

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

**DULUTH ENTERTAINMENT AND
CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

YEARS ENDED DECEMBER 31, 2007 AND 2006

Description of the Office of the State Auditor

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

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

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

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

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

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

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

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

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

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**DULUTH ENTERTAINMENT AND
CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

Years Ended December 31, 2007 and 2006



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

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DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)

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**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

ORGANIZATION
DECEMBER 31, 2007

| | <u>Term Expires</u> |
|--|---------------------|
| Directors | |
| John Arnold | June 30, 2009 |
| Robert Beaudin | June 30, 2009 |
| Robert Eaton | January 3, 2011 |
| Mark Emmel | June 30, 2009 |
| Gregory Fox | January 3, 2011 |
| Jim Laumeyer | June 30, 2010 |
| Darlene Marshall | June 30, 2010 |
| David McMillan | January 3, 2011 |
| Debra Messer | January 3, 2011 |
| Marsha Signorelli | June 30, 2010 |
| Yvonne Prettner Solon | June 30, 2008 |
| Officers | |
| President | |
| Mark Emmel | June 30, 2009 |
| Vice President | |
| Robert Eaton | January 3, 2011 |
| Treasurer (Duluth City Treasurer) | |
| Brian Hansen | Indefinite |
| Executive Director | |
| Daniel J. Russell | Indefinite |

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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

Duluth Entertainment and Convention Center
Authority Board

We have audited the accompanying financial statements of the Duluth Entertainment and Convention Center Authority, a component unit of the City of Duluth, as of and for the years ended December 31, 2007 and 2006, as listed in the table of contents. 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 the Duluth Entertainment and Convention Center Authority as of December 31, 2007 and 2006, 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.

As discussed in Note 2.F. to the financial statements, during the year ended December 31, 2007, the Authority adopted Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

The Management's Discussion and Analysis and the other required supplementary information referred to in the table of contents are not required parts of the financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures to this information, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 30, 2008, on our consideration of the Duluth Entertainment and Convention Center 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

May 30, 2008

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

MANAGEMENT'S DISCUSSION AND ANALYSIS

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**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2007
(Unaudited)**

This section presents a narrative overview and analysis of the Duluth Entertainment and Convention Center Authority's financial condition and activities for the fiscal year ended December 31, 2007. This information should be read in conjunction with the financial statements.

FINANCIAL HIGHLIGHTS

- In 2007, total net assets decreased \$0.5 million, or 1.3 percent, over the course of the year's operations.
- Total operating revenue did not change significantly in 2007 compared to last year.
- Total operating expenses in 2007 increased by \$0.2 million, or 1.7 percent, compared to 2006.

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, and other management tools were used for this analysis.

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

The financial statements include a statement of net assets; statement of revenues, expenses, and changes in net assets; statement of cash flows; and notes to the financial statements. The statement of net assets presents the financial position of the Authority on a full accrual, historical cost basis. The statement of net assets provides information about the nature and amount of resources and obligations at year-end. The statement of revenues, expenses, and changes in net assets presents the results of the business activities over the course of the fiscal year and information as to how the net assets changed during the year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Authority's recovery of its costs.

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

The notes to the financial statements provide required disclosures and other information essential to a full understanding of material data provided in the statements. The notes present information on 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 April 22, 1963, the Minnesota State Legislature approved the Laws, 1963, Chapter 305, creating the Duluth Arena-Auditorium Board (the "Board"). The Board consisted of seven Directors. The Board, according to Section 5, Subdivision 2, is conferred the power and duty to contract for and superintend the erection, construction, equipping, and furnishing of such arena-auditorium and to administer, promote, control, direct, manage, and operate such arena-auditorium as a municipal facility. Legislation in 1985 renamed the Board the Duluth State Convention Center Administrative Board. In addition, the legislation added four Board members to be appointed by the Governor. In 1998, legislation again changed the name to the Duluth Entertainment and Convention Center Authority (the Authority).

The Authority's mission statement, as defined by the Board of Directors, is committed to provide a multi-dimensional entertainment and convention facility with high quality integrated support services that will maximize the economic and social benefit to our business community, our investors, our clients, and our customers. The method used to accomplish the mission will always revolve around: providing a consistently high level of customer service; operating in a fiscally responsible manner; always recognizing our obligations as a public entity; providing a well-maintained facility that is a source of pride for the community; insisting on excellence in all aspects of Duluth Entertainment Convention Center operations, including safety of the public and employees; broad public access to facility and events; and partnership with community businesses.

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

FINANCIAL ANALYSIS

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

| Condensed Statement of Net Assets | | | | | |
|--|------------------|------------------|------------------|-----------------|-------------------|
| (000s) | | | | | |
| | 2007 | 2006 | 2005 | Dollar Change | |
| | | | | 2006 to 2007 | 2005 to 2006 |
| Assets | | | | | |
| Current and other assets | \$ 1,459 | \$ 1,080 | \$ 1,424 | \$ 379 | \$ (344) |
| Capital assets | 38,949 | 39,531 | 41,539 | (582) | (2,008) |
| Total Assets | \$ 40,408 | \$ 40,611 | \$ 42,963 | \$ (203) | \$ (2,352) |
| Liabilities | | | | | |
| Current liabilities | \$ 1,682 | \$ 1,743 | \$ 2,228 | \$ (61) | \$ (485) |
| Long-term liabilities | 3,888 | 3,563 | 4,255 | 325 | (692) |
| Total Liabilities | \$ 5,570 | \$ 5,306 | \$ 6,483 | \$ 264 | \$ (1,177) |
| Net Assets | | | | | |
| Invested in capital assets | \$ 34,538 | \$ 35,242 | \$ 36,551 | \$ (704) | \$ (1,309) |
| Restricted | 88 | 83 | 82 | 5 | 1 |
| Unrestricted | 212 | (20) | (153) | 232 | 133 |
| Total Net Assets | \$ 34,838 | \$ 35,305 | \$ 36,480 | \$ (467) | \$ (1,175) |

In 2007, net assets decreased \$0.5 million to \$34.8 million, down from \$35.3 million in 2006. The decrease in net assets, due to an increase in accumulated depreciation, was offset by \$0.8 million in capital contributions. In 2006, net assets decreased \$1.2 million to \$35.3 million, down from \$36.5 million in 2005. The decrease in net assets was primarily due to an increase in accumulated depreciation.

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

| | 2007 | 2006 | 2005 | Dollar Change Increase (Decrease) | |
|---|------------------|-------------------|-------------------|--------------------------------------|-------------------|
| | | | | 2006 to 2007 | 2005 to 2006 |
| Operating revenues | \$ 7,265 | \$ 7,260 | \$ 7,345 | \$ 5 | \$ (85) |
| Nonoperating revenues | 981 | 890 | 792 | 91 | 98 |
| Total Revenues | \$ 8,246 | \$ 8,150 | \$ 8,137 | \$ 96 | \$ 13 |
| Operating expenses | \$ 9,154 | \$ 9,001 | \$ 9,329 | \$ 153 | \$ (328) |
| Interest expense | 303 | 320 | 361 | (17) | (41) |
| Amortization of bond issue costs | 4 | 4 | 5 | - | (1) |
| Loss on sale of assets | 19 | - | - | 19 | - |
| Total Expenses | \$ 9,480 | \$ 9,325 | \$ 9,695 | \$ 155 | \$ (370) |
| Excess of Revenues Over (Under) Expenses | \$ (1,234) | \$ (1,175) | \$ (1,558) | \$ (59) | \$ 383 |
| Capital contributions | 767 | - | - | 767 | - |
| Change in Net Assets | \$ (467) | \$ (1,175) | \$ (1,558) | \$ 708 | \$ 383 |
| Net Assets - January 1 | 35,305 | 36,480 | 38,038 | (1,175) | (1,558) |
| Net Assets - December 31 | \$ 34,838 | \$ 35,305 | \$ 36,480 | \$ (467) | \$ (1,175) |

Comparison with Budget
(000s)

| | 2007 Actual | 2007 Budget | Variance with Budget | Percent Change (%) |
|--|------------------|------------------|----------------------------|--------------------------|
| Operating revenues | \$ 7,265 | \$ 7,529 | \$ (264) | (3.5) |
| Nonoperating revenues | 981 | 925 | 56 | 5.9 |
| Total Revenues | \$ 8,246 | \$ 8,454 | \$ (208) | (2.5) |
| Operating expenses | \$ 9,154 | \$ 9,160 | \$ 6 | 0.1 |
| Interest expense | 303 | 327 | 24 | 7.3 |
| Amortization of bond issue costs | 4 | 4 | - | - |
| Loss on sale of assets | 19 | - | (19) | (100.0) |
| Total Expenses | \$ 9,480 | \$ 9,491 | \$ 11 | 0.1 |
| Excess of Revenues Over (Under) Expenses | \$ (1,234) | \$ (1,037) | \$ (197) | (19.0) |
| Capital contributions | 767 | - | 767 | 100.0 |
| Net Assets - January 1 | 35,305 | 35,305 | - | - |
| Net Assets - December 31 | \$ 34,838 | \$ 34,268 | \$ 570 | 1.7 |

(Unaudited)

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Revenues

The Authority's operating revenues increased \$5,000 to \$7.3 million in 2007. Nonoperating revenues were up \$90,000 compared to last year due to an increase in Hotel/Motel tax revenue.

Expenses

The Authority's operating expenses increased \$152,000 to \$9.2 million in 2007 due to other postemployee benefits reporting per Governmental Accounting Standards Board Statement 45.

Budgetary Highlights

Operating revenues were lower than budget by \$264,000 in 2007 due to lower attendance at the Omnimax. Operating expenses were on budget due in 2007, missing budget by \$11,000, or 0.1 percent.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

| | Capital Assets (000s) | | Dollar Change | Percent Change (%) |
|--------------------------------|--------------------------|------------------|------------------|--------------------------|
| | 2007 | 2006 | | |
| Land | \$ 906 | \$ 906 | \$ - | - |
| Land improvements | 303 | 303 | - | - |
| Buildings and structures | 62,065 | 61,801 | 264 | 0.4 |
| Equipment | 7,960 | 7,173 | 787 | 11.0 |
| Work in progress | 62 | 25 | 37 | 148.0 |
| Subtotal | \$ 71,296 | \$ 70,208 | \$ 1,088 | 1.6 |
| Less: accumulated depreciation | (32,347) | (30,676) | (1,671) | 5.5 |
| Net Capital Assets | <u>\$ 38,949</u> | <u>\$ 39,532</u> | <u>\$ (583)</u> | (1.5) |

By the end of 2007, the Authority had invested \$71.3 million in capital assets. The \$1.1 million increase during the past year was mainly due to the additions of the ice floor (\$842K) and the donated sound shell (\$767K), less the sale of assets (\$578K). For more information, see Note 2.C. to the financial statements.

Debt Administration

| | Debt (000s) | | | |
|-------------------------|-----------------|-----------------|------------------|--------------------------|
| | 2007 | 2006 | Dollar Change | Percent Change (%) |
| Ice floor lease | \$ 843 | \$ - | \$ 843 | 100.0 |
| Locker room lease | 1,022 | 1,119 | (97) | (8.7) |
| Omnimax bonds | 2,910 | 3,565 | (655) | (18.4) |
| Server lease | - | 27 | (27) | (100.0) |
| Omnimax platter upgrade | - | 11 | (11) | (100.0) |
| Total Debt | <u>\$ 4,775</u> | <u>\$ 4,722</u> | <u>\$ 53</u> | 1.1 |

As of December 31, 2007, the Authority's outstanding debt increased \$53,000, or 1.1 percent, compared to December 31, 2006. Additional debt incurred in 2007 includes the ice floor lease. For additional information, see Notes 2.J. and 2.K. to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

Many factors were considered when completing the budget for 2008. Convention business in 2008 will be a little better than in recent years. A modest increase in revenue is projected for 2008 compared to the 2007 budget mainly for catering and building services. Rent and building services prices for 2008 were established in 2004 and included a minimal increase for some goods and services. New catering prices will be in effect in January 2008, and some concessions prices were increased in October 2007. Operating expenses in 2008 are projected to increase modestly compared to the 2007 budget. Cost increases are budgeted for utilities and cost of goods sold.

REQUESTS FOR INFORMATION

This financial report is designed to provide 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 Director, Duluth Entertainment and Convention Center Authority, 350 Harbor Drive, Duluth, Minnesota 55802.

FINANCIAL STATEMENTS

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**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

EXHIBIT A

**COMPARATIVE STATEMENT OF NET ASSETS
DECEMBER 31, 2007 AND 2006**

| | 2007 | 2006 |
|---|----------------------|----------------------|
| <u>Assets</u> | | |
| Current assets | | |
| Cash and cash equivalents | \$ 469,291 | \$ 146,295 |
| Accounts receivable | 378,318 | 296,784 |
| Due from City of Duluth | 109,343 | 97,586 |
| Inventory | 156,324 | 162,421 |
| Prepaid items | 21,463 | 20,507 |
| Total current assets | \$ 1,134,739 | \$ 723,593 |
| Restricted current assets | | |
| Assets restricted for customers' deposits | | |
| Cash and cash equivalents | \$ 206,192 | \$ 228,424 |
| Accounts receivable | 20,693 | 29,955 |
| Assets restricted for employee flexible benefits | | |
| Cash and cash equivalents | 1,074 | 3,319 |
| Total restricted current assets | \$ 227,959 | \$ 261,698 |
| Total current assets | \$ 1,362,698 | \$ 985,291 |
| Noncurrent assets | | |
| Restricted debt service - assets held by trustee | | |
| Lease financing escrow account | \$ 88,385 | \$ 83,185 |
| Bond issuance costs | 7,534 | 11,221 |
| Total noncurrent assets, other than capital assets | \$ 95,919 | \$ 94,406 |
| Capital assets | | |
| Not depreciated | \$ 967,801 | \$ 930,601 |
| Depreciated | 70,328,028 | 69,276,942 |
| Less: allowance for depreciation | (32,347,252) | (30,676,152) |
| Total capital assets - net of accumulated depreciation | \$ 38,948,577 | \$ 39,531,391 |
| Total noncurrent assets | \$ 39,044,496 | \$ 39,625,797 |
| Total Assets | \$ 40,407,194 | \$ 40,611,088 |

**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

**EXHIBIT A
(Continued)**

**COMPARATIVE STATEMENT OF NET ASSETS
DECEMBER 31, 2007 AND 2006**

| | 2007 | 2006 |
|---|----------------------|----------------------|
| <u>Liabilities</u> | | |
| Current liabilities | | |
| Accounts payable | \$ 250,797 | \$ 270,338 |
| Salaries payable | 77,211 | 66,595 |
| Compensated absences payable - current | 91,439 | 109,305 |
| Due to City of Duluth | 17,700 | - |
| Accrued interest payable | 41,103 | 31,673 |
| Deferred revenue | 188,231 | 214,920 |
| General obligation revenue bonds payable - current | 685,000 | 655,000 |
| Capital leases payable - current | 102,699 | 133,293 |
| | \$ 1,454,180 | \$ 1,481,124 |
| Current liabilities payable from restricted assets | | |
| Customer deposits | \$ 226,886 | \$ 258,379 |
| Employee flexible benefits plan | 1,074 | 3,319 |
| | \$ 227,960 | \$ 261,698 |
| | \$ 1,682,140 | \$ 1,742,822 |
| Noncurrent liabilities | | |
| Compensated absences payable - long-term | \$ 67,286 | \$ 62,504 |
| General obligation revenue bonds payable - long-term | 2,225,000 | 2,910,000 |
| Less: unamortized discount | (7,627) | (11,349) |
| Less: deferred amount on refunding | (335,813) | (421,565) |
| Capital leases payable - long-term | 1,761,870 | 1,023,797 |
| Net other postemployment benefits liability | 176,825 | - |
| | \$ 3,887,541 | \$ 3,563,387 |
| | \$ 5,569,681 | \$ 5,306,209 |
| <u>Net Assets</u> | | |
| Net Assets | | |
| Invested in capital assets, net of related debt | \$ 34,537,448 | \$ 35,242,215 |
| Restricted for debt service | 88,385 | 83,185 |
| Unrestricted | 211,680 | (20,521) |
| | \$ 34,837,513 | \$ 35,304,879 |

**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

EXHIBIT B

**COMPARATIVE STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006**

| | 2007 | 2006 |
|---|-----------------------|-----------------------|
| Operating Revenues | | |
| Sales | \$ 3,039,450 | \$ 3,155,298 |
| Charges for services | 3,949,380 | 3,857,001 |
| Miscellaneous | 275,688 | 247,891 |
| | \$ 7,264,518 | \$ 7,260,190 |
| Operating Expenses | | |
| Personal services | \$ 3,901,923 | \$ 3,814,183 |
| Supplies and services | 1,267,932 | 1,381,319 |
| Utilities | 795,384 | 690,298 |
| Other services and charges | 1,141,840 | 1,064,348 |
| Depreciation | 2,046,569 | 2,051,156 |
| | \$ 9,153,648 | \$ 9,001,304 |
| Operating Income (Loss) | \$ (1,889,130) | \$ (1,741,114) |
| Nonoperating Revenues (Expenses) | | |
| Interest income | \$ 7,298 | \$ 8,673 |
| Hotel/motel tax revenue | 973,207 | 881,349 |
| Interest expense | (302,707) | (319,838) |
| Amortization of bond issue costs | (3,687) | (4,360) |
| Loss on sale of capital assets | (19,311) | - |
| | \$ 654,800 | \$ 565,824 |
| Income (Loss) Before Contributions | \$ (1,234,330) | \$ (1,175,290) |
| Capital contributions | 766,964 | - |
| Change in Net Assets | \$ (467,366) | \$ (1,175,290) |
| Net Assets - January 1 | 35,304,879 | 36,480,169 |
| Net Assets - December 31 | \$ 34,837,513 | \$ 35,304,879 |

**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

EXHIBIT C

**COMPARATIVE STATEMENT OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2007 AND 2006**

| | 2007 | 2006 |
|--|-----------------------|-----------------------|
| Cash Flows from Operating Activities | | |
| Cash received from customers | \$ 6,858,376 | \$ 6,722,312 |
| Cash paid to suppliers | (3,200,922) | (3,357,566) |
| Cash paid to employees | (3,729,811) | (3,779,566) |
| Other operating revenues | 275,688 | 247,891 |
| Net cash provided by (used in) operating activities | \$ 203,331 | \$ (166,929) |
| Cash Flows from Noncapital Financing Activities | | |
| City of Duluth hotel/motel taxes | \$ 961,450 | \$ 867,958 |
| Cash Flows from Capital and Related Financing Activities | | |
| Proceeds from sale of capital assets | \$ 183,261 | \$ - |
| Principal paid on lease purchases | (135,521) | (158,454) |
| Interest paid on lease purchases | (59,316) | (63,136) |
| Payment to lease escrow account | (3,149) | - |
| Principal paid on bonds payable | (655,000) | (630,000) |
| Interest paid on bonds payable | (145,075) | (170,275) |
| Acquisition or construction of capital assets | (56,709) | (43,715) |
| Net cash provided by (used in) capital and related financing activities | \$ (871,509) | \$ (1,065,580) |
| Cash Flows from Investing Activities | | |
| Interest on investments | \$ 5,247 | \$ 6,990 |
| Net Increase (Decrease) in Cash and Cash Equivalents | \$ 298,519 | \$ (357,561) |
| Cash and Cash Equivalents - January 1 | 378,038 | 735,599 |
| Cash and Cash Equivalents - December 31 | \$ 676,557 | \$ 378,038 |
| Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities | | |
| Net operating income (loss) | \$ (1,889,130) | \$ (1,741,114) |
| Adjustments to reconcile net operating income (loss) to net cash provided by (used in) operating activities | | |
| Depreciation | 2,046,569 | 2,051,156 |
| Changes in assets and liabilities | | |
| Decrease (increase) in receivables | (72,272) | (3,407) |
| Decrease (increase) in inventory | 6,097 | (2,256) |
| Decrease (increase) in prepaid items | (956) | 3,632 |
| Increase (decrease) in payables | 173,450 | (188,755) |
| Increase (decrease) in deferred revenue | (26,689) | 44,085 |
| Increase (decrease) in employee flexible benefits plan deposits | (2,245) | 395 |
| Increase (decrease) in customer deposits | (31,493) | (330,665) |
| Net Cash Provided by (Used in) Operating Activities | \$ 203,331 | \$ (166,929) |

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

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**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

EXHIBIT C
(Continued)

**COMPARATIVE STATEMENT OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2007 AND 2006**

| | <u>2007</u> | <u>2006</u> |
|--|-------------|-------------|
| Noncash Investing, Capital, and Financing Activities | | |
| The Authority earned interest on the debt service reserve account. | \$ 2,051 | \$ 1,683 |
| The Authority acquired capital assets under lease purchase agreements. | 842,654 | - |
| The Authority acquired capital assets by donation. | 766,964 | - |

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**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2007**

1. Summary of Significant Accounting Policies

The Duluth Entertainment and Convention Center Authority was created by Minn. Laws 1963, ch. 305; Minn. Laws 1985, 1st Spec. Sess., ch. 15, § 36, as amended; and by Minn. Laws 1998, ch. 404, § 61. The Authority has the power to contract, administer, promote, control, direct, manage, and operate the Duluth Entertainment and Convention Center for the City of Duluth and the State of Minnesota. The Authority consists of seven Directors appointed by the Mayor of the City of Duluth and approved by resolution of the City Council and four Directors appointed by the Governor of Minnesota.

The accounting policies of the Authority conform to generally accepted accounting principles.

A. Financial Reporting Entity

For financial reporting purposes, a reporting entity includes all funds, organizations, agencies, boards, commissions, and authorities for which it is financially accountable and other organizations for which the nature and significance of their relationship with it are such that exclusion would cause its financial statements to be misleading or incomplete. The Governmental Accounting Standards Board (GASB) has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the reporting entity to impose its will on that organization, or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the reporting entity.

As required by generally accepted accounting principles, these financial statements present the Duluth Entertainment and Convention Center Authority, a component unit of the City of Duluth. The Authority is included in the City of Duluth's reporting entity because of the significance of its operational or financial relationships with the City.

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)

1. Summary of Significant Accounting Policies (Continued)

B. Basis of Presentation

The accounts of the Duluth Entertainment and Convention Center Authority are presented as an enterprise fund. Enterprise funds are used to account for operations that are 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.

C. Basis of Accounting

Accounting records are maintained on the accrual basis, under which revenues are recorded when earned and expenses are recorded when liabilities are incurred.

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

D. Budget and Budgetary Accounting

Budgetary control is maintained through an annual budget adopted by the Duluth Entertainment and Convention Center Authority. The budget is prepared on the accrual basis of accounting.

E. Cash and Cash Equivalents

Cash and cash equivalents consist of cash and investments held by the Treasurer of the City of Duluth. Investments are stated at fair value, and investment revenue is recorded as it is earned. 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. The lease financing escrow account is not considered to be a cash equivalent because the Authority cannot withdraw from this account at any time without penalty.

F. Inventories of Merchandise for Resale

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

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)

1. Summary of Significant Accounting Policies (Continued)

G. Capital Assets

All capital assets are valued at historical or estimated historical cost. Donated capital assets are recorded at estimated fair market value at the date of donation.

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

Net interest costs on funds borrowed to finance construction of capital assets in proprietary funds are capitalized during the construction period and amortized over the life of the related asset.

H. Depreciation

Depreciation of capital assets is determined using the straight-line method. The estimated useful lives of the assets are 40 years for buildings and structures, 20 years for improvements, and 3 to 20 years for equipment.

I. Restricted Assets

Restricted assets consist of promoter-escrowed funds, the employee flexible benefit plan account, and assets held by a trustee. Promoter-escrowed funds consist of cash and receivables escrowed on behalf of various promoters related to advance ticket sales for upcoming events. The employee flexible spending plan account consists of amounts withheld from employees pursuant to Internal Revenue Service regulations designated for reimbursement to employees for specific plan expenses. Assets held by the trustee consist of cash held pursuant to a reserve requirement of a lease agreement as described in Note 2.J.

When an expense is incurred for purposes for which both restricted and unrestricted net assets are available, it is the Authority's policy to use restricted resources first.

J. Deferred Revenue

Deferred revenue represents advance deposits to reserve Authority facilities for future events, proceeds from the sale of gift certificates for the Omnimax Theater that have not been redeemed as of year-end, and lease revenues that have not been earned as of year-end.

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)

1. Summary of Significant Accounting Policies (Continued)

K. Operating Revenues

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

L. 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.

M. Trade-Offs

The Authority exchanges scoreboard advertising, attraction admissions, building rent, and other services for other non-monetary assets or services such as radio, television, or print advertising. The value of the services exchanged are debited to the appropriate expense accounts and credited to the appropriate revenue accounts.

2. Detailed Notes

A. Deposits and Investments

Minn. Laws 1963, ch. 305, designates the City of Duluth Treasurer as the Treasurer of the Authority. Minn. Stat. §§ 118A.02 and 118A.04 authorize the City Treasurer to deposit the Authority's cash and to invest in certificates of deposit in financial institutions designated by the Duluth City Council. Minnesota statutes require that all of the Authority's deposits be covered by insurance, surety bond, or collateral.

Minn. Stat. §§ 118A.04 and 118A.05 authorize the types of investment securities available to the City of Duluth Treasurer.

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)

2. Detailed Notes

A. Deposits and Investments (Continued)

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

The following is a summary of the Authority's cash and investments at December 31, 2007 and 2006:

| | 2007 | 2006 |
|--|------------|------------|
| Current assets | | |
| City of Duluth pooled cash account | \$ 270,888 | \$ 96,154 |
| Checking account - ticket office | 7,000 | 7,000 |
| Checking account - employee flexible benefits plan | 7,399 | 7,399 |
| Savings account - operating reserve | 151,399 | 3,137 |
| Petty cash and change funds | 32,605 | 32,605 |
| Total current assets | \$ 469,291 | \$ 146,295 |
| Restricted current assets | | |
| Ticket office customer deposits - checking | \$ 184,007 | \$ 198,478 |
| Ticket office customer deposits - savings | 12,985 | 22,746 |
| Ticket office change fund | 9,200 | 7,200 |
| Employee flexible benefits plan - checking | 1,074 | 3,319 |
| Total restricted current assets | \$ 207,266 | \$ 231,743 |
| Restricted noncurrent assets | | |
| Lease reserve - savings escrow | \$ 88,385 | \$ 83,185 |
| Total | \$ 764,942 | \$ 461,223 |

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)

2. Detailed Notes (Continued)

B. Due From City of Duluth

Amounts due from the City of Duluth at December 31, 2007 and 2006, are as follows:

| | 2007 | 2006 |
|-----------------|------------|-----------|
| Hotel/motel tax | \$ 109,343 | \$ 97,586 |

C. Capital Assets

A summary of the changes in the capital asset accounts for the years ended December 31, 2007 and 2006, follows:

| | Balance January 1, 2007 | Increase | Decrease | Balance December 31, 2007 |
|---------------------------------------|-------------------------------|--------------|------------|---------------------------------|
| Capital assets not depreciated | | | | |
| Land | \$ 905,601 | \$ - | \$ - | \$ 905,601 |
| Construction in progress | 25,000 | 37,200 | - | 62,200 |
| Total capital assets not depreciated | \$ 930,601 | \$ 37,200 | \$ - | \$ 967,801 |
| Capital assets depreciated | | | | |
| Land improvements | \$ 302,957 | \$ - | \$ - | \$ 302,957 |
| Buildings | 61,800,844 | 842,654 | 578,041 | 62,065,457 |
| Equipment | 7,173,141 | 786,473 | - | 7,959,614 |
| Total capital assets depreciated | \$ 69,276,942 | \$ 1,629,127 | \$ 578,041 | \$ 70,328,028 |
| Less: accumulated depreciation for | | | | |
| Land improvements | \$ 302,957 | \$ - | \$ - | \$ 302,957 |
| Buildings | 24,881,375 | 1,782,055 | 375,469 | 26,287,961 |
| Equipment | 5,491,820 | 264,514 | - | 5,756,334 |
| Total accumulated depreciation | \$ 30,676,152 | \$ 2,046,569 | \$ 375,469 | \$ 32,347,252 |
| Total capital assets depreciated, net | \$ 38,600,790 | \$ (417,442) | \$ 202,572 | \$ 37,980,776 |
| Capital Assets, Net | \$ 39,531,391 | \$ (380,242) | \$ 202,572 | \$ 38,948,577 |

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)

2. Detailed Notes

C. Capital Assets (Continued)

| | Balance January 1, 2006 | Increase | Decrease | Balance December 31, 2006 |
|---------------------------------------|-------------------------------|-----------------------|-------------|---------------------------------|
| Capital assets not depreciated | | | | |
| Land | \$ 905,601 | \$ - | \$ - | \$ 905,601 |
| Construction in progress | 25,000 | - | - | 25,000 |
| Total capital assets not depreciated | <u>\$ 930,601</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 930,601</u> |
| Capital assets depreciated | | | | |
| Land improvements | \$ 302,957 | \$ - | \$ - | \$ 302,957 |
| Buildings | 61,800,844 | - | - | 61,800,844 |
| Equipment | 7,129,426 | 43,715 | - | 7,173,141 |
| Total capital assets depreciated | <u>\$ 69,233,227</u> | <u>\$ 43,715</u> | <u>\$ -</u> | <u>\$ 69,276,942</u> |
| Less: accumulated depreciation for | | | | |
| Land improvements | \$ 302,957 | \$ - | \$ - | \$ 302,957 |
| Buildings | 23,099,320 | 1,782,055 | - | 24,881,375 |
| Equipment | 5,222,719 | 269,101 | - | 5,491,820 |
| Total accumulated depreciation | <u>\$ 28,624,996</u> | <u>\$ 2,051,156</u> | <u>\$ -</u> | <u>\$ 30,676,152</u> |
| Total capital assets depreciated, net | <u>\$ 40,608,231</u> | <u>\$ (2,007,441)</u> | <u>\$ -</u> | <u>\$ 38,600,790</u> |
| Capital Assets, Net | <u>\$ 41,538,832</u> | <u>\$ (2,007,441)</u> | <u>\$ -</u> | <u>\$ 39,531,391</u> |

D. Risk Management

The Authority is exposed to various risks of loss related to torts; injuries to employees; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. These risks are covered by commercial insurance purchased from independent third parties. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years. There were no significant reductions in insurance coverage from the previous year. The Authority retains the risk of loss for the first \$10,000 per occurrence.

Permanent employees are eligible to participate in the City of Duluth Group Health Internal Service Fund operated by the City of Duluth for the benefit of governmental units of the City. The Authority pays an annual premium for health and dental insurance coverage.

**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

2. Detailed Notes (Continued)

E. Pension Plans

1. Plan Description

All full-time and certain part-time employees of the Duluth Entertainment and Convention Center Authority are covered by defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the Public 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.

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

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

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

For Public Employees Retirement Fund members whose annuity is calculated using Method 1, a full annuity is available when age plus years of service equal 90. A reduced retirement annuity is also available to eligible members seeking early retirement.

**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

2. Detailed Notes

E. Pension Plans

1. Plan Description (Continued)

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

PERA issues a publicly available financial report that includes financial statements and required supplementary information for the Public 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.

2. Funding Policy

Pension benefits are funded from member and employer contributions and income from the investment of fund assets. Minn. Stat. ch. 353 sets the rates for employer and employee contributions. The Authority makes annual contributions to the pension plans equal to the amount required by state statutes. Public Employees Retirement Fund Basic Plan members and Coordinated Plan members were required to contribute 9.10 and 5.75 percent, respectively, of their annual covered salary in 2007. Contribution rates in the Coordinated Plan increased in 2008 to 6.00 percent.

The Authority is required to contribute the following percentages of annual covered payroll in 2007 and 2008:

| | <u>2007</u> | <u>2008</u> |
|----------------------------------|-------------|-------------|
| Public Employees Retirement Fund | | |
| Basic Plan members | 11.78% | 11.78% |
| Coordinated Plan members | 6.25 | 6.50 |

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)

2. Detailed Notes

E. Pension Plans

2. Funding Policy (Continued)

The Authority's contributions for the years ending December 31, 2007, 2006, and 2005, for the Public Employees Retirement Fund were:

| <u>2007</u> | <u>2006</u> | <u>2005</u> |
|-------------|-------------|-------------|
| \$ 146,996 | \$ 147,709 | \$ 133,680 |

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

F. Postemployment Benefits

In 2007, the Authority prospectively implemented the requirements of a new accounting pronouncement, GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

1. Plan Description and Funding Policy

The Authority provides health insurance benefits for certain retired employees under a single-employer self-insured plan. Employees who retired between January 1, 1983, and January 1, 1995, and employees who were full-time employees prior to January 1, 1995, and retire from the Authority at or after age 62 with at least ten years of full-time service, are eligible to receive hospital/medical benefits to the same extent as active employees for the life of the retiree or surviving spouse. The Authority will pay 80 percent of the premium for these qualifying retirees. The benefits are provided through the City of Duluth's self-insurance plan. A separate report is not issued for the plan. The authority to provide this benefit is established in Minn. Stat. § 471.61, subd. 2a.

Active employees who retire from the Authority when eligible to receive a retirement benefit from PERA who do not qualify for the aforementioned benefits, and do not participate in any other health benefits program providing coverage similar to that herein described, will be eligible to continue coverage with respect to both themselves and their eligible dependents under the Authority's health

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)

2. Detailed Notes

F. Postemployment Benefits

1. Plan Description and Funding Policy (Continued)

benefits program. These retirees are required to pay 100 percent of the total premium cost. Since the premium is a blended rate determined on the entire active and retiree population, the retirees are receiving an implicit rate subsidy. As of June 1, 2007, 13 retirees were receiving health benefits from the Authority's health plan.

The Authority's employment contract with the Executive Director provides for continuing family health insurance coverage for a period of 24 months following the termination of his employment contract. The Authority will provide this benefit.

The cost of other postemployment benefits is funded on a "pay-as-you-go" method.

2. Annual OPEB Cost and Net OPEB Obligation

The Authority's annual other postemployment benefit (OPEB) cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The following table shows the components of the Authority's annual OPEB cost for 2007, the amount actually contributed to the plan, and changes in the Authority's net OPEB obligation:

| | | |
|------------------------------------|----|----------------|
| Annual required contribution (ARC) | \$ | 284,355 |
| Interest on net OPEB obligation | | - |
| Adjustment to ARC | | - |
| | | <hr/> |
| Annual OPEB cost | \$ | 284,355 |
| Contributions during the year | | (107,530) |
| | | <hr/> |
| Increase in net OPEB obligation | \$ | 176,825 |
| Net OPEB, beginning of year | | - |
| | | <hr/> |
| Net OPEB, end of year | \$ | <u>176,825</u> |

**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

2. Detailed Notes

F. Postemployment Benefits

2. Annual OPEB Cost and Net OPEB Obligation (Continued)

The Authority's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2007 were as follows:

| | Fiscal Year Ended December 31, 2007 |
|--|--|
| Percentage of Annual OPEB Cost Contributed | 37.82% |
| Annual OPEB Cost | \$ 284,355 |
| Employer Contributions | 107,530 |
| Net OPEB Obligation | \$ 176,825 |

3. Funding Status and Funding Progress

The actuarial accrued liability for benefits at December 31, 2007, is \$3,709,014. The Authority currently has no assets that have been irrevocably deposited in a trust for future health benefits, thus the entire amount is unfunded. The covered payroll (annual payroll of active employees covered by the plan) is \$1,456,880. The ratio of the unfunded actuarially accrued liabilities (UAAL) to covered payroll is 254.58 percent.

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

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)

2. Detailed Notes

F. Postemployment Benefits (Continued)

4. Actuarial Methods and Assumptions

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

In the June 1, 2007, actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 4.50 percent discount rate, which is based on the estimated long-term investment yield on the general assets of the Authority. The annual healthcare cost trend rate is 10.00 percent initially, reduced incrementally to an ultimate rate of 5.00 percent after 10 years. The unfunded actuarial accrued liability is being amortized as a level dollar amount over 30 years.

G. Compensated Absences

Full-time employees are granted from 10 to 25 days of vacation time per year depending on their years of service. Vacation earned during one year must be taken within the following year. The Executive Director is allowed to carry forward up to 50 days of vacation. Upon termination of employment, employees are compensated for the full value of all unused vacation pay. Part-time employees who work more than 1,000 hours in a calendar year will receive a personal day off (8 hours) for each 100 hours worked in excess of 1,000 hours. Unused vacation and personal leave earned as of December 31, 2007 and 2006, is estimated to be \$91,439 and \$109,305, respectively, and is recognized as a liability in the financial statements. The Executive Director's employment contract provides a benefit of six months of current salary upon termination. This has been accrued in the financial statements in the amount of \$67,286 and \$62,504 as of December 31, 2007 and 2006, respectively. Sick leave is earned at the rate of 1.5 days per month for full-time personnel. No more than 150 days may be carried over at the end of any year. Employees are not compensated for unused sick leave upon termination of employment.

**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

2. Detailed Notes

G. Compensated Absences (Continued)

The contingent liability for sick leave at December 31, 2007 and 2006, was estimated to be \$558,865 and \$566,201, respectively, and is not recognized as a liability in the financial statements.

H. Deferred Revenue

Deferred revenue consists of the following:

| | 2007 | 2006 |
|------------------------------------|------------|------------|
| Advance deposits for future events | \$ 122,995 | \$ 126,639 |
| Gift certificates | 51,430 | 48,281 |
| Deferred lease revenue | 13,806 | 40,000 |
| Total | \$ 188,231 | \$ 214,920 |

I. Minimum Future Rents Receivable

On October 1, 1981, the Authority entered into a 30-year lease agreement with the Duluth Curling Club, Inc., to occupy a portion of the Pioneer Hall Clubrooms for a rental rate of \$1.14 per square foot per year, and the Pioneer Hall Annex Ice Arena for a rental rate of \$1.12 per square foot per six-month period. The rental rate increases or decreases annually by 65 percent of the change in the Consumer Price Index from July 1 to June 30 each year.

On August 15, 2002, the Authority entered into a nine-year lease with the Duluth Curling Club, Inc., to occupy additional locker room space, formerly occupied by the Duluth Chamber of Commerce, for \$7.80 per square foot annually. The rental rate increases or decreases annually by the percent change in the Consumer Price Index, not to exceed five percent in any one year.

On January 9, 2001, the Authority entered into an amended lease agreement with Duluth Superior Excursions for six years with two five-year options to renew. This agreement is for the lease of space and facilities. Rent is adjusted annually based on the percentage increase in the Consumer Price Index. In 2007, rent was \$50,200.

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)

2. Detailed Notes

I. Minimum Future Rents Receivable (Continued)

On March 20, 2001, the Authority entered into a lease agreement with the University of Minnesota for nine years to rent space and facilities for the men's and women's hockey programs. The annual rent ranges from \$224,646 in year one of the agreement to \$290,146 in year nine.

On April 13, 2004, the Authority entered into a lease agreement with Cinema Entertainment Corporation (CEC) for 20 years with two five-year options to renew. This agreement is for the lease of property on which CEC constructed a theater. The annual rent of \$175,000 will be increased by two percent each year in years 2 through 10 and three percent each year in years 11 through 20. In May 2007, Marcus Theatre Corporation purchased the Duluth 10 theater from CEC and is now responsible for the lease.

Minimum future rents on non-cancelable leases are:

| | |
|------------|---------------------|
| 2008 | \$ 591,519 |
| 2009 | 456,057 |
| 2010 | 316,130 |
| 2011 | 303,474 |
| 2012 | 201,020 |
| After 2012 | <u>2,836,833</u> |
| Total | <u>\$ 4,705,033</u> |

J. Leases Payable

In May 2001, the Authority entered into a lease agreement to finance improvements to the locker rooms used by University of Minnesota - Duluth hockey teams. The lease agreement runs for 15 years, with interest at 5.25 percent and semi-annual payments of \$77,500. At lease expiration, the locker room improvements will become the Authority's property and, as such, they have been recorded as capital assets. At December 31, 2007, the locker room improvements are valued at \$1,534,313, with accumulated depreciation of \$460,293.

**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

2. Detailed Notes

J. Leases Payable (Continued)

In August 2007, the Authority entered into a lease agreement to finance a new ice floor for the arena. The lease runs ten years at 4.74 percent interest and includes two semi-annual, interest-only payments of \$20,145 followed by 18 semi-annual payments of \$58,558. After all installments have been paid, the ice floor will become the Authority's property and, as such, it has been recorded as a capital asset valued at \$842,654 on December 31, 2007. There was no depreciation on this asset in 2007.

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

| Year | Locker Room | | Ice Floor | |
|-------------|-------------|--------------|------------|------------|
| | Interest | Principal | Interest | Principal |
| 2008 | \$ 52,302 | \$ 102,698 | \$ 39,958 | \$ - |
| 2009 | 46,839 | 108,161 | 39,055 | 77,096 |
| 2010 | 41,086 | 113,914 | 35,358 | 80,794 |
| 2011 | 35,028 | 119,972 | 31,483 | 84,669 |
| 2012 | 28,646 | 126,354 | 27,422 | 88,729 |
| 2013 - 2017 | 44,944 | 450,470 | 69,043 | 511,712 |
| Total | \$ 248,845 | \$ 1,021,569 | \$ 242,319 | \$ 843,000 |

| Year | Total | |
|-------------|------------|--------------|
| | Interest | Principal |
| 2008 | \$ 92,260 | \$ 102,698 |
| 2009 | 85,894 | 185,257 |
| 2010 | 76,444 | 194,708 |
| 2011 | 66,511 | 204,641 |
| 2012 | 56,068 | 215,083 |
| 2013 - 2017 | 113,987 | 962,182 |
| Total | \$ 491,164 | \$ 1,864,569 |

The lease agreement for the locker room improvements required the Authority to deposit \$77,500 into a reserve account to secure the lease purchase payments.

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)

2. Detailed Notes (Continued)

K. Long-Term Debt

Outstanding bonds consist of \$6,970,000 General Obligation Refunding Revenue Bonds issued April 1, 2001, interest rates at 3.5 percent to 4.2 percent, interest payable June 1 and December 1.

The annual debt service requirements to maturity of the General Obligation Refunding Revenue Bonds as of December 31, 2007, are:

| <u>Year</u> | <u>Interest</u> | <u>Principal</u> | <u>Total</u> |
|--------------|-------------------|---------------------|---------------------|
| 2008 | \$ 118,875 | \$ 685,000 | \$ 803,875 |
| 2009 | 91,475 | 710,000 | 801,475 |
| 2010 | 63,075 | 740,000 | 803,075 |
| 2011 | 32,550 | 775,000 | 807,550 |
| Total | \$ 305,975 | \$ 2,910,000 | \$ 3,215,975 |

The following is a schedule of long-term liability activity of the Duluth Entertainment and Convention Center Authority for the years ended December 31, 2007 and 2006.

| | <u>Balance January 1, 2007</u> | <u>Additions</u> | <u>Reductions</u> | <u>Balance December 31, 2007</u> | <u>Due Within One Year</u> |
|--|--|-------------------|-------------------|--|--------------------------------|
| General obligation refunding revenue bonds | \$ 3,565,000 | \$ - | \$ 655,000 | \$ 2,910,000 | \$ 685,000 |
| Capital leases payable | 1,157,090 | 843,000 | 135,521 | 1,864,569 | 102,699 |
| Compensated absences payable | 171,809 | 120,152 | 133,236 | 158,725 | 91,439 |
| Total | \$ 4,893,899 | \$ 963,152 | \$ 923,757 | \$ 4,933,294 | \$ 879,138 |

| | <u>Balance January 1, 2006</u> | <u>Additions</u> | <u>Reductions</u> | <u>Balance December 31, 2006</u> | <u>Due Within One Year</u> |
|--|--|-------------------|-------------------|--|--------------------------------|
| General obligation refunding revenue bonds | \$ 4,195,000 | \$ - | \$ 630,000 | \$ 3,565,000 | \$ 655,000 |
| Capital leases payable | 1,315,544 | - | 158,454 | 1,157,090 | 133,293 |
| Compensated absences payable | 142,762 | 126,805 | 97,758 | 171,809 | 109,305 |
| Total | \$ 5,653,306 | \$ 126,805 | \$ 886,212 | \$ 4,893,899 | \$ 897,598 |

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)

2. Detailed Notes (Continued)

L. Budget to Actual for 2007 and 2006

The Duluth Entertainment and Convention Center Authority adopts a budget to be approved by the Duluth City Council. A summary of the operating budgets for the fiscal years ended December 31, 2007 and 2006, follows:

| | 2007 | | |
|------------------------------------|----------------|----------------|----------------------------|
| | Budget | Actual | Favorable (Unfavorable) |
| Operating Revenues | \$ 7,528,645 | \$ 7,264,518 | \$ (264,127) |
| Operating Expenses | 9,160,449 | 9,153,648 | 6,801 |
| Operating Income (Loss) | \$ (1,631,804) | \$ (1,889,130) | \$ (257,326) |
| Nonoperating Revenues (Expenses) | 593,885 | 654,800 | 60,915 |
| Income (Loss) Before Contributions | \$ (1,037,919) | \$ (1,234,330) | \$ (196,411) |
| Capital contributions | - | 766,964 | 766,964 |
| Change in Net Assets | \$ (1,037,919) | \$ (467,366) | \$ 570,553 |
| | | | |
| | 2006 | | |
| | Budget | Actual | Favorable (Unfavorable) |
| Operating Revenues | \$ 7,264,325 | \$ 7,260,190 | \$ (4,135) |
| Operating Expenses | 9,137,794 | 9,001,304 | 136,490 |
| Operating Income (Loss) | \$ (1,873,469) | \$ (1,741,114) | \$ 132,355 |
| Nonoperating Revenues (Expenses) | 464,912 | 565,824 | 100,912 |
| Change in Net Assets | \$ (1,408,557) | \$ (1,175,290) | \$ 233,267 |

REQUIRED SUPPLEMENTARY INFORMATION

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**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

**SCHEDULE OF FUNDING PROGRESS
OTHER POSTEMPLOYMENT BENEFIT PLAN
DECEMBER 31, 2007**

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (b) | Unfunded Actuarial Accrued Liability (UAAL) (b - a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as Percentage of Covered Payroll ((b - a)/c) |
|--------------------------------|-------------------------------------|--|--|--------------------------|---------------------------|---|
| June 1, 2007 | \$ - | \$ 3,709,014 | \$ 3,709,014 | 0.00% | \$ 1,456,880 | 254.58% |

Notes to Schedule of Funding Progress

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

The Authority implemented Governmental Accounting Standards Board Statement 45 for the fiscal year ended December 31, 2007. Information for prior years is not available.

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**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF DULUTH)**

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2007**

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

A. INTERNAL CONTROL

ITEM ARISING THIS YEAR

07-1 Journal Entries

Journal entries are made on the general ledger system by the Finance Director and the General Ledger Accountant. The journal entries made by the General Ledger Accountant are reviewed by the Finance Director. The journal entries made by the Finance Director are not reviewed and approved by anyone else.

The ability to make journal entries on the general ledger system is a powerful function. It allows those employees with access to the journal entry function to make changes to general ledger accounts.

To improve internal controls over this function, we recommend the Finance Director review whether any other personnel besides the Finance Director and General Ledger Accountant have access to the journal entry function and, if so, determine if there is a logical need for that access. We also recommend a procedure be established to require review and approval of journal entries by someone other than the person making the journal entries. This approval should be documented by signature on a journal entry form or a printed copy of the journal entry made. There should be supporting documentation attached to the journal entry or sufficient explanation on the journal entry to explain why the journal entry is being made and who is making the journal entry.

A report which lists all journal entries made to the general ledger system should be reviewed periodically by the person charged with review and approval of journal entries. Review of this report would be to ensure that no journal entries have been made which have not been submitted for review and approval and journal entries are not being made by staff who are not authorized to make journal entries.

Client's Response:

The Executive Director will review journal entries made by the Finance Director. A procedure will be set up to ensure this is completed on a monthly basis.

B. MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM NOT RESOLVED

99-1 Meals

In our prior audit, we noted 13 instances where the Authority paid for meals for meetings between staff members only with no outside parties present. During our current audit, we noted 10 occasions where staff-on-staff meals were paid for by the Authority. During our review of this area, we found that while Authority staff documented who attended the meeting and the topics discussed, they did not document the necessity of meeting during the meal time.

The Minnesota Attorney General held in Op. Atty. Gen. 63a-2, May 6, 1965, that there exists no public purpose for a public unit to pay lunch expenses when its employees meet over a lunch hour. Stated another way, public employees who work together cannot go to lunch and charge their employer, even if they do business while eating.

In prior audits, we have also noted instances where liquor was reimbursed as part of the meal. We did not note any occasions where liquor was reimbursed during the current audit. However, in nine instances, the vouchers which we reviewed for meal reimbursements were not itemized vouchers; therefore, we were unable to determine the nature of the charges.

The issue of the Authority reimbursing employees for meals has been addressed in past management letters. The position of the Office of the State Auditor and the Attorney General's Office is that staff-on-staff meals do not meet the "public purpose" standard required by the state constitution. It is the position of the Office of the State Auditor that reimbursement for liquor as part of a meal would never meet the "public purpose" standard.

The Authority's travel and entertainment policy does not address that liquor is an unallowable cost. The City of Duluth's meal reimbursement policy and the State of Minnesota's policies do not allow alcohol as a reimbursable cost.

Reimbursements of liquor as part of a meal should not be allowed by the Authority's Board of Directors. We recommend the Authority's travel and entertainment policy specifically prohibit reimbursement for alcohol. Some cities have avoided expenditures for alcohol by allowing separate non-profit entities, such as convention and visitors bureaus, to handle some promotional services. We suggest this type of arrangement be considered by the Authority.

We recommend the Authority Board discontinue the practice of paying for meals where only staff attends. Itemized receipts should support vouchers so that accounting staff can determine that only appropriate charges are reimbursed.

Client's Response:

On January 29, 2008, the DECC Board of Directors adopted a new DECC Employee Meal Policy. The policy prohibits reimbursement of meals when only DECC employees are present.

At the October 30, 2007, Board meeting, the DECC Board of Directors unanimously passed a motion stating that future liquor expenses will not be reimbursed by the DECC.

ITEMS ARISING THIS YEAR

07-2 Prompt Payment of Invoices

Minn. Stat. § 471.425 requires a municipality to make payment to a vendor according to the terms of the contract, or within 35 days of the completed delivery of the goods or services or the receipt of the invoice, whichever is later. Six of the 40 vouchers we tested during our audit were not paid within the 35-day time period required by the statute.

We recommend the Authority review the payment process and establish procedures to comply with Minn. Stat. § 471.425.

Client's Response:

The Finance Director will review accounts payable procedures to ensure prompt payment on all future invoices.

07-3 Withholding Affidavit for Contractors (IC134)

Minn. Stat. § 270C.66 requires the Authority to obtain a certificate by the Commissioner of Revenue that each contractor or subcontractor has withheld Minnesota taxes pursuant to law (either a certified Form IC134 "Withholding Affidavit for Contractors;" or a confirmation page from the Department of Revenue, if the contractor withholding affidavit is submitted electronically).

The Authority did not obtain a certificate from Commercial Refrigeration before making final settlement on the contract for the ice floor placement.

We recommend the Authority obtain the required certified Form IC134 or Department of Revenue confirmation page before making final settlement on any construction contracts.

Client's Response:

This was a result of a misunderstanding of the role of the architect/engineering firm regarding the contractor. This will be monitored more closely on future projects.



REBECCA OTTO
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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

Duluth Entertainment and Convention Center
Authority Board

We have audited the financial statements of the Duluth Entertainment and Convention Center Authority, a component unit of the City of Duluth, as of and for the year ended December 31, 2007, and have issued our report thereon dated May 30, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Duluth Entertainment and Convention Center 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph of this section and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Authority's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Authority's financial statements that is more than inconsequential will not be prevented or detected by the Authority's internal control. We considered the deficiency described in the accompanying Schedule of Findings and Recommendations as item 07-1 to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Authority's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we do not believe the significant deficiency described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Duluth Entertainment and Convention Center 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 Local Government*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* contains six categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, and miscellaneous provisions. Our study included all of the listed categories.

The results of our tests indicate that, for the items tested, the Duluth Entertainment and Convention Center Authority complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Recommendations as items 99-1, 07-2, and 07-3.

The Duluth Entertainment and Convention Center Authority's written responses to the significant deficiency 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 Duluth Entertainment and Convention Center Authority Board, Mayor and City Council of Duluth, the Authority's management, and others within the Duluth Entertainment and Convention Center 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

May 30, 2008