

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
(COMPONENT UNIT OF THE CITY OF DULUTH)
DULUTH, MINNESOTA

FOR THE YEARS ENDED APRIL 30, 2011 AND 2010

Description of the Office of the State Auditor

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

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

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

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

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

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

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

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

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

Office of the State Auditor
525 Park Street, Suite 500
Saint Paul, Minnesota 55103
(651) 296-2551
state.auditor@osa.state.mn.us
www.auditor.state.mn.us

This document can be made available in alternative formats upon request. Call 651-296-2551 [voice] or 1-800-627-3529 [relay service] for assistance; or visit the Office of the State Auditor's web site: www.auditor.state.mn.us.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
(COMPONENT UNIT OF THE CITY OF DULUTH)
DULUTH, MINNESOTA**

For the Years Ended April 30, 2011 and 2010



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

This page was left blank intentionally.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

TABLE OF CONTENTS

	<u>Exhibit</u>	<u>Page</u>
Introductory Section		
Organization		1
Financial Section		
Independent Auditor's Report		2
Management's Discussion and Analysis		4
Basic Financial Statements		
Comparative Statement of Net Assets	1	11
Comparative Statement of Revenues, Expenses, and Changes in Net Assets	2	13
Comparative Statement of Cash Flows	3	14
Notes to the Financial Statements		15
Supplementary Information		
Comparative Statement of Operating Revenues	A-1	30
Comparative Statement of Operating Expenses	A-2	31
Statement of Capital Improvements	B-1	32
Management and Compliance Section		
Schedule of Findings and Recommendations		33
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>		37

This page was left blank intentionally.

This page was left blank intentionally.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

ORGANIZATION
APRIL 30, 2011

	<u>Term Ending</u>
Directors	
Jane Gilbert-Howard	June 30, 2012
Alan Johnson (resigned October 7, 2010)	June 30, 2012
David Kohlhaas	June 30, 2014
Will Munger	June 30, 2012
Nancy Nelson	June 30, 2012
Veronica Nelson	June 30, 2014
Neale Roth	June 30, 2012
Cory Salmela	June 30, 2014
Todd Torvinen	June 30, 2014
Executive Director	
Renee Mattson	
Officers	
Chair	
Todd Torvinen	
Vice Chair	
Neale Roth	
Secretary	
Jane Gilbert-Howard	

This page was left blank intentionally.

This page was left blank intentionally.



REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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

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

INDEPENDENT AUDITOR'S REPORT

Mayor and City Council
City of Duluth

Board of Directors
Spirit Mountain Recreation Area Authority

We have audited the accompanying basic financial statements of Spirit Mountain Recreation Area Authority, a component unit of the City of Duluth, as of and for the years ended April 30, 2011 and 2010. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Spirit Mountain Recreation Area Authority as of April 30, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In accordance with auditing standards generally accepted in the

United States of America, we have applied certain limited procedures to the required supplementary information, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the basic financial statements. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. This information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 14, 2012, on our consideration of Spirit Mountain Recreation Area Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

February 14, 2012

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

MANAGEMENT'S DISCUSSION AND ANALYSIS

This page was left blank intentionally.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
APRIL 30, 2011
(Unaudited)**

This section presents management's analysis of the Authority's financial condition and activities for the fiscal year ended April 30, 2011. This information should be read in conjunction with the financial statements.

FINANCIAL HIGHLIGHTS

- The City of Duluth issued a \$1.647 million Gross Revenue Recreational Facility Bond in 2003 to refinance existing Authority debt. The bond is not a general obligation of the City and is payable from the Authority's gross revenues. The City pledged tourism taxes in the amount of \$225,000 per year, effective January 1, 2004, as part of the gross revenues of the project. The tourism tax pledge by the City will allow the Authority to invest a minimum of \$225,000 in capital improvements on an annual basis over the life of the bond.
- In fiscal year 2011, the Timber Twister Alpine Coaster was constructed, accompanied by a concession building and parking lot. The total project cost was \$2.4 million, of which \$2.3 million was financed through a capital lease. During its 2011 inaugural year of operation, the Timber Twister grossed over \$736,000.

OVERVIEW OF ANNUAL FINANCIAL REPORT

The Management's Discussion and Analysis (MD&A) serves as an introduction to the financial statements. The MD&A represents management's examination and analysis of the Authority's financial condition and performance. Summary financial statement data, key financial and operational indicators used in the Authority's strategic plan, budget, bond resolutions, and other management tools were used for this analysis.

The financial statements report information about the Authority using full accrual accounting methods as utilized by similar business activities in the private sector.

The financial statements include a statement of net assets; a statement of revenues, expenses, and changes in net assets; a statement of cash flows; and notes to the financial statements. The statement of net assets presents the financial position of the Authority on a full accrual historical cost basis. While the statement of net assets provides information about the nature and amount of resources and obligations at year-end, the statement of revenues, expenses, and changes in net assets presents the results of the business activities over the course of the fiscal year and

information as to how the net assets changed during the year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Authority's recovery of its costs.

The statement of cash flows presents changes in cash and cash equivalents resulting from operational, financing, and investing activities. This statement presents cash receipt and cash disbursement information without consideration of the earnings event, when an obligation arises, or depreciation of capital assets.

The notes to the financial statements provide required disclosures and other information essential to a full understanding of material data provided in the statements. The notes present information about the Authority's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies, and subsequent events, if any.

The financial statements were prepared by the Authority's staff from the detailed books and records of the Authority. The financial statements were audited and adjusted, if material, during the independent external audit process.

SUMMARY OF ORGANIZATION AND BUSINESS

On May 18, 1973, the Minnesota State Legislature enacted the Laws, 1973, Chapter 327 (the "Act") creating the Spirit Mountain Recreation Area Authority. The mission of the Authority as defined in section one of the Act is as follows: The purpose of this Act is to facilitate the development of a land area with the following objectives: (1) the development of wide-range recreational facilities available to both local residents and tourists; (2) the aiding of the economy of northeastern Minnesota by encouraging private enterprise efforts in conjunction with the recreational facilities; and (3) the preservation of the environment in the area by a timely and intelligent plan of development. The Authority was created to have the power and duty to manage the property made up of the Area. The State Legislature itself conferred upon the Authority the power and responsibility for the operation and management of the Area. The Mayor of Duluth appoints nine community members to serve on the Board of Directors that oversees the Authority.

The main form of recreation provided to both local residents and visitors is skiing; alpine, nordic, and snowboarding; and, in fiscal year 2012, the year-round Timber Twister Alpine Coaster was joined by the new year-round Timber Flyer Zip Line, a 9-hole miniature golf course and a new snow tubing park, now branded as the Spirit Mountain Adventure Park. The Authority also hosts the world's largest on snow Snocross race, the Duluth National, over Thanksgiving weekend. Summertime activities include special events, banquets, meetings, corporate events, and camping, with banquets becoming an ever larger business for the Authority, with 65 wedding receptions hosted in fiscal year 2012 and an additional 40+ corporate/other events.

The Authority does not have taxing power. Operations are funded from customer revenues. Customer revenues, together with City tourism taxes, fund the acquisition and construction of capital assets.

FINANCIAL ANALYSIS

The following comparative condensed financial statements and other selected information serve as the key financial data and indicators for management, monitoring, and planning. Comments regarding budget-to-actual variances and year-to-year variances are included in each section by the name of the statement or account.

Condensed Statement of Net Assets

	FY 2011	FY 2010	Change from 2010 to 2011		FY 2009
			Dollar	Percent (%)	
Current and other assets	\$ 724,744	\$ 654,102	\$ 70,642	11	\$ 779,426
Capital assets	7,032,936	5,832,933	1,200,003	21	5,314,097
Total Assets	\$ 7,757,680	\$ 6,487,035	\$ 1,270,645	20	\$ 6,093,523
Current liabilities	\$ 935,337	\$ 923,757	\$ 11,580	1	\$ 771,869
Long-term liabilities	2,533,046	1,457,350	1,075,696	74	1,132,892
Total Liabilities	\$ 3,468,383	\$ 2,381,107	\$ 1,087,276	46	\$ 1,904,761
Net Assets					
Invested	\$ 4,105,471	\$ 3,946,824	\$ 158,647	4	\$ 3,848,174
Restricted	250,000	250,000	-	-	340,014
Unrestricted	(66,174)	(90,896)	24,722	27	574
Total Net Assets	\$ 4,289,297	\$ 4,105,928	\$ 183,369	4	\$ 4,188,762

As can be seen from the table, capital assets increased \$1,200,003 from 2010 to 2011, due mainly to the construction of the Timber Twister, Spirit Mountain's Alpine Coaster. Long-term liabilities increased 74 percent due to the Timber Twister capital lease.

**Condensed Statements of Revenues, Expenses, and Changes in Net Assets
(Comparative Amounts)**

	FY 2011	FY 2010	Change from 2010 to 2011		FY 2009
			Dollar	Percent (%)	
Operating revenues	\$ 4,390,727	\$ 3,512,650	\$ 878,077	25	\$ 3,841,498
Nonoperating revenues	282,763	226,145	56,618	25	287,900
Total Revenues	\$ 4,673,490	\$ 3,738,795	\$ 934,695	25	\$ 4,129,398
Operating expenses	\$ 3,732,472	\$ 3,235,339	\$ 497,133	15	\$ 3,557,416
Nonoperating expenses	121,661	62,268	59,393	95	55,221
Depreciation/amortization	635,988	524,022	111,966	21	409,498
Total Expenses	\$ 4,490,121	\$ 3,821,629	\$ 668,492	17	\$ 4,022,135
Changes in Net Assets	\$ 183,369	\$ (82,834)	\$ 266,203	321	\$ 107,263
Beginning Net Assets	4,105,928	4,188,762	(82,834)	(2)	4,081,499
Ending Net Assets	\$ 4,289,297	\$ 4,105,928	\$ 183,369	4	\$ 4,188,762

**Condensed Statements of Revenues, Expenses, and Changes in Net Assets
(2011 Budget and Actual)**

	Actual	Budget	Budget to Actual Variance	Budget % Variance
Operating revenues	\$ 4,390,727	\$ 4,364,229	\$ 26,498	1
Nonoperating revenues	282,763	279,400	3,363	1
Total Revenues	\$ 4,673,490	\$ 4,643,629	\$ 29,861	1
Operating expenses	\$ 3,732,472	\$ 3,759,803	\$ 27,331	1
Nonoperating expenses	121,661	115,888	(5,773)	(5)
Depreciation/amortization	635,988	453,060	(182,928)	(40)
Total Expenses	\$ 4,490,121	\$ 4,328,751	\$ (161,370)	(4)
Changes in Net Assets	\$ 183,369	\$ 314,878	\$ (131,509)	(42)
Beginning Net Assets	4,105,928	4,105,928	-	-
Ending Net Assets	\$ 4,289,297	\$ 4,420,806	\$ (131,509)	(3)

Revenues

The Authority earns operating revenues in both winter and summer. Operating revenues increased \$878,077, or 25 percent, in 2011 compared to 2010, due mainly to the opening of the Timber Twister Alpine Coaster. Nonoperating revenues increased \$56,618, or 25 percent, in 2011 compared to 2010, due mainly to an increase in the amount of city tourism tax received as well as a Forest Management Plan donation.

Expenses

The Authority's operating expenses increased \$497,133, or 15 percent, from 2010 due mainly to an increase in utilities, supplies, other services and charges, and the addition of benefit-eligible positions, which resulted from the increase in year-round operations. Total expenses increased 17 percent, including an increase in depreciation from the Timber Twister Alpine Coaster.

Budgetary Highlights

The Authority creates an annual operating budget, which includes proposed expenses and means of financing them. Once management and the Board of Directors approve the budget, it is presented to the Duluth City Council for final approval. The Authority's operating budget remains in effect the entire year and is not revised. Management and the Board of Directors are presented detailed monthly financial statements. However, they are not reported on nor shown in the financial statement section of this report.

Operating revenues exceeded budgeted projections due mainly to a successful opening of the Timber Twister Alpine Coaster.

Total expenses exceeded budgeted projections due primarily to the depreciation of the Timber Twister Alpine Coaster.

CAPITAL ASSETS

	FY 2011	FY 2010	Change	
			Dollar	Percent (%)
Land	\$ 2,466,253	\$ 2,466,253	\$ -	-
Equipment	8,576,478	6,618,781	1,957,697	30
Plant equipment	826,566	781,629	44,937	6
Building and improvements	4,234,272	4,036,074	198,198	5
Furniture and fixtures	250,622	242,452	8,170	3
Other capital assets	724,388	401,533	322,855	80
Work in progress	76,949	813,854	(736,905)	(91)
Subtotal	\$ 17,155,528	\$ 15,360,576	\$ 1,794,952	12
Less: accumulated depreciation	(10,122,592)	(9,527,643)	(594,949)	6
Net Property and Equipment	\$ 7,032,936	\$ 5,832,933	\$ 1,200,003	21

By the end of fiscal year 2011, the Authority had invested \$17.15 million in capital assets. The \$2,478,750 cumulative increase in equipment, buildings and improvements, and other capital assets is mainly due to the construction of the Timber Twister Alpine Coaster, concession building, and parking lot.

The Authority's ongoing capital plan improvements are made with the long-term goals of the Spirit Mountain Master Plan in mind. During 2010, these upgrades/improvements included a major project with the construction of the Timber Twister Alpine Coaster, concession building, and parking lot. This new attraction is the keystone to the area becoming a true four-season recreation venue and has greatly enhanced the Authority's operating revenues as it has been a tremendously popular draw for visitors and residents alike. In addition to this significant project, improvements included new computer equipment, blinds in the chalet, replacement of snowmobiles and all terrain vehicles, and a multitude of other small but necessary replacements. As always, we continue to seek ways to streamline the operation, find efficiencies, and provide the best possible guest experience.

Debt Administration

	FY 2011	FY 2010	Change	
			Dollar	Percent (%)
Alpine Coaster lease	\$ 2,235,851	\$ 753,134	\$ 1,482,717	197
Groomer lease	220,918	307,692	(86,774)	(28)
Lease/leaseback (revenue bonds)	420,809	620,104	(199,295)	(32)
Rental lease	143,544	205,179	(61,635)	(30)
Total Debt	<u>\$ 3,021,122</u>	<u>\$ 1,886,109</u>	<u>\$ 1,135,013</u>	60

At the end of fiscal year 2011, the Authority's outstanding debt increased \$1,135,013 to \$3.02 million, due to the addition of the Timber Twister Alpine Coaster lease netted against the principal payments of the other three existing leases.

ECONOMIC AND OTHER FACTORS

The Authority must consider many factors when setting the fiscal year 2012 budget. The economic downturn continues to plague the ski industry, and Spirit Mountain is not immune from lessened consumer confidence and shrinking spending habits; additionally, weather challenges hamper the consumers' excitement for winter sporting activities. Season pass sales started strong in 2010, but waned as weather became an early season factor. We continually seek ways to strengthen our regional appeal and have found success with the reduced price college season pass. The savings the students see for the pass price they more than make up for in food and beverage purchases. The Alpine Coaster is open year-round, and we have had strong attendance during the winter season. We have continued to add attractions to complement the coaster and feel the key to our growth and success will be more year-round activities that appeal

to families. The coaster has increased our visibility as new visitors to the resort are exposed to the many opportunities available for winter recreation, camping, lodging at the Villas, and banquets.

The banquet business has continued to be a strong revenue producer in 2011; 2012 and 2013 bookings are very strong. We know that in our competitive set in the Duluth market, we far exceed other facilities' numbers.

We look forward to an improved economy, additional four-season recreational enhancements, and a successful winter and summer season.

FINANCIAL CONTACT

This financial report is designed to provide our customers and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have any questions about this report, or need additional financial information, contact the Finance Department, Spirit Mountain Recreation Area Authority, 9500 Spirit Mountain Place, Duluth, Minnesota 55810.

This page was left blank intentionally.

BASIC FINANCIAL STATEMENTS

This page was left blank intentionally.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

EXHIBIT 1

**COMPARATIVE STATEMENT OF NET ASSETS
APRIL 30, 2011 AND 2010**

	2011	2010
Assets		
Current assets		
Cash and cash equivalents	\$ 91,816	\$ 14,322
Accounts receivable	57,004	48,027
Inventory	102,958	111,645
Prepaid items	27,057	5,546
Restricted assets		
Cash and cash equivalents - restricted for capital improvements	225,000	225,000
Total current assets	\$ 503,835	\$ 404,540
Noncurrent assets		
Cash and cash equivalents - restricted for workers' compensation claims	\$ 25,000	\$ 25,000
Planning and development costs - net of accumulated amortization	195,259	222,935
Debt issuance costs - net of accumulated amortization	650	1,627
Total noncurrent assets, other than capital	\$ 220,909	\$ 249,562
Capital assets		
Non-depreciable	\$ 2,543,202	\$ 3,280,107
Depreciable	14,612,326	12,080,469
Less: allowance for depreciation	(10,122,592)	(9,527,643)
Total capital assets - net of accumulated depreciation	\$ 7,032,936	\$ 5,832,933
Total noncurrent assets	\$ 7,253,845	\$ 6,082,495
Total Assets	\$ 7,757,680	\$ 6,487,035

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

**EXHIBIT 1
(Continued)**

**COMPARATIVE STATEMENT OF NET ASSETS
APRIL 30, 2011 AND 2010**

	2011	2010
Liabilities		
Current liabilities		
Accounts payable	\$ 63,564	\$ 125,672
Due to City of Duluth	134,407	89,898
Due to other governments	2,994	5,611
Accrued salaries payable	34,210	40,907
Accrued vacation payable	74,963	66,823
Accrued interest payable	11,643	13,714
Leases payable	279,712	229,847
Revenue bonds payable	208,364	198,912
Deferred revenue	125,480	152,373
Total current liabilities	\$ 935,337	\$ 923,757
Noncurrent liabilities		
Leases payable	\$ 2,320,601	\$ 1,036,158
Revenue bonds payable	212,445	421,192
Total noncurrent liabilities	\$ 2,533,046	\$ 1,457,350
Total Liabilities	\$ 3,468,383	\$ 2,381,107
Net Assets		
Invested in capital assets - net of related debt	\$ 4,105,471	\$ 3,946,824
Restricted for capital improvements	225,000	225,000
Restricted for workers' compensation claims	25,000	25,000
Unrestricted	(66,174)	(90,896)
Total Net Assets	\$ 4,289,297	\$ 4,105,928

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

EXHIBIT 2

**COMPARATIVE STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED APRIL 30, 2011 AND 2010**

	2011	2010
Operating Revenues		
Sales	\$ 1,075,069	\$ 906,593
Less: cost of goods sold	(416,922)	(328,112)
Gross profit on sales	\$ 658,147	\$ 578,481
Charges for services	3,657,236	2,878,320
Miscellaneous	75,344	55,849
Total Operating Revenues	\$ 4,390,727	\$ 3,512,650
Operating Expenses		
Personal services	\$ 2,188,645	\$ 2,004,874
Supplies	287,107	218,403
Utilities	408,040	295,577
Other services and charges	848,680	716,485
Amortization	28,652	18,583
Depreciation	607,336	505,439
Total Operating Expenses	\$ 4,368,460	\$ 3,759,361
Operating Income (Loss)	\$ 22,267	\$ (246,711)
Nonoperating Revenues (Expenses)		
Earnings on investments	\$ 1,137	\$ 1,145
Tourism tax	275,000	225,000
Gain (loss) on sale or disposition of capital assets - net	1,483	-
Forest management plan	5,143	-
Interest expense	(121,661)	(62,268)
Total Nonoperating Revenues (Expenses)	\$ 161,102	\$ 163,877
Change in Net Assets	\$ 183,369	\$ (82,834)
Net Assets - May 1	4,105,928	4,188,762
Net Assets - April 30	\$ 4,289,297	\$ 4,105,928

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

EXHIBIT 3

**COMPARATIVE STATEMENT OF CASH FLOWS
YEARS ENDED APRIL 30, 2011 AND 2010**

	2011	2010
Cash Flows from Operating Activities		
Cash received from customers	\$ 4,642,324	\$ 3,794,751
Cash paid to suppliers	(1,939,678)	(1,491,298)
Cash paid to employees	(2,187,202)	(2,015,188)
Other cash received	75,344	55,849
	\$ 590,788	\$ 344,114
Cash Flows from Capital and Related Financing Activities		
Capital lease payments	\$ (285,762)	\$ (174,254)
Acquisition and construction of capital assets	(228,669)	(395,028)
	\$ (514,431)	\$ (569,282)
Cash Flows from Investing Activities		
Interest on investments	\$ 1,137	\$ 1,145
	\$ 77,494	\$ (224,023)
Cash and Cash Equivalents - May 1	264,322	488,345
Cash and Cash Equivalents - April 30	\$ 341,816	\$ 264,322
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities		
Net operating income (loss)	\$ 22,267	\$ (246,711)
Adjustments to reconcile net operating income (loss) to net cash provided by (used in) operating activities		
Depreciation	607,336	505,439
Amortization	28,652	18,583
Change in assets and liabilities		
Decrease (increase) in receivables	(8,977)	27,426
Decrease (increase) in inventory	8,687	(21,477)
Decrease (increase) in prepaid items	(21,511)	654
Increase (decrease) in accounts payable	(20,216)	41,899
Increase (decrease) in salaries payable	(6,697)	(12,641)
Increase (decrease) in vacation payable	8,140	2,327
Increase (decrease) in deferred revenue	(26,893)	28,615
	\$ 590,788	\$ 344,114
Noncash Investing, Capital, and Financing Activities		
Capital assets acquired under lease purchase agreements	\$ 1,587,016	\$ 753,134

The City of Duluth directly makes revenue bond payments for the Spirit Mountain Recreation Area Authority. The revenue bonds are secured by the Authority, but tourism tax is actually used to fund the bond payments. The Authority is to withhold \$225,000 in revenue to use for capital improvements. A capital improvement budget is submitted and approved by the City.

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

Page 14

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED APRIL 30, 2011 AND 2010**

1. Summary of Significant Accounting Policies

Organization

Spirit Mountain Recreation Area Authority was created by Minn. Laws 1973, ch. 327, for the purpose of developing and operating wide-range recreational facilities in the Spirit Mountain area within and adjacent to the City of Duluth, Minnesota. The management of the Authority is vested in nine directors appointed by the Mayor of Duluth and approved by resolution of the City Council.

The accounting policies of Spirit Mountain Recreation Area Authority conform to generally accepted accounting principles.

A. Financial Reporting Entity

The Authority is a component unit of the City of Duluth reporting entity and, therefore, is included in the City's Comprehensive Annual Financial Report.

B. Fund Accounting

The Authority is accounted for as an enterprise fund. Enterprise funds account for operations financed and operated in a manner similar to private business enterprises-- where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

The principal operating revenues of the Authority are charges to customers for sales and services for recreational activities offered within the Spirit Mountain area. All revenues not meeting this definition are reported as nonoperating revenues.

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

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

C. Basis of Accounting

The Authority uses the accrual basis of accounting. Revenues are recognized when they are earned, and expenses are recognized when they are incurred. Pursuant to Governmental Accounting Standards Board (GASB) Statement 20, the Authority has elected not to apply accounting standards issued after November 30, 1989, by the Financial Accounting Standards Board.

D. Assets

For purposes of the statement of cash flows, all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased are considered to be cash equivalents.

Inventories of supplies and merchandise for resale are priced at the lower of cost or market value on a first-in, first-out basis.

Development costs, consisting of engineering, feasibility study, and interest costs during construction, have been recorded at cost and are being amortized over 40 years.

Monies restricted for the payment of capital improvements, special projects, and workers' compensation claims are accounted for as restricted assets. When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first and then unrestricted resources as needed.

Capital assets are stated at cost. Interest costs incurred during construction are not capitalized unless determined to be significant. Depreciation of capital assets is determined using the straight-line method. The estimated useful lives of the assets are:

<u>Classification</u>	<u>Range</u>
Buildings and structures	5 to 40 years
Equipment	3 to 40 years
Furniture and fixtures	5 to 20 years
Other fixed assets	2 to 40 years

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

E. Trade-Offs

The Authority issues ski lift passes, rentals, lessons, etc., in exchange for other non-monetary assets or services, such as advertising and other promotional services. The value of the lift passes, rentals, or lessons is credited to the appropriate revenue account and debited to the appropriate expense account.

F. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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

A. Budget

The Authority adopts an annual budget which is approved by the Duluth City Council. A comparison of budget to actual for the years ended April 30, 2011 and 2010, follows:

	2011		Variance Favorable (Unfavorable)
	Budget	Actual	
Operating Revenues			
Sales	\$ 1,242,447	\$ 1,075,069	\$ (167,378)
Less: cost of goods sold	(438,680)	(416,922)	21,758
Gross profit on sales	\$ 803,767	\$ 658,147	\$ (145,620)
Charges for services	3,506,987	3,657,236	150,249
Miscellaneous	53,475	75,344	21,869
Total Operating Revenues	\$ 4,364,229	\$ 4,390,727	\$ 26,498

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes

A. Budget (Continued)

	2011		
	Budget	Actual	Variance Favorable (Unfavorable)
Operating Expenses			
Personal services	\$ 2,246,660	\$ 2,188,645	\$ 58,015
Supplies	235,307	287,107	(51,800)
Utilities	398,798	408,040	(9,242)
Other services and charges	879,038	848,680	30,358
Amortization	9,060	28,652	(19,592)
Depreciation	444,000	607,336	(163,336)
Total Operating Expenses	\$ 4,212,863	\$ 4,368,460	\$ (155,597)
Operating Income (Loss)	\$ 151,366	\$ 22,267	\$ (129,099)
Nonoperating Revenues (Expenses)			
Earnings on investments	\$ 4,400	\$ 1,137	\$ (3,263)
City of Duluth hotel-motel, food, and beverage tax	275,000	275,000	-
Gain (loss) on sale or disposition of capital assets - net	-	1,483	1,483
Forest management plan	-	5,143	5,143
Interest expense	(115,888)	(121,661)	(5,773)
Total Nonoperating Revenues (Expenses)	\$ 163,512	\$ 161,102	\$ (2,410)
Change in Net Assets	\$ 314,878	\$ 183,369	\$ (131,509)

	2010		
	Budget	Actual	Variance Favorable (Unfavorable)
Operating Revenues			
Sales	\$ 1,048,150	\$ 906,593	\$ (141,557)
Less: cost of goods sold	(380,759)	(328,112)	52,647
Gross profit on sales	\$ 667,391	\$ 578,481	\$ (88,910)
Charges for services	3,404,692	2,878,320	(526,372)
Miscellaneous	49,600	55,849	6,249
Total Operating Revenues	\$ 4,121,683	\$ 3,512,650	\$ (609,033)

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes

A. Budget (Continued)

	2010		Variance Favorable (Unfavorable)
	Budget	Actual	
Operating Expenses			
Personal services	\$ 2,126,696	\$ 2,004,874	\$ 121,822
Supplies	254,105	218,403	35,702
Utilities	366,100	295,577	70,523
Other services and charges	858,897	716,485	142,412
Amortization	9,060	18,583	(9,523)
Depreciation	444,000	505,439	(61,439)
Total Operating Expenses	<u>\$ 4,058,858</u>	<u>\$ 3,759,361</u>	<u>\$ 299,497</u>
Operating Income (Loss)	<u>\$ 62,825</u>	<u>\$ (246,711)</u>	<u>\$ (309,536)</u>
Nonoperating Revenues (Expenses)			
Earnings on investments	\$ 4,400	\$ 1,145	\$ (3,255)
City of Duluth hotel-motel, food, and beverage tax	225,000	225,000	-
Interest expense	(60,340)	(62,268)	(1,928)
Total Nonoperating Revenues (Expenses)	<u>\$ 169,060</u>	<u>\$ 163,877</u>	<u>\$ (5,183)</u>
Change in Net Assets	<u>\$ 231,885</u>	<u>\$ (82,834)</u>	<u>\$ (314,719)</u>

B. Deposits

The Treasurer of the City of Duluth is designated by Minn. Laws 1973, ch. 327, as Treasurer of the Authority. Authority deposits are pooled with all other City deposits. The City Treasurer is authorized by Minn. Stat. §§ 118A.02 and 118A.04 to deposit cash and to invest in certificates of deposit in financial institutions designated by the Duluth City Council. Minnesota statutes require that all Authority deposits be covered by insurance, surety bond, or collateral.

The types of investments available to the City Treasurer are detailed in Minn. Stat. §§ 118A.04 and 118A.05. Investments are stated at fair value.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes

B. Deposits (Continued)

Additional disclosures required by GASB Statement No. 40, *Deposits and Investment Risk Disclosures*, are disclosed on an entity-wide basis in the City of Duluth's Comprehensive Annual Financial Report. The Authority is a component unit of the City of Duluth.

Following is a summary of the Authority's cash:

	April 30	
	2011	2010
City Treasurer	\$ 327,391	\$ 255,397
Petty cash and change funds	14,425	8,925
Total Cash and Cash Equivalents	\$ 341,816	\$ 264,322
Current assets		
Unrestricted	\$ 91,816	\$ 14,322
Restricted for capital improvements	225,000	225,000
Noncurrent assets		
Restricted for workers' compensation claims	25,000	25,000
Total Cash and Cash Equivalents	\$ 341,816	\$ 264,322

C. Capital Assets

A summary of the changes in capital assets for the years ended April 30, 2011 and 2010, follows:

	Balance May 1, 2010	Additions	Deductions	Reclassification	Balance April 30, 2011
Capital assets not depreciated					
Land and land improvements	\$ 2,466,253	\$ -	\$ -	\$ -	\$ 2,466,253
Construction in progress	813,854	1,807,339	-	(2,544,244)	76,949
Total capital assets not depreciated	\$ 3,280,107	\$ 1,807,339	\$ -	\$ (2,544,244)	\$ 2,543,202

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes

C. Capital Assets (Continued)

	Balance May 1, 2010	Additions	Deductions	Reclassification	Balance April 30, 2011
Capital assets depreciated					
Buildings and structures	\$ 4,036,074	\$ 198,198	\$ -	\$ -	\$ 4,234,272
Equipment	7,400,410	2,015,021	12,387	-	9,403,044
Furniture and fixtures	242,452	8,170	-	-	250,622
Other capital assets	401,533	322,855	-	-	724,388
Total capital assets depreciated	<u>\$ 12,080,469</u>	<u>\$ 2,544,244</u>	<u>\$ 12,387</u>	<u>\$ -</u>	<u>\$ 14,612,326</u>
Less: accumulated depreciation for					
Buildings and structures	\$ 2,764,258	\$ 155,410	\$ -	\$ -	\$ 2,919,668
Equipment	6,244,981	405,128	12,387	-	6,637,722
Furniture and fixtures	205,851	9,664	-	-	215,515
Other capital assets	312,553	37,134	-	-	349,687
Total accumulated depreciation	<u>\$ 9,527,643</u>	<u>\$ 607,336</u>	<u>\$ 12,387</u>	<u>\$ -</u>	<u>\$ 10,122,592</u>
Total capital assets depreciated, net	<u>\$ 2,552,826</u>	<u>\$ 1,936,908</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,489,734</u>
Capital Assets, Net	<u>\$ 5,832,933</u>	<u>\$ 3,744,247</u>	<u>\$ -</u>	<u>\$ (2,544,244)</u>	<u>\$ 7,032,936</u>

	Balance May 1, 2009	Additions	Deductions	Reclassification	Balance April 30, 2010
Capital assets not depreciated					
Land and land improvements	\$ 2,466,253	\$ -	\$ -	\$ -	\$ 2,466,253
Construction in progress	-	1,148,162	-	(334,308)	813,854
Total capital assets not depreciated	<u>\$ 2,466,253</u>	<u>\$ 1,148,162</u>	<u>\$ -</u>	<u>\$ (334,308)</u>	<u>\$ 3,280,107</u>
Capital assets depreciated					
Buildings and structures	\$ 3,985,887	\$ -	\$ -	\$ 50,187	\$ 4,036,074
Equipment	7,255,247	-	-	145,163	7,400,410
Furniture and fixtures	229,589	-	-	12,863	242,452
Other capital assets	399,325	-	-	2,208	401,533
Total capital assets depreciated	<u>\$ 11,870,048</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 210,421</u>	<u>\$ 12,080,469</u>
Less: accumulated depreciation for					
Buildings and structures	\$ 2,612,365	\$ 151,893	\$ -	\$ -	\$ 2,764,258
Equipment	5,919,064	325,917	-	-	6,244,981
Furniture and fixtures	197,287	8,564	-	-	205,851
Other capital assets	293,488	19,065	-	-	312,553
Total accumulated depreciation	<u>\$ 9,022,204</u>	<u>\$ 505,439</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,527,643</u>
Total capital assets depreciated, net	<u>\$ 2,847,844</u>	<u>\$ (505,439)</u>	<u>\$ -</u>	<u>\$ 210,421</u>	<u>\$ 2,552,826</u>
Capital Assets, Net	<u>\$ 5,314,097</u>	<u>\$ 642,723</u>	<u>\$ -</u>	<u>\$ (123,887)*</u>	<u>\$ 5,832,933</u>

*Reclassification balance is due to construction in progress item reclassified to planning and development.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes (Continued)

D. Vacation, Sick Leave, and Compensatory Time

Full-time employees are granted from 10 to 20 days of vacation per year depending on their years of service. Maximum amounts of vacation time that can be accumulated depend on which union bargaining unit is representing the employee. Sick leave is accumulated at the rate of 30 days per year up to a maximum of 120 days for those employees covered by the Minnesota Arrowhead District Council 96.

Staff personnel are granted from one to four weeks of vacation per year depending on their years of service. Staff may carry forward no more than the amount that was earned in the year. Staff personnel are granted 30 days of sick leave per year.

Unpaid vacation pay earned as of April 30, 2011 and 2010, is \$74,963 and \$66,823, respectively, and is recognized as a liability in the financial statements.

Sick leave is recorded as an expense when paid. The contingent liability for unused sick leave is not recognized in the financial statements.

E. Due to City of Duluth

The amounts due to the City at April 30, 2011 and 2010, follow:

	2011	2010
General Fund - cost allocation plan	\$ -	\$ 39,306
General Fund - sales tax	2,407	2,666
Self-Insurance Fund - insurance premiums	-	47,926
General Fund - line of credit	132,000	-
Total	\$ 134,407	\$ 89,898

In 2005, the City of Duluth and the Authority agreed on a repayment schedule for cost allocation and insurance premiums. The total amount was repaid by the end of fiscal year April 30, 2011.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes

E. Due to City of Duluth (Continued)

The City of Duluth extends the Authority a line of credit each year up to \$350,000 to assist in the management of cash flow within the budget approved. Spirit Mountain Recreation Area Authority is allowed to draw upon the line of credit as needed beginning May 1 through October 31, and it needs to be repaid in full at least once per calendar year, by October 31 of that year. If repaid as agreed with the City Treasurer, no interest shall be charged. The Authority obtained \$132,000 on April 28, 2011, and repaid the money on October 31, 2012.

F. Long-Term Debt

The following is a summary of the long-term bonded debt transactions of the Authority.

	2011	2010
Bonds Payable - May 1	\$ 620,104	\$ 810,726
Payments	(199,295)	(190,622)
Bonds Payable - April 30	\$ 420,809	\$ 620,104
Amount Due Within One Year	\$ 208,364	\$ 198,912

Bonds payable comprise the following issue:

A \$1,646,750 City of Duluth Gross Revenue Recreational Facility Bond dated March 28, 2003, with interest at 4.50 percent, is due in semi-annual installments on June 1 and December 1, through 2012. The bond is not a general obligation of the City and is payable from Authority gross revenues. The City has pledged tourism taxes in the amount of \$225,000 per year as part of the gross revenues of the project. The Authority is required to deposit \$75,000 on each November 15, December 15, and January 15 to the Repair and Replacement Account each year until 2012. The monies in this account can then be expended by the Authority for repairs and replacements made to the facilities. The bond was issued to refinance existing debt. The refinancing resulted in a \$53,850 deferred loss, which is amortized over the life of the old debt.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes

F. Long-Term Debt (Continued)

The Duluth City Council approved Resolution 10-0181R on April 2, 2010, allowing the Authority to use the restricted repair and replacement monies of \$225,000 for general operating expenses as needed for fiscal year ending April 30, 2011. In addition, on November 25, 2009, the Council approved an additional \$50,000 of tourism taxes to be allocated to the Authority in fiscal year ending April 30, 2011, with Resolution 09-0731R. The Council determined that construction of the Alpine Coaster would fulfill the obligation of the Authority to expend monies for necessary repairs and replacements to the recreation facilities.

The annual requirements to service the debt follow:

Fiscal Year Ended April 30	Principal	Interest
2012	\$ 208,364	\$ 16,636
2013	212,445	7,154
Total	\$ 420,809	\$ 23,790

G. Capitalized Lease Obligations

Capitalized lease obligations consist of the following at April 30, 2011:

Type of Property	
Equipment	\$ 2,699,027
Less: accumulated amortization	(423,560)
Net Capital Lease Property	\$ 2,275,467

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes

G. Capitalized Lease Obligations (Continued)

Minimum future lease payments follow:

Fiscal Year Ended April 30	Principal	Interest
2012	\$ 279,712	\$ 102,467
2013	291,412	90,545
2014	182,746	79,057
2015	140,682	72,526
2016	146,257	66,950
2017 - 2021	826,907	239,130
2022 - 2025	732,597	61,019
Total	<u>\$ 2,600,313</u>	<u>\$ 711,694</u>

Capitalized lease obligations at April 30, 2011, consist of the following leases:

A \$317,261 lease purchase for ski rental equipment, dated June 26, 2008, due in periodic installments during the ski season through November 2013, with interest at 4.125 percent.	\$ 143,544
A \$435,968 lease purchase for two groomers, dated November 5, 2008, due in periodic installments during the ski season through December 2013, with interest at 4.25 percent.	220,918
A \$2,340,150 lease purchase for purchase, design, and installation of an Alpine Coaster and construction of a ticket/concession building and parking lot, dated January 26, 2010, due in periodic installments commencing September 1, 2010, through February 1, 2025, with interest at 3.96 percent.	<u>2,235,851</u>
Total	<u>\$ 2,600,313</u>
Current portion	\$ 279,712
Long-term portion	<u>2,320,601</u>
Total	<u>\$ 2,600,313</u>

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes (Continued)

H. Operating Lease

The Authority is obligated under an operating lease for office equipment. Lease expense for fiscal year 2011 is \$5,523 and \$4,608 for fiscal year 2010. The future minimum rental payments, which are not reported as liabilities in the financial statements at April 30, 2011, are \$5,523 due in fiscal year 2012.

I. Mountain Villas Agreements

In November 1979, the Authority entered into an agreement with the Mountain Villas Owner's Association, Inc., for the rental of property associated with 15 rental housing units sold by the Authority to the Association. The agreement provides for an annual base rental payment of \$15,000 by the Association and features an annual inflation adjustment clause equal to the change in the consumer price index. This clause was not invoked by the Authority until 1989.

In October 1989, the Authority entered into another agreement with the Mountain Villas Owner's Association, Inc., to manage the 15 rental housing units owned by the Association. The agreement provides payment to the Authority of an annual base management fee of \$24,000 plus ten percent of gross sales.

3. Risk Management

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; employee health and dental; and natural disasters. The Authority participates in the City of Duluth Internal Service Fund to insure against its obligation to provide benefits to employees pursuant to the Minnesota Workers' Compensation Act and to insure against general liability claims, except the liability claims arising by reason of selling, serving, or furnishing alcoholic beverages. The Authority purchases commercial insurance for all risks of loss not covered by the City's Internal Service Fund. There were no significant reductions in insurance coverage from the previous year. There were no settlements in excess of insurance for any of the past three fiscal years.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

3. Risk Management (Continued)

For claims arising from the Workers' Compensation Act, insured through the City of Duluth Self-Insurance Internal Service Fund, the Authority retains responsibility for attorney fees on contested claims. In addition, the Authority escrows \$25,000 as a reserve fund to pay excess workers' compensation claims and costs that exceed the agreed-upon value of plan participation with the City. No liability has been recognized in the financial statements for excess workers' compensation claims and costs.

For general liability claims, insured through the City of Duluth Self-Insurance Internal Service Fund, the Authority retains responsibility for paying the first \$50,000 of each loss resulting from each occurrence. The maximum coverage provided by the City was \$300,000 per claimant; \$1,000,000 per occurrence. The estimated liability of the Authority for general liability claims, where coverage is not provided by the City, is accrued if the Authority's attorney determines settlement is probable, based on a case-by-case evaluation. The attorney has indicated there are \$104,300 in claims that may become losses to the Authority.

4. Defeased Debt

On March 31, 2003, the City of Duluth issued a Gross Revenue Recreational Facility Bond, with an interest rate of 4.50 percent, to refund the Authority's refinancing lease, having an interest rate of 4.85 percent. The \$1,646,750 Gross Revenue Recreation Facility Bond was issued at par. The proceeds, together with Authority funds of \$53,527, were used to refund a \$1,646,750 refinancing lease with accrued interest of \$53,527.

As a result of the refunding, the Authority increased its total debt service requirement by \$312,471, which resulted in an economic loss (difference between the present value of the debt service payments on the old and new debt) of \$106,360.

As part of the agreement to issue the Gross Revenue Recreational Facility Bond, the City of Duluth pledged tourism taxes in the amount of \$225,000 per year to pay principal and interest on the bond.

5. Subsequent Event

The Authority entered into a \$600,000 lease purchase agreement with Beacon Bank for the purchase, design, and installation of a two-person zip line, six-lane tubing park, and miniature golf course, dated June 1, 2011, due in periodic installments commencing October 1, 2011, through June 1, 2016.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

6. Pension Plans - Defined Benefit Plans

A. Plan Description

All full-time and certain part-time employees of Spirit Mountain Recreation Area Authority are covered by defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the General Employees Retirement Fund, which is a cost-sharing, multiple-employer retirement plan. The plan is established and administered in accordance with Minn. Stat. chs. 353 and 356.

General Employees Retirement Fund members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security, and Basic Plan members are not. All new members must participate in the Coordinated Plan.

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

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

For General Employees Retirement Fund members whose annuity is calculated using Method 1, a full annuity is available when age plus years of service equal 90. Normal retirement age is 65 for members hired prior to July 1, 1989, and is the age for unreduced Social Security benefits capped at age 66 for Coordinated Plan members hired on or after July 1, 1989. A reduced retirement annuity is also available to eligible members seeking early retirement.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

6. Pension Plans - Defined Benefit Plans

A. Plan Description (Continued)

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

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

B. Funding Policy

Pension benefits are funded from member and employer contributions and income from the investment of fund assets. Rates for employer and employee contributions are set by Minn. Stat. ch. 353. The Authority makes annual contributions to the pension plans equal to the amount required by state statutes. General Employees Retirement Fund Basic Plan members and Coordinated Plan members are required to contribute 9.10 and 6.25 percent, respectively, of their annual covered salary.

The Authority is required to contribute the following percentages of annual covered payroll in 2010 and 2011:

	2010	2011
General Employees Retirement Fund		
Basic Plan members	11.78%	11.78%
Coordinated Plan members	7.00	7.25

The Authority's contributions for the years ending April 30, 2011, 2010, and 2009, for the General Employees Retirement Fund were:

	2011	2010	2009
General Employees Retirement Fund	\$ 81,230	\$ 71,628	\$ 71,847

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

This page was left blank intentionally.

SUPPLEMENTARY INFORMATION

This page was left blank intentionally.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

EXHIBIT A-1

**COMPARATIVE STATEMENT OF OPERATING REVENUES
YEARS ENDED APRIL 30, 2011 AND 2010**

	2011	2010
Sales		
Food	\$ 622,309	\$ 524,064
Liquor	302,291	259,072
Ski shop	150,469	123,457
Less: cost of goods sold	(416,922)	(328,112)
Net sales	\$ 658,147	\$ 578,481
Charges for services		
Season pass	\$ 1,102,872	\$ 1,089,969
Daily lift tickets	957,284	986,926
Alpine coaster	736,342	-
Ski school and snow sports	127,015	122,319
Ski rental	228,520	229,215
Snowboard rental	85,289	85,191
Locker rental	25,260	25,343
Nordic tickets and rental	12,405	15,835
Snocross	145,244	95,633
Campground	114,680	108,498
Mountain villa management fee	97,975	91,679
Marketing revenue	24,350	27,712
Total charges for services	\$ 3,657,236	\$ 2,878,320
Miscellaneous		
Other revenues	\$ 75,344	\$ 55,849
Total Operating Revenues	\$ 4,390,727	\$ 3,512,650

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

EXHIBIT A-2

**COMPARATIVE STATEMENT OF OPERATING EXPENSES
YEARS ENDED APRIL 30, 2011 AND 2010**

	2011	2010
Department		
Food and beverage	\$ 344,027	\$ 315,679
Housekeeping	100,244	92,122
Rental	71,000	76,077
Ski shop	38,230	40,702
Campground	96,534	74,872
Parking and shuttle	26,041	20,419
Building and grounds	249,604	213,114
Snocross	143,906	123,846
Ski school and snow sports center	97,893	104,058
Outside mountain operations	1,216,242	1,106,645
Nordic	9,342	8,794
Ski patrol	12,196	7,519
Sales and marketing	459,175	425,792
Office administration	615,509	580,542
Mountain villas	45,794	45,158
Adventure park	206,735	-
	\$ 3,732,472	\$ 3,235,339
Total departmental costs		
Amortization	28,652	18,583
Depreciation	607,336	505,439
	\$ 4,368,460	\$ 3,759,361
Total Operating Expenses		

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

EXHIBIT B-1

**STATEMENT OF CAPITAL IMPROVEMENTS
YEAR ENDED APRIL 30, 2011**

	Repair and Replacement Account Capital Improvements	Non-Repair and Replacement Account Capital Improvements	Total
Construction in Progress			
New vestibule entrance for Bear Paw and Eagles Nest	\$ -	\$ 2,326	\$ 2,326
Permitting fees	-	10,318	10,318
Forest management plan	-	2,800	2,800
Water supply engineering for easement	-	682	682
2011 Honda all terrain vehicles	-	12,450	12,450
Snowgun nozzle replacement	-	7,388	7,388
Computer replacement	-	6,324	6,324
Prep kitchen updates	-	2,158	2,158
Café/breakroom blinds	-	2,748	2,748
Grand Avenue project	-	36,480	36,480
Reupholster Moosehead furniture	-	4,277	4,277
New phone system	-	32,287	32,287
Lower bridge	-	46,103	46,103
Eagles Nest/Bear Paw entrance #2	-	18,545	18,545
Portable race building	-	1,958	1,958
High top tables - Moosehead	-	1,145	1,145
2011 snowmobile	-	8,070	8,070
2010 rental racks	-	4,168	4,168
Window replacement	-	2,515	2,515
Door and frame replacement	-	3,402	3,402
Miniature golf course	-	5,797	5,797
Alpine coaster	50,000	1,545,398	1,595,398
	50,000	1,545,398	1,595,398
Total Construction in Progress	\$ 50,000	\$ 1,757,339	\$ 1,807,339

Repair and Replacement Account Summary

Net Assets - restricted for capital improvements at April 30, 2010	\$ 225,000
2010 repair and replacement account deposits	275,000
Repair and replacement account capital improvements	(50,000)
Repair and replacement funds moved to operating account	(225,000)
	275,000
Net Assets - restricted for capital improvements at April 30, 2011	\$ 225,000

This page was left blank intentionally.

This page was left blank intentionally.

**SPIRIT MOUNTAIN RECREATION AREA AUTHORITY
DULUTH, MINNESOTA**

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED APRIL 30, 2011**

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEM NOT RESOLVED

09-1 Internal Control - Segregation of Duties, Documentation, and Monitoring

Management is responsible for establishing and maintaining effective internal control. This includes designing and implementing programs and controls to prevent and detect errors and fraud, ensuring fair presentation of the financial statements and related notes, and monitoring ongoing activities. Adequate segregation of duties and written policies and procedures are key control activities in an organization's accounting system. Monitoring helps to ensure that internal control continues to operate effectively.

The size of Spirit Mountain Recreation Area Authority and its staffing limits the internal control that management can design and implement into the organization. Management should be aware that segregation of duties is not adequate from an internal control point of view. Ideally, responsibilities should be separated among employees so that a single employee is not able to authorize a transaction, record the transaction in accounts, and be responsible for custody of the asset resulting from the transaction. In addition, the work of one individual should be either independent of, or serve to check on, the work of another. Such arrangements reduce the risk of undetected errors and limit opportunities to misappropriate assets or conceal intentional misstatement.

An outside payroll service is not used to process payroll; it is processed by Authority staff. This puts an even greater burden on the Authority, already limited by its small staff size, to prevent, and detect and correct, errors and irregularities. In addition, access controls currently in the payroll module of the computerized accounting system cannot be limited or restricted for staff that process payroll. Therefore, the Finance Director, who is responsible for processing payroll, also has access to make changes to the employee master file in the computerized payroll module for occurrences such as new hires, terminations, and pay increases. The Human Resources Manager, who is responsible for maintenance of the employee master file, has access to only employee master files and

not to the processing components of the computerized payroll module. The Executive Director is responsible for reviewing an extensive number of reports in an effort to mitigate payroll-related internal control weaknesses.

We recommend the Board of Directors be mindful that limited staffing and segregation of duties causes inherent risks in safeguarding the Authority's assets and the proper reporting of its financial activity. We recommend the Board of Directors continue to implement oversight procedures and monitor those procedures to determine if they are still effective internal controls. This is especially important in the payroll area.

Client's Response:

As noted previously, Spirit Mountain takes the implementation of internal controls very seriously. We continually work to improve and strengthen our internal controls and policies related to them. With regard to the payroll processing, the Authority has been able to save significantly by bringing this function in-house. Before doing so, the Authority discussed this issue with the State Auditor to ensure we had all the proper controls in place.

The Finance Director does the payroll processing and as such must have complete access to all aspects of the payroll system to process the payroll and make changes to the employee master file.

There are numerous steps involved in payroll, and procedures have been instituted to ensure payroll is processed properly. All department supervisors are required to review their payroll and approve for accuracy. Once done they submit signed and approved timesheets for each employee in their department. The supervisors are also responsible for any missed punches and entering vacation, sick and holiday pay for their employees.

The Executive Director reviews all aspects of the payroll process, paying careful attention to the payroll for the Finance Director.

All the detailed reports are reviewed and approved by the Executive Director. In addition to this review, the Human Resources Director reviews the "Calculate" report that shows the pay amount for each employee of the Authority.

We firmly believe the steps taken do ensure the veracity of the payroll, are proper and leave little room for either mistakes or improper pay amounts.

II. OTHER FINDINGS AND RECOMMENDATIONS

MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM NOT RESOLVED

09-3 Donation to Nonprofit Foundation

The Authority entered into an agreement with the Duluth-Superior Area Community Foundation (Foundation), a non-profit corporation. The agreement requires the Authority to “irrevocably assign, convey, transfer and deliver to the Trustee property set forth in Exhibit A” to the Foundation as trustee of a fund to be known as the “Spirit Mountain Recreation Area Authority Fund” (Fund). The net income and principal of the Fund must be disbursed by the Foundation “exclusively for educational and charitable uses and purposes” according to the Foundation’s articles of incorporation and bylaws. Exhibit A to the agreement is blank, except for a sentence indicating “(This page is where the establishing gift to the fund will be listed).” The Authority donated \$5,000 to the Foundation.

Each expenditure of public funds must be authorized by law and for a public purpose. *See e.g.* Minn. Const., art. X, § 1 (“Taxes . . . shall be levied and collected for public purposes.”). For this reason, the Minnesota Attorney General’s Office has consistently stated that no donations of public funds to people, non-profits, charities, etc., are permitted unless based upon specific statutory or charter authority. *See, e.g.*, Ops. Att’y. Gen. 442a-17 (Jan. 17, 1938) (Red Cross), 59-A-3 (May 21, 1948), and (Sept. 28, 1933) (Boy Scouts). The assumption is that a gift of public funds to an individual or private entity necessarily serves a private rather than a public purpose. *See* Ops. Att’y. Gen. 107-a-3 (Jan. 22, 1980), 270-D (Aug. 12, 1977), and 59a-22 (Dec. 4, 1934). The Office of the State Auditor knows of no specific statutory or charter authority for this charitable gift.

We recommend that the Authority follow Minnesota law and cease donations to the Foundation, that it recover all money already donated, and terminate the agreement.

Client's Response:

Spirit Mountain Recreation Area Authority entered into the above noted agreement with the Duluth Superior Area Community Foundation (DSACF), not to benefit any other organization than Spirit Mountain. We disagree with the findings for two important reasons:

- 1. The donation of \$5,000 was for the specific benefit of Spirit Mountain and will come back to the Authority in the form of grants once the fund is fully endowed. The donation was not made for the benefit of another non-profit organization. The DSACF has the staff, the expertise and the experience to host our endowment fund and exists for that purpose.*
- 2. The funds generated by the grants from the endowment will far exceed the initial \$5,000 contribution once fully endowed. These grants will enable Spirit Mountain to provide important programming for the youth in the region, both summer and winter.*

The only entity to benefit from the initial contribution and subsequent grants will be Spirit Mountain Recreation Area.



REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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

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

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

Mayor and City Council
City of Duluth

Board of Directors
Spirit Mountain Recreation Area Authority

We have audited the basic financial statements of Spirit Mountain Recreation Area Authority, a component unit of the City of Duluth, as of and for the year ended April 30, 2011, and have issued our report thereon dated February 14, 2012. 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 Spirit Mountain Recreation Area Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Authority's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined above. However, we identified a deficiency in internal control over financial reporting, described in the Schedule of Findings and Recommendations as item 09-1, that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Spirit Mountain Recreation Area Authority'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 Political Subdivisions*, 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 Political Subdivisions* 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, Spirit Mountain Recreation Area Authority complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Recommendations as item 09-3.

Spirit Mountain Recreation Area Authority's written responses to the internal control and legal compliance findings identified in our audit have been included in the Schedule of Findings and Recommendations. We did not audit the Authority's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Board of Directors, Mayor and City Council of Duluth, the Authority's management, and others within Spirit Mountain Recreation Area Authority and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

February 14, 2012

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR