	\$ 6,820,289
Expenditures		
Current		
General government	\$ 3,565,405	\$ -
Public safety	2,733,008	-
Highways and streets	-	9,608,919
Sanitation	241,282	-
Human services	-	-
Health	-	-
Culture and recreation	607,175	-
Conservation of natural resources	153,794	-
Economic development	56,223	-
Capital outlay	-	-
Intergovernmental	-	-
Debt service		
Principal retirement	20,712	15,942
Interest	-	-
Bond issuance costs	-	-
Miscellaneous	-	-
	\$ 7,377,599	\$ 9,624,861
Excess of Revenues Over (Under) Expenditures	\$ 165,044	\$ (2,804,572)
Other Financing Sources (Uses)		
Transfers in from governmental funds	\$ -	\$ -
Proceeds from capital lease	-	73,356
Transfers out to governmental funds	(182,587)	-
	\$ (182,587)	\$ 73,356
Net Change in Fund Balances	\$ (17,543)	\$ (2,731,216)
Fund Balance - January 1	6,298,147	4,537,899
Increase (decrease) in reserved for inventories	-	(13,448)
Fund Balance - December 31	\$ 6,280,604	\$ 1,793,235

EXHIBIT 5

Human Services	Forfeited Tax	Debt Service	Other Governmental Funds	Total Governmental Funds
\$ 1,139,052	\$ 8,401	\$ 598,380	\$ 60,990	\$ 6,062,920
-	4,226	-	-	28,558
2,810,560	23,805	57,643	130,681	11,790,777
128,970	237,319	-	-	990,345
-	-	-	-	66,437
-	-	-	-	18,382
-	-	10,097	-	300,671
81,707	462,177	178,761	2,389	1,040,000
\$ 4,160,289	\$ 735,928	\$ 844,881	\$ 194,060	\$ 20,298,090
\$ -	\$ -	\$ -	\$ 5,457	\$ 3,570,862
-	-	-	69,055	2,802,063
-	-	-	-	9,608,919
-	-	-	-	241,282
3,852,017	-	-	-	3,852,017
307,366	-	-	-	307,366
-	-	-	2,866	610,041
-	546,821	-	109,221	809,836
-	-	-	2,250	58,473
-	45,208	-	-	45,208
-	-	160,255	-	160,255
-	-	1,075,000	100,000	1,211,654
-	-	203,914	27,750	231,664
-	-	116	-	116
-	-	6,673	-	6,673
\$ 4,159,383	\$ 592,029	\$ 1,445,958	\$ 316,599	\$ 23,516,429
\$ 906	\$ 143,899	\$ (601,077)	\$ (122,539)	\$ (3,218,339)
\$ -	\$ -	\$ 182,587	\$ -	\$ 182,587
-	-	-	-	73,356
-	-	-	-	(182,587)
\$ -	\$ -	\$ 182,587	\$ -	\$ 73,356
\$ 906	\$ 143,899	\$ (418,490)	\$ (122,539)	\$ (3,144,983)
5,174,713	171,661	2,128,064	1,019,940	19,330,424
-	-	-	-	(13,448)
\$ 5,175,619	\$ 315,560	\$ 1,709,574	\$ 897,401	\$ 16,171,993

**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, 2004**

Net change in fund balances - total governmental funds (Exhibit 5)	\$	(3,144,983)
<p>Amounts reported for governmental activities in the statement of activities are different because:</p>		
<p>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.</p>		
Expenditures for general capital assets, infrastructure, and other related capital assets adjustment	\$ 4,779,999	
Current year depreciation	<u>(2,086,799)</u>	2,693,200
<p>In the statement of activities, only the gain or loss on the disposal of capital assets is reported; whereas in the governmental funds, the proceeds from the disposal increase financial resources. Therefore, the change in net assets differs from the change in fund balance by the book value of the capital assets disposed of.</p>		
		(15,965)
<p>Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.</p>		
		(1,494,710)
<p>Bond/note/lease proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets.</p>		
		(73,356)
<p>Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.</p>		
Principal repayments		
General obligation bonds	\$ 1,210,000	
Notes payable	120,712	
Capital lease	<u>15,942</u>	1,346,654
<p>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.</p>		
Change in accrued interest payable	\$ 26,714	
Amortization of bond issuance costs	(8,427)	
Change in compensated absences	(10,861)	
Change in inventories	<u>(13,448)</u>	<u>(6,022)</u>
Change in net assets of governmental activities (Exhibit 2)	\$	<u>(695,182)</u>

PROPRIETARY FUNDS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 7

**STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
SEPTEMBER 30, 2004**

	Nursing Home Enterprise Fund
<u>Assets</u>	
Current assets	
Petty cash and change funds	\$ 500
Accounts receivable-net	602,268
Inventories	18,313
Prepaid items	48,381
	\$ 669,462
Noncurrent assets	
Restricted cash, cash equivalents, and investments	
Resident trust funds	\$ 7,213
Capital assets	4,186,874
Less: accumulated depreciation	(1,804,438)
	\$ 2,382,436
Total noncurrent assets	\$ 2,389,649
Total Assets	\$ 3,059,111

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**EXHIBIT 7
(Continued)**

**STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
SEPTEMBER 30, 2004**

	Nursing Home Enterprise Fund
<u>Liabilities</u>	
Current liabilities	
Accounts payable	\$ 84,027
Salaries payable	27,953
Accrued vacation payable	55,961
Compensated absences payable - current	27,260
Due to other governments	25,767
Capital leases payable - current	1,805
	\$ 222,773
Current liabilities payable from restricted assets	
Due to residents	\$ 7,213
	\$ 7,213
Noncurrent liabilities	
Compensated absences payable - long-term	\$ 71,440
Capital leases payable - long-term	6,680
	\$ 78,120
Total noncurrent liabilities	\$ 78,120
Total Liabilities	\$ 308,106
<u>Net Assets</u>	
Invested in capital assets - net of related debt	\$ 2,373,951
Unrestricted	377,054
	\$ 2,751,005

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 8

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2004**

	<u>Nursing Home Enterprise Fund</u>
Operating Revenues	
Patient services revenues	\$ 3,069,422
Ancillary and other services	84,066
Miscellaneous	<u>43,363</u>
Total Operating Revenues	\$ 3,196,851
Operating Expenses	
Nursing services	\$ 1,214,118
Other care-related	93,536
Other services and charges	54,236
Dietary	343,746
Laundry	50,660
Housekeeping	55,078
Plant operations	191,028
Other property and related costs	182,027
Administration	348,908
Employee benefits	472,385
Depreciation	<u>126,659</u>
Total Operating Expenses	\$ 3,132,381
Operating income	\$ 64,470
Nonoperating revenues (expenses)	
Miscellaneous revenue	\$ 800
Interest expense	(937)
Operating grants	2,609
Nursing Home payment adjustment	<u>6,540</u>
Total Nonoperating Revenues (Expenses)	\$ 9,012
Change in Net Assets	\$ 73,482
Net Assets - October 1	<u>2,677,523</u>
Net Assets - September 30	<u><u>2,751,005</u></u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 9

**STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE YEAR ENDED SEPTEMBER 30, 2004
Increase (Decrease) in Cash and Cash Equivalents**

	<u>Nursing Home Enterprise Fund</u>
Cash Flows from Operating Activities	
Cash received from customers	\$ 2,855,044
Cash received from miscellaneous sources	800
Cash paid to suppliers	(879,205)
Cash paid to employees	<u>(2,205,372)</u>
Net cash provided by (used in) operating activities	<u>\$ (228,733)</u>
Cash Flows from Noncapital Financing Activities	
Nursing Home payment adjustment received	\$ 6,540
Operating grants received	<u>2,609</u>
Net cash provided by (used in) noncapital financing activities	<u>\$ 9,149</u>
Cash Flows from Capital and Related Financing Activities	
Principal payments on capital lease	\$ (1,634)
Interest expense	(937)
Acquisition of capital assets	<u>(58,671)</u>
Net cash provided by (used in) capital and related financing activities	<u>\$ (61,242)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>\$ (280,826)</u>
Cash and Cash Equivalents - October 1	<u>281,326</u>
Cash and Cash Equivalents at September 30	<u><u>\$ 500</u></u>
Reconciliation of operating income to net cash provided by (used in) operating activities	
Operating income	<u>\$ 64,470</u>
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities	
Depreciation	\$ 126,659
Miscellaneous nonoperating revenue	800
Changes in assets and liabilities	
(Increase) decrease in receivables	(367,574)
(Increase) decrease in inventories	3,364
(Increase) decrease in prepaid items	(2,130)
Increase (decrease) in accounts payable	(4,179)
Increase (decrease) in salaries payable	(69,237)
Increase (decrease) in accrued vacation payable	(6,673)
Increase (decrease) in due to other governments	<u>25,767</u>
Total adjustments	<u>\$ (293,203)</u>
Net cash provided by (used in) operating activities	<u><u>\$ (228,733)</u></u>

Noncash Investing, Capital and Financing Activities

In 2004, the Nursing Home disposed of capital assets costing \$6,460 with a net book value of \$0.

FIDUCIARY FUNDS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

EXHIBIT 10

**FIDUCIARY FUNDS
STATEMENT OF FIDUCIARY NET ASSETS
DECEMBER 31, 2004**

	<u>Agency</u>
<u>Assets</u>	
Cash and cash equivalents	<u>\$ 876,292</u>
<u>Liabilities</u>	
Accounts payable	\$ 466,424
Taxes collected in advance	10,526
Due to other governments	303,762
Customer deposits - current	<u>95,580</u>
Total Liabilities	<u>\$ 876,292</u>

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2004**

1. Summary of Significant Accounting Policies

The County's financial statements are prepared in accordance with generally accepted accounting principles (GAAP) for the year ended December 31, 2004. 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:

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

A. Financial Reporting Entity

Discretely Presented Component Unit (Continued)

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

The Lake County Housing and Redevelopment Authority (HRA) is governed by a four-member board appointed by the Lake County Board of Commissioners. The Lake County Housing and Redevelopment Authority 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 which are described in Note 4.D.

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 units. 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 revenues, 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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basic Financial Statements

1. Government-Wide Statements (Continued)

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.

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 activity are offset by program revenues. Direct expenses are those that are 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 that are restricted to meeting the operational or capital requirements of a particular function or activity. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

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.

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

**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 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.

The Forfeited Tax 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 County reports the following major enterprise fund:

The Sunrise Nursing Home 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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

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 revenues 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 revenues to be available if they are collected within 90 days after the end of the current 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, 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.

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

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

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, 2004, 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 2004 were \$291,997.

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, but does operate in a manner consistent with Rule 2a7 of the Investment Company Act of 1940. Therefore, the fair value of the County's position in the pool is the same as the value of the pool shares.

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;
- (4) bankers' acceptances of United States banks;

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

2. Deposits and Investments (Continued)

- (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.

3. Receivables and Payables

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

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

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.

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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, and Net Assets or Equity

6. Capital Assets (Continued)

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset's 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.

Property, plant, and equipment of the primary government, as well as the component unit, is 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 - 15

7. Compensated Absences

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

1. Summary of Significant Accounting Policies

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

8. Deferred Revenue

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned.

9. Long-Term Obligations

In the government-wide financial statements, and proprietary fund types in the 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 that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

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

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.

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	\$	13,670,272
Restricted cash and pooled investments		7,213
Component unit		
Cash and pooled investments		68,918
Restricted cash and pooled investments		78,817
Fiduciary funds		
Cash and pooled investments		<u>876,292</u>
Total Cash and Investments	\$	<u>14,701,512</u>

Minn. Stat. §§ 118A.02 and 118A.04 authorize the County to deposit its cash and to invest in certificates of deposit in financial institutions designated by the County Treasurer. At December 31, 2004, the carrying amount of the County's deposits totaled \$552,991. The carrying amount of the Lake County Housing and Redevelopment Authority's deposits was \$144,278. The bank balance deposit amounts were \$969,103 and \$140,267, respectively. Minnesota statutes require that all County deposits be covered by insurance, surety bond, or collateral.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments (Continued)

Following is a summary of the deposits covered by insurance or collateral at December 31, 2004.

	<u>Bank Balance</u>
Covered Deposits	
Insured, or collateralized with securities held by the County or its agent in the County's name	
Primary government	\$ 208,403
Component unit	140,267
Collateralized with securities held by the pledging financial institution's agent in the County's name	
Primary government	760,700
Total covered deposits	\$ 1,109,370

Three levels of custodial credit risk for securities are defined by generally accepted accounting principles:

- (1) securities that are insured or registered, or for which the securities are held by the County or its agent in the County's name;
- (2) securities that are uninsured and unregistered and are held by the counterparty's trust department or agent in the County's name; and
- (3) securities that are uninsured and unregistered and are held by the counterparty, or by its trust department or agent, but not in the County's name.

Following is a summary of the fair values of the County's investments, categorized into the aforementioned levels of risk, at December 31, 2004:

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments (Continued)

	Category			Fair Value
	1	2	3	
U.S. government securities	\$ 927,960	\$ -	\$ 8,354,256	\$ 9,282,216
Negotiable certificates of deposit	72,040	-	416,207	488,247
Cash with escrow agent	-	-	1,006,361	1,006,361
	<u>\$ 1,000,000</u>	<u>\$ -</u>	<u>\$ 9,776,824</u>	<u>\$ 10,776,824</u>
Add				
Petty cash and change funds				2,950
Escheat cash				10,948
Money market mutual funds				188,370
MAGIC				3,025,151
Deposits				
Primary government				552,991
Component unit				144,278
				<u>144,278</u>
Total Cash and Investments				<u>\$ 14,701,512</u>

2. Receivables

Receivables as of December 31, 2004, year-end 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	\$ 215,747	\$ -
Due from other governments	1,997,503	-
Accounts	1,035,619	21,429
Interest	50,467	-
Loans receivable	908,527	721,477
Leases receivable	190,000	80,000
	<u>\$ 4,397,863</u>	<u>\$ 822,906</u>
Business-Type Activities		
Accounts	<u>\$ 602,268</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, 2004, was as follows:

Governmental Activities

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	\$ 1,062,269	\$ 50,000	\$ -	\$ 1,112,269
Capital assets depreciated				
Buildings	\$ 9,197,513	\$ 180,490	\$ -	\$ 9,378,003
Improvements other than buildings	348,495	-	-	348,495
Machinery, furniture, and equipment	6,390,625	307,400	38,360	6,659,665
Infrastructure	64,854,146	4,242,109	-	69,096,255
Total capital assets depreciated	\$ 80,790,779	\$ 4,729,999	\$ 38,360	\$ 85,482,418
Less: accumulated depreciation for				
Buildings	\$ 2,777,320	\$ 211,122	\$ -	\$ 2,988,442
Improvements other than buildings	215,896	15,479	-	231,375
Machinery, furniture, and equipment	4,343,113	514,081	22,395	4,834,799
Infrastructure	9,282,514	1,346,117	-	10,628,631
Total accumulated depreciation	\$ 16,618,843	\$ 2,086,799	\$ 22,395	\$ 18,683,247
Total capital assets depreciated, net	\$ 64,171,936	\$ 2,643,200	\$ 15,965	\$ 66,799,171
Governmental Activities Capital Assets, Net	\$ 65,234,205	\$ 2,693,200	\$ 15,965	\$ 67,911,440

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

3. Capital Assets (Continued)

Business-Type Activities

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	\$ 15,000	\$ -	\$ -	\$ 15,000
Capital assets depreciated				
Buildings	\$ 3,479,881	\$ 20,191	\$ 3,285	\$ 3,496,787
Land improvements	91,983	-	-	91,983
Machinery, furniture, and equipment	547,799	38,480	3,175	583,104
Total capital assets depreciated	\$ 4,119,663	\$ 58,671	\$ 6,460	\$ 4,171,874
Less: accumulated depreciation for				
Buildings	\$ 1,198,033	\$ 90,854	\$ 3,285	\$ 1,285,602
Land improvements	68,609	2,852	-	71,461
Machinery, furniture, and equipment	417,597	32,953	3,175	447,375
Total accumulated depreciation	\$ 1,684,239	\$ 126,659	\$ 6,460	\$ 1,804,438
Total capital assets depreciated, net	\$ 2,435,424	\$ (67,988)	\$ -	\$ 2,367,436
Business-Type Activities Capital Assets, Net	\$ 2,450,424	\$ (67,988)	\$ -	\$ 2,382,436

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

Governmental Activities	
General government	\$ 99,620
Public safety	215,011
Highways and streets, including depreciation of infrastructure assets	1,604,690
Human services	11,638
Sanitation	31,351
Culture and recreation	98,027
Conservation of natural resources	26,462
Total Depreciation Expense - Governmental Activities	<u>\$ 2,086,799</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

3. Capital Assets

Business-Type Activities (Continued)

Business-Type Activities		
Nursing home	\$	126,659

B. Interfund Receivables, Payables, and Transfers

The composition of interfund balances as of December 31, 2004, is as follows:

1. Due To/From Other Funds

Receivable Fund	Payable Fund	Amount
General	Debt Service	\$ 106,088
	Human Services	2,588
Total Due to General Fund		\$ 108,676
Road and Bridge Fund	Human Services	225
Forfeited Tax Fund	Road and Bridge Fund	148,933
Total Due To/From Other Funds		\$ 257,834

2. Due To/From Primary Government and Component Units

Receivable Entity	Payable Entity	Amount
Component Unit - Lake County Housing and Redevelopment Authority	Primary Government - Debt Service Fund	\$ 2,538
Primary Government - Debt Service	Component Unit - Lake County Housing and Redevelopment Authority	\$ 566,538

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds (Continued)

C. Liabilities

1. Payables

Payables at December 31, 2004, were as follows:

	Governmental Activities	Business-Type Activities
Accounts payable	\$ 216,200	\$ 84,027
Escheat property payable	10,948	-
Salaries	283,008	83,914
Contracts	358,490	-
Due to other governments	120,957	25,767
Total Payables	\$ 989,603	\$ 193,708

2. Construction Commitments

The County has awarded the contracts for the construction of a new Human Services building. Little or no construction work had been performed as of year-end. The contract commitment on this project was:

	Spent-to-Date	Remaining Commitment
Governmental Activities		
Human Services	\$ -	\$ 4,161,194

3. 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, 2004 the copier is valued at \$11,000. There is \$2,200 of accumulated depreciation on this asset through September 30, 2004.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities

3. Leases

Business Type Activities

Capital Leases (Continued)

The present value of the future minimum lease payments is shown below:

Year Ending December 31	Governmental Activities
2005	\$ 2,571
2006	2,571
2007	2,571
2008	2,571
Total minimum lease payments	\$ 10,284
Less: amount representing interest	(1,799)
Present Value of Minimum Lease Payments	\$ 8,485
Current portion	\$ 1,805
Long-term portion	6,680
Total	\$ 8,485

4. Long-Term Debt

Governmental Activities

Type of Indebtedness	Final Maturity	Installment Amounts	Interest Rates (%)	Original Issue Amount	Outstanding Balance December 31, 2004
General Obligation Bonds					
G.O. Tax Increment Bonds, Series 1994D	2009	\$30,000 - \$280,000	8.10 - 9.00	\$ 1,825,000	\$ 1,195,000
G.O. Jail Lease Revenue Bonds, Series 1996A	2007	\$95,000 - \$155,000	4.00 - 5.10	1,245,000	440,000

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities

4. Long-Term Debt

Governmental Activities (Continued)

<u>Type of Indebtedness</u>	<u>Final Maturity</u>	<u>Installment Amounts</u>	<u>Interest Rates (%)</u>	<u>Original Issue Amount</u>	<u>Outstanding Balance December 31, 2004</u>
General Obligation Bonds					
G.O. Taxable Tax Increment Refunding Bonds, Series 2003A	2007	\$80,000 - \$85,000	2.50 - 3.50	250,000	250,000
G.O. Refunding Bonds, Series 2003B	2009	\$130,000 - \$150,000	2.50 - 3.00	700,000	700,000
G.O. Tax Increment Refunding Bonds, Series 2003C	2009	\$250,000 - \$275,000	2.75 - 4.00	1,045,000	1,045,000
Total General Obligation Bonds				<u>\$ 5,065,000</u>	<u>\$ 3,630,000</u>
Other Long-Term Debt					
G.O. General Obligation Revenue Note	2012	\$20,304 - \$24,286	2.00	\$ 222,422	\$ 181,406
Promissory Note	2008	\$100,000	6.00	500,000	400,000
Capital Lease	2008	\$15,942	4.25	73,356	57,414
Total Other Long-Term Debt				<u>\$ 795,778</u>	<u>\$ 638,820</u>

Business-Type Activities - Lake County Nursing Home

<u>Type of Indebtedness</u>	<u>Final Maturity</u>	<u>Installment Amounts</u>	<u>Interest Rates (%)</u>	<u>Original Issue Amount</u>	<u>Outstanding Balance September 30, 2004</u>
Capital Leases	2008	\$2,571	10.00	<u>\$ 11,000</u>	<u>\$ 8,485</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities (Continued)

5. Debt Service Requirements

Debt service requirements at December 31, 2004 were as follows:

Governmental Activities

Year Ending December 31	General Obligation Bonds		Other Long-Term Debt - Notes	
	Principal	Interest	Principal	Interest
2005	\$ 550,000	\$ 175,787	\$ 134,582	\$ 27,761
2006	835,000	141,278	135,590	20,753
2007	870,000	99,781	136,631	13,712
2008	670,000	59,345	137,706	6,635
2009	705,000	20,350	22,879	1,772
2010 - 2012	-	-	71,432	2,520
Total	\$ 3,630,000	\$ 496,541	\$ 638,820	\$ 73,153

Business-Type Activities - Lake County Nursing Home

Year Ending September 30	Capital Leases	
	Principal	Interest
2005	\$ 1,805	\$ 766
2006	1,994	577
2007	2,202	369
2008	2,484	87
Total	\$ 8,485	\$ 1,799

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities

6. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2004, was as follows:

Governmental Activities

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
General obligation bonds	\$ 4,840,000	\$ -	\$ 1,210,000	\$ 3,630,000	\$ 1,545,000
Notes payable	702,118	-	120,712	581,406	121,128
Total bonds and notes payable	\$ 5,542,118	\$ -	\$ 1,330,712	\$ 4,211,406	\$ 1,666,128
Capital lease payable	-	73,356	15,942	57,414	13,454
Compensated absences	1,116,025	511,083	500,222	1,126,886	-
Governmental Activity Long-Term Liabilities	<u>\$ 6,658,143</u>	<u>\$ 584,439</u>	<u>\$ 1,846,876</u>	<u>\$ 5,395,706</u>	<u>\$ 1,679,582</u>

Business-Type Activities - Lake County Nursing Home

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Business-Type Activity Long-Term Liabilities					
Capital leases	\$ 10,119	\$ -	\$ 1,634	\$ 8,485	\$ 1,805
Compensated absences	98,700	-	-	98,700	27,260
Business-Type Activity Long-Term Liabilities	<u>\$ 108,819</u>	<u>\$ -</u>	<u>\$ 1,634</u>	<u>\$ 107,185</u>	<u>\$ 29,065</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.

7. Advance Crossover Refunding of Debt

On December 1, 2003, Lake County issued General Obligation Tax Increment Crossover Refunding Bonds, Series 2003C, in the amount of \$1,045,000 with interest rates of 2.75 to 4.00 percent to advance crossover refund the following issue:

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities

7. Advance Crossover Refunding of Debt (Continued)

General Obligation Tax Increment Bonds, Series 1994D, maturing on and after February 1, 2006. The balance of the outstanding maturities to be refunded is \$995,000 and interest rates are 8.80 to 9.00 percent.

The proceeds from the bonds were placed with an escrow agent in an irrevocable trust from which U.S. Treasury Securities were purchased. The County is responsible for the principal and interest on the original issue through February 1, 2005. The refunded bonds were called and paid by the escrow agent on February 1, 2005. The escrow agent will pay the interest due on the Series 2003 bonds through February 1, 2005; thereafter the County will be responsible for the payment of debt service. The principal balance of both the original issue and the refunding issue will be shown on the balance sheet until the call date of the refunded bonds, at which time the 1994 Series bonds will be paid and the liability for those bonds will be removed.

As a result of the advance crossover refunding, the County reduced its total debt service requirements by \$90,876, which resulted in an economic gain (difference between the present value of the debt service payments on the old and new debt service) of \$81,770.

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). The PERA administers the Public Employees Retirement Fund, the Public Employees Police and Fire Fund, and the Public Employees Correctional Fund, which are cost-sharing, multiple-employer retirement plans. These plans are established and administered in accordance with Minn. Stat. chs. 353 and 356.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Defined Benefit Plan

Plan Description (Continued)

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 and have direct contact with inmates are covered by the Public Employees Correctional Fund.

The PERA provides retirement benefits as well as disability benefits to members and benefits to survivors upon death of eligible members. Benefits are established by state statute and vest after three years of credited service. The retirement benefits are based on a member's highest average salary for any five successive years of allowable service, age, and years of credit at termination of service.

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Defined Benefit Plan

Plan Description (Continued)

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

The PERA issues a publicly available financial report that includes financial statements and required supplementary information for the Public Employees Retirement Fund, the Public Employees Police and Fire Fund, and the Public Employees Correctional Fund. That report may be obtained on the web at 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 employee contributions and income from the investment of fund assets. Minn. Stat. ch. 353 sets the rates for employer and employee contributions. These statutes are established and amended by the State Legislature. The 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 are required to contribute 9.10 and 5.10 percent, respectively, of their annual covered salary. Public Employees Police and Fire Fund members are required to contribute 6.20 percent of their annual covered salary. Public Employees Correctional Fund members are required to contribute 5.83 percent of their annual covered salary.

The County is required to contribute the following percentages of annual covered payroll:

Public Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	5.53
Public Employees Police and Fire Fund	9.30
Public Employees Correctional Fund	8.75

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

A. Defined Benefit Plan

Funding Policy (Continued)

The County's contributions for the years ending December 31, 2004, 2003, and 2002, for the Public Employees Retirement Fund, the Public Employees Police and Fire Fund, and the Public Employees Correctional Fund were:

	Public Employees Retirement Fund	Public Employees Police and Fire Fund	Public Employees Correctional Fund
2004	\$ 321,277	\$ 78,239	\$ 31,523
2003	316,260	71,159	29,654
2002	310,195	67,526	32,261

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

B. Defined Contribution Plan

The Public Employees Defined Contribution Plan is a multiple-employer deferred compensation plan for local government officials, except elected county sheriffs. The plan is established and administered 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.

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.

No vesting period is required to receive benefits in the Defined Contribution Plan. At the time of retirement or termination, the market value of the member's account is distributed to the member or another qualified plan.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

3. Employee Retirement Systems and Pension Plans

B. Defined Contribution Plan (Continued)

The County's contributions for the years ending December 31, 2004, 2003, and 2002, were \$5,190, \$5,452, and \$1,301, respectively, equal to the contractually required contributions for each year as set by state statute.

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.

The Workers' Compensation Division of the 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. The MCIT participates in the Workers' Compensation Reinsurance Association with coverage at \$720,000 per claim in 2004 and \$760,000 in 2005. Should the MCIT Workers' Compensation Division liabilities exceed assets, the MCIT may assess the County in a method and amount to be determined by the MCIT.

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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

A. Risk Management (Continued)

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.

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	
	2004	2003
Unpaid claims, beginning of fiscal year	\$ -	\$ -
Incurred claims (including IBNRs)	91,054	89,030
Claims payments	(91,054)	(89,030)
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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

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

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 \$1,035,000 of which \$222,344 has been paid through December 31, 2004. The outstanding commitment at December 31, 2004, is \$812,656. 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.

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.

Arrowhead Regional Corrections is financed through state grants and contributions from the participating counties. During 2003 (the most recent information available), County contributions were in the following proportion:

Carlton County	8.92%
Cook County	1.44%
Koochiching County	2.07%
Lake County	2.25%
St. Louis County	<u>85.32%</u>
Total	<u>100.00%</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Arrowhead Regional Corrections (Continued)

In 2003, the Arrowhead Regional Corrections adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements--and Management Discussion and Analysis--for State and Local Governments*. Below is a summary of the financial information from Arrowhead Regional Corrections' Government-Wide Statements:

Total Assets	\$ 10,643,296
Total Liabilities	4,241,067
Total Net Assets	6,402,229
Total Revenues	18,074,303
Total Expenses	17,129,073
Change in Net Assets	945,230

The Total Assets balance included \$6,668,481 of Capital Assets - Net of Accumulated Depreciation. The Total Liabilities balance included \$3,426,359 in Long-Term Liabilities.

Lake County provided \$206,660 in funding during 2004. Separate financial information can be obtained from:

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

Community Health Services 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 Services Board. This agreement was entered into January 1, 1977, and is established pursuant to Minn. Stat. § 471.59.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Community Health Services Board (Continued)

The Community Health Services 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 2004.

At December 31, 2003 (the most recent information available), the Community Health Services Board's summary of financial information was:

Total Assets	\$	905,053
Total Liabilities		824,406
Total Fund Equity		80,647
Total Revenues		3,112,101
Total Expenditures		3,088,831
Increase (Decrease) In Fund Balance		23,270

Separate financial information can be obtained from:

Carlton, Cook, Lake and St. Louis Counties
Community Health Board
325 South Lake Avenue
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 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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Northeast Minnesota Office of Job Training (Continued)

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

At fiscal year-end June 30, 2004, the Northeast Minnesota Office of Job Training had net assets of \$1,382,550 and long-term debt of \$758,370. The change in net assets was \$394,478 for the year ended June 30, 2004.

Separate financial information can be obtained from:

Northeast Minnesota Office of Job Training
820 North Ninth Street
Suite 200
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.

MCIS is governed by an 11-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, 2002 (the most recent information available), was:

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Minnesota Counties Information Systems (Continued)

Total Assets	\$	555,861
Total Liabilities		244,987
Total Fund Equity		310,874
Total Revenues		1,728,440
Total Expenditures		1,771,971
Increase (Decrease) in Fund Balance		(43,531)

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.

The joint powers are Cook, Itasca, Koochiching, Lake, Lake of the Woods, 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, 2002, (the most recent available information) is shown below:

Total Assets	\$	21,821
Total Liabilities		1,632
Total Fund Equity		20,189
Total Revenues		47,500
Total Expenditures		28,911
Increase (Decrease) in Fund Balance		18,589

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

D. Joint Ventures

Northern Counties Land Use Board (Continued)

The County contributed \$2,400 during 2004 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, MN 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.

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, 2004, is as follows:

Assets	\$ <u>466,424</u>
Liabilities	\$ <u>466,424</u>

**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 made no payments to the North Shore Management Board in 2004.

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 2004.

F. Related Parties

Lake County Housing and Redevelopment Authority

The Lake County Housing and Redevelopment Authority (HRA) is a discretely presented component unit of Lake County. During 1996, the HRA issued \$1,245,000 in General Obligation Jail Lease Revenue Bonds, with \$440,000 outstanding at December 31, 2004. The bonds were issued to finance the jail portion of the County Law Enforcement Center. The jail is owned by the HRA and is leased to Lake County. The County makes lease payments in the amounts necessary to make the bond principal and interest payments each year. When all of the bonds have been paid off, the title to the jail will pass to the County. Because the debt is essentially an obligation of the County, it is shown as County debt in the County's government-wide financial statements. It is also shown as debt in the separately issued financial statements of the Lake County Housing and Redevelopment Authority because the HRA issued the bonds. The debt is eliminated from the HRA Component Unit column on the County's financial statements to eliminate double reporting of the debt.

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,

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

4. Summary of Significant Contingencies and Other Items

G. Tax-Forfeited Land (Continued)

seedlings, tree planting, and logging roads, are accounted for as current operating expenditures. Revenues in excess of expenditures are distributed to the County and cities, towns, and school districts within the County according to state statute.

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, and a secretary-treasurer, elected annually. At year-end December 31, 2004, there are four Board members and one vacancy.

Basis of Presentation

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

The Authority reports the following major governmental fund:

The General Fund is the Authority's primary operating fund. It accounts for all financial resources of the general government not accounted for in other funds.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

A. Summary of Significant Accounting Policies

Basis of Presentation (Continued)

The Authority reports the following major enterprise fund:

The Silverpointe Enterprise Fund is used to account for the operations of a 25-unit senior housing facility in Silver Bay, Minnesota. The facility is owned by the Authority and was built to provide quality and affordable housing for senior citizens in Lake County. Silverpointe is operated similar to a business enterprise. The intent of the Authority is that the cost of providing housing services to the general public, on a continuing basis, is financed or recovered primarily through user charges.

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.

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 Housing and Redevelopment Authority considers all revenues to be available if they are collected within 90 days after the end of the current 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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

A. Summary of Significant Accounting Policies

Measurement Focus and Basis of Accounting (Continued)

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

Cash and Cash Equivalents

The Authority's cash and cash equivalents consists of savings and checking accounts, cash on hand, and certificates of deposits, 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."

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 on 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.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

A. Summary of Significant Accounting Policies (Continued)

Capital Assets

Capital assets, which include land, buildings and structures, and equipment, 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 \$1,000 and have an expected life of at least 5 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 asset's lives are not capitalized.

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

Assets	Years
Buildings and structures	25 - 40
Equipment	7

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. Prior Period Restatement

An adjustment was made to the Authority's General Fund prior year fund balance to account for a change in revenue recognition for receivables. Prior year receivables that were not collected within the Authority's period of availability should be shown as deferred revenue.

Fund Balance - December 31, 2003, as reported	\$ (126,328)
Restatement	(116,005)
Fund Balance - December 31, 2003, as restated	\$ (242,333)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures (Continued)

C. Detailed Notes on All Funds

Assets

Deposits and Investments

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

Unrestricted		
Cash and cash equivalents	\$	68,918
Restricted assets		
Cash and cash equivalents		
Debt service		69,198
Customer deposits		9,619
		147,735
Total Cash	\$	147,735

Minn. Stat. §§ 118A.02 and 118A.04 authorize the Authority to deposit its cash and to invest in certificates of deposit in financial institutions. At December 31, 2004, the carrying amount of the Authority's deposits totaled \$140,364. The bank balance deposit amount was \$140,267. Minnesota statutes require that all County deposits be covered by insurance, surety bond, or collateral.

Following is a summary of the deposits covered by insurance or collateral at December 31, 2004.

		<u>Bank Balance</u>
Covered Deposits		
Insured, or collateralized with securities held by the Authority or its agent in the Authority's name		\$ 140,267
		140,267

Included in cash is \$3,457 held by the Lake County Treasurer for the Authority.

Three levels of custodial credit risk for securities are defined by generally accepted accounting principles:

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

C. Detailed Notes on All Funds

Assets

Deposits and Investments (Continued)

- (1) securities that are insured or registered, or for which the securities are held by the County or its agent in the County's name;
- (2) securities that are uninsured and unregistered and are held by the counterparty's trust department or agent in the County's name; and
- (3) securities that are uninsured and unregistered and are held by the counterparty, or by its trust department or agent, but not in the County's name.

At December 31, 2004, the Authority did not own any investments that required classification regarding custodial credit risk.

Receivables

Receivables as of December 31, 2004, year-end for the Authority's governmental activities are as follows:

	Total Receivables	Amounts Not Scheduled for Collection During the Subsequent Year
Governmental Activities		
Taxes	\$ 10,413	\$ -
Accounts receivable	119,771	-
Accrued interest	75	-
Due from other governments	68,632	-
Due from Lake County	2,538	-
Loans receivable	83,000	55,000
Total Governmental Activities	\$ 284,429	\$ 55,000

There were no receivables for the Silverpointe Enterprise Fund at December 31, 2004.

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

C. Detailed Notes on All Funds

Assets

Receivables (Continued)

Loan Receivable

The Authority has an \$83,000 loan receivable from North Shore Business Enterprise Center, Inc., an unrelated non-profit organization. The loan is without interest. Annual principal payments are scheduled of \$28,000 due on September 1, 2005; \$28,000 due on September 1, 2006; and the final payment of \$27,000 due on September 1, 2007.

Capital Assets

Capital asset activity for the year ended December 31, 2004, was as follows:

Governmental Activities

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not depreciated				
Land	\$ 208,629	\$ -	\$ -	\$ 208,629
Capital assets depreciated				
Buildings and structures	\$ 1,250,973	\$ -	\$ -	\$ 1,250,973
Less: accumulated depreciation for				
Buildings and structures	215,963	31,670	-	247,633
Total capital assets depreciated, net	\$ 1,035,010	\$ (31,670)	\$ -	\$ 1,003,340
Governmental Activities Capital Assets, Net	\$ 1,243,639	\$ (31,670)	\$ -	\$ 1,211,969

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

C. Detailed Notes on All Funds

Assets (Continued)

Capital Assets (Continued)

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> </u>	<u> </u>	<u> </u>	<u> </u>
Total capital assets depreciated	\$ 1,883,028	\$ -	\$ -	\$ 1,883,028
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Less: accumulated depreciation for				
Buildings and structures	\$ 309,271	\$ 46,978	\$ -	\$ 356,249
Equipment	3,399	512	-	3,911
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total accumulated depreciation	\$ 312,670	\$ 47,490	\$ -	\$ 360,160
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Business-Type Activities Capital Assets, Net	<u>\$ 1,570,358</u>	<u>\$ (47,490)</u>	<u>\$ -</u>	<u>\$ 1,522,868</u>

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

Governmental Activities	
Urban and economic development	<u>\$ 31,760</u>
Business-Type Activities	
Senior housing	<u>\$ 47,490</u>

Interfund Receivables, Payables, and Transfers

The composition of interfund balances as of December 31, 2004, is as follows:

Due To/From Other Funds

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Silverpointe Enterprise Fund	<u>\$ 14,380</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

C. Detailed Notes on All Funds (Continued)

Liabilities

Long-Term Debt

Governmental Activities

Type of Indebtedness	Final Maturity	Installment Amounts	Interest Rates (%)	Original Issue Amount	Outstanding Balance December 31, 2004
1996 General Obligation Jail Lease Revenue Bonds	2007	\$95,000 - \$155,000	4.00 to 5.10	\$ 1,245,000	\$ 440,000

Business-Type Activities

Type of Indebtedness	Final Maturity	Installment Amounts	Interest Rate (%)	Original Issue Amount	Outstanding Balance December 31, 2004
1996 General Obligation Senior Housing Bonds	2027	Varies	3.92	\$ 1,160,642	\$ 1,028,962

Debt Service Requirements

Debt service requirements at December 31, 2004, were as follows:

Governmental Activities

Year Ending December 31	Revenue Bonds	
	Principal	Interest
2005	\$ 140,000	\$ 18,585
2006	145,000	11,530
2007	155,000	3,953
Totals	\$ 440,000	\$ 34,068

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

C. Detailed Notes on All Funds

Liabilities (Continued)

Business-Type Activities

<u>Year Ending December 31</u>	<u>Revenue Bonds</u>	
	<u>Principal</u>	<u>Interest</u>
2005	\$ 30,100	\$ 39,076
2006	30,589	38,609
2007	31,810	37,388
2008	33,079	36,119
2009	34,400	34,798
2010 - 2014	193,723	152,267
2015 - 2019	235,594	110,396
2020 - 2024	286,514	59,476
2025 - 2027	153,153	7,317
Totals	<u>\$ 1,028,962</u>	<u>\$ 515,446</u>

Changes in Long-Term Liabilities

Governmental 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 Jail					
Lease Revenue Bonds	\$ 575,000	\$ -	\$ 135,000	\$ 440,000	\$ 140,000

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	\$ 1,056,781	\$ -	\$ 27,819	\$ 1,028,962	\$ 30,100

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

C. Detailed Notes on All Funds

Liabilities (Continued)

Tax Increment Financing Districts

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

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 operating transfers to Lake County in its financial statements.

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; injuries to employees; 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

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

5. Component Unit Disclosures

D. Summary Disclosure of Significant Contingencies

Tax Increment Assistance (Continued)

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 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.

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 continued 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 their 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 their 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.

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, 2004**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Revenues				
Taxes	\$ 3,918,263	\$ 3,918,263	\$ 3,245,722	\$ (672,541)
Licenses and permits	19,147	19,147	24,332	5,185
Intergovernmental	2,333,857	2,333,857	3,173,552	839,695
Charges for services	367,330	367,330	412,846	45,516
Fines and forfeits	77,600	77,600	66,437	(11,163)
Gifts and contributions	-	-	18,382	18,382
Investments earnings	340,000	340,000	290,574	(49,426)
Miscellaneous	203,185	203,185	310,798	107,613
Total Revenues	\$ 7,259,382	\$ 7,259,382	\$ 7,542,643	\$ 283,261
Expenditures				
Current				
General government				
Commissioners	\$ 504,812	\$ 504,812	\$ 470,231	\$ 34,581
Courts	291,122	291,122	275,268	15,854
Law library	22,000	22,000	21,720	280
County administration	69,748	69,748	62,877	6,871
County auditor	423,524	423,524	437,195	(13,671)
County assessor	382,010	382,010	362,808	19,202
Elections	13,725	13,725	12,843	882
Accounting and auditing	45,000	45,000	64,364	(19,364)
Data processing	348,058	348,058	315,266	32,792
Central services	184,165	184,165	180,581	3,584
Personnel	111,404	111,404	111,001	403
Attorney	272,215	272,215	300,447	(28,232)
Recorder	213,809	213,809	198,047	15,762
Planning and zoning	169,536	169,536	238,826	(69,290)
Buildings and plant	466,587	466,587	440,478	26,109
Veterans service officer	56,218	56,218	56,409	(191)
Training	5,000	5,000	674	4,326
Motor pool	11,300	11,300	15,481	(4,181)
Other general government	1,135	1,135	889	246
Total general government	\$ 3,591,368	\$ 3,591,368	\$ 3,565,405	\$ 25,963

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 1
(Continued)

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2004**

	<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	\$ 1,230,157	\$ 1,230,157	\$ 1,384,554	\$ (154,397)
Sheriff's forfeited property	-	-	1,608	(1,608)
Boat and water safety	-	-	38,758	(38,758)
Ambulance	54,500	151,678	140,821	10,857
Emergency services	78,245	78,245	67,174	11,071
Coroner	20,000	20,000	10,781	9,219
County jail	573,512	573,512	699,231	(125,719)
Community corrections	209,685	209,685	209,510	175
Sentence to serve	54,455	54,455	53,593	862
Civil defense	63,263	63,263	67,676	(4,413)
Other public safety	30,234	30,234	59,302	(29,068)
Total public safety	\$ 2,314,051	\$ 2,411,229	\$ 2,733,008	\$ (321,779)
Sanitation				
Solid waste	\$ 128,082	\$ 128,082	\$ 85,458	\$ 42,624
Recycling	184,000	184,000	145,473	38,527
Hazardous waste	20,500	20,500	10,351	10,149
Total sanitation	\$ 332,582	\$ 332,582	\$ 241,282	\$ 91,300
Culture and recreation				
Historical society	\$ 43,000	\$ 43,000	\$ 43,000	\$ -
Arenas	106,572	106,572	167,150	(60,578)
Humane society	3,500	3,500	3,500	-
Memorial Day observance	500	500	500	-
Recreation board	126,634	126,634	126,308	326
Knife River Marina	12,895	12,895	4,740	8,155
Trails	90,650	90,650	194,006	(103,356)
County/Regional library	67,971	67,971	67,971	-
Total culture and recreation	\$ 451,722	\$ 451,722	\$ 607,175	\$ (155,453)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 1
(Continued)

**BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2004**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Expenditures				
Current (Continued)				
Conservation of natural resources				
Cooperative extension	\$ 81,563	\$ 81,563	\$ 80,016	\$ 1,547
Soil and water conservation	31,065	31,065	31,128	(63)
Agricultural society/county fair	15,800	15,800	18,249	(2,449)
Water planning	19,401	19,401	19,401	-
Wetland challenge	5,000	5,000	5,000	-
Total conservation of natural resources	\$ 152,829	\$ 152,829	\$ 153,794	\$ (965)
Economic development				
Information centers	\$ 27,593	\$ 27,593	\$ 28,723	\$ (1,130)
Airports	27,500	27,500	27,500	-
Total economic development	\$ 55,093	\$ 55,093	\$ 56,223	\$ (1,130)
Debt service				
Principal retirement	\$ -	\$ -	\$ 20,712	\$ (20,712)
Total Expenditures	\$ 6,897,645	\$ 6,994,823	\$ 7,377,599	\$ (382,776)
Excess of Revenues Over (Under) Expenditures	\$ 361,737	\$ 264,559	\$ 165,044	\$ (99,515)
Other Financing Sources (Uses)				
Transfers out to governmental funds	-	-	(182,587)	(182,587)
Net Change in Fund Balance	\$ 361,737	\$ 264,559	\$ (17,543)	\$ (282,102)
Fund Balance - January 1	6,298,147	6,298,147	6,298,147	-
Fund Balance - December 31	\$ 6,659,884	\$ 6,562,706	\$ 6,280,604	\$ (282,102)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 2

**BUDGETARY COMPARISON SCHEDULE
ROAD AND BRIDGE FUND
FOR THE YEAR ENDED DECEMBER 31, 2004**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Revenues				
Taxes	\$ 1,231,454	\$ 1,231,454	\$ 1,010,375	\$ (221,079)
Intergovernmental	4,472,514	4,472,514	5,594,536	1,122,022
Charges for services	145,300	145,300	211,210	65,910
Miscellaneous	105,000	105,000	4,168	(100,832)
Total Revenues	\$ 5,954,268	\$ 5,954,268	\$ 6,820,289	\$ 866,021
Expenditures				
Current				
Highways and streets				
Administration	\$ 266,050	\$ 266,050	\$ 286,258	\$ (20,208)
Maintenance	1,548,700	1,548,700	1,577,884	(29,184)
Construction	3,565,400	3,565,400	7,117,376	(3,551,976)
Equipment maintenance and shop	560,885	560,885	627,401	(66,516)
Total highways and streets	\$ 5,941,035	\$ 5,941,035	\$ 9,608,919	\$ (3,667,884)
Debt service				
Principal retirement	-	-	15,942	(15,942)
Total Expenditures	\$ 5,941,035	\$ 5,941,035	\$ 9,624,861	\$ (3,683,826)
Excess of Revenues Over (Under) Expenditures	\$ 13,233	\$ 13,233	\$ (2,804,572)	\$ (2,817,805)
Other Financing Sources (Uses)				
Proceeds from capital lease	-	-	73,356	73,356
Net Change in Fund Balance	\$ 13,233	\$ 13,233	\$ (2,731,216)	\$ (2,744,449)
Fund Balance - January 1	4,537,899	4,537,899	4,537,899	-
Increase (decrease) in reserved for inventories	-	-	(13,448)	(13,448)
Fund Balance - December 31	\$ 4,551,132	\$ 4,551,132	\$ 1,793,235	\$ (2,757,897)

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 3

**BUDGETARY COMPARISON SCHEDULE
HUMAN SERVICES FUND
FOR THE YEAR ENDED DECEMBER 31, 2004**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Revenues				
Taxes	\$ 1,439,651	\$ 1,439,651	\$ 1,139,052	\$ (300,599)
Intergovernmental	2,360,874	2,360,874	2,810,560	449,686
Charges for services	73,500	73,500	128,970	55,470
Miscellaneous	56,250	56,250	81,707	25,457
Total Revenues	\$ 3,930,275	\$ 3,930,275	\$ 4,160,289	\$ 230,014
Expenditures				
Current				
Human services				
Income maintenance	\$ 649,853	\$ 649,853	\$ 761,808	\$ (111,955)
Social services	2,994,787	2,994,787	3,090,209	(95,422)
Total human services	\$ 3,644,640	\$ 3,644,640	\$ 3,852,017	\$ (207,377)
Health				
Nursing service	\$ 27,683	\$ 27,683	\$ 42,735	\$ (15,052)
Transportation	26,196	26,196	17,928	8,268
Environmental health	72,047	72,047	65,405	6,642
Health education	159,709	159,709	181,298	(21,589)
Total health	\$ 285,635	\$ 285,635	\$ 307,366	\$ (21,731)
Total Expenditures	\$ 3,930,275	\$ 3,930,275	\$ 4,159,383	\$ (229,108)
Net Change in Fund Balance	\$ -	\$ -	\$ 906	\$ 906
Fund Balance - January 1	5,174,713	5,174,713	5,174,713	-
Fund Balance - December 31	\$ 5,174,713	\$ 5,174,713	\$ 5,175,619	\$ 906

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 4

**BUDGETARY COMPARISON SCHEDULES
FORFEITED TAX FUND
FOR THE YEAR ENDED DECEMBER 31, 2004**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Revenues				
Taxes	\$ -	\$ -	\$ 8,401	\$ 8,401
Licenses and permits	575	575	4,226	3,651
Intergovernmental	32,241	32,241	23,805	(8,436)
Charges for services	150,000	150,000	237,319	87,319
Miscellaneous	435,900	435,900	462,177	26,277
Total Revenues	\$ 618,716	\$ 618,716	\$ 735,928	\$ 117,212
Expenditures				
Current				
Conservation of natural resources				
Land use	\$ 535,782	\$ 535,782	\$ 546,821	\$ (11,039)
Capital outlay				
Capital outlay - conservation	33,000	33,000	45,208	(12,208)
Total Expenditures	\$ 568,782	\$ 568,782	\$ 592,029	\$ (23,247)
Excess of Revenues Over (Under) Expenditures	\$ 49,934	\$ 49,934	\$ 143,899	\$ 93,965
Other Financing Sources (Uses)				
Transfers in from governmental funds	70,000	70,000	-	(70,000)
Net Change in Fund Balance	\$ 119,934	\$ 119,934	\$ 143,899	\$ 23,965
Fund Balance - January 1	171,661	171,661	171,661	-
Fund Balance - December 31	\$ 291,595	\$ 291,595	\$ 315,560	\$ 23,965

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

**NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2004**

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 head 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, 2004, expenditures exceeded appropriations in the following funds:

General Fund	\$ 382,776
Road and Bridge Special Revenue Fund	3,683,826
Human Services Special Revenue Fund	229,108
Forfeited Tax Special Revenue Fund	23,247
Economic Development Special Revenue Fund	2,250
Debt Service Fund	252,856

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SUPPLEMENTARY INFORMATION

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GOVERNMENTAL FUNDS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Statement 1

**COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
DECEMBER 31, 2004**

	<u>Resource Development</u>	<u>Special Revenue Economic Development</u>	<u>Unorganized Townships</u>	<u>Total Nonmajor Governmental Funds (Exhibit 3)</u>
<u>Assets</u>				
Cash and pooled investments	\$ 750,568	\$ 1,559	\$ 112,933	\$ 865,060
Undistributed cash in agency funds	-	-	2,259	2,259
Taxes receivable				
Prior	-	-	1,840	1,840
Loans receivable	-	90,151	-	90,151
Total Assets	\$ 750,568	\$ 91,710	\$ 117,032	\$ 959,310
<u>Liabilities and Fund Balances</u>				
Liabilities				
Due to other governments	\$ -	\$ -	\$ 61,155	\$ 61,155
Deferred revenue - unavailable	-	-	754	754
Total Liabilities	\$ -	\$ -	\$ 61,909	\$ 61,909
Fund Balances				
Reserved for loans receivable	\$ -	\$ 90,151	\$ -	\$ 90,151
Unreserved				
Undesignated	750,568	1,559	55,123	807,250
Total Fund Balances	\$ 750,568	\$ 91,710	\$ 55,123	\$ 897,401
Total Liabilities and Fund Balances	\$ 750,568	\$ 91,710	\$ 117,032	\$ 959,310

**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, 2004**

	Special Revenue			Total
	Resource Development	Economic Development	Unorganized Townships	
Revenues				
Taxes	\$ -	\$ -	\$ 60,990	\$ 60,990
Intergovernmental	117,861	-	12,820	130,681
Miscellaneous	-	2,268	121	2,389
Total Revenues	\$ 117,861	\$ 2,268	\$ 73,931	\$ 194,060
Expenditures				
Current				
General government	\$ -	\$ -	\$ 5,457	\$ 5,457
Public safety	-	-	69,055	69,055
Culture and recreation	2,866	-	-	2,866
Conservation of natural resources	109,221	-	-	109,221
Economic development	-	2,250	-	2,250
Debt service				
Principal retirement	100,000	-	-	100,000
Interest	27,750	-	-	27,750
Total Expenditures	\$ 239,837	\$ 2,250	\$ 74,512	\$ 316,599
Net Change in Fund Balance	\$ (121,976)	\$ 18	\$ (581)	\$ (122,539)
Fund Balance - January 1	872,544	91,692	55,704	1,019,940
Fund Balance - December 31	\$ 750,568	\$ 91,710	\$ 55,123	\$ 897,401

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

SPECIAL REVENUE FUNDS

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

The Unorganized Townships 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.

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 5

**BUDGETARY COMPARISON SCHEDULE
RESOURCE DEVELOPMENT SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2004**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Revenues				
Intergovernmental	\$ 154,415	\$ 154,415	\$ 117,861	\$ (36,554)
Expenditures				
Current				
Culture and recreation				
Trails	\$ -	\$ -	\$ 2,866	\$ (2,866)
Conservation of natural resources				
Forestry	135,109	135,109	105,063	30,046
Other	70,000	70,000	4,158	65,842
Capital outlay				
Capital outlay - conservation	127,750	127,750	-	127,750
Debt service				
Principal retirement	-	-	100,000	(100,000)
Interest	-	-	27,750	(27,750)
Total Expenditures	\$ 332,859	\$ 332,859	\$ 239,837	\$ 93,022
Net Change in Fund Balance	\$ (178,444)	\$ (178,444)	\$ (121,976)	\$ 56,468
Fund Balance - January 1	872,544	872,544	872,544	-
Fund Balance - December 31	\$ 694,100	\$ 694,100	\$ 750,568	\$ 56,468

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 6

**BUDGETARY COMPARISON SCHEDULES
ECONOMIC DEVELOPMENT FUND
FOR THE YEAR ENDED DECEMBER 31, 2004**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>		
Revenues				
Miscellaneous	\$ 6,492	\$ 6,492	\$ 2,268	\$ (4,224)
Expenditures				
Current				
Economic development				
Community development	-	-	2,250	(2,250)
Net Change in Fund Balance	\$ 6,492	\$ 6,492	\$ 18	\$ (6,474)
Fund Balance - January 1	91,692	91,692	91,692	-
Fund Balance - December 31	<u>\$ 98,184</u>	<u>\$ 98,184</u>	<u>\$ 91,710</u>	<u>\$ (6,474)</u>

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 7

**BUDGETARY COMPARISON SCHEDULE
UNORGANIZED TOWNSHIPS SPECIAL REVENUE FUND
FOR THE YEAR ENDED DECEMBER 31, 2004**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Revenues				
Taxes	\$ 75,985	\$ 75,985	\$ 60,990	\$ (14,995)
Intergovernmental	-	-	12,820	12,820
Miscellaneous	195	195	121	(74)
Total Revenues	\$ 76,180	\$ 76,180	\$ 73,931	\$ (2,249)
Expenditures				
Current				
General government				
Elections	\$ 5,310	\$ 5,310	\$ 5,457	\$ (147)
Public safety				
Emergency services	72,220	72,220	69,055	3,165
Culture and recreation				
Library	3,000	3,000	-	3,000
Total Expenditures	\$ 80,530	\$ 80,530	\$ 74,512	\$ 6,018
Net Change in Fund Balance	\$ (4,350)	\$ (4,350)	\$ (581)	\$ 3,769
Fund Balance - January 1	55,704	55,704	55,704	-
Fund Balance - December 31	\$ 51,354	\$ 51,354	\$ 55,123	\$ 3,769

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 8

**BUDGETARY COMPARISON SCHEDULE
DEBT SERVICE FUND
FOR THE YEAR ENDED DECEMBER 31, 2004**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Revenues				
Taxes	\$ 515,390	\$ 515,390	\$ 598,380	\$ 82,990
Intergovernmental	-	-	57,643	57,643
Interest on investments	1,500	1,500	10,097	8,597
Miscellaneous	301,720	301,720	178,761	(122,959)
Total Revenues	\$ 818,610	\$ 818,610	\$ 844,881	\$ 26,271
Expenditures				
Intergovernmental				
General government	\$ -	\$ -	\$ 160,255	\$ (160,255)
Debt service				
Principal retirement	970,000	970,000	1,075,000	(105,000)
Interest	215,911	215,911	203,914	11,997
Bond issuance costs	-	-	116	(116)
Administrative (fiscal) charges	7,191	7,191	6,673	518
Total Expenditures	\$ 1,193,102	\$ 1,193,102	\$ 1,445,958	\$ (252,856)
Excess of Revenues Over (Under) Expenditures	\$ (374,492)	\$ (374,492)	\$ (601,077)	\$ (226,585)
Other Financing Sources (Uses)				
Transfers in from governmental funds	-	-	182,587	182,587
Net Change in Fund Balance	\$ (374,492)	\$ (374,492)	\$ (418,490)	\$ (43,998)
Fund Balance - January 1	2,128,064	2,128,064	2,128,064	-
Fund Balance - December 31	\$ 1,753,572	\$ 1,753,572	\$ 1,709,574	\$ (43,998)

FIDUCIARY FUNDS

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Statement 3

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2004**

	Balance January 1	Additions	Deductions	Balance December 31
<u>CITIES, TOWNS AND OTHER GOVERNMENTS</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 209,800	\$ 8,311,155	\$ 8,447,577	\$ 73,378
<u>Liabilities</u>				
Due to other governments	\$ 209,800	\$ 8,311,155	\$ 8,447,577	\$ 73,378
 <u>TAXES AND PENALTIES</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 312,114	\$ 12,735,232	\$ 12,836,971	\$ 210,375
<u>Liabilities</u>				
Taxes collected in advance	\$ 2,932	\$ 10,526	\$ 2,932	\$ 10,526
Due to other governments	309,182	12,724,706	12,834,039	199,849
Total Liabilities	\$ 312,114	\$ 12,735,232	\$ 12,836,971	\$ 210,375
 <u>STATE</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 37,735	\$ 525,316	\$ 532,516	\$ 30,535
<u>Liabilities</u>				
Due to other governments	\$ 37,735	\$ 525,316	\$ 532,516	\$ 30,535

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

*Statement 3
(Continued)*

**COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL AGENCY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2004**

	Balance January 1	Additions	Deductions	Balance December 31
<u>SEWER SYSTEM DEPOSITS</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 47,765	\$ 53,390	\$ 5,575	\$ 95,580
<u>Liabilities</u>				
Customer deposits-current	\$ 47,765	\$ 53,390	\$ 5,575	\$ 95,580
 <u>NORTH SHORE COLLABORATIVE</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 485,198	\$ 247,430	\$ 266,204	\$ 466,424
<u>Liabilities</u>				
Accounts payable	\$ 485,198	\$ 247,430	\$ 266,204	\$ 466,424
 <u>TOTAL ALL AGENCY FUNDS</u>				
<u>Assets</u>				
Cash and pooled investments	\$ 1,092,612	\$ 21,872,523	\$ 22,088,843	\$ 876,292
<u>Liabilities</u>				
Accounts payable	\$ 485,198	\$ 247,430	\$ 266,204	\$ 466,424
Taxes collected in advance	2,932	10,526	2,932	10,526
Due to other governments	556,717	21,561,177	21,814,132	303,762
Customer deposits-current	47,765	53,390	5,575	95,580
Total Liabilities	\$ 1,092,612	\$ 21,872,523	\$ 22,088,843	\$ 876,292

OTHER SCHEDULE

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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 9

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
FOR THE YEAR ENDED DECEMBER 31, 2004**

		Total Governmental Funds
		<hr/>
Shared Revenue		
State		
Highway users tax	\$	5,057,697
County program aid		664,025
PERA rate reimbursement		24,475
Disparity reduction aid		165,608
Police aid		67,299
Taconite credit		576,948
Enhanced 911		40,702
Market value credit aid		483,781
Temporary court administration aid		216,421
		<hr/>
Total Shared Revenue	\$	7,296,956
<hr/>		
Reimbursement for Services		
State		
Minnesota Department of Human Services	\$	1,089,810
<hr/>		
Payments		
State		
Payments in lieu of taxes	\$	415,819
<hr/>		
Grants		
State		
Minnesota Department/Board of		
Public Safety	\$	20,995
Health		92,116
Natural Resources		302,829
Human Services		901,536
Veterans Affairs		2,800
Office of Environmental Assistance		24,559
Pollution Control Agency		10,900
Miscellaneous boards		5,014
		<hr/>
Total State	\$	1,360,749
<hr/>		

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 9
(Continued)

**SCHEDULE OF INTERGOVERNMENTAL REVENUE
FOR THE YEAR ENDED DECEMBER 31, 2004**

	Total Governmental Funds
	<hr/>
Grants (Continued)	
Federal	
Department of	
Agriculture	\$ 1,098,002
Commerce	56,002
Interior	137,865
Justice	1,258
Transportation	13,931
Environmental Protection Agency	675
Health and Human Services	256,102
Homeland Security	63,608
	<hr/>
Total Federal	\$ 1,627,443
	<hr/>
Total State and Federal Grants	\$ 2,988,192
	<hr/>
Total Intergovernmental Revenue	\$ 11,790,777
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**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 10

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2004**

I. SUMMARY OF AUDITOR'S RESULTS

- A. Our report expresses an unqualified opinion on the basic financial statements of Lake County.
- B. Reportable conditions in internal control were disclosed by the audit of financial statements of Lake County and are reported in the "Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*." None were material weaknesses.
- 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 in accordance with Section 510(a) of OMB Circular A-133.
- G. The major program is:
 - National Forest Lands - 3/4 of 1% CFDA #10.668
- H. The threshold for distinguishing between Types A and B programs was \$300,000.
- I. Lake County was determined not 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

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

We recommend that Lake 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:

Lake County management is aware of the potential problems associated with a limited staff and the segregation of duties. Procedures, policies, and internal controls are periodically reviewed by department heads and supervisory personnel.

03-2 Capital Asset Record Keeping System

During 2003, the Lake County Board hired a consultant to assist them in establishing an inventory of the County's capital assets and infrastructure assets as of December 31, 2002.

As part of the project, the consultant used certain capitalization thresholds, useful lives, and depreciation methods approved by the County Auditor. However, the capital asset policies were never formally adopted by the County Board. The County Board has purchased a capital asset accounting system to account for purchases and dispositions of capital assets, and to maintain the depreciation records on the capital assets. However, the capital asset system has not been put into use.

We recommend the County Board determine how the inventory of capital assets information will be maintained and updated in the future. A capital asset policy will need to be formally adopted which addresses the areas of capitalization thresholds, useful lives of various classes of capital assets, and depreciation methods. Staff will need to be assigned to enter the capital asset inventory which was generated by the consultant into the new capital asset system. The capital asset accounting system will need to be maintained on a current basis. Procedures should be established on how purchases and disposals of capital assets will be identified by department heads and how the information will be transmitted to the person responsible for maintaining the capital asset system. Physical inventories of each department's capital assets should be taken on a periodic basis.

Client's Response:

The County Board will review and adopt a capital asset policy. The addition of staff may be necessary to establish the capital asset database on recently acquired software. Responsibility for maintaining the database will need to be assigned, and County department heads will need to be notified that the department head will be required to keep each department's assigned capital asset inventory current.

PREVIOUSLY REPORTED ITEM RESOLVED

Delinquent Taxes Receivable (96-13)

Delinquent taxes receivable for years prior to 1998 were recorded in the County's financial statements. However, the delinquent tax records for the periods up to 1988 have not been updated, and the balances from 1988-1993 were not reliable because of problems which occurred during the transfer of information to the MCIS tax system.

Resolution

Delinquent taxes receivable for years prior to 1998 are no longer reported in the financial statements.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

None.

IV. OTHER FINDINGS AND RECOMMENDATIONS

A. MINNESOTA LEGAL COMPLIANCE

ITEM ARISING THIS YEAR

04-1 Bidding

In 2004, the County Board awarded a contract for the construction of a new Human Services Building for \$4,161,194. The County Board solicited bids for this project by posting the bid notice in several Builder's Exchanges. These are construction industry non-profit organizations.

Minn. Stat. §§ 471.345 and 375.21 require that all contracts estimated to exceed \$50,000 be solicited by public notice and awarded to the lowest responsible bidder. A county must generally advertise for bids in a qualified legal newspaper. As an alternative, Minn. Stat. § 331A.03, subd. 3 allows the County to use its website or recognized industry trade journals to disseminate solicitations of bids. However, the County must simultaneously publish the bid notice in the County's official newspaper for at least six months following the designation of an alternative method for soliciting bids.

We recommend the County Board solicit bids by public notice in the official newspaper as required by Minn. Stat § 471.345 for contracts estimated to exceed \$50,000. If an alternative method of soliciting bids is designated, the County Board should follow the requirements of Minn. Stat. § 331A.03 to notify the public of where the alternative designated method can be found. The bid notices should also be published simultaneously in the official newspaper for at least six months after the designation of an alternative method.

Client's Response

The architect for this project was responsible for drafting bids, documents, and advertising. The County staff was unaware that the bid was not published in the official newspaper. The County will follow this recommendation in the future.

PREVIOUSLY REPORTED ITEM RESOLVED

Publication of Financial Statements (03-1)

Minn. Stat. § 375.17 requires the County Board to publish its financial statements annually in the form prescribed by the State Auditor. Lake County did not publish its financial statement for the year ended December 31, 2002.

Resolution

The County Board published the 2003 financial statements in 2004.

B. MANAGEMENT PRACTICES

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

96-16 Purchasing Policy

We recommended in our prior audit that the County Board adopt a formal purchasing policy to establish County procedures regarding the purchasing function. A purchasing policy would help those responsible for County purchasing to know what guidelines need to be followed.

The County Board has not addressed this recommendation.

Client's Response:

The Board will develop and adopt a formal purchasing policy.

03-4 Annual Financial Report

Lake County has a responsibility to prepare financial statements and publish them for its citizens and others. In previous years, the Office of the State Auditor (OSA) has helped the County to prepare its annual financial report. The annual financial report includes financial statements, related notes to the financial statements, and schedules.

A step in preparing financial statements is the preparation of schedules and worksheets to summarize the County's financial record accounts for the financial report. For example, the records of the County could have several different receivable or revenue accounts combined into one line for financial reporting. Also, accounts need to be analyzed to decide if revenue should be accrued for receipts received after year-end, or payables accrued for expenditures made after year-end.

Currently, Lake County staff prepare only limited amounts of information for the financial statements. OSA staff have been providing nonaudit services necessary for preparation of the annual financial report. These nonaudit services provided include, but may not be limited to, the following: summarizing each fund's cash

transactions in the format for financial presentation in a trial balance; summarizing receivable and payable information for the trial balances; summarizing capital assets and long-term debt at the end of the year; and converting the cash basis information to modified or full accrual.

Recent changes to *Government Auditing Standards* issued by the Comptroller General of the United States require the OSA to reassess the nonaudit services it provides to its audit clients. The primary effect of the change in *Government Auditing Standards* on the County is that the County needs to prepare the summary schedules of receivables and payables, classify its accounts for the financial statements, prepare the trial balances for audit, and make all policy decisions. If necessary, we will continue to prepare financial statements based on this data, as technical assistance.

We recommend the County Board direct the appropriate County staff to prepare the summary schedules and trial balances. The staff assigned to prepare this information should have a good understanding of generally accepted accounting principles for government and should be given the time and resources needed to complete the information required for the annual financial report by a date which is mutually agreed to with the OSA.

Client's Response:

The County Board will need to make a determination as to whether additional staff will be necessary to accomplish this. Current staffing levels are not able to produce the various schedules and worksheets for the financial report.

PREVIOUSLY REPORTED ITEM RESOLVED

General Ledger Cash Account (03-3)

In our prior audit, we noted the cash balance as reported on the Integrated Financial System (IFS) general ledger system for several of the County's funds did not agree with the IFS generated treasurer's cash trial balance report at year-end.

Resolution

There were no instances noted in the current audit where the IFS general ledger cash did not agree with the IFS treasurer's cash trial balance report.

C. 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 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 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 the employees are provided OPEBs.
- If OPEB exists, will the government advance fund the benefits or pay as you go?
- Will a trust be established to hold assets that may be set aside to fund the OPEB?
- Obtain an actuary to determine the annual costs and liabilities that need to be recognized.

If applicable for Lake County, GASB Statement No. 43 and Statement No. 45 would be implemented for years ended December 31, 2007 and 2008, respectively.

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OTHER REQUIRED REPORTS

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PATRICIA ANDERSON
STATE AUDITOR

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING 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 Lake County as of and for the year ended December 31, 2004, and have issued our report thereon dated August 10, 2005. The financial statements include the Nursing Home Enterprise Fund as of and for the year ended September 30, 2004. 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 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 certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. 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. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 96-11 and 03-2.

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

financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe neither of the reportable conditions indicated above is 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 item 04-1.

This report is intended solely for the information and use of the Board and management 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: August 10, 2005



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PATRICIA ANDERSON
STATE AUDITOR

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, 2004. 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, 2004.

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 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 Lake County as of and for the year ended December 31, 2004, and have issued our report thereon dated August 10, 2005. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise 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, 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: August 10, 2005

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 11

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2004**

Federal Grantor Pass-Through Agency Grant Program Title	Federal CFDA Number	Expenditures
U.S. Department of Agriculture		
Direct		
U.S. Forest Service Cooperative Agreement	R9-9-95-35B	\$ 8,809
Passed Through Carlton-Cook-Lake-St. Louis Community Health Board Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)	10.557	17,828
Passed Through Minnesota Department of Human Services Matching Grant for Food Stamp Program	10.561	534
Passed Through Minnesota Department of Finance National Forest Lands - 25% Payments to States	10.665	183,581
National Forest Lands - 3/4 of 1%	10.668	<u>887,250</u>
Total U.S. Department of Agriculture		<u>\$ 1,098,002</u>
U.S. Department of Commerce		
Passed Through Minnesota Department of Natural Resources Coastal Zone Management Administration Award	11.419	<u>\$ 56,002</u>
U.S. Department of the Interior		
Direct		
Payments in Lieu of Taxes	15.226	<u>\$ 137,865</u>
U.S. Department of Justice		
Passed Through Minnesota Department of Public Safety Crime Victim Assistance Grant	16.575	<u>\$ 1,258</u>
U.S. Environmental Protection Agency		
Passed Through Minnesota Department of Health State Indoor Radon Grants	66.032	<u>\$ 675</u>
U.S. Department of Health and Human Services		
Direct		
Food and Drug Administration Research Grant	93.103	\$ 2,000
Passed Through Carlton-Cook-Lake-St. Louis Community Health Board Center for Disease Control and Prevention - Bioterrorism Grant	93.283	20,021
Maternal and Child Health	93.994	13,243

**LAKE COUNTY
TWO HARBORS, MINNESOTA**

Schedule 11
(Continued)

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2004**

Federal Grantor Pass-Through Agency Grant Program Title	Federal CFDA Number	Expenditures
U.S. Department of Health and Human Services (Continued)		
Passed Through Minnesota Department of Human Services Temporary Assistance for Needy Families	93.558	50,190
Child Welfare Services	93.645	1,073
Foster Care - Title IV-E	93.658	36,462
Social Services Block Grant Title XX	93.667	112,083
Chafee Foster Care Independence Program	93.674	12,873
Community Mental Health Block Grant	93.958	2,961
Passed Through Minnesota Department of Education Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596	5,196
Total U.S. Department of Health and Human Services		\$ 256,102
U.S. Department of Homeland Security		
Passed Through Minnesota Department of Public Safety State Domestic Preparedness Equipment Support Program	97.004	\$ 37,963
Emergency Management Performance Grants	97.042	15,654
State and Local All Hazards Emergency Operations Planning	97.051	5,000
Passed Through Minnesota Department of Natural Resources Boating Safety Financial Assistance	97.012	4,991
Total U.S. Department of Homeland Security		\$ 63,608
Total Federal Awards		\$ 1,613,512

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.
3. Pass-through grant numbers were not assigned by the pass-through agencies.
4. Expenditures on this schedule differ from federal revenues reported in the financial statements because of modified accrual revenue recognition. In 2004, \$13,931 of grants receivable became available.