CITY OF GRAND MARAIS, MINNESOTA

FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION
Year Ended December 31, 2007

CITY OF GRAND MARAIS, MINNESOTA

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December 31, 2007

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CITY OF GRAND MARAIS, MINNESOTA

ORGANIZATION
December 31, 2007

CITY COUNCIL

Mayor	Evelyn Larsen
Councilmember	Edward Bolstad
Councilmember	Kay Costello
Councilmember	Tim Kennedy
Councilmember	William Lenz

ADMINISTRATION

City Administrator	Michael J. Roth

FINANCIAL SECTION

Walker, Giroux, Hahne LTD

CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

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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, 2007, 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, 2007, and the respective changes in financial position, and cash flows, where applicable, 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 16, 2008, 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 important for 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, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Walker, Hirsimaki & Nelson, Ltd.

June 16, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

CITY OF GRAND MARAIS, MINNESOTA

MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2007

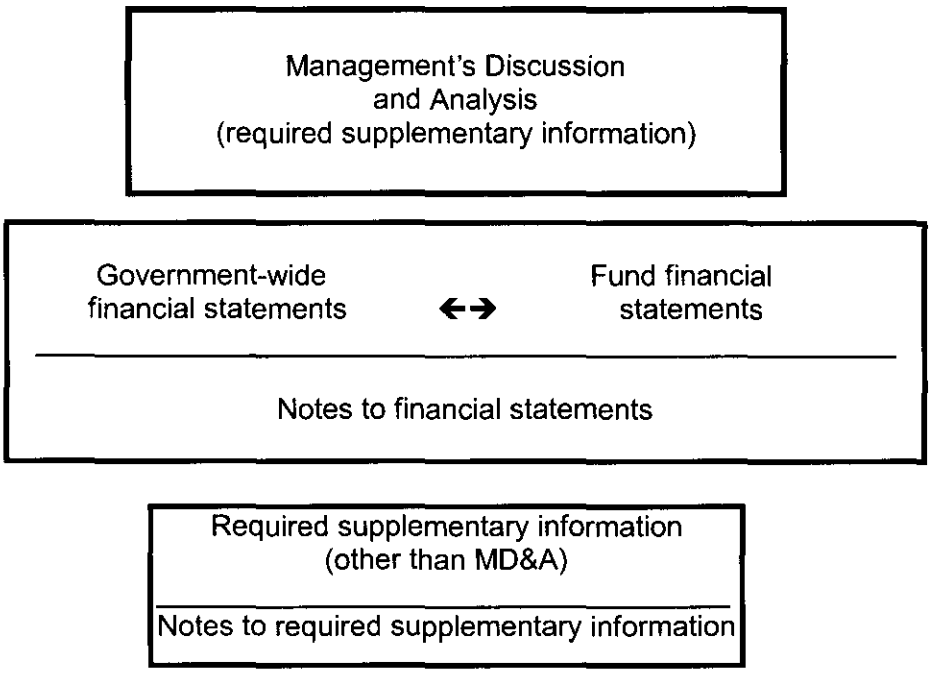
The City of Grand Marais, Minnesota's management's discussion and analysis provides an overview of the City's financial activities for the year ended December 31, 2007. Since this information is designed to focus on the current year's activities, resulting changes, and currently known facts, it should be read in conjunction with the City of Grand Marais, Minnesota's financial statements.

FINANCIAL HIGHLIGHTS

- Governmental activities' total net assets are $4,922,363, of which $3,138,604 is invested in capital assets, net of related debt.
- Business-type activities have total net assets of $11,380,312. Invested in capital assets, net of related debt represents $8,444,888 of the total.
- The City of Grand Marais's net assets increased by $741,413 for the year ended December 31, 2007. Of the increase, a decrease of ($272,978) was in the governmental activities' net assets and $1,014,391 represented the increase in business-type activities' net assets.
- The net cost of governmental activities was $366,992 for the current year. The net cost was funded by general revenues and other items totaling $1,037,253.
- Governmental funds' fund balances increased by $147,133.

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.



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

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 $15,561,262 to $16,302,675. During 2007, the governmental activities had a decrease in net assets and the 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	
	2007	2006	2007	2006	2007	2006
Current and other assets	$ 2,863,413	$ 2,633,605	$ 3,903,544	$ 3,636,379	$ 6,766,957	$ 6,269,984
Capital assets	7,284,604	6,382,491	13,986,464	13,179,504	21,271,068	19,561,995
Total assets	10,148,017	9,016,096	17,890,008	16,815,883	28,038,025	25,831,979
Long-term debt outstanding	5,021,000	3,506,000	5,541,576	5,763,576	10,562,576	9,269,576
Other liabilities	204,654	314,755	968,120	686,386	1,172,774	1,001,141
Total liabilities	5,225,654	3,820,755	6,509,696	6,449,962	11,735,350	10,270,717
Net assets						
Invested in capital assets, net of debt	3,138,604	3,751,491	8,444,888	7,415,928	11,583,492	11,167,419
Restricted	-	-	942,478	897,899	942,478	897,899
Unrestricted	1,783,759	1,443,850	1,992,946	2,052,094	3,776,705	3,495,944
Total net assets	$ 4,922,363	$ 5,195,341	$11,380,312	$10,365,921	$16,302,675	$15,561,262

Net assets of the City's governmental activities decreased by 5.25 percent ($4,922,363 compared to $5,195,341) in 2007.

Net assets of the City's business-type activities increased by 9.79 percent ($11,380,312 compared to $10,365,921) in 2007.

Table 2
Changes in Net Assets

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2007	2006	2007	2006	2007	2006
Revenues						
Program revenues:						
Fees, fines, charges, and other	$ 907,657	$ 861,220	$4,956,500	$4,571,192	$5,864,157	$5,432,412
Operating grants and contributions	118,475	125,811	-	-	118,475	125,811
Capital grants and contributions	795,030	361,991	48,471	42,790	843,501	404,781
General revenues:						
Property taxes	679,576	608,006	-	-	679,576	608,006
Intergovernmental	269,287	327,522	-	-	269,287	327,522
Other general revenues	88,390	77,314	56,475	63,487	144,865	140,801
Total revenues	2,858,415	2,361,864	5,061,446	4,677,469	7,919,861	7,039,333
Program expenses:						
General government	356,941	379,919	-	-	356,941	379,919
Public safety	227,718	219,715	-	-	227,718	219,715
Streets	350,728	344,170	-	-	350,728	344,170
Culture and recreation	1,016,372	1,008,214	-	-	1,016,372	1,008,214
Interest	236,395	172,632	-	-	236,395	172,632
Liquor store	-	-	1,234,726	1,212,416	1,234,726	1,212,416
Golf course	-	-	180,668	159,844	180,668	159,844
Electric	-	-	2,595,477	1,947,387	2,595,477	1,947,387
Water	-	-	393,926	357,518	393,926	357,518
Sewer	-	-	509,078	468,600	509,078	468,600
Total program expenses	2,188,154	2,124,650	4,913,875	4,145,765	7,102,029	6,270,415
Excess (deficit) before special item and transfers	670,261	237,214	147,571	531,704	817,832	768,918
Special item	4,293	(20,209)	(80,712)	-	(76,419)	(20,209)
Transfers	(947,532)	200,000	947,532	(200,000)	-	-
Increase (decrease) in net assets	$ (272,978)	$ 417,005	$1,014,391	$ 331,704	$ 741,413	$ 748,709

Governmental Activities

The cost of all governmental activities this year was $2,188,154. As shown in the Statement of Activities, some of the cost was paid by those who directly benefited from the programs ($907,657) or by other governments and organizations that subsidized certain programs with grants and contributions ($913,505). Our taxpayers financed $679,576 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.

Table 3
Governmental Activities

	Total Cost of Services		Net Cost (Revenue) of Services	
	2007	2006	2007	2006
Culture and recreation	$ 1,016,372	$ 1,008,214	$ 107,224	$ 101,211
General government	356,941	379,919	235,614	263,828
Streets	350,728	344,170	147,251	290,888
Public safety	227,718	219,715	175,347	172,867
Economic development	-	-	(534,839)	(225,798)
All others	236,395	172,632	236,395	172,632
Totals	$ 2,188,154	$ 2,124,650	$ 366,992	$ 775,628

Business-Type Activities

Revenues of the City's business-type activities were $5,061,446; expenses were $4,913,875 (see Table 2). There was a change in net assets of $1,014,391 during the year ended December 31, 2007. The factors driving these results include:

- Electric, water, and sewer utility user fee rate increases
- Capital contributions of $878,818 from the City to the water and sewer enterprise funds

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

As the City completed the year, its governmental funds reported a combined fund balance of $2,358,523 which is above last year's total of $2,211,390. Included in this year's total fund balance is a surplus of $602,064 in the City's general fund. The general fund had a decrease of $(814,179). The largest decrease of $(52,506) in the other governmental funds was in the Debt Service Fund due to principal and interest payments exceeding revenues.

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 $11,563 below the final budget amounts. Resources available for appropriation were $35,379 above the final budgeted amounts. Although the City received less in property taxes than expected, more intergovernmental aids and charges for services were received.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2007, the City had $21,271,068 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 $1,709,073 over last year.

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

	Governmental Activities		Business-type Activities		Totals	
	2007	2006	2007	2006	2007	2006
Land	$ 630,922	$ 630,922	$ 186,100	$ 186,100	$ 817,022	$ 817,022
Construction in progress	2,001,370	1,400,645	236,108	1,386,290	2,237,478	2,786,935
Buildings	1,186,387	1,268,114	4,871,954	5,077,312	6,058,341	6,345,426
Improvements	423,322	440,543	40,648	44,255	463,970	484,798
Infrastructure	2,645,595	2,443,289	8,162,832	5,957,653	10,808,427	8,400,942
Machinery and equipment	128,407	127,969	336,395	375,801	464,802	503,770
Licensed vehicles	268,601	71,009	152,427	152,093	421,028	223,102
Totals	$7,284,604	$6,382,491	$13,986,464	$13,179,504	$21,271,068	$19,561,995

This year's major additions were the EDA Cedar Grove Business Park project in the governmental activities, electric system upgrades in the Electric Enterprise Fund, water reservoir improvements in the Water Enterprise Fund, and a fire truck.

More detailed information about the City's capital assets is presented in Note 4 to the financial statements.

Debt

At year-end, the City had $10,562,576 in long-term debt outstanding versus $9,269,576 last year—as shown in Table 5.

Table 5
Outstanding Debt, at Year-end

	Governmental Activities		Business-type Activities		Totals	
	2007	2006	2007	2006	2007	2006
General obligation bonds (backed by the City)	$5,021,000	$3,506,000	$ -	$ -	$ 5,021,000	$3,506,000
Electric system revenue bonds	-	-	4,110,000	4,270,000	4,110,000	4,270,000
General obligation sewer revenue bonds	-	-	372,000	372,000	372,000	372,000
General obligation revenue notes	-	-	1,059,576	1,121,576	1,059,576	1,121,576
Total	$5,021,000	$3,506,000	$5,541,576	$5,763,576	$10,562,576	$9,269,576

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 $2,855,515 state-imposed limit.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS

The City's elected and appointed officials considered many factors when setting the 2008 budget and tax rates.

- The property tax levy increase will be held to 4.01%.
- The City's capital improvement plan anticipates $3,500,000 in projects in 2008 - 2009.
- Electric rates were increased 3% for 2008 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, 2007

	Primary Government		
	Governmental Activities	Business-type Activities	Total
ASSETS			
Cash and cash equivalents	$ 1,497,618	$ 1,784,985	$ 3,282,603
Investments	-	100,000	100,000
Taxes receivable	102,382	-	102,382
Special assessments receivable	275,207	245,219	520,426
Accounts receivable	9,633	346,814	356,447
Internal balances	61,608	(61,608)	-
Loans receivable	11,154	-	11,154
Inventories	20,670	438,768	459,438
Prepaid items	44,378	42,916	87,294
Deferred debt issue costs	20,950	111,251	132,201
Temporarily restricted assets			
Cash and cash equivalents	-	895,199	895,199
Investments	819,813	-	819,813
Capital assets not being depreciated:			
Land	630,922	186,100	817,022
Construction in progress	2,001,370	236,108	2,237,478
Capital assets, net of accumulated depreciation:			
Buildings	1,186,387	4,871,954	6,058,341
Improvements	423,322	40,648	463,970
Infrastructure	2,645,595	8,162,832	10,808,427
Machinery and equipment	128,407	336,395	464,802
Licensed vehicles	268,601	152,427	421,028
TOTAL ASSETS	10,148,017	17,890,008	28,038,025
LIABILITIES			
Accounts payable	65,156	465,349	530,505
Salaries payable	73,988	95,119	169,107
Customer deposits	-	12,800	12,800
Deferred revenues	-	338,773	338,773
Accrued interest payable	65,510	56,079	121,589
Noncurrent liabilities			
Due within one year	95,000	239,576	334,576
Due in more than one year	4,926,000	5,302,000	10,228,000
TOTAL LIABILITIES	5,225,654	6,509,696	11,735,350
NET ASSETS			
Invested in capital assets, net of related debt	3,138,604	8,444,888	11,583,492
Restricted for other purposes	-	942,478	942,478
Unrestricted	1,783,759	1,992,946	3,776,705
TOTAL NET ASSETS	$ 4,922,363	$ 11,380,312	$ 16,302,675

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

CITY OF GRAND MARAIS, MINNESOTA

STATEMENT OF ACTIVITIES
Year Ended December 31, 2007

Functions/Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions
PRIMARY GOVERNMENT			
Governmental Activities			
General government	$ 356,941	$ 121,327	$ -
Public safety	227,718	51,321	1,050
Streets	350,728	-	-
Culture and recreation	1,016,372	735,009	117,425
Economic development	-	-	-
Interest on long-term debt	236,395	-	-
Total Governmental Activities	2,188,154	907,657	118,475
Business-type Activities			
Liquor Store	$ 1,234,726	$ 1,467,139	$ -
Golf Course	180,668	151,655	-
Electric	2,595,477	2,442,018	-
Water	393,926	348,962	-
Sewer	509,078	546,726	-
Total Business-type Activities	4,913,875	4,956,500	-
TOTAL PRIMARY GOVERNMENT	$ 7,102,029	$ 5,864,157	$ 118,475
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 assets			
Transfers			
Total General Revenues, Special Item, and Transfers			
CHANGE IN NET ASSETS			
NET ASSETS - JANUARY 1			
NET ASSETS - DECEMBER 31			

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

Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets Primary Government Governmental Activities	Business-type Activities	Total
$ -	$ (235,614)	$ -	$ (235,614)
-	(175,347)	-	(175,347)
203,477	(147,251)	-	(147,251)
56,714	(107,224)	-	(107,224)
534,839	534,839	-	534,839
-	(236,395)	-	(236,395)
795,030	(366,992)	-	(366,992)
$ -	-	232,413	232,413
-	-	(29,013)	(29,013)
-	-	(153,459)	(153,459)
48,471	-	3,507	3,507
-	-	37,648	37,648
48,471	-	91,096	91,096
$ 843,501	(366,992)	91,096	(275,896)
	550,558	-	550,558
	129,018	-	129,018
	6,890	-	6,890
	269,287	-	269,287
	81,500	56,475	137,975
	4,293	(80,712)	(76,419)
	(947,532)	947,532	-
	94,014	923,295	1,017,309
	(272,978)	1,014,391	741,413
	5,195,341	10,365,921	15,561,262
	$ 4,922,363	$ 11,380,312	$ 16,302,675

CITY OF GRAND MARAIS, MINNESOTA

BALANCE SHEET
GOVERNMENTAL FUNDS
December 31, 2007

	General Fund	Debt Service Fund	EDA Cedar Grove Business Park Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
ASSETS					
Cash and cash equivalents	$ 486,476	$ 174,567	$ 318,347	$ 518,228	$ 1,497,618
Investments	-	819,813	-	-	819,813
Taxes receivable	91,866	10,516	-	-	102,382
Special assessments receivable	-	275,207	-	-	275,207
Accounts receivable	8,024	-	-	1,609	9,633
Due from other funds	121,101	69,130	-	-	190,231
Loans receivables	-	-	-	11,154	11,154
Inventories	20,670	-	-	-	20,670
Prepaid items	41,223	-	-	3,155	44,378
TOTAL ASSETS	$ 769,360	$ 1,349,233	$ 318,347	$ 534,146	$ 2,971,086
LIABILITIES AND FUND BALANCES					
LIABILITIES					
Accounts payable	$ 50,244	$ -	$ -	$ 14,912	$ 65,156
Salaries payable	56,122	-	-	17,866	73,988
Due to other funds	2,494	126,129	-	-	128,623
Deferred revenue	58,436	275,206	-	11,154	344,796
TOTAL LIABILITIES	167,296	401,335	-	43,932	612,563
FUND BALANCES					
Reserved for debt service	-	819,813	-	-	819,813
Unreserved, designated	415,655	-	-	72,653	488,308
Unreserved, undesignated, reported in					
General Fund	186,409	-	-	-	186,409
Special revenue funds	-	-	-	417,561	417,561
Debt service fund	-	128,085	-	-	128,085
Capital projects funds	-	-	318,347	-	318,347
TOTAL FUND BALANCES	602,064	947,898	318,347	490,214	2,358,523
TOTAL LIABILITIES AND FUND BALANCES	$ 769,360	$ 1,349,233	$ 318,347	$ 534,146	$ 2,971,086

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, 2007

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

TOTAL FUND BALANCES, GOVERNMENTAL FUNDS	$	2,358,523
Unamortized bond issuance costs are susceptible to full accrual on the government-wide statements.		20,950
Capital assets used in governmental activities are not current financial resources and therefore are not reported in the funds.		7,284,604
Deferred revenue in governmental funds is susceptible to full accrual on the government-wide statements.		344,796
Interest payable on long-term debt is susceptible to full accrual on the government-wide statements.		(65,510)
Long-term liabilities, including bonds payable are not due and payable in the current period and therefore not reported in the governmental funds.		(5,021,000)
NET ASSETS OF GOVERNMENTAL ACTIVITIES	$	4,922,363

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, 2007

	General Fund	Debt Service Fund	EDA Cedar Grove Business Park Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
REVENUES					
Taxes					
Property	$ 502,840	$ 129,018	$ -	$ -	$ 631,858
Franchise	-	-	-	6,890	6,890
Special assessments	821	74,050	60,000	-	134,871
Licenses and permits	77,799	-	-	-	77,799
Intergovernmental	275,604	-	474,839	155,450	905,893
Charges for services	811,509	-	-	13,731	825,240
Fines	2,734	-	-	-	2,734
Gifts and contributions	1,050	-	-	12,371	13,421
Interest	18,128	27,946	19,194	16,232	81,500
Miscellaneous	1,884	-	-	5,784	7,668
TOTAL REVENUES	1,692,369	231,014	554,033	210,458	2,687,874
EXPENDITURES					
Current					
General government	358,970	-	-	-	358,970
Public safety	419,895	-	-	-	419,895
Streets	233,435	-	-	-	233,435
Culture and recreation	691,720	-	-	239,814	931,534
Debt service					
Principal	-	115,000	-	-	115,000
Interest and other charges	-	168,520	59,945	-	228,465
Bond issuance costs	-	-	30,168	-	30,168
Capital outlay					
Streets	-	-	-	12,726	12,726
Culture and recreation	-	-	-	554	554
Economic development	-	-	1,775,573	-	1,775,573
TOTAL EXPENDITURES	1,704,020	283,520	1,865,686	253,094	4,106,320
DEFICIENCY OF REVENUES OVER EXPENDITURES	(11,651)	(52,506)	(1,311,653)	(42,636)	(1,418,446)
OTHER FINANCING SOURCES (USES)					
Transfers in	200,000	-	-	780,851	980,851
Transfers out	(1,006,821)	-	-	(42,744)	(1,049,565)
Bonds issued	-	-	1,630,000	-	1,630,000
Proceeds from sale of assets	4,293	-	-	-	4,293
TOTAL OTHER FINANCING SOURCES (USES)	(802,528)	-	1,630,000	738,107	1,565,579
NET CHANGE IN FUND BALANCES	(814,179)	(52,506)	318,347	695,471	147,133
FUND BALANCES - JANUARY 1	1,416,243	1,000,404	-	(205,257)	2,211,390
FUND BALANCES - DECEMBER 31	$ 602,064	$ 947,898	$ 318,347	$ 490,214	$ 2,358,523

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, 2007

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

NET CHANGE IN FUND BALANCES - TOTAL GOVERNMENTAL FUNDS		$ 147,133
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.		
Expenditures for capital assets	2,020,583	
Less current year depreciation	(239,651)	
Net capital assets		1,780,932
Capital assets were contributed to the Water and Sewer Enterprise Funds.		(878,818)
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.		
Change in deferred revenue - delinquent property taxes	47,798	
Change in deferred revenue - special assessments receivable	128,524	
Change in deferred revenue - loans receivable	(5,784)	
		170,538
Debt issued provides current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduced long-term liabilites in the statement of net assets.		
Debt issued	(1,630,000)	
Principal repaid	115,000	
		(1,515,000)
Governmental funds report bond discounts and issuance costs as expenditures; however, in the statement of activities, these costs are amortized over the life of the corresponding debt.		20,950
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.		
Change in accrued interest payable on long-term debt		1,287
CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES		$ (272,978)

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

CITY OF GRAND MARAIS, MINNESOTA

STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
December 31, 2007

	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	$ 541,446	$ -	$ 457,676	$ -	$ 785,863	$ 1,784,985
Investments	100,000	-	-	-	-	100,000
Accounts receivable	425	125	262,201	30,635	53,428	346,814
Due from other funds	619	-	150,354	124,897	1,672	277,542
Special assessments receivable	-	-	-	245,219	-	245,219
Inventories	124,674	10,588	283,737	19,645	124	438,768
Prepaid items	6,679	4,927	22,427	4,802	4,081	42,916
TOTAL CURRENT ASSETS	773,843	15,640	1,176,395	425,198	845,168	3,236,244
NONCURRENT ASSETS						
Restricted cash and cash equivalents						
Revenue bond covenant accounts	-	-	417,309	-	-	417,309
MPCA contract accounts	-	-	-	-	477,890	477,890
Total restricted cash and cash equivalents	-	-	417,309	-	477,890	895,199
Deferred debt issue costs	-	-	111,251	-	-	111,251
Capital assets						
Land	-	154,100	25,000	5,000	2,000	186,100
Construction in progress	-	-	-	236,108	-	236,108
Buildings	24,248	89,466	2,759,697	1,815,454	2,516,190	7,205,055
Improvements	-	304,340	-	-	-	304,340
Infrastructure	-	-	3,307,935	4,146,996	2,769,512	10,224,443
Machinery and equipment	130,739	154,041	159,127	432,368	1,306,700	2,182,975
Licensed vehicles	-	500	279,809	33,753	72,485	386,547
Less accumulated depreciation	(118,893)	(424,222)	(1,154,116)	(2,002,462)	(3,039,411)	(6,739,104)
Total capital assets (net of accumulated depreciation)	36,094	278,225	5,377,452	4,667,217	3,627,476	13,986,464
TOTAL NONCURRENT ASSETS	36,094	278,225	5,906,012	4,667,217	4,105,366	14,992,914
TOTAL ASSETS	809,937	293,865	7,082,407	5,092,415	4,950,534	18,229,158
LIABILITIES						
CURRENT LIABILITIES						
Accounts payable	43,038	352	206,131	200,741	15,087	465,349
Salaries payable	25,096	18,778	20,659	13,608	16,978	95,119
Accrued interest payable	-	-	29,614	9,725	16,740	56,079
Due to other funds	-	619	83,094	227,300	28,137	339,150
Deferred revenue	-	-	338,773	-	-	338,773
Customer deposits payable	-	-	12,800	-	-	12,800
Bonds, notes, and loans payable - current	-	-	175,000	58,576	6,000	239,576
TOTAL CURRENT LIABILITIES	68,134	19,749	866,071	509,950	82,942	1,546,846
NONCURRENT LIABILITIES						
Bonds, notes and loans payable	-	-	3,935,000	1,001,000	366,000	5,302,000
TOTAL LIABILITIES	68,134	19,749	4,801,071	1,510,950	448,942	6,848,846
NET ASSETS						
Invested in capital assets, net of related debt	36,094	278,225	1,267,452	3,607,641	3,255,476	8,444,888
Restricted for other purposes	-	-	390,414	-	552,064	942,478
Unrestricted	705,709	(4,109)	623,470	(26,176)	694,052	1,992,946
TOTAL NET ASSETS	$ 741,803	$ 274,116	$ 2,281,336	$ 3,581,465	$ 4,501,592	$ 11,380,312

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, 2007

	Business-type Activities - Enterprise Funds					
	Liquor Store Enterprise Fund	Golf Course Enterprise Fund	Electric Enterprise Fund	Water Enterprise Fund	Sewer Enterprise Fund	Totals
REVENUES						
Charges for sales and services	$ 1,467,139	$ 151,655	$ 2,442,018	$ 348,962	$ 546,726	$ 4,956,500
OPERATING EXPENSES						
Cost of sales	984,464	14,725	1,446,973	-	-	2,446,162
Salaries	145,080	85,673	171,514	108,877	117,676	628,820
Employee benefits and payroll taxes	43,649	22,283	61,287	38,296	40,113	205,628
Advertising	6,657	2,208	616	-	-	9,481
Contract services	-	-	211,099	8,954	113,042	333,095
Facility fees	-	-	61,090	-	-	61,090
Insurance	4,076	4,440	24,634	4,374	3,600	41,124
Miscellaneous	18,191	4,240	16,452	4,692	4,433	48,008
Rent	22,000	-	1,600	1,600	1,600	26,800
Repairs and maintenance	3,468	3,222	65,875	18,104	8,212	98,881
Supplies	4,231	20,065	163,365	20,655	13,409	221,725
Telephone	522	917	1,471	2,247	599	5,756
Utilities	-	3,292	4,079	23,490	53,186	84,047
Depreciation	2,388	19,603	176,075	135,217	136,422	469,705
TOTAL OPERATING EXPENSES	1,234,726	180,668	2,406,130	366,506	492,292	4,680,322
OPERATING INCOME (LOSS)	232,413	(29,013)	35,888	(17,544)	54,434	276,178
NONOPERATING REVENUES (EXPENSES)						
Interest income	15,268	-	23,124	-	18,083	56,475
Special assessments	-	-	-	48,471	-	48,471
Interest expense	-	-	(189,347)	(27,420)	(16,786)	(233,553)
Gain (loss) on disposal of capital assets	-	-	(81,518)	806	-	(80,712)
TOTAL NONOPERATING REVENUES (EXPENSES)	15,268	-	(247,741)	21,857	1,297	(209,319)
INCOME (LOSS) BEFORE CONTRIBUTIONS AND TRANSFERS	247,681	(29,013)	(211,853)	4,313	55,731	66,859
Capital contributions	-	-	-	439,409	439,409	878,818
Transfers in	-	230,000	-	-	42,744	272,744
Transfers out	(200,000)	-	-	(4,030)	-	(204,030)
CHANGE IN NET ASSETS	47,681	200,987	(211,853)	439,692	537,884	1,014,391
TOTAL NET ASSETS - JANUARY 1	694,122	73,129	2,493,189	3,141,773	3,963,708	10,365,921
TOTAL NET ASSETS - DECEMBER 31	$ 741,803	$ 274,116	$ 2,281,336	$ 3,581,465	$ 4,501,592	$ 11,380,312

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, 2007

	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	$ 1,466,970	$ 151,530	$ 2,398,775	$ 343,256	$ 535,470	$ 4,896,001
Cash paid to suppliers	(1,081,851)	(78,775)	(1,984,211)	(126,425)	(247,322)	(3,518,584)
Cash paid to employees	(135,906)	(77,383)	(175,782)	(98,943)	(117,072)	(605,086)
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	249,213	(4,628)	238,782	117,888	171,076	772,331
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Transfers in from other funds	-	230,000	-	-	42,744	272,744
Transfers out to other funds	(200,000)	-	-	(4,030)	-	(204,030)
Advances to other funds	(619)	(214,773)	-	(99,708)	(5,156)	(320,256)
Advances from other funds	-	-	67,137	57,536	-	124,673
NET CASH PROVIDED (USED) BY NONCAPITAL FINANCING ACTIVITIES	(200,619)	15,227	67,137	(46,202)	37,588	(126,869)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES						
Purchase or construction of fixed assets	(10,225)	(10,599)	(223,245)	(40,407)	(17,117)	(301,593)
Special assessments collected	-	-	-	57,904	-	57,904
Principal paid on long-term debt	-	-	(160,000)	(62,000)	-	(222,000)
Interest paid on long-term debt	-	-	(183,137)	(27,989)	(16,007)	(227,133)
Sale of capital assets	-	-	17,929	806	-	18,735
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	(10,225)	(10,599)	(548,453)	(71,686)	(33,124)	(674,087)
CASH FLOWS FROM INVESTING ACTIVITIES						
Interest on investments	13,207	-	23,124	-	18,083	54,414
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	51,576	-	(219,410)	-	193,623	25,789
CASH AND CASH EQUIVALENTS, JANUARY 1	489,870	-	1,094,395	-	1,070,130	2,654,395
CASH AND CASH EQUIVALENTS, DECEMBER 31	$ 541,446	$ -	$ 874,985	$ -	$ 1,263,753	$ 2,680,184

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, 2007

	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 (USED) BY OPERATING ACTIVITIES						
Operating income (loss)	$ 232,413	$ (29,013)	$ 35,888	$ (17,544)	$ 54,434	$ 276,178
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:						
Depreciation	2,388	19,603	176,075	135,217	136,422	469,705
Changes in assets and liabilities						
(Increase) decrease in:						
Accounts receivable	(169)	(125)	(45,943)	(5,706)	(11,256)	(63,199)
Inventories	4,856	(2,142)	9,079	(1,330)	100	10,563
Prepaid items	(1,684)	(1,451)	(3,102)	(497)	(853)	(7,587)
Increase (decrease) in:						
Accounts payable	2,235	210	68,353	(2,186)	(8,375)	60,237
Salaries payable	9,174	8,290	(4,268)	9,934	604	23,734
Customer deposits	-	-	2,700	-	-	2,700
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	$ 249,213	$ (4,628)	$ 238,782	$ 117,888	$ 171,076	$ 772,331
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:						
Total capital asset additions	$ 10,225	$ 10,599	$ 223,245	$ 675,517	$ 456,526	$ 1,376,112
Contributions of capital assets from government	-	-	-	(439,409)	(439,409)	(878,818)
Accounts payable	-	-	-	(195,701)	-	(195,701)
Cash paid for capital assets	$ 10,225	$ 10,599	$ 223,245	$ 40,407	$ 17,117	$ 301,593

The accompanying notes are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS

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 council-members.

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, 2007.

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.

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 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.

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:

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

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.

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 and revenue notes.

   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.

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 - 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.

NOTE 2 - CASH AND CASH EQUIVALENTS AND INVESTMENTS (CONTINUED)

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

Cash	$ 3,751,862
Petty Cash	3,217
Certificates of Deposit	192,958
Investments	1,149,578
Total	$ 5,097,615

Deposits

Custodial Credit Risk – Deposits
Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the City will not be able to recover its deposits. 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 $3,944,820; the bank balance was $4,239,012. Of the bank balance, $476,627 was insured; of the remaining balance, $553,472 was collateralized with securities held by the pledging financial institution's agent in the City's name and $3,208,913 was collateralized with securities held by the pledging financial institution's agent but not in the City's name.

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.

NOTE 2 - CASH AND CASH EQUIVALENTS AND INVESTMENTS (CONTINUED)

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, 2007, 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, 2007, the City had the following investments:

		Maturity
		Less than
Investment Type	Fair Value	2 Years
U.S. Treasury State and Local Government Securities	$ 819,813	$ 819,813
Federal Home Loan Mortgage Corp. Note	100,000	100,000
Minnesota Municipal Money Market Fund	209,607	209,607
Smith Barney Money Market Funds	20,086	20,086
Wells Fargo Money Market Funds	72	72
Total Investments	$ 1,149,578	$ 1,149,578

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 3 - 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, 2007 was $11,154.

NOTE 4 - CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2007, was as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
Governmental activities				
Capital assets, not being depreciated:				
Land	$ 630,922	$ -	$ -	$ 630,922
Construction in progress	1,400,645	1,788,299	(1,187,574)	2,001,370
Total capital assets, not being depreciated	2,031,567	1,788,299	(1,187,574)	2,632,292
Capital assets, being depreciated:				
Buildings	4,315,279	3,911	-	4,319,190
Improvements	524,162	-	-	524,162
Infrastructure	4,192,906	311,256	-	4,504,162
Machinery and equipment	325,826	16,841	(12,000)	330,667
Licensed vehicles	217,995	209,031	(22,500)	404,526
Total capital assets, being depreciated	9,576,168	541,039	(34,500)	10,082,707
Less accumulated depreciation for:				
Buildings	(3,047,165)	(85,638)	-	(3,132,803)
Improvements	(83,619)	(17,221)	-	(100,840)
Infrastructure	(1,749,617)	(108,950)	-	(1,858,567)
Machinery and equipment	(197,857)	(16,403)	12,000	(202,260)
Licensed vehicles	(146,986)	(11,439)	22,500	(135,925)
Total accumulated depreciation	(5,225,244)	(239,651)	34,500	(5,430,395)
Total capital assets, being depreciated, net	4,350,924	301,388	-	4,652,312
Governmental activities capital assets, net	$ 6,382,491	$ 2,089,687	$ (1,187,574)	$ 7,284,604
Business-type activities				
Capital assets, not being depreciated:				
Land	$ 186,100	$ -	$ -	$ 186,100
Construction in progress	1,386,290	407,287	(1,557,469)	236,108
Total capital assets, not being depreciated	1,572,390	407,287	(1,557,469)	422,208
Capital assets, being depreciated:				
Buildings	7,369,327	-	(164,272)	7,205,055
Improvements	301,387	2,953	-	304,340
Infrastructure	8,242,699	2,465,805	(484,061)	10,224,443
Machinery and equipment	2,170,045	34,989	(22,059)	2,182,975
Licensed vehicles	404,000	22,547	(40,000)	386,547
Total capital assets, being depreciated	18,487,458	2,526,294	(710,392)	20,303,360
Less accumulated depreciation for:				
Buildings	(2,292,015)	(177,900)	136,814	(2,333,101)
Improvements	(257,132)	(6,560)	-	(263,692)
Infrastructure	(2,285,046)	(191,966)	415,401	(2,061,611)
Machinery and equipment	(1,794,244)	(71,066)	18,730	(1,846,580)
Licensed vehicles	(251,907)	(22,213)	40,000	(234,120)
Total accumulated depreciation	(6,880,344)	(469,705)	610,945	(6,739,104)
Total capital assets, being depreciated, net	11,607,114	2,056,589	(99,447)	13,564,256
Business-type activities capital assets, net	$ 13,179,504	$ 2,463,876	$ (1,656,916)	$ 13,986,464

NOTE 4 - CAPITAL ASSETS (CONTINUED)

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

Governmental activities	
General government	$ 1,881
Public safety	16,854
Streets	117,292
Culture and recreation	103,624
Total depreciation expense-governmental activities	$ 239,651
Business-type activities	
Liquor Store	$ 2,388
Golf Course	19,603
Electric	176,075
Water	135,217
Sewer	136,422
Total depreciation expense-business-type activities	$ 469,705

NOTE 5 - 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, 2007, the rate stabilization reserve was $338,773.

NOTE 6 - LONG-TERM LIABILITIES

The City issues general obligation bonds, improvement notes and revenue notes and bonds 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. The City has also 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.

On January 9, 2007, the City issued general obligation temporary improvement bonds to temporarily finance construction of street, water, and sewer improvements in Cedar Grove Business Park.

NOTE 67 - LONG-TERM LIABILITIES (CONTINUED)

Components of long-term liabilities are as follows:

	Issue Date	Interest Rates	Original Issue	Final Maturity	Principal Outstanding
Governmental Activities					
General Obligation Bonds					
1980 Water and Sewer Revenue	05/28/1980	5.00%	$ 867,000	01/01/2010	$ 106,000
2000 Improvement	07/01/2000	5.60-6.20%	$ 1,025,000	02/01/2021	855,000
2004 Improvement	06/01/2004	3.40-5.10%	$ 710,000	02/01/2025	660,000
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
2007 Temporary Improvement	01/09/2007	3.65%	$ 1,630,000	01/09/2010	1,630,000
Total General Obligation Bonds					5,021,000
Governmental Activities Long-term Liabilities					5,021,000
Business-type activities					
Revenue Bonds					
2003 Electric System	05/01/2003	3.00-4.875%	$ 2,885,000	05/01/2023	2,455,000
2004 Electric System	09/01/2004	4.00-4.80%	$ 815,000	05/01/2023	755,000
2005 Electric System	06/21/2005	2.75-4.60%	$ 940,000	05/01/2024	900,000
2006 GO Sewer	09/15/2004	4.50%	$ 372,000	01/01/2036	372,000
Total Revenue Bonds					4,482,000
General Obligation Notes					
1999 Water Revenue	04/27/1999	2.56%	$ 484,112	08/20/2019	332,000
2004 Improvement	07/21/2004	2.53%	$ 812,229	02/20/2024	727,576
Total General Obligation Notes					1,059,576
Business-type Activities Long-term Liabilities					5,541,576
Total Long-Term Liabilities					$ 10,562,576

Long-term liability activity for the year ended December 31, 2007 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Governmental activities					
Bonds Payable					
1980 GO Water and Sewer Revenue	$ 156,000	$ -	$ 50,000	$ 106,000	$ -
2000 GO Improvements	895,000	-	40,000	855,000	40,000
2004 GO Improvements	685,000	-	25,000	660,000	25,000
2005 GO Improvements	895,000	-	-	895,000	30,000
2005 GO Improvement Refunding	875,000	-	-	875,000	-
2007 GO Temporary Improvement	-	1,630,000	-	1,630,000	-
Governmental Activities - Long-term Liabilities	$ 3,506,000	$ 1,630,000	$ 115,000	$ 5,021,000	$ 95,000

NOTE 6 - LONG-TERM LIABILITIES (CONTINUED)

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Business-type Activities					
Bonds Payable					
2003 Electric System Revenue	$ 2,565,000	$ -	$ 110,000	$ 2,455,000	$ 115,000
2004 Electric System Revenue	785,000	-	30,000	755,000	35,000
2005 Electric System Revenue	920,000	-	20,000	900,000	25,000
2006 GO Sewer Revenue	372,000	-	-	372,000	6,000
Total Bonds Payable	4,642,000	-	160,000	4,482,000	181,000
Notes Payable					
1999 GO Water Revenue	355,000	-	23,000	332,000	24,000
2004 GO Improvement	766,576	-	39,000	727,576	34,576
Total Notes Payable	1,121,576	-	62,000	1,059,576	58,576
Business-type Activities - Long-term Liabilities	$ 5,763,576	$ -	$ 222,000	$ 5,541,576	$ 239,576

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

Year Ending December 31	Governmental Activities		Business-Type Activities		Government-wide	
	Principal	Interest	Principal	Interest	Principal	Interest
2008	$ 95,000	$ 184,903	$ 239,576	$ 218,044	$ 334,576	$ 402,947
2009	197,000	214,829	248,000	210,491	445,000	425,320
2010	1,839,000	176,131	254,000	202,318	2,093,000	378,449
2011	165,000	136,866	260,000	193,441	425,000	330,307
2012	175,000	129,410	272,000	184,000	447,000	313,410
2013-2017	990,000	514,983	1,514,000	758,160	2,504,000	1,273,143
2018-2022	1,100,000	236,336	1,759,000	419,958	2,859,000	656,294
2023-2027	460,000	48,220	827,000	80,765	1,287,000	128,985
2028-2032	-	-	86,000	30,420	86,000	30,420
2033-2036	-	-	82,000	9,450	82,000	9,450
Total	$ 5,021,000	$ 1,641,678	$ 5,541,576	$ 2,307,047	$10,562,576	$ 3,948,725

On January 3, 2008, the City issued a $470,000 Water Revenue Note, Series 2008A to finance water reservoir and utility improvements construction with final payments due December 1, 2027.

NOTE 7 - INTERFUND BALANCES AND ACTIVITY

The composition of interfund balances as of December 31, 2007, is as follows:

Due to/from other funds –

Receivable Fund	Payable Fund	Amount
General	Electric Enterprise	$ 83,094
General	Water Enterprise	25,876
General	Sewer Enterprise	12,131
Debt Service	Water Enterprise	53,124
Debt Service	Sewer Enterprise	16,006
Liquor Store Enterprise	Golf Enterprise	619
Electric Enterprise	General	2,054
Electric Enterprise	Water Enterprise	148,300
Water Enterprise	General	112
Water Enterprise	Debt Service	124,785
Sewer Enterprise	General	328
Sewer Enterprise	Debt Service	1,344
		$ 467,773

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, 2007 consisted of the following:

	Transfers Out				
	General Fund	Liquor Store Enterprise Fund	Water Enterprise Fund	Nonmajor Funds	Total
Transfers In					
General Fund	$ -	$ 200,000	$ -	$ -	$ 200,000
Golf Course Enterprise Fund	230,000	-	-	-	230,000
Sewer Enterprise Fund	-	-	-	42,744	42,744
Nonmajor Funds	776,821	-	4,030	-	780,851
	$ 1,006,821	$ 200,000	$ 4,030	$ 42,744	$ 1,253,595

Transfers are used to: 1) close capital projects funds, 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) cover prior years' deficits in the golf enterprise fund.

NOTE 8 - FUND EQUITY

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

General Fund	
Designated for:	
Street seal coat project	$ 70,965
Buildings	51,713
Insurance reserve	10,804
Street equipment	23,450
Street improvements	258,723
Total General Fund - Designated	$ 415,655
Library Special Revenue Fund	
Designated for library improvements	$ 72,653

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

Electric Enterprise Fund	
Restricted for debt service	$ 390,414
Sewer Enterprise Fund	
Restricted for MPCA contract	$ 552,064

NOTE 9 - 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 and retains the risk for the deductible portions of the insurance. 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 10 - 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 $1,775,572 in 2007 and $225,798 in 2006 on infrastructure for this project.

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

NOTE 11 - 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.

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 2007 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 12 - 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, 2007, 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 outstanding construction projects as of December 31, 2007. The projects were evidenced by contractual commitments with contractors.

Project	Spent-to-Date	Commitment Remaining
Water improvements	$ 195,701	$ 23,307
Business Park	$ 1,674,429	$ 97,442

NOTE 13 - 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 $21,943 on December 31, 2007.

NOTE 14 - 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.

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.

NOTE 14 - DEFINED BENEFIT PENSION PLANS - STATEWIDE (CONTINUED)

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 5.75%, respectively, of their annual covered salary in 2007. Contribution rates in the Coordinated Plan will increase in 2008 to 6.0%. The City of Grand Marais is required to contribute the following percentages of annual covered payroll: 11.78% for Basic Plan PERF members and 6.25% for Coordinated Plan PERF members. Employer contribution rates for the Coordinated Plan will increase to 6.50%, effective January 1, 2008. The City's contributions to the Public Employees Retirement Fund for the years ending December 31, 2007, 2006, and 2005 were $70,576, $64,410, and $59,847, respectively. The City's contributions were equal to the contractually required contributions for each year as set by state statute.

NOTE 15 - ENVIRONMENTAL SITE CLEAN UP OF FORMER ELECTRIC POWER PLANT

The City has identified the site of its former electric power plant as requiring remediation and clean up. Cleanup expenses of $176,793 were incurred during 2007. The estimated remaining costs of $413,000 are not recorded since the City is anticipating reimbursement from the Minnesota Petro Fund for a significant portion of the cost.

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, 2007

	Budgeted Amounts		Actual Amounts, Budgetary Basis	Variance with Final Budget - Positive (Negative)
	Original	Final		
REVENUES				
Taxes				
Property	$ 540,829	$ 540,829	$ 502,840	$ (37,989)
Special assessments	2,066	2,066	821	(1,245)
Licenses and permits	69,350	69,350	77,799	8,449
Intergovernmental	260,001	260,001	275,604	15,603
Charges for services	758,464	758,464	811,509	53,045
Fines	7,280	7,280	2,734	(4,546)
Gifts and contributions	500	500	1,050	550
Interest	18,000	18,000	18,128	128
Miscellaneous	500	500	1,884	1,384
TOTAL REVENUES	1,656,990	1,656,990	1,692,369	35,379
EXPENDITURES				
Current				
General government	376,374	376,374	358,970	17,404
Public safety	213,970	213,970	419,895	(205,925)
Streets	336,292	336,292	233,435	102,857
Culture and recreation	788,947	788,947	691,720	97,227
TOTAL EXPENDITURES	1,715,583	1,715,583	1,704,020	11,563
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(58,593)	(58,593)	(11,651)	46,942
OTHER FINANCING SOURCES (USES)				
Transfers in	200,000	200,000	200,000	-
Transfers out	(116,029)	(116,029)	(1,006,821)	(890,792)
Proceeds from sale of assets	-	-	4,293	4,293
TOTAL OTHER FINANCING SOURCES (USES)	83,971	83,971	(802,528)	(886,499)
NET CHANGE IN FUND BALANCE	25,378	25,378	(814,179)	(839,557)
FUND BALANCE - JANUARY 1	1,416,243	1,416,243	1,416,243	-
FUND BALANCE - DECEMBER 31	$ 1,441,621	$ 1,441,621	$ 602,064	$ (839,557)

NOTE TO REQUIRED SUPPLEMENTARY INFORMATION
December 31, 2007

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.

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

CITY OF GRAND MARAIS, MINNESOTA

COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
December 31, 2007

	Library Special Revenue Fund	Cable TV Special Revenue Fund	Storefront Renovation Special Revenue Fund	Capital Improvements Capital Projects Fund	Street, Water, and Sewer Capital Projects Fund	Total Nonmajor Governmental Funds
ASSETS						
Cash and cash equivalents	$ 403,699	$ 1,815	$ 102,029	$ -	$ 10,685	$ 518,228
Accounts receivable	-	1,609	-	-	-	1,609
Loans receivables	-	-	11,154	-	-	11,154
Prepaid items	2,155	1,000	-	-	-	3,155
TOTAL ASSETS	$ 405,854	$ 4,424	$ 113,183	$ -	$ 10,685	$ 534,146
LIABILITIES AND FUND BALANCES						
LIABILITIES						
Accounts payable	$ 4,227	$ -	$ -	$ -	$ 10,685	$ 14,912
Salaries payable	17,866	-	-	-	-	17,866
Deferred revenue	-	-	11,154	-	-	11,154
TOTAL LIABILITIES	22,093	-	11,154	-	10,685	43,932
FUND BALANCES						
Unreserved, designated	72,653	-	-	-	-	72,653
Unreserved, undesignated	311,108	4,424	102,029	-	-	417,561
TOTAL FUND BALANCES	383,761	4,424	102,029	-	-	490,214
TOTAL LIABILITIES AND FUND BALANCES	$ 405,854	$ 4,424	$ 113,183	$ -	$ 10,685	$ 534,146

CITY OF GRAND MARAIS, MINNESOTA

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
NONMAJOR GOVERNMENTAL FUNDS
Year Ended December 31, 2007

	Library Special Revenue Fund	Cable TV Special Revenue Fund	Storefront Renovation Special Revenue Fund	Capital Improvements Capital Projects Fund	Street, Water, and Sewer Capital Projects Fund	Total Nonmajor Governmental Funds
REVENUES						
Taxes - franchise fee	$ -	$ 6,890	$ -	$ -	$ -	$ 6,890
Intergovernmental	94,213	-	-	47,784	13,453	155,450
Charges for services	13,731	-	-	-	-	13,731
Gifts and contributions	3,441	-	-	8,930	-	12,371
Interest	15,498	-	601	133	-	16,232
Miscellaneous	-	-	5,784	-	-	5,784
TOTAL REVENUES	126,883	6,890	6,385	56,847	13,453	210,458
EXPENDITURES						
Current						
Culture and recreation	227,814	12,000	-	-	-	239,814
Capital outlay						
Streets	-	-	-	-	12,726	12,726
Culture and recreation	-	-	-	554	-	554
TOTAL EXPENDITURES	227,814	12,000	-	554	12,726	253,094
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(100,931)	(5,110)	6,385	56,293	727	(42,636)
OTHER FINANCING SOURCES (USES)						
Transfers in	112,529	3,500	-	73,680	591,142	780,851
Transfers out	-	-	-	-	(42,744)	(42,744)
TOTAL OTHER FINANCING SOURCES (USES)	112,529	3,500	-	73,680	548,398	738,107
NET CHANGE IN FUND BALANCES	11,598	(1,610)	6,385	129,973	549,125	695,471
FUND BALANCES - JANUARY 1	372,163	6,034	95,644	(129,973)	(549,125)	(205,257)
FUND BALANCES - DECEMBER 31	$ 383,761	$ 4,424	$ 102,029	$ -	$ -	$ 490,214

CITY OF GRAND MARAIS, MINNESOTA

GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
Year Ended December 31, 2007

REVENUES	
Taxes	
General property	$ 502,840
Special Assessments	821
Licenses and permits	77,799
Intergovernmental	
State	
Local government aid	198,686
Market value credit	51,833
PERA aid	5,315
Other state aids	19,770
Total Intergovernmental	275,604
Charges for Services	
General government	
Rent	36,296
Miscellaneous	5,348
Public safety	
Fire protection contacts	48,587
Culture and recreation	
Park	604,836
Swimming pool	54,974
Boat harbors	61,468
Total Charges for Services	811,509
Fines	
Court fines	2,734
Gifts and Contributions	1,050
Interest	18,128
Miscellaneous	
Insurance recoveries	833
Other	1,051
Total Miscellaneous	1,884
TOTAL REVENUES	1,692,369

CITY OF GRAND MARAIS, MINNESOTA

GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
(CONTINUED)
Year Ended December 31, 2007

EXPENDITURES	
Current	
General Government	
Mayor and council	$ 29,002
City clerk	142,831
Elections	7,953
Independent audit	10,550
Legal	24,245
Planning and zoning	32,072
Data processing	4,752
Buildings	53,457
Buildings capital outlay	3,911
Other	50,197
Total General Government	358,970
Public Safety	
Police	140,059
Fire	64,823
Fire	209,031
Medical services	4,922
Animal control	1,060
Total Public Safety	419,895
Streets	
Maintenance	208,319
Street lighting	25,116
Total Streets	233,435
Culture and Recreation	
Recreation	310,449
Recreation capital outlay	2,500
Swimming pool	263,337
Swimming pool capital outlay	8,147
Boat harbors	77,691
Boat harbors capital outlay	8,694
City parks	20,902
Total Culture and Recreation	691,720
TOTAL EXPENDITURES	1,704,020
DEFICIENCY OF REVENUES OVER EXPENDITURES	(11,651)
OTHER FINANCING SOURCES (USES)	
Transfers in	200,000
Transfers out	(1,006,821)
Proceeds from sale of assets	4,293
TOTAL OTHER FINANCING SOURCES (USES)	(802,528)
NET CHANGE IN FUND BALANCE	(814,179)
FUND BALANCE - JANUARY 1	1,416,243
FUND BALANCE - DECEMBER 31	$ 602,064

Walker, Giroux, Hahne LLP

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

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, 2007, which collectively comprise the City of Grand Marais, Minnesota's basic financial statements and have issued our report thereon dated June 16, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered 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 2007-1 and 2007-2 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 2007-2 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 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 16, 2008, 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.

Walker, Hirons & Nelson, Ltd

June 16, 2008

CITY OF GRAND MARAIS, MINNESOTA

SCHEDULE OF FINDINGS AND RESPONSES
Year Ended December 31, 2007

SIGNIFICANT DEFICIENCIES

2007-1. 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.

2007-2. 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, 2007, 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 16, 2008, contains our report on significant deficiencies in the City's internal control. This letter does not affect our report dated June 16, 2008, 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:

Internal Control and Operating Efficiency

1. 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.

2. We noted that internal control policies require that the City Administrator and department heads review and approve vendor invoices for payment. We noted that, in the absence of the City Administrator, only the department heads are approving the invoices for payment. We recommend that the City Administrator and another designated individual approve all invoices for payment.

3. Merchandise and other miscellaneous sales must be recorded in the general ledger when billed. Currently, the sales are recorded when payment is received resulting in poor internal controls over receivables and revenue transactions. Also, an outstanding accounts receivable balance by customer report should be generated monthly and reconciled to the general ledger.

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.

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.

Walker, Hirons & Nelson, Ltd.

June 16, 2008