

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

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

YEARS ENDED DECEMBER 31, 2006 AND 2005

Description of the Office of the State Auditor

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

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

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

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

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

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

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

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

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

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

Years Ended December 31, 2006 and 2005



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

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

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

ORGANIZATION
DECEMBER 31, 2006

	<u>Term Expires</u>
Directors	
John Arnold	June 30, 2009
Robert Beaudin	June 30, 2009
John Bray	June 30, 2007
Marti Buscaglia	June 30, 2007
Robert Eaton	January 1, 2007
Mark Emmel	June 30, 2009
Gregory Fox	January 1, 2007
David McMillan	January 1, 2007
Debra Messer	January 1, 2007
Marsha Signorelli	June 30, 2007
Yvonne Prettner Solon	June 30, 2008
Officers	
President	
Mark Emmel	June 30, 2009
Vice President	
Robert Eaton	January 1, 2007
Treasurer (Duluth City Treasurer)	
Larry Jeneson	Indefinite
Executive Director	
Daniel J. Russell	Indefinite

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REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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INDEPENDENT AUDITOR'S REPORT

Mayor and City Council
City of Duluth

Duluth Entertainment and Convention Center
Authority Board

We have audited the accompanying financial statements of the Duluth Entertainment and Convention Center Authority, a component unit of the City of Duluth, as of and for the years ended December 31, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the Convention Center's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Duluth Entertainment and Convention Center Authority as of December 31, 2006 and 2005, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 23, 2007, on our consideration of the Duluth Entertainment and Convention Center Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

May 23, 2007

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

**MANAGEMENT'S DISCUSSION AND ANALYSIS
DECEMBER 31, 2006
(Unaudited)**

This section presents a narrative overview and analysis of the Duluth Entertainment and Convention Center Authority's financial condition and activities for the fiscal year ended December 31, 2006. This information should be read in conjunction with the financial statements.

FINANCIAL HIGHLIGHTS

- In 2006, total net assets decreased \$1.2 million, or 3.2 percent, over the course of the year's operations.
- Total operating revenue decreased 1.1 percent, or \$0.08 million, in 2006 compared to last year.
- Total operating expenses in 2006 decreased by \$0.3 million, or 3.5 percent, compared to 2005.

OVERVIEW OF ANNUAL FINANCIAL REPORT

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

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

The financial statements include a statement of net assets; statement of revenues, expenses, and changes in net assets; statement of cash flows; and notes to the financial statements. The statement of net assets presents the financial position of the Convention Center on a full accrual, historical cost basis. The statement of net assets provides information about the nature and amount of resources and obligations at year-end. The statement of revenues, expenses, and changes in net assets presents the results of the business activities over the course of the fiscal year and information as to how the net assets changed during the year. All changes in net assets

are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Convention Center's recovery of its costs.

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

The notes to the financial statements provide required disclosures and other information essential to a full understanding of material data provided in the statements. The notes present information on the Convention Center's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies, and subsequent events, if any.

The financial statements were prepared by the Convention Center's staff from the detailed books and records of the Convention Center. The financial statements were audited and adjusted, if material, during the independent external audit process.

SUMMARY OF ORGANIZATION AND BUSINESS

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

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

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

FINANCIAL ANALYSIS

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

Condensed Statement of Net Assets					
(000s)					
	2006	2005	2004	Dollar Change	
				2005 to 2006	2004 to 2005
Assets					
Current and other assets	\$ 1,080	\$ 1,424	\$ 1,092	\$ (344)	\$ 332
Capital assets	39,531	41,539	43,417	(2,008)	(1,878)
Total Assets	\$ 40,611	\$ 42,963	\$ 44,509	\$ (2,352)	\$ (1,546)
Liabilities					
Current liabilities	\$ 1,743	\$ 2,228	\$ 1,679	\$ (485)	\$ 549
Long-term liabilities	3,563	4,255	4,792	(692)	(537)
Total Liabilities	\$ 5,306	\$ 6,483	\$ 6,471	\$ (1,177)	\$ 12
Net Assets					
Invested in capital assets	\$ 35,242	\$ 36,551	\$ 37,928	\$ (1,309)	\$ (1,377)
Restricted	83	82	81	1	1
Unrestricted	(20)	(153)	29	133	(182)
Total Net Assets	\$ 35,305	\$ 36,480	\$ 38,038	\$ (1,175)	\$ (1,558)

In 2006, net assets decreased \$1.2 million to \$35 million, down from \$36 million in 2005. The decrease in net assets was primarily due to a \$2.0 million increase in accumulated depreciation. In 2005, net assets decreased \$1.6 million to \$36 million, down from \$38 million in 2004. The decrease in net assets was primarily due to an increase in accumulated depreciation.

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

	2006	2005	2004	Dollar Change Increase (Decrease)	
				2005 to 2006	2004 to 2005
Operating revenues	\$ 7,260	\$ 7,345	\$ 7,010	\$ (85)	\$ 335
Nonoperating revenues	890	792	814	98	(22)
Total Revenues	\$ 8,150	\$ 8,137	\$ 7,824	\$ 13	\$ 313
Operating expenses	\$ 9,001	\$ 9,329	\$ 9,232	\$ (328)	\$ 97
Interest expense	320	361	377	(41)	(16)
Amortization of bond issue costs	4	5	6	(1)	(1)
Total Expenses	\$ 9,325	\$ 9,695	\$ 9,615	\$ (370)	\$ 80
Excess of Revenues Over (Under) Expenses	\$ (1,175)	\$ (1,558)	\$ (1,791)	\$ 383	\$ 233
Donated capital	-	-	2,534	-	(2,534)
Change in Net Assets	\$ (1,175)	\$ (1,558)	\$ 743	\$ 383	\$ (2,301)
Net Assets - January 1	36,480	38,038	37,295	(1,558)	743
Net Assets - December 31	<u>\$ 35,305</u>	<u>\$ 36,480</u>	<u>\$ 38,038</u>	<u>\$ (1,175)</u>	<u>\$ (1,558)</u>

**Comparison with Budget
(000s)**

	2006 Actual	2006 Budget	Variance with Budget	Percent Change (%)
Operating revenues	\$ 7,260	\$ 7,264	\$ (4)	(0.1)
Nonoperating revenues	890	800	90	11.3
Total Revenues	\$ 8,150	\$ 8,064	\$ 86	1.1
Operating expenses	\$ 9,001	\$ 9,138	\$ (137)	(1.5)
Interest expense	320	331	(11)	(3.3)
Amortization of bond issue costs	4	4	-	-
Total Expenses	\$ 9,325	\$ 9,473	\$ (148)	(1.6)
Excess of Revenues Over (Under) Expenses	\$ (1,175)	\$ (1,409)	\$ 234	16.6
Net Assets - January 1	36,480	36,480	-	-
Net Assets - December 31	<u>\$ 35,305</u>	<u>\$ 35,071</u>	<u>\$ 234</u>	<u>0.7</u>

(Unaudited)

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Revenues

The Convention Center's operating revenues decreased \$85,000 to \$7.3 million in 2006 mainly due to lower Omnimax revenues compared to 2005. Nonoperating revenues were up \$98,000 compared to last year due to an increase in Hotel/Motel tax revenue.

Expenses

The Convention Center's operating expenses decreased \$328,000 to \$9.0 million in 2006 due to a change from natural gas to hot water heat and a reduction in Omnimax film royalty expense due to lower attendance.

Budgetary Highlights

Operating revenues were on budget in 2006, missing budget by only 0.1 percent. Operating expenses were lower than budgeted due to lower utility expenses and film costs.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

	Capital Assets (000s)			Percent Change (%)
	2006	2005	Dollar Change	
Land	\$ 906	\$ 906	\$ -	-
Land improvements	303	303	-	-
Buildings and structures	61,801	61,801	-	-
Equipment	7,173	7,129	44	0.6
Work in progress	25	25	-	-
	<hr/>	<hr/>	<hr/>	
Subtotal	\$ 70,208	\$ 70,164	\$ 44	0.1
Less: accumulated depreciation	<hr/> (30,676)	<hr/> (28,625)	<hr/> (2,051)	7.2
Net Capital Assets	<hr/> <u>\$ 39,532</u>	<hr/> <u>\$ 41,539</u>	<hr/> <u>\$ (2,007)</u>	(4.8)

By the end of 2006, the Convention Center had invested \$70.2 million in capital assets. The minimal increase during the past year was mainly due to the purchase of a steamer (\$19,000) for the catering kitchen. For more information, see Note 2.C. to the financial statements.

Debt Administration

	Debt (000s)		Dollar Change	Percent Change (%)
	2006	2005		
Copier lease	\$ -	\$ 1	\$ (1)	(100.0)
Locker room lease	1,119	1,212	(93)	(7.7)
Omnimax bonds	3,565	4,195	(630)	(15.0)
Server lease	27	50	(23)	(46.0)
Omnimax platter upgrade	11	53	(42)	(79.3)
Total Debt	<u>\$ 4,722</u>	<u>\$ 5,511</u>	<u>\$ (789)</u>	(14.3)

As of December 31, 2006, the Convention Center's outstanding debt decreased \$789,000, or 14.3 percent, compared to December 31, 2005. There was no additional debt incurred in 2006. For additional information, see Notes 2.J. and 2.K. to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

Many factors were considered when completing the budget for 2007. Convention business in 2007 will be similar to the business in recent years. A modest increase in revenue is projected for 2007 compared to the 2006 budget mainly for parking revenue. The daily parking rate increased from \$3.00 to \$4.00 on January 1, 2007. Rent and building services prices for 2007 were established in 2003 and included a minimal increase for some goods and services. New catering prices will be effective in the spring of 2007 and concessions prices were increased in October 2006. Overall 2007 operating expenses are projected to remain the same compared to the 2006 budget.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Convention Center's finances and to demonstrate the Convention Center's accountability for the money it receives. If you have any questions about this report, or need additional financial information, contact the Finance Director, Duluth Entertainment and Convention Center Authority, 350 Harbor Drive, Duluth, Minnesota 55802.

FINANCIAL STATEMENTS

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

EXHIBIT A

**COMPARATIVE STATEMENT OF NET ASSETS
DECEMBER 31, 2006 AND 2005**

	2006	2005
<u>Assets</u>		
Current assets		
Cash and cash equivalents	\$ 146,295	\$ 191,856
Accounts receivable	296,784	275,107
Due from City of Duluth	97,586	84,195
Inventory	162,421	160,165
Prepaid items	20,507	24,139
Total current assets	\$ 723,593	\$ 735,462
Restricted current assets		
Assets restricted for customers' deposits		
Cash and cash equivalents	\$ 228,424	\$ 540,819
Accounts receivable	29,955	48,225
Assets restricted for employee flexible benefits		
Cash and cash equivalents	3,319	2,924
Total restricted current assets	\$ 261,698	\$ 591,968
Total current assets	\$ 985,291	\$ 1,327,430
Noncurrent assets		
Restricted debt service - assets held by trustee		
Lease financing escrow account	\$ 83,185	\$ 81,502
Bond issuance costs	11,221	15,581
Total noncurrent assets, other than capital	\$ 94,406	\$ 97,083
Capital assets		
Not depreciated	\$ 930,601	\$ 930,601
Depreciated	69,276,942	69,233,227
Less: allowance for depreciation	(30,676,152)	(28,624,996)
Total capital assets - net of accumulated depreciation	\$ 39,531,391	\$ 41,538,832
Total noncurrent assets	\$ 39,625,797	\$ 41,635,915
Total Assets	\$ 40,611,088	\$ 42,963,345

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

**EXHIBIT A
(Continued)**

**COMPARATIVE STATEMENT OF NET ASSETS
DECEMBER 31, 2006 AND 2005**

	2006	2005
<u>Liabilities</u>		
Current liabilities		
Accounts payable	\$ 270,338	\$ 493,315
Salaries payable	66,595	61,420
Compensated absences payable - current	109,305	86,758
Accrued interest payable	31,673	35,394
Deferred revenue	214,920	170,835
General obligation revenue bonds payable - current	655,000	630,000
Capital leases payable - current	133,293	158,454
	\$ 1,481,124	\$ 1,636,176
Current liabilities payable from restricted assets		
Customer deposits	\$ 258,379	\$ 589,044
Employee flexible benefits plan	3,319	2,924
	\$ 261,698	\$ 591,968
	\$ 1,742,822	\$ 2,228,144
Noncurrent liabilities		
Compensated absences payable - long-term	\$ 62,504	\$ 56,004
General obligation revenue bonds payable - long-term	2,910,000	3,565,000
Less: unamortized discount	(11,349)	(15,745)
Less: deferred amount on refunding	(421,565)	(507,317)
Capital leases payable - long-term	1,023,797	1,157,090
	\$ 3,563,387	\$ 4,255,032
	\$ 5,306,209	\$ 6,483,176
<u>Net Assets</u>		
Net Assets		
Invested in capital assets, net of related debt	\$ 35,242,215	\$ 36,551,350
Restricted for debt service	83,185	81,502
Unrestricted	(20,521)	(152,683)
	\$ 35,304,879	\$ 36,480,169

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

EXHIBIT B

**COMPARATIVE STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005**

	2006	2005
Operating Revenues		
Sales	\$ 3,155,298	\$ 3,034,671
Charges for services	3,857,001	4,073,834
Miscellaneous	247,891	236,275
	\$ 7,260,190	\$ 7,344,780
Operating Expenses		
Personal services	\$ 3,814,183	\$ 3,858,204
Supplies and services	1,381,319	1,272,953
Utilities	690,298	876,868
Other services and charges	1,064,348	1,256,239
Depreciation	2,051,156	2,064,084
	\$ 9,001,304	\$ 9,328,348
Operating Income (Loss)	\$ (1,741,114)	\$ (1,983,568)
Nonoperating Revenues (Expenses)		
Interest income	\$ 8,673	\$ 3,047
Hotel/motel tax revenue	881,349	789,303
Interest expense	(319,838)	(360,926)
Amortization of bond issue costs	(4,360)	(4,999)
	\$ 565,824	\$ 426,425
Change in Net Assets	\$ (1,175,290)	\$ (1,557,143)
Net Assets - January 1	36,480,169	38,037,312
Net Assets - December 31	\$ 35,304,879	\$ 36,480,169

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

EXHIBIT C

**COMPARATIVE STATEMENT OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2006 AND 2005**

	2006	2005
Cash Flows from Operating Activities		
Cash received from customers	\$ 6,722,312	\$ 7,403,720
Cash paid to suppliers	(3,357,566)	(3,279,063)
Cash paid to employees	(3,779,566)	(3,791,986)
Other operating revenues	247,891	236,275
Net cash provided by (used in) operating activities	\$ (166,929)	\$ 568,946
Cash Flows from Noncapital Financing Activities		
City of Duluth hotel/motel taxes	\$ 867,958	\$ 756,528
Cash Flows from Capital and Related Financing Activities		
Principal paid on lease purchases	\$ (158,454)	\$ (116,865)
Interest paid on lease purchases	(63,136)	(79,218)
Principal paid on bonds payable	(630,000)	(605,000)
Interest paid on bonds payable	(170,275)	(194,475)
Acquisition or construction of capital assets	(43,715)	(55,965)
Net cash provided by (used in) capital and related financing activities	\$ (1,065,580)	\$ (1,051,523)
Cash Flows from Investing Activities		
Interest on investments	\$ 6,990	\$ 1,961
Net Increase (Decrease) in Cash and Cash Equivalents	\$ (357,561)	\$ 275,912
Cash and Cash Equivalents - January 1	735,599	459,687
Cash and Cash Equivalents - December 31	\$ 378,038	\$ 735,599
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities		
Net operating income (loss)	\$ (1,741,114)	\$ (1,983,568)
Adjustments to reconcile net operating income (loss) to net cash provided by (used in) operating activities		
Depreciation	2,051,156	2,064,084
Changes in assets and liabilities		
Decrease (increase) in receivables	(3,407)	(4,591)
Decrease (increase) in inventory	(2,256)	(1,762)
Decrease (increase) in prepaid items	3,632	(21,507)
Increase (decrease) in payables	(188,755)	214,777
Increase (decrease) in deferred revenue	44,085	18,116
Increase (decrease) in employee flexible benefits plan deposits	395	1,707
Increase (decrease) in customer deposits	(330,665)	281,690
Net Cash Provided by (Used in) Operating Activities	\$ (166,929)	\$ 568,946

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

EXHIBIT C
(Continued)

**COMPARATIVE STATEMENT OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2006 AND 2005**

	<u>2006</u>	<u>2005</u>
Noncash Investing, Capital, and Financing Activities		
The Convention Center earned interest on the debt service reserve account.	\$ 1,683	\$ 1,085
The Convention Center acquired capital assets under lease purchase agreements.	-	130,278

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

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005**

1. Summary of Significant Accounting Policies

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

The accounting policies of the Convention Center conform to generally accepted accounting principles.

A. Financial Reporting Entity

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

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

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

1. Summary of Significant Accounting Policies (Continued)

B. Basis of Presentation

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

C. Basis of Accounting

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

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

D. Budget and Budgetary Accounting

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

E. Cash and Cash Equivalents

Cash and cash equivalents consist of cash and investments held by the Treasurer of the City of Duluth. Investments are stated at fair value, and investment revenue is recorded as it is earned. For purposes of the statement of cash flows, all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased are considered to be cash equivalents. The lease financing escrow account is not considered to be a cash equivalent because the Convention Center cannot withdraw from this account at any time without penalty.

F. Inventories of Merchandise for Resale

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

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

1. Summary of Significant Accounting Policies (Continued)

G. Capital Assets

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

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

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

H. Depreciation

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

I. Restricted Assets

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

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

J. Deferred Revenue

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

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
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1. Summary of Significant Accounting Policies (Continued)

K. Operating Revenues

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

L. Use of Estimates

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

M. Trade-Offs

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

2. Detailed Notes

A. Deposits and Investments

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

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

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
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2. Detailed Notes

A. Deposits and Investments (Continued)

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

The following is a summary of the Convention Center's cash and investments at December 31, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Current assets		
City of Duluth pooled cash account	\$ 96,154	\$ 118,436
Checking account - ticket office	7,000	7,000
Checking account - employee flexible benefits plan	7,399	7,399
Savings account - operating reserve	3,137	26,416
Petty cash and change funds	<u>32,605</u>	<u>32,605</u>
Total current assets	<u>\$ 146,295</u>	<u>\$ 191,856</u>
Restricted current assets		
Ticket office customer deposits - checking	\$ 198,478	\$ 509,197
Ticket office customer deposits - savings	22,746	22,422
Ticket office change fund	7,200	9,200
Employee flexible benefits plan - checking	<u>3,319</u>	<u>2,924</u>
Total restricted current assets	<u>\$ 231,743</u>	<u>\$ 543,743</u>
Restricted noncurrent assets		
Lease reserve - savings escrow	<u>\$ 83,185</u>	<u>\$ 81,502</u>
Total	<u><u>\$ 461,223</u></u>	<u><u>\$ 817,101</u></u>

B. Due From City of Duluth

Amounts due from the City of Duluth at December 31, 2006 and 2005, are as follows:

	<u>2006</u>	<u>2005</u>
Hotel/motel tax	<u>\$ 97,586</u>	<u>\$ 84,195</u>

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

2. Detailed Notes (Continued)

C. Capital Assets

A summary of the changes in the capital asset accounts for the years ended December 31, 2006 and 2005, follows:

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

	Balance January 1, 2005	Increase	Decrease	Transfers	Balance December 31, 2005
Capital assets not depreciated					
Land	\$ 905,601	\$ -	\$ -	\$ -	\$ 905,601
Construction in progress	-	25,000	-	-	25,000
Total capital assets not depreciated	\$ 905,601	\$ 25,000	\$ -	\$ -	\$ 930,601
Capital assets depreciated					
Land improvements	\$ 302,957	\$ -	\$ -	\$ -	\$ 302,957
Buildings	61,774,777	-	-	26,067	61,800,844
Equipment	6,994,250	161,243	-	(26,067)	7,129,426
Total capital assets depreciated	\$ 69,071,984	\$ 161,243	\$ -	\$ -	\$ 69,233,227

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

2. Detailed Notes

C. Capital Assets (Continued)

	Balance January 1, 2005	Increase	Decrease	Transfers	Balance December 31, 2005
Less: accumulated depreciation for					
Land improvements	\$ 302,957	\$ -	\$ -	\$ -	\$ 302,957
Buildings	21,317,265	1,782,055	-	-	23,099,320
Equipment	4,940,690	282,029	-	-	5,222,719
Total accumulated depreciation	\$ 26,560,912	\$ 2,064,084	\$ -	\$ -	\$ 28,624,996
Total capital assets depreciated, net	\$ 42,511,072	\$ (1,902,841)	\$ -	\$ -	\$ 40,608,231
Capital Assets, Net	\$ 43,416,673	\$ (1,877,841)	\$ -	\$ -	\$ 41,538,832

D. Risk Management

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

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

E. Hospital/Medical Benefits for Retirees

Employees who retired between January 1, 1983, and January 1, 1995, and employees who were full-time employees prior to January 1, 1995, and retire from Convention Center employment at or after age 62 with at least ten years of full-time service, are eligible to receive hospital/medical benefits to the same extent as active employees for the life of the retiree or surviving spouse. The authority to provide this benefit is established in Minn. Stat. § 471.61, subd. 2a. These benefits are provided through the

**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
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2. Detailed Notes

E. Hospital/Medical Benefits for Retirees (Continued)

City of Duluth's self-insurance plan. The Convention Center's premiums are based on the City of Duluth's historical experience in paying claims. The Convention Center recognizes the cost of providing these benefits by expensing the annual insurance premiums. The cost of retirees' hospital/medical premiums was \$96,808 in 2006 and \$71,798 in 2005. There are currently 13 retirees eligible to receive benefits.

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

F. Pension Plans

1. Plan Description

All full-time and certain part-time employees of the Duluth Entertainment and Convention Center Authority are covered by defined benefit plans administered by the Public Employees Retirement Association of Minnesota (PERA). The PERA administers the Public Employees Retirement Fund, which is a cost-sharing, multiple-employer retirement plan. The plan is established and administered in accordance with Minn. Stat. chs. 353 and 356.

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

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

Two methods are used to compute benefits for Coordinated and Basic Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the

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

2. Detailed Notes

F. Pension Plans

1. Plan Description (Continued)

annuity accrual rate for a Basic Plan member is 2.2 percent of average salary for each of the first ten years of service and 2.7 percent for each year thereafter. For a Coordinated Plan member, the annuity accrual rate is 1.2 percent of average salary for each of the first ten years of service and 1.7 percent for each successive year. Using Method 2, the annuity accrual rate is 2.7 percent of average salary for Basic Plan members and 1.7 percent for Coordinated Plan members for each year of service.

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

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

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

2. Funding Policy

Pension benefits are funded from member and employer contributions and income from the investment of fund assets. Minn. Stat. ch. 353 sets the rates for employer and employee contributions. These statutes are established and amended by the State Legislature. The Convention Center makes annual contributions to the pension plans equal to the amount required by state statutes. Public Employees Retirement Fund Basic Plan members and Coordinated Plan members were required to contribute 9.10 and 5.50 percent, respectively, of their annual covered

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
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2. Detailed Notes

F. Pension Plans

2. Funding Policy (Continued)

salary in 2006. Contribution rates in the Coordinated Plan increased in 2007 to 5.75 percent. The Convention Center is required to contribute the following percentages of annual covered payroll:

In 2006	
Public Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	6.00
In 2007	
Public Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	6.25

The Convention Center's contributions for the years ending December 31, 2006, 2005, and 2004, were \$147,709, \$133,680, and \$133,680, respectively, equal to the contractually required contributions for each year as set by state statute.

G. Compensated Absences

Full-time employees are granted from 10 to 25 days of vacation time per year depending on their years of service. Vacation earned during one year must be taken within the following year. The Executive Director is allowed to carry forward up to 50 days of vacation. Upon termination of employment, employees are compensated for the full value of all unused vacation pay. Part-time employees who work more than 1,000 hours in a calendar year will receive a personal day off (eight hours) for each 100 hours worked in excess of 1,000 hours. Unused vacation and personal leave earned as of December 31, 2006 and 2005, is estimated to be \$109,305 and \$86,758, respectively, and is recognized as a liability in the financial statements. The Executive Director's employment contract provides a benefit of six months of current salary upon termination. This has been accrued in the financial statements in the amount of \$62,504 as of December 31, 2006.

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
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2. Detailed Notes

G. Compensated Absences (Continued)

Sick leave is earned at the rate of one and one-half days per month for full-time personnel. No more than 150 days may be carried over at the end of any year. Employees are not compensated for unused sick leave upon termination of employment.

The contingent liability for sick leave at December 31, 2006 and 2005, was estimated to be \$566,201 and \$577,871, respectively, and is not recognized as a liability in the financial statements.

H. Deferred Revenue

Deferred revenue consists of the following:

	2006	2005
Advance deposits for future events	\$ 126,639	\$ 124,148
Gift certificates	48,281	46,687
Deferred lease revenue	40,000	-
Total	\$ 214,920	\$ 170,835

I. Minimum Future Rents Receivable

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

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

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
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2. Detailed Notes

I. Minimum Future Rents Receivable (Continued)

On January 9, 2001, the Convention Center entered into an amended lease agreement with Duluth Superior Excursions for six years with two five-year options to renew. This agreement is for the lease of space and facilities. The annual rent of \$42,554 in years 2002 through 2006 is adjusted annually based on the percentage increase in the Consumer Price Index.

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

On April 13, 2004, the Convention Center entered into a lease agreement with Cinema Entertainment Corporation for 20 years with two five-year options to renew. This agreement is for the lease of property on which Cinema Entertainment Corporation constructed a theater. The annual rent of \$175,000 will be increased by two percent each year in years 2 through 10 and three percent each year in years 11 through 20.

Minimum future rents on non-cancelable leases are:

2007	\$ 574,295
2008	589,239
2009	453,781
2010	313,858
2011	301,174
After 2011	<u>3,037,853</u>
Total	<u>\$ 5,270,200</u>

J. Leases Payable

In May 2001, the Convention Center entered into a lease agreement to finance improvements to the locker rooms used by University of Minnesota - Duluth hockey teams. The lease agreement runs for 15 years, with interest at 5.25 percent and semi-annual payments of \$77,500. At lease expiration, the locker room improvements will become the Convention Center's property and, as such, they have been recorded as capital assets. At December 31, 2006, the locker room improvements are valued at \$1,534,313, with accumulated depreciation of \$383,578.

DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
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2. Detailed Notes

J. Leases Payable (Continued)

In January 2005, the Convention Center entered into a lease agreement to finance computer server equipment. The lease runs for three years, with interest at 11.9 percent and monthly payments of \$2,250. At lease expiration, the server will become the Convention Center's property and, as such, it has been recorded as a capital asset. At December 31, 2006, the server is valued at \$66,644, with accumulated depreciation of \$26,658.

In October 2005, the Convention Center entered into an installment purchase agreement to upgrade projection equipment for the Omnimax Theater. The agreement is for 18 months at zero percent interest and monthly payments of \$3,535. After all installments have been paid, the equipment will become the Convention Center's property and, as such, it has been recorded as a capital asset valued at \$63,634 at December 31, 2006, with accumulated depreciation of \$6,363.

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

Year	Omnimax Platter Upgrade		Server	
	Interest	Principal	Interest	Principal
2007	\$ -	\$ 10,606	\$ 1,828	\$ 25,175
2008	-	-	21	2,229
2009	-	-	-	-
2010	-	-	-	-
2011	-	-	-	-
2012 - 2016	-	-	-	-
Total	\$ -	\$ 10,606	\$ 1,849	\$ 27,404

Year	Locker Room		Total	
	Interest	Principal	Interest	Principal
2007	\$ 57,488	\$ 97,512	\$ 59,316	\$ 133,293
2008	52,302	102,698	52,323	104,927
2009	46,839	108,161	46,839	108,161
2010	41,086	113,914	41,086	113,914
2011	35,028	119,972	35,028	119,972
2012 - 2016	73,590	576,823	73,590	576,823
Total	\$ 306,333	\$ 1,119,080	\$ 308,182	\$ 1,157,090

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

2. Detailed Notes

J. Leases Payable (Continued)

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

K. Long-Term Debt

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

The annual debt service requirements to maturity of the General Obligation Refunding Revenue Bonds as of December 31, 2006, are:

<u>Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>
2007	\$ 145,075	\$ 655,000	\$ 800,075
2008	118,875	685,000	803,875
2009	91,475	710,000	801,475
2010	63,075	740,000	803,075
2011	32,550	775,000	807,550
Total	<u>\$ 451,050</u>	<u>\$ 3,565,000</u>	<u>\$ 4,016,050</u>

The following is a schedule of long-term liability activity of the Duluth Entertainment and Convention Center Authority for the years ended December 31, 2006 and 2005.

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

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2. Detailed Notes

K. Long-Term Debt (Continued)

	Balance January 1, 2005	Additions	Reductions	Balance December 31, 2005	Due Within One Year
General obligation refunding revenue bonds	\$ 4,800,000	\$ -	\$ 605,000	\$ 4,195,000	\$ 630,000
Capital leases payable	1,302,131	130,278	116,865	1,315,544	158,454
Compensated absences payable	89,842	188,263	135,343	142,762	86,758
Total	<u>\$ 6,191,973</u>	<u>\$ 318,541</u>	<u>\$ 857,208</u>	<u>\$ 5,653,306</u>	<u>\$ 875,212</u>

L. Budget to Actual for 2006 and 2005

The Duluth Entertainment and Convention Center Authority adopts a budget to be approved by the Duluth City Council. A summary of the operating budgets for the fiscal years ended December 31, 2006 and 2005, follows:

	2006		
	Budget	Actual	Favorable (Unfavorable)
Operating Revenues	\$ 7,264,325	\$ 7,260,190	\$ (4,135)
Operating Expenses	9,137,794	9,001,304	136,490
Operating Income (Loss)	\$ (1,873,469)	\$ (1,741,114)	\$ 132,355
Nonoperating Revenues (Expenses)	464,912	565,824	100,912
Change in Net Assets	<u>\$ (1,408,557)</u>	<u>\$ (1,175,290)</u>	<u>\$ 233,267</u>
	2005		
	Budget	Actual	Favorable (Unfavorable)
Operating Revenues	\$ 7,126,680	\$ 7,344,780	\$ 218,100
Operating Expenses	8,994,134	9,328,348	(334,214)
Operating Income (Loss)	\$ (1,867,454)	\$ (1,983,568)	\$ (116,114)
Nonoperating Revenues (Expenses)	442,358	426,425	(15,933)
Change in Net Assets	<u>\$ (1,425,096)</u>	<u>\$ (1,557,143)</u>	<u>\$ (132,047)</u>

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**DULUTH ENTERTAINMENT AND CONVENTION CENTER AUTHORITY
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**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2006**

A. MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM NOT RESOLVED

99-1 Meals

In our prior audit, we noted 12 instances where the Duluth Entertainment and Convention Center Authority paid for meals for meetings between staff members with no outside parties present. During our current audit, we noted 13 occasions where staff-on-staff meals were paid for by the Convention Center, including a retirement party for a long-time employee. During our review of this area, we found that while Convention Center staff documented who attended the meeting and the topics discussed, they did not document the necessity of meeting during the meal time.

The Minnesota Attorney General held in Op. Atty. Gen. 63a-2, May 6, 1965, that there exists no public purpose for a public unit to pay lunch expenses when its employees meet over a lunch hour. Stated another way, public employees who work together cannot go to lunch and charge their employer, even if they do business while eating. Also, it is the Attorney General's position that non-monetary benefits, such as employee social events, must be specifically authorized by law or charter. There is no specific statutory authority for the Convention Center to use public funds for employee social events, such as retirement parties.

In prior audits, we have also noted instances where liquor was reimbursed as part of the meal. During the current audit, we noted six occasions where liquor was reimbursed. One instance where liquor was reimbursed involved a staff-on-staff meeting. Also, in some instances, vouchers reviewed for meal reimbursement were not itemized; therefore, we were unable to determine the nature of the charges.

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

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

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

We recommend the Convention Center Board discontinue the practice of paying for meals where only staff attends. Itemized receipts should support vouchers so that accounting staff can determine that only appropriate charges are reimbursed. Retirement parties should not be paid for out of public funds. Employees should pool their own resources to fund such events.

Client's Response:

The DECC operates 24 hours a day, 7 days a week which makes it unique compared to other state facilities. Trying to coordinate manager schedules in such a facility, we find it necessary for staff to occasionally meet during a meal. DECC policy allows for such meetings with prior approval of the Executive Director.

The DECC regularly entertains potential show promoters and convention planners as a means to bring business to the facility. Occasionally, it is necessary to provide alcoholic beverages as part of meal expenses for certain guests. This is a business decision and standard throughout the industry. We recognize the State Auditor's Office position on the matter; however, we do not believe it prudent to change our policy to prohibit reimbursement for alcohol. Whenever possible, we have an event partner pick up the cost of the alcohol.

B. OTHER ITEM FOR CONSIDERATION

Other Postemployment Benefits (OPEB)

The Governmental Accounting Standards Board (GASB) recently issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes financial reporting for OPEB plans, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which governs employer accounting and financial reporting for OPEB. These standards, similar to what GASB Statements 25 and 27 did for government employee pension benefits and plans, provide the accounting and reporting standards for

the various other postemployment benefits many local governments offer to their employees. OPEB can include many different benefits offered to retirees such as health, dental, life, and long-term care insurance coverage.

If retirees are included in an insurance plan and pay a rate similar to that paid for younger active employees, this implicit subsidy is considered OPEB. In fact, local governments may be required to continue medical insurance coverage pursuant to Minn. Stat. § 471.61, subd. 2b. This benefit is common when accumulated sick leave is used to pay for retiree medical insurance. Under the new GASB statements, accounting for OPEB is now similar to the accounting used by governments for pension plans.

Some of the issues that the Convention Center Board will need to address in order to comply with the statements are:

- determine if the employees are provided OPEB;
- if OPEB are being provided, the Board will have to determine whether it will advance fund the benefits or pay for them on a pay-as-you-go basis;
- if OPEB are being provided, and the Board determines that the establishment of a trust is desirable in order to fund the OPEB, the Board will have to wait until legislation is enacted authorizing the creation of an OPEB trust and establishing an applicable investment standard; and
- in order to determine annual costs and liabilities that need to be recognized, the Board will have to decide whether to hire an actuary.

If applicable for the Duluth Entertainment and Convention Center Authority, GASB Statements 43 and 45 would be implemented for the years ended December 31, 2006 and 2007, respectively.

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

Mayor and City Council
City of Duluth

Duluth Entertainment and Convention Center
Authority Board

We have audited the financial statements of the Duluth Entertainment and Convention Center Authority, a component unit of the City of Duluth, as of and for the year ended December 31, 2006, and have issued our report thereon dated May 23, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Duluth Entertainment and Convention Center Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Convention Center's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Convention Center's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Convention Center's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted

accounting principles such that there is more than a remote likelihood that a misstatement of the Convention Center's financial statements that is more than inconsequential will not be prevented or detected by the Convention Center's internal control.

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

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

Minnesota Legal Compliance

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

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

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

Also included in the Schedule of Findings and Recommendations is an other item for consideration. We believe this information to be of benefit to the Duluth Entertainment and Convention Center Authority and is reported for that purpose.

The Duluth Entertainment and Convention Center Authority's written response to the legal compliance finding identified in our audit has not been subjected to any auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Duluth Entertainment and Convention Center Authority Board, Mayor and City Council of Duluth, and the Convention Center's management and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

May 23, 2007