

CITY OF GRAND MARAIS, MINNESOTA

**FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION
Year Ended December 31, 2006**

CITY OF GRAND MARAIS, MINNESOTA

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December 31, 2006

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CITY OF GRAND MARAIS, MINNESOTA

**ORGANIZATION
December 31, 2006**

CITY COUNCIL

Mayor	Mark Sandbo
Councilmember	Edward Bolstad
Councilmember	Kay Costello
Councilmember	Tim Kennedy
Councilmember	Bob Spry

ADMINISTRATION

City Administrator	Michael J. Roth
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FINANCIAL SECTION



CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

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218-749-4880 • FAX 218-749-8528

INDEPENDENT AUDITOR'S REPORT

To the City Council
City of Grand Marais, Minnesota

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Grand Marais, Minnesota, as of and for the year ended December 31, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of City of Grand Marais, Minnesota's, management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Grand Marais, Minnesota, as of December 31, 2006, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 25, 2007, on our consideration of the City of Grand Marais, Minnesota'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.

The management's discussion and analysis and budgetary comparison information, as listed in the table of contents, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Grand Marais, Minnesota's basic financial statements. The combining nonmajor and individual fund financial statements are presented for purposes of additional analysis 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, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Walker, Hironaka & Nelson, Ltd

June 25, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

CITY OF GRAND MARAIS, MINNESOTA

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2006

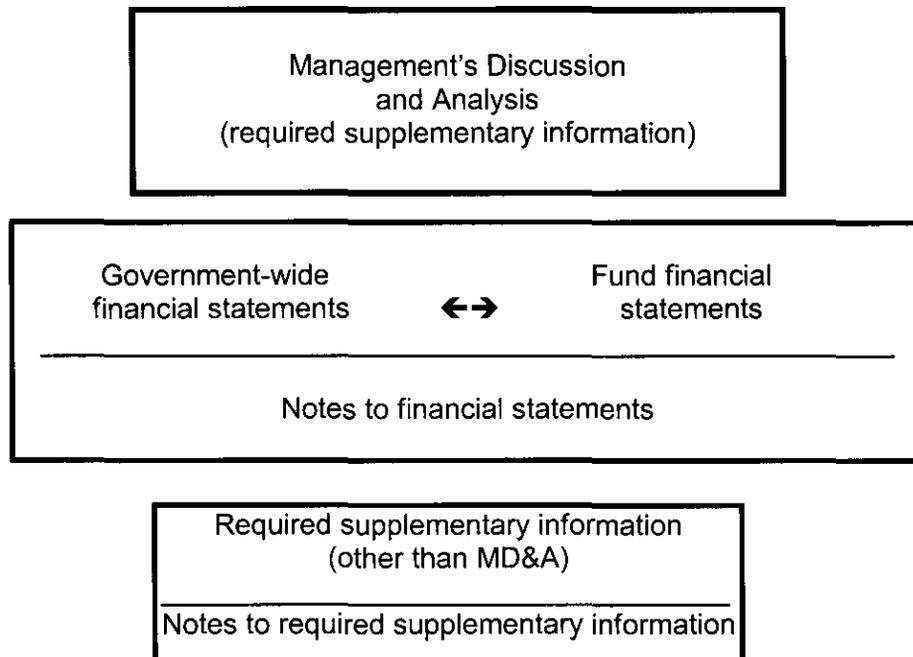
The City of Grand Marais, Minnesota's management's discussion and analysis provides an overview of the City's financial activities for the year ended December 31, 2006. Since this information is designed to focus on the current year's activities, resulting changes, and currently known facts, it should be read in conjunction with the City of Grand Marais, Minnesota's financial statements.

FINANCIAL HIGHLIGHTS

- Governmental activities' total net assets are \$5,195,341, of which \$3,751,491 is invested in capital assets, net of related debt.
- Business-type activities have total net assets of \$10,365,921. Invested in capital assets, net of related debt represents \$7,415,928 of the total.
- The City of Grand Marais's net assets increased by \$748,709 for the year ended December 31, 2006. Of the increase, an increase of \$417,005 was in the governmental activities' net assets and \$331,704 represented the increase in business-type activities' net assets.
- The net cost of governmental activities was \$775,628 for the current year. The net cost was funded by general revenues and other items totaling \$1,192,633.
- Governmental funds' fund balances decreased by \$(466,008).

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the basic financial statements. The City of Grand Marais, Minnesota's basic financial statements consist of three parts: government-wide financial statements, fund financial statements, and notes to the financial statements. The management's discussion and analysis (this section) is required to accompany the basic financial statements, and therefore, is included as required supplementary information. The following chart demonstrates how the different pieces are interrelated.



CITY OF GRAND MARAIS, MINNESOTA

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2006

There are two government-wide financial statements. The statement of net assets and the statement of activities provide information about the activities of the City as a whole and present a longer-term view of the City's finances. The fund financial statements explain how governmental activities were financed in the short term as well as what remains for future spending. Fund financial statements also report the City's operations in more detail than the government-wide statements by providing information about the City's most significant funds.

Government-wide Financial Statements

The statement of net assets and the statement of activities report information about the City, as a whole, and about its activities in a way that helps the reader determine whether the City's financial condition has improved or declined as a result of the year's activities. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These government-wide statements report the City's net assets and how they have changed. You can think of the City's net assets — the difference between assets and liabilities—as one way to measure the City's financial health or financial position. Increases or decreases in the City's net assets are one indicator of whether its financial health is improving or deteriorating. However, other nonfinancial factors, such as changes in the City's property tax base and state aid and the condition of City buildings also need to be considered in assessing the overall health of the City.

In the statement of net assets and the statement of activities, all activities are shown in the governmental activities and business-type activities:

- Governmental activities—Most of the City's basic services are reported here, including general government, public safety, streets, culture and recreation, and economic development. Property taxes and state and federal grants and aids finance most of these activities.
- Business-type activities—The City charges a fee to customers to help it cover all or most of the cost of services it provides. The City's liquor store, golf course, electric, water, and sewer services are reported here.

Fund Financial Statements

The fund financial statements provide detailed information about the significant funds—not the City as a whole. Some funds are required to be established by State law and by bond covenants. However, the City establishes some funds to help it control and manage money for a particular purpose or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money. The City's two kinds of funds—governmental and proprietary—use different accounting methods.

- Governmental funds—Most of the City's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using the modified accrual basis of accounting. This method measures cash and all other

CITY OF GRAND MARAIS, MINNESOTA

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2006

financial assets that can be readily converted to cash. The governmental fund statements provide a detailed short-term view of the City's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in a reconciliation statement following each governmental fund financial statement.

- Proprietary funds—When the City charges customers for the services it provides—whether to outside customers or to other units of the City—these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. In fact, the City's enterprise funds (a component of proprietary funds) are the same as the business-type activities we report in the government-wide statements but provide more detail and additional information, such as cash flows.

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

The City's combined net assets increased from \$14,812,553 to \$15,561,262. During 2006, both the governmental activities and business-type activities had an increase in net assets. Our analysis below focuses on the net assets (Table 1) and changes in net assets (Table 2) of the City's governmental and business-type activities.

**Table 1
Net Assets**

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2006	2005	2006	2005	2006	2005
Current and other assets	\$2,633,605	\$3,159,740	\$ 3,636,379	\$ 3,798,417	\$ 6,269,984	\$ 6,958,157
Capital assets	<u>6,382,491</u>	<u>5,553,691</u>	<u>13,179,504</u>	<u>12,989,641</u>	<u>19,561,995</u>	<u>18,543,332</u>
Total assets	<u>9,016,096</u>	<u>8,713,431</u>	<u>16,815,883</u>	<u>16,788,058</u>	<u>25,831,979</u>	<u>25,501,489</u>
Long-term debt outstanding	3,506,000	3,614,000	5,763,576	5,984,576	9,269,576	9,598,576
Other liabilities	314,755	321,095	686,386	769,265	1,001,141	1,090,360
Total liabilities	<u>3,820,755</u>	<u>3,935,095</u>	<u>6,449,962</u>	<u>6,753,841</u>	<u>10,270,717</u>	<u>10,688,936</u>
Net assets						
Invested in capital assets, net of debt	3,751,491	2,762,654	7,415,928	7,005,067	11,167,419	9,767,721
Restricted	-	-	897,899	851,449	897,899	851,449
Unrestricted	<u>1,443,850</u>	<u>2,015,682</u>	<u>2,052,094</u>	<u>2,177,701</u>	<u>3,495,944</u>	<u>4,193,383</u>
Total net assets	<u>\$5,195,341</u>	<u>\$4,778,336</u>	<u>\$ 10,365,921</u>	<u>\$ 10,034,217</u>	<u>\$15,561,262</u>	<u>\$14,812,553</u>

Net assets of the City's governmental activities increased by 8.73 percent (\$5,195,341 compared to \$4,778,336) in 2006.

Net assets of the City's business-type activities increased by 3.31 percent (\$10,365,921 compared to \$10,034,217) in 2006.

CITY OF GRAND MARAIS, MINNESOTA

**MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2006**

**Table 2
Changes in Net Assets**

	Governmental Activities		Business-Type Activities		Total Primary Government	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Revenues						
Program revenues:						
Fees, fines, charges, and other	\$ 861,220	\$ 782,345	\$4,571,192	\$4,251,090	\$5,432,412	\$5,033,435
Operating grants and contributions	125,811	116,015	-	11,200	125,811	127,215
Capital grants and contributions	361,991	116,652	42,790	17,768	404,781	134,420
General revenues:						
Property taxes	608,006	580,139	-	-	608,006	580,139
Intergovernmental	327,522	281,550	-	-	327,522	281,550
Other general revenues	<u>77,314</u>	<u>104,527</u>	<u>63,487</u>	<u>29,860</u>	<u>140,801</u>	<u>134,387</u>
Total revenues	<u>2,361,864</u>	<u>1,981,228</u>	<u>4,677,469</u>	<u>4,309,918</u>	<u>7,039,333</u>	<u>6,291,146</u>
Program expenses:						
General government	379,919	340,451	-	-	379,919	340,451
Public safety	219,715	202,696	-	-	219,715	202,696
Streets	344,170	323,722	-	-	344,170	323,722
Culture and recreation	1,008,214	948,791	-	-	1,008,214	948,791
Interest	172,632	169,928	-	-	172,632	169,928
Liquor store	-	-	1,212,416	1,144,492	1,212,416	1,144,492
Golf course	-	-	159,844	151,245	159,844	151,245
Electric	-	-	1,947,387	1,847,878	1,947,387	1,847,878
Water	-	-	357,518	291,837	357,518	291,837
Sewer	-	-	468,600	466,393	468,600	466,393
Total program expenses	<u>2,124,650</u>	<u>1,985,588</u>	<u>4,145,765</u>	<u>3,901,845</u>	<u>6,270,415</u>	<u>5,887,433</u>
Excess (deficit) before special item and transfers	237,214	(4,360)	531,704	408,073	768,918	403,713
Special item	(20,209)	-	-	-	(20,209)	-
Transfers	<u>200,000</u>	<u>(277,131)</u>	<u>(200,000)</u>	<u>277,131</u>	<u>-</u>	<u>-</u>
Increase (decrease) in net assets	<u>\$ 417,005</u>	<u>\$ (281,491)</u>	<u>\$ 331,704</u>	<u>\$ 685,204</u>	<u>\$ 748,709</u>	<u>\$ 403,713</u>

Governmental Activities

The cost of all governmental activities this year was \$2,124,650. As shown in the Statement of Activities, some of the cost was paid by those who directly benefited from the programs (\$861,220) or by other governments and organizations that subsidized certain programs with grants and contributions (\$487,802). Our taxpayers financed \$608,006 of the cost through property taxes.

Table 3 presents the cost of each of the City's five largest programs, as well as each program's net cost (total cost less revenues generated by the activities). The net cost shows the financial burden that was placed on the City's taxpayers by each of these programs.

CITY OF GRAND MARAIS, MINNESOTA

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2006

**Table 3
Governmental Activities**

	Total Cost of Services		Net Cost (Revenue) of Services	
	2006	2005	2006	2005
Culture and recreation	\$ 1,008,214	\$ 948,791	\$ 101,211	\$ 114,610
General government	379,919	340,451	263,828	283,740
Streets	344,170	323,722	290,888	248,195
Public safety	219,715	202,696	172,867	154,103
Economic development	-	-	(225,798)	-
All others	<u>172,632</u>	<u>169,928</u>	<u>172,632</u>	<u>169,928</u>
Totals	<u>\$ 2,124,650</u>	<u>\$ 1,985,588</u>	<u>\$ 775,628</u>	<u>\$ 970,576</u>

Business-Type Activities

Revenues of the City's business-type activities were \$4,677,469; expenses were \$4,145,765 (see Table 2). There was a change in net assets of \$331,704 during the year ended December 31, 2006. The factors driving these results include:

- Electric, water, and sewer utility user fee rate increases

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

As the City completed the year, its governmental funds reported a combined fund balance of \$2,211,390 which is below last year's total of \$2,677,398. Included in this year's total fund balance is a surplus of \$1,416,243 in the City's general fund. The general fund had a decrease of \$(32,238). The largest decrease of \$(293,600) in the other governmental funds was in the Street, Water, and Sewer Capital Projects Fund due to capital project costs exceeding revenues. The costs in excess of revenue will be covered in subsequent borrowings as planned.

GENERAL FUND BUDGETARY HIGHLIGHTS

Over the course of the year, the City did not revise the general fund budget. The actual charges to appropriations (expenditures) were \$39,866 above the final budget amounts. Resources available for appropriation were \$103,800 above the final budgeted amounts. The City received more intergovernmental aids than expected.

CITY OF GRAND MARAIS, MINNESOTA

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2006

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2006, the City had \$19,561,995 invested in a broad range of capital assets (net of accumulated depreciation), including land, construction in progress, buildings, improvements, infrastructure, machinery and equipment, and licensed vehicles. (See Table 4 below.) This amount represents a net increase (including additions and deductions) of \$1,018,663 over last year.

**Table 4
Capital Assets at Year-end
(Net of Depreciation)**

	Governmental Activities		Business-type Activities		Totals	
	2006	2005	2006	2005	2006	2005
Land	\$ 630,922	\$ 630,922	\$ 186,100	\$ 186,100	\$ 817,022	\$ 817,022
Construction in progress	1,400,645	1,083,351	1,386,290	1,061,313	2,786,935	2,144,664
Buildings	1,268,114	938,269	5,077,312	5,034,040	6,345,426	5,972,309
Improvements	440,543	178,216	44,255	47,560	484,798	225,776
Infrastructure	2,443,289	2,525,099	5,957,653	6,105,221	8,400,942	8,630,320
Machinery and equipment	127,969	144,703	375,801	406,368	503,770	551,071
Licensed vehicles	<u>71,009</u>	<u>53,131</u>	<u>152,093</u>	<u>149,039</u>	<u>223,102</u>	<u>202,170</u>
Totals	<u>\$6,382,491</u>	<u>\$5,553,691</u>	<u>\$13,179,504</u>	<u>\$12,989,641</u>	<u>\$19,561,995</u>	<u>\$18,543,332</u>

This year's major additions were the 2nd Street/9th Avenue W. project in the governmental activities, electric system upgrades in the Electric Enterprise Fund, and water reservoir improvements in the Water Enterprise Fund.

More detailed information about the City's capital assets is presented in Note 5 to the financial statements.

CITY OF GRAND MARAIS, MINNESOTA

**MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2006**

Debt

At year-end, the City had \$9,269,576 in long-term debt outstanding versus \$9,598,576 last year—as shown in Table 5.

**Table 5
Outstanding Debt, at Year-end**

	Governmental Activities		Business-type Activities		Totals	
	2006	2005	2006	2005	2006	2005
General obligation bonds (backed by the City)	\$3,506,000	\$3,614,000	\$ -	\$ -	\$3,506,000	\$3,614,000
Electric system revenue bonds	-	-	4,270,000	4,430,000	4,270,000	4,430,000
Wastewater revenue bonds	-	-	-	372,000	-	372,000
General obligation sewer revenue bonds	-	-	372,000	-	372,000	-
General obligation revenue notes	-	-	1,121,576	1,182,576	1,121,576	1,182,576
Total	\$3,506,000	\$3,614,000	\$5,763,576	\$5,984,576	\$9,269,576	\$9,598,576

The State limits the amount of net debt that the City can issue to 2 percent of the market value of all taxable property in the City. The City's outstanding qualifying net debt of \$0 is significantly below the \$2,491,258 state-imposed limit.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS

The City's elected and appointed officials considered many factors when setting the 2007 budget and tax rates.

- The property tax levy increase will be held to 4.01%.
- The City's five year capital improvement plan anticipates \$3,500,000 in projects, with no new projects in 2007.
- Electric rates were increased 15% for 2007 in response to increasing fuel costs and wholesale rates.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the City Administrator, Michael J. Roth, City of Grand Marais, 15 N. Broadway, Grand Marais, Minnesota 55706.

BASIC FINANCIAL STATEMENTS

CITY OF GRAND MARAIS, MINNESOTA

STATEMENT OF NET ASSETS
December 31, 2006

	Primary Government		
	Governmental Activities	Business-type Activities	Total
ASSETS			
Cash and cash equivalents	\$ 1,289,963	\$ 1,527,747	\$ 2,817,710
Investments	-	97,938	97,938
Taxes receivable	30,775	-	30,775
Special assessments receivable	146,681	254,652	401,333
Accounts receivable	7,181	283,615	290,796
Internal balances	257,191	(257,191)	-
Loans receivable	16,938	-	16,938
Inventories	19,761	449,331	469,092
Prepaid items	35,893	35,329	71,222
Deferred debt issue costs	-	118,310	118,310
Temporarily restricted assets			
Cash and cash equivalents	-	1,126,648	1,126,648
Investments	829,222	-	829,222
Capital assets not being depreciated:			
Land	630,922	186,100	817,022
Construction in progress	1,400,645	1,386,290	2,786,935
Capital assets, net of accumulated depreciation:			
Buildings	1,268,114	5,077,312	6,345,426
Improvements	440,543	44,255	484,798
Infrastructure	2,443,289	5,957,653	8,400,942
Machinery and equipment	127,969	375,801	503,770
Licensed vehicles	71,009	152,093	223,102
TOTAL ASSETS	9,016,096	16,815,883	25,831,979
LIABILITIES			
Accounts payable	174,297	209,411	383,708
Salaries payable	73,661	71,384	145,045
Customer deposits	-	10,100	10,100
Deferred revenues	-	338,773	338,773
Accrued interest payable	66,797	56,718	123,515
Noncurrent liabilities			
Due within one year	65,000	222,000	287,000
Due in more than one year	3,441,000	5,541,576	8,982,576
TOTAL LIABILITIES	3,820,755	6,449,962	10,270,717
NET ASSETS			
Invested in capital assets, net of related debt	3,751,491	7,415,928	11,167,419
Restricted for other purposes	-	897,899	897,899
Unrestricted	1,443,850	2,052,094	3,495,944
TOTAL NET ASSETS	\$ 5,195,341	\$ 10,365,921	\$ 15,561,262

The accompanying notes are an integral part of these financial statements.

CITY OF GRAND MARAIS, MINNESOTA

STATEMENT OF ACTIVITIES
Year Ended December 31, 2006

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>		
		<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>
PRIMARY GOVERNMENT				
Governmental Activities				
General government	\$ 379,919	\$ 116,091	\$ -	\$ -
Public safety	219,715	28,917	17,931	-
Streets	344,170	-	-	53,282
Culture and recreation	1,008,214	716,212	107,880	82,911
Economic development	-	-	-	225,798
Interest on long-term debt	172,632	-	-	-
Total Governmental Activities	<u>2,124,650</u>	<u>861,220</u>	<u>125,811</u>	<u>361,991</u>
Business-type Activities				
Liquor Store	\$ 1,212,416	\$ 1,439,520	\$ -	\$ -
Golf Course	159,844	147,813	-	-
Electric	1,947,387	2,166,672	-	-
Water	357,518	320,973	-	42,790
Sewer	468,600	496,214	-	-
Total Business-type Activities	<u>4,145,765</u>	<u>4,571,192</u>	<u>-</u>	<u>42,790</u>
TOTAL PRIMARY GOVERNMENT	<u>\$ 6,270,415</u>	<u>\$ 5,432,412</u>	<u>\$ 125,811</u>	<u>\$ 404,781</u>

General Revenues:

Taxes:

Property taxes, levied for general purposes

Property taxes, levied for specific purposes

Franchise taxes

Grants and contributions not restricted to specific programs

Unrestricted investment earnings

Special item - disposal of capital asset

Transfers

Total General Revenues, Special Item, and Transfers

CHANGE IN NET ASSETS

NET ASSETS - JANUARY 1

Prior period adjustment

NET ASSETS - DECEMBER 31

The accompanying notes are an integral part of these financial statements.

Net (Expense) Revenue and Changes in Net Assets
Primary Government

Governmental Activities	Business-type Activities	Total
\$ (263,828)	\$ -	\$ (263,828)
(172,867)	-	(172,867)
(290,888)	-	(290,888)
(101,211)	-	(101,211)
225,798	-	225,798
(172,632)	-	(172,632)
<u>(775,628)</u>	<u>-</u>	<u>(775,628)</u>
-	227,104	227,104
-	(12,031)	(12,031)
-	219,285	219,285
-	6,245	6,245
-	27,614	27,614
<u>-</u>	<u>468,217</u>	<u>468,217</u>
<u>(775,628)</u>	<u>468,217</u>	<u>(307,411)</u>
500,374	-	500,374
107,632	-	107,632
7,138	-	7,138
327,522	-	327,522
70,176	63,487	133,663
(20,209)	-	(20,209)
<u>200,000</u>	<u>(200,000)</u>	<u>-</u>
<u>1,192,633</u>	<u>(136,513)</u>	<u>1,056,120</u>
417,005	331,704	748,709
4,764,836	10,034,217	14,799,053
<u>13,500</u>	<u>-</u>	<u>13,500</u>
<u>\$ 5,195,341</u>	<u>\$ 10,365,921</u>	<u>\$ 15,561,262</u>

CITY OF GRAND MARAIS, MINNESOTA

BALANCE SHEET
GOVERNMENTAL FUNDS
December 31, 2006

	General Fund	Debt Service Fund	Street, Water, and Sewer Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
ASSETS					
Cash and cash equivalents	\$ 541,103	\$ 258,228	\$ -	\$ 490,632	\$ 1,289,963
Investments	-	829,222	-	-	829,222
Taxes receivable	26,480	4,295	-	-	30,775
Special assessments receivable	-	146,681	-	-	146,681
Accounts receivable	490	-	-	6,691	7,181
Due from other funds	921,708	88,294	25,102	14,812	1,049,916
Loans receivables	-	-	-	16,938	16,938
Inventories	19,761	-	-	-	19,761
Prepaid items	33,130	-	-	2,763	35,893
TOTAL ASSETS	\$ 1,542,672	\$ 1,326,720	\$ 25,102	\$ 531,836	\$ 3,426,330
LIABILITIES AND FUND BALANCES					
LIABILITIES					
Accounts payable	\$ 58,649	\$ -	\$ 109,620	\$ 6,028	\$ 174,297
Salaries payable	56,206	-	-	17,455	73,661
Due to other funds	936	179,635	464,607	147,547	792,725
Deferred revenue	10,638	146,681	-	16,938	174,257
TOTAL LIABILITIES	126,429	326,316	574,227	187,968	1,214,940
FUND BALANCES					
Reserved for debt service	-	829,222	-	-	829,222
Unreserved, designated	582,030	-	-	75,070	657,100
Unreserved, undesignated, reported in					
General Fund	834,213	-	-	-	834,213
Special revenue funds	-	-	-	398,771	398,771
Debt service fund	-	171,182	-	-	171,182
Capital projects funds	-	-	(549,125)	(129,973)	(679,098)
TOTAL FUND BALANCES	1,416,243	1,000,404	(549,125)	343,868	2,211,390
TOTAL LIABILITIES AND FUND BALANCES	\$ 1,542,672	\$ 1,326,720	\$ 25,102	\$ 531,836	\$ 3,426,330

The accompanying notes are an integral part of these financial statements.

CITY OF GRAND MARAIS, MINNESOTA

RECONCILIATION OF THE BALANCE SHEET OF GOVERNMENTAL FUNDS TO THE
STATEMENT OF NET ASSETS
December 31, 2006

Amounts reported for governmental activities in the statement of net assets are different because:

TOTAL FUND BALANCES, GOVERNMENTAL FUNDS	\$ 2,211,390
Capital assets used in governmental activities are not current financial resources and therefore are not reported in the funds.	6,382,491
Deferred revenue in governmental funds is susceptible to full accrual on the government-wide statements.	174,257
Interest payable on long-term debt is susceptible to full accrual on the government-wide statements.	(66,797)
Long-term liabilities, including bonds payable are not due and payable in the current period and therefore not reported in the governmental funds.	<u>(3,506,000)</u>
NET ASSETS OF GOVERNMENTAL ACTIVITIES	<u>\$ 5,195,341</u>

The accompanying notes are an integral part of these financial statements.

CITY OF GRAND MARAIS, MINNESOTA

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
 GOVERNMENTAL FUNDS
 Year Ended December 31, 2006

	<u>General Fund</u>	<u>Debt Service Fund</u>	<u>Street, Water, and Sewer Capital Projects Fund</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
REVENUES					
Taxes					
Property	\$ 497,216	\$ 107,632	\$ -	\$ -	\$ 604,848
Franchise	-	-	-	7,138	7,138
Special assessments	13,986	35,668	-	-	49,654
Licenses and permits	75,938	-	-	-	75,938
Intergovernmental	301,878	-	91,456	370,279	763,613
Charges for services	765,724	-	-	12,504	778,228
Fines	6,304	-	-	-	6,304
Gifts and contributions	450	-	-	33,111	33,561
Interest	24,760	28,682	1,504	15,230	70,176
Miscellaneous	666	-	-	14,816	15,482
TOTAL REVENUES	<u>1,686,922</u>	<u>171,982</u>	<u>92,960</u>	<u>453,078</u>	<u>2,404,942</u>
EXPENDITURES					
Current					
General government	378,086	-	-	-	378,086
Public safety	202,770	-	-	-	202,770
Streets	259,160	-	-	-	259,160
Culture and recreation	811,615	-	-	236,216	1,047,831
Debt service					
Principal	-	108,000	-	-	108,000
Interest and other charges	-	161,922	-	-	161,922
Capital outlay					
Streets	-	-	386,560	24,182	410,742
Culture and recreation	-	-	-	276,641	276,641
Economic development	-	-	-	225,798	225,798
TOTAL EXPENDITURES	<u>1,651,631</u>	<u>269,922</u>	<u>386,560</u>	<u>762,837</u>	<u>3,070,950</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>35,291</u>	<u>(97,940)</u>	<u>(293,600)</u>	<u>(309,759)</u>	<u>(666,008)</u>
OTHER FINANCING SOURCES (USES)					
Transfers in	200,000	-	-	267,529	467,529
Transfers out	(267,529)	-	-	-	(267,529)
TOTAL OTHER FINANCING SOURCES (USES)	<u>(67,529)</u>	<u>-</u>	<u>-</u>	<u>267,529</u>	<u>200,000</u>
NET CHANGE IN FUND BALANCES	(32,238)	(97,940)	(293,600)	(42,230)	(466,008)
FUND BALANCES - JANUARY 1	<u>1,448,481</u>	<u>1,098,344</u>	<u>(255,525)</u>	<u>386,098</u>	<u>2,677,398</u>
FUND BALANCES - DECEMBER 31	<u>\$ 1,416,243</u>	<u>\$ 1,000,404</u>	<u>\$ (549,125)</u>	<u>\$ 343,868</u>	<u>\$ 2,211,390</u>

The accompanying notes are an integral part of these financial statements.

CITY OF GRAND MARAIS, MINNESOTA

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND
BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
Year Ended December 31, 2006**

Amounts reported for governmental activities in the statement of activities are different because:

NET CHANGE IN FUND BALANCES - TOTAL GOVERNMENTAL FUNDS		\$ (466,008)
<p>Governmental funds report outlays for capital assets as expenditures; however, in the statement of activities, the cost of those assets is depreciated over their estimated useful lives.</p>		
Expenditures for capital assets	1,086,813	
Less current year depreciation	<u>(237,804)</u>	
Net capital assets		849,009
<p>Some revenues reported in the statement of activities do not require the use of current financial resources and therefore are not reported as revenues in governmental funds.</p>		
Change in deferred revenue - delinquent property taxes	3,157	
Change in deferred revenue - special assessments receivable	(31,503)	
Change in deferred revenue - loans receivable	<u>(14,731)</u>	
		(43,077)
<p>Repayment of dept principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.</p>		
		108,000
<p>Some expenses reported in the statement of activities do not require the use of current financial resources and these are not reported as expenditures in governmental funds.</p>		
Change in accrued interest payable on long-term debt		(10,710)
Undepreciated cost of demolished bathhouse		(20,209)
CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES		<u>\$ 417,005</u>

The accompanying notes are an integral part of these financial statements.

CITY OF GRAND MARAIS, MINNESOTA

STATEMENT OF NET ASSETS
 PROPRIETARY FUNDS
 December 31, 2006

Business-type Activities - Enterprise Funds

	Liquor Store Enterprise Fund	Golf Course Enterprise Fund	Electric Enterprise Fund	Water Enterprise Fund	Sewer Enterprise Fund	Totals
ASSETS						
CURRENT ASSETS						
Cash and cash equivalents	\$ 489,870	\$ -	\$ 436,750	\$ -	\$ 601,127	\$ 1,527,747
Investments	97,938	-	-	-	-	97,938
Accounts receivable	256	-	216,258	24,929	42,172	283,615
Due from other funds	-	-	216,559	182,433	1,672	400,664
Special assessments receivable	-	-	-	254,652	-	254,652
Inventories	129,530	8,446	292,816	18,315	224	449,331
Prepaid items	4,995	3,476	19,325	4,305	3,228	35,329
TOTAL CURRENT ASSETS	722,589	11,922	1,181,708	484,634	648,423	3,049,276
NONCURRENT ASSETS						
Restricted cash and cash equivalents						
Revenue bond covenant accounts	-	-	657,645	-	-	657,645
MPCA contract accounts	-	-	-	-	469,003	469,003
Total restricted cash and cash equivalents	-	-	657,645	-	469,003	1,126,648
Deferred debt issue costs	-	-	118,310	-	-	118,310
Capital assets						
Land	-	154,100	25,000	5,000	2,000	186,100
Construction in progress	-	-	1,386,290	-	-	1,386,290
Buildings	24,248	89,466	2,923,969	1,815,454	2,516,190	7,369,327
Improvements	-	301,387	-	-	-	301,387
Infrastructure	-	-	2,205,009	3,707,587	2,330,103	8,242,699
Machinery and equipment	135,574	146,395	166,127	432,367	1,289,582	2,170,045
Licensed vehicles	-	500	284,369	46,646	72,485	404,000
Less accumulated depreciation	(131,564)	(404,619)	(1,561,035)	(1,880,137)	(2,902,989)	(6,880,344)
Total capital assets (net of accumulated depreciation)	28,258	287,229	5,429,729	4,126,917	3,307,371	13,179,504
TOTAL NONCURRENT ASSETS	28,258	287,229	6,205,684	4,126,917	3,776,374	14,424,462
TOTAL ASSETS	750,847	299,151	7,387,392	4,611,551	4,424,797	17,473,738
LIABILITIES						
CURRENT LIABILITIES						
Accounts payable	40,803	142	137,778	7,226	23,462	209,411
Salaries payable	15,922	10,488	24,926	3,674	16,374	71,384
Accrued interest payable	-	-	30,464	10,294	15,960	56,718
Due to other funds	-	215,392	82,162	327,008	33,293	657,855
Deferred revenue	-	-	338,773	-	-	338,773
Customer deposits payable	-	-	10,100	-	-	10,100
Bonds, notes, and loans payable - current	-	-	160,000	62,000	-	222,000
TOTAL CURRENT LIABILITIES	56,725	226,022	784,203	410,202	89,089	1,566,241
NONCURRENT LIABILITIES						
Bonds, notes and loans payable	-	-	4,110,000	1,059,576	372,000	5,541,576
TOTAL LIABILITIES	56,725	226,022	4,894,203	1,469,778	461,089	7,107,817
NET ASSETS						
Invested in capital assets, net of related debt	28,258	287,229	1,159,729	3,005,341	2,935,371	7,415,928
Restricted for other purposes	-	-	388,669	-	509,230	897,899
Unrestricted	665,864	(214,100)	944,791	136,432	519,107	2,052,094
TOTAL NET ASSETS	\$ 694,122	\$ 73,129	\$ 2,493,189	\$ 3,141,773	\$ 3,963,708	\$ 10,365,921

The accompanying notes are an integral part of these financial statements.

CITY OF GRAND MARAIS, MINNESOTA

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
 PROPRIETARY FUNDS
 Year Ended December 31, 2006

	Business-type Activities - Enterprise Funds					Totals
	Liquor Store Enterprise Fund	Golf Course Enterprise Fund	Electric Enterprise Fund	Water Enterprise Fund	Sewer Enterprise Fund	
REVENUES						
Charges for sales and services	\$ 1,439,520	\$ 147,813	\$ 2,166,672	\$ 320,973	\$ 496,214	\$ 4,571,192
OPERATING EXPENSES						
Cost of sales	977,044	13,310	1,199,334	-	-	2,189,688
Salaries	131,234	74,581	172,644	81,157	111,776	571,392
Employee benefits and payroll taxes	39,567	15,724	56,113	27,528	39,424	178,356
Advertising	7,503	772	-	-	-	8,275
Bad debts	-	-	49	14	14	77
Contract services	-	-	34,676	20,222	77,735	132,633
Facility fees	-	-	59,183	-	-	59,183
Insurance	4,146	4,610	20,187	3,554	4,275	36,772
Miscellaneous	17,356	3,475	19,406	2,457	9,148	51,842
Rent	24,000	-	800	800	800	26,400
Repairs and maintenance	5,445	3,742	19,968	14,669	5,503	49,327
Supplies	3,840	19,865	67,990	20,168	14,003	125,866
Telephone	574	918	1,457	2,242	614	5,805
Utilities	-	2,889	5,396	21,205	50,248	79,738
Depreciation	1,707	19,958	170,469	134,485	135,036	461,655
TOTAL OPERATING EXPENSES	<u>1,212,416</u>	<u>159,844</u>	<u>1,827,672</u>	<u>328,501</u>	<u>448,576</u>	<u>3,977,009</u>
OPERATING INCOME (LOSS)	<u>227,104</u>	<u>(12,031)</u>	<u>339,000</u>	<u>(7,528)</u>	<u>47,638</u>	<u>594,183</u>
NONOPERATING REVENUES (EXPENSES)						
Interest income	11,321	-	22,951	15,261	13,954	63,487
Special assessments	-	-	-	42,790	-	42,790
Interest expense	-	-	(119,715)	(29,017)	(20,024)	(168,756)
TOTAL NONOPERATING REVENUES (EXPENSES)	<u>11,321</u>	<u>-</u>	<u>(96,764)</u>	<u>29,034</u>	<u>(6,070)</u>	<u>(62,479)</u>
INCOME (LOSS) BEFORE CONTRIBUTIONS AND TRANSFERS	<u>238,425</u>	<u>(12,031)</u>	<u>242,236</u>	<u>21,506</u>	<u>41,568</u>	<u>531,704</u>
Transfers in	-	-	-	18,949	-	18,949
Transfers out	(200,000)	-	(6,316)	-	(12,633)	(218,949)
CHANGE IN NET ASSETS	<u>38,425</u>	<u>(12,031)</u>	<u>235,920</u>	<u>40,455</u>	<u>28,935</u>	<u>331,704</u>
TOTAL NET ASSETS - JANUARY 1	<u>655,697</u>	<u>85,160</u>	<u>2,257,269</u>	<u>3,101,318</u>	<u>3,934,773</u>	<u>10,034,217</u>
TOTAL NET ASSETS - DECEMBER 31	<u>\$ 694,122</u>	<u>\$ 73,129</u>	<u>\$ 2,493,189</u>	<u>\$ 3,141,773</u>	<u>\$ 3,963,708</u>	<u>\$ 10,365,921</u>

The accompanying notes are an integral part of these financial statements.

CITY OF GRAND MARAIS, MINNESOTA

STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
Year Ended December 31, 2006

Business-type Activities - Enterprise Funds

	Liquor Store Enterprise Fund	Golf Course Enterprise Fund	Electric Enterprise Fund	Water Enterprise Fund	Sewer Enterprise Fund	Totals
CASH FLOWS FROM OPERATING ACTIVITIES						
Cash received from customers	\$ 1,439,292	\$ 147,813	\$ 2,168,502	\$ 320,328	\$ 494,277	\$ 4,570,212
Cash paid to suppliers	(1,082,540)	(68,313)	(1,581,309)	(119,638)	(179,210)	(3,031,010)
Cash paid to employees	(130,516)	(77,251)	(171,082)	(82,164)	(119,912)	(580,925)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>226,236</u>	<u>2,249</u>	<u>416,111</u>	<u>118,526</u>	<u>195,155</u>	<u>958,277</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Transfers in from other funds	-	-	-	18,949	-	18,949
Transfers out to other funds	(200,000)	-	(6,316)	-	(12,633)	(218,949)
Advances to other funds	-	-	(142,402)	(73,857)	-	(216,259)
Advances from other funds	-	9,348	-	215,906	24,128	249,382
NET CASH PROVIDED (USED) BY NONCAPITAL FINANCING ACTIVITIES	<u>(200,000)</u>	<u>9,348</u>	<u>(148,718)</u>	<u>160,998</u>	<u>11,495</u>	<u>(166,877)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES						
Purchase or construction of fixed assets	(20,529)	(11,597)	(264,407)	(262,804)	(17,643)	(576,980)
Special assessments collected	-	-	-	58,596	-	58,596
Principal paid on long-term debt	-	-	(160,000)	(61,000)	(372,000)	(593,000)
Interest paid on long-term debt	-	-	(188,037)	(29,577)	(24,128)	(241,742)
Proceeds from sewer revenue bonds	-	-	-	-	372,000	372,000
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(20,529)</u>	<u>(11,597)</u>	<u>(612,444)</u>	<u>(294,785)</u>	<u>(41,771)</u>	<u>(981,126)</u>
CASH FLOWS FROM INVESTING ACTIVITIES						
Interest on investments	11,602	-	22,951	15,261	13,954	63,768
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	17,309	-	(322,100)	-	178,833	(125,958)
CASH AND CASH EQUIVALENTS, JANUARY 1	<u>472,561</u>	<u>-</u>	<u>1,416,495</u>	<u>-</u>	<u>891,297</u>	<u>2,780,353</u>
CASH AND CASH EQUIVALENTS, DECEMBER 31	<u>\$ 489,870</u>	<u>\$ -</u>	<u>\$ 1,094,395</u>	<u>\$ -</u>	<u>\$ 1,070,130</u>	<u>\$ 2,654,395</u>

The accompanying notes are an integral part of these statements.

CITY OF GRAND MARAIS, MINNESOTA

STATEMENT OF CASH FLOWS (CONTINUED)
 PROPRIETARY FUNDS
 Year Ended December 31, 2006

Business-type Activities - Enterprise Funds

	Liquor Store Enterprise Fund	Golf Course Enterprise Fund	Electric Enterprise Fund	Water Enterprise Fund	Sewer Enterprise Fund	Totals
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES						
Operating income (loss)	\$ 227,104	\$ (12,031)	\$ 339,000	\$ (7,528)	\$ 47,638	\$ 594,183
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:						
Depreciation	1,707	19,958	170,469	134,485	135,036	461,655
Changes in assets and liabilities (Increase) decrease in:						
Accounts receivable	(228)	-	1,230	(645)	(1,937)	(1,580)
Inventories	(12,848)	(2,369)	11,921	(6,511)	246	(9,561)
Prepaid items	(1,059)	(737)	(6,279)	(1,975)	1,002	(9,048)
Increase (decrease) in:						
Accounts payable	10,842	98	(102,392)	1,707	21,306	(68,439)
Salaries payable	718	(2,670)	1,562	(1,007)	(8,136)	(9,533)
Customer deposits	-	-	600	-	-	600
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 226,236	\$ 2,249	\$ 416,111	\$ 118,526	\$ 195,155	\$ 958,277
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:						
Total capital asset additions	\$ 20,529	\$ 11,597	\$ 338,945	\$ 262,804	\$ 17,643	\$ 651,518
Capitalized interest	-	-	(74,538)	-	-	(74,538)
Cash paid for capital assets	\$ 20,529	\$ 11,597	\$ 264,407	\$ 262,804	\$ 17,643	\$ 576,980

The accompanying notes are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS

CITY OF GRAND MARAIS, MINNESOTA

NOTES TO FINANCIAL STATEMENTS

December 31, 2006

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Grand Marais, Minnesota, a political subdivision of the State of Minnesota, is a statutory city, governed by an elected city council which consists of one mayor and four councilmembers.

The accounting policies of the City of Grand Marais, Minnesota, comply with Generally Accepted Accounting Principles (GAAP). The City applies all relevant Governmental Accounting Standards Board (GASB) pronouncements. Proprietary funds apply Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails.

The accounting and reporting framework and the more significant accounting policies and practices are discussed in subsequent sections of this Note. The remainder of the Notes are organized to provide explanations, including required disclosures, of the City's financial activities for the year ended December 31, 2006.

A. Financial Reporting Entity

Accounting principles generally accepted in the United States of America require that the reporting entity include (1) the City, (2) organizations for which the City is financially accountable and (3) other organizations for which the nature and significance of their relationship with the City are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. Based on the application of these criteria, there are no component units that should be included within the City's reporting entity.

B. Basic Financial Statements

Government-wide Financial Statements

The government-wide financial statements (i.e. the statement of net assets and the statement of activities) report information on all of the activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. *Governmental activities*, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include: 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by the given function or segment, and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

CITY OF GRAND MARAIS, MINNESOTA

**NOTES TO FINANCIAL STATEMENTS
December 31, 2006**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fund Financial Statements

The City segregates transactions related to certain functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. Separate statements are presented for governmental and proprietary activities. These statements present each major fund as a separate column on the fund financial statements; all non-major funds are aggregated and presented in a single column.

The description of the funds included in this report are as follows:

Governmental Funds

Governmental funds are those funds through which most governmental functions typically are financed. The measurement focus of governmental funds is on the sources, uses and balance of current financial resources. The City has presented the following governmental funds:

Major Governmental Funds:

The General Fund is the primary operating fund of the City and is used to account for all financial resources relating to the general government, except those required to be accounted for in another fund.

The Debt Service Fund is used to account for the accumulation of resources for, and the payment of, long-term debt principal, interest, and related costs.

The Street, Water and Sewer Capital Projects Fund is used to account for the construction of a major combined street, water and sewer project.

Nonmajor Governmental Funds:

Special Revenue Funds, including the library, cable TV, and storefront renovation special revenue funds, are used to account for specific revenues that are legally restricted to expenditure for particular purposes.

Capital Projects Funds are used to account for the acquisition and construction of major capital assets other than those financed by proprietary funds.

Proprietary Funds

Proprietary funds are accounted for using the economic resources measurement focus and the accrual basis of accounting. The accounting objectives are determinations of net income, financial position and cash flow. All assets and liabilities are included on the Statement of Net Assets. The City has presented the following proprietary funds:

CITY OF GRAND MARAIS, MINNESOTA

**NOTES TO FINANCIAL STATEMENTS
December 31, 2006**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Major Proprietary Funds:

The Liquor Store Enterprise Fund is used to account for the revenues generated from liquor sales.

The Golf Course Enterprise Fund is used to account for the revenues generated from golf course fees and sales.

The Electric Enterprise Fund is used to account for the revenues generated from the charges for distribution of electric services to the residential and commercial users of the City.

The Water Enterprise Fund is used to account for the revenues generated from the charges for distribution of water to the residential and commercial users of the City.

The Sewer Enterprise Fund is used to account for revenues generated from the charges for wastewater treatment services provided to the residential and commercial users of the City.

C. Measurement Focus and Basis of Accounting

Measurement focus refers to what is being measured; basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied.

The government-wide statements and fund financial statements for proprietary funds are reported using the economic resources measurement focus and the accrual basis of accounting. The economic resources measurement focus means all assets and liabilities (whether current or non-current) are included on the statement of net assets and the operating statements present increases (revenues) and decreases (expenses) in net total assets. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized at the time the liability is incurred. Property taxes are generally recognized as revenues in the fiscal year for which they are levied. Grants and similar items are recognized when all requirements imposed by the provider have been met.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed. Depreciation expense can be specifically identified by program and is included in the direct expenses of each program. Interest on long-term debt is considered an indirect expense and is reported separately on the Statement of Activities. Generally, the effect of material interfund activity has been removed from the government-wide financial statements.

Governmental fund financial statements are reported using the current financial resources measurement focus and are accounted for using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both "measurable and available"). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the

CITY OF GRAND MARAIS, MINNESOTA

NOTES TO FINANCIAL STATEMENTS

December 31, 2006

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

current period or soon enough thereafter to be used to pay liabilities of the current period. The City considers property taxes as available if they are collected within 60 days after year end. Grant revenue is recorded in the year in which the related expenditure is made. Other revenue is considered available if collected within one year. Expenditures are generally recorded when a liability is incurred. However, expenditures are recorded as prepaid for approved disbursements incurred in advance of the year in which the item or service is to be used and debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, special assessments and loan repayments are considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the government.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's enterprise funds are charges to customers. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

D. Cash and Cash Equivalents

For the purpose of the statement of cash flows, cash and cash equivalents are defined as cash on hand, demand deposits and short-term investments purchased with a maturity of three months or less.

E. Assets, Liabilities and Fund Balances

- 1) Cash balances for all funds of the City are maintained on a combined basis and invested to the extent possible, in allowable short-term investments. All investments are stated at fair value.
- 2) The City maintains inventories in its general fund and enterprise funds. All inventories are valued at cost, on a first-in, first-out (FIFO) basis, and the cost of these inventories are recorded as expenditures when consumed rather than when purchased.
- 3) Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances".

Legally authorized transfers are treated as interfund transfers and are included in the results of operations of both Governmental and Proprietary Funds.

- 4) Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

CITY OF GRAND MARAIS, MINNESOTA

NOTES TO FINANCIAL STATEMENTS

December 31, 2006

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- 5) Restricted assets are cash and cash equivalents whose use is limited by legal requirements such as a bond indenture. Restricted assets are reported only in the government-wide and proprietary fund financial statements.
- 6) Capital assets, which include land, construction in progress, improvements, buildings, infrastructure, machinery and equipment, and licensed vehicles are reported in the applicable governmental or business-type activities columns in the government-wide financial statements and in the proprietary fund financial statements.

Capital assets are capitalized at historical cost, or estimated historical cost for assets where actual historical cost is not available. Donated assets are recorded as capital assets at their estimated fair value at the date of donation. The City elected not to report general infrastructure assets acquired prior to January 1, 2004, therefore, general infrastructure assets include only those acquired subsequent to January 1, 2004. The City maintains a threshold level of \$2,500 or more for capitalizing land, improvements, buildings, infrastructure, machinery and equipment, and licensed vehicles. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives is not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed.

Capital assets are depreciated using the straight-line method over their estimated useful lives. When assets are no longer needed by the City, such assets are either disposed of if it is determined there is no value, or sold for an immaterial amount. Useful lives vary from 20 to 50 years for improvements, buildings and infrastructure, and 4 to 30 years for machinery and equipment, and licensed vehicles. Land and construction in progress are not being depreciated.

- 7) Delinquent property taxes receivable, less any delinquent taxes that are to be received within 60 days, are recorded as a deferred revenue in the fund financial statements because they are not available to finance the current year operations of the City. Deferred revenue reported in the debt service fund represents special assessments receivable and in the Storefront Renovation Special Revenue Fund represents loans receivable.
- 8) In the government-wide financial statements and proprietary fund type financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs, if material, are reported as deferred charges and amortized over the term of the related debt. The long-term debt consists primarily of general obligation improvement and revenue bonds, revenue notes, and a lease purchase agreement.

Long-term debt for governmental funds is not reported as a liability in the fund financial statements. Debt proceeds are reported as other financing sources and payment of principal and interest are reported as expenditures. Severance pay expenditures are recognized at retirement date.

CITY OF GRAND MARAIS, MINNESOTA

NOTES TO FINANCIAL STATEMENTS

December 31, 2006

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- 9) Net assets represent the difference between assets and liabilities in the government-wide financial statements. Net assets invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used to build or acquire the capital assets. Net assets are reported as restricted in the government-wide financial statement when there are limitations imposed on their use through external restrictions imposed by creditors, grantors, or laws or regulations of other governments.

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

F. Revenues and Expenditures

- 1) The property tax calendar in Minnesota follows the calendar year. Property tax levies are certified to the County Auditor in December of each year for collection from taxpayers in May and October of the following calendar year. In Minnesota, counties act as collection agents for all property taxes. The county spreads all levies over taxable property. Property taxes become a lien on the property the following January 1. The county generally remits taxes to the City at periodic intervals as they are collected. A portion of property taxes levied is paid by the State of Minnesota through various tax credits, which are included in revenue from state sources in the financial statements.

Federal, state, and other revenues are reported under the legal and contractual requirements of the individual programs and are classified into essentially two types of revenues. In one, monies must be expended for the specific purpose before any amounts will be paid to the City; therefore, revenues are recognized based on expenditures recorded. In the other, monies are virtually unrestricted as to purpose of expenditure, and the resources are recorded as revenue at the time of receipt or earlier if they are available.

- 2) City employees earn vacation and sick leave based on years of service and union and employment contracts. Vacation leave may be accrued up to 1½ times the amount of actual vacation earned in the previous year. The liability for accrued vacation leave is recorded in the appropriate funds as an accrued liability. City employees accrue sick leave at the rate of 12 hours per month, up to a maximum of 960 hours. Unpaid sick leave does not vest and, therefore, is not accrued. Sick pay is expensed in the year taken.

NOTE 2 - STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Fund Deficits

The following funds had a deficit fund balances at December 31, 2006:

CITY OF GRAND MARAIS, MINNESOTA

NOTES TO FINANCIAL STATEMENTS

December 31, 2006

NOTE 2 - STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY (CONTINUED)

	<u>Deficit</u>
Fund balance:	
Street, Water and Sewer	
Capital Projects Fund	\$ (549,125)
Capital Improvements	
Capital Projects Fund	\$ (129,973)

The fund balance deficits occurred because expenditures exceeded revenues and transfers. The City plans to eliminate these deficits through future revenues or transfers.

NOTE 3 - CASH AND CASH EQUIVALENTS AND INVESTMENTS

The City's funds are combined (pooled) and invested to the extent available in various investments authorized by Minnesota statutes. This pool functions essentially as a demand account for all participating funds. Each fund's portion of this pool is displayed on the financial statements as "cash and cash equivalents, investments and restricted assets". Several funds hold cash and investments separate from the cash and investment pool.

"Cash and cash equivalents, investments, and restricted assets" recorded are comprised of:

Cash	\$ 3,323,799
Petty Cash	3,187
Certificates of Deposit	239,931
Investments	<u>1,304,601</u>
Total	<u>\$ 4,871,518</u>

Deposits

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure the City's deposits may not be returned to it. The City's deposit policy requires that deposits in excess of FDIC insurance of \$100,000 be protected by pledged securities.

The City maintains deposits at financial institutions authorized by the City Council. Minnesota statutes require that all City deposits be protected by insurance, surety bond or collateral. The market value of collateral pledged must equal 110 percent of the deposits not covered by insurance or bonds. State statutes authorize the types of securities which may be pledged as collateral and require that those securities be held in safekeeping by the City or in a financial institution other than that furnishing the collateral. At year-end, the carrying amount of the City's deposits, which includes certificates of deposit, was \$3,563,730; the bank balance was \$3,586,399. Of the bank balance, \$520,404 was insured; of the remaining balance, \$575,219 was collateralized with securities held by the pledging financial institution's agent in the City's name and \$2,490,776 was collateralized with securities held by the pledging financial institution's agent but not in the City's name.

CITY OF GRAND MARAIS, MINNESOTA

NOTES TO FINANCIAL STATEMENTS

December 31, 2006

NOTE 3 - CASH AND CASH EQUIVALENTS AND INVESTMENTS (CONTINUED)

Investments

Custodial Credit Risk – Investments

For an investment, custodial credit risk is the risk that in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or securities that are in the possession of an outside party. The City does not have a formal investment policy for custodial credit risk for investments. All investments purchased by the City are held by a third-party safekeeping agent appointed as custodian.

Credit Risk and Concentration of Credit Risk

According to the City's investment policy, the City is authorized and allowed by state statute to invest in qualified repurchase agreements, obligations of the U.S. government, obligations of the State of Minnesota or its municipalities, shares of certain investment companies, banker's acceptance notes, commercial paper issued by United States corporations rated A-1, P-1 and F-1, and guaranteed investment contracts.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The City's investments in U.S. Treasury State and Local Government securities are not rated and the Federal Home Loan Mortgage Corp. Note has a credit quality rating of AAA. The City also has investments in money market funds which are not rated as to credit risk.

The City places no limit on the amount the City may invest in any one issuer and, as of December 31, 2006, had no investments (other than U.S. Government or U.S. Government guaranteed obligations) in any issuer that exceeded five percent of net assets.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of investments will adversely affect the fair value of an investment. The City does not have a formal investment policy that addresses interest rate risk.

The City manages its exposure to fair value losses arising from changing interest rates by purchasing investments with varying maturity dates. As of December 31, 2006, the City had the following investments:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Maturity</u>		
		<u>Less than 2 Years</u>	<u>2 - 5 Years</u>	<u>More than 5 Years</u>
U.S. Treasury State and Local Government Securities	\$ 829,222	\$ 829,222	\$ -	\$ -
Federal Home Loan Mortgage Corp. Note	97,938	-	-	97,938
Minnesota Municipal Money Market Fund	325,436	325,436	-	-
Smith Barney Money Market Funds	51,959	51,959	-	-
Wells Fargo Money Market Funds	<u>46</u>	<u>46</u>	-	-
Total Investments	<u>\$ 1,304,601</u>	<u>\$ 1,206,663</u>	<u>\$ -</u>	<u>\$ 97,938</u>

CITY OF GRAND MARAIS, MINNESOTA

NOTES TO FINANCIAL STATEMENTS

December 31, 2006

NOTE 3 - CASH AND CASH EQUIVALENTS AND INVESTMENTS (CONTINUED)

The City utilizes the Minnesota Municipal Money Market (4M) Fund which is an external investment pool not registered with the Securities Exchange Commission (SEC) that follows the same regulatory rules of the SEC under rule 2a7. The fair value of the position in the pool is the same as the value of the pool shares.

NOTE 4 - NOTES RECEIVABLE

Several businesses have received loans from the City through the City's Storefront Loan Program. The unpaid principal balance on these loans as of December 31, 2006 was \$16,938.

CITY OF GRAND MARAIS, MINNESOTA

NOTES TO FINANCIAL STATEMENTS
December 31, 2006

NOTE 5 - CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2006, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
Governmental activities				
Capital assets, not being depreciated:				
Land	\$ 630,922	\$ -	\$ -	\$ 630,922
Construction in progress	<u>1,083,351</u>	<u>753,675</u>	<u>(436,381)</u>	<u>1,400,645</u>
Total capital assets, not being depreciated	<u>1,714,273</u>	<u>753,675</u>	<u>(436,381)</u>	<u>2,031,567</u>
Capital assets, being depreciated:				
Buildings	3,930,198	436,381	(51,300)	4,315,279
Improvements	244,613	279,549	-	524,162
Infrastructure	4,168,724	24,182	-	4,192,906
Machinery and equipment	325,826	-	-	325,826
Licensed vehicles	<u>188,588</u>	<u>29,407</u>	<u>-</u>	<u>217,995</u>
Total capital assets, being depreciated	<u>8,857,949</u>	<u>769,519</u>	<u>(51,300)</u>	<u>9,576,168</u>
Less accumulated depreciation for:				
Buildings	(2,991,929)	(86,327)	31,091	(3,047,165)
Improvements	(66,397)	(17,222)	-	(83,619)
Infrastructure	(1,643,625)	(105,992)	-	(1,749,617)
Machinery and equipment	(181,123)	(16,734)	-	(197,857)
Licensed vehicles	<u>(135,457)</u>	<u>(11,529)</u>	<u>-</u>	<u>(146,986)</u>
Total accumulated depreciation	<u>(5,018,531)</u>	<u>(237,804)</u>	<u>31,091</u>	<u>(5,225,244)</u>
Total capital assets, being depreciated, net	<u>3,839,418</u>	<u>531,715</u>	<u>(20,209)</u>	<u>4,350,924</u>
Governmental activities capital assets, net	<u>\$ 5,553,691</u>	<u>\$ 1,285,390</u>	<u>\$ (456,590)</u>	<u>\$ 6,382,491</u>
 Business-type activities				
Capital assets, not being depreciated:				
Land	\$ 186,100	\$ -	\$ -	\$ 186,100
Construction in progress	<u>1,061,313</u>	<u>324,977</u>	<u>-</u>	<u>1,386,290</u>
Total capital assets, not being depreciated	<u>1,247,413</u>	<u>324,977</u>	<u>-</u>	<u>1,572,390</u>
Capital assets, being depreciated:				
Buildings	7,143,787	225,540	-	7,369,327
Improvements	297,268	4,119	-	301,387
Infrastructure	8,210,245	32,454	-	8,242,699
Machinery and equipment	2,130,883	39,162	-	2,170,045
Licensed vehicles	<u>378,735</u>	<u>25,265</u>	<u>-</u>	<u>404,000</u>
Total capital assets, being depreciated	<u>18,160,918</u>	<u>326,540</u>	<u>-</u>	<u>18,487,458</u>
Less accumulated depreciation for:				
Buildings	(2,109,746)	(182,269)	-	(2,292,015)
Improvements	(249,708)	(7,424)	-	(257,132)
Infrastructure	(2,105,024)	(180,022)	-	(2,285,046)
Machinery and equipment	(1,724,515)	(69,729)	-	(1,794,244)
Licensed vehicles	<u>(229,696)</u>	<u>(22,211)</u>	<u>-</u>	<u>(251,907)</u>
Total accumulated depreciation	<u>(6,418,689)</u>	<u>(461,655)</u>	<u>-</u>	<u>(6,880,344)</u>
Total capital assets, being depreciated, net	<u>11,742,229</u>	<u>(135,115)</u>	<u>-</u>	<u>11,607,114</u>
Business-type activities capital assets, net	<u>\$ 12,989,642</u>	<u>\$ 189,862</u>	<u>\$ -</u>	<u>\$ 13,179,504</u>

CITY OF GRAND MARAIS, MINNESOTA

NOTES TO FINANCIAL STATEMENTS

December 31, 2006

NOTE 5 - CAPITAL ASSETS (CONTINUED)

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental activities	
General government	\$ 1,833
Public safety	16,945
Streets	114,417
Culture and recreation	<u>104,609</u>
Total depreciation expense- governmental activities	\$ <u>237,804</u>
Business-type activities	
Liquor Store	\$ 1,707
Golf Course	19,958
Electric	170,469
Water	134,485
Sewer	<u>135,036</u>
Total depreciation expense- business-type activities	\$ <u>461,655</u>

NOTE 6 - RATE STABILIZATION PROVISION

A reserve for rate stabilization was established in 1996. The concept of rate stabilization is used by utilities to defer current revenues to future periods to reduce impacts of future rate increases to customers. The reserve, which is recorded as deferred revenue, will be used to offset future rate increases and maintain income stability in future periods. At December 31, 2006, the rate stabilization reserve was \$338,773.

NOTE 7 - LONG-TERM LIABILITIES

The City issues general obligation bonds, improvement notes and revenue notes to finance the purchase of major capital items and the acquisition or construction of major capital facilities or improvements. Bonded indebtedness has also been entered into to advance refund general obligation bonds. General obligation bonds and notes have been issued for both governmental and business-type activities and are being repaid from the applicable resources. The City has also issued electric system revenue bonds to finance the construction of an electric generation plant and capital improvements to the electrical system. The electric revenue bonds and interest are payable solely from the net revenues of the Electric Enterprise Fund.

Short-term debt was authorized and issued to finance capital project expenditures for the street, water, and sewer project prior to issuance of permanent long-term debt, through the issuance of bond anticipation notes (BAN's). On January 17, 2006, the City issued general obligation sewer revenue bonds to refund the bond anticipation notes used to finance construction of the sewage disposal system. The sewer revenue bonds and interest are payable solely from the net revenues of the Sewer Enterprise Fund; thus, the BAN was reclassified to long-term debt in the Sewer Enterprise Fund in 2005.

CITY OF GRAND MARAIS, MINNESOTA

**NOTES TO FINANCIAL STATEMENTS
December 31, 2006**

NOTE 7 - LONG-TERM LIABILITIES (CONTINUED)

Components of long-term liabilities are as follows:

	<u>Issue Date</u>	<u>Interest Rates</u>	<u>Original Issue</u>	<u>Final Maturity</u>	<u>Principal Outstanding</u>
Governmental Activities					
General Obligation Bonds					
1980 Water and Sewer Revenue	05/28/1980	5.00%	\$ 867,000	01/01/2010	\$ 156,000
2000 Improvement	07/01/2000	5.60-6.20%	\$ 1,025,000	02/01/2021	895,000
2004 Improvement	06/01/2004	3.40-5.10%	\$ 710,000	02/01/2025	685,000
2005 Improvement	11/22/2005	3.50-4.60%	\$ 895,000	02/01/2027	895,000
2005 Improvement Refunding	01/06/2005	3.40-4.60%	\$ 875,000	02/01/2021	875,000
Total General Obligation Bonds					<u>3,506,000</u>
Governmental Activities Long-term Liabilities					<u>3,506,000</u>
Business-type activities					
Revenue Bonds					
2003 Electric System	05/01/2003	3.00-4.875%	\$ 2,885,000	05/01/2023	2,565,000
2004 Electric System	09/01/2004	4.00-4.80%	\$ 815,000	05/01/2023	785,000
2005 Electric System	06/21/2005	2.75-4.60%	\$ 940,000	05/01/2024	920,000
2006 GO Sewer	09/15/2004	4.50%	\$ 372,000	01/01/2036	372,000
Total Revenue Bonds					<u>4,642,000</u>
General Obligation Notes					
1999 Water Revenue	04/27/1999	2.56%	\$ 484,112	08/20/2019	355,000
2004 Improvement	07/21/2004	2.53%	\$ 812,229	02/20/2024	766,576
Total General Obligation Notes					<u>1,121,576</u>
Business-type Activities Long-term Liabilities					<u>5,763,576</u>
Total Long-Term Liabilities					<u>\$ 9,269,576</u>

Long-term liability activity for the year ended December 31, 2006 was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Governmental activities					
Bonds Payable					
1980 GO Water and Sewer Revenue	\$ 204,000	\$ -	\$ 48,000	\$ 156,000	\$ -
2000 GO Improvements	930,000	-	35,000	895,000	40,000
2004 GO Improvements	710,000	-	25,000	685,000	25,000
2005 GO Improvements	895,000	-	-	895,000	-
2005 GO Improvement Refunding	<u>875,000</u>	-	-	<u>875,000</u>	-
Governmental Activities - Long-term Liabilities	<u>\$ 3,614,000</u>	<u>\$ -</u>	<u>\$ 108,000</u>	<u>\$ 3,506,000</u>	<u>\$ 65,000</u>

CITY OF GRAND MARAIS, MINNESOTA

NOTES TO FINANCIAL STATEMENTS

December 31, 2006

NOTE 7 - LONG-TERM LIABILITIES (CONTINUED)

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Business-type Activities					
Bonds Payable					
2003 Electric System Revenue	\$ 2,675,000	\$ -	\$ 110,000	\$ 2,565,000	\$ 110,000
2004 Electric System Revenue	815,000	-	30,000	785,000	30,000
2005 Electric System Revenue	940,000	-	20,000	920,000	20,000
2004 Wastewater Revenue (BAN)	372,000	-	372,000	-	-
2006 GO Sewer Revenue	-	<u>372,000</u>	-	<u>372,000</u>	-
Total Bonds Payable	<u>4,802,000</u>	<u>372,000</u>	<u>532,000</u>	<u>4,642,000</u>	
Notes Payable					
1999 GO Water Revenue	378,000	-	23,000	355,000	23,000
2004 GO Improvement	<u>804,576</u>	-	<u>38,000</u>	<u>766,576</u>	<u>39,000</u>
Total Notes Payable	<u>1,182,576</u>	-	<u>61,000</u>	<u>1,121,576</u>	
Business-type Activities - Long-term Liabilities	<u>\$ 5,984,576</u>	<u>\$ 372,000</u>	<u>\$ 593,000</u>	<u>\$ 5,763,576</u>	<u>\$ 222,000</u>

Minimum annual principal and interest payments required to retire long-term liabilities are as follows:

<u>Year Ending December 31</u>	<u>Governmental Activities</u>		<u>Business-Type Activities</u>		<u>Government-wide</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 65,000	\$ 158,770	\$ 222,000	\$ 224,402	\$ 287,000	\$ 383,172
2008	145,000	162,955	245,000	220,617	390,000	383,572
2009	197,000	155,334	253,000	212,932	450,000	368,266
2010	209,000	146,384	259,000	204,633	468,000	351,017
2011	165,000	136,866	266,000	195,620	431,000	332,486
2012-2016	945,000	561,116	1,487,000	822,738	2,432,000	1,383,854
2017-2021	1,225,000	295,543	1,749,000	500,066	2,974,000	795,609
2022-2026	490,000	70,795	1,099,576	125,997	1,589,576	196,792
2027-2031	65,000	1,495	82,000	34,110	147,000	35,605
2032-2036	-	-	101,000	13,995	101,000	13,995
Total	<u>\$ 3,506,000</u>	<u>\$ 1,689,258</u>	<u>\$ 5,763,576</u>	<u>\$ 2,555,110</u>	<u>\$ 9,269,576</u>	<u>\$ 4,244,368</u>

Interest of \$74,538 on the Electric System Revenue Bonds has been capitalized as construction in progress in the Electric Enterprise Fund.

CITY OF GRAND MARAIS, MINNESOTA

NOTES TO FINANCIAL STATEMENTS

December 31, 2006

NOTE 8 - INTERFUND BALANCES AND ACTIVITY

The composition of interfund balances as of December 31, 2006, is as follows:

Due to/from other funds –

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Capital Improvement Capital Projects	\$ 147,547
General	Street, Water, and Sewer Capital Projects	460,577
General	Golf Enterprise	215,392
General	Electric Enterprise	82,162
General	Water Enterprise	7,839
General	Sewer Enterprise	8,191
Debt Service	Water Enterprise	88,294
Capital Improvements		
Capital Projects	Water Enterprise	14,812
Street, Water, and Sewer		
Capital Projects	Sewer Enterprise	25,102
Electric Enterprise	General	496
Electric Enterprise	General	216,063
Water Enterprise	General	112
Water Enterprise	Debt Service	178,291
Water Enterprise	Street, Water, and Sewer Capital Projects	4,030
Sewer Enterprise	General	328
Sewer Enterprise	Debt Service	1,344
		<u>\$ 1,450,580</u>

The balances resulted from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

Interfund transfers for the year ended December 31, 2006 consisted of the following:

	<u>Transfers Out</u>				<u>Total</u>
	<u>General Fund</u>	<u>Liquor Store Enterprise Fund</u>	<u>Electric Enterprise Fund</u>	<u>Sewer Enterprise Fund</u>	
<u>Transfers In</u>					
General Fund	\$ -	\$ 200,000	\$ -	\$ -	\$ 200,000
Library Special Revenue Fund	106,010	-	-	-	106,010
Cable TV Special Revenue Fund	7,000	-	-	-	7,000
Capital Improvements					
Capital Projects Fund	154,519	-	-	-	154,519
Water Enterprise Fund	-	-	6,316	12,633	18,949
	<u>\$ 267,529</u>	<u>\$ 200,000</u>	<u>\$ 6,316</u>	<u>\$ 12,633</u>	<u>\$ 486,478</u>

CITY OF GRAND MARAIS, MINNESOTA

**NOTES TO FINANCIAL STATEMENTS
December 31, 2006**

NOTE 8 - INTERFUND BALANCES AND ACTIVITY (CONTINUED)

Transfers are used to: 1) fund the City's portion of capital asset purchases or construction, 2) move profits or excess cash from the Liquor Store Enterprise Fund to the General Fund, 3) move the City's contribution to the City library and cable TV operations, and 4) move the electric and sewer enterprise funds' contribution to the water enterprise fund for the purchase of a vehicle.

NOTE 9 - FUND EQUITY

The amounts reported as fund balances unreserved, designated on the Balance Sheet are comprised of the following:

<u>General Fund</u>	
Designated for:	
Street seal coat project	\$ 55,964
Buildings	45,624
Fire equipment	77,464
Insurance reserve	10,804
Street equipment	8,450
Street improvements	<u>383,724</u>
Total General Fund - Designated	<u>\$ 582,030</u>
<u>Library Special Revenue Fund</u>	
Designated for library improvements	<u>\$ 75,070</u>

The amounts reported as net assets restricted for other purposes on the statement of net assets is comprised of the following:

<u>Electric Enterprise Fund</u>	
Restricted for debt service	<u>\$ 388,669</u>
<u>Sewer Enterprise Fund</u>	
Restricted for MPCA contract	<u>\$ 509,230</u>

NOTE 10 - PRIOR PERIOD ADJUSTMENTS

The following prior period adjustment has been made in the financial statements and is reported as an adjustment to beginning net assets:

**Adjustments to net assets of governmental activities
in the government-wide financial statements:**

Add storm water management project cost to capital assets	<u>\$ 13,500</u>
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CITY OF GRAND MARAIS, MINNESOTA

**NOTES TO FINANCIAL STATEMENTS
December 31, 2006**

NOTE 11 - RISK MANAGEMENT

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets, errors and omissions; injuries to employees; and natural disasters. To cover these risks of loss, except for boiler and machinery risks, the City, as allowed under state statutes, joined the League of Minnesota Cities Insurance Trust, a public entity risk pool currently operating as a common risk management and insurance program for its member cities. The City pays annual premiums to the Trust for its insurance coverage. The League of Minnesota Cities Insurance Trust is self-sustaining through member premiums and reinsures through commercial companies for claims in excess of the limits set by the Trustees. The City carries commercial insurance for boiler and machinery risks. There were no significant increases or reductions in insurance from the previous year. Settled claims resulting from these risks have not exceeded insurance coverage in any of the past three fiscal years.

NOTE 12 - JOINTLY GOVERNED ORGANIZATION

Cook County/Grand Marais Joint Economic Development Authority

The City of Grand Marais and Cook County established through special legislation the Cook County/Grant Marais Joint Economic Development Authority to jointly increase the tax base and employment opportunities of the City and County through public support of private development efforts.

The Authority is governed by seven commissioners composed of three members appointed by the City and four members appointed by the County.

The Authority is currently developing lots to be sold and constructing an office building in Cedar Grove Business Park. The City, in consideration for construction of street improvements, water and sewer extensions and curb and gutter on the platted roads in the Business Park, has entered into an agreement with the Authority whereby owners will be assessed \$60,000 per platted lot, payable from the closing proceeds at the time of sale. The City expended \$225,798 on infrastructure in 2006 for this project.

On January 9, 2007, the City of Grand Marais issued \$1,630,000 General Obligation Temporary Improvement Bonds to temporarily finance the improvements. Interest is payable semi-annually and final payment of principal is due January 9, 2010.

NOTE 13 - JOINT VENTURE

Joint Recreation Board

The City entered into a joint powers agreement with Independent School District No. 166-Cook County and Cook County to build, manage, and maintain recreational facilities for the benefit of both residents and visitors to Cook County.

The Joint Recreation Board is governed by a nine-member board composed of three members from the City, three from the County, and three from the School District.

CITY OF GRAND MARAIS, MINNESOTA

**NOTES TO FINANCIAL STATEMENTS
December 31, 2006**

NOTE 13 - JOINT VENTURE (CONTINUED)

If the agreement is terminated, all real and personal property will be sold and any surplus money and property remaining after payment of all liabilities shall be returned to the parties in proportion to each party's total contribution over the three years prior to termination.

The City contributed \$0 during 2006 to the Joint Recreation Board. Complete financial information can be obtained from the Joint Recreation Board, Cook County Courthouse, 411 West Second Street, Grand Marais, MN 55604.

NOTE 14 - OTHER COMMITMENTS AND CONTINGENCIES

Grants

The City participates in grant programs, which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the City has not complied with the rules and regulations governing the grants, refunds of any money received may be required and the collectibility of any related receivable at December 31, 2006, may be impaired. In the opinion of the City, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying financial statements for such contingencies.

Electric Utility Commitment

The Grand Marais Public Utilities Commission purchases power from Southern Minnesota Municipal Power Agency (SMMPA) under a power sales contract which extends to April 1, 2030. Under the terms of the contract, the Commission is obligated to buy all the electrical power and energy needed to operate the electric utilities through the term of the contract. The City of Grand Marais and SMMPA have entered into a quick-start capacity and energy purchase agreement in which SMMPA has agreed to purchase all of the energy and capacity of the Grand Marais generating plant. SMMPA will pay the Grand Marais Public Utilities \$216,000 annually for the capacity of the plant. The term of this contract is the period commencing on the commercial operating date of the plant (February 18, 2004) and ending on the day of the contract year that includes the twentieth anniversary of the commercial operating date, unless earlier terminated or extended as provided in the agreement.

Construction Commitment

The City had an outstanding construction project as of December 31, 2006. The project was evidenced by a contractual commitment with a contractor.

<u>Project</u>	<u>Spent-to-Date</u>	<u>Commitment Remaining</u>
2 nd Street & 9 th Avenue Improvements	\$ 1,046,091	\$ 8,673
Electrical Distribution Upgrade	\$ 1,386,290	\$ 78,041

CITY OF GRAND MARAIS, MINNESOTA

NOTES TO FINANCIAL STATEMENTS

December 31, 2006

NOTE 15 - FUNDS HELD BY OTHERS

The City of Grand Marais' Public Library is a beneficiary of a designated fund at Minnesota Community Foundation. Pursuant to the terms of the agreement establishing this fund, property contributed to Minnesota Community Foundation is held as a separate fund designated for the benefit of the City of Grand Marais' Public Library. The agreement provides that payments from the fund to the City of Grand Marais' Public Library can be made at the discretion of the Minnesota Community Foundation at such times and in such amounts and for such charitable purposes as the Minnesota Community Foundation deems appropriate. The fund is not included in the City of Grand Marais, Minnesota's financial statements, since all property in the fund was contributed to Minnesota Community Foundation to be held and administered for the benefit of the City of Grand Marais' Public Library. The market value of the fund assets was approximately \$20,167 on December 31, 2006.

NOTE 16 - DEFINED BENEFIT PENSION PLANS - STATEWIDE

A. Plan Description

All full-time and certain part-time employees of the City of Grand Marais, Minnesota, are covered by defined benefit plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the Public Employees Retirement Fund (PERF) which is a cost-sharing, multiple-employer retirement plan. This plan is established and administered in accordance with *Minnesota Statutes*, Chapter 353 and 356.

PERF members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security and Basic Plan members are not. All new members must participate in the Coordinated Plan.

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

Two methods are used to compute benefits for PERF's Coordinated and Basic Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Basic Plan member is 2.2 percent of average salary for each of the first 10 years of service and 2.7 percent for each remaining year. The annuity accrual rate for a Coordinated Plan member is 1.2 percent of average salary for each of the first 10 years and 1.7 percent for each remaining year. Under Method 2, the annuity accrual rate is 2.7 percent of average salary for Basic Plan members and 1.7 percent for Coordinated Plan members for each year of service. For PERF members hired prior to July 1, 1989 whose annuity is calculated using Method 1, a full annuity is available when age plus years of service equal 90. Normal retirement age is 65 for Basic and Coordinated members hired prior to July 1, 1989. Normal retirement age is the age for unreduced social security benefits capped at 66 for Coordinated members hired on or after July 1, 1989. A reduced retirement annuity is also available to eligible members seeking early retirement.

CITY OF GRAND MARAIS, MINNESOTA

**NOTES TO FINANCIAL STATEMENTS
December 31, 2006**

NOTE 16 - DEFINED BENEFIT PENSION PLANS - STATEWIDE (CONTINUED)

There are different types of annuities available to members upon retirement. A single-life annuity is a lifetime annuity that ceases upon the death of the retiree--no survivor annuity is payable. There are also various types of joint and survivor annuity options available which will be payable over joint lives. Members may also leave their contributions in the fund upon termination of public service in order to qualify for a deferred annuity at retirement age. Refunds of contributions are available at any time to members who leave public service, but before retirement benefits begin.

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 receiving them yet are bound by the provisions in effect at the time they last terminated their public service.

PERA issues a publicly available financial report that includes financial statements and required supplementary information for PERF. That report may be obtained on the internet at www.mnpera.org, by writing to PERA at 60 Empire Drive #200, St. Paul, Minnesota, 55103-2088 or by calling 1-651-296-7460 or 1-800-652-9026.

B. Funding Policy

Minnesota Statutes Chapter 353 sets the rates for employer and employee contributions. These statutes are established and amended by the state legislature. The City makes annual contributions to the pension plans equal to the amount required by state statutes. PERF Basic Plan members and Coordinated Plan members are required to contribute 9.10% and 5.50%, respectively, of their annual covered salary in 2006. Contribution rates in the Coordinated Plan will increase in 2007 to 5.75%. The City of Grand Marais is required to contribute the following percentages of annual covered payroll: 11.78% for Basic Plan PERF members, 6.0% for Coordinated Plan PERF members. Employer contribution rates for the Coordinated Plan will increase to 6.25%, effective January 1, 2007. The City's contributions to the Public Employees Retirement Fund for the years ending December 31, 2006, 2005, and 2004 were \$64,410, \$59,847, and \$56,695, respectively. The City's contributions were equal to the contractually required contributions for each year as set by state statute.

REQUIRED SUPPLEMENTARY INFORMATION

CITY OF GRAND MARAIS, MINNESOTA

GENERAL FUND

**SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
Year Ended December 31, 2006**

	<u>Budgeted Amounts</u>		<u>Actual Amounts, Budgetary Basis</u>	<u>Variance with Final Budget - Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES				
Taxes				
Property	\$ 536,141	\$ 536,141	\$ 497,216	\$ (38,925)
Special assessments	-	-	13,986	13,986
Licenses and permits	71,850	71,850	75,938	4,088
Intergovernmental	218,604	218,604	301,878	83,274
Charges for services	733,627	733,627	765,724	32,097
Fines	6,700	6,700	6,304	(396)
Gifts and contributions	500	500	450	(50)
Interest	15,000	15,000	24,760	9,760
Miscellaneous	700	700	666	(34)
TOTAL REVENUES	<u>1,583,122</u>	<u>1,583,122</u>	<u>1,686,922</u>	<u>103,800</u>
EXPENDITURES				
Current				
General government	320,434	320,434	378,086	(57,652)
Public safety	213,174	213,174	202,770	10,404
Streets	318,698	318,698	259,160	59,538
Culture and recreation	759,459	759,459	811,615	(52,156)
TOTAL EXPENDITURES	<u>1,611,765</u>	<u>1,611,765</u>	<u>1,651,631</u>	<u>(39,866)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(28,643)</u>	<u>(28,643)</u>	<u>35,291</u>	<u>63,934</u>
OTHER FINANCING SOURCES (USES)				
Transfers in	-	-	200,000	200,000
Transfers out	(188,010)	(188,010)	(267,529)	(79,519)
TOTAL OTHER FINANCING SOURCES (USES)	<u>(188,010)</u>	<u>(188,010)</u>	<u>(67,529)</u>	<u>120,481</u>
NET CHANGE IN FUND BALANCE	<u>(216,653)</u>	<u>(216,653)</u>	<u>(32,238)</u>	<u>184,415</u>
FUND BALANCE - JANUARY 1	<u>1,448,481</u>	<u>1,448,481</u>	<u>1,448,481</u>	<u>-</u>
FUND BALANCE - DECEMBER 31	<u>\$ 1,231,828</u>	<u>\$ 1,231,828</u>	<u>\$ 1,416,243</u>	<u>\$ 184,415</u>

CITY OF GRAND MARAIS, MINNESOTA

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
December 31, 2006**

NOTE 1 - BUDGETING

The City Clerk/Treasurer prepares a proposed budget for the City's funds on the same basis as the fund financial statements. The City Council adopts an annual budget for the fiscal year for the City's General Fund, Special Revenue Funds, and Debt Service Fund.

Legal budgetary control is at the fund account level; management control is exercised at line-item levels. Budget appropriations lapse at year end, if unexpended.

Budgeted amounts are as originally adopted or as amended by the City Council. The Schedule of Revenues, Expenditures and Changes in Fund Balance – Budget and Actual – General Fund presents a comparison of budgetary data to actual results.

NOTE 2 – EXCESS OF EXPENDITURES OVER APPROPRIATIONS

Expenditures exceeded appropriations in the following fund for the year ended December 31, 2006:

	<u>Excess</u>
General Fund	\$ 39,866

This overexpenditure was funded by available fund balance.

OTHER SUPPLEMENTARY INFORMATION

NONMAJOR GOVERNMENTAL FUNDS

Special Revenue Funds

Special revenue funds are used to account for specific revenues that are legally restricted to expenditure for particular purposes.

The Library Special Revenue Fund is used to account for county grants, charges for services, and private donations that are restricted to the library operations.

The Cable TV Special Revenue Fund is used to account for revenues collected to fund the operation of a local channel to televise local events.

The Storefront Renovation Special Revenue Fund is used to account for collection and disbursement of revolving loan funds to area businesses for storefront renovation.

Capital Projects Funds

Capital projects funds are used to account for the acquisition and construction of major capital facilities other than those financed by proprietary funds.

The Capital Improvement Capital Projects Fund is used to account for the construction of various capital assets.

The EDA Cedar Grove Business Park Capital Projects Fund is used to account for the construction of infrastructure and streets in the Cedar Grove Business Park.

CITY OF GRAND MARAIS, MINNESOTA

COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
December 31, 2006

	Library Special Revenue Fund	Cable TV Special Revenue Fund	Storefront Renovation Special Revenue Fund	Capital Improvements Capital Projects Fund	EDA Cedar Grove Business Park Capital Projects Fund	Total Nonmajor Governmental Funds
ASSETS						
Cash and cash equivalents	\$ 390,145	\$ 3,343	\$ 95,644	\$ -	\$ 1,500	\$ 490,632
Accounts receivable	-	1,691	-	5,000	-	6,691
Due from other funds	-	-	-	14,812	-	14,812
Loans receivables	-	-	16,938	-	-	16,938
Prepaid items	1,763	1,000	-	-	-	2,763
TOTAL ASSETS	\$ 391,908	\$ 6,034	\$ 112,582	\$ 19,812	\$ 1,500	\$ 531,836
LIABILITIES AND FUND BALANCES						
LIABILITIES						
Accounts payable	\$ 2,290	\$ -	\$ -	\$ 2,238	\$ 1,500	\$ 6,028
Salaries payable	17,455	-	-	-	-	17,455
Due to other funds	-	-	-	147,547	-	147,547
Deferred revenue	-	-	16,938	-	-	16,938
TOTAL LIABILITIES	19,745	-	16,938	149,785	1,500	187,968
FUND BALANCES						
Unreserved, designated	75,070	-	-	-	-	75,070
Unreserved, undesignated	297,093	6,034	95,644	(129,973)	-	268,798
TOTAL FUND BALANCES	372,163	6,034	95,644	(129,973)	-	343,868
TOTAL LIABILITIES AND FUND BALANCES	\$ 391,908	\$ 6,034	\$ 112,582	\$ 19,812	\$ 1,500	\$ 531,836

CITY OF GRAND MARAIS, MINNESOTA

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
 NONMAJOR GOVERNMENTAL FUNDS
 Year Ended December 31, 2006

	Library Special Revenue Fund	Cable TV Special Revenue Fund	Storefront Renovation Special Revenue Fund	Capital Improvements Capital Projects Fund	EDA Cedar Grove Business Park Capital Projects Fund	Total Nonmajor Governmental Funds
REVENUES						
Taxes - franchise fee	\$ -	\$ 7,138	\$ -	\$ -	\$ -	\$ 7,138
Intergovernmental	92,265	-	-	52,216	225,798	370,279
Charges for services	12,504	-	-	-	-	12,504
Gifts and contributions	2,416	-	-	30,695	-	33,111
Interest	13,550	-	988	692	-	15,230
Miscellaneous	-	-	14,731	85	-	14,816
TOTAL REVENUES	<u>120,735</u>	<u>7,138</u>	<u>15,719</u>	<u>83,688</u>	<u>225,798</u>	<u>453,078</u>
EXPENDITURES						
Current						
Culture and recreation	224,216	12,000	-	-	-	236,216
Capital outlay						
Streets	-	-	-	24,182	-	24,182
Culture and recreation	-	-	-	276,641	-	276,641
Economic development	-	-	-	-	225,798	225,798
TOTAL EXPENDITURES	<u>224,216</u>	<u>12,000</u>	<u>-</u>	<u>300,823</u>	<u>225,798</u>	<u>762,837</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(103,481)</u>	<u>(4,862)</u>	<u>15,719</u>	<u>(217,135)</u>	<u>-</u>	<u>(309,759)</u>
OTHER FINANCING SOURCES (USES)						
Transfers in	<u>106,010</u>	<u>7,000</u>	<u>-</u>	<u>154,519</u>	<u>-</u>	<u>267,529</u>
NET CHANGE IN FUND BALANCES	<u>2,529</u>	<u>2,138</u>	<u>15,719</u>	<u>(62,616)</u>	<u>-</u>	<u>(42,230)</u>
FUND BALANCES - JANUARY 1	<u>369,634</u>	<u>3,896</u>	<u>79,925</u>	<u>(67,357)</u>	<u>-</u>	<u>386,098</u>
FUND BALANCES - DECEMBER 31	<u>\$ 372,163</u>	<u>\$ 6,034</u>	<u>\$ 95,644</u>	<u>\$ (129,973)</u>	<u>\$ -</u>	<u>\$ 343,868</u>

CITY OF GRAND MARAIS, MINNESOTA

GENERAL FUND
 STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
 Year Ended December 31, 2006

REVENUES

Taxes

General property \$ 497,216

Special Assessments 13,986

Licenses and permits 75,938

Intergovernmental

State

Local government aid 213,163

Market value credit 52,719

PERA aid 5,315

Fire aid 17,481

Other state aids 13,200

Total Intergovernmental 301,878

Charges for Services

General government

Rent 35,532

Miscellaneous 3,954

Public safety

Fire protection contacts 22,613

Culture and recreation

Park 581,476

Swimming pool 58,652

Boat harbors 63,497

Total Charges for Services 765,724

Fines

Court fines 6,304

Gifts and Contributions 450

Interest 24,760

Miscellaneous

Insurance recoveries 626

Other 40

Total Miscellaneous 666

TOTAL REVENUES 1,686,922

CITY OF GRAND MARAIS, MINNESOTA

GENERAL FUND
 STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
 (CONTINUED)
 Year Ended December 31, 2006

EXPENDITURES

Current

General Government

Mayor and council	28,083
City clerk	137,476
Independent audit	9,750
Legal	21,151
Planning and zoning	81,689
Data processing	2,699
Buildings	57,234
Other	40,004
Total General Government	<u>378,086</u>

Public Safety

Police	140,000
Fire	56,220
Medical services	4,848
Animal control	1,702
Total Public Safety	<u>202,770</u>

Streets

Maintenance	202,958
Street lighting	26,795
Capital outlay	29,407
Total Streets	<u>259,160</u>

Culture and Recreation

Recreation	331,411
Recreation capital outlay	141,318
Swimming pool	258,660
Boat harbors	60,834
Boat harbors capital outlay	2,908
City parks	16,484
Total Culture and Recreation	<u>811,615</u>

TOTAL EXPENDITURES

1,651,631

EXCESS OF REVENUES OVER EXPENDITURES

35,291

OTHER FINANCING SOURCES (USES)

Transfers in	200,000
Transfers out	(267,529)
TOTAL OTHER FINANCING SOURCES (USES)	<u>(67,529)</u>

NET CHANGE IN FUND BALANCE

(32,238)

FUND BALANCE - JANUARY 1

1,448,481

FUND BALANCE - DECEMBER 31

\$ 1,416,243



**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**

To the City Council
City of Grand Marais, Minnesota

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Grand Marais, Minnesota, as of and for the year ended December 31, 2006, which collectively comprise the City of Grand Marais, Minnesota's basic financial statements and have issued our report thereon dated June 25, 2007. 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 City of Grand Marais, Minnesota's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph 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 certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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 entity'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 entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying schedule of findings and responses as items 2006-1 and 2006-2 to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or a 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 entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the 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, of the significant deficiencies described above, we consider item 2006-2 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether City of Grand Marais, Minnesota'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*.

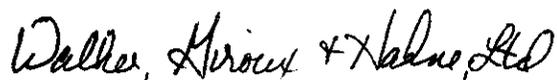
We also conducted our audit in accordance with the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government*, promulgated by the State Auditor pursuant to Minn. Stat. §6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* covers six main 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 City of Grand Marais, Minnesota, complied with the material terms and conditions of applicable legal provisions.

We noted certain matters that we reported to management of City of Grand Marais, Minnesota in a separate letter dated June 25, 2007, included under this cover.

City of Grand Marais, Minnesota's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit City of Grand Marais, Minnesota's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the City Council, management, and the State of Minnesota, and is not intended to be and should not be used by anyone other than these specified parties.



June 25, 2007

CITY OF GRAND MARAIS, MINNESOTA
SCHEDULE OF FINDINGS AND RESPONSES
Year Ended December 31, 2006

SIGNIFICANT DEFICIENCIES

2006-1. SEGREGATION OF DUTIES

Condition

Due to the limited number of personnel within the City's financial and utility offices, the segregation of accounting functions necessary to ensure adequate internal accounting control is not possible.

Criteria

The concentration of duties and responsibilities in a limited number of individuals is not desirable from an internal accounting control point of view.

Effect

Because of the weakness in segregation of duties, the City has not provided adequate internal control over its transactions.

Cause

This occurred because of staffing limitation caused by fiscal constraints.

Recommendations

Officials and management of the City should constantly be aware of this condition, attempt to segregate duties as much as possible and provide oversight to partially compensate for this deficiency.

Corrective Action Plan (CAP)

1. Explanation of Disagreement with Audit Finding
There is no disagreement with the audit finding.
2. Actions Planned in Response to Finding
The City Administrator will attempt to monitor transactions and structure the duties of office personnel to help ensure as much segregation of duties as possible within the City's staffing limitations and funding constraints.
3. Official Responsible for Ensuring CAP
Michael J. Roth, City Administrator, is the official responsible for ensuring this plan.
4. Planned Completion Date for CAP
The City's Administrator has been monitoring transactions and reviewing the duties of office personnel on an ongoing basis.
5. Plan to Monitor Completion of CAP
The City Council recognizes the weakness in segregation of duties and has continually provided oversight to partially compensate for this deficiency.

CITY OF GRAND MARAIS, MINNESOTA

**SCHEDULE OF FINDINGS AND RESPONSES (CONTINUED)
Year Ended December 31, 2006**

2006-2. LACK OF CONTROL OVER FINANCIAL REPORTING PROCESS

Condition and Criteria

As part of the audit, management requested us to prepare a draft of your financial statements, including the related notes to financial statements. Management reviewed, approved, and accepted responsibility for those financial statements prior to their issuance; however, management did not perform a detailed review of the financial statements.

Effect

The potential exists that a material misstatement of the financial statements could occur and not be prevented or detected by the City's internal control.

Cause

This occurred because of staffing limitations caused by fiscal constraints.

Recommendations

In order to provide controls over the financial statement preparation services at an appropriate level, we suggest management establish effective review policies and procedures.

Corrective Action Plan (CAP)

1. Explanation of Disagreement with Audit Finding
There is no disagreement with the audit finding.
2. Actions Planned in Response to Finding
The City has determined that the cost and training involved to review or prepare their own financial statements exceeds the benefit that would result.
3. Official Responsible for Ensuring CAP
None – see number 2 above.
4. Planned Completion Date for CAP
None – see number 2 above.
5. Plan to Monitor Completion of CAP
None – see number 2 above.



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MANAGEMENT LETTER

To the City Council
 City of Grand Marais, Minnesota

In planning and performing our audit of the financial statements of the City of Grand Marais, Minnesota, as of and for the year ended December 31, 2006, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) 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 City's internal control.

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. A separate report dated June 25, 2007, contains our report on significant deficiencies in the City's internal control. This letter does not affect our report dated June 25, 2007, on the financial statements of the City of Grand Marais, Minnesota.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and suggestions with management, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations. Our comments and suggestions are summarized as follows:

Prior Year Comments

1. The City should review capital projects funds with negative fund balances to determine ways to eliminate the deficits in these projects.
2. We noted that sales of merchandise and the related sales tax are not recorded in the general ledger until the payment is received from the customer. Also, the sales tax is improperly recorded in a revenue account.

Merchandise sold should be recorded when billed and the related sales tax should be recorded in the sales tax liability account as follows:

		<u>Dr</u>	<u>Cr</u>
(asset)	Merchandise receivable	1065.00	
(revenue)	Merchandise		1000.00
(liability)	Sales tax payable		65.00

The sales tax should be remitted to the State for the month of sale.

When the customer makes a payment, the entry should be as follows:

		<u>Dr</u>	<u>Cr</u>
	Cash	1065.00	
	Merchandise receivable		1065.00

Internal Control and Operating Efficiency

1. Remittance advices and/or photocopies of the checks received for miscellaneous receipts should be retained by the Public Utilities Department and attached to the deposit receipt.
2. Minnesota State Statute §471.425 requires municipalities to pay all bills within the time period set by the terms of the contract or within the standard payment period of 35 days. We suggest that the City attempt to pay all bills within this time period.
3. State statutes require that each contract between the City and a prime contractor require the prime contractor to pay subcontractors within 10 days of receipt of payment from the City or pay interest of 1.5 percent per month or any part of a month. City officials must be aware of this requirement and follow the requirement to ensure the City is in compliance with state statutes.
4. To support payments to credit card companies, the original invoices must be attached to the credit card statement.

New Accounting Standards

GASB Statement No. 45

The Governmental Accounting Standards Board (GASB) issued Statement No. 45 *Accounting and Financial Reporting by Employers for Post-Employment Benefits Other Than Pensions* (OPEB), which will significantly change the reporting of the City's post-employment benefits. The statement requires actuarial valuations for OPEB at least every two years for plans with 200 or more members, and every three years for plans with fewer than 200 members. Plans with fewer than 100 members have the option to apply a simplified alternative measure to eliminate the need for outside actuarial valuations. This statement is effective in three phases based on the same criteria as those defined for the implementation of GASB Statement No. 34. City of Grand Marais, Minnesota, will be required to implement the standard in the fiscal year beginning January 1, 2009.

The City's management should review the requirements of the new statement in advance of the effective date and plan for implementation.

Statements on Auditing Standards

The Auditing Standards Board of the American Institute of CPA's has issued new statements on auditing standards that significantly impact: 1) the required level of audit documentation and risk assessment; 2) the manner of reporting audit findings to audit committees, or their equivalents; and 3) the amount of time spent on audits by financial auditors, for periods beginning on or after December 15, 2006.

This report is intended solely for the information and use of the City Council, management, the State of Minnesota, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Walker, Hironaka & Nelson, Ltd

June 25, 2007