

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

DULUTH AIRPORT AUTHORITY
(A COMPONENT UNIT OF THE
CITY OF DULUTH, MINNESOTA)

FOR THE YEARS ENDED DECEMBER 31, 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.

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**DULUTH AIRPORT AUTHORITY
(A COMPONENT UNIT OF THE
CITY OF DULUTH, MINNESOTA)**

For the Years Ended December 31, 2011 and 2010



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

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**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

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**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

**ORGANIZATION
DECEMBER 31, 2011**

	<u>Term Ending</u>
Directors	
John M. Eagleton	July 1, 2013
Conrad Firling	July 1, 2012
Michael G. Lundstrom	July 1, 2012
Robert Pearson	July 1, 2012
Sue Ross	July 1, 2013
Ken Stromquist	July 1, 2013
Roger D. Wedin	July 1, 2014
Executive Director	
Brian Ryks	
Officers	
President	
John M. Eagleton	
Vice President	
Robert Pearson	
Secretary	
Michael G. Lundstrom	

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REBECCA OTTO
STATE AUDITOR

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INDEPENDENT AUDITOR'S REPORT

Mayor and City Council
City of Duluth

Board of Directors
Duluth Airport Authority

We have audited the accompanying financial statements of the Duluth Airport Authority, a component unit of the City of Duluth, as of and for the years ended December 31, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the Duluth Airport 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; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 the Duluth Airport Authority as of December 31, 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 and Required Supplementary Information as listed in the table of contents 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 an opinion on the financial statements that collectively comprise the Duluth Airport Authority's basic financial statements as a whole. The supplementary information, including the Schedule of Expenditures of Federal Awards required by OMB Circular A-133, and the Schedule of Passenger Facility Charges Collected and Expended, as listed in the table of contents, are presented for purposes of additional analysis and are 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 June 19, 2012, on our consideration of the Duluth Airport Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

June 19, 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS

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DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA

MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2011
(Unaudited)

Our discussion and analysis of the Duluth Airport Authority's (Authority) financial performance provides an overview of the Authority's financial activities for the fiscal year ended December 31, 2011. Please read it in conjunction with the financial statements.

FINANCIAL HIGHLIGHTS

- Operating expenses (before depreciation and amortization) decreased \$159.6 thousand, or 5 percent, compared to fiscal year 2010, due to increased costs for utilities and operating supplies.
- Operating revenues increased \$37.5 thousand, or 1 percent, primarily due to increased revenues earned in fuel sales at Sky Harbor Airport of \$39.5 thousand.
- Nonoperating federal and state grant revenues and contributed capital increased \$3.5 million, or 36 percent, from 2010; the increases are due to support capital costs for the new terminal currently under construction. Total net assets increased \$8.4 million, or 11 percent, compared to fiscal year 2010.
- Total number of passengers decreased by 11.1 thousand, or 4 percent, for a total of 295.2 thousand in 2011. The decrease was due to Allegiant discontinuing summer Orlando service relative to 2010.
- Total traffic count as recorded by the FAA tower increased by 6.3 thousand, or 13 percent. Of this figure, approximately 80 percent is commercial and general aviation traffic, with the remaining 20 percent military traffic.
- Landing fee revenues for 2011 decreased by \$61.3 thousand, or 16 percent, due primarily to decreased commercial activity with training flights that had occurred in 2010 as well as the Allegiant summer schedule change.
- Passenger facility charge revenue decreased by \$18.8 thousand in 2011, or 4 percent, compared to 2010, which is attributed to the 4-percent passenger count decrease from 2010.

- Customer facility charges on rental car transactions began in July 2011. The charges are to support capital improvements and operating costs associated with rental car occupied space. \$107.6 thousand was generated in 2011.
- Total parking lot sales increased by \$12.3 thousand, or 2 percent, for 2011.
- Total car rental concession sales increased by just \$1.2 thousand for 2011.
- The 2010/2011 State Maintenance and Operations Agreement, which became effective July 1, 2009, provided for \$168.6 thousand of state aid.
- The Transportation Security Administration's agreement with the Authority, effective October 1, 2007, through September 30, 2012, reimbursed the Authority 14 hours per day for contracted law enforcement personnel, or approximately \$7.4 thousand per month.

OVERVIEW OF ANNUAL FINANCIAL REPORT

The Management's Discussion and Analysis (MD&A) serves as an introduction to the Duluth Airport Authority's financial statements. The MD&A represents management's examination and analysis of the Authority's financial condition and well-being. Summary financial statement data, key financial and operational indicators used in the Authority's strategic plan, budget, 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 receipts 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 that are 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 during the independent external audit process.

SUMMARY OF ORGANIZATION AND BUSINESS

The Legislative Act of 1969, Chapter 577, as approved on May 22, 1969, authorized the organization of the Authority. The purpose of this act was to promote the public welfare and to serve the public interest, convenience and necessity, promote air navigation and transportation, national, state and local; and to these ends, to develop full potentials of aviation in the City of Duluth as an aviation center; and to provide for the most economical and effective use of aeronautical facilities and services in the City of Duluth; and to this end, the Authority shall cooperate with and assist the federal government and the Director of Aeronautics of this state, and shall seek to coordinate its aeronautic activities with these bodies. This Legislative Act established a Board of seven Directors appointed by the Mayor and conferred upon this Board the power and duty to administer, promote, control, direct, and manage and operate all airports owned. On October 9, 1985, the Bylaws were adopted (amended October 16, 1986, and September 16, 1997). These Bylaws established regular monthly meetings, a term for officers, and the appointment of an Executive Director.

The Duluth Airport Authority's mission is dedicated to providing safe, secure, customer-friendly, and progressive air transportation facilities that serve the traveling public and promote economic growth throughout the region.

The Duluth International Airport consists of two runways, which provide take-off and landing facilities for all types of commercial and general aviation aircraft, as well as military aircraft. The main runway 9-27 is 10,152 feet long by 150 feet wide and can handle the world's largest aircraft. The cross runway 3-21 is 5,699 feet long by 150 feet wide. The Duluth International Airport is located on 3,294 acres of land and encompasses approximately one-half of the old Duluth Air Force Base. The Authority also operates Sky Harbor Airport, which is both a sea plane base and a general aviation airport. The landside runway is 3,050 long by 75 feet wide. In the bay, there is also a 10,000-foot by 2,000-foot water runway.

Operating revenue for the Authority comes from a variety of sources including: car rental concessions, parking, space and land rentals, Fixed Base Operator (FBO) concessions, Transportation Security Agency reimbursement for law enforcement, maintenance and operations grant funds from the State of Minnesota, and landing fees. The Authority is self-sufficient and is not subsidized by the City of Duluth for operations or capital improvement costs.

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.

Condensed Statement of Net Assets (000s)

	FY 2011	FY 2010	FY 2009
Current and other assets	\$ 5,473	\$ 5,513	\$ 4,888
Capital assets	70,800	68,259	62,896
Construction in progress	17,416	11,550	11,662
Total Assets	\$ 93,689	\$ 85,322	\$ 79,446
Current liabilities	\$ 3,568	\$ 3,586	\$ 3,297
Long-term liabilities	1,583	1,567	1,171
Total Liabilities	\$ 5,151	\$ 5,153	\$ 4,468
Net Assets			
Invested in capital assets, net of related debt	\$ 87,974	\$ 79,539	\$ 74,262
Unrestricted	564	630	716
Total Net Assets	\$ 88,538	\$ 80,169	\$ 74,978

As the table illustrates, net assets increased by \$8.4 million to \$88.5 million in 2011. The increase in net assets was primarily due to the \$8.4 million increase in invested in capital assets, as well as a decrease of \$66.0 thousand in unrestricted net assets.

Condensed Statement of Revenues, Expenses, and Changes in Net Assets (000s)

	FY 2011		FY 2010	FY 2009
	Actual	Budget	Actual	Actual
Total operating revenues	\$ 3,645	\$ 3,506	\$ 3,607	\$ 3,002
Total operating expenses	(9,226)	(8,519)	(8,883)	(8,200)
Income (Loss)	\$ (5,581)	\$ (5,013)	\$ (5,276)	\$ (5,198)
Nonoperating revenues	579	615	591	524
Other revenues	13,423	19,068	9,923	12,985
Nonoperating expenses	(52)	(50)	(46)	(86)
Change in Net Assets	\$ 8,369	\$ 14,620	\$ 5,192	\$ 8,225

REVENUES

Operating revenues increased by \$37.5 thousand, or one percent, in 2011 relative to 2010. Operating revenues were generally flat during the year consistent with the minor change in passenger activity. The operating revenue increase is due primarily to increased aviation fuel sales at Sky Harbor Airport of \$39.5 thousand.

EXPENSES

Duluth Airport Authority's operating expenses increased by \$343.3 thousand to \$9,226 thousand in 2011, up from \$8,883 thousand in 2010. Utilities expense increased by \$9.6 thousand to \$589.3 thousand in 2011, and Personal Services expenses decreased by \$34.6 thousand in 2011 compared to 2010. Depreciation and amortization expense in 2011 from completed construction projects and equipment purchases increased by \$502.8 thousand in 2011 compared to 2010.

BUDGETARY HIGHLIGHTS

The Duluth Airport Authority develops an annual operating budget which includes proposed expenses as well as proposed sources of revenue to pay for them. The Authority Board approves the operating budget, and it also receives final approval from the Duluth City Council. The Authority's operating budget remains in effect for the entire fiscal year without being revised. Management and the Board of Directors are presented detailed monthly financial statements as well as an in-depth quarterly analysis of key indicators and budgetary progress.

The airline industry remains competitive and volatile with fuel cost unpredictability continuing to plague profitability and continued service to smaller and marginally profitable markets. Positive for Duluth, Allegiant Airlines now has had several full and productive years of service to Las Vegas and Sanford, Florida from Duluth twice weekly. In 2011, Allegiant began new service twice weekly to Mesa, Arizona, as well. Additionally, United Airlines' twice daily direct service between Duluth and its Chicago O'Hare hub has been successfully in place for more than two years. The establishment of additional air service to our market is continually being pursued with various carriers. Finally, Monaco Air continues to have productive and successful operations as the FBO offering quality service with a well-respected reputation. Monaco's services and operations have led to more activity for international, corporate, charter, and general aviation users of the Duluth Airport as well as increased revenues for the Authority.

The Authority continued to make improvements to facilities and infrastructure and respond to new security directives. In 2011, the following projects or additions to projects reached completion and were transferred to fixed asset records: (1) North Business Development Area - \$3.0 million; (2) Additional New Terminal Building Design - \$745.1 thousand; (3) Acquisition of Building 311 from the Federal Prison - \$770 thousand; (4) Acquisition of 3 Oshkosh snow blowers from the Department of Defense - \$277.4 thousand; (5) Completion of the New Terminal Parking Lot - \$3.3 million; and (6) Additions to the Sky Harbor Environmental Assessment and Feasibility Study - \$528.1 thousand.

Groundbreaking began in 2009 for the new \$77 million Passenger Terminal Building and supporting infrastructure. During 2010, Phase I, consisting of site work, new roadways, infrastructure, and new parking lots, was completed. Phase II, involving New Terminal Building foundation, structure, and enclosure, is well underway with estimated completion in mid- to late summer of 2012. The entire construction project is expected to last up to four years. Federal, state, and local airport dollars will fund the project.

The union contract between the Authority and AFSCME Local 66 was renegotiated in 2010 and is effective through December 31, 2012.

	Capital Assets (000s)			Total Percent (%) Change
	FY 2011	FY 2010	Dollar Change Increase (Decrease)	
Land	\$ 3,361	\$ 3,361	\$ -	-
Runways	80,173	77,146	3,027	3.92
Buildings	37,506	35,985	1,521	4.23
Equipment	10,005	6,599	3,406	51.61
Construction in progress	17,416	11,550	5,866	50.79
Total capital assets	\$ 148,461	\$ 134,641	\$ 13,820	10.26
Less: accumulated depreciation	(60,245)	(54,832)	(5,413)	9.87
Net Capital Assets	\$ 88,216	\$ 79,809	\$ 8,407	10.53

At the end of 2011, the Authority has invested approximately \$148.5 million in capital assets since its inception. The \$13.8 million increase in capital assets this past year is due to several major projects, including a new terminal parking lot, additional terminal building design, and equipment and building acquisitions.

The Authority recently updated its Airport Capital Improvement Program through 2017, which includes for 2012:

- \$13.3 million for the new terminal building construction,
- \$500 thousand for airfield improvements, and
- \$47 thousand for new equipment.

DEBT ADMINISTRATION

The City of Duluth obtained a \$500,000 loan from the Minnesota Investment Fund to remedy soil conditions on Duluth Airport Authority property in support of new business development. On December 20, 2005, the Authority entered into an agreement with the Duluth Economic Development Authority that provided the Authority make payments due on the loan in the amount of \$400,000. The loan is noninterest-bearing, payable in 180 monthly installments of \$2,222 beginning February 2006. The noncurrent portion of the loan payable is \$215,555.

The Authority entered into a Lease Acquisition Agreement with North Country Aviation (NCA) on November 1, 2005. The agreement required the Authority pay NCA \$497,379 in order to acquire NCA's FBO lease agreement and facilitate its transfer to Monaco Air Duluth. The note is payable by the Authority as Airport Facility Revenue Note, Series2005A. The note is for a term of 13 years, payable each June 1 and December 1 commencing June 1, 2007. Interest is compounded at 8.85 percent per annum.

Debt (000s)

A summary of changes in the revenue note balances are:

	<u>FY 2011</u>
Balance - January 1	\$ 441
Additions	-
Payments	<u>(36)</u>
Balance - December 31	<u>\$ 405</u>

ECONOMIC AND OTHER FACTORS

When setting the 2011 budget, the Authority took many factors into consideration: the prolonged and severe economic recession and slow recovery still underway; the continuing financial and operational turmoil of the commercial aviation sector; the continuing vigilance of security requirements and its effects on commercial air travel and airport passenger handling; weather conditions which dictate utility costs and overtime for snow removal crews, energy, operating supplies, labor, and benefits price increases; and a general review of all rates and services so that revenue will keep pace with expenses. The Authority has taken steps to raise all rental and concession fees to competitive rates and carefully manages its costs for equipment, supplies, and services. The Authority actively seeks new lessees to occupy vacant space as well as economic development opportunities that are a good fit for the aviation sector. Examples of this are the Authority's development efforts in partnership with the Duluth Economic Development Authority to facilitate usage of the former Northwest Airlines Maintenance Facility. The Authority will continue to seek diversifying revenue sources in order to be less reliant on airline revenue sources.

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 Director of Finance, Duluth Airport Authority, 4701 Grinden Drive, Duluth, Minnesota 55811.

BASIC FINANCIAL STATEMENTS

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**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

EXHIBIT 1

**COMPARATIVE STATEMENT OF NET ASSETS
DECEMBER 31, 2011 AND 2010**

	2011	2010
Assets		
Current assets		
Cash and cash equivalents	\$ 169,136	\$ 632,306
Accounts receivable	275,661	328,556
Grants receivable	69,570	103,387
Inventory	98,909	62,225
Prepaid items	40,093	29,238
Assets restricted for construction		
Cash and cash equivalents	332,996	309,829
Accounts receivable	71,426	76,374
Grants receivable	3,408,307	3,372,484
Total current assets	\$ 4,466,098	\$ 4,914,399
Noncurrent assets		
Capital assets		
Nondepreciable	\$ 20,777,709	\$ 14,910,950
Depreciable	127,684,168	119,729,705
Less: allowance for depreciation	(60,245,706)	(54,832,111)
Net capital assets	\$ 88,216,171	\$ 79,808,544
Other assets		
Airport planning costs - net of accumulated amortization of \$882,446 in 2011 and \$785,607 in 2010	\$ 733,468	\$ 289,831
Lease buyout costs - net of accumulated amortization of \$254,429 in 2011 and \$218,035 in 2010	272,951	309,345
Total other assets	\$ 1,006,419	\$ 599,176
Total noncurrent assets	\$ 89,222,590	\$ 80,407,720
Total Assets	\$ 93,688,688	\$ 85,322,119

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

**EXHIBIT 1
(Continued)**

**COMPARATIVE STATEMENT OF NET ASSETS
DECEMBER 31, 2011 AND 2010**

	2011	2010
Liabilities		
Current liabilities payable from unrestricted assets		
Accounts payable	\$ 178,101	\$ 143,158
Due to the City of Duluth	625,000	25,092
Due to other governments	-	35,475
Accrued salaries payable	49,324	52,267
Accrued vacation payable	91,831	75,511
Construction contracts payable	6,833	9,480
Deferred revenue	19,781	19,781
Revenue notes payable	40,040	36,719
Loans payable	26,667	26,667
Total current liabilities payable from unrestricted assets	\$ 1,037,577	\$ 424,150
Current liabilities payable from restricted assets		
Construction contracts payable	2,530,392	3,161,650
Total current liabilities	\$ 3,567,969	\$ 3,585,800
Noncurrent liabilities		
Deferred revenue	\$ 337,052	\$ 357,312
Revenue notes payable	364,777	404,817
Loans payable	215,555	242,222
Net other postemployment benefits liability	665,139	562,511
Total noncurrent liabilities	\$ 1,582,523	\$ 1,566,862
Total Liabilities	\$ 5,150,492	\$ 5,152,662
Net Assets		
Invested in capital assets - net of related debt	\$ 87,973,949	\$ 79,539,655
Unrestricted	564,247	629,802
Total Net Assets	\$ 88,538,196	\$ 80,169,457

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

EXHIBIT 2

**COMPARATIVE STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2011 AND 2010**

	2011	2010
Operating Revenues		
Charges for services	\$ 3,644,913	\$ 3,607,373
Operating Expenses		
Personal services	\$ 1,487,320	\$ 1,521,869
Supplies	76,407	77,449
Utilities	589,256	579,672
Other services and charges	1,344,040	1,477,605
Depreciation	5,595,951	5,121,608
Amortization	133,233	104,750
Total Operating Expenses	\$ 9,226,207	\$ 8,882,953
Operating Income (Loss)	\$ (5,581,294)	\$ (5,275,580)
Nonoperating Revenues (Expenses)		
Investment earnings	\$ 6,873	\$ 8,841
Passenger facility charge	563,245	582,047
Gain (loss) on disposal of capital assets	8,441	(791)
Interest expense	(51,550)	(45,772)
Total Nonoperating Revenues (Expenses)	\$ 527,009	\$ 544,325
Net Income (Loss) Before Capital Contributions	\$ (5,054,285)	\$ (4,731,255)
Capital Contributions		
Capital grants		
Federal	\$ 8,778,088	\$ 6,803,173
State	3,597,579	3,084,243
Contributed capital	1,047,357	35,598
Total Capital Contributions	\$ 13,423,024	\$ 9,923,014
Change in Net Assets	\$ 8,368,739	\$ 5,191,759
Net Assets - January 1	80,169,457	74,977,698
Net Assets - December 31	\$ 88,538,196	\$ 80,169,457

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

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**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

EXHIBIT 3

**COMPARATIVE STATEMENT OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2011 AND 2010**

	2011	2010
Cash Flows from Operating Activities		
Cash received from customers	\$ 3,430,810	\$ 3,236,417
Cash paid to suppliers	(2,082,866)	(2,328,014)
Cash paid to employees	(1,371,315)	(1,508,596)
Other cash receipts	300,465	258,316
	\$ 277,094	\$ (341,877)
Cash Flows from Noncapital Financing Activities		
Principal paid on revenue note	\$ (36,719)	\$ (33,673)
Interest paid on revenue note	(38,281)	(41,327)
	\$ (75,000)	\$ (75,000)
Cash Flows from Capital and Related Financing Activities		
Principal paid on loans	\$ (26,667)	\$ (26,667)
Capital grants - federal	8,754,942	7,030,779
Capital grants - state	3,622,105	2,547,176
Capital grants - local	-	250,000
Advance from fixed base operator	-	371,033
Passenger facility charge	568,193	559,538
Acquisition or construction of capital assets	(13,567,543)	(9,675,956)
	\$ (648,970)	\$ 1,055,903
Cash Flows from Investing Activities		
Interest on investments	\$ 6,873	\$ 8,841
	\$ (440,003)	\$ 647,867
Net Increase (Decrease) in Cash and Cash Equivalents		
	\$ 942,135	\$ 294,268
Cash and Cash Equivalents - January 1		
	\$ 502,132	\$ 942,135
Cash and Cash Equivalents - December 31	\$ 502,132	\$ 942,135

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

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

**EXHIBIT 3
(Continued)**

**COMPARATIVE STATEMENT OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2011 AND 2010**

	2011	2010
Reconciliation of Operating Income (Loss) to Net Cash		
Provided by (Used in) Operating Activities		
Operating income (loss)	\$ (5,581,294)	\$ (5,275,580)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities		
Depreciation	5,595,951	5,121,608
Amortization	133,233	104,750
Changes in assets and liabilities		
(Increase) decrease in receivables	86,712	(17,887)
(Increase) decrease in inventories	(36,684)	33,075
(Increase) decrease in prepaid items	(10,855)	997
Increase (decrease) in payables	90,381	(214,087)
Increase (decrease) in deferred revenue	(350)	(94,753)
	\$ 277,094	\$ (341,877)
Net Cash Provided by (Used in) Operating Activities	\$ 277,094	\$ (341,877)

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**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

1. Summary of Significant Accounting Policies

The accounting policies of the Duluth Airport Authority conform with generally accepted accounting principles.

A. Financial Reporting Entity

The Duluth Airport Authority was created by the Legislature of the State of Minnesota in 1969 to operate and maintain the aeronautic facilities and services in the City of Duluth. The Authority is a component unit of the City of Duluth according to criteria established by the Governmental Accounting Standards Board (GASB) for determining the financial reporting entity. Specific criteria include: the management of the Authority is vested in seven Directors appointed by the Mayor of Duluth and approved by the City Council, and the City Council approves the budget of the Authority.

B. Basis of Presentation

The accounts of the Duluth Airport Authority are presented as an enterprise fund. Enterprise funds are used to 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.

Enterprise funds distinguish operating revenues from nonoperating items. Operating revenues generally result from providing and delivering services in connection with a principal ongoing activity. The principal operating revenues of the Authority are charges to customers for the use and lease of airport facilities. All revenues not meeting this definition are reported as nonoperating revenues.

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 GASB Statement 20, the Authority has elected to not apply accounting standards issued after November 30, 1989, by the Financial Accounting Standards Board.

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

D. Budget

The Authority adopts an annual budget, which is approved by the Duluth City Council. The budget is prepared on the accrual basis of accounting.

E. Cash and Cash Equivalents

Cash and cash equivalents consist of cash and investments held by the Duluth City Treasurer. Investments are stated at fair value. 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.

F. Accounts Receivable

Amounts due from individuals and organizations are recorded as receivables at year-end. These include amounts owed pursuant to lease agreements.

G. Inventory

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

H. Restricted Assets

Monies restricted for the payment of construction contracts and passenger facility charge revenues 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.

I. Capital Assets

Purchased or constructed capital assets are stated at cost. Donated capital assets are stated at their estimated fair value at the time of the donation. The Authority's policy is to capitalize assets with a useful life of one year or more and a minimum cost of \$5,000.

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

J. Depreciation

Depreciation of capital assets is determined using the straight-line method. The estimated useful lives of the assets are:

<u>Classification</u>	<u>Years</u>
Runways	15
Buildings	30
Equipment	5 to 10

K. Other Assets

Airport planning costs and lease buyout costs are being amortized by the straight-line method over 10 to 20 years.

L. Deferred Revenue

Amounts received as advance payments for construction, rentals, and commissions are reported as deferred revenue until they are earned.

M. Passenger Facility Charges

The Duluth Airport Authority has been authorized by the Federal Aviation Administration to collect passenger facility charges to finance capital improvements at Duluth International Airport and Duluth Sky Harbor Airport.

N. 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.

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes

A. Deposits and Investments

The Authority and the City Council of Duluth are authorized by Minn. Stat. §§ 118A.02 and 118A.04 to designate a depository of public funds and to invest in certificates of deposit. Minnesota statutes require that all Authority deposits be covered by insurance, surety bond, or collateral.

The Authority may invest in the types of securities authorized by Minn. Stat. §§ 118A.04 and 118A.05.

Additional disclosures, as required by GASB Statement No. 3, *Deposits with Financial Institutions, Investments (Including Repurchase Agreements), and Reverse Repurchase Agreements*, and GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, are disclosed on an entity-wide basis in the City of Duluth's Comprehensive Annual Financial Report. The Duluth Airport Authority is a component unit of the City of Duluth.

The following is a summary of the Authority's cash:

	December 31	
	2011	2010
City's pooled cash and investments	\$ 96,177	\$ 512,872
Authority's checking accounts	405,836	429,013
Petty cash funds	119	250
Total	\$ 502,132	\$ 942,135
Detail as shown on Comparative Balance Sheet		
Current assets		
Cash and cash equivalents	\$ 169,136	\$ 632,306
Assets restricted for construction		
Cash and cash equivalents	332,996	309,829
Total Cash and Cash Equivalents	\$ 502,132	\$ 942,135

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes (Continued)

B. Capital Assets

A summary of changes in capital assets at December 31, 2011 and 2010, follows:

	Balance January 1, 2011	Increase	Decrease	Transfers/ Reclassifications	Balance December 31, 2011
Capital assets not depreciated					
Land	\$ 3,361,434	\$ -	\$ -	\$ -	\$ 3,361,434
Construction in progress	11,549,516	13,504,022	-	(7,637,263)	17,416,275
Total capital assets not depreciated	\$ 14,910,950	\$ 13,504,022	\$ -	\$ (7,637,263)	\$ 20,777,709
Capital assets depreciated					
Buildings	\$ 35,985,220	\$ 776,100	\$ -	\$ 745,051	\$ 37,506,371
Runways	77,145,495	5,600	-	3,021,708	80,172,803
Equipment	6,598,990	277,357	201,380	3,330,027	10,004,994
Total capital assets depreciated	\$ 119,729,705	\$ 1,059,057	\$ 201,380	\$ 7,096,786	\$ 127,684,168
Less: accumulated depreciation for					
Buildings	\$ 11,652,926	\$ 1,061,286	\$ -	\$ -	\$ 12,714,212
Runways	38,671,264	3,968,557	-	-	42,639,821
Equipment	4,507,921	566,108	182,356	-	4,891,673
Total accumulated depreciation	\$ 54,832,111	\$ 5,595,951	\$ 182,356	\$ -	\$ 60,245,706
Total capital assets depreciated, net	\$ 64,897,594	\$ (4,536,894)	\$ 19,024	\$ 7,096,786	\$ 67,438,462
Capital Assets, Net	\$ 79,808,544	\$ 8,967,128	\$ 19,024	\$ (540,477)	\$ 88,216,171

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes

B. Capital Assets (Continued)

	Balance January 1, 2010	Increase	Decrease	Transfers/ Reclassifications	Balance December 31, 2010
Capital assets not depreciated					
Land	\$ 3,361,434	\$ -	\$ -	\$ -	\$ 3,361,434
Construction in progress	11,661,797	10,325,285	-	(10,437,566)	11,549,516
Total capital assets not depreciated	\$ 15,023,231	\$ 10,325,285	\$ -	\$ (10,437,566)	\$ 14,910,950
Capital assets depreciated					
Buildings	\$ 32,039,713	\$ 56,436	\$ -	\$ 3,889,071	\$ 35,985,220
Runways	70,605,596	-	-	6,539,899	77,145,495
Equipment	6,617,801	-	18,811	-	6,598,990
Total capital assets depreciated	\$ 109,263,110	\$ 56,436	\$ 18,811	\$ 10,428,970	\$ 119,729,705
Less: accumulated depreciation for					
Buildings	\$ 10,627,091	\$ 1,025,835	\$ -	\$ -	\$ 11,652,926
Runways	34,904,279	3,766,985	-	-	38,671,264
Equipment	4,197,104	328,788	17,971	-	4,507,921
Total accumulated depreciation	\$ 49,728,474	\$ 5,121,608	\$ 17,971	\$ -	\$ 54,832,111
Total capital assets depreciated, net	\$ 59,534,636	\$ (5,065,172)	\$ 840	\$ 10,428,970	\$ 64,897,594
Capital Assets, Net	\$ 74,557,867	\$ 5,260,113	\$ 840	\$ (8,596)	\$ 79,808,544

Transfers and reclassifications for 2011 and 2010 do not net out to zero because there was construction in progress transferred to "Other Assets - Airport Planning Costs" which is not included on this summary (\$540,477 in 2011 and \$8,596 in 2010).

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes

B. Capital Assets (Continued)

As of December 31, 2011, the Authority had the following commitments with respect to unfinished construction projects:

Projects	Remaining Construction Commitment
AIP 48	\$ 793,451
AIP 49	241,160
AIP 50	579,844
AIP 51	3,786,067
AIP 52	894,671
AIP 53	764,522
SP 6901-162	690,100
SP 6901-165	1,809,343
SP 6901-168	2,029,381
Transportation Security Administration	1,693,751
Total	\$ 13,282,290

As of December 31, 2010, the Authority had the following commitments with respect to unfinished construction projects:

Projects	Remaining Construction Commitment
AIP 45	\$ 152,344
AIP 47	450,785
AIP 48	3,746,900
AIP 49	1,943,453
SP 6901-162	1,191,678
SP 6901-165	1,883,624
North Business Development Area	195,484
Total	\$ 9,564,268

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes (Continued)

C. Vacation and Sick Leave

Full-time employees are granted from 12 to 28 days of vacation time per year depending on their years of service. Maximum amounts of vacation time that can be accumulated range from 18 to 42 days. Unpaid vacation time earned at year-end is recognized as a liability in the financial statements. Sick leave is accrued by employees at the rate of 4 hours per pay period and may be accumulated to a maximum of 120 days, 60 days, or 30 days, depending on the employee's start date. Sick leave is recorded as an expense when paid. Employees are not compensated for unused sick leave. Any liability for earned, unused sick leave is not recognized in the financial statements.

D. Leases

The Authority leases space and other facilities under various rates and terms. All such leases are considered to be operating leases.

Minimum future rents receivable on noncancelable leases are:

2012	\$	125,408
2013		124,180
2014		123,001
2015		123,001
2016		123,001
After 2016		<u>1,538,523</u>
Total	\$	<u>2,157,114</u>

Contingent rental income from operating leases for 2011 and 2010 was \$294,551 and \$415,139, respectively.

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes (Continued)

E. Budgets

The Duluth Airport Authority adopts a budget to be approved by the Duluth City Council. A summary of the operating budget for the fiscal years ended December 31, 2011 and 2010, is:

	2011		Variance Favorable (Unfavorable)
	Budget	Actual	
Operating Revenues			
Charges for services	\$ 3,505,600	\$ 3,644,913	\$ 139,313
Operating Expenses			
Personal services	\$ 1,703,800	\$ 1,487,320	\$ 216,480
Supplies	175,000	76,407	98,593
Utilities	500,000	589,256	(89,256)
Other services and charges	1,190,200	1,344,040	(153,840)
Depreciation	4,830,000	5,595,951	(765,951)
Amortization	120,000	133,233	(13,233)
Total Operating Expenses	\$ 8,519,000	\$ 9,226,207	\$ (707,207)
Net Operating Income (Loss)	\$ (5,013,400)	\$ (5,581,294)	\$ (567,894)
Nonoperating Revenues (Expenses)			
Investment earnings	\$ 15,000	\$ 6,873	\$ (8,127)
Passenger facility charge	600,000	563,245	(36,755)
Gain (loss) on disposal of capital assets	-	8,441	8,441
Interest expense	(50,281)	(51,550)	(1,269)
Total Nonoperating Revenues (Expenses)	\$ 564,719	\$ 527,009	\$ (37,710)
Net Income (Loss) Before Capital Contributions	\$ (4,448,681)	\$ (5,054,285)	\$ (605,604)
Capital Contributions			
Capital grants - federal	\$ 12,138,755	\$ 8,778,088	\$ (3,360,667)
Capital grants - state	6,929,890	3,597,579	(3,332,311)
Contributed capital	-	1,047,357	1,047,357
Total Capital Contributions	\$ 19,068,645	\$ 13,423,024	\$ (5,645,621)
Change in Net Assets	\$ 14,619,964	\$ 8,368,739	\$ (6,251,225)

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes

E. Budgets (Continued)

	2010		Variance Favorable (Unfavorable)
	Budget	Actual	
Operating Revenues			
Charges for services	\$ 3,258,500	\$ 3,607,373	\$ 348,873
Operating Expenses			
Personal services	\$ 1,655,400	\$ 1,521,869	\$ 133,531
Supplies	190,000	77,449	112,551
Utilities	500,000	579,672	(79,672)
Other services and charges	1,004,800	1,477,605	(472,805)
Depreciation	4,500,000	5,121,608	(621,608)
Amortization	125,000	104,750	20,250
Total Operating Expenses	\$ 7,975,200	\$ 8,882,953	\$ (907,753)
Net Operating Income (Loss)	\$ (4,716,700)	\$ (5,275,580)	\$ (558,880)
Nonoperating Revenues (Expenses)			
Investment earnings	\$ 25,000	\$ 8,841	\$ (16,159)
Passenger facility charge	550,000	582,047	32,047
Gain (loss) on disposal of capital assets	-	(791)	(791)
Interest expense	(41,327)	(45,772)	(4,445)
Total Nonoperating Revenues (Expenses)	\$ 533,673	\$ 544,325	\$ 10,652
Net Income (Loss) Before Capital Contributions	\$ (4,183,027)	\$ (4,731,255)	\$ (548,228)
Capital Contributions			
Capital grants - federal	\$ 9,021,500	\$ 6,803,173	\$ (2,218,327)
Capital grants - state	1,770,600	3,084,243	1,313,643
Contributed capital	-	35,598	35,598
Total Capital Contributions	\$ 10,792,100	\$ 9,923,014	\$ (869,086)
Change in Net Assets	\$ 6,609,073	\$ 5,191,759	\$ (1,417,314)

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes (Continued)

F. Long-Term Debt

On November 1, 2005, the Authority issued an Airport Facility Revenue Note, Series 2005A, to finance the lease buyout of the Authority's Fixed Base Operator. The principal of the note is \$497,379, payable in semi-annual payments on June 1 and December 1 each year, commencing June 1, 2007, until final maturity on June 1, 2019, with an annual interest rate of 8.85 percent.

The City of Duluth obtained a loan from the Minnesota Investment Fund (MIF). Proceeds from the loan have been used to remedy soil conditions on Duluth Airport Authority property. The Duluth Airport Authority has agreed to make payments when due on the loan in the total amount of \$400,000. Payments are due in 180 monthly installments of \$2,222 from February 2006 to January 2021. There is no interest charged on this loan.

The annual requirements to service the debt follow:

Year Ended December 31	Revenue Note		MIF Loan
	Principal	Interest	Principal
2012	\$ 40,040	\$ 34,960	\$ 26,667
2013	43,662	31,338	26,667
2014	47,612	27,388	26,667
2015	51,919	23,081	26,667
2016	56,615	18,385	26,667
2017 to 2021	164,969	22,531	108,887
Total	\$ 404,817	\$ 157,683	\$ 242,222

A summary of the changes in the long-term debt follows:

	2011	2010
Balance - January 1	\$ 710,425	\$ 770,765
Additions	-	-
Payments	(63,386)	(60,340)
Balance - December 31	\$ 647,039	\$ 710,425
Due Within One Year	\$ 66,707	\$ 63,386

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

2. Detailed Notes (Continued)

G. Line of Credit

The City of Duluth extended the Duluth Airport Authority a line of credit of up to \$2,000,000 to assist in the management of cash flows in connection with the Authority's new airport terminal construction project. Interest at a rate of 4.0 percent was charged on drawn funds. In August 2011, the line of credit limit was increased to \$4,000,000, and the interest rate charged was decreased to 2.5 percent.

During 2011, draws on the line of credit were taken by the Authority totaling \$6,280,000, and repayments of \$5,655,000 were made on the draws. The remaining balance outstanding of \$625,000 is reported as Due to the City of Duluth on the Comparative Statement of Net Assets at December 31, 2011.

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 Joint Powers Enterprise Trust to provide its employees health and dental benefits. The Authority purchases commercial insurance for all other risks of loss. 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.

Employee health and dental benefits are provided through the City of Duluth Joint Powers Enterprise Trust at premium rates established by the Trust for all plan participants.

4. Major Customers

Major customers of services provided by the Duluth Airport Authority in 2011 were:

	<u>Operating Revenues</u>	<u>Percentage of Total Operating Revenues</u>
DELTA Airlines	\$ 525,765	14.4%

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

4. Major Customers (Continued)

Major customers of services provided by the Duluth Airport Authority in 2010 were:

	<u>Operating Revenues</u>	<u>Percentage of Total Operating Revenues</u>
DELTA Airlines	\$ 445,021	12.3%

5. Pension Plans

A. Plan Description

All full-time and certain part-time employees of the Duluth Airport Authority are covered by defined benefit 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. No Authority members belong to the Basic 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 (five years for those first eligible for membership after June 30, 2010). Defined retirement benefits are based on a member's average yearly salary for the five highest-paid consecutive years of allowable service, age, and years of credit at termination of service.

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

5. Pension Plans

A. Plan Description (Continued)

Two methods are used to compute benefits for Coordinated 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 is 1.2 percent of average salary for each of the first ten years of service and 1.7 percent for each successive year. Using Method 2, the annuity accrual rate is 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.

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. These statutes are established and amended by the State Legislature. The Duluth Airport Authority makes annual contributions to the pension plans equal to the amount required by state statutes. General Employees Retirement Fund Coordinated Plan members are required to contribute 6.25 percent of their annual covered salary.

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

5. Pension Plans

B. Funding Policy (Continued)

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

General Employees Retirement Fund Coordinated Plan members	7.25%
---	-------

The Authority's contributions for the years ending December 31, 2011, 2010, and 2009, for the General Employees Retirement Fund were:

<u>2011</u>	<u>2010</u>	<u>2009</u>
\$ 73,362	\$ 67,081	\$ 65,123

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

6. Other Postemployment Benefits (OPEB)

A. Plan Description and Funding Policy

The Authority provides postemployment health care benefits and term life insurance coverage in accordance with union contract or Authority policy. Union contract postemployment benefits extend to Authority employees retiring on or after January 1, 1983, who receive retirement benefits from the PERA. In addition, the Authority has extended the same postemployment benefits to Authority employees retired prior to January 1, 1983. Fifteen retirees meet these eligibility requirements.

The Authority participates in the City of Duluth Joint Powers Enterprise Trust and pays the required premiums to provide health care benefits and term life insurance for eligible retirees and claimed dependents. Health care premiums are paid by the Authority to the same extent as active employees for the life of the retiree or the surviving spouse. Life insurance premiums are also paid by the Authority for the life of the retiree. Premiums paid for eligible retirees and claimed dependents for health care insurance in 2011 totaled \$97,381. In 2010, the amount paid was \$101,547.

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

6. Other Postemployment Benefits (OPEB) (Continued)

B. Annual OPEB Cost and Net OPEB Obligation

The Authority's annual OPEB cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial accrued liabilities (or funding excess) over a period not to exceed 30 years. The following table shows the components of the Authority's annual OPEB cost for 2011, the amount actually contributed to the plan, and changes in the Authority's net OPEB obligation:

ARC	\$	207,509
Interest on net OPEB obligation		32,063
Adjustment to ARC		(39,563)

Annual OPEB cost	\$	200,009
Contributions during the year		(97,381)

Increase in net OPEB obligation	\$	102,628
Net OPEB - Beginning of Year		562,511

Net OPEB - End of Year	\$	665,139

The Authority's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2010 and 2011, were as follows:

	Fiscal Year Ended December 31	
	2010	2011
Percentage of Annual OPEB Cost Contributed	45.00%	48.69%
Annual OPEB cost	\$ 225,643	\$ 200,009
Employer contributions	101,547	97,381
Net Increase in Net OPEB Obligation	\$ 124,096	\$ 102,628

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

6. Other Postemployment Benefits (OPEB) (Continued)

C. Funded Status and Funding Progress

The actuarial accrued liability for benefits at December 31, 2011, as of the most recent actuarial valuation date, is \$1,911,042. The Authority currently has no assets that have been irrevocably deposited in a trust for future health benefits; thus, the entire amount is unfunded. The covered payroll (annual payroll of active employees covered by the plan) is \$858,000. The ratio of the unfunded actuarially accrued liabilities to covered payroll is 222.73 percent.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and health care cost trends. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The Schedule of Funding Progress - Other Postemployment Benefits, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

D. Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques that are designed to reduce the effect of short-term volatility in actuarial accrued liabilities, consistent with the long-term perspective of the calculations.

In the June 1, 2011, actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 5.7 percent discount rate, which is based on the estimated long-term investment yield on the general assets of the Authority. The annual health care cost trend rate is 10.0 percent initially, reduced incrementally to an ultimate rate of 5.0 percent after 10 years. The unfunded actuarial accrued liability is being amortized as a level dollar amount over 30 years.

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

7. Subsequent Events

In May 2012, the City of Duluth issued General Obligation Airport Improvement Bonds, Series 2012B, on behalf of the Duluth Airport Authority. The bonds have a face value of \$7,650,000 and will be repaid over a period of 15 years. Proceeds of the bonds will be used to provide the local match of federal and state grants in relation to a new terminal facility and for funding involved with a new parking ramp, access road, and aprons.

REQUIRED SUPPLEMENTARY INFORMATION

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**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

EXHIBIT A-1

**SCHEDULE OF FUNDING PROGRESS - OTHER POSTEMPLOYMENT BENEFITS
DECEMBER 31, 2011**

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded Actuarial Accrued Liability (UAAL) (b - a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a)/c)
June 1, 2011	\$ -	\$ 1,911,042	\$ 1,911,042	0.00%	\$ 858,000	222.73%
June 1, 2009	-	2,085,377	2,085,377	0.00	1,073,859	194.19
June 1, 2007	-	2,913,973	2,913,973	0.00	933,230	312.25

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**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

**NOTES TO THE SCHEDULE OF FUNDING
PROGRESS - OTHER POSTEMPLOYMENT BENEFITS
DECEMBER 31, 2011**

The Duluth Airport Authority implemented Governmental Accounting Standards Board Statement 45 for the fiscal year ended December 31, 2007.

Actuarial valuations were performed in 2007, 2009, and 2011. No valuations were performed in 2008 or 2010; therefore, funding progress information for 2008 and 2010 are not included on this schedule.

The Authority currently has no assets that have been irrevocably deposited in a trust for future health benefits. Therefore, the actuarial value of assets is zero.

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SUPPLEMENTARY INFORMATION

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**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

EXHIBIT B-1

**COMPARATIVE STATEMENT OF OPERATING REVENUES
YEARS ENDED DECEMBER 31, 2011 AND 2010**

	2011	2010
Operating Revenues		
Charges for services		
Tower building		
Space rental and services	\$ 187,801	\$ 178,956
Terminal building		
Loading bridges rent	\$ 53,859	\$ 53,859
Space rental	399,462	405,890
Utility sales	46,114	41,296
Car rental commissions	360,690	359,534
Other commissions	5,989	7,278
Percentage of lessees' sales	7,001	9,009
Other income	128,726	165,510
Total terminal building	\$ 1,001,841	\$ 1,042,376
Parking lot		
Parking lot commissions	\$ 887,378	\$ 875,091
Land, field, and runways		
Transportation Security Administration charges	\$ 73,543	\$ 88,628
State aid for maintenance and operation	168,569	222,097
Rental income	363,133	316,216
Customer facility charge	107,640	-
Fuel flowage fees	114,107	109,314
Landing fees	329,073	390,329
Percentage of lessees' sales	36,146	33,064
Utility sales	15,864	14,753
Total land, field, and runways	\$ 1,208,075	\$ 1,174,401
Hangar		
Space rental	\$ 156,939	\$ 157,238
Utility sales	21,089	41,326
Total hangar	\$ 178,028	\$ 198,564
Sky Harbor		
State aid for maintenance and operation	\$ 20,285	\$ 20,285
Rental income	32,951	29,272
Fuel sales	123,640	84,144
Percentage of lessees' sales	603	967
Other income	4,311	3,317
Total Sky Harbor	\$ 181,790	\$ 137,985
Total Operating Revenues	\$ 3,644,913	\$ 3,607,373

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

EXHIBIT C-1

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2011**

Federal Grantor Pass-Through Agency Grant Program Title	Federal CFDA Number	Pass-Through Grant Number	Expenditures
U.S. Department of Commerce			
Direct			
Public Works and Economic Development Facilities	11.300	06-01-05315	\$ 37,430
U.S. Department of Defense - National Guard Bureau			
Direct			
National Guard Military Operations and Maintenance Projects			
Military Construction Cooperative Agreement	12.401	Various	5,605
Federal Aviation Administration			
Passed Through Minnesota Department of Transportation -			
Aeronautics			
Airport Improvement Program	20.106	Various	8,557,443
U.S. Department of Homeland Security			
Direct			
Port Security Research and Development Grant	97.060	HSTS04-05-A-DEP348	177,610
Total Expenditures of Federal Awards			<u>\$ 8,778,088</u>

**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2011**

1. Reporting Entity

The Schedule of Expenditures of Federal Awards presents the activities of federal award programs expended by the Duluth Airport Authority. The Authority's reporting entity is defined in Note 1 to the financial statements.

2. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Duluth Airport Authority under programs of the federal government for the year ended December 31, 2011. The information in this schedule is presented in accordance with the requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the schedule presents only a selected portion of the operations of the Duluth Airport Authority, it is not intended to and does not present the financial position, changes in net assets, or cash flows of the Duluth Airport Authority.

3. Summary of Significant Accounting Policies

Expenditures reported on the schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through entity identifying numbers are presented where available.

4. Subrecipients

Of the expenditures presented in the schedule, the Duluth Airport Authority did not provide federal awards to any subrecipients.

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**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

EXHIBIT C-2

**SCHEDULE OF PASSENGER FACILITY CHARGES COLLECTED AND EXPENDED
FOR THE YEAR AND EACH QUARTER WITHIN THE YEAR ENDED DECEMBER 31, 2011**

	<u>Seventh Application*</u>	<u>Eighth Application**</u>	<u>Ninth Application**</u>	<u>Tenth Application**</u>
Passenger Facility Charge Collections****				
Prior to January 1, 2011	<u>\$ 2,459,884</u>	<u>\$ 519,556</u>	<u>\$ 286,620</u>	<u>\$ -</u>
Collections in 2011				
First quarter	\$ -	\$ -	\$ -	\$ 133,870
Second quarter	-	-	-	154,375
Third quarter	-	-	-	133,975
Fourth quarter	-	-	-	146,148
Adjustments ***	<u>(13,460)</u>	<u>(5,251)</u>	<u>(84,798)</u>	<u>103,509</u>
Total collections in 2011	<u>\$ (13,460)</u>	<u>\$ (5,251)</u>	<u>\$ (84,798)</u>	<u>\$ 671,877</u>
Total Collected Through December 31, 2011	\$ 2,446,424	\$ 514,305	\$ 201,822	\$ 671,877
Approved expenses through December 31, 2011	<u>(2,113,428)</u>	<u>(514,305)</u>	<u>(201,822)</u>	<u>(671,877)</u>
Unexpended Balance - December 31, 2011	<u><u>\$ 332,996</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>

*Federal Aviation Administration Record of Decision passenger facility charge effective date for Application Seven is April 1, 2005.

**Federal Aviation Administration's Acknowledgment of Intent of passenger facility charge effective date for Application Eight is September 30, 2008; Application Nine is October 1, 2010; and Application Ten is January 20, 2011.

***Adjustments in 2011 were due to changes per the final FAA closeout reports for Applications Seven, Eight, and Nine.

****Cash basis of accounting - reported when received rather than when earned in accordance with passenger facility charge reporting guidelines.

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**DULUTH AIRPORT AUTHORITY
DULUTH, MINNESOTA**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2011**

I. SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: **Unqualified**

Internal control over financial reporting:

- Material weaknesses identified? **No**
- Significant deficiency identified? **Yes**

Noncompliance material to the financial statements noted? **No**

Federal Awards

Internal control over major programs:

- Material weaknesses identified? **No**
- Significant deficiencies identified? **No**

Type of auditor's report issued on compliance for major programs: **Unqualified**

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133? **No**

The major program is:

Airport Improvement Program

CFDA #20.106

The threshold for distinguishing between Types A and B programs was \$300,000.

Duluth Airport Authority qualified as low-risk auditee? **Yes**

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEM NOT RESOLVED

06-1 Segregation of Duties

Criteria: A good system of internal control provides for an adequate segregation of duties so that no one individual handles a transaction from its inception to completion.

Condition: Due to the limited number of office personnel within the Authority, segregation of the accounting functions necessary to ensure adequate internal accounting control is not possible.

Context: This is not unusual in operations the size of the Duluth Airport Authority; however, the Authority'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.

Effect: Inadequate segregation of duties could adversely affect the Authority's ability to detect misstatements in amounts that would be material in relation to the financial statements in a timely period by employees in the normal course of performing their assigned functions.

Cause: The size of the Duluth Airport Authority and its staffing limits the internal control that management can design and implement into the organization.

Recommendation: We recommend that the Authority's management be aware of the lack of segregation of duties of the accounting functions and, where possible, implement oversight procedures to ensure that the internal control policies and procedures are being implemented by staff to the extent possible.

Client's Response:

We are aware of the limited number of personnel, and the Authority Management has implemented oversight procedures and will continue to monitor the staff to help assure controls and procedures are being followed.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

PREVIOUSLY REPORTED ITEM RESOLVED

Reporting – Investments for Public Works and Economic Development Facilities Grant (10-1)

An error was found in our testing of a Financial Status Report submitted to the U.S. Department of Commerce for the fiscal year ended September 30, 2010. On the report, cumulative outlays to date were underreported for the Investments for Public Works and Economic Development Facilities federal grant program (CFDA #11.300).

Resolution

Testing of the federal award report submitted in the current audit revealed no errors.

IV. FINDINGS - PASSENGER FACILITY CHARGE (PFC) REGULATIONS

None.

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

Mayor and City Council
City of Duluth

Board of Directors
Duluth Airport Authority

We have audited the basic financial statements of the Duluth Airport Authority, a component unit of the City of Duluth, as of and for the year ended December 31, 2011, and have issued our report thereon dated June 19, 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

Management of the Duluth Airport Authority is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Duluth Airport 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 Questioned Costs as item 06-1, 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 the Duluth Airport 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, the Duluth Airport Authority complied with the material terms and conditions of applicable legal provisions.

The Duluth Airport Authority's written response to the internal control finding identified in our audit has been included in the Schedule of Findings and Questioned Costs. We did not audit the Authority's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors, Mayor and City Council of Duluth, management, others within the Duluth Airport Authority, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

June 19, 2012

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REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 AND PASSENGER FACILITY CHARGE PROGRAMS

Mayor and City Council
City of Duluth

Board of Directors
Duluth Airport Authority

Compliance

We have audited the compliance of the Duluth Airport Authority, a component unit of the City of Duluth, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on its major federal program for the year ended December 31, 2011. The Duluth Airport Authority'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 Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We have also audited the Duluth Airport Authority's compliance with requirements applicable to its passenger facility charge (PFC) funds collected and expended for the year ended December 31, 2011. Compliance with the requirements of laws and regulations applicable to PFC funds is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority'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; OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*; and

Passenger Facility Charge Audit Guide for Public Agencies, issued by the Federal Aviation Administration. 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 or PFC program occurred. An audit includes examining, on a test basis, evidence about the Duluth Airport Authority'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 Authority's compliance with those requirements.

In our opinion, the Duluth Airport Authority complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal program and its PFC program for the year ended December 31, 2011.

Internal Control Over Compliance

Management of the Duluth Airport Authority is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs and PFC programs. In planning and performing our audit, we considered the Authority's internal control over compliance with requirements that could have a direct and material effect on a major federal program and on a PFC program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance 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 compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the Board of Directors, Mayor and City Council of Duluth, management and others within the Duluth Airport Authority, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

June 19, 2012

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR