CITY OF GRAND MARAIS, MINNESOTA

FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

Year Ended December 31, 2011

CITY OF GRAND MARAIS, MINNESOTA

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CITY OF GRAND MARAIS, MINNESOTA

ORGANIZATION
December 31, 2011

CITY COUNCIL

Mayor	Laurence Carlson
Councilmember	Tim Kennedy
Councilmember	William Lenz
Councilmember	Jan Sivertson
Councilmember	Robert Spry

ADMINISTRATION

City Administrator	Michael J. Roth

[redacted]

Walker, Giroux, Hahne LTD

CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

P.O. Box 960 • 225 1st Street North, Suite 2400 • Virginia, Minnesota 55792
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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, 2011, 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 the 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, 2011, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, City of Grand Marais, Minnesota adopted the provisions of GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions,* in 2011.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 15, 2012, 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, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise 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 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Walker, Hirsch & Nelson, Ltd.

June 15, 2012

[redacted]AGEMENT'S [redacted] AND ANALYSIS

CITY OF GRAND MARAIS, MINNESOTA

MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2011

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, 2011. 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 $7,645,791, of which $3,307,792 is invested in capital assets, net of related debt.
- Business-type activities have total net assets of $13,909,981. Invested in capital assets, net of related debt represents $9,279,288 of the total.
- The City of Grand Marais's net assets increased by $2,104,648 for the year ended December 31, 2011. Of the increase, an increase of $1,314,445 was reported in the governmental activities' net assets and $790,203 represented the increase in business-type activities' net assets. The increases are primarily due to capital grants and contributions.
- The net revenue of governmental activities was $766,617 for the current year. General revenues totaled $850,359.
- Governmental funds' fund balances increased by $215,527.

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. This report also contains required and other supplementary information in addition to the basic financial statements.

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 aids 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.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Other Information

In addition to the basic financial statements and accompanying notes, this report also presents the required supplementary information for budgetary comparison schedules. Combining and individual financial statements are presented immediately following the required supplementary information.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of a City's financial position. The following tables show that in the case of the City of Grand Marais, assets exceeded liabilities by $21,555,772, an increase from the prior year.

Table 1
Net Assets

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2011	2010	2011	2010	2011	2010
Current and other assets	$ 4,538,635	$ 4,497,500	$ 5,349,654	$ 4,951,954	$ 9,888,289	$ 9,449,454
Capital assets	9,352,792	8,403,886	14,219,288	14,100,555	23,572,080	22,504,441
Total assets	13,891,427	12,901,386	19,568,942	19,052,509	33,460,369	31,953,895
Long-term debt outstanding	6,045,000	6,250,000	4,940,000	5,220,000	10,985,000	11,470,000
Other liabilities	200,636	320,040	718,961	712,731	919,597	1,032,771
Total liabilities	6,245,636	6,570,040	5,658,961	5,932,731	11,904,597	12,502,771
Net assets						
Invested in capital assets, net of debt	3,307,792	2,153,886	9,279,288	8,880,555	12,587,080	11,034,441
Restricted	2,284,926	2,450,138	1,189,220	1,198,715	3,474,146	3,648,853
Unrestricted	2,053,073	1,727,322	3,441,473	3,040,508	5,494,546	4,767,830
Total net assets	$ 7,645,791	$ 6,331,346	$ 13,909,981	$ 13,119,778	$ 21,555,772	$ 19,451,124

Net assets of the City's governmental activities increased by 20.8 percent ($7,645,791 compared to $6,331,346) in 2011. Unrestricted net assets—the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation, or other legal requirements - increased from a $1,727,322 surplus at December 31, 2010 to a $2,053,073 surplus at the end of this year.

Net assets of the City's business-type activities increased by 6.0 percent ($13,909,981 compared to $13,119,778) in 2011.

Table 2
Changes in Net Assets

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2011	2010	2011	2010	2011	2010
Revenues						
Program revenues:						
Fees, fines, charges, and other	$ 1,175,197	$ 1,124,419	$ 5,374,263	$ 5,295,059	$ 6,549,460	$ 6,419,478
Operating grants and contributions	122,573	153,196	-	-	122,573	153,196
Capital grants and contributions	1,760,423	876,532	-	99,887	1,760,423	976,419
General revenues:						
Property taxes	752,429	690,775	27,876	30,396	780,305	721,171
Grants and contributions not restricted to specific programs	119,432	117,243	-	-	119,432	117,243
Other general revenues (losses)	(21,502)	25,083	28,047	20,088	6,545	45,171
Total revenues	3,908,552	2,987,248	5,430,186	5,445,430	9,338,738	8,432,678
Program expenses:						
General government	344,623	350,449	-	-	344,623	350,449
Public safety	224,078	262,236	-	-	224,078	262,236
Streets	341,175	333,471	-	-	341,175	333,471
Culture and recreation	1,124,121	1,041,014	-	-	1,124,121	1,041,014
Interest	257,579	268,505	-	-	257,579	268,505
Liquor store	-	-	1,392,605	1,397,804	1,392,605	1,397,804
Golf course	-	-	156,318	160,078	156,318	160,078
Electric	-	-	2,462,576	2,424,943	2,462,576	2,424,943
Water	-	-	392,725	395,314	392,725	395,314
Sewer	-	-	545,707	555,527	545,707	555,527
Total program expenses	2,291,576	2,255,675	4,949,931	4,933,666	7,241,507	7,189,341
Excess before extraordinary item and transfers	1,616,976	731,573	480,255	511,764	2,097,231	1,243,337
Extraordinary item	7,417	85,355	-	-	7,417	85,355
Transfers	(309,948)	303,306	309,948	(303,306)	-	-
Change in net assets	1,314,445	1,120,234	790,203	208,458	2,104,648	1,328,692
Net assets, January 1	6,331,346	5,211,112	13,119,778	12,911,320	19,451,124	18,122,432
Net assets, December 31	$ 7,645,791	$ 6,331,346	$13,909,981	$13,119,778	$21,555,772	$19,451,124

Governmental Activities

The most significant revenues of the governmental activities are grants and contributions for operating and for capital projects. Capital grants and contributions, 45% of revenues, include the County's contribution of the library building addition and library equipment and grants for major projects or purchases of equipment. Operating grants and contributions, 3% of revenues, are used for operating expenses. The next largest revenues are fees, fines, charges and other comprised mostly of culture and recreation fees totaling 30% of revenues. Unrestricted grants and contributions, 3% of revenues, are used to finance the general activities. Property taxes levied for general purposes amount to $752,429 or 19% of revenues, an increase of $61,654 over the prior year.

Culture and recreation expenses are the most significant (49%), followed by general government (15%), streets (15%), interest on long-term debt (11%), and public safety (10%).

Business-Type Activities

Revenues of the City's business-type activities were $5,430,186; expenses were $4,949,931 (see Table 2). Net assets increased by $790,203 during the year ended December 31, 2011. Factors driving these results include:

- Operations produced income of $644,214 during the year ended December 31, 2011.
- All segments recorded operating income except for the golf course.
- Water and sewer infrastructure assets of $605,630 were contributed by the City.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

Governmental Funds

The focus of the City's governmental funds is to provide information on near term inflows, outflows and balances of spendable resources. In particular, the unassigned fund balance may serve as a useful measure of the City's net resources available for spending at the end of the year.

At December 31, 2011, the City's governmental funds reported total ending fund balances of $3,100,139, an increase of $215,527 in comparison with the prior year. Restricted funds, which are considered unavailable for appropriation for general operations, made up nearly 34%, or $1,058,630, of the total ending fund balance. The nonspendable fund balance of $36,190 is also not available for general operations. The committed fund balance represents revenues collected to fund the operation of a local TV channel. The City assigned $625,263 to specific purposes.

At the end of the year, the general fund reported a fund balance of $1,794,229, increasing $311,136 from the prior year. General fund revenues were $81,846 more than the prior year's and expenditures decreased by $7,155. During the current year, the general fund transfers to other funds were $151,706, which exceeded the prior year's transfers of $130,275.

The library special revenue fund recorded an increase in fund balance of $983 compared to $14,910 in the prior year. The City receives funding for 50% of the budget from the County for the library operations. In 2011, the County paid for construction of an addition to the library and other improvements and equipment totaling $1,473,112 and contributed the same to the City upon completion of the project.

The debt service fund recorded an increase in fund balance of $32,861 primarily due to transfers in from other funds.

In other governmental funds, the only significant change in fund balance, a decrease of $120,579, occurred in the EDA Cedar Grove Capital Projects Fund due to a transfer to the debt service fund of $130,000.

Proprietary Funds
The proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

The liquor store enterprise fund accounts for the operations of the City owned liquor store. In 2011, operating revenues increased by $784, while the operating expenses decreased by $5,199 from the prior year. The liquor store operations produced an operating income of $238,744 for this current year, which is an increase of $5,983 from the prior year's operating income. A transfer out of $200,000 was made during 2011 to the general fund, as in prior years.

The golf course enterprise fund accounts for the operations of the municipal golf course. In 2011, operating revenues increased by $1,859 compared to the prior year. The golf course operations produced an operating loss of $14,986. The City transferred in $13,907 from the general fund to partially fund this loss. Net assets decreased by $1,050 for the year.

The electric enterprise fund accounts for the electric operations of the City. In 2011, operating revenues increased by $63,040 compared to the prior year because of increased KWH sold and receipt of pole attachment agreement payments. Operating expenses also increased from the prior year by $45,062. The electric operations produced operating income of $344,676 in 2011. Interest expense charged to the electric distribution was $164,039. Net assets increased by $186,099.

The water enterprise fund accounts for the water operations of the City. In 2011, operating revenues decreased by $591 compared to the prior year. Operating expenses increased by $15. In 2011, operating income of $25,320 was recorded compared to an operating income of $25,926 in the prior year. Interest expense charged to the water operations was $40,318. A transfer to the debt service fund was made in the amount of $45,315 during 2011. The City contributed property and equipment totaling $367,887. Net assets increased by $346,617.

The sewer enterprise fund accounts for the sewer operations of the City. In 2011, operating revenues increased by $14,112 compared to the prior year because of increased acceptance of gray water/sludge gallons from independent haulers. Operating expenses decreased from the prior year by $9,505. The sewer operations produced operating income of $50,460 in 2011. Interest expense charged to the sewer operations was $15,525. A transfer of $65,210 was made to the debt service fund. The City contributed property and equipment totaling $237,743. These transactions resulted in an increase of $215,873 in net assets in the current year.

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 $140,745 below the final budget amounts. The only negative variance occurred in the culture and recreation program due to unbudgeted replacement of boilers at the pool when the old boiler failed. Resources available for appropriation were $94,726 above the final budgeted amounts. Although the City received less in property taxes than expected, more intergovernmental aids and charges for services were received. Transfers out to other funds exceeded the amount budgeted by $16,766.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2011, the City had $23,572,080 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 3 below.) This amount represents a net increase (including additions and deductions) of $1,067,639 over last year.

Table 3
Capital Assets at Year-end
(Net of Depreciation)

	Governmental Activities		Business-type Activities		Totals	
	2011	2010	2011	2010	2011	2010
Land	$ 630,922	$ 630,922	$ 186,100	$ 186,100	$ 817,022	$ 817,022
Construction in progress	-	2,133,202	-	-	-	2,133,202
Buildings	2,447,135	1,120,894	4,539,881	4,338,770	6,987,016	5,459,664
Improvements	436,307	460,321	37,489	39,354	473,796	499,675
Infrastructure	5,342,810	3,633,569	9,208,099	9,243,976	14,550,909	12,877,545
Machinery and equipment	212,062	157,423	176,470	199,202	388,532	356,625
Licensed vehicles	283,556	267,555	71,249	93,153	354,805	360,708
Totals	$9,352,792	$8,403,886	$14,219,288	$14,100,555	$23,572,080	$22,504,441

This year's major additions were a library building addition and completion of the Cedar Grove Business Park improvements.

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 $10,985,000 in long-term debt outstanding versus $11,470,000 last year—as shown in Table 4.

Table 4
Outstanding Debt, at Year-end

	Governmental Activities		Business-type Activities		Totals	
	2011	2010	2011	2010	2011	2010
General obligation bonds (backed by the City)	$6,045,000	$6,250,000	$ -	$ -	$ 6,045,000	$ 6,250,000
Electric system revenue bonds	-	-	3,380,000	3,570,000	3,380,000	3,570,000
General obligation sewer revenue bonds	-	-	345,000	352,000	345,000	352,000
General obligation notes	-	-	815,000	878,000	815,000	878,000
Water revenue note	-	-	400,000	420,000	400,000	420,000
Total	$6,045,000	$6,250,000	$4,940,000	$5,220,000	$ 10,985,000	$11,470,000

The State limits the amount of net debt that the City can issue to 3 percent of the market value of all taxable property in the City. As of December 31, 2011, the City had no outstanding qualifying net debt that applied to this $4,869,999 state-imposed limit.

Additional information on the City's long-term debt can be found in Note 6 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The City's elected and appointed officials considered many factors when setting the 2012 budget, adopting the tax levy, and setting fees that will be charged for the business-type activities.

- The property tax levy increase will be held to -1.32%.
- Utility rates were held to a 0% increase.
- The City's capital plan for 2012 includes the purchase of a mower for the golf course, purchase of a pickup for the sewer department and building the Community Connection entrance and trails in the Recreation Park.
- Employees were given a 1.5% cost of living adjustment raise.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the City's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the City Administrator, Michael J. Roth, City of Grand Marais, P.O. Box 600, Grand Marais, Minnesota 55604.

BASIC FINANCIAL STATEMENTS

CITY OF GRAND MARAIS, MINNESOTA

STATEMENT OF NET ASSETS
December 31, 2011

	Primary Government		
	Governmental Activities	Business-type Activities	Total
ASSETS			
Cash and cash equivalents	$ 2,861,503	$ 3,595,553	$ 6,457,056
Taxes receivable	69,048	-	69,048
Special assessments receivable	1,162,452	201,590	1,364,042
Accounts receivable	75,445	329,952	405,397
Internal balances	180,441	(180,441)	-
Loans receivable	68,884	-	68,884
Inventories	15,194	403,259	418,453
Prepaid items	20,996	12,882	33,878
Deferred debt issue costs	84,672	91,268	175,940
Temporarily restricted assets			
Cash and cash equivalents	-	795,591	795,591
Investments	-	100,000	100,000
Capital assets not being depreciated:			
Land	630,922	186,100	817,022
Capital assets, net of accumulated depreciation:			
Buildings	2,447,135	4,539,881	6,987,016
Improvements	436,307	37,489	473,796
Infrastructure	5,342,810	9,208,099	14,550,909
Machinery and equipment	212,062	176,470	388,532
Licensed vehicles	283,556	71,249	354,805
TOTAL ASSETS	13,891,427	19,568,942	33,460,369
LIABILITIES			
Accounts payable	38,340	234,500	272,840
Salaries payable	59,299	79,604	138,903
Customer deposits	-	17,700	17,700
Unearned revenues	-	338,773	338,773
Accrued interest payable	102,997	48,384	151,381
Noncurrent liabilities			
Due within one year	265,000	292,000	557,000
Due in more than one year	5,780,000	4,648,000	10,428,000
TOTAL LIABILITIES	6,245,636	5,658,961	11,904,597
NET ASSETS			
Invested in capital assets, net of related debt	3,307,792	9,279,288	12,587,080
Restricted for:			
Capital projects	13,026	-	13,026
Debt service	1,876,788	591,934	2,468,722
Library	251,814	-	251,814
Sewer equipment replacement	-	597,286	597,286
Storefront renovation	143,298	-	143,298
Unrestricted	2,053,073	3,441,473	5,494,546
TOTAL NET ASSETS	$ 7,645,791	$ 13,909,981	$ 21,555,772

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

CITY OF GRAND MARAIS, MINNESOTA

STATEMENT OF ACTIVITIES
Year Ended December 31, 2011

Functions/Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions
PRIMARY GOVERNMENT			
Governmental Activities			
General government	$ 344,623	$ 160,151	$ 6,865
Public safety	224,078	51,451	4,050
Streets	341,175	-	-
Culture and recreation	1,124,121	963,595	111,658
Economic development	-	-	-
Interest on long-term debt	257,579	-	-
Total Governmental Activities	2,291,576	1,175,197	122,573
Business-type Activities			
Liquor Store	$ 1,392,605	$ 1,631,349	$ -
Golf Course	156,318	141,332	-
Electric	2,462,576	2,643,213	-
Water	392,725	377,727	-
Sewer	545,707	580,642	-
Total Business-type Activities	4,949,931	5,374,263	-
TOTAL PRIMARY GOVERNMENT	$ 7,241,507	$ 6,549,460	$ 122,573

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
Loss on sale of capital assets
Extraordinary item
Insurance recovery - storm damage
Transfers
Total General Revenues, Extraordinary 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
$ -	$ (177,607)	$ -	$ (177,607)
-	(168,577)	-	(168,577)
37,516	(303,659)	-	(303,659)
1,478,542	1,429,674	-	1,429,674
244,365	244,365	-	244,365
-	(257,579)	-	(257,579)
1,760,423	766,617	-	766,617
$ -	-	238,744	238,744
-	-	(14,986)	(14,986)
-	-	180,637	180,637
-	-	(14,998)	(14,998)
-	-	34,935	34,935
-	-	424,332	424,332
$ 1,760,423	766,617	424,332	1,190,949
	615,525	-	615,525
	136,904	27,876	164,780
	4,745	-	4,745
	119,432	-	119,432
	13,004	28,047	41,051
	(39,251)	-	(39,251)
	7,417	-	7,417
	(309,948)	309,948	-
	547,828	365,871	913,699
	1,314,445	790,203	2,104,648
	6,331,346	13,119,778	19,451,124
	$ 7,645,791	$ 13,909,981	$ 21,555,772

CITY OF GRAND MARAIS, MINNESOTA

BALANCE SHEET
GOVERNMENTAL FUNDS
December 31, 2011

	General Fund	Library Special Revenue Fund	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
ASSETS					
Cash and cash equivalents	$ 1,638,689	$ 507,794	$ 593,011	$ 122,009	$ 2,861,503
Taxes receivable	61,251	-	7,797	-	69,048
Special assessments receivable	-	-	1,162,452	-	1,162,452
Accounts receivable	74,325	-	-	1,120	75,445
Due from other funds	81,913	-	113,528	-	195,441
Loans receivables	5,040	-	-	63,844	68,884
Inventories	15,194	-	-	-	15,194
Prepaid items	20,494	502	-	-	20,996
TOTAL ASSETS	$ 1,896,906	$ 508,296	$ 1,876,788	$ 186,973	$ 4,468,963
LIABILITIES AND FUND BALANCES					
LIABILITIES					
Accounts payable	$ 30,900	$ 7,440	$ -	$ -	$ 38,340
Salaries payable	41,888	17,411	-	-	59,299
Due to other funds	-	-	-	15,000	15,000
Deferred revenue	29,889	-	1,162,452	63,844	1,256,185
TOTAL LIABILITIES	102,677	24,851	1,162,452	78,844	1,368,824
FUND BALANCES					
Nonspendable	35,688	502	-	-	36,190
Restricted	-	251,814	714,336	92,480	1,058,630
Committed	-	-	-	15,649	15,649
Assigned	394,134	231,129	-	-	625,263
Unassigned	1,364,407	-	-	-	1,364,407
TOTAL FUND BALANCES	1,794,229	483,445	714,336	108,129	3,100,139
TOTAL LIABILITIES AND FUND BALANCES	$ 1,896,906	$ 508,296	$ 1,876,788	$ 186,973	$ 4,468,963

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, 2011

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

TOTAL FUND BALANCES, GOVERNMENTAL FUNDS	$	3,100,139
Unamortized bond issuance costs are susceptible to full accrual on the government-wide statements.		84,672
Capital assets used in governmental activities are not current financial resources and therefore are not reported in the funds.		9,352,792
Deferred revenue in governmental funds is susceptible to full accrual on the government-wide statements.		1,256,185
Interest payable on long-term debt is susceptible to full accrual on the government-wide statements.		(102,997)
Long-term liabilities, including bonds payable are not due and payable in the current period and therefore not reported in the governmental funds.		(6,045,000)
NET ASSETS OF GOVERNMENTAL ACTIVITIES	$	7,645,791

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, 2011

	General Fund	Library Special Revenue Fund	Debt Service Fund	Other Governmental Funds	Total Governmental Funds
REVENUES					
Taxes					
Property	$ 606,467	$ -	$ 136,904	$ -	$ 743,371
Franchise	-	-	-	4,745	4,745
Special assessments	4,262	-	103,358	-	107,620
Licenses and permits	83,888	-	-	-	83,888
Intergovernmental	143,224	96,216	-	244,365	483,805
Charges for services	1,074,761	11,950	-	-	1,086,711
Fines	3,485	-	-	-	3,485
Gifts and contributions	5,050	1,485,553	-	-	1,490,603
Interest	7,553	1,613	1,685	2,153	13,004
Miscellaneous	1,114	-	-	15,284	16,398
TOTAL REVENUES	1,929,804	1,595,332	241,947	266,547	4,033,630
EXPENDITURES					
Current					
General government	346,410	-	-	-	346,410
Public safety	209,216	-	-	-	209,216
Streets	225,215	-	-	-	225,215
Culture and recreation	897,411	1,717,405	-	597	2,615,413
Economic development	-	-	-	30,000	30,000
Debt service					
Principal	-	-	205,000	-	205,000
Interest and other charges	-	-	258,418	-	258,418
Capital outlay					
Economic development	-	-	-	235,403	235,403
TOTAL EXPENDITURES	1,678,252	1,717,405	463,418	266,000	4,125,075
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	251,552	(122,073)	(221,471)	547	(91,445)
OTHER FINANCING SOURCES (USES)					
Transfers in	200,000	123,056	254,332	-	577,388
Transfers out	(151,706)	-	-	(130,000)	(281,706)
Sale of capital assets	3,873	-	-	-	3,873
TOTAL OTHER FINANCING SOURCES (USES)	52,167	123,056	254,332	(130,000)	299,555
EXTRAORDINARY ITEM					
Insurance recovery - storm damage	7,417	-	-	-	7,417
NET CHANGE IN FUND BALANCES	311,136	983	32,861	(129,453)	215,527
FUND BALANCES - JANUARY 1	1,483,093	482,462	681,475	237,582	2,884,612
FUND BALANCES - DECEMBER 31	$ 1,794,229	$ 483,445	$ 714,336	$ 108,129	$ 3,100,139

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, 2011

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

NET CHANGE IN FUND BALANCES - TOTAL GOVERNMENTAL FUNDS		$ 215,527
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	1,877,481	
Less current year depreciation	(279,821)	
Net capital assets		1,597,660
Capital assets were contributed to the Water and Sewer Enterprise Funds.		(605,630)
Governmental funds report the entire net sales price (proceeds) from sale of an asset as revenue because it provides current financial resources. In contrast, the statement of activities reports only the gain on the sale of the assets. Thus, the change in net assets differs from the change in fund balance by the cost of the asset sold.		(43,124)
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	9,224	
Change in deferred revenue - special assessments receivable	(79,766)	
Change in deferred revenue - loans receivable	14,715	
		(55,827)
Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduced long-term liabilites in the statement of net assets.		
Principal repaid		205,000
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.		5,547
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		(4,708)
CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES		$ 1,314,445

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

CITY OF GRAND MARAIS, MINNESOTA

STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
December 31, 2011

	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	$ 820,741	$ 23,615	$ 1,340,589	$ 253,975	$ 1,156,633	$ 3,595,553
Accounts receivable	-	-	250,236	32,180	47,536	329,952
Due from other funds	-	-	23	235	-	258
Special assessments receivable	-	-	-	201,590	-	201,590
Inventories	118,916	4,400	262,755	16,854	334	403,259
Prepaid items	1,386	681	8,056	1,207	1,552	12,882
TOTAL CURRENT ASSETS	941,043	28,696	1,861,659	506,041	1,206,055	4,543,494
NONCURRENT ASSETS						
Restricted cash and cash equivalents						
Revenue bond covenant accounts	-	-	405,147	-	-	405,147
MPCA contract accounts	-	-	-	-	390,444	390,444
Total restricted cash and cash equivalents	-	-	405,147	-	390,444	795,591
Restricted investments						
MPCA contract accounts	-	-	-	-	100,000	100,000
Deferred debt issue costs	-	-	83,015	8,253	-	91,268
Capital assets						
Land	-	154,100	25,000	5,000	2,000	186,100
Buildings	20,529	89,466	2,759,697	2,287,824	2,462,238	7,619,754
Improvements	-	310,058	-	-	-	310,058
Infrastructure	-	-	3,328,723	5,257,583	3,525,050	12,111,356
Machinery and equipment	144,722	149,306	137,045	400,193	1,099,593	1,930,859
Licensed vehicles	-	500	240,918	28,150	52,885	322,453
Less accumulated depreciation	(128,963)	(456,395)	(1,914,974)	(2,485,867)	(3,275,093)	(8,261,292)
Total capital assets (net of accumulated depreciation)	36,288	247,035	4,576,409	5,492,883	3,866,673	14,219,288
TOTAL NONCURRENT ASSETS	36,288	247,035	5,064,571	5,501,136	4,357,117	15,206,147
TOTAL ASSETS	977,331	275,731	6,926,230	6,007,177	5,563,172	19,749,641
LIABILITIES						
CURRENT LIABILITIES						
Accounts payable	36,057	4,073	181,321	6,062	6,987	234,500
Salaries payable	20,605	18,972	21,181	2,960	15,886	79,604
Accrued interest payable	-	-	25,300	7,559	15,525	48,384
Due to other funds	-	-	66,846	48,318	65,535	180,699
Deferred revenue	-	-	338,773	-	-	338,773
Customer deposits payable	-	-	17,700	-	-	17,700
Bonds, notes, and loans payable - current	-	-	200,000	84,000	8,000	292,000
TOTAL CURRENT LIABILITIES	56,662	23,045	851,121	148,899	111,933	1,191,660
NONCURRENT LIABILITIES						
Bonds, notes and loans payable	-	-	3,180,000	1,131,000	337,000	4,648,000
TOTAL LIABILITIES	56,662	23,045	4,031,121	1,279,899	448,933	5,839,660
NET ASSETS						
Invested in capital assets, net of related debt	36,288	247,035	1,196,409	4,277,883	3,521,673	9,279,288
Restricted for debt service	-	-	390,344	201,590	-	591,934
Restricted for sewer equipment replacement	-	-	-	-	597,286	597,286
Unrestricted	884,381	5,651	1,308,356	247,805	995,280	3,441,473
TOTAL NET ASSETS	$ 920,669	$ 252,686	$ 2,895,109	$ 4,727,278	$ 5,114,239	$ 13,909,981

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, 2011

	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	$ 1,631,349	$ 141,332	$ 2,643,213	$ 377,727	$ 580,642	$ 5,374,263
OPERATING EXPENSES						
Cost of sales	1,089,824	14,800	1,564,399	-	-	2,669,023
Salaries	164,989	79,305	195,995	74,487	128,381	643,157
Employee benefits and payroll taxes	54,612	22,362	68,133	38,011	58,529	241,647
Advertising	6,198	1,846	17	-	-	8,061
Bad debts	276	-	8,028	446	622	9,372
Contract services	-	-	49,567	8,503	115,683	173,753
Facility fees	-	-	63,978	-	-	63,978
Insurance	4,052	4,951	30,608	3,036	6,509	49,156
Miscellaneous	23,992	2,826	28,517	1,738	5,874	62,947
Rent	38,400	-	9,000	4,500	4,500	56,400
Repairs and maintenance	2,872	3,412	31,021	7,208	6,185	50,698
Supplies	2,778	12,422	34,360	20,319	18,001	87,880
Telephone	712	816	981	2,255	559	5,323
Utilities	-	3,591	4,729	22,839	58,657	89,816
Depreciation	3,900	9,987	209,204	169,065	126,682	518,838
TOTAL OPERATING EXPENSES	1,392,605	156,318	2,298,537	352,407	530,182	4,730,049
OPERATING INCOME (LOSS)	238,744	(14,986)	344,676	25,320	50,460	644,214
NONOPERATING REVENUES (EXPENSES)						
Interest income	3,920	29	4,853	11,027	8,218	28,047
Property taxes	-	-	-	27,876	-	27,876
Interest expense	-	-	(164,039)	(40,318)	(15,525)	(219,882)
TOTAL NONOPERATING REVENUES (EXPENSES)	3,920	29	(159,186)	(1,415)	(7,307)	(163,959)
INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS AND TRANSFERS	242,664	(14,957)	185,490	23,905	43,153	480,255
Capital contributions	-	-	-	367,887	237,743	605,630
Transfers in	-	13,907	609	140	187	14,843
Transfers out	(200,000)	-	-	(45,315)	(65,210)	(310,525)
CHANGE IN NET ASSETS	42,664	(1,050)	186,099	346,617	215,873	790,203
TOTAL NET ASSETS - JANUARY 1	878,005	253,736	2,709,010	4,380,661	4,898,366	13,119,778
TOTAL NET ASSETS - DECEMBER 31	$ 920,669	$ 252,686	$ 2,895,109	$ 4,727,278	$ 5,114,239	$ 13,909,981

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, 2011

	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	$ 1,631,630	$ 141,450	$ 2,683,151	$ 377,305	$ 578,819	$ 5,412,355
Cash paid to suppliers	(1,216,337)	(57,078)	(1,877,700)	(113,519)	(266,505)	(3,531,139)
Cash paid to employees	(164,964)	(78,037)	(196,469)	(81,804)	(130,234)	(651,508)
NET CASH PROVIDED BY OPERATING ACTIVITIES	250,329	6,335	608,982	181,982	182,080	1,229,708
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Transfers in from other funds	-	13,907	609	140	187	14,843
Transfers out to other funds	(200,000)	-	-	(45,315)	(65,210)	(310,525)
Advances to other funds	-	-	(23)	-	-	(23)
Advances from other funds	-	-	1,017	32,863	325	34,205
NET CASH PROVIDED (USED) BY NONCAPITAL FINANCING ACTIVITIES	(200,000)	13,907	1,603	(12,312)	(64,698)	(261,500)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES						
Purchase or construction of fixed assets	-	(2,616)	(7,709)	(7,817)	(13,799)	(31,941)
Special assessments collected	-	-	-	9,426	-	9,426
Property taxes collected	-	-	-	27,876	-	27,876
Principal paid on long-term debt	-	-	(190,000)	(83,000)	(7,000)	(280,000)
Interest paid on long-term debt	-	-	(158,391)	(40,384)	(15,840)	(214,615)
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	-	(2,616)	(356,100)	(93,899)	(36,639)	(489,254)
CASH FLOWS FROM INVESTING ACTIVITIES						
Sale of investments	-	-	-	-	100,000	100,000
Interest on investments	3,920	29	4,853	11,027	8,218	28,047
NET CASH PROVIDED BY INVESTING ACTIVITIES	3,920	29	4,853	11,027	108,218	128,047
NET INCREASE IN CASH AND CASH EQUIVALENTS	54,249	17,655	259,338	86,798	188,961	607,001
CASH AND CASH EQUIVALENTS, JANUARY 1	766,492	5,960	1,486,398	167,177	1,358,116	3,784,143
CASH AND CASH EQUIVALENTS, DECEMBER 31	$ 820,741	$ 23,615	$ 1,745,736	$ 253,975	$ 1,547,077	$ 4,391,144

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

CITY OF GRAND MARAIS, MINNESOTA

STATEMENT OF CASH FLOWS (CONTINUED)
PROPRIETARY FUNDS
Year Ended December 31, 2011

	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)	$ 238,744	$ (14,986)	$ 344,676	$ 25,320	$ 50,460	$ 644,214
Adjustments to reconcile operating income (loss) to net cash providedby operating activities:						
Depreciation	3,900	9,987	209,204	169,065	126,682	518,838
Changes in assets and liabilities						
(Increase) decrease in:						
Accounts receivable	281	118	37,688	(422)	(1,823)	35,842
Inventories	1,404	2,033	3,963	(309)	124	7,215
Prepaid items	4,273	4,007	1,782	2,431	2,564	15,057
Increase (decrease) in:						
Accounts payable	1,702	3,908	9,893	(6,786)	5,926	14,643
Salaries payable	25	1,268	(474)	(7,317)	(1,853)	(8,351)
Customer deposits	-	-	2,250	-	-	2,250
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	$ 250,329	$ 6,335	$ 608,982	$ 181,982	$ 182,080	$ 1,229,708
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:						
Total capital asset additions	$ -	$ 2,616	$ 7,709	$ 375,704	$ 251,542	$ 637,571
Contributions of capital assets from government	-	-	-	(367,887)	(237,743)	(605,630)
Cash paid for capital assets	$ -	$ 2,616	$ 7,709	$ 7,817	$ 13,799	$ 31,941

The accompanying notes are an integral part of these financial 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, 2011.

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 fund 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 used to account for and report all financial resources not accounted for in another fund.

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

The Debt Service Fund is used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest.

Nonmajor Governmental Funds:

Special Revenue Funds are used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects.

Capital Projects Funds are used to account for and report financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets. Capital projects funds exclude those types of capital-related outflows 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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

amount of the transaction can be determined and "available" means collectible within the 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. Implementation of New Accounting Principles

For the year ending December 31, 2011, the City implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* issued by the Governmental Accounting Standards Board. GASB Statement No. 54 establishes standards for fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. Additionally, the definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are clarified by the provisions in this Statement. Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds. The capital projects fund type definition also was clarified for better alignment with the needs of preparers and users. Definitions of other governmental fund types also have been modified for clarity and consistency.

E. 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.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

F. 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". Outstanding balances between funds are reported as "due to/from other funds".

   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.

5) Restricted assets are cash and cash equivalents and investments 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, buildings, improvements, 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, buildings, improvements, 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.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

7) Government-wide financial statements report unearned revenue in connection with resources that have been received, but not yet earned. Governmental funds defer revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period and resources that have been received, but not yet earned.

   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.

   In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures. Severance pay expenditures are recognized at retirement date.

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, proprietary fund equity is classified the same as in the government-wide statements. Fund balances of the governmental funds are classified as follows:

Nonspendable—amounts that cannot be spent either because they are in nonspendable form, such as inventory and prepaid items, or because they are legally or contractually required to be maintained intact.

Restricted—amounts that can be spent only for specific purposes because of enabling legislation or because of constraints that are externally imposed by creditors, grantors, contributors, or the laws or regulations of other governments.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Committed—amounts that can be used only for specific purposes determined by a formal action of the City Council. The City Council is the highest level of decision making authority for the City. Commitments may be established, modified, or rescinded only through ordinances or resolutions approved by the City Council.

Assigned—amounts that do not meet the criteria to be classified as restricted or committed but that are intended to be used for specific purposes. The City Council or, City Administrator or Finance Director authorized by the City Council may assign amounts for specific purposes.

Unassigned—all other spendable amounts.

When an expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available, the City considers restricted funds to have been spent first. When an expenditure is incurred for which committed, assigned, or unassigned fund balances are available, the City considers amounts to have been spent first out of committed funds, then assigned funds, and finally unassigned funds, as needed, unless the City Council has provided otherwise in its commitment or assignment actions.

G. 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. The liability for accrued vacation leave is recorded in the appropriate funds as an accrued liability. 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.

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

Cash	$ 6,671,403
Petty Cash	3,200
Certificates of Deposit	212,000
Investments	466,044
Total	$ 7,352,647

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 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 $6,883,403; the bank balance was $6,921,389. Of the bank balance, $800,859 was insured; of the remaining balance, $620,530 was collateralized with securities held by the pledging financial institution's agent in the City's name and $5,500,000 was collateralized with an irrevocable standby letter of credit.

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 money market funds 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, 2011, had no investments (other than U.S. government or U.S. government guaranteed obligations) in any issuer that exceeded five percent of total investments.

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, 2011, the City had the following investments:

			Maturity	
Investment Type	Fair Value	Rating	Less than 2 Years	Over 5 Years
Minnesota Municipal Money Market Fund	$ 215,216	not rated	$ 215,216	$ -
Morgan Stanley Smith Barney Money Market Funds	150,745	not rated	150,745	-
Wells Fargo Money Market Funds	83	not rated	83	-
Federal Home Loan Mortgage Corp. Bonds	100,000	AA+ (S&P)	-	100,000
Total Investments	$ 466,044		$ 366,044	$ 100,000

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, 2011 was $63,844.

On February 18, 2009, the City loaned $100,000 to the Cook County/Grand Marais Joint Economic Development Authority. The note bears interest at 6% and was due on October 15, 2010. A payment of $100,000 was made in 2010 for principal and interest. The balance as of December 31, 2011 was $5,040.

NOTE 4 - CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2011, was as follows:

	Beginning Balance	Additions	Deletions	Transfers	Ending Balance
Governmental activities					
Capital assets, not being depreciated:					
Land	$ 630,922	$ -	$ -	$ -	$ 630,922
Construction in progress	2,133,202	235,403	(2,368,605)	-	-
Total capital assets, not being depreciated	2,764,124	235,403	(2,368,605)	-	630,922
Capital assets, being depreciated:					
Buildings	4,464,467	1,426,517	(25,905)	-	5,865,079
Improvements	622,309	13,591	(18,981)	-	616,919
Infrastructure	5,863,700	1,849,841	-	-	7,713,541
Machinery and equipment	405,888	79,255	(27,307)	-	457,836
Licensed vehicles	428,749	35,849	(22,500)	-	442,098
Total capital assets, being depreciated	11,785,113	3,405,053	(94,693)	-	15,095,473
Less accumulated depreciation for:					
Buildings	(3,343,573)	(75,974)	1,603	-	(3,417,944)
Improvements	(161,988)	(24,265)	5,641	-	(180,612)
Infrastructure	(2,230,131)	(140,600)	-	-	(2,370,731)
Machinery and equipment	(248,465)	(19,134)	21,825	-	(245,774)
Licensed vehicles	(161,194)	(19,848)	22,500	-	(158,542)
Total accumulated depreciation	(6,145,351)	(279,821)	51,569	-	(6,373,603)
Total capital assets, being depreciated, net	5,639,762	3,125,232	(43,124)	-	8,721,870
Governmental activities capital assets, net	$ 8,403,886	$ 3,360,635	$ (2,411,729)	$ -	$ 9,352,792
Business-type activities					
Capital assets, not being depreciated:					
Land	$ 186,100	$ -	$ -	$ -	$ 186,100
Capital assets, being depreciated:					
Buildings	7,205,055	-	(153,041)	567,740	7,619,754
Improvements	310,058	-	-	-	310,058
Infrastructure	12,066,919	621,156	(8,979)	(567,740)	12,111,356
Machinery and equipment	2,165,130	16,415	(250,686)	-	1,930,859
Licensed vehicles	342,053	-	(19,600)	-	322,453
Total capital assets, being depreciated	22,089,215	637,571	(432,306)	-	22,294,480
Less accumulated depreciation for:					
Buildings	(2,866,285)	(196,307)	153,041	(170,322)	(3,079,873)
Improvements	(270,704)	(1,865)	-	-	(272,569)
Infrastructure	(2,822,943)	(259,615)	8,979	170,322	(2,903,257)
Machinery and equipment	(1,965,928)	(39,147)	250,686	-	(1,754,389)
Licensed vehicles	(248,900)	(21,904)	19,600	-	(251,204)
Total accumulated depreciation	(8,174,760)	(518,838)	432,306	-	(8,261,292)
Total capital assets, being depreciated, net	13,914,455	118,733	-	-	14,033,188
Business-type activities capital assets, net	$14,100,555	$ 118,733	$ -	$ -	$14,219,288

NOTE 4 - CAPITAL ASSETS (CONTINUED)

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

Governmental activities	
General government	$ 894
Public safety	25,381
Streets	149,451
Culture and recreation	104,095
Total depreciation expense-governmental activities	$ 279,821
Business-type activities	
Liquor Store	$ 3,900
Golf Course	9,987
Electric	209,204
Water	169,065
Sewer	126,682
Total depreciation expense-business-type activities	$ 518,838

NOTE 5 - RATE STABILIZATION PROVISION

A reserve for rate stabilization in the electric enterprise fund 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, 2011, 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 electric revenue bonds are payable solely from the net revenues of the Electric Enterprise Fund, the water revenue notes are payable solely from the net revenues of the Water Enterprise Fund, and the sewer revenue bond is payable solely from the net revenues of the Sewer Enterprise Fund.

NOTE 6 - 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					
2004 Improvement	06/01/2004	3.40-5.10%	$ 710,000	02/01/2025	$ 555,000
2005 Improvement	11/22/2005	3.50-4.60%	$ 895,000	02/01/2027	770,000
2005 Improvement Refunding	01/06/2005	3.40-4.60%	$ 875,000	02/01/2021	715,000
2008 Improvement	10/07/2008	3.25-4.50%	$ 2,695,000	02/01/2029	2,330,000
2009 Improvement Refunding	12/10/2009	2.10-4.70%	$ 1,675,000	02/01/2031	1,675,000
Governmental Activities Long-term Liabilities					6,045,000
Business-type activities					
Revenue Bonds					
2003 Electric System	05/01/2003	3.00-4.875%	$ 2,885,000	05/01/2023	1,975,000
2004 Electric System	09/01/2004	4.00-4.80%	$ 815,000	05/01/2023	615,000
2005 Electric System	06/21/2005	2.75-4.60%	$ 940,000	05/01/2024	790,000
Total Revenue Bonds					3,380,000
General Obligation Revenue Bonds					
2006 Sewer	01/17/2006	4.50%	$ 372,000	01/01/2036	345,000
General Obligation Notes					
1999 Water Revenue	04/27/1999	2.56%	$ 484,112	08/20/2019	232,000
2004 Improvement	08/11/2004	2.53%	$ 812,229	02/20/2024	583,000
Total General Obligation Notes					815,000
Revenue Note					
2008 Water	01/24/2008	3.59%	$ 470,000	12/01/2027	400,000
Business-type Activities Long-term Liabilities					4,940,000
Total Long-Term Liabilities					$ 10,985,000

Governmental Funds

The City issued GO improvement bonds to finance various improvement projects within the City in 2004 of $710,000, in 2005 of $895,000, and in 2008 of $2,695,000. Principal and interest paid for the current year on these issues was $308,735. At December 31, 2011 principal and interest on the bonds to be paid from special assessments levied upon the benefitted property and ad valorem taxes to maturity is:

Issue	Maturity	Principal and Interest
2004	2025	$ 771,490
2005	2027	1,079,573
2008	2029	3,347,764
		$ 5,198,827

NOTE 6 - LONG-TERM LIABILITIES (CONTINUED)

In 2005, the City issued $875,000 GO improvement refunding bonds of which the proceeds were used to effect a crossover refunding of $815,000 of the outstanding GO Improvement Bonds of 2000 issued to finance the costs of various municipal improvements within the City. Principal and interest paid for the current year was $86,438. At December 31, 2011, principal and interest to maturity in 2021 to be paid primarily from special assessments levied upon the benefitted property and ad valorem taxes totaled $884,541.

In 2009, the City issued $1,675,000 improvement refunding bonds of which the proceeds were used to effect a refunding of $1,630,000 of the outstanding GO Temporary Improvement Bonds of 2007 issued to finance various municipal improvement projects within the City. Principal and interest paid for the current year was $64,470. At December 31, 2011, principal and interest to maturity in 2031 to be paid primarily from special assessments levied upon the benefitted property and ad valorem taxes totaled $2,482,642.

Enterprise Funds

The City has pledged Electric Enterprise Fund revenues, net of any normal and reasonable expenses of operations, to repay electric system revenue bonds issued in 2003 of $2,885,000, in 2004 of $815,000, and in 2005 of $940,000. Proceeds from the bonds were used to finance electric system improvements. Principal and interest paid for the current year on these issues was $345,781. At December 31, 2011 principal and interest on the bonds to be paid from pledged future revenues to maturity is:

Issue	Maturity	Principal and Interest
2003	2023	$ 2,584,759
2004	2023	800,310
2005	2024	1,112,938
		$ 4,498,007

The City has pledged future Sewer Enterprise Fund revenues, net of any normal and reasonable expenses of operations, to repay $372,000 in GO sewer revenue bonds issued in 2006. Proceeds from the bonds were used to finance improvements to the sewer system. Principal and interest paid for the current year was $22,840. At December 31, 2011, principal and interest on the bonds to maturity in 2036 to be paid from pledged future revenues totaled $580,935.

The City has pledged future Water Enterprise Fund revenues, net of any normal and reasonable expenses for operations, to repay a $484,112 GO revenue note issued in 1999, an $812,229 GO improvement note issued in 2004, and a $470,000 revenue note issued in 2008. Proceeds from all three issues were used to finance water system renovations and improvements. Principal and interest paid for the current year on all three issues was $119,661. At December 31, 2011, principal and interest on the notes to be paid from pledged future revenues, and special assessments and ad valorem taxes for the 2004 issue, to maturity is:

Issue	Maturity	Principal and Interest
1999	2019	$ 259,597
2004	2024	684,213
2008	2027	563,858
		$ 1,507,668

NOTE 6 - LONG-TERM LIABILITIES (CONTINUED)

Long-term liability activity for the year ended December 31, 2011 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Governmental activities					
Bonds Payable					
2004 GO Improvements	$ 585,000	$ -	$ 30,000	$ 555,000	$ 30,000
2005 GO Improvements	805,000	-	35,000	770,000	35,000
2005 GO Improvement Refunding	770,000	-	55,000	715,000	60,000
2008 GO Improvement	2,415,000	-	85,000	2,330,000	85,000
2009 GO Improvement Refunding	1,675,000	-	-	1,675,000	55,000
Governmental Activities - Long-term Liabilities	$ 6,250,000	$ -	$ 205,000	$ 6,045,000	$ 265,000
Business-type Activities					
Bonds Payable					
2003 Electric System Revenue	$ 2,100,000	$ -	$ 125,000	$ 1,975,000	$ 130,000
2004 Electric System Revenue	650,000	-	35,000	615,000	40,000
2005 Electric System Revenue	820,000	-	30,000	790,000	30,000
2006 GO Sewer Revenue	352,000	-	7,000	345,000	8,000
Total Bonds Payable	3,922,000	-	197,000	3,725,000	208,000
Notes Payable					
1999 GO Water Revenue	258,000	-	26,000	232,000	26,000
2004 GO Improvement	620,000	-	37,000	583,000	38,000
2008 Water Revenue	420,000	-	20,000	400,000	20,000
Total Notes Payable	1,298,000	-	83,000	1,215,000	84,000
Business-type Activities - Long-term Liabilities	$ 5,220,000	$ -	$ 280,000	$ 4,940,000	$ 292,000

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

Year Ending	Governmental Activities		Business-Type Activities		Government-wide	
December 31	Principal	Interest	Principal	Interest	Principal	Interest
2012	$ 265,000	$ 246,626	$ 292,000	$ 201,747	$ 557,000	$ 448,373
2013	270,000	237,564	299,000	190,813	569,000	428,377
2014	280,000	227,890	311,000	179,374	591,000	407,264
2015	305,000	217,316	324,000	167,352	629,000	384,668
2016	315,000	205,728	331,000	154,688	646,000	360,416
2017-2021	1,765,000	825,884	1,837,000	552,241	3,602,000	1,378,125
2022-2026	1,675,000	452,805	1,333,000	151,111	3,008,000	603,916
2027-2031	1,170,000	107,197	112,000	35,289	1,282,000	142,486
2032-2036	-	-	101,000	13,995	101,000	13,995
Total	$ 6,045,000	$ 2,521,010	$ 4,940,000	$ 1,646,610	$10,985,000	$ 4,167,620

NOTE 7 - INTERFUND BALANCES AND ACTIVITY

The composition of interfund balances as of December 31, 2011, is as follows:

Due to/from other funds –

Receivable Fund	Payable Fund	Amount
General	Electric Enterprise	$ 66,846
General	Storefront Renovation Special Revenue	15,000
General	Sewer Enterprise	67
Debt Service	Water Enterprise	48,318
Debt Service	Sewer Enterprise	65,210
Electric Enterprise	Sewer Enterprise	23
Water Enterprise	Sewer Enterprise	235
		$ 195,699

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, 2011 consisted of the following:

	Transfers Out					
	General Fund	Liquor Store Enterprise Fund	Water Enterprise Fund	Sewer Enterprise Fund	Nonmajor Fund EDA Cedar Grove Business Park Capital Projects Fund	Total
Transfers In						
General Fund	$ -	$ 200,000	$ -	$ -	$ -	$ 200,000
Library Special Revenue Fund	123,056	-	-	-	-	123,056
Debt Service Fund	13,807	-	45,315	65,210	130,000	254,332
Golf Course Enterprise Fund	13,907	-	-	-	-	13,907
Electric Enterprise Fund	609	-	-	-	-	609
Water Enterprise Fund	140	-	-	-	-	140
Sewer Enterprise Fund	187	-	-	-	-	187
	$ 151,706	$ 200,000	$ 45,315	$ 65,210	$ 130,000	$ 592,231

Transfers are used to: 1) move profits or excess cash from the Liquor Store Enterprise Fund to the General Fund; 2) move the City's contribution to the City library; 3) move funds from the Water and Sewer Enterprise funds and the Cedar Grove Business Park Capital Projects Fund to the Debt Service Fund for debt service expenditures; and 4) fund the operations of the Golf Course.

NOTE 8 - FUND EQUITY

As of December 31, 2011, fund balances are comprised of the following:

	General Fund	Library Special Revenue Fund	Debt Service Fund	Nonmajor Governmental Funds	Total
Nonspendable:					
Inventories	$ 15,194	$ -	$ -	$ -	$ 15,194
Prepaid items	20,494	502	-	-	20,996
Total Nonspendable	35,688	502	-	-	36,190
Restricted:					
Library	-	251,814	-	-	251,814
Debt service	-	-	714,336	-	714,336
Storefront renovation	-	-	-	79,454	79,454
Capital projects	-	-	-	13,026	13,026
Total Restricted	-	251,814	714,336	92,480	1,058,630
Committed:					
Cable TV	-	-	-	15,649	15,649
Assigned:					
Buildings	51,713	-	-	-	51,713
Insurance reserve	10,804	-	-	-	10,804
Street equipment	18,282	-	-	-	18,282
Street improvements	242,370	-	-	-	242,370
Street sealcoat project	70,965	-	-	-	70,965
Library	-	231,129	-	-	231,129
Total Assigned	394,134	231,129	-	-	625,263
Unassigned	1,364,407	-	-	-	1,364,407
Total fund balances	$ 1,794,229	$ 483,445	$ 714,336	$ 108,129	$ 3,100,139

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 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 $235,403 in 2011 on infrastructure for this project.

NOTE 11 - JOINT VENTURE

Joint Powers Agreement for Library Services
The City of Grand Marais entered into a joint powers agreement with Cook County on December 15, 1992. The purpose of the agreement is to provide library services to the residents of the City and County through the City's Grand Marais Public Library. The County, in consideration of the services provided to its residents, agrees to continue its membership in the multi-county Arrowhead Library System and contribute 50% of the budgeted annual operating costs of the library board to the City, which totaled $96,216 in 2011.

The library is governed by a board of seven members serving staggered three-year terms and appointed by the Mayor of the City with the consent of the City Council. Four members shall be residents of the City and three members shall be county residents from outside the City limits.

If the agreement is terminated, any capital assets (other than the original library building) purchased during the term of the agreement having a purchase price in excess of $1,000, shall be reimbursed fifty percent of the then market value to the County. This reimbursement only applies to the purchase price paid from the normal operating budget shared by the City and County and shall not apply to the purchase price paid by gift, grant, or other outside funding.

In 2011, the County paid for the construction of an addition to the library and other improvements and equipment totaling $1,473,112 and contributed the same to the City upon completion of the project.

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.

NOTE 11 - JOINT VENTURE (CONTINUED)

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.

In 2011, the City did not contribute 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, 2011, 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, 2050. 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.

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

NOTE 13 - FUNDS HELD BY OTHERS (CONTINUED)

Minnesota Community Foundation at such times and in such amounts and for such charitable purposes as the Minnesota Community Foundation deems appropriate. The fund is not included in the City of Grand Marais, Minnesota's financial statements, since all property in the fund was contributed to Minnesota Community Foundation to be held and administered for the benefit of the City of Grand Marais' Public Library. The market value of the fund assets was approximately $20,415 on December 31, 2011.

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 General Employees Retirement Fund (GERF) which is a cost-sharing, multiple-employer retirement plan. This plan is established and administered in accordance with *Minnesota Statutes*, Chapter 353 and 356.

GERF members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security and Basic Plan members are not. 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 PERA's Coordinated and Basic Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Basic Plan member is 2.2 percent of average salary for each of the first 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 GERF 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.

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

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

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

PERA issues a publicly available financial report that includes financial statements and required supplementary information for GERF. 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. GERF Basic Plan members and Coordinated Plan members were required to contribute 9.10% and 6.25%, respectively, of their annual covered salary in 2011. In 2011, the City of Grand Marais was required to contribute the following percentages of annual covered payroll: 11.78% for Basic Plan members and 7.25% for Coordinated Plan members. The City's contributions to the Public Employees Retirement Fund for the years ending December 31, 2011, 2010, and 2009 were $87,853, $83,267, and $78,148, respectively. The City's contributions were equal to the contractually required contributions for each year as set by state statute.

NOTE 15 - DEFINED CONTRIBUTION PLAN

One council member of the City of Grand Marais, Minnesota is covered by the Public Employees Defined Contribution Plan (PEDCP), a multiple-employer deferred compensation plan administered by the Public Employees Retirement Association of Minnesota (PERA). The PEDCP is a tax qualified plan under Section 401(a) of the Internal Revenue Code and all contributions by or on behalf of employees are tax deferred until time of withdrawal.

Plan benefits depend solely on amounts contributed to the plan plus investment earnings, less administrative expenses. Minnesota Statutes, Chapter 353D.03, specifies plan provisions, including the employee and employer contribution rates for those qualified personnel who elect to participate. An eligible elected official who decides to participate contributes 5 percent of salary which is matched by the elected official's employer. Employees who are paid for their

NOTE 15 - DEFINED CONTRIBUTION PLAN (CONTINUED)

services may elect to make member contributions in an amount not to exceed the employer share. Employer and employee contributions are combined and used to purchase shares in one or more of the seven accounts of the Minnesota Supplemental Investment Fund. For administering the plan, PERA receives 2 percent of employer contributions and twenty-five hundredths of one percent of the assets in each member's account annually.

Total contributions made by the City of Grand Marais, Minnesota during fiscal year 2011 were:

Contribution Amount		Percentage of Covered Payroll		Required
Employee	Employer	Employee	Employer	Rates
$ 240	$ 240	5.0%	5.0%	5.0%

NOTE 16 - EXTRAORDINARY ITEM - STORM DAMAGE

In October of 2010, a storm caused significant damage to the City owned pool building. Costs to repair or replace the damages totaled $95,355. The City recovered $85,355 from insurance proceeds in 2010 and $7,417 in 2011.

NOTE 17 - SUBSEQUENT EVENT

As of June 15, 2012, the City is in the process of issuing $1,965,000 Electric System Revenue Refunding Bonds, Series 2012A to refund the 2013 through 2023 maturities of the $2,885,000 Electric System Revenue Bonds, Series 2003.

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, 2011

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
REVENUES				
Taxes				
Property	$ 650,880	$ 650,880	$ 606,467	$ (44,413)
Special assessments	7,787	7,787	4,262	(3,525)
Licenses and permits	79,400	79,400	83,888	4,488
Intergovernmental	101,737	101,737	143,224	41,487
Charges for services	985,374	985,374	1,074,761	89,387
Fines	900	900	3,485	2,585
Gifts and contributions	-	-	5,050	5,050
Interest	9,000	9,000	7,553	(1,447)
Miscellaneous	-	-	1,114	1,114
TOTAL REVENUES	1,835,078	1,835,078	1,929,804	94,726
EXPENDITURES				
Current				
General government	362,605	362,605	346,410	16,195
Public safety	233,217	233,217	209,216	24,001
Streets	338,452	338,452	225,215	113,237
Culture and recreation	884,723	884,723	897,411	(12,688)
TOTAL EXPENDITURES	1,818,997	1,818,997	1,678,252	140,745
EXCESS OF REVENUES OVER EXPENDITURES	16,081	16,081	251,552	235,471
OTHER FINANCING SOURCES (USES)				
Transfers in	200,000	200,000	200,000	-
Transfers out	(134,940)	(134,940)	(151,706)	(16,766)
Sale of capital assets	-	-	3,873	3,873
TOTAL OTHER FINANCING SOURCES (USES)	65,060	65,060	52,167	(12,893)
EXTRAORDINARY ITEM				
Insurance recovery - storm damage	-	-	7,417	7,417
NET CHANGE IN FUND BALANCE	81,141	81,141	311,136	229,995
FUND BALANCE - JANUARY 1	1,483,093	1,483,093	1,483,093	-
FUND BALANCE - DECEMBER 31	$ 1,564,234	$ 1,564,234	$ 1,794,229	$ 229,995

See notes to required supplementary information.

CITY OF GRAND MARAIS, MINNESOTA

LIBRARY SPECIAL REVENUE FUND
SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
Year Ended December 31, 2011

	Budgeted Amounts		Actual Amounts, Budgetary Basis	Variance with Final Budget - Positive (Negative)
	Original	Final		
REVENUES				
Intergovernmental	$ 96,899	$ 96,899	$ 96,216	$ (683)
Charges for services	13,999	13,999	11,950	(2,049)
Gifts and contributions	-	-	1,485,553	1,485,553
Interest	-	-	1,613	1,613
TOTAL REVENUES	110,898	110,898	1,595,332	1,484,434
EXPENDITURES				
Current				
Culture and recreation	232,576	232,576	1,717,405	(1,484,829)
DEFICIENCY OF REVENUES OVER EXPENDITURES	(121,678)	(121,678)	(122,073)	(395)
OTHER FINANCING SOURCES				
Transfers in	124,679	124,679	123,056	(1,623)
NET CHANGE IN FUND BALANCE	3,001	3,001	983	(2,018)
FUND BALANCE - JANUARY 1	482,462	482,462	482,462	-
FUND BALANCE - DECEMBER 31	$ 485,463	$ 485,463	$ 483,445	$ (2,018)

See notes to required supplementary information.

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 Schedules of Revenues, Expenditures and Changes in Fund Balance – Budget and Actual – General Fund and Library Special Revenue Fund present comparisons of budgetary data to actual results.

NOTE 2 - EXCESS OF EXPENDITURES OVER APPROPRIATIONS

Expenditures exceeded appropriations in the following fund for the year ended December 31, 2011:

	Excess
Library Special Revenue Fund	$1,484,829

This overexpenditure was funded by gifts and contributions and an available fund balance.

OTHER SUPPLEMENTARY INFORMATION

NONMAJOR GOVERNMENTAL FUNDS

Special Revenue Funds

Special revenue funds are used to account for and report the proceeds of specific revenue sources that are legally restricted or committed to expenditure for specified purposes other than debt service or capital projects.

The Cable TV Special Revenue Fund is used to account for revenues collected to fund the operation of a TV 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 and report financial resources that are restricted, committed or assigned to expenditure for capital outlays, including the acquisition and construction of capital facilities and other capital assets. Capital projects funds exclude those types of capital-related outflows financed by proprietary funds.

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

CITY OF GRAND MARAIS, MINNESOTA

COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
December 31, 2011

	Cable TV Special Revenue Fund	Storefront Renovation Special Revenue Fund	EDA Cedar Grove Business Park Capital Projects Fund	Total Nonmajor Governmental Funds
ASSETS				
Cash and cash equivalents	$ 14,529	$ 94,454	$ 13,026	$ 122,009
Accounts receivable	1,120	-	-	1,120
Loans receivables	-	63,844	-	63,844
TOTAL ASSETS	$ 15,649	$ 158,298	$ 13,026	$ 186,973
LIABILITIES AND FUND BALANCES				
LIABILITIES				
Due to other funds	$ -	$ 15,000	$ -	$ 15,000
Deferred revenue	-	63,844	-	63,844
TOTAL LIABILITIES	-	78,844	-	78,844
FUND BALANCES				
Restricted	-	79,454	13,026	92,480
Committed	15,649	-	-	15,649
TOTAL FUND BALANCES	15,649	79,454	13,026	108,129
TOTAL LIABILITIES AND FUND BALANCES	$ 15,649	$ 158,298	$ 13,026	$ 186,973

CITY OF GRAND MARAIS, MINNESOTA

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
NONMAJOR GOVERNMENTAL FUNDS
Year Ended December 31, 2011

	Cable TV Special Revenue Fund	Storefront Renovation Special Revenue Fund	EDA Cedar Grove Business Park Capital Projects Fund	Total Nonmajor Governmental Funds
REVENUES				
Taxes - franchise fee	$ 4,745	$ -	$ -	$ 4,745
Intergovernmental	-	-	244,365	244,365
Interest	-	1,694	459	2,153
Miscellaneous	-	15,284	-	15,284
TOTAL REVENUES	4,745	16,978	244,824	266,547
EXPENDITURES				
Current				
Culture and recreation	597	-	-	597
Economic development	-	30,000	-	30,000
Capital outlay				
Economic development	-	-	235,403	235,403
TOTAL EXPENDITURES	597	30,000	235,403	266,000
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	4,148	(13,022)	9,421	547
OTHER FINANCING USES				
Transfers out	-	-	(130,000)	(130,000)
NET CHANGE IN FUND BALANCES	4,148	(13,022)	(120,579)	(129,453)
FUND BALANCES - JANUARY 1	11,501	92,476	133,605	237,582
FUND BALANCES - DECEMBER 31	$ 15,649	$ 79,454	$ 13,026	$ 108,129

CITY OF GRAND MARAIS, MINNESOTA

GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
Year Ended December 31, 2011

REVENUES	
Taxes	
General property	$ 606,467
Special Assessments	4,262
Licenses and permits	83,888
Intergovernmental	
State	
Local government aid	96,422
Market value credit	17,695
PERA aid	5,315
Fire aid	2,000
Other state aids	21,792
Total Intergovernmental	143,224
Charges for Services	
General government	
Rent	64,189
Miscellaneous	10,961
Public safety	
Fire protection contacts	47,967
Culture and recreation	
Park	722,388
Swimming pool	142,275
Boat harbors	86,981
Total Charges for Services	1,074,761
Fines	
Court fines	3,485
Gifts and Contributions	5,050
Interest	7,553
Miscellaneous	
Other	1,114
TOTAL REVENUES	1,929,804

CITY OF GRAND MARAIS, MINNESOTA

GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
(CONTINUED)
Year Ended December 31, 2011

EXPENDITURES	
Current	
General Government	
Mayor and council	$ 27,773
City clerk	160,244
City clerk capital outlay	2,680
Elections	10,715
Independent audit	12,750
Legal	25,399
Planning and zoning	25,838
Buildings	59,202
Other	21,809
Total General Government	346,410
Public Safety	
Police	140,000
Fire	52,962
Fire capital outlay	10,520
Medical services	3,364
Animal control	2,370
Total Public Safety	209,216
Streets	
Maintenance	164,901
Street lighting	26,823
Capital outlay	33,491
Total Streets	225,215
Culture and Recreation	
Recreation	420,984
Recreation capital outlay	90,270
Swimming pool	269,657
Swimming pool capital outlay	26,575
Boat harbors	58,807
City parks	25,688
City parks capital outlay	5,430
Total Culture and Recreation	897,411
TOTAL EXPENDITURES	1,678,252
EXCESS OF REVENUES OVER EXPENDITURES	251,552
OTHER FINANCING SOURCES (USES)	
Transfers in	200,000
Transfers out	(151,706)
Sale of capital assets	3,873
TOTAL OTHER FINANCING SOURCES (USES)	52,167
EXTRAORDINARY ITEM	
Insurance recovery - storm damage	7,417
NET CHANGE IN FUND BALANCE	311,136
FUND BALANCE - JANUARY 1	1,483,093
FUND BALANCE - DECEMBER 31	$ 1,794,229

CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

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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, 2011, which collectively comprise the City of Grand Marais, Minnesota's basic financial statements and have issued our report thereon dated June 15, 2012. 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

Management of City of Grand Marais, Minnesota is responsible for establishing and maintaining effective 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 of Grand Marais, Minnesota's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of Grand Marais, Minnesota'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 was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness and another deficiency that we consider to be a significant deficiency.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses as item 2011-2 to be a material weakness.

A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying schedule of findings and responses as item 2011-1 to be a significant deficiency.

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 Political Subdivisions*, 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 Political Subdivisions* 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 15, 2012, 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 the response.

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, Hirsch & Nelson, Ltd.

June 15, 2012

CITY OF GRAND MARAIS, MINNESOTA

SCHEDULE OF FINDINGS AND RESPONSES
Year Ended December 31, 2011

SIGNIFICANT DEFICIENCIES

2011-1. 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 limitations 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.

2011-2. LACK OF CONTROL OVER FINANCIAL REPORTING PROCESS

Condition and Criteria
As part of the audit, management requested that the auditor prepare a draft of the City's 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 does not possess the technical expertise to comply with governmental accounting standards.

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
   Management has determined that the cost and training involved to review or prepare the City's 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, 2011, 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. Accordingly, we do not express 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 15, 2012, contains our report on significant deficiencies or material weaknesses in the City's internal control. This letter does not affect our report dated June 15, 2012, 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:

Interfund Activity
We noted that interfund transfers and receivables/payables did not match at year end. When interfund activity is recorded, corresponding entries must be made in both the paying and receiving funds.

Receipts
We noted monthly receipts from other locations, such as the pool, were dated and deposited into the bank account subsequent to month end. To aid in reconciling the bank statement at month end, we suggest that the month end date be reflected on these deposit slips.

Met Life Stock
We noted that dividend income was received from Met Life in 2011. The stock was probably received in a prior year as a result of the insurance company's demutualization. This stock investment should be recorded on the general leger for internal control purposes. In addition, we recommend that you consult your legal advisor as to whether this is an allowable investment.

Contracting and Bidding
During our review of bid/quote files we noted the following:

1) Most of the time only the vendor awarded the bid or quote was listed in the minutes. We recommend that all vendors be listed in the minutes, along with the dollar amount quoted.

2) In one instance, requests for quotes were sent to several vendors, but the requests were not dated. We recommend that the request for quotation be dated to ensure that the City allowed time for vendors to respond.

3) An ad calling for bids for the sale of old used City vehicles was placed on the local website, but a hard copy of the ad was not on file. We recommend that a copy of all bid ads be maintained on file.

4) Bid files should be kept on all projects and should be arranged in an orderly fashion to assure all bid procedures are being followed. We suggest bid files contain at least the following:

   a) Specifications;
   b) Copy of Council minutes requesting bids;
   c) Copy of newspaper advertisement;
   d) Copy of bids, bid bonds, performance bonds, certified checks and tabulations, if necessary;
   e) Council minutes should include bid opening dates, time, who was present, all bids submitted, and Council approval with a clear reference to who was awarded the bid;
   f) If low bid is not awarded, minutes must state reasons;
   g) Copy of all signed contracts and agreements.

Utility Billing Adjustments
With regard to utility billing adjustments, we noted the following:

1) We noted that a list of bad debts presented to the Commission for approval to write-off contained only account numbers and amounts. As an internal control measure, we recommend that the customer names also be included on the list.

2) We noted that the utility billing clerk is able to adjust customer bills without approval. In addition, in some cases, original entries are voided or deleted rather than documenting the change through an adjustment. To aid in reconciling the monthly accounts receivable to the general ledger and to strengthen internal controls, we recommend that a properly authorized written credit memo form be used to ensure that credit is properly issued and recorded for accounting purposes.

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, Hirsch & Nelson, Ltd.

June 15, 2012