

# STATE OF MINNESOTA

## Office of the State Auditor



**Rebecca Otto**  
**State Auditor**

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

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

**For the Years Ended December 31, 2007 and 2006**



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

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**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

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**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

ORGANIZATION  
DECEMBER 31, 2007

|                    | <u>Term Ending</u> |
|--------------------|--------------------|
| Directors          |                    |
| Nancy Aronson Norr | July 1, 2008       |
| David Boe          | July 1, 2008       |
| John Eagleton      | July 1, 2010       |
| Conrad Firling     | July 1, 2009       |
| Roy Niemi          | July 1, 2010       |
| Michael Orman      | July 1, 2009       |
| Robert Pearson     | July 1, 2009       |
| Executive Director |                    |
| Brian Ryks         |                    |
| Officers           |                    |
| President          |                    |
| Nancy Aronson Norr |                    |
| Vice President     |                    |
| Michael Orman      |                    |
| Secretary          |                    |
| John Eagleton      |                    |

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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

Board of Directors  
Duluth Airport Authority

We have audited the accompanying basic financial statements of the Duluth Airport 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 Airport 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 6 to the financial statements, during the year ended December 31, 2007, the Authority adopted Governmental Accounting Standards Board (GASB) 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 listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We applied certain limited procedures, which consisted primarily 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.

Our audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying financial information listed as supplementary information in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Authority. The supplementary information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 13, 2008, on our consideration of the Duluth Airport Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

June 13, 2008

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

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**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

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

Our discussion and analysis of the Duluth Airport Authority's financial performance provides an overview of the Airport's financial activities for the fiscal year ended December 31, 2007. Please read it in conjunction with the financial statements.

**FINANCIAL HIGHLIGHTS**

- Operating expenses (before depreciation and amortization) increased \$451.7 thousand, or 14 percent, compared to Fiscal Year 2006. The increase is attributed primarily to price increases for fuel; employee benefits costs in workers' compensation, travel, and salaries; and increased costs for professional services for an incentive based airline development consultant.
- Operating revenue increased \$420.9 thousand, or 13 percent, due in large part to increased revenues and activity related to and resulting from Midwest Airlines operating in Duluth during much of 2007. Additionally, additional rental properties contributed to the revenue growth.
- Non-operating federal and state grant revenues declined \$3.3 million, or 27 percent, from 2006. Contributed capital increased \$2.6 million from 2006 due primarily to the transfer of a hangar from the Air National Guard. Total net assets increased \$8.3 million, or 14 percent, compared to Fiscal Year 2006.
- Total number of passengers increased by 60.4 thousand, or 21 percent, for a total of 349.5 thousand in 2007.
- Total traffic count as recorded by the FAA tower increased by 3.0 thousand, or 4 percent. Of this figure, approximately 80 percent is commercial and general aviation traffic, with the remaining 20 percent military traffic.
- Landing fee revenues for 2007 increased by \$79.4 thousand, or 25 percent, due to increased traffic count and higher commercial activity.
- Passenger Facility Charge revenue increased \$156.9 thousand in 2007, or 30 percent, compared to 2006, which is attributed to the record passenger counts of 2007.

- Total Parking Lot concession sales increased by \$161.0 thousand, or 25 percent, for 2007.
- Total Car Rental concession sales increased by \$60.8 thousand, or 16 percent, for 2007.
- The 2007/2008 State Maintenance and Operations Agreement, which became effective July 1, 2007, provided for \$185.4 thousand of state aid.
- The Transportation Security Administration extended its agreement with DAA effective October 1, 2007, through September 30, 2012, to reimburse the DAA 14 hours per day for contracted Law Enforcement personnel, or approximately \$7.3 thousand per month.

## **OVERVIEW OF ANNUAL FINANCIAL REPORT**

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

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

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

The statement of cash flows 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 that are essential to a full understanding of material data provided in the statements. The notes present information about the Authority's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies, and subsequent events, if any. The financial statements were prepared by the Duluth Airport Authority's staff from the detailed books and records of the Authority. The financial statements were audited and adjusted during the independent external audit process.

## **SUMMARY OF ORGANIZATION AND BUSINESS**

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

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

Operating revenue for the Duluth Airport Authority comes from a variety of sources including: car rental concessions, parking, space and land rentals, Fixed Base Operator concessions, TSA reimbursement for law enforcement, maintenance and operations grant funds from the State of Minnesota, landing fees, and Air National Guard joint use funds. The DAA is self-sufficient and is not subsidized by the City of Duluth for operations or capital improvement costs.

## FINANCIAL ANALYSIS

The following comparative condensed financial statements and other selected information serve as the key financial data and indicators for management, monitoring, and planning. Comments regarding year-to-year variances follow.

### Condensed Statement of Net Assets (000s)

|  | <u>FY 2007</u>   | <u>FY 2006</u>   | <u>FY 2005</u>   |
|--|------------------|------------------|------------------|
| Current and restricted assets                | \$ 3,920         | \$ 9,167         | \$ 5,663         |
| Capital assets                               | 56,811           | 28,225           | 25,791           |
| Construction in progress                     | <u>9,185</u>     | <u>29,254</u>    | <u>20,606</u>    |
| Total Assets                                 | <u>\$ 69,916</u> | <u>\$ 66,646</u> | <u>\$ 52,060</u> |
| Current liabilities                          | \$ 2,583         | \$ 7,745         | \$ 4,191         |
| Long-term liabilities                        | <u>1,075</u>     | <u>981</u>       | <u>670</u>       |
| Total Liabilities                            | <u>\$ 3,658</u>  | <u>\$ 8,726</u>  | <u>\$ 4,861</u>  |
| Net Assets                                   |                  |                  |                  |
| Restricted passenger facility charge revenue |                  |                  |                  |
| Invested in capital assets                   | \$ 65,081        | \$ 56,439        | \$ 45,622        |
| Unrestricted                                 | <u>1,177</u>     | <u>1,481</u>     | <u>1,577</u>     |
| Total Net Assets                             | <u>\$ 66,258</u> | <u>\$ 57,920</u> | <u>\$ 47,199</u> |

As can be seen from the table, net assets increased by \$8.3 million to \$66.3 million in 2007, up from \$57.9 million in 2006. The increase in net assets was primarily due to the \$8.6 million increase in invested in capital assets, as well as a decrease of \$304 thousand in unrestricted net assets.

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

|                          | FY 2007                |                        | FY 2006                 | FY 2005                 |
|--------------------------|------------------------|------------------------|-------------------------|-------------------------|
|                          | Actual                 | Budget                 | Actual                  | Actual                  |
| Total operating revenues | \$ 3,617               | \$ 3,332               | \$ 3,196                | \$ 2,811                |
| Total operating expenses | <u>(7,613)</u>         | <u>(5,457)</u>         | <u>(5,509)</u>          | <u>(5,275)</u>          |
| Income (Loss)            | <u>\$ (3,996)</u>      | <u>\$ (2,125)</u>      | <u>\$ (2,313)</u>       | <u>\$ (2,464)</u>       |
| Non-operating revenues   | \$ 790                 | \$ 773                 | \$ 666                  | \$ 584                  |
| Other revenues           | 11,657                 | 3,501                  | 12,413                  | 12,811                  |
| Non-operating expenses   | <u>(113)</u>           | <u>(23)</u>            | <u>(45)</u>             | <u>(9)</u>              |
| Change In Net Assets     | <u><u>\$ 8,338</u></u> | <u><u>\$ 2,126</u></u> | <u><u>\$ 10,721</u></u> | <u><u>\$ 10,922</u></u> |

## REVENUES

Operating revenues increased by \$420.9 thousand, or 13 percent, in 2007 relative to 2006. The increase is due to several factors, the most significant being additional activity associated with a record passenger year including landing fees, parking and rental car concessions, and space rental income. Additionally, the Authority acquired additional hangar and other properties that generated rental revenues.

## EXPENSES

Duluth Airport Authority's expenses increased by \$2,104 thousand to \$7,613 thousand in 2007, up from \$5,509 thousand in 2006. The increase was due primarily to increased depreciation expense from completed construction projects and equipment purchases, increased fuel costs, and to increased employee benefits expense in workers' compensation and other postemployment benefits. Expenses for repairs and maintenance increased by \$44.8 thousand due to upkeep of aging facilities and due to airfield lighting component cost increases. Expense for operating supplies increased by \$33.9 thousand due primarily to increased fuel costs. Employee benefits expenses increased by \$236.1 thousand due largely to an increase of \$164.8 thousand in health insurance and other postemployment benefits costs and to workers' compensation expense increases of \$68.1 thousand from claim payments. Payroll costs increased from \$867 thousand in 2006 to \$910.4 thousand in 2007.

## **BUDGETARY HIGHLIGHTS**

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

The past five years have been challenging and tumultuous for the aviation industry. The return of passenger travel has been gradual. The effects of 9/11, which transformed airline and passenger security, resulted in increased costs and numerous airline bankruptcies.

The airline industry remains intensely competitive and volatile. Increased fuel costs plague profitability and continued service to smaller marginally profitable markets. Positively for Duluth, Allegiant Airlines had another full and productive year of service to Las Vegas from Duluth twice weekly. Midwest Airlines began operating two flights daily from Duluth to Milwaukee but unfortunately discontinued service in November 2007. Finally, Monaco Air has had a productive and successful year of operations as the Fixed Base Operator. Their marketing efforts for international servicing have shown very positive results. Monaco's operations have led to more services for corporate, charter, and general aviation users as well as increased revenues for the DAA.

The DAA continued to make improvements to facilities, infrastructure, and respond to new security directives with the following major projects completed in 2007: (1) Runway 9/27 Rehabilitation/Shoulder and Lighting Project - \$8.4 million, (2) Perimeter Road and Fencing - \$10.7 million, and (3) TSA Baggage Screening Expansion - \$2.2 million.

The union contract between the Duluth Airport Authority and AFSCME Local 66 was renegotiated in 2006 and is effective through December 31, 2009.

**Capital Assets**  
(000s)

|                                | <u>FY 2007</u>       | <u>FY 2006</u>       | <u>Dollar Change</u><br><u>Increase (Decrease)</u> | <u>Total %</u><br><u>Change</u> |
|--------------------------------|----------------------|----------------------|--|---------------------------------|
| Land                           | \$ 3,361             | \$ 2,898             | \$ 463   | 15.98                           |
| Runways                        | 66,491               | 41,441               | 25,050   | 60.45                           |
| Buildings                      | 21,077               | 15,777               | 5,300  | 33.59                           |
| Equipment                      | 6,485                | 4,763                | 1,722  | 36.15                           |
| Construction in progress       | <u>9,185</u>         | <u>29,254</u>        | <u>(20,069)</u>                                    | (68.60)                         |
| <br>Total capital assets       | <br>\$ 106,599       | <br>\$ 94,133        | <br>\$ 12,466                                      | <br>13.24                       |
| Less: accumulated depreciation | <u>41,169</u>        | <u>37,318</u>        | <u>3,851</u>                                       | 10.32                           |
| <br>Net Capital Assets         | <br><u>\$ 65,430</u> | <br><u>\$ 56,815</u> | <br><u>\$ 8,615</u>                                | <br>15.16                       |

At the end of 2007, the Duluth Airport Authority has invested approximately \$106.6 million in capital assets since its inception. The \$12 million increase in capital assets this past year is due to several major projects including the Phase 3 Rehabilitation of Runway 9/27, the North Perimeter Road and Fencing construction, completion of the TSA Terminal Expansion, equipment purchases of \$1.5 million, and Sky Harbor Dock and Ramp improvements.

The Duluth Airport Authority recently submitted a new Airport Capital Improvement Program (ACIP) through 2019, which includes for 2008:

- \$2.4 million for Phase 1 of the new Terminal design,
- \$3.0 million for General Aviation site development,
- \$1.2 million for General Aviation hangars,
- \$400 thousand for an additional passenger loading bridge, and
- \$677 thousand for Sky Harbor Airport environmental assessment.

## DEBT ADMINISTRATION

The City of Duluth obtained a \$500,000 loan from the Minnesota Investment Fund (MIF) to remedy soil conditions on Duluth Airport Authority (DAA) property. On December 20, 2005, the DAA entered into an agreement with the Duluth Economic Development Authority (DEDA) that provided that DAA agreed to make payments due on the loan in the amount of \$400,000. The loan is non-interest bearing, payable in 180 monthly installments of \$2,222 beginning February 2006. The non-current portion of the loan payable is \$322,222.

The Duluth Airport Authority entered into a Lease Acquisition Agreement with North Country Aviation (NCA) on November 1, 2005, where DAA agrees to pay NCA \$497,378.55. The purpose of the note was to acquire the NCA's FBO lease agreement and to facilitate its transfer to Monaco Air. Such amount shall be payable by the DAA as Airport Facility Revenue Note, Series 2005A. The note is for a term of 13 years, payable each June 1st and December 1st commencing June 1, 2007. Interest is compounded at 8.85 percent per annum.

### Debt (000s)

A summary of changes in the revenue note balances are:

|                       | FY 2007       |
|-----------------------|---------------|
| Balance - January 1   | \$ 497        |
| Additions             | -             |
| Payments              | -             |
| Balance - December 31 | <u>\$ 497</u> |

## ECONOMIC AND OTHER FACTORS

When setting the 2007 budget, the Duluth Airport Authority took many factors into consideration: the continuing financial turmoil of the commercial aviation sector, the still lingering effects of 9/11 and its effects on commercial air travel as well as airport security, weather conditions which dictate utility costs and overtime for snow removal crews, energy price increases, and a general review of all rates and services so that revenue will keep pace with expenses. The Duluth Airport Authority has taken steps to raise all rental and concession fees to competitive rates and carefully manages costs for supplies and services. The DAA actively seeks new lessees to occupy vacant space as well as economic development opportunities that are a good fit for the aviation sector. An example of this is the DAA's development efforts for the North Business Area and its partnership with the Duluth Economic Development Authority to facilitate Cirrus Design's leasing of the former Northwest Airlines Maintenance Facility. The Duluth Airport Authority will continue to seek diversifying revenue sources in order to be less reliant on airline revenue sources.



## **FINANCIAL CONTACT**

This financial report is designed to provide our customers and creditors with a general overview of the Duluth Airport Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Director of Finance, Duluth Airport Authority, 4701 Grinden Drive, Duluth, Minnesota 55811.

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## **BASIC FINANCIAL STATEMENTS**

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**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

**EXHIBIT A**

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

|   | <b>2007</b>          | <b>2006</b>          |
|---|----------------------|----------------------|
| <b>Assets</b>   |                      |                      |
| <b>Current assets</b>   |                      |                      |
| Cash and cash equivalents   | \$ 383,492           | \$ 1,456,121         |
| Accounts receivable   | 718,754              | 405,343              |
| Grants receivable   | 60,999               | 57,855               |
| Inventory   | 87,100               | 64,759               |
| Prepaid items   | 49,849               | 49,375               |
| Assets restricted for construction  |                      |                      |
| Cash and cash equivalents   | 366,495              | 4,487,234            |
| Accounts receivable   | 48,221               | 75,272               |
| Grants receivable   | 2,205,271            | 2,570,990            |
| <b>Total current assets</b>   | <b>\$ 3,920,181</b>  | <b>\$ 9,166,949</b>  |
| <b>Noncurrent assets</b>  |                      |                      |
| <b>Capital assets</b>   |                      |                      |
| Nondepreciable  | \$ 12,546,485        | \$ 32,151,871        |
| Depreciable   | 94,051,962           | 61,980,161           |
| Less: allowance for depreciation  | (41,168,791)         | (37,317,485)         |
| <b>Net capital assets</b>   | <b>\$ 65,429,656</b> | <b>\$ 56,814,547</b> |
| <b>Other assets</b>   |                      |                      |
| Airport planning costs, net of accumulated amortization of<br>\$543,625 in 2007 and \$481,881 in 2006 | \$ 147,252           | \$ 208,996           |
| Lease buyout costs, net of accumulated amortization of<br>\$108,853 in 2007 and \$72,460 in 2006      | 418,526              | 454,919              |
| <b>Total other assets</b>   | <b>\$ 565,778</b>    | <b>\$ 663,915</b>    |
| <b>Total noncurrent assets</b>  | <b>\$ 65,995,434</b> | <b>\$ 57,478,462</b> |
| <b>Total Assets</b>   | <b>\$ 69,915,615</b> | <b>\$ 66,645,411</b> |

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

**EXHIBIT A  
(Continued)**

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

|   | <b>2007</b>          | <b>2006</b>          |
|---|----------------------|----------------------|
| <b>Liabilities</b>                              |                      |                      |
| <b>Current liabilities</b>                      |                      |                      |
| Accounts payable                                | \$ 73,168            | \$ 70,793            |
| Due to City of Duluth                           | 30,900               | 29,939               |
| Due to other governments                        | 31,417               | 24,573               |
| Accrued salaries payable                        | 28,885               | 21,008               |
| Accrued vacation payable                        | 63,419               | 57,234               |
| Construction contracts payable                  | 1,870,906            | 2,898,574            |
| Accrued interest payable                        | 41,050               | 52,904               |
| Deferred revenue                                | 416,567              | 4,563,133            |
| Loans payable                                   | 26,667               | 26,667               |
| <b>Total current liabilities</b>                | <b>\$ 2,582,979</b>  | <b>\$ 7,744,825</b>  |
| <b>Noncurrent liabilities</b>                   |                      |                      |
| Deferred revenue                                | \$ 96,339            | \$ 134,433           |
| Loans payable                                   | 322,222              | 348,889              |
| Revenue notes payable                           | 497,379              | 497,379              |
| Net other postemployment benefits liability     | 158,824              | -                    |
| <b>Total noncurrent liabilities</b>             | <b>\$ 1,074,764</b>  | <b>\$ 980,701</b>    |
| <b>Total Liabilities</b>                        | <b>\$ 3,657,743</b>  | <b>\$ 8,725,526</b>  |
| <b>Net Assets</b>                               |                      |                      |
| Invested in capital assets, net of related debt | \$ 65,080,767        | \$ 56,438,991        |
| Unrestricted                                    | 1,177,105            | 1,480,894            |
| <b>Total Net Assets</b>                         | <b>\$ 66,257,872</b> | <b>\$ 57,919,885</b> |

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

**EXHIBIT B**

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

|   | <b>2007</b>           | <b>2006</b>           |
|---|-----------------------|-----------------------|
| <b>Operating Revenues</b>                             |                       |                       |
| Charges for services                                  | \$ <b>3,616,723</b>   | \$ <b>3,195,847</b>   |
| <b>Operating Expenses</b>                             |                       |                       |
| Personal services                                     | \$ 1,471,756          | \$ 1,259,992          |
| Supplies  | 119,115               | 110,802               |
| Utilities   | 442,317               | 452,535               |
| Other services and charges                            | 1,615,385             | 1,373,499             |
| Depreciation  | 3,865,686             | 2,188,723             |
| Amortization  | 98,137                | 123,851               |
| <b>Total Operating Expenses</b>                       | <b>\$ 7,612,396</b>   | <b>\$ 5,509,402</b>   |
| <b>Net Operating Income (Loss)</b>                    | <b>\$ (3,995,673)</b> | <b>\$ (2,313,555)</b> |
| <b>Nonoperating Revenues (Expenses)</b>               |                       |                       |
| Earnings on investments                               | \$ 568                | \$ 91,401             |
| Passenger facility charge                             | 685,633               | 528,706               |
| Gain (loss) on disposal of capital assets             | (65,081)              | -                     |
| Interest expense                                      | (48,146)              | (45,630)              |
| Marketing grant                                       | 77,713                | 46,042                |
| Small community air service development grant         | 26,461                | -                     |
| <b>Total Nonoperating Revenues (Expenses)</b>         | <b>\$ 677,148</b>     | <b>\$ 620,519</b>     |
| <b>Net Income (Loss) Before Capital Contributions</b> | <b>\$ (3,318,525)</b> | <b>\$ (1,693,036)</b> |
| <b>Capital Contributions</b>                          |                       |                       |
| Capital grants  |                       |                       |
| Federal   | \$ 8,548,529          | \$ 12,199,085         |
| State   | 459,435               | 120,066               |
| Contributed capital                                   | 2,648,548             | 94,432                |
| <b>Total Capital Contributions</b>                    | <b>\$ 11,656,512</b>  | <b>\$ 12,413,583</b>  |
| <b>Change in Net Assets</b>                           | <b>\$ 8,337,987</b>   | <b>\$ 10,720,547</b>  |
| <b>Net Assets - January 1</b>                         | <b>57,919,885</b>     | <b>47,199,338</b>     |
| <b>Net Assets - December 31</b>                       | <b>\$ 66,257,872</b>  | <b>\$ 57,919,885</b>  |

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

**EXHIBIT C**

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

|  | <b>2007</b>           | <b>2006</b>         |
|--|-----------------------|---------------------|
| <b>Cash Flows from Operating Activities</b>  |                       |                     |
| Cash received from customers   | \$ 3,032,130          | \$ 3,066,836        |
| Cash paid to suppliers   | (2,189,452)           | (2,293,021)         |
| Cash paid to employees   | (1,457,694)           | (1,247,153)         |
| Other cash receipts  | 239,674               | 223,476             |
|  | <b>\$ (375,342)</b>   | <b>\$ (249,862)</b> |
| <b>Cash Flows from Noncapital Financing Activities</b>   |                       |                     |
| Small community air service development grant  | <b>\$ 26,461</b>      | <b>\$ 76,493</b>    |
| <b>Cash Flows from Capital and Related Financing Activities</b>  |                       |                     |
| Principal paid on loans  | \$ (26,667)           | \$ (24,444)         |
| Capital grants - federal   | 5,204,961             | 16,242,713          |
| Capital grants - state   | 118,656               | 161,760             |
| Passenger facility charge  | 712,684               | 513,091             |
| Acquisition or construction of capital assets  | (10,854,689)          | (13,167,286)        |
|  | <b>\$ (4,845,055)</b> | <b>\$ 3,725,834</b> |
| <b>Cash Flows from Investing Activities</b>  |                       |                     |
| Interest on investments  | <b>\$ 568</b>         | <b>\$ 91,401</b>    |
| <b>Net Increase (Decrease) in Cash and Cash Equivalents</b>  | <b>\$ (5,193,368)</b> | <b>\$ 3,643,866</b> |
| <b>Cash and Cash Equivalents - January 1</b>   | <b>5,943,355</b>      | <b>2,299,489</b>    |
| <b>Cash and Cash Equivalents - December 31</b>   | <b>\$ 749,987</b>     | <b>\$ 5,943,355</b> |
| <b>Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used for) Operating Activities</b>     |                       |                     |
| <b>Net operating income (loss)</b>   | \$ (3,995,673)        | \$ (2,313,555)      |
| Adjustments to reconcile net operating income (loss) to net cash provided by (used for) operating activities |                       |                     |
| Depreciation   | 3,865,686             | 2,188,723           |
| Amortization   | 98,137                | 123,851             |
| Marketing grant  | 77,713                | 46,042              |
| Changes in assets and liabilities  |                       |                     |
| Decrease (increase) in receivables   | (316,555)             | 83,358              |
| Decrease (increase) in inventory   | (22,341)              | (9,775)             |
| Decrease (increase) in prepaids  | (474)                 | 10,240              |
| Increase (decrease) in payables  | 24,242                | (343,811)           |
| Increase (decrease) in deferred revenue  | (106,077)             | (34,935)            |
|  | <b>\$ (375,342)</b>   | <b>\$ (249,862)</b> |



**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

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

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1. Summary of Significant Accounting Policies

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

A. Financial Reporting Entity

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

B. Basis of Presentation

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

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

C. Basis of Accounting

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

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

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1. Summary of Significant Accounting Policies (Continued)

D. Budget

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

E. Cash and Cash Equivalents

Cash and cash equivalents consist of cash and investments held by the Duluth City Treasurer. Investments are stated at fair value. For purposes of the statement of cash flows, all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased are considered to be cash equivalents.

F. Accounts Receivable

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

G. Inventory

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

H. Restricted Assets

Monies restricted for the payment of construction contracts and passenger facility charge revenues are accounted for as restricted assets. When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first and then unrestricted resources as needed.

I. Capital Assets

Capital assets are stated at cost. The Authority's policy is to capitalize assets with a useful life of one year or more and a minimum cost of \$5,000.

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

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1. Summary of Significant Accounting Policies (Continued)

J. Depreciation

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

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

K. Other Assets

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

L. Deferred Revenue

Amounts received as advance payments for construction, rentals, and parking lot commissions are reported as deferred revenue until they are earned. In addition, a rent abatement agreement for land improvements is reported as deferred revenue until earned.

M. Passenger Facility Charges

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

N. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

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2. Detailed Notes

A. Deposits and Investments

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

Minn. Stat. §§ 118A.04 and 118A.05 authorize the types of securities available to the Authority for investment.

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

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

|  | December 31 |              |
|--|-------------|--------------|
|  | 2007        | 2006         |
| City pooled cash and investments             | \$ 196,667  | \$ 242,582   |
| Authority checking accounts                  | 7,631       | 6,816        |
| Authority savings account                    | 545,439     | 5,693,707    |
| Petty cash funds                             | 250         | 250          |
| Total  | \$ 749,987  | \$ 5,943,355 |
| Detail as shown on Comparative Balance Sheet |             |              |
| Current assets                               |             |              |
| Cash and cash equivalents                    | \$ 383,492  | \$ 1,456,121 |
| Assets restricted for construction           |             |              |
| Cash and cash equivalents                    | 366,495     | 4,487,234    |
| Total Cash and Cash Equivalents              | \$ 749,987  | \$ 5,943,355 |

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

2. Detailed Notes (Continued)

B. Capital Assets

A summary of changes in capital assets at December 31, 2007 and 2006, follows:

|                                       | Balance<br>January 1,<br>2007 | Increase              | Decrease         | Transfers              | Balance<br>December 31,<br>2007 |
|---------------------------------------|-------------------------------|-----------------------|------------------|------------------------|---------------------------------|
| Capital assets not depreciated        |                               |                       |                  |                        |                                 |
| Land                                  | \$ 2,898,360                  | \$ -                  | \$ -             | \$ 463,074             | \$ 3,361,434                    |
| Construction in progress              | 29,253,511                    | 9,755,952             | -                | (29,824,412)           | 9,185,051                       |
| Total capital assets not depreciated  | <u>\$ 32,151,871</u>          | <u>\$ 9,755,952</u>   | <u>\$ -</u>      | <u>\$ (29,361,338)</u> | <u>\$ 12,546,485</u>            |
| Capital assets depreciated            |                               |                       |                  |                        |                                 |
| Buildings                             | \$ 15,776,863                 | \$ 2,779,940          | \$ 74,611        | \$ 2,593,861           | \$ 21,076,053                   |
| Runways                               | 41,440,774                    | 9,982                 | -                | 25,040,406             | 66,491,162                      |
| Equipment                             | 4,762,524                     | -                     | 4,848            | 1,727,071              | 6,484,747                       |
| Total capital assets depreciated      | <u>\$ 61,980,161</u>          | <u>\$ 2,789,922</u>   | <u>\$ 79,459</u> | <u>\$ 29,361,338</u>   | <u>\$ 94,051,962</u>            |
| Less: accumulated depreciation for    |                               |                       |                  |                        |                                 |
| Buildings                             | \$ 8,649,109                  | \$ 422,549            | \$ 9,948         | \$ -                   | \$ 9,061,710                    |
| Runways                               | 25,084,755                    | 3,168,288             | -                | -                      | 28,253,043                      |
| Equipment                             | 3,583,621                     | 274,849               | 4,432            | -                      | 3,854,038                       |
| Total accumulated depreciation        | <u>\$ 37,317,485</u>          | <u>\$ 3,865,686</u>   | <u>\$ 14,380</u> | <u>\$ -</u>            | <u>\$ 41,168,791</u>            |
| Total capital assets depreciated, net | <u>\$ 24,662,676</u>          | <u>\$ (1,075,764)</u> | <u>\$ 65,079</u> | <u>\$ 29,361,338</u>   | <u>\$ 52,883,171</u>            |
| Capital Assets, Net                   | <u>\$ 56,814,547</u>          | <u>\$ 8,680,188</u>   | <u>\$ 65,079</u> | <u>\$ -</u>            | <u>\$ 65,429,656</u>            |
|                                       |                               |                       |                  |                        |                                 |
|                                       | Balance<br>January 1,<br>2006 | Increase              | Decrease         | Transfers              | Balance<br>December 31,<br>2006 |
| Capital assets not depreciated        |                               |                       |                  |                        |                                 |
| Land                                  | \$ 2,228,456                  | \$ 518,603            | \$ -             | \$ 151,301             | \$ 2,898,360                    |
| Construction in progress              | 20,605,786                    | 12,807,998            | -                | (4,160,273)            | 29,253,511                      |
| Total capital assets not depreciated  | <u>\$ 22,834,242</u>          | <u>\$ 13,326,601</u>  | <u>\$ -</u>      | <u>\$ (4,008,972)</u>  | <u>\$ 32,151,871</u>            |
| Capital assets depreciated            |                               |                       |                  |                        |                                 |
| Buildings                             | \$ 15,737,438                 | \$ 39,425             | \$ -             | \$ -                   | \$ 15,776,863                   |
| Runways                               | 37,449,467                    | -                     | -                | 3,991,307              | 41,440,774                      |
| Equipment                             | 4,733,288                     | 28,110                | 3,184            | 4,310                  | 4,762,524                       |
| Total capital assets depreciated      | <u>\$ 57,920,193</u>          | <u>\$ 67,535</u>      | <u>\$ 3,184</u>  | <u>\$ 3,995,617</u>    | <u>\$ 61,980,161</u>            |

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

2. Detailed Notes

B. Capital Assets (Continued)

|                                       | Balance<br>January 1,<br>2006 | Increase       | Decrease | Transfers    | Balance<br>December 31,<br>2006 |
|---------------------------------------|-------------------------------|----------------|----------|--------------|---------------------------------|
| Less: accumulated depreciation for    |                               |                |          |              |                                 |
| Buildings                             | \$ 8,214,890                  | \$ 434,219     | \$ -     | \$ -         | \$ 8,649,109                    |
| Runways                               | 23,535,228                    | 1,549,527      | -        | -            | 25,084,755                      |
| Equipment                             | 3,381,828                     | 204,977        | 3,184    | -            | 3,583,621                       |
| Total accumulated depreciation        | \$ 35,131,946                 | \$ 2,188,723   | \$ 3,184 | \$ -         | \$ 37,317,485                   |
| Total capital assets depreciated, net | \$ 22,788,247                 | \$ (2,121,188) | \$ -     | \$ 3,995,617 | \$ 24,662,676                   |
| Capital Assets, Net                   | \$ 45,622,489                 | \$ 11,205,413  | \$ -     | \$ (13,355)  | \$ 56,814,547                   |

Included in capital asset additions for 2006 is \$94,432 in contributed capital. This is comprised of \$89,406 from the City of Duluth for soil cleanup on Airport grounds and \$5,026 from an Airport lessee for improvement to the restaurant facilities.

Included in capital asset additions for 2007 is \$2,648,548 in contributed capital. This is for two buildings on Airport grounds turned over to the Authority from other governmental units. These are recorded at fair market value.

As of December 31, 2007, the Authority had the following commitments with respect to unfinished construction projects:

| Projects                           | Remaining<br>Construction<br>Commitment |
|------------------------------------|---|
| AIP 05                             | \$ 569,493                              |
| AIP 38                             | 244,458                                 |
| AIP 39                             | 164,713                                 |
| AIP 40                             | 1,225,052                               |
| AIP 41                             | 477,478                                 |
| AIP 43                             | 228,409                                 |
| SP 6901-151                        | 278,470                                 |
| Air National Guard By-pass Project | 397,282                                 |
| Total                              | \$ 3,585,355                            |

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

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2. Detailed Notes

B. Capital Assets (Continued)

As of December 31, 2006, the Authority had the following commitments with respect to unfinished construction projects:

| Projects                           | Remaining<br>Construction<br>Commitment |
|------------------------------------|---|
| AIP 38                             | \$ 384,742                              |
| AIP 39                             | 173,382                                 |
| AIP 40                             | 1,024,043                               |
| AIP 41                             | 549,098                                 |
| AIP 42                             | 1,561,230                               |
| SP 6901-151                        | 252,450                                 |
| Air National Guard By-pass Project | 397,282                                 |
| Air National Guard ARFF II/paving  | 4,142,886                               |
| Total                              | \$ 8,485,113                            |

C. Vacation and Sick Leave

Full-time employees are granted from 12 to 28 days of vacation time per year depending on their years of service. Maximum amounts of vacation time that can be accumulated range from 18 to 42 days. Unpaid vacation time earned at year-end is recognized as a liability in the financial statements. Sick leave is granted to a maximum of 120 days per illness and is recorded as an expense when paid. Employees are not compensated for unused sick leave. Any liability for earned, unused sick leave is not recognized in the financial statements.

D. Leases

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

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

2. Detailed Notes

D. Leases (Continued)

Minimum future rents receivable on noncancellable leases are:

|            |           |                  |
|------------|-----------|------------------|
| 2008       | \$        | 185,857          |
| 2009       |           | 185,857          |
| 2010       |           | 185,857          |
| 2011       |           | 170,603          |
| 2012       |           | 166,831          |
| After 2012 |           | <u>1,913,575</u> |
| Total      | <u>\$</u> | <u>2,808,580</u> |

Contingent rental income from operating leases for 2007 and 2006 was \$1,209,390 and \$957,269, respectively.

E. Budgets

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

|                             | 2007                  |                       | Variance<br>Favorable<br>(Unfavorable) |
|-----------------------------|-----------------------|-----------------------|--|
|                             | Budget                | Actual                |  |
| Operating Revenues          |                       |                       |  |
| Charges for services        | \$ 3,331,750          | \$ 3,616,723          | \$ 284,973                             |
| Operating Expenses          |                       |                       |  |
| Personal services           | \$ 1,703,200          | \$ 1,471,756          | \$ 231,444                             |
| Supplies                    | 174,400               | 119,115               | 55,285                                 |
| Utilities                   | 486,500               | 442,317               | 44,183                                 |
| Other services and charges  | 1,012,900             | 1,615,385             | (602,485)                              |
| Depreciation                | 2,000,000             | 3,865,686             | (1,865,686)                            |
| Amortization                | 80,000                | 98,137                | (18,137)                               |
| Total Operating Expenses    | <u>\$ 5,457,000</u>   | <u>\$ 7,612,396</u>   | <u>\$ (2,155,396)</u>                  |
| Net Operating Income (Loss) | <u>\$ (2,125,250)</u> | <u>\$ (3,995,673)</u> | <u>\$ (1,870,423)</u>                  |



**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

2. Detailed Notes

E. Budgets (Continued)

|  | 2007                  |                       |  |
|--|-----------------------|-----------------------|--|
|  | Budget                | Actual                | Variance<br>Favorable<br>(Unfavorable) |
| Nonoperating Revenues (Expenses)               |                       |                       |  |
| Earnings on investments                        | \$ 70,000             | \$ 568                | \$ (69,432)                            |
| Passenger facility charge                      | 650,000               | 685,633               | 35,633                                 |
| Gain (loss) on disposal of capital assets      | -                     | (65,081)              | (65,081)                               |
| Interest expense                               | (22,500)              | (48,146)              | (25,646)                               |
| Marketing grant                                | 52,500                | 77,713                | 25,213                                 |
| Small community air service development grant  | -                     | 26,461                | 26,461                                 |
| Total Nonoperating Revenues (Expenses)         | <u>\$ 750,000</u>     | <u>\$ 677,148</u>     | <u>\$ (72,852)</u>                     |
| Net Income (Loss) Before Capital Contributions | <u>\$ (1,375,250)</u> | <u>\$ (3,318,525)</u> | <u>\$ (1,943,275)</u>                  |
| Capital Contributions                          |                       |                       |  |
| Capital grants - federal                       | \$ 2,863,550          | \$ 8,548,529          | \$ 5,684,979                           |
| Capital grants - state                         | 637,300               | 459,435               | (177,865)                              |
| Contributed capital                            | -                     | 2,648,548             | 2,648,548                              |
| Total Capital Contributions                    | <u>\$ 3,500,850</u>   | <u>\$ 11,656,512</u>  | <u>\$ 8,155,662</u>                    |
| Change in Net Assets                           | <u>\$ 2,125,600</u>   | <u>\$ 8,337,987</u>   | <u>\$ 6,212,387</u>                    |
|  |                       |                       |  |
|  | 2006                  |                       |  |
|  | Budget                | Actual                | Variance<br>Favorable<br>(Unfavorable) |
| Operating Revenues                             |                       |                       |  |
| Charges for services                           | \$ 3,117,756          | \$ 3,195,847          | \$ 78,091                              |
| Operating Expenses                             |                       |                       |  |
| Personal services                              | \$ 1,561,600          | \$ 1,259,992          | \$ 301,608                             |
| Supplies                                       | 154,200               | 110,802               | 43,398                                 |
| Utilities                                      | 520,180               | 452,535               | 67,645                                 |
| Other services and charges                     | 906,250               | 1,373,499             | (467,249)                              |
| Depreciation                                   | 2,005,000             | 2,188,723             | (183,723)                              |
| Amortization                                   | 90,000                | 123,851               | (33,851)                               |
| Total Operating Expenses                       | <u>\$ 5,237,230</u>   | <u>\$ 5,509,402</u>   | <u>\$ (272,172)</u>                    |
| Net Operating Income (Loss)                    | <u>\$ (2,119,474)</u> | <u>\$ (2,313,555)</u> | <u>\$ (194,081)</u>                    |

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

2. Detailed Notes

E. Budgets (Continued)

|   | 2006                  |                       | Variance<br>Favorable<br>(Unfavorable) |
|---|-----------------------|-----------------------|--|
|   | Budget                | Actual                |  |
| Nonoperating Revenues (Expenses)                      |                       |                       |  |
| Earnings on investments                               | \$ 40,000             | \$ 91,401             | \$ 51,401                              |
| Passenger facility charge                             | 520,000               | 528,706               | 8,706                                  |
| Interest expense                                      | -                     | (45,630)              | (45,630)                               |
| Marketing grant                                       | -                     | 46,042                | 46,042                                 |
| <b>Total Nonoperating Revenues (Expenses)</b>         | <b>\$ 560,000</b>     | <b>\$ 620,519</b>     | <b>\$ 60,519</b>                       |
| <b>Net Income (Loss) Before Capital Contributions</b> | <b>\$ (1,559,474)</b> | <b>\$ (1,693,036)</b> | <b>\$ (133,562)</b>                    |
| Capital Contributions                                 |                       |                       |  |
| Capital grants - federal                              | \$ 10,388,045         | \$ 12,199,085         | \$ 1,811,040                           |
| Capital grants - state                                | 2,459,290             | 120,066               | (2,339,224)                            |
| Contributed capital                                   | -                     | 94,432                | 94,432                                 |
| <b>Total Capital Contributions</b>                    | <b>\$ 12,847,335</b>  | <b>\$ 12,413,583</b>  | <b>\$ (433,752)</b>                    |
| <b>Change in Net Assets</b>                           | <b>\$ 11,287,861</b>  | <b>\$ 10,720,547</b>  | <b>\$ (567,314)</b>                    |

F. Long-Term Debt

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

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

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

2. Detailed Notes

F. Long-Term Debt (Continued)

The annual requirements to service the debt follow:

| Year Ended<br>December 31 | Revenue Note      |                   | MIF Loan          |
|---------------------------|-------------------|-------------------|-------------------|
|                           | Principal         | Interest          | Principal         |
| 2008                      | \$ -              | \$ 75,000         | \$ 26,667         |
| 2009                      | 22,170            | 52,830            | 26,667            |
| 2010                      | 33,673            | 41,327            | 26,667            |
| 2011                      | 36,719            | 38,281            | 26,667            |
| 2012                      | 40,040            | 34,960            | 26,667            |
| 2013 - 2017               | 261,545           | 113,455           | 133,334           |
| 2018 - 2021               | 103,232           | 9,268             | 82,220            |
| Total                     | <u>\$ 497,379</u> | <u>\$ 365,121</u> | <u>\$ 348,889</u> |

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

|                       | 2007              | 2006              |
|-----------------------|-------------------|-------------------|
| Balance - January 1   | \$ 872,935        | \$ 497,379        |
| Additions             | -                 | 400,000           |
| Payments              | (26,667)          | (24,444)          |
| Balance - December 31 | <u>\$ 846,268</u> | <u>\$ 872,935</u> |
| Due Within One Year   | <u>\$ 26,667</u>  | <u>\$ 26,667</u>  |

3. Risk Management

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; employee health and dental; and natural disasters. The Authority participates in the City of Duluth internal service funds to provide its employees health and dental benefits and to insure against its obligation to provide benefits to employees pursuant to the Minnesota Workers' Compensation Act. The Authority purchases commercial insurance for all other risks of loss. There were no significant reductions in insurance coverage from the previous year. There were no settlements in excess of insurance for any of the past three fiscal years.

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

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3. Risk Management (Continued)

Employee health and dental benefits are provided through the City of Duluth Group Health Internal Service Fund at premium rates established by the City for all plan participants.

An annual contribution is made to the City of Duluth Self-Insurance Internal Service Fund to provide for payment of workers' compensation claims and costs. Additional amounts may be charged to the Authority for contested claims.

4. Major Customers

Major customers of services provided by the Duluth Airport Authority in 2007 were:

|                    | Operating<br>Revenues | Percentage<br>of Total<br>Operating<br>Revenues |
|--------------------|-----------------------|---|
| Northwest Airlines | \$ 509,182            | 14.1  |
| APCOA, Inc.        | 799,740               | 22.1  |

Major customers of services provided by the Duluth Airport Authority in 2006 were:

|                    | Operating<br>Revenues | Percentage<br>of Total<br>Operating<br>Revenues |
|--------------------|-----------------------|---|
| Northwest Airlines | \$ 495,750            | 15.5  |
| APCOA, Inc.        | 638,755               | 20.0  |

5. Pension Plans

A. Plan Description

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

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

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5. Pension Plans

A. Plan Description (Continued)

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 retirement benefits are based on a member's highest average salary for any five successive years of allowable service, age, and years of credit at termination of service.

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

For 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.

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.

The 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](http://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.

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

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5. Pension Plans (Continued)

B. 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:

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

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

|    | 2007   | 2006      | 2005      |
|----|--------|-----------|-----------|
| \$ | 57,354 | \$ 51,299 | \$ 44,088 |

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

6. Other 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*.

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

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6. Other Postemployment Benefits (Continued)

A. Plan Description and Funding Policy

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

The Authority participates in the City of Duluth Group Health Internal Service Fund and pays the required premiums to provide health care benefits and term life insurance for eligible retirees and claimed dependents. Health care premiums are paid by the Authority to the same extent as active employees for the life of the retiree or the surviving spouse. Life insurance premiums are also paid by the Authority for the life of the retiree. Premiums paid for eligible retirees and claimed dependents for health care insurance in 2007 totaled \$105,372. In 2006, the amount paid was \$121,046.

B. 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:

|                                 |    |           |
|---------------------------------|----|-----------|
| ARC                             | \$ | 264,196   |
| Interest on net OPEB obligation |    | -         |
| Adjustment to ARC               |    | -         |
|                                 |    | -         |
| Annual OPEB cost                | \$ | 264,196   |
| Contributions during the year   |    | (105,372) |
|                                 |    | (105,372) |
| Increase in net OPEB obligation | \$ | 158,824   |
| Net OPEB, beginning of year     |    | -         |
|                                 |    | -         |
| Net OPEB, end of year           | \$ | 158,824   |

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

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6. Other Postemployment Benefits

B. 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:

| <u>Fiscal Year Ended</u> | <u>Annual OPEB Cost</u> | <u>Employer Contribution</u> | <u>Percentage of Annual OPEB Cost Contributed</u> | <u>Net OPEB Obligation</u> |
|--------------------------|-------------------------|------------------------------|---|----------------------------|
| December 31, 2007        | \$ 264,196              | \$ 105,372                   | 39.88%  | \$ 158,824                 |

C. Funding Status and Funding Progress

The actuarial accrued liability for benefits at December 31, 2007, is \$2,913,973. 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 \$933,230. The ratio of the unfunded actuarially accrued liabilities (UAAL) to covered payroll is 312.25 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, present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

D. Actuarial Methods and Assumptions

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



**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

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6. Other Postemployment Benefits

D. Actuarial Methods and Assumptions (Continued)

In the June 1, 2007, actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 5.7 percent discount rate, which is based on the estimated long-term investment yield on the general assets of the Authority. The annual healthcare cost trend rate is 10 percent initially, reduced incrementally to an ultimate rate of 5 percent after ten years. The unfunded actuarial accrued liability is being amortized as a level dollar amount over 30 years.

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**REQUIRED SUPPLEMENTARY INFORMATION**

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**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

**Schedule 1**

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

| Actuarial<br>Valuation<br>Date | Actuarial<br>Value of<br>Assets<br>(a) | Actuarial<br>Accrued<br>Liability<br>(b) | Unfunded<br>Actuarial<br>Accrued<br>Liability<br>(UAAL)<br>(b - a) | Funded<br>Ratio<br>(a/b) | Covered<br>Payroll<br>(c) | UAAL as a<br>Percentage<br>of Covered<br>Payroll<br>((b - a)/c) |
|--------------------------------|--|--|--|--------------------------|---------------------------|---|
| June 1, 2007                   | \$ -                                   | \$ 2,913,973                             | \$ 2,913,973   | 0.00%                    | \$ 933,230                | 312.25%   |

**Notes**

The Authority implemented GASB Statement No. 45 for the fiscal year ended December 31, 2007. Information for prior years is not available.

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

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**SUPPLEMENTARY INFORMATION**

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**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

**Schedule 2**

**COMPARATIVE STATEMENT OF OPERATING REVENUES  
YEARS ENDED DECEMBER 31, 2007 AND 2006**

|   | 2007         | 2006         |
|---|--------------|--------------|
| <b>Operating Revenues</b>                           |              |              |
| <b>Charges for services</b>                         |              |              |
| <b>Tower building</b>                               |              |              |
| Space rental and services                           | \$ 169,531   | \$ 211,110   |
| <b>Terminal building</b>                            |              |              |
| Loading bridges rent                                | \$ 44,952    | \$ 32,620    |
| Space rental  | 388,372      | 344,807      |
| Utility sales                                       | 32,438       | 32,436       |
| Car rental commissions                              | 430,994      | 370,244      |
| Other commissions                                   | 5,009        | 1,974        |
| Percentage of lessees' sales                        | 10,969       | 12,312       |
| Other income  | 161,170      | 146,411      |
| <b>Total terminal building</b>                      | \$ 1,073,904 | \$ 940,804   |
| <b>Parking lot</b>                                  |              |              |
| Parking lot commissions                             | \$ 799,740   | \$ 638,755   |
| <b>Land, field, and runways</b>                     |              |              |
| Airport use contract - Minnesota Air National Guard | \$ 42,500    | \$ 50,000    |
| Transportation Security Administration charges      | 86,371       | 88,938       |
| State aid for maintenance and operation             | 165,105      | 176,211      |
| Rental income                                       | 378,034      | 331,511      |
| Fuel flowage fees                                   | 132,582      | 121,807      |
| Landing fees  | 396,032      | 316,589      |
| Percentage of lessees' sales                        | 33,693       | 30,690       |
| Utility sales                                       | 12,905       | 10,563       |
| <b>Total land, field, and runways</b>               | \$ 1,247,222 | \$ 1,126,309 |
| <b>Hangar</b>                                       |              |              |
| Space rental  | \$ 176,585   | \$ 126,021   |
| Utility sales                                       | 32,260       | 25,390       |
| <b>Total hangar</b>                                 | \$ 208,845   | \$ 151,411   |
| <b>Sky Harbor</b>                                   |              |              |
| State aid for maintenance and operation             | \$ 20,285    | \$ 20,285    |
| Rental income                                       | 24,378       | 24,368       |
| Fuel sales  | 64,657       | 73,146       |
| Percentage of lessees' sales                        | 2,871        | 2,947        |
| Other income  | 5,290        | 6,712        |
| <b>Total Sky Harbor</b>                             | \$ 117,481   | \$ 127,458   |
| <b>Total Operating Revenues</b>                     | \$ 3,616,723 | \$ 3,195,847 |

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**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

*Schedule 3*

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED DECEMBER 31, 2007

**I. SUMMARY OF AUDITOR'S RESULTS**

- A. Our report expresses an unqualified opinion on the basic financial statements of the Duluth Airport Authority.
- B. A significant deficiency in internal control was disclosed by the audit of the financial statements of the Duluth Airport Authority and is reported in the "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*." The significant deficiency is not considered a material weakness.
- C. No instances of noncompliance material to the financial statements of the Duluth Airport Authority were disclosed during the audit.
- D. No matters involving internal control over compliance relating to the audit of the major federal award programs were reported in the "Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133 and Passenger Facility Charge Programs."
- E. The Auditor's Report on Compliance for the major federal award programs for the Duluth Airport Authority expresses an unqualified opinion.
- F. No findings were disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133.
- G. The major programs are:

|  |              |
|--|--------------|
| Airport Improvement Program                  | CFDA #20.106 |
| Port Security Research and Development Grant | CFDA #97.060 |
- H. The threshold for distinguishing between Types A and B programs was \$300,000.
- I. The Duluth Airport Authority was determined to be a low-risk auditee.

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEM NOT RESOLVED

06-1 Internal Control/Segregation of Duties

Management is responsible for establishing and maintaining internal control. This responsibility includes the internal control over the various accounting cycles, the fair presentation of the financial statements and related notes, and the accuracy and completeness of all financial records and related information. Adequate segregation of duties is a key internal control in an organization's accounting system. The size of the Duluth Airport Authority and its staffing limits the internal control that management can design and implement into the organization. Management should be aware that segregation of duties is not adequate from an internal control point of view.

Management is responsible for the accuracy and completeness of all financial records and related information. Also, management is responsible for controls over the period-end financial reporting process, including controls over procedures used to enter transaction totals into the general ledger; initiate, authorize, record, and process journal entries into the general ledger; and record recurring and nonrecurring adjustments to the financial statements.

Management has requested that we prepare the annual financial statements and related notes. This arrangement is not unusual for an organization the size of the Duluth Airport Authority. This decision was based on the availability of the Authority's staff and the cost benefit of using our expertise. During our audit, we proposed the following adjustments to convert the Authority's financial records to the financial statements as reported.

- Capital assets and contributed capital were increased by \$2,648,548 to recognize the transfer of ownership of two buildings to the Authority from other governmental units;
- \$25,639,640 of construction in progress was reclassified to the appropriate capital asset accounts for items that were put into use or projects substantially complete; and
- \$1,485,653 of additional depreciation expense and accumulated depreciation was recognized.

We recommend the Authority Board 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 Authority Board continue to implement oversight procedures and monitor those procedures to determine if they are still effective internal controls.

Client's Response:

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

**III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS**

COMPLIANCE

PREVIOUSLY REPORTED ITEM RESOLVED

**National Guard Military Construction Cooperative Agreement, Cash  
Management - CFDA #12.401 (06-2)**

The Duluth Airport Authority earned interest on funds advanced to them from the National Guard Bureau and used the interest earned to fund operations of the airport. This is not allowable per National Guard Grant Regulations.

**Resolution**

The amount of interest earned on the advances was determined and paid back to the granting authority.

**IV. FINDINGS – PASSENGER FACILITY CHARGE (PFC) REGULATIONS**

None.

**V. OTHER FINDINGS AND RECOMMENDATIONS**

MINNESOTA LEGAL COMPLIANCE

ITEM ARISING THIS YEAR

07-1 Vehicle Expense Reimbursement

The Executive Director receives a monthly vehicle allowance of \$250 to cover the cost of the use of his personal vehicle on official Authority business. Our review of travel expenses showed that, in addition, he receives a 48.5 cents per mile reimbursement for out-of-town travel.

Minn. Stat. § 471.665 authorizes public entities to compensate or reimburse their employees for the employees' use of personal vehicles on official business. It allows governing bodies to set a mileage allowance or to pay a "monthly or periodic allowance" in lieu of the mileage allowance. Since one allowance is "in lieu of" the other, public entities can pay either, but not both.

We recommend the Authority Board review its policy for the reimbursement of expenses for personal vehicle use and make appropriate revisions to comply with Minnesota statutes.

Client's Response:

*The Authority Board and Authority Management have reviewed employee reimbursement policies for personal vehicle use to insure compliance with applicable Minnesota statutes.*



## **OTHER REQUIRED REPORTS**

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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**

Mayor and City Council  
City of Duluth

Board of Directors  
Duluth Airport Authority

We have audited the basic financial statements of the Duluth Airport Authority, a component unit of the City of Duluth, as of and for the year ended December 31, 2007, and have issued our report thereon dated June 13, 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 Airport Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

Our consideration of the 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 Questioned Costs as item 06-1 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 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 believe the significant deficiency described above is not a material weakness.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Duluth Airport Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

#### Minnesota Legal Compliance

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for 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 Airport Authority complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Questioned Costs as item 07-1.

The Duluth Airport Authority's written responses to the significant deficiency and legal compliance finding identified in our audit have been included in the Schedule of Findings and Questioned Costs. We did not audit the Authority's responses and, accordingly, we express no opinion on them.

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

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

June 13, 2008

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

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REBECCA OTTO  
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## **REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 AND PASSENGER FACILITY CHARGE PROGRAMS**

Mayor and City Council  
City of Duluth

Board of Directors  
Duluth Airport Authority

### Compliance

We have audited the compliance of the Duluth Airport Authority, a component unit of the City of Duluth, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended December 31, 2007. The Duluth Airport Authority's major federal programs are identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We have also audited the Duluth Airport Authority's compliance with requirements applicable to its passenger facility charge (PFC) funds collected and expended for the year ended December 31, 2007. Compliance with the requirements of laws and regulations applicable to PFC funds is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*; and *Passenger Facility Charge Audit Guide for Public Agencies*, issued by the Federal Aviation

Administration (FAA). Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program or PFC program occurred. An audit includes examining, on a test basis, evidence about the Duluth Airport Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Authority's compliance with those requirements.

In our opinion, the Duluth Airport Authority complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs and its PFC program for the year ended December 31, 2007.

#### Internal Control Over Compliance

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

A control deficiency in internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Authority's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the Authority's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the Authority's internal control.

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



Schedule of Expenditures of Federal Awards and Schedule of Passenger Facility Charges  
Collected and Expended

We have audited the basic financial statements of the Duluth Airport Authority as of and for the year ended December 31, 2007, and have issued our report thereon dated June 13, 2008. Our audit was performed for the purpose of forming an opinion on the Duluth Airport Authority's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards and Schedule of Passenger Facility Charges Collected and Expended are presented for purposes of additional analysis as required by OMB Circular A-133 and the FAA's *Passenger Facility Charge Audit Guide for Public Agencies* and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

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

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

June 13, 2008

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**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

**Schedule 4**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED DECEMBER 31, 2007**

| <b>Federal Grantor<br/>Pass-Through Agency<br/>Grant Program Title</b>        | <b>Federal<br/>CFDA<br/>Number</b> | <b>Pass-Through<br/>Grant Number</b> | <b>Expenditures</b>               |
|---|------------------------------------|--------------------------------------|-----------------------------------|
| <b>Federal Aviation Administration</b>  |                                    |                                      |                                   |
| Passed Through Minnesota Department of Transportation -<br>Aeronautics        |                                    |                                      |                                   |
| AIP-3-27-0025-04  | 20.106                             | 6901-26                              | \$ 10,345                         |
| AIP-3-27-0025-05  | 20.106                             | 6901-27                              | 96,421                            |
| AIP-3-27-0024-37  | 20.106                             | 6901-142                             | 86,673                            |
| AIP-3-27-0024-38  | 20.106                             | 6901-144                             | 584,245                           |
| AIP-3-27-0024-39  | 20.106                             | 6901-147                             | 36,574                            |
| AIP-3-27-0024-40  | 20.106                             | 6901-149                             | 438,817                           |
| AIP-3-27-0024-41  | 20.106                             | 6901-150                             | 126,131                           |
| AIP-3-27-0024-42  | 20.106                             | 6901-151                             | 980,469                           |
| AIP-3-27-0024-43  | 20.106                             | 6901-155                             | <u>1,136,403</u>                  |
| <b>Total CFDA No. 20.106</b>  |                                    |                                      | <b>\$ <u>3,496,078</u></b>        |
| <b>Department of Defense - National Guard Bureau</b>                          |                                    |                                      |                                   |
| Direct  |                                    |                                      |                                   |
| Military Construction Cooperative Agreement                                   | 12.401                             | W912LM-06-2-2101                     | \$ 4,144,852                      |
| Military Construction Cooperative Agreement                                   | 12.401                             | W912LM-05-2-1051                     | 25,874                            |
| Military Construction Cooperative Agreement                                   | 12.401                             | W912LM-07-2-1053                     | <u>42,990</u>                     |
| <b>Total CFDA No. 12.401</b>  |                                    |                                      | <b>\$ <u>4,213,716</u></b>        |
| <b>Department of Labor</b>  |                                    |                                      |                                   |
| Passed Through Minnesota Department of Employment<br>and Economic Development |                                    |                                      |                                   |
| Workforce Investment Act - Dislocated Workers                                 | 17.260                             | 5774500                              | <b>\$ <u>83,064</u></b>           |
| <b>Department of Transportation</b>   |                                    |                                      |                                   |
| Direct  |                                    |                                      |                                   |
| Small Community Air Service Development Pilot Program                         | 20.930                             | DOT Order 2003-9-14                  | <b>\$ <u>26,461</u></b>           |
| <b>Department of Homeland Security</b>  |                                    |                                      |                                   |
| Direct  |                                    |                                      |                                   |
| Port Security Research and Development Grant                                  | 97.060                             | HSTS04-05-A-DEP348                   | <b>\$ <u>755,671</u></b>          |
| <b>Total Expenditures of Federal Awards</b>                                   |                                    |                                      | <b>\$ <u><u>8,574,990</u></u></b> |

Notes to Schedule of Expenditures of Federal Awards

1. The Schedule of Expenditures of Federal Awards presents the activity of federal award programs expended by the Duluth Airport Authority. The Authority's reporting entity is defined in Note 1 to the basic financial statements.
2. The expenditures on this schedule are on the accrual basis of accounting.
3. During 2007, the Duluth Airport Authority did not pass any federal money to subrecipients.

**DULUTH AIRPORT AUTHORITY  
DULUTH, MINNESOTA**

Schedule 5

**SCHEDULE OF PASSENGER FACILITY CHARGES COLLECTED AND EXPENDED  
FOR THE YEAR AND EACH QUARTER WITHIN THE YEAR ENDED DECEMBER 31, 2007**

| <b>Application</b>                                 |           |                    |  |
|--|-----------|--------------------|--|
| <b>Seventh Application*</b>                        |           |                    |  |
| Passenger Facility Charge Collections**            |           |                    |  |
| Prior to January 1, 2007***                        | \$        | 1,010,979          |  |
| Collections in 2007                                |           |                    |  |
| First quarter                                      | \$        | 141,081            |  |
| Second quarter                                     |           | 223,085            |  |
| Third quarter                                      |           | 136,737            |  |
| Fourth quarter                                     |           | 211,781            |  |
| <b>Total collections in 2007</b>                   | <b>\$</b> | <b>712,684</b>     |  |
| <b>Total Collected Through December 31, 2007</b>   | <b>\$</b> | <b>1,723,663</b>   |  |
| <b>Approved expenses through December 31, 2007</b> |           | <b>(1,723,663)</b> |  |
| <b>Unexpended Balance - December 31, 2007</b>      | <b>\$</b> | <b>-</b>           |  |

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

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

\*\*\*Prior year collections include a \$170,581 transfer in of over-collections from PFC's sixth application.