

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, 2012 AND 2011

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.

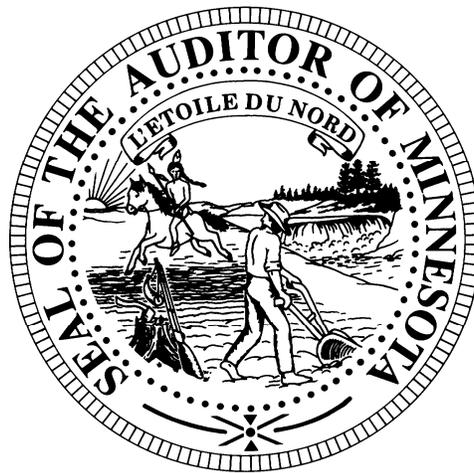
The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employees Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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

For the Years Ended April 30, 2012 and 2011



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

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

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

ORGANIZATION
APRIL 30, 2012

	<u>Term Ending</u>
Directors	
Jane Gilbert-Howard	June 30, 2012
David Kohlhaas	June 30, 2014
Will Munger	June 30, 2012
Nancy Nelson	June 30, 2012
Veronica Nelson	June 30, 2014
Dan O'Neill	June 30, 2014
Neale Roth	June 30, 2012
Cory Salmela	June 30, 2014
Todd Torvinen	June 30, 2014
Executive Director	
Renee Mattson	
Officers	
Chair	
Neale Roth	
Vice Chair	
Jane Gilbert-Howard	
Secretary	
David Kohlhaas	

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

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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, 2012 and 2011. 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, 2012 and 2011, 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 an opinion on the basic financial statements of the Spirit Mountain Recreation Area Authority. 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 presented 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 April 30, 2013, 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

April 30, 2013

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

**MANAGEMENT'S DISCUSSION AND ANALYSIS
APRIL 30, 2012
(Unaudited)**

This section presents management's analysis of the Authority's financial condition and activities for the fiscal year ended April 30, 2012. 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. That bond was paid off in December 2012.
- 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 2012, the Timber Twister grossed over \$1,098,000.

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

changes in net position presents the results of the business activities over the course of the fiscal year and information as to how the net position changed during the year. All changes in net position 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 present 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 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 forms of recreation provided to both local residents and visitors are skiing, alpine, Nordic, 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 67 wedding receptions hosted in fiscal year 2013 and an additional 40+ corporate/other events. In the summer of 2012, the Authority installed a new four-place detachable lift to replace a

similar lift and added a new chalet with a year-round bar and restaurant and a new parking lot at the Grand Avenue entrance. Additionally, two mountain bike trails were constructed, which will add lift access mountain biking to the list of summer attractions and further establish Spirit Mountain as a year-round recreational facility.

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 Position

	FY 2012	FY 2011	Change from 2011 to 2012		FY 2010
			Dollar	Percent (%)	
Current and other assets	\$ 629,473	\$ 724,744	\$ (95,271)	(13)	\$ 654,102
Capital assets	8,888,493	7,032,936	1,855,557	26	5,832,933
Total Assets	\$ 9,517,966	\$ 7,757,680	\$ 1,760,286	23	\$ 6,487,035
Current liabilities	\$ 1,402,971	\$ 935,337	\$ 467,634	50	\$ 923,757
Long-term liabilities	2,430,306	2,533,046	(102,740)	(4)	1,457,350
Total Liabilities	\$ 3,833,277	\$ 3,468,383	\$ 364,894	11	\$ 2,381,107
Net Position					
Invested	\$ 5,815,115	\$ 4,105,471	\$ 1,709,644	42	\$ 3,946,824
Restricted	-	250,000	(250,000)	(100)	250,000
Unrestricted	(130,426)	(66,174)	(64,252)	(97)	(90,896)
Total Net Position	\$ 5,684,689	\$ 4,289,297	\$ 1,395,392	33	\$ 4,105,928

As can be seen from the table, capital assets increased \$1,855,557 from 2011 to 2012 due mainly to the construction in process of the new express chair lift.

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

	FY 2012	FY 2011	Change from 2011 to 2012		FY 2010
			Dollar	Percent (%)	
Operating revenues	\$ 4,430,892	\$ 4,390,727	\$ 40,165	1	\$ 3,512,650
Non-operating revenues	1,724,293	282,763	1,441,530	510	226,145
Total Revenues	\$ 6,155,185	\$ 4,673,490	\$ 1,481,695	32	\$ 3,738,795
Operating expenses	\$ 3,992,771	\$ 3,732,472	\$ 260,299	7	\$ 3,235,339
Non-operating expenses	126,269	121,661	4,608	4	62,268
Depreciation/amortization	640,753	635,988	4,765	-	524,022
Total Expenses	\$ 4,759,793	\$ 4,490,121	\$ 269,672	6	\$ 3,821,629
Changes in Net Position	\$ 1,395,392	\$ 183,369	\$ 1,212,023	661	\$ (82,834)
Beginning Net Position	4,289,297	4,105,928	183,369	5	4,188,762
Ending Net Position	<u>\$ 5,684,689</u>	<u>\$ 4,289,297</u>	<u>\$ 1,395,392</u>	<u>33</u>	<u>\$ 4,105,928</u>

**Condensed Statements of Revenues, Expenses, and Changes in Net Position
(2012 Budget and Actual)**

	Actual	Budget	Budget to Actual Variance	Budget % Variance
Operating revenues	\$ 4,430,892	\$ 5,046,662	\$ (615,770)	(12)
Non-operating revenues	1,724,293	351,500	1,372,793	391
Total Revenues	\$ 6,155,185	\$ 5,398,162	\$ 757,023	14
Operating expenses	\$ 3,992,771	\$ 4,147,441	\$ (154,670)	(4)
Non-operating expenses	126,269	140,142	(13,873)	(10)
Depreciation/amortization	640,753	529,560	111,193	21
Total Expenses	\$ 4,759,793	\$ 4,817,143	\$ (57,350)	(1)
Changes in Net Position	\$ 1,395,392	\$ 581,019	\$ 814,373	140
Beginning Net Position	4,289,297	4,289,297	-	-
Ending Net Position	<u>\$ 5,684,689</u>	<u>\$ 4,870,316</u>	<u>\$ 814,373</u>	<u>17</u>

Revenues

The Authority earns operating revenues in both winter and summer. Operating revenues increased \$40,165, or 1 percent, in 2012 compared to 2011. Nonoperating revenues increased \$1,441,530, or 510 percent, in 2012 compared to 2011 due mainly to bond proceeds received by the City of Duluth to construct a new express lift.

Expenses

The Authority's operating expenses increased \$260,299, or 7 percent, from 2011 due mainly to an increase in utilities, salaries and wages, and associated costs resulting from the increase in year-round operations. Worker's comp expense more than tripled from 2011 to 2012 as a result of being taken off the City of Duluth self-insurance plan.

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.

Nonoperating revenues significantly exceeded budgeted projections due to capital contributions being received from the City of Duluth for the construction of the new ski lift and the Grand Avenue Chalet.

CAPITAL ASSETS

	FY 2012	FY 2011	Change	
			Dollar	Percent (%)
Land	\$ 2,466,253	\$ 2,466,253	\$ -	-
Equipment	9,320,983	8,576,478	744,505	9
Plant equipment	863,026	826,566	36,460	4
Building and improvements	4,514,037	4,234,272	279,765	7
Furniture and fixtures	256,675	250,622	6,053	2
Other capital assets	724,388	724,388	-	-
Work in progress	1,440,249	76,949	1,363,300	1772
Subtotal	\$ 19,585,611	\$ 17,155,528	\$ 2,430,083	14
Less: accumulated depreciation	(10,697,118)	(10,122,592)	(574,526)	(6)
Net Property and Equipment	\$ 8,888,493	\$ 7,032,936	\$ 1,855,557	26

By the end of fiscal year 2012, the Authority had invested \$19.58 million in capital assets. The \$1,855,557 cumulative increase in equipment, buildings and improvements, and other capital assets is mainly due to the construction in process of the new express chair lift and the new chalet.

The Authority's ongoing capital plan improvements are made with the long-term goals of the Spirit Mountain Master Plan in mind. During 2012, these upgrades/improvements included a major project with the construction of the Timber Flyer Zip Line, a 9-hole miniature golf course, and a 4-lane snow tubing hill. Building new attractions 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 a new grand vestibule entrance on the original chalet to make the entry more prominent and new carpet tile throughout the second floor of the Moosehead Chalet, in addition to numerous small but necessary improvement projects. As always, we continue to seek ways to streamline the operation, find efficiencies, and provide the best possible guest experience.

Debt Administration

	FY 2012	FY 2011	Change	
			Dollar	Percent (%)
Alpine Coaster lease	\$ 2,120,904	\$ 2,235,851	\$ (114,947)	(5)
Groomer lease	130,406	220,918	(90,512)	(41)
Lease/leaseback (revenue bonds)	212,445	420,809	(208,364)	(49)
Zip/Tube/Golf lease	530,289	-	530,289	100
Rental lease	79,334	143,544	(64,210)	(45)
Total Debt	<u>\$ 3,073,378</u>	<u>\$ 3,021,122</u>	<u>\$ 52,256</u>	2

At the end of fiscal year 2012, the Authority's outstanding debt increased \$52,256 due to the addition of the Zip Line, snow tubing hill, and a 9-hole miniature golf course.

ECONOMIC AND OTHER FACTORS

The Authority must consider many factors when setting the fiscal year 2013 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. The winter of 2011/2012 saw a dramatic lack of snow throughout North America and an industry average of 16.3 percent loss of projected revenues for ski resorts. To boost revenues and encourage continued ski/board activity, Spirit Mountain offered an aggressively priced season pass and was successful in maintaining a large season pass base. 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 Adventure Park 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 Adventure Park 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 as the number of events grows annually. With the addition of the new Grand Avenue Chalet, we have created a new neighborhood gathering spot and as such have seen new banquet business in that facility as well. 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 successful winter and summer seasons.

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.

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BASIC FINANCIAL STATEMENTS

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

EXHIBIT 1

**COMPARATIVE STATEMENT OF NET POSITION
APRIL 30, 2012 AND 2011**

	2012	2011
Assets		
Current assets		
Cash and cash equivalents	\$ 240,970	\$ 91,816
Accounts receivable	103,596	57,004
Inventory	117,324	102,958
Prepaid items	-	27,057
Restricted assets		
Cash and cash equivalents - restricted for capital improvements	-	225,000
Total current assets	\$ 461,890	\$ 503,835
Noncurrent assets		
Cash and cash equivalents - restricted for workers' compensation claims	\$ -	\$ 25,000
Planning and development costs - net of accumulated amortization	167,583	195,259
Debt issuance costs - net of accumulated amortization	-	650
Total noncurrent assets, other than capital	\$ 167,583	\$ 220,909
Capital assets		
Non-depreciable	\$ 3,906,502	\$ 2,543,202
Depreciable	15,679,109	14,612,326
Less: allowance for depreciation	(10,697,118)	(10,122,592)
Total capital assets - net of accumulated depreciation	\$ 8,888,493	\$ 7,032,936
Total noncurrent assets	\$ 9,056,076	\$ 7,253,845
Total Assets	\$ 9,517,966	\$ 7,757,680

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

**EXHIBIT 1
(Continued)**

**COMPARATIVE STATEMENT OF NET POSITION
APRIL 30, 2012 AND 2011**

	2012	2011
Liabilities		
Current liabilities		
Accounts payable	\$ 59,911	\$ 63,564
Due to City of Duluth	174,239	134,407
Due to other governments	12,916	2,994
Accrued salaries payable	22,637	34,210
Accrued vacation payable	78,481	74,963
Accrued interest payable	8,145	11,643
Leases payable	430,627	279,712
Revenue bonds payable	212,445	208,364
Deferred revenue	403,570	125,480
Total current liabilities	\$ 1,402,971	\$ 935,337
Noncurrent liabilities		
Leases payable	\$ 2,430,306	\$ 2,320,601
Revenue bonds payable	-	212,445
Total noncurrent liabilities	\$ 2,430,306	\$ 2,533,046
Total Liabilities	\$ 3,833,277	\$ 3,468,383
Net Position		
Invested in capital assets - net of related debt	\$ 5,815,115	\$ 4,105,471
Restricted for capital improvements	-	225,000
Restricted for workers' compensation claims	-	25,000
Unrestricted	(130,426)	(66,174)
Total Net Position	\$ 5,684,689	\$ 4,289,297

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

EXHIBIT 2

**COMPARATIVE STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEARS ENDED APRIL 30, 2012 AND 2011**

	2012	2011
Operating Revenues		
Sales	\$ 965,357	\$ 1,075,069
Less: cost of goods sold	(396,195)	(416,922)
Gross profit on sales	\$ 569,162	\$ 658,147
Charges for services	3,775,127	3,657,236
Miscellaneous	86,603	75,344
Total Operating Revenues	\$ 4,430,892	\$ 4,390,727
Operating Expenses		
Personal services	\$ 2,419,397	\$ 2,188,645
Supplies	283,935	287,107
Utilities	423,818	408,040
Other services and charges	865,621	848,680
Amortization	28,327	28,652
Depreciation	612,426	607,336
Total Operating Expenses	\$ 4,633,524	\$ 4,368,460
Operating Income (Loss)	\$ (202,632)	\$ 22,267
Nonoperating Revenues (Expenses)		
Earnings on investments	\$ 1,558	\$ 1,137
Grant revenue	40,000	-
Tourism tax	350,000	275,000
Gain (loss) on sale or disposition of capital assets - net	11,000	1,483
Forest management plan	-	5,143
Capital contributions from City of Duluth	1,321,735	-
Interest expense	(126,269)	(121,661)
Total Nonoperating Revenues (Expenses)	\$ 1,598,024	\$ 161,102
Change in Net Position	\$ 1,395,392	\$ 183,369
Net Position - May 1	4,289,297	4,105,928
Net Position - April 30	\$ 5,684,689	\$ 4,289,297

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

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

EXHIBIT 3

**COMPARATIVE STATEMENT OF CASH FLOWS
YEARS ENDED APRIL 30, 2012 AND 2011**

	2012	2011
Cash Flows from Operating Activities		
Cash received from customers	\$ 4,943,044	\$ 4,642,324
Cash paid to suppliers	(1,881,839)	(1,939,678)
Cash paid to employees	(2,427,452)	(2,187,202)
Other cash received	86,603	75,344
Net cash provided by (used in) operating activities	\$ 720,356	\$ 590,788
Cash Flows from Capital and Related Financing Activities		
Capital grants	\$ 40,000	\$ -
Capital contributions from the City of Duluth	1,321,735	-
Proceeds from sale of capital assets	11,000	-
Capital lease payments	(327,512)	(285,762)
Acquisition and construction of capital assets	(1,867,983)	(228,669)
Net cash provided by (used in) capital and related financing activities	\$ (822,760)	\$ (514,431)
Cash Flows from Investing Activities		
Interest on investments	\$ 1,558	\$ 1,137
Net Increase (Decrease) in Cash and Cash Equivalents	\$ (100,846)	\$ 77,494
Cash and Cash Equivalents - May 1	341,816	264,322
Cash and Cash Equivalents - April 30	\$ 240,970	\$ 341,816
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities		
Net operating income (loss)	\$ (202,632)	\$ 22,267
Adjustments to reconcile net operating income (loss) to net cash provided by (used in) operating activities		
Depreciation	612,426	607,336
Amortization	28,327	28,652
Change in assets and liabilities		
Decrease (increase) in receivables	(46,592)	(8,977)
Decrease (increase) in inventory	(14,366)	8,687
Decrease (increase) in prepaid items	27,057	(21,511)
Increase (decrease) in accounts payable	46,101	(20,216)
Increase (decrease) in salaries payable	(11,573)	(6,697)
Increase (decrease) in vacation payable	3,518	8,140
Increase (decrease) in deferred revenue	278,090	(26,893)
Net Cash Provided by (Used in) Operating Activities	\$ 720,356	\$ 590,788

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

***EXHIBIT 3
(Continued)***

**COMPARATIVE STATEMENT OF CASH FLOWS
YEARS ENDED APRIL 30, 2012 AND 2011**

	<u>2012</u>	<u>2011</u>
Noncash Investing, Capital, and Financing Activities		
Capital assets acquired under lease purchase agreements	\$ 600,000	\$ 1,587,016

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.

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

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED APRIL 30, 2012 AND 2011**

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. The Authority has implemented Governmental Accounting Standards Board (GASB) Statements No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements and No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.

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 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, 2012 and 2011, follows:

	2012		Variance Favorable (Unfavorable)
	Budget	Actual	
Operating Revenues			
Sales	\$ 1,047,026	\$ 965,357	\$ (81,669)
Less: cost of goods sold	(389,247)	(396,195)	(6,948)
Gross profit on sales	\$ 657,779	\$ 569,162	\$ (88,617)
Charges for services	4,324,363	3,775,127	(549,236)
Miscellaneous	64,520	86,603	22,083
Total Operating Revenues	\$ 5,046,662	\$ 4,430,892	\$ (615,770)

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

2. Detailed Notes

A. Budget (Continued)

	2012		Variance Favorable (Unfavorable)
	Budget	Actual	
Operating Expenses			
Personal services	\$ 2,499,345	\$ 2,419,397	\$ 79,948
Supplies	278,989	283,935	(4,946)
Utilities	393,044	423,818	(30,774)
Other services and charges	976,063	865,621	110,442
Amortization	28,653	28,327	326
Depreciation	500,907	612,426	(111,519)
Total Operating Expenses	<u>\$ 4,677,001</u>	<u>\$ 4,633,524</u>	<u>\$ 43,477</u>
Operating Income (Loss)	<u>\$ 369,661</u>	<u>\$ (202,632)</u>	<u>\$ (572,293)</u>
Nonoperating Revenues (Expenses)			
Earnings on investments	\$ 1,500	\$ 1,558	\$ 58
Grant revenue	-	40,000	40,000
Tourism tax	350,000	350,000	-
Gain (loss) on sale or disposition of capital assets - net	-	11,000	11,000
Capital contributions from City of Duluth	-	1,321,735	1,321,735
Interest expense	(140,142)	(126,269)	13,873
Total Nonoperating Revenues (Expenses)	<u>\$ 211,358</u>	<u>\$ 1,598,024</u>	<u>\$ 1,386,666</u>
Change in Net Position	<u>\$ 581,019</u>	<u>\$ 1,395,392</u>	<u>\$ 814,373</u>

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

2. Detailed Notes

A. Budget (Continued)

	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
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 Position	\$ 314,878	\$ 183,369	\$ (131,509)

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

2. Detailed Notes (Continued)

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.

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	
	2012	2011
City Treasurer	\$ 227,045	\$ 327,391
Petty cash and change funds	13,925	14,425
Total Cash and Cash Equivalents	\$ 240,970	\$ 341,816
Current assets		
Unrestricted	\$ 240,970	\$ 91,816
Restricted for capital improvements	-	225,000
Noncurrent assets		
Restricted for workers' compensation claims	-	25,000
Total Cash and Cash Equivalents	\$ 240,970	\$ 341,816

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

2. Detailed Notes (Continued)

C. Capital Assets

A summary of the changes in capital assets for the years ended April 30, 2012 and 2011, follows:

	Balance May 1, 2011	Additions	Deductions	Reclassification	Balance April 30, 2012
Capital assets not depreciated					
Land and land improvements	\$ 2,466,253	\$ -	\$ -	\$ -	\$ 2,466,253
Construction in progress	76,949	1,718,266	-	(354,966)	1,440,249
Total capital assets not depreciated	\$ 2,543,202	\$ 1,718,266	\$ -	\$ (354,966)	\$ 3,906,502
Capital assets depreciated					
Buildings and structures	\$ 4,234,272	\$ 40,480	\$ -	\$ 239,285	\$ 4,514,037
Equipment	9,403,044	703,184	37,900	115,681	10,184,009
Furniture and fixtures	250,622	6,053	-	-	256,675
Other capital assets	724,388	-	-	-	724,388
Total capital assets depreciated	\$ 14,612,326	\$ 749,717	\$ 37,900	\$ 354,966	\$ 15,679,109
Less: accumulated depreciation for					
Buildings and structures	\$ 2,919,668	\$ 162,274	\$ -	\$ -	\$ 3,081,942
Equipment	6,637,722	397,741	37,900	-	6,997,563
Furniture and fixtures	215,515	10,108	-	-	225,623
Other capital assets	349,687	42,303	-	-	391,990
Total accumulated depreciation	\$ 10,122,592	\$ 612,426	\$ 37,900	\$ -	\$ 10,697,118
Total capital assets depreciated, net	\$ 4,489,734	\$ 137,291	\$ -	\$ 354,966	\$ 4,981,991
Capital Assets, Net	\$ 7,032,936	\$ 1,855,557	\$ -	\$ -	\$ 8,888,493

	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
Capital assets depreciated					
Buildings and structures	\$ 4,036,074	\$ -	\$ -	\$ 198,198	\$ 4,234,272
Equipment	7,400,410	-	12,387	2,015,021	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	\$ 12,080,469	\$ -	\$ 12,387	\$ 2,544,244	\$ 14,612,326

**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
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>\$ (607,336)</u>	<u>\$ -</u>	<u>\$ 2,544,244</u>	<u>\$ 4,489,734</u>
Capital Assets, Net	<u>\$ 5,832,933</u>	<u>\$ 1,200,003</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,032,936</u>

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, 2012 and 2011, is \$78,481 and \$74,963, 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.

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

2. Detailed Notes (Continued)

E. Due to City of Duluth

The amounts due to the City at April 30, 2012 and 2011, follow:

	<u>2012</u>	<u>2011</u>
General Fund - sales tax	\$ 4,239	\$ 2,407
General Fund - line of credit	<u>170,000</u>	<u>132,000</u>
Total	<u>\$ 174,239</u>	<u>\$ 134,407</u>

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 to assist in the management of cash flows. The amounts withdrawn need to be repaid in full at least once per calendar year. On November 23, 2011, the City of Duluth passed resolution 11-0648R changing the date when the line of credit is to be repaid in full each year from October 31 each year, to December 31 to better match the seasonal cash flow needs of the Authority. The Authority repaid the City Treasurer the outstanding balance of \$170,000 in full on December 31, 2012.

Changes in line of credit balance for the years ending December 31, 2012 and 2011, were:

	<u>2012</u>	<u>2011</u>
Beginning	\$ 132,000	\$ -
Draws	170,000	132,000
Repayments	<u>132,000</u>	<u>-</u>
Ending	<u>\$ 170,000</u>	<u>\$ 132,000</u>

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

2. Detailed Notes (Continued)

F. Long-Term Debt

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

	<u>2012</u>	<u>2011</u>
Bonds Payable - May 1	\$ 420,809	\$ 620,104
Payments	<u>(208,364)</u>	<u>(199,295)</u>
Bonds Payable - April 30	<u>\$ 212,445</u>	<u>\$ 420,809</u>
Amount Due Within One Year	<u>\$ 212,445</u>	<u>\$ 208,364</u>

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.

The Duluth City Council approved Resolution 12-0143 on April 9, 2012, to allow the \$225,000 in the restricted repair and replacement account to be made available for general operating expenses as needed by the authority. Construction of the new chalet on Grand Avenue and acquisition of a new ski lift together with other improvements have been determined to fulfill the obligation of the authority to expend monies for repairs and replacements to the recreation facilities. The repair and replacement account was funded in 2012 through \$350,000 of tourism tax proceeds allocated to the Authority by the City of Duluth Council through resolution on November 15, 2012.

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

2. Detailed Notes

F. Long-Term Debt (Continued)

The annual requirements to service the debt follow:

Fiscal Year Ended April 30	Principal	Interest
2013	\$ 212,445	\$ 7,154

G. Pledge Agreement with City of Duluth

On February 23, 2012, the City of Duluth issued General Obligation Tax Abatement Bonds, Series 2012A, in the amount of \$7,055,000. The proceeds from these bonds will be used to finance capital improvements to the Spirit Mountain Recreation Area Authority, including lift improvements, parking lot improvements, and a new chalet on Grand Avenue.

The Authority entered into a pledge agreement with the City of Duluth dated February 23, 2012. Under this agreement, the City has pledged tax abatement revenue for paying the principal and interest on the bonds, but the City's and Authority's plan of finance for the project is for the City to provide \$500,000 per year of tourism taxes toward the repayment of the bond principal and interest, and the Authority pledge operating revenues to pay the balance of the principal and interest owed each year until the bond is paid off in 2030.

H. Contract Commitments

The Authority was in the process of constructing a new chalet and a new ski lift at year-end. As of April 30, 2012, the Authority had the following contract commitments with respect to these projects:

Grand Avenue Chalet	\$	3,392,349
Ski lift		2,234,768
Total Contract Commitments	\$	5,627,117

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

2. Detailed Notes (Continued)

I. Capitalized Lease Obligations

Capitalized lease obligations consist of the following at April 30, 2012:

Type of Property		
Equipment	\$	3,342,943
Less: accumulated amortization		(652,617)
Net Capital Lease Property	\$	2,690,326

Minimum future lease payments follow:

Fiscal Year Ended April 30	Principal	Interest
2013	\$ 430,627	\$ 110,184
2014	295,762	93,647
2015	270,425	81,941
2016	281,528	70,502
2017	175,508	60,909
2018 - 2022	860,725	205,314
2023 - 2025	546,358	34,046
Total	\$ 2,860,933	\$ 656,543

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

2. Detailed Notes

I. Capitalized Lease Obligations (Continued)

Capitalized lease obligations at April 30, 2012, 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.	\$ 79,334
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.	130,406
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.	2,120,904
A \$600,000 lease purchase for purchase, design, and installation of a zip line, tubing hill, and mini golf course, dated June 1, 2011, due in periodic installments commencing October 1, 2011, through June 1, 2016, with interest at 4.05 percent.	<u>530,289</u>
Total	<u>\$ 2,860,933</u>
Current portion	\$ 430,627
Long-term portion	<u>2,430,306</u>
Total	<u>\$ 2,860,933</u>

J. Operating Lease

The Authority is obligated under an operating lease for office equipment. Lease expense for fiscal year 2012 is \$5,335 and \$5,523 for fiscal year 2011. The future minimum rental payments, which are not reported as liabilities in the financial statements at April 30, 2012, are \$5,335 due in fiscal year 2013.

K. 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.

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

2. Detailed Notes

K. Mountain Villas Agreements (Continued)

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.

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. 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.

4. Defeased Debt

On March 31, 2003, the City of Duluth issued a Gross Revenue Recreational Facility Bond, with an interest rate of 4.5 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.

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

4. Defeased Debt (Continued)

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. 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 (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.

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.

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

5. Pension Plans - Defined Benefit Plans

A. Plan Description (Continued)

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 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 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 2011 and 2012:

	<u>2011</u>	<u>2012</u>
General Employees Retirement Fund		
Basic Plan members	11.78%	11.78%
Coordinated Plan members	7.25	7.25

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

5. Pension Plans - Defined Benefit Plans

B. Funding Policy (Continued)

The Authority's contributions for the years ending April 30, 2012, 2011, and 2010, for the General Employees Retirement Fund were:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
General Employees Retirement Fund	\$ 94,435	\$ 81,230	\$ 71,628

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

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SUPPLEMENTARY INFORMATION

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

EXHIBIT A-1

**COMPARATIVE STATEMENT OF OPERATING REVENUES
YEARS ENDED APRIL 30, 2012 AND 2011**

	2012	2011
Sales		
Food	\$ 574,369	\$ 622,309
Liquor	287,706	302,291
Ski shop	103,282	150,469
Less: cost of goods sold	(396,195)	(416,922)
Net sales	\$ 569,162	\$ 658,147
Charges for Services		
Season pass	\$ 974,256	\$ 1,102,872
Daily lift tickets	893,407	957,284
Alpine coaster	1,098,170	736,342
Ski school and snow sports	135,577	127,015
Ski rental	219,991	228,520
Snowboard rental	68,775	85,289
Locker rental	25,009	25,260
Nordic tickets and rental	3,060	12,405
Snocross	127,521	145,244
Campground	110,203	114,680
Mountain Villas management fee	98,608	97,975
Marketing revenue	20,550	24,350
Total charges for services	\$ 3,775,127	\$ 3,657,236
Miscellaneous		
Other revenues	\$ 86,603	\$ 75,344
Total Operating Revenues	\$ 4,430,892	\$ 4,390,727

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

EXHIBIT A-2

**COMPARATIVE STATEMENT OF OPERATING EXPENSES
YEARS ENDED APRIL 30, 2012 AND 2011**

	2012	2011
Department		
Food and beverage	\$ 333,345	\$ 344,027
Housekeeping	86,497	100,244
Rental	69,837	71,000
Ski shop	36,126	38,230
Campground	87,980	96,534
Parking and shuttle	21,600	26,041
Building and grounds	249,386	249,604
Snocross	132,006	143,906
Ski school and snow sports center	122,213	97,893
Outside mountain operations	1,311,639	1,216,242
Nordic	2,408	9,342
Ski patrol	5,146	12,196
Sales and marketing	522,884	459,175
Office administration	627,460	615,509
Mountain Villas	46,996	45,794
Adventure Park	337,248	206,735
	\$ 3,992,771	\$ 3,732,472
Total departmental costs		
Amortization	28,327	28,652
Depreciation	612,426	607,336
	\$ 4,633,524	\$ 4,368,460
Total Operating Expenses		

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

EXHIBIT B-1

**STATEMENT OF CAPITAL IMPROVEMENTS
YEAR ENDED APRIL 30, 2012**

	Repair and Replacement Account Capital Improvements	Non-Repair and Replacement Account Capital Improvements	Total
Capital Improvements			
Permitting fees	\$ -	\$ 301	\$ 301
Grand Avenue project	-	8,687	8,687
Eagles Nest/Bear Paw entrance #2	218,413	-	218,413
Miniature golf course	-	109,884	109,884
Snowguns	19,000	-	19,000
Zip Line	-	309,472	309,472
Mowing tractor	38,464	-	38,464
Campground updates	3,000	-	3,000
Coaster tent	-	3,107	3,107
Tubing hill	-	220,763	220,763
E-Commerce module	24,761	-	24,761
Mechanical toom blinds	-	1,714	1,714
Bus	3,500	-	3,500
Shaft motor	-	10,200	10,200
Computer/security equipment	-	7,347	7,347
Ski shop blinds	-	1,232	1,232
Boards & Boots	-	33,005	33,005
Outside painting BP/EN	-	4,187	4,187
Phone wire - Team Duluth Building	-	4,352	4,352
Carpet replacement	23,239	622	23,861
New LED lighting	-	6,031	6,031
Moosehead entrance	-	3,400	3,400
2011 Ski Doo	-	8,283	8,283
New Grand Avenue Chalet	-	141,426	141,426
Grand Avenue parking	-	34,324	34,324
New lift	-	1,175,232	1,175,232
Great Lakes restoration	-	30,000	30,000
Skis and boots/bindings	-	24,037	24,037
Total Capital Improvements	\$ 330,377	\$ 2,137,606	\$ 2,467,983

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

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED APRIL 30, 2012**

**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 and Monitoring

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 limited.

Context: This is not unusual in operations the size of Spirit Mountain Recreation Area 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 Authority has indicated it does not have the economic resources needed to hire additional qualified accounting staff in order to adequately segregate duties in all departments.

Recommendation: 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.

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.

We have worked diligently over the years to improve our internal controls and in fact, this comment was noted as resolved previously based on suggestions from the Auditor that the Executive Director review all journal entries to provide the oversight necessary to eliminate this issue. This suggestion was implemented and has continued since the recommendation.

PREVIOUSLY REPORTED ITEM RESOLVED

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

Duties related to payroll were especially concentrated in that the Finance Director was responsible for payroll processing, had access and the ability to make changes to the employee master files, and had complete access to the general ledger system.

Resolution

The payroll processing duties were re-assigned from the Finance Director to a Payroll Administrator who does not have access to the master files. All detailed payroll reports are reviewed and approved by the Executive Director.

II. OTHER FINDINGS AND RECOMMENDATIONS

MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM NOT RESOLVED

09-3 Donation to Nonprofit Foundation

Criteria: Each expenditure of public funds must be authorized by law and for a public purpose.

Condition: 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.

Context: 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. 59a-3 (Aug. 19, 1947) (no authority to donate to 4-H Clubs), 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).

Effect: Because there is no specific statutory or charter authority, the Authority’s contribution to the Foundation is not authorized by law.

Cause: The Authority entered into the agreement with the Foundation not to benefit any other organization than the Authority and contends this is a proper expenditure due to the future benefit it will provide to the Authority.

Recommendation: We recommend 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 the Spirit Mountain Recreation Area Authority.

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

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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
Spirit Mountain Recreation Area Authority

We have audited the 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, 2012, and have issued our report thereon dated April 30, 2013. 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 Spirit Mountain Recreation Area Authority is responsible for establishing and maintaining effective 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

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

April 30, 2013