

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

YEAR ENDED APRIL 30, 2015

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 150 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 700 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**

Year Ended April 30, 2015



**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, 2015

	<u>Term Ending</u>
Directors	
David Kohlhaas	June 30, 2017
Dan O'Neill	June 30, 2017
Greg Benson	June 30, 2015
Sean Flaherty	June 30, 2015
Elaine Hansen	June 30, 2017
Jane Gilbert-Howard	June 30, 2017
Neale Roth	June 30, 2015
Cory Salmela	June 30, 2017
Todd Torvinen	June 30, 2017
Executive Director	
Brandy Ream	
Officers	
Chair	
David Kohlhaas	
Vice Chair	
Dan O'Neill	
Secretary	
Cory Salmela	

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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INDEPENDENT AUDITOR'S REPORT

Mayor and City Council
City of Duluth, Minnesota

Board of Directors
Spirit Mountain Recreation Area Authority

Report on the Financial Statements

We have audited the accompanying financial statements of Spirit Mountain Recreation Area Authority, a component unit of the City of Duluth, Minnesota, as of and for the year ended April 30, 2015, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Authority's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2015, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter - Change in Accounting Principle

As discussed in Note 1 to the financial statements, in fiscal year 2015 the Authority adopted new accounting guidance by implementing the provisions of Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, which represents a change in accounting principles. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

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 GASB, 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. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, 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.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Spirit Mountain Recreation Area Authority's basic financial statements. The supplementary information as 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. Such 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 17, 2016, 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* in considering Spirit Mountain Recreation Area Authority's internal control over financial reporting and compliance.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

February 17, 2016

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

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MANAGEMENT'S DISCUSSION AND ANALYSIS

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

**MANAGEMENT'S DISCUSSION AND ANALYSIS
APRIL 30, 2015
(Unaudited)**

This section presents management's analysis of the Authority's financial condition and activities for the fiscal year ended April 30, 2015. This information should be read in conjunction with the financial statements.

FINANCIAL HIGHLIGHTS

- During fiscal year 2015, a new management team was in place bringing multiple years of ski area management to Spirit Mountain.
- Fiscal year 2015 noted a decrease in expenses of over \$450,000.
- Fiscal year 2015 noted over \$239,000 in FEMA-related purchases and reimbursements.

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 form of recreation provided to both local residents and visitors is 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, mountain biking, and camping, with banquets becoming an ever larger business for the Authority, with wedding receptions and 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 bar and restaurant and a new parking lot at the Grand Avenue entrance. During 2014, two mountain bike trails were constructed, which added lift access mountain biking to the list of summer attractions and further established Spirit Mountain as a year-round recreational facility. The Authority currently has eight mountain bike trails and a skills park.

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 Statements of Net Position

	FY 2015	FY 2014*	Change from 2014 to 2015		FY 2013
			Dollar	Percent (%)	
Current and other assets	\$ 1,248,835	\$ 598,349	\$ 650,486	109	\$ 854,958
Capital assets	14,388,502	13,674,738	713,764	5	14,022,820
Total Assets	\$ 15,637,337	\$ 14,273,087	\$ 1,364,250	10	\$ 14,877,778
Deferred outflows of resources					
Deferred pension obligation outflows	\$ 278,000	\$ 98,251	\$ 179,749	183	\$ -
Current liabilities	\$ 2,711,138	\$ 1,828,870	\$ 882,268	48	\$ 1,642,115
Long-term liabilities	3,294,425	3,719,934	(425,509)	(11)	2,328,074
Total Liabilities	\$ 6,005,563	\$ 5,548,304	\$ 456,759	8	\$ 3,970,189
Deferred inflows of resources					
Deferred pension obligation inflows	\$ 401,086	\$ -	\$ 401,086	-	\$ -
Net Position					
Net investment in capital assets	\$ 12,198,983	\$ 11,346,750	\$ 852,233	8	\$ 11,404,450
Unrestricted	(2,690,295)	(2,524,216)	(166,079)	7	(496,861)
Total Net Position	\$ 9,508,688	\$ 8,822,534	\$ 686,154	8	\$ 10,907,589

*For fiscal year 2015, a restatement of prior net position was required because of a change in accounting principle. This change is reflected in the 2014 column. See Note 1 for change in accounting principle.

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

	FY 2015	FY 2014	Change from 2014 to 2015		FY 2013
			Dollar	Percent (%)	
Operating revenues	\$ 4,316,070	\$ 4,621,902	\$ (305,832)	(7)	\$ 4,387,088
Nonoperating revenues	748,514	247,119	501,395	203	418,636
Contributions from City of Duluth	725,848	223,323	502,525	225	5,437,650
Total Revenues	\$ 5,790,432	\$ 5,092,344	\$ 698,088	14	\$ 10,243,374
Operating expenses	\$ 4,311,916	\$ 4,603,344	\$ (291,428)	(6)	\$ 4,167,932
Nonoperating expenses	84,386	116,082	(31,696)	(27)	127,989
Depreciation/amortization	707,976	835,897	(127,921)	(15)	724,553
Total Expenses	\$ 5,104,278	\$ 5,555,323	\$ (451,045)	(8)	\$ 5,020,474
Change in Net Position	\$ 686,154	(462,979)	\$ 1,149,133	(248)	\$ 5,222,900
Beginning Net Position	8,822,534*	10,907,589	(2,085,055)	(19)	5,684,689
Ending Net Position	<u>\$ 9,508,688</u>	<u>\$ 10,444,610</u>	<u>\$ (935,922)</u>	<u>(9)</u>	<u>\$ 10,907,589</u>

*For fiscal year 2015, a restatement of prior year net position was required because of a change in accounting principle. This change is not reflected in the 2014 column. See Note 1 for information on change in accounting principle.

**Condensed Statement of Revenues, Expenses, and Change in Net Position
(2015 Budget and Actual)**

	Actual	Budget	Budget to Actual Variance	Budget % Variance
Operating revenues	\$ 4,316,070	\$ 5,444,356	\$ (1,128,286)	(21)
Nonoperating revenues	748,514	145,704	602,810	414
Contributions from City of Duluth	725,848	-	725,848	100
Total Revenues	\$ 5,790,432	\$ 5,590,060	\$ 200,372	4
Operating expenses	\$ 4,311,916	\$ 4,757,262	\$ (445,346)	(9)
Nonoperating expenses	84,386	119,677	(35,291)	(29)
Depreciation/amortization	707,976	647,700	60,276	9
Total Expenses	\$ 5,104,278	\$ 5,524,639	\$ (420,361)	(8)
Change in Net Position	\$ 686,154	\$ 65,421	\$ 620,733	949
Beginning Net Position, restated	8,822,534	8,822,534	-	-
Ending Net Position	<u>\$ 9,508,688</u>	<u>\$ 8,887,955</u>	<u>\$ 620,733</u>	<u>7</u>

Revenues

The Authority earns operating revenues in both winter and summer. Operating revenues decreased \$305,832, or 7 percent, in 2015 compared to 2014. Nonoperating revenues and contributions increased by \$1,003,920, or 213 percent, in 2015 compared to 2014 due to increased grant revenue and tourism tax received during 2015.

Expenses

The Authority's operating expenses decreased \$291,428, or 6 percent, from 2014 due mainly to reduction in personal service costs.

Budgetary Highlights

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

Operating revenues were \$1,128,286, or 21 percent below budget due mainly to season passes, daily lift tickets, and Grand Avenue Chalet sales being lower than anticipated.

CAPITAL ASSETS

	FY 2015	FY 2014	Change	
			Dollar	Percent (%)
Land and land improvements	\$ 2,553,244	\$ 2,544,192	\$ 9,052	-
Equipment	11,338,376	11,179,712	158,664	1
Plant equipment	894,197	863,026	31,171	4
Buildings and structures	7,966,219	7,952,404	13,815	-
Furniture and fixtures	256,675	256,675	-	-
Other capital assets	802,903	802,903	-	-
Construction in progress	1,252,661	315,707	936,954	297
Subtotal	\$ 25,064,275	\$ 23,914,619	\$ 1,149,656	5
Less: accumulated depreciation	(10,675,773)	(10,239,881)	(435,892)	4
Total Capital Assets, Net	<u>\$ 14,388,502</u>	<u>\$ 13,674,738</u>	<u>\$ 713,764</u>	5

The Authority's ongoing capital plan improvements are made with the long-term goals of the Spirit Mountain Master Plan in mind. Building new attractions is the keystone to the area becoming a true four-season recreation venue. As always, we continue to seek ways to streamline the operation, find efficiencies, and provide the best possible guest experience.

Debt Administration

	FY 2015	FY 2014	Change	
			Dollar	Percent (%)
Alpine Coaster lease	\$ 1,702,636	\$ 1,847,892	\$ (145,256)	(8)
Groomer leases	330,940	194,293	136,647	70
Zip/Tube/Golf lease	155,943	285,803	(129,860)	(45)
Total Debt	\$ 2,189,519	\$ 2,327,988	\$ (138,469)	(6)

During fiscal year 2015, the Authority's outstanding debt decreased \$138,469.

ECONOMIC AND OTHER FACTORS

The Authority must consider many factors when setting the fiscal year budgets. Spirit Mountain is not immune from lessened consumer confidence and shrinking spending habits; additionally, weather challenges hamper the consumers' excitement for winter sporting activities. March of 2015 was extremely difficult for the winter recreation area. We closed for the season the first weekend in March. March is typically a heavy revenue month of \$650,000 on average. Without being open all March, we saw a significant impact on revenue. Additionally, severe cold weather kept many visitors away and caused the Authority to close for seven business days. The entire pricing structure on tickets and season passes has been evaluated and restructured. We continue to offer an affordable season pass that has value to our operation. Our pricing for walk-up tickets was reviewed and changed as well. The Adventure Park is open seasonally, and we have had strong attendance during the winter season.

We have continued to add attractions to complement the coaster, such as mountain bike trails, 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 continues to be a strong revenue source for Spirit Mountain. However, after a detailed analysis of our pricing structure, it was found that our pricing was not reflective of the cost of business, and we were not seeing the revenues Spirit Mountain had anticipated. With this stated, all pricing for banquets has been adjusted, and significant changes will come forth in 2017.

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

FINANCIAL CONTACT

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

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BASIC FINANCIAL STATEMENTS

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

EXHIBIT 1

**STATEMENT OF NET POSITION
APRIL 30, 2015**

Assets	
Current assets	
Cash and cash equivalents	\$ 333,927
Accounts receivable	78,250
Due from City of Duluth	564,787
Prepaid insurance	92,027
Inventory	89,049
	<hr/>
Total current assets	\$ 1,158,040
Noncurrent assets	
Planning and development costs - net of accumulated amortization	\$ 90,795
	<hr/>
Capital assets	
Non-depreciable	\$ 3,805,905
Depreciable	21,258,370
Less: accumulated depreciation	(10,675,773)
	<hr/>
Total capital assets - net of accumulated depreciation	\$ 14,388,502
	<hr/>
Total noncurrent assets	\$ 14,479,297
	<hr/>
Total Assets	\$ 15,637,337
Deferred Outflows of Resources	
Deferred pension obligation outflows	\$ 278,000
	<hr/>
Liabilities	
Current liabilities	
Accounts payable	\$ 127,674
Contracts payable	512,347
Due to City of Duluth	1,205,932
Due to other governments	18,662
Accrued salaries payable	31,885
Accrued vacation payable	79,486
Accrued interest payable	6,294
Leases payable	379,504
Unearned revenue	349,354
	<hr/>
Total current liabilities	\$ 2,711,138
Noncurrent liabilities	
Leases payable	\$ 1,810,015
Pension liability	1,484,410
	<hr/>
Total noncurrent liabilities	\$ 3,294,425
	<hr/>
Total Liabilities	\$ 6,005,563

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 1
(Continued)***

**STATEMENT OF NET POSITION
APRIL 30, 2015**

Deferred Inflows of Resources	
Deferred pension obligation inflows	<u>\$ 401,086</u>
Net Position	
Net investment in capital assets	\$ 12,198,983
Unrestricted	<u>(2,690,295)</u>
Total Net Position	<u><u>\$ 9,508,688</u></u>

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

EXHIBIT 2

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED APRIL 30, 2015**

Operating Revenues	
Sales	\$ 1,387,852
Less: cost of goods sold	<u>(490,375)</u>
Gross profit on sales	\$ 897,477
Charges for services	3,331,900
Miscellaneous	<u>86,693</u>
Total Operating Revenues	<u>\$ 4,316,070</u>
Operating Expenses	
Personal services	\$ 2,760,387
Supplies	229,851
Utilities	438,702
Other services and charges	882,976
Amortization	23,353
Depreciation	<u>684,623</u>
Total Operating Expenses	<u>\$ 5,019,892</u>
Operating Income (Loss)	<u>\$ (703,822)</u>
Nonoperating Revenues (Expenses)	
Earnings on investments	\$ 1,386
Grant revenue	271,428
Tourism tax	475,700
Interest expense	<u>(84,386)</u>
Total Nonoperating Revenues (Expenses)	<u>\$ 664,128</u>
Income (Loss) Before Contributions	\$ (39,694)
Capital contributions from City of Duluth	<u>725,848</u>
Change in Net Position	\$ 686,154
Net Position - May 1, as restated (Note 1)	<u>8,822,534</u>
Net Position - April 30	<u><u>\$ 9,508,688</u></u>

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

EXHIBIT 3

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED APRIL 30, 2015**

Cash Flows from Operating Activities	
Cash received from customers	\$ 4,101,106
Cash paid to suppliers	(1,161,801)
Cash paid to employees	(2,758,453)
Other cash received	86,693
	<hr/>
Net cash provided by (used in) operating activities	\$ 267,545
Cash Flows from Capital and Related Financing Activities	
Capital grants	\$ 271,428
Capital contributions from City of Duluth	725,848
City of Duluth hotel/motel taxes	475,700
Capital lease payments	(426,129)
Acquisition and construction of capital assets	(1,196,387)
	<hr/>
Net cash provided by (used in) capital and related financing activities	\$ (149,540)
Cash Flows from Investing Activities	
Interest on investments	\$ 1,386
	<hr/>
Net Increase (Decrease) in Cash and Cash Equivalents	\$ 119,391
Cash and Cash Equivalents - May 1	214,536
	<hr/>
Cash and Cash Equivalents - April 30	\$ 333,927
	<hr/> <hr/>

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

**EXHIBIT 3
(Continued)**

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED APRIL 30, 2015**

Reconciliation of operating income (loss) to net cash provided by (used in) operating activities	
Net operating income (loss)	\$ (703,822)
Adjustments to reconcile net operating income (loss) to net cash provided by (used in) operating activities	
Depreciation	684,623
Amortization	23,353
Change in assets and liabilities	
Decrease (increase) in accounts receivable	63,982
Decrease (increase) in due from City of Duluth	(564,787)
Decrease (increase) in prepaid insurance	(92,027)
Decrease (increase) in inventory	38,384
Increase (decrease) in accounts payable	(47,992)
Increase (decrease) in contracts payable	512,347
Increase (decrease) in due to City of Duluth	355,240
Increase (decrease) in due to other governments	2,499
Increase (decrease) in accrued salaries payable	26,821
Increase (decrease) in accrued vacation payable	(10,307)
Increase (decrease) in deferred pension obligation outflows	(179,749)
Increase (decrease) in deferred pension obligation inflows	401,086
Increase (decrease) in pension liability	(235,917)
Increase (decrease) in unearned revenue	(6,189)
Net Cash Provided by (Used in) Operating Activities	\$ <u>267,545</u>
Noncash Investing, Capital, and Financing Activities	
Capital assets acquired under lease purchase agreements	\$ 202,200

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

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED APRIL 30, 2015**

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 with generally accepted accounting principles.

Change in Accounting Principles

During the year ended April 30, 2015, the Authority adopted Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions; an amendment of GASB Statement No. 27*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. GASB Statement 68 requires governments providing defined benefit pension benefits to record the net pension obligation as a liability on their financial statements and to more comprehensively and comparably measure the annual costs of pension benefits. The Statement also enhances accountability and transparency through revised and new note disclosures and Required Supplementary Information (RSI).

GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, an amendment of GASB Statement No. 68, was also implemented for the year ending April 30, 2015. This Statement addresses an issue regarding application of the transition provisions of GASB Statement 68. The Statement eliminates some potential understatement of balances that could arise with the restatement of beginning balances under GASB Statement 68. The Authority has a restatement of April 30, 2014, net position as a result of the adoption of GASB Statements 68 and 71.

Net Position, April 30, 2014, as previously reported	\$ 10,444,610
Change in accounting principles	<u>(1,622,076)</u>
Net Position, April 30, 2014, restated	<u>\$ 8,822,534</u>

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

1. Summary of Significant Accounting Policies (Continued)

A. Financial Reporting Entity

The Authority is a discretely presented component unit of the City of Duluth reporting entity and, therefore, is included in the City's Comprehensive Annual Financial Report because of the significance of its operations and financial relationships with the City.

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.

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.

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position

1. Cash

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.

2. Inventories

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

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

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position
(Continued)

3. Capital Assets

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 capital assets	2 to 40 years

4. Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and will not be recognized as an outflow of resources (expense) until then. Currently, the Authority has one item, pension obligation outflows, that qualifies for reporting in this category. The pension obligation amounts are deferred and the length of the expense recognition period is equal to the average of the expected remaining service lives of all employees that are provided with pensions through the pension plan, determined as of the beginning of the measurement period.

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Authority has only one type of item, pension obligation inflows, that qualifies for reporting in this category. The differences between projected and actual earnings on pension plan investments are recognized over a five-year period.

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

1. Summary of Significant Accounting Policies

D. Assets, Liabilities, Deferred Outflows/Inflows of Resources, and Net Position
(Continued)

5. Classification of Net Position

Net position is classified in the following categories:

Net investment in capital assets - the amount of net position representing capital assets, net of accumulated depreciation, and reduced by outstanding debt, if any, attributed to the acquisition, construction or improvement of the assets.

Restricted net position - the amount of net position for which external restrictions have been imposed by creditors, grantors, contributors, or laws or constitutional provisions or enabling legislation.

Unrestricted net position - the amount of net position that does not meet the definition of restricted or net investment in capital assets.

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.

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

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 year ended April 30, 2015, was as follows:

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
Operating Revenues			
Sales	\$ 915,150	\$ 1,387,852	\$ 472,702
Less: cost of goods sold	(538,437)	(490,375)	48,062
Gross profit on sales	\$ 376,713	\$ 897,477	\$ 520,764
Charges for services	5,030,743	3,331,900	(1,698,843)
Miscellaneous	36,900	86,693	49,793
Total Operating Revenues	<u>\$ 5,444,356</u>	<u>\$ 4,316,070</u>	<u>\$ (1,128,286)</u>
Operating Expenses			
Personal services	\$ 3,001,256	\$ 2,760,387	\$ 240,869
Supplies	344,851	229,851	115,000
Utilities	499,373	438,702	60,671
Other services and charges	911,782	882,976	28,806
Amortization	23,700	23,353	347
Depreciation	624,000	684,623	(60,623)
Total Operating Expenses	<u>\$ 5,404,962</u>	<u>\$ 5,019,892</u>	<u>\$ 385,070</u>
Operating Income (Loss)	<u>\$ 39,394</u>	<u>\$ (703,822)</u>	<u>\$ (743,216)</u>
Nonoperating Revenues (Expenses)			
Earnings on investments	\$ -	\$ 1,386	\$ 1,386
Grant revenue	-	271,428	271,428
Tourism tax	145,704	475,700	329,996
Interest expense	(119,677)	(84,386)	35,291
Total Nonoperating Revenues (Expenses)	<u>\$ 26,027</u>	<u>\$ 664,128</u>	<u>\$ 638,101</u>
Income (Loss) Before Contributions	\$ 65,421	\$ (39,694)	\$ (105,115)
Capital contributions from City of Duluth	<u>-</u>	<u>725,848</u>	<u>725,848</u>
Change in Net Position	<u>\$ 65,421</u>	<u>\$ 686,154</u>	<u>\$ 620,733</u>

**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 as of April 30, 2015:

City Treasurer	\$	306,682
Petty cash and change funds		<u>27,245</u>
Total Cash and Cash Equivalents	\$	<u>333,927</u>

C. Capital Assets

Capital asset activity for the year ended April 30, 2015, was as follows:

	Balance May 1, 2014	Additions	Deductions	Balance April 30, 2015
Capital assets not depreciated				
Land and land improvements	\$ 2,544,192	\$ 9,052	\$ -	\$ 2,553,244
Construction in progress	<u>315,707</u>	<u>936,954</u>	<u>-</u>	<u>1,252,661</u>
Total capital assets not depreciated	<u>\$ 2,859,899</u>	<u>\$ 946,006</u>	<u>\$ -</u>	<u>\$ 3,805,905</u>

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

2. Detailed Notes

C. Capital Assets (Continued)

	Balance May 1, 2014	Additions	Deductions	Balance April 30, 2015
Capital assets depreciated				
Buildings and structures	\$ 7,952,404	\$ 13,815	\$ -	\$ 7,966,219
Equipment	12,042,738	438,566	248,731	12,232,573
Furniture and fixtures	256,675	-	-	256,675
Other capital assets	802,903	-	-	802,903
Total capital assets depreciated	\$ 21,054,720	\$ 452,381	\$ 248,731	\$ 21,258,370
Less: accumulated depreciation for				
Buildings and structures	\$ 3,529,496	\$ 226,155	\$ -	\$ 3,755,651
Equipment	5,985,619	411,183	248,731	6,148,071
Furniture and fixtures	244,376	5,948	-	250,324
Other capital assets	480,390	41,337	-	521,727
Total accumulated depreciation	\$ 10,239,881	\$ 684,623	\$ 248,731	\$ 10,675,773
Total capital assets depreciated, net	\$ 10,814,839	\$ (232,242)	\$ -	\$ 10,582,597
Capital Assets, Net	\$ 13,674,738	\$ 713,764	\$ -	\$ 14,388,502

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, 2015, is \$79,486 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, 2015, is as follow:

General Fund - sales tax	\$ 5,932
General Fund - line of credit	<u>1,200,000</u>
Total	<u>\$ 1,205,932</u>

The City of Duluth extends the Authority a line of credit each year 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 May 30, 2014, the City of Duluth passed resolution 14-0281R changing the date when the line of credit is to be repaid in full from December 31, 2014, to December 31, 2015, and extending the line of credit up to \$1,200,000.

Changes in line of credit balance for the year ending April 30, 2015, were as follows:

Beginning	\$ 845,000
Draws	<u>355,000</u>
Ending	<u>\$ 1,200,000</u>

F. 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 were 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.

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

2. Detailed Notes

F. Pledge Agreement with City of Duluth (Continued)

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 to pledge operating revenues to pay the balance of the principal and interest owed each year until the bond is paid off in 2030.

G. Capitalized Lease Obligations

Capitalized lease obligations consist of the following at April 30, 2015:

Type of Property		
Equipment	\$	3,453,731
Less: accumulated amortization		(922,539)
Net Capital Lease Property	\$	2,531,192

Minimum future lease payments follow:

Fiscal Year Ended April 30	Principal	Interest
2016	\$ 379,504	\$ 80,674
2017	271,977	67,732
2018	228,785	58,139
2019	207,455	49,893
2020	200,830	41,805
2021 - 2025	900,968	95,309
Total	\$ 2,189,519	\$ 393,552

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

2. Detailed Notes

G. Capitalized Lease Obligations (Continued)

Capitalized lease obligations at April 30, 2015, consist of the following leases:

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.	\$ 1,702,636
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.	155,943
A \$266,519 lease purchase for a groomer, dated October 15, 2012, due in periodic installments through October 1, 2017, with interest at 3.50 percent.	141,185
A \$202,200 lease purchase for a groomer, dated December 23, 2014, due in periodic installments through December 23, 2019, with interest at 3.50 percent.	<u>189,755</u>
Total	<u>\$ 2,189,519</u>
Current portion	\$ 379,504
Long-term portion	<u>1,810,015</u>
Total	<u>\$ 2,189,519</u>

H. Operating Lease

The Authority is obligated under an operating lease for office equipment. Lease expense for fiscal year 2015 is \$5,335. The future minimum rental payments, which are not reported as liabilities in the financial statements at April 30, 2015, are \$5,335 due in fiscal year 2016.

I. Mountain Villas Agreements

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

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

2. Detailed Notes

I. 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.

J. Contract Commitment

The Authority was in the process of constructing a new water line at year-end. As of April 30, 2015, the Authority had contract commitments with the project of \$5,706,852.

3. Risk Management

The Authority uses State Fund Mutual (SFM) to insure against its obligation to provide benefits to employees pursuant to the Minnesota Workers' Compensation Act. The Authority participates in the City of Duluth Internal Service Fund 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. 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.

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

4. Pension Plans - Defined Benefit Plans

A. Plan Description

Spirit Mountain Recreation Area Authority participates in the following cost-sharing multiple-employer defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA's defined benefit pension plans are established and administered in accordance with Minnesota Statutes, Chapters 353 and 356. PERA's defined benefit pension plans are tax qualified plans under Section 401 (a) of the Internal Revenue Code.

All full-time and certain part-time employees of Spirit Mountain Recreation Area Authority are covered by the General Employees Retirement Fund (GERF). GERF 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. The Basic Plan was closed to new members in 1967. All new members must participate in the Coordinated Plan.

B. Benefits Provided

PERA provides retirement, disability, and death benefits. Benefit provisions are established by state statute and can be modified only by the state legislature. Benefit increases are provided to benefit recipients each January. Increases are related to the funding ratio of the plan. Members in plans that are at least 90 percent funded for two consecutive years are given 2.5 percent increases. Members in plans that have not exceeded 90 percent funded, or have fallen below 80 percent, are given 1.0 percent increases.

The benefit provisions stated in the following 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 their public service.

Benefits are based on a member's highest average salary for any five successive years of allowable service, age, and years of credit at termination of service. Two methods are used to compute benefits for PERA's 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 remaining year. The annuity accrual rate for a

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

4. Pension Plans - Defined Benefit Plans

B. Benefits Provided (Continued)

Coordinated Plan member is 1.2 percent of average salary for each of the first ten years and 1.7 percent for each remaining year. Under Method 2, the annuity accrual rate is 2.7 percent of average salary for Basic Plan members and 1.7 percent for Coordinated Plan members for each year of service. For members hired prior to July 1, 1989, a full annuity is available when age plus years of service equal 90 and normal retirement age is 65. For members hired on or after July 1, 1989, normal retirement age is the age for unreduced Social Security benefits capped at 66. Disability benefits are available for vested members and are based upon years of service and average high-five salary.

C. Contributions

Minnesota Statutes Chapter 353 sets the rates for employer and employee contributions. Contribution rates can be modified only by the state legislature. Basic Plan members and Coordinated Plan members were required to contribute 9.10 percent and 6.50 percent, respectively, of their annual covered salary in calendar year 2014. Basic Plan members' contribution rates remained the same; however, Coordinated Plan members contributed 6.50 percent of pay in 2015. In calendar year 2014, the Authority was required to contribute 11.78 percent of pay for Basic Plan members and 7.25 percent for Coordinated Plan members. In 2015, employer rates increased to 7.50 percent in the Coordinated Plan and remained the same for the Basic Plan. Spirit Mountain Recreation Area Authority's contributions to the GERS for the year ended April 30, 2015, were \$104,147. Spirit Mountain Recreation Area Authority's contributions were equal to the required contributions as set by state statute.

D. Pension Costs

At April 30, 2015, Spirit Mountain Recreation Area Authority reported a liability of \$1,484,410 for its proportionate share of the GERS's net pension liability. The net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. Spirit Mountain Recreation Area Authority's proportion of the net pension liability was based on the Authority's contributions received by PERA during the measurement period for employer payroll paid dates from July 1, 2013, through June 30, 2014, relative to the total employer contributions received from all of PERA's participating employers. At June 30, 2014, Spirit Mountain Recreation Area Authority's proportion was 0.0316 percent.

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

4. Pension Plans - Defined Benefit Plans

D. Pension Costs (Continued)

For the year ended April 30, 2015, Spirit Mountain Recreation Area Authority recognized pension expense of \$104,147 for its proportionate share of the GERP's pension expense.

At April 30, 2015, Spirit Mountain Recreation Area Authority reported its proportionate share of the GERP's deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual economic experience	\$ 22,781	\$ -
Changes in actuarial assumptions	152,983	-
Difference between projected and actual investment earnings	-	401,086
Contributions paid to PERA subsequent to the measurement date	102,236	-
Total	\$ 278,000	\$ 401,086

The \$102,236 reported as deferred outflows of resources related to pensions resulting from Spirit Mountain Recreation Area Authority contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended April 30, 2016. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended June 30	Pension Expense Amount
2016	\$ (41,684)
2017	(41,684)
2018	(41,684)
2019	(100,270)
2020	-

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

4. Pension Plans - Defined Benefit Plans (Continued)

E. Actuarial Assumptions

The total pension liability in the June 30, 2014, actuarial valuation was determined using the entry age normal actuarial cost method and the following actuarial assumptions:

Inflation	2.75 percent per year
Active member payroll growth	3.50 percent per year
Investment rate of return	7.90 percent

Salary increases were based on a service-related table. Mortality rates for active members, retirees, survivors, and disabilitants were based on RP-2000 tables for males or females, as appropriate, with slight adjustments. Benefit increases for retirees are assumed to be 1.0 percent effective every January 1st through 2026 and 2.5 percent thereafter.

Actuarial assumptions used in the June 30, 2014, valuation were based on the results of actuarial experience studies. The experience study in the GERS was for the period July 1, 2004, through June 30, 2008, with an update of economic assumptions in 2014.

The following changes in actuarial assumptions occurred in 2014: As of July 1, 2013, the postretirement benefit increase rate was assumed to increase from 1.0 percent to 2.5 percent on January 1, 2046. As of July 1, 2014, the postretirement benefit increase rate was assumed to increase from 1.0 percent to 2.5 percent on January 1, 2031.

The long-term expected rate of return on pension plan investments is 7.9 percent. The State Board of Investment, which manages the investments of PERA, prepares an analysis of the reasonableness of the long-term expected rate of return on a regular basis using a building-block method in which best-estimate ranges of expected future rates of return are developed for each major asset class. These ranges are combined to produce an expected long-term rate of return by weighting the expected future rates of return by the target asset allocation percentages.

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

4. Pension Plans - Defined Benefit Plans

E. Actuarial Assumptions (Continued)

The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
Domestic stocks	45%	5.50%
International stocks	15	6.00
Bonds	18	1.45
Alternative assets	20	6.40
Cash	2	0.50

F. Discount Rate

The discount rate used to measure the total pension liability was 7.9 percent. The projection of cash flows used to determine the discount rate assumed that employee and employer contributions will be made at the rate specified in statute. Based on that assumption, each of the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

G. Pension Liability Sensitivity

The following presents Spirit Mountain Recreation Area Authority's proportionate share of the net pension liability for all plans it participates in, calculated using the discount rate disclosed in the preceding paragraph, as well as what the Authority's proportionate share of the net pension liability would be if it were calculated using a discount rate 1.0 percentage point lower or 1.0 percentage point higher than the current discount rate:

	<u>1% Decrease in Discount Rate (6.9%)</u>	<u>Discount Rate (7.9%)</u>	<u>1% Increase in Discount Rate (8.9%)</u>
Spirit Mountain Recreation Area Authority's proportionate share of the GERP net pension liability	\$ 2,392,928	\$ 1,484,410	\$ 736,913

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

4. Pension Plans - Defined Benefit Plans (Continued)

H. Pension Plan Fiduciary Net Position

Detailed information about the pension plan's fiduciary net position is available in a separately issued PERA financial report that includes financial statements and required supplementary information. That report may be obtained on the internet at www.mnpera.org; by writing to PERA at 60 Empire Drive, Suite 200, St. Paul, Minnesota 55103-2088; or by calling (651) 296-7460 or 1-800-652-9026.

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REQUIRED SUPPLEMENTARY INFORMATION

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

EXHIBIT A-1

**SCHEDULE OF PROPORTIONATE SHARE OF NET PENSION LIABILITY
GENERAL EMPLOYEES RETIREMENT FUND
APRIL 30, 2015**

<u>Measurement Date</u>	<u>Employer's Proportion of Net Pension Liability (Asset)</u>	<u>Employer's Proportionate Share of the Net Pension Liability (Asset) (a)</u>	<u>Covered Payroll (b)</u>	<u>Employer's Proportionate Share of the Net Pension Liability (Asset) as a Percentage of Covered Payroll (a/b)</u>	<u>Plan Fiduciary Net Position as a Percentage of the Total Pension Liability</u>
2014	0.0316%	\$ 1,484,410	\$ 1,737,780	85.42%	78.75%

This schedule is intended to show information for ten years. Additional years will be displayed as they become available. The amounts presented for each fiscal year were determined June 30 of the previous year.

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

EXHIBIT A-2

**SCHEDULE OF CONTRIBUTIONS
GENERAL EMPLOYEES RETIREMENT FUND
APRIL 30, 2015**

<u>Fiscal Year Ending</u>	<u>Statutorily Required Contributions (a)</u>	<u>Contributions in Relation to Statutorily Required Contributions (b)</u>	<u>Contribution Deficiency (Excess) (a-b)</u>	<u>Covered Payroll (c)</u>	<u>Contributions as a Percentage of Covered Payroll (b/c)</u>
2015	\$ 127,523	\$ 104,147	\$ (23,376)	\$ 1,737,780	5.99%

This schedule is intended to show information for ten years. Additional years will be displayed as they become available. The amounts presented for each fiscal year were determined April 30 of the previous year.

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SUPPLEMENTARY INFORMATION

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

EXHIBIT B-1

**STATEMENT OF OPERATING REVENUES
YEAR ENDED APRIL 30, 2015**

Sales	
Food	\$ 515,637
Liquor	262,949
Ski shop	107,004
Grand Avenue Chalet	502,262
Less: cost of goods sold	<u>(490,375)</u>
Net sales	<u>\$ 897,477</u>
Charges for Services	
Season pass	\$ 844,166
Daily lift tickets	806,095
Alpine coaster	813,682
Ski school and snow sports	127,191
Ski rental	184,977
Snowboard rental	52,087
Locker rental	14,294
Nordic tickets and rental	459
Snocross	159,551
Campground	136,011
Mountain Villas management fee	105,127
Marketing revenue	12,950
Summer activities	<u>75,310</u>
Total charges for services	<u>\$ 3,331,900</u>
Miscellaneous	
Other revenues	<u>\$ 86,693</u>
Total Operating Revenues	<u><u>\$ 4,316,070</u></u>

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

EXHIBIT B-2

**STATEMENT OF OPERATING EXPENSES
YEAR ENDED APRIL 30, 2015**

Department	
Food and beverage	\$ 369,637
Housekeeping	151,641
Rental	48,589
Ski shop	31,512
Campground	65,161
Parking and shuttle	3,367
Building and grounds	334,741
Snocross	172,842
Ski school and snow sports center	110,276
Outside mountain operations	1,203,267
Nordic	3,030
Ski patrol	9,201
Sales and marketing	358,210
Office administration	831,196
Mountain Villas	47,700
Grand Avenue Chalet	262,414
Summer activities	65,565
Adventure Park	<u>243,567</u>
Total departmental costs	\$ 4,311,916
Amortization	23,353
Depreciation	<u>684,623</u>
Total Operating Expenses	<u><u>\$ 5,019,892</u></u>

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

EXHIBIT C-1

**STATEMENT OF CAPITAL IMPROVEMENTS
YEAR ENDED APRIL 30, 2015**

	Repair and Replacement Account Capital Improvements	Non-Repair and Replacement Account Capital Improvements	Total
Capital Improvements			
Computer equipment	\$ -	\$ 18,699	\$ 18,699
Water project development	-	750,484	750,484
Bike trail	-	83,070	83,070
Groomer	-	275,764	275,764
New Grand Avenue chalet	-	7,358	7,358
Plow	-	50,299	50,299
ATV and tractors	-	110,642	110,642
Disc golf course	-	9,052	9,052
Snowmobiles	-	19,279	19,279
Snow gun	-	16,000	16,000
Air conditioner	-	9,171	9,171
Skis/poles	-	1,460	1,460
Other equipment	-	6,847	6,847
Bridge	103,400	-	103,400
Campground repairs	5,962	-	5,962
Total Capital Improvements	\$ 109,362	\$ 1,358,125	\$ 1,467,487

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

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED APRIL 30, 2015**

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

INTERNAL CONTROL

ITEMS ARISING THIS YEAR

Finding 2015-001

Segregation of Duties

Criteria: Management is responsible for establishing and maintaining internal control. Adequate segregation of duties is a key internal control in preventing and detecting errors or irregularities. To protect Spirit Mountain Recreation Area Authority's assets, proper segregation of the record-keeping, custody, and authorization functions should be in place, and where management decides segregation of duties may not be cost effective, compensating controls should be in place.

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

Context: The size of the Authority and its staffing limits the internal control that management can design and implement into the organization. Without proper segregation of duties, errors or irregularities may not be detected timely.

Effect: Inadequate segregation of duties could adversely affect the Authority's ability to detect misstatements in a timely period by employees in the normal course of performing their assigned functions.

Cause: The size of Spirit Mountain Recreation Area Authority and its staffing limits the internal control that management can design and implement into the organization.

Recommendation: Management should be aware that segregation of duties is not adequate from an internal control point of view. We recommend the Board of Directors and management be mindful that limited staffing causes inherent risks in safeguarding the Authority's assets and the proper reporting of its financial activity. We recommend the Board of Directors and management continue to implement oversight procedures and monitor those procedures to determine if they are still effective internal controls.

Client's Response:

During fiscal year 2015, we had employee turnover in relations to the finance director and payroll and vault supervisor. During this time, while hiring for these vacancies and during our transition period, the segregation of duties has been limited. At the end of fiscal year 2015, we were in the process of hiring for said positions. We will review our segregation of duties and monitor for compliance.

Finding 2015-002

Audit Adjustments

Criteria: 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, misstatement of the financial statements on a timely basis. Auditing standards define a material weakness as a deficiency, or combination of deficiencies, in internal control 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.

Condition: During our audit, we identified material adjustments that resulted in significant changes to the Authority's financial statements.

Context: The inability to detect material misstatements in the financial statements increases the likelihood that the financial statements would not be fairly presented.

Effect: Capital assets and contracts payable were increased by \$442,547 for unrecorded water line project costs incurred prior to year-end. Due from City of Duluth increased by \$564,787 for water line project costs that were reimbursed through grant revenue of \$32,300 and capital contributions of \$532,487.

Cause: The adjustments resulted from controls not detecting these errors and the Authority not ensuring that all transactions have been properly recorded to be presented in the financial statements.

Recommendation: We recommend the Authority staff review the trial balances and journal entries in detail to ensure that all transactions have been properly recorded to be presented in the financial statements.

Client's Response:

This adjustment was made due to how the state and city funding for the water project was and is being controlled. In the future, if such a project arises again or we receive other city or state funding, we will verify all transactions and seek the state auditors' help.



REBECCA OTTO
STATE AUDITOR

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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*

Independent Auditor's Report

Mayor and City Council
City of Duluth, Minnesota

Board of Directors
Spirit Mountain Recreation Area Authority

We have audited, 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, the financial statements of Spirit Mountain Recreation Area Authority, a component unit of the City of Duluth, Minnesota, as of and for the year ended April 30, 2015, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated February 17, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Spirit Mountain Recreation Area Authority's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances 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.

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 material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Recommendations, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness and an item that we consider to be a significant deficiency.

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. We consider the deficiency described in the accompanying Schedule of Findings and Recommendations as item 2015-002 to be a material weakness.

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. We consider the deficiency described in the accompanying Schedule of Findings and Recommendations as item 2015-001 to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Spirit Mountain Recreation Area Authority's financial statements are free from 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

The *Minnesota Legal Compliance Audit Guide for Political Subdivisions*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65, contains six categories of compliance to be tested in connection with the audit of the Authority's financial statements: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, and miscellaneous provisions. Our audit considered all of the listed categories, except that we did not test for compliance with the provisions of deposits and investments because the City of Duluth has custody of the Authority's deposits and is responsible for compliance.

In connection with our audit, nothing came to our attention that caused us to believe that Spirit Mountain Recreation Area Authority failed to comply with the provisions of the *Minnesota Legal Compliance Audit Guide for Political Subdivisions*. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Authority's noncompliance with the above referenced provisions.

Spirit Mountain Recreation Area Authority's Response to Findings

Spirit Mountain Recreation Area Authority's responses to the internal control findings identified in our audit have been included in the Schedule of Findings and Recommendations. The Authority's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting, compliance, and the provisions of the *Minnesota Legal Compliance Audit Guide for Political Subdivisions* and the results of that testing, and not to provide an opinion on the effectiveness of the Authority's internal control over financial reporting or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance. Accordingly, this communication is not suitable for any other purpose.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

February 17, 2016