

CITY OF PEQUOT LAKES, MINNESOTA

**FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION**

YEAR ENDED DECEMBER 31, 2011

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INTRODUCTORY SECTION

**CITY OF PEQUOT LAKES, MINNESOTA
 PRINCIPAL CITY OFFICIALS
 DECEMBER 31, 2011**

Position	Name	Term Expires
<u>Elected Officials</u>		
Mayor	Nancy Adams	December 31, 2012
Council Member	Cathy Malecha	December 31, 2012
Council Member	Jerry Akerson	December 31, 2014
Council Member	Tom Ryan	December 31, 2012
Council Member	Dave Sjoblad	December 31, 2014
<u>Appointed</u>		
Clerk/Treasurer	Sandra Peine	
Attorney	Paul Sandelin	
Auditor	CliftonLarsonAllen LLP	

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FINANCIAL SECTION



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INDEPENDENT AUDITORS' REPORT

Honorable Mayor and
Members of the City Council
City of Pequot Lakes
Pequot Lakes, 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 the City of Pequot Lakes, 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 the City of Pequot Lakes' management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Pequot Lakes, as of December 31, 2011, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in the notes to the financial statements, the City of Pequot Lakes adopted the provisions of Government Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, as of and for the year ended December 31, 2011. This statement results in the City reporting restricted, committed, assigned, and unassigned fund balances in its governmental fund types.

Honorable Mayor and
Members of the City Council
City of Pequot Lakes

In accordance with *Government Auditing Standards*, we have also issued our report dated April 3, 2012, on our consideration of the City'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 conjunction with this report 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, budgetary comparison information, and schedules of funding progress on pages 4-15, 53-56, and 57-58, respectively, 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 the City of Pequot Lakes' basic financial statements. The combining and individual nonmajor fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial statements are the responsibility of management and were derived from and relate 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 taken as a whole.



CliftonLarsonAllen LLP

Brainerd, Minnesota
April 3, 2012

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REQUIRED SUPPLEMENTARY INFORMATION

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2011**

This section of the City of Pequot Lakes' (City) annual financial report presents our discussion and analysis of the City's financial performance during the fiscal year that ended on December 31, 2011. The Management's Discussion and Analysis (MD&A) is an element of Required Supplementary Information specified in the Governmental Accounting Standard Board's (GASB) Statement No. 34 – *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. Certain comparative information between the current year, 2011 and the prior year, 2010 is required to be presented in the MD&A.

FINANCIAL HIGHLIGHTS

Key financial highlights for 2011 include the following:

- ◆ City-wide net assets increased 4% over the prior year. The primary reason for the increase is due to additional grant money and a decrease in spending due to a tight budget.
- ◆ Overall, governmental fund-level revenues totaled \$2,141,270 and were \$366,282 more than expenditures. This excess of revenues over expenditures is due to an increase in tax revenues and a decrease in capital outlay expenditures.
- ◆ The General Fund's fund balance increased \$285,991 (28%) from the prior year due mainly to a decrease in capital outlay expenditures relating to highways and streets.
- ◆ The Water Enterprise Fund net assets increased \$9,663 (1.33%) from the prior year. Depreciation expense in this fund totaled \$62,953. Sewer Enterprise Fund net assets increased \$113,209 (11%) from the prior year including the impact of the depreciation expense of \$24,354.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial section of the annual report consists of four parts – Independent Auditors' Report, required supplementary information which includes the management's discussion and analysis (this section), the basic financial statements, and supplementary information. The basic financial statements include two kinds of statements that present different views of the City:

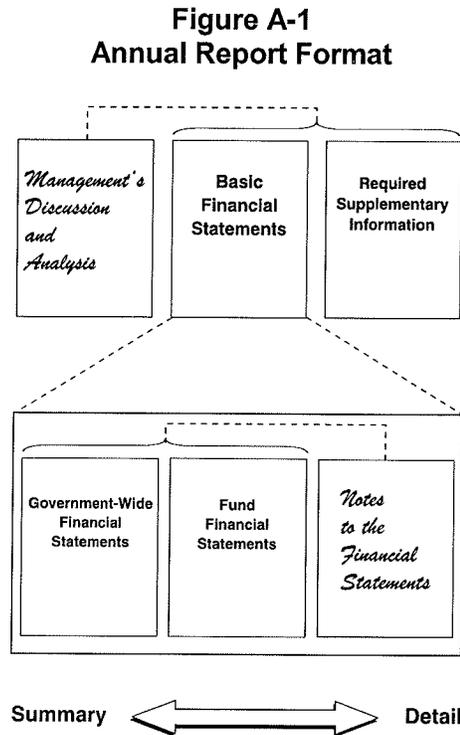
- ◆ The first two statements are City-wide financial statements which provide both short-term and long-term information about the City's overall financial status.
- ◆ The remaining statements are fund financial statements which focus on individual parts of the City, reporting the City's operations in more detail than the City-wide statements.
 - The governmental funds statements tell how basic services such as general government, public safety, and public works were financed in the short term as well as what remains for future spending.

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2011**

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

The financial statements also include notes that explain some of the information in the statements and provide more detailed data.

Figure A-1 shows how the various parts of this annual report are arranged and related to one another.



**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2011**

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

Figure A-2 summarizes the major features of the City's financial statements, including the portion of the City's activities they cover and the types of information they contain. The remainder of this overview section of management's discussion and analysis highlights the structure and contents of each of the statements.

**Figure A-2
Major Features of the City's Financial Statements**

Type of Statements	Government-Wide	Governmental Funds	Proprietary Funds
Scope	Entire City's government (except fiduciary funds).	The activities of the City that are not proprietary or fiduciary.	The activities of the City that operate similar to private businesses: water and sewer.
Required Financial Statements	Statement of net assets.	Balance sheet.	Statement of net assets.
	Statement of activities.	Statement of revenues, expenditures and changes in fund balance.	Statement of revenues, expenses, and changes in net assets and statement of cash flows.
Accounting Basis and Measurement Focus	Accrual accounting and economic resources focus.	Modified accrual accounting and current financial resources focus.	Accrual accounting and economic resources focus.
Type of Asset/Liability Information	All assets and liabilities, both financial and capital, short-term and long-term.	Only assets expected to be used up and liabilities that come due during the year or soon thereafter, no capital assets included.	All assets and liabilities, both financial and capital, and short-term and long-term.
Type of Inflow/Outflow Information	All revenues and expenses during year, regardless of when cash is received or paid.	Revenues for which cash is received during or soon after the end of the year, expenditures when goods or services have been received and payment is due during the year or soon thereafter.	All revenues and expenses during the year, regardless of when cash is received or paid.

City-Wide Statements

The City-wide statements report information about the City as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes all of the City's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two City-wide statements report the City's net assets and how they have changed. Net assets – the difference between the City's assets and liabilities – are one way to measure the City's financial health or position.

- ◆ Over time, increases or decreases in the City's net assets are an indicator of whether its financial position is improving or deteriorating, respectively.
- ◆ To assess the overall health of the City, you need to consider additional non-financial factors such as changes in the City's property tax base and the condition of City buildings and other facilities.

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2011**

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

City-Wide Statements (Continued)

In the City-wide financial statements the City's activities are shown in two categories:

- ◆ Governmental activities – The City's basic services are included here. Property taxes, special assessments and state aids finance most of these activities.
- ◆ Business-type activities – The City's enterprise fund operations are included here. Charges for services finance most of these activities.

Fund Financial Statements

The fund financial statements provide more detailed information about the City's funds – focusing on its most significant or “major” funds – not the City as a whole. Funds are accounting devices the City uses to keep track of specific sources of funding and spending on particular programs:

- ◆ Some funds are required by state law and by bond covenants.
- ◆ The City establishes other funds to control and manage money for particular purposes (e.g., repaying its long-term debts) or to show that it is properly using certain revenues (e.g., federal grants).

The City has two kinds of funds:

- ◆ Governmental funds – The City's basic services are included in governmental funds, which generally focus on (1) how cash and other financial assets that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps to determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs. Because this information does not encompass the additional long-term focus of the City-wide statements, we provide additional information after the governmental funds statements that explain the relationship (or differences) between them.
- ◆ Proprietary funds – The City reports three proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses enterprise funds to account for its water and sewer utilities. Proprietary fund financial statements provide the same type of information as the government-wide financial statements, only in more detail.

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2011**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

Net Assets

The City's total net assets were \$8,865,432 on December 31, 2011 (see Table A-1).

**Table A-1
The City's Net Assets**

	Governmental Activities		Business-Type Activities		Total	
	2011	2010	2011	2010	2011	2010
Current and Other Assets	\$ 2,206,890	\$ 1,826,327	\$ 1,448,637	\$ 1,259,906	\$ 3,655,527	\$ 3,086,233
Capital and Noncurrent Assets	5,450,062	5,691,909	2,099,487	2,186,794	7,549,549	7,878,703
Total Assets	7,656,952	7,518,236	3,548,124	3,446,700	11,205,076	10,964,936
Current Liabilities	198,950	230,216	230,235	224,252	429,185	454,468
Long-Term Liabilities	496,440	572,708	1,414,019	1,441,450	1,910,459	2,014,158
Total Liabilities	695,390	802,924	1,644,254	1,665,702	2,339,644	2,468,626
Net Assets						
Invested in Capital Assets, Net of Related Debt	4,966,411	5,123,267	671,289	734,795	5,637,700	5,858,062
Restricted	71,481	82,053	-	-	71,481	82,053
Unrestricted	1,923,670	1,509,992	1,232,581	1,046,203	3,156,251	2,556,195
Total Net Assets	\$ 6,961,562	\$ 6,715,312	\$ 1,903,870	\$ 1,780,998	\$ 8,865,432	\$ 8,496,310

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2011**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONTINUED)

Changes in Net Assets

The City-wide total revenues were \$2,655,686 the year ended December 31, 2011. Property taxes and intergovernmental revenues accounted for 67% of total revenue for the year (see Table A-2).

Table A-2
Change in Net Assets

	Governmental Activities		Total % Change	Business-Type Activities		Total % Change	Total		Total % Change
	2011	2010		2011	2010		2011	2010	
REVENUES									
Program Revenues									
Charges for Services	\$ 314,994	\$ 356,603	(11.7)%	\$ 465,464	\$ 445,341	4.5 %	\$ 780,458	\$ 801,944	(2.7)%
Operating Grants and Contributions	183,378	93,608	95.9	-	-	-	183,378	93,608	95.9
Capital Grants and Contributions	75,372	37,261	102.3	-	-	-	75,372	37,261	102.3
General Revenues									
Property Taxes	1,512,450	1,409,071	7.3	-	-	-	1,512,450	1,409,071	7.3
Unrestricted State Aid	3,367	4,204	(19.9)	-	-	-	3,367	4,204	(19.9)
Investment Earnings	14,767	21,080	(29.9)	10,323	14,853	(30.5)	25,090	35,933	(30.2)
Other	71,771	53,328	34.6	3,800	3,600	5.6	75,571	56,928	32.7
Total Revenues	2,176,099	1,975,155	10.2	479,587	463,794	3.4	2,655,686	2,438,949	8.9
EXPENSES									
General Government	486,359	498,774	(2.5)	-	-	-	486,359	498,774	(2.5)
Public Safety	845,715	908,500	(6.9)	-	-	-	845,715	908,500	(6.9)
Highways and Streets	446,630	404,786	10.3	-	-	-	446,630	404,786	10.3
Sanitation	11,906	10,884	9.4	-	-	-	11,906	10,884	9.4
Water	-	-	-	233,980	241,171	(3.0)	233,980	241,171	(3.0)
Sewer	-	-	-	117,544	146,478	(19.8)	117,544	146,478	(19.8)
Stormsewer	-	-	-	-	261,324	(100.0)	-	261,324	(100.0)
Culture and Recreation	53,486	51,691	3.5	-	-	-	53,486	51,691	3.5
Economic Development	69,347	116,684	(40.6)	-	-	-	69,347	116,684	(40.6)
Interest	21,597	25,055	(13.8)	-	-	-	21,597	25,055	(13.8)
Total Expenses	1,935,040	2,016,374	(4.0)	351,524	648,973	(45.8)	2,286,564	2,665,347	(14.2)
TRANSFERS IN (OUT)	5,191	261,121	(98.0)	(5,191)	(259)	(1904.2)	-	260,862	(100.0)
CHANGE IN NET ASSETS	246,250	219,902	12.0	122,872	(185,438)	(166.3)	369,122	34,464	971.0
Net Assets - Beginning of Year	6,715,312	6,495,410	3.4	1,780,998	1,966,436	(9.4)	8,496,310	8,461,846	0.4
NET ASSETS - END OF YEAR	<u>\$ 6,961,562</u>	<u>\$ 6,715,312</u>		<u>\$ 1,903,870</u>	<u>\$ 1,780,998</u>		<u>\$ 8,865,432</u>	<u>\$ 8,496,310</u>	

Total revenues surpassed expenses, increasing net assets \$369,122 over last year.

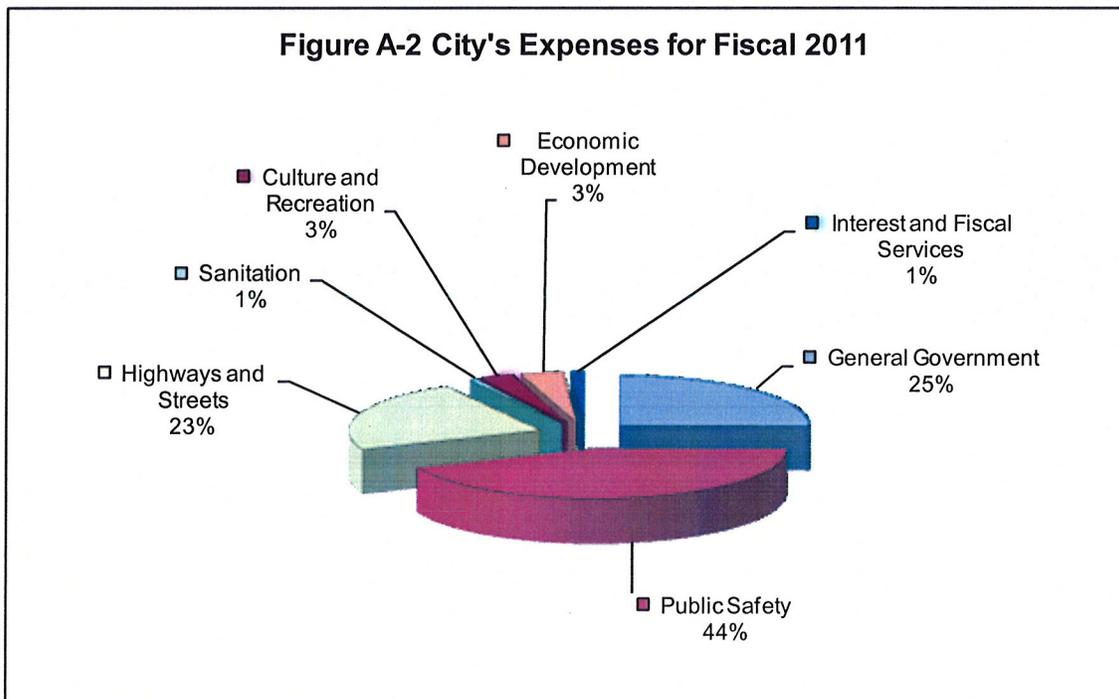
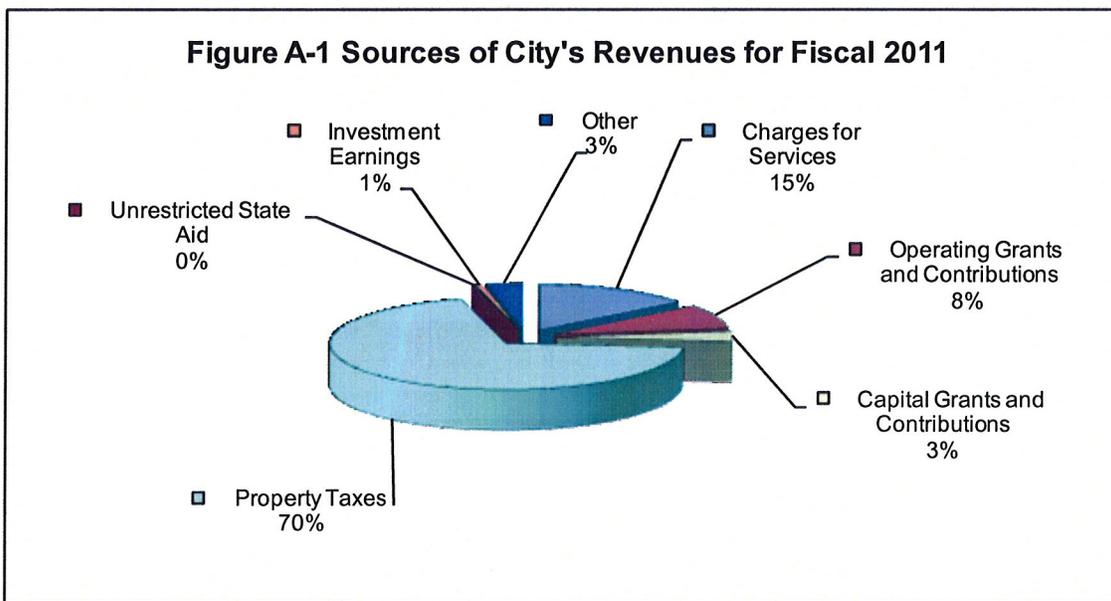
**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2011**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONTINUED)

Changes in Net Assets (Continued)

The City-wide cost of all governmental activities this year was \$1,935,040.

- ◆ Some of the cost was paid by the users of the City's programs \$314,994.
- ◆ The federal and state governments subsidized certain programs with grants and contributions \$258,750.
- ◆ The remainder of the City's governmental activities costs \$1,361,296, however, were paid for by City taxpayers and the taxpayers of our state.



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**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2011**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE (CONTINUED)

Changes in Net Assets (Continued)

**Table A-3
Total and Net Cost of Services**

	Total Cost of Services		Percentage Change	Net (Revenue) Cost of Providing Services		Percentage Change
	2011	2010		2011	2010	
GOVERNMENTAL ACTIVITIES						
General Government	\$ 486,359	\$ 498,774	(2.5)%	\$ 445,564	\$ 420,784	5.9 %
Public Safety	845,715	908,500	(6.9)	445,164	578,165	(23.0)
Highways and Streets	446,630	404,786	10.3	420,486	403,522	4.2
Sanitation	11,906	10,884	9.4	(11,543)	(4,585)	151.8
Culture and Recreation	53,486	51,691	3.5	(15,094)	3,502	(531.0)
Economic Development	69,347	116,684	(40.6)	55,122	102,459	(46.2)
Interest	21,597	25,055	(13.8)	21,597	25,055	(13.8)
Total	<u>\$ 1,935,040</u>	<u>\$ 2,016,374</u>	(4.0)	<u>\$ 1,361,296</u>	<u>\$ 1,528,902</u>	(11.0)
BUSINESS-TYPE ACTIVITIES						
Water	\$ 233,980	\$ 241,171	(3.0)%	\$ (6,876)	\$ 6,671	(203.1)%
Sewer	117,544	146,478	(19.8)	(107,064)	(64,363)	66.3
Stormsewer	-	261,324	(100.0)	-	261,324	(100.0)
Total	<u>\$ 351,524</u>	<u>\$ 648,973</u>	(45.8)	<u>\$ (113,940)</u>	<u>\$ 203,632</u>	(156.0)

FINANCIAL ANALYSIS OF THE CITY AT THE FUND LEVEL

The financial performance of the City is reflected in its governmental funds as well. As the City completed the year, its governmental funds reported a combined fund balance of \$1,911,686.

Revenues for the City's governmental funds were \$2,141,270, while total expenditures were \$1,774,988.

The General Fund's fund balance increased \$285,991 from the prior year. This is due primarily to a increase in tax revenues and decrease in capital outlay expenditures relating to highways and streets.

The Fire Fund's fund balance increased \$41,454 from the prior year, due to an increase in fire contract revenue and the recognition of fire state aid.

The Business Park Fund's fund balance increased \$19,642 from the prior year, because there were minimal business park expenditures.

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2011**

FINANCIAL ANALYSIS OF THE CITY AT THE FUND LEVEL (CONTINUED)

The Water Enterprise Fund's net assets increased \$9,663 from the prior year. This is due primarily to the increase in water revenue.

The Sewer Enterprise Fund's net assets increased \$113,209. This increase is due to an increase in sewer sales revenue, debt payoff, and department reorganization.

GENERAL FUND

The following schedule presents a summary of General Fund Revenues:

**Table A-4
General Fund Revenues**

	Year Ended		Change	
	December 31,	December 31,	Increase	Percent
	2011	2010	(Decrease)	
Taxes and Specials	\$ 1,399,415	\$ 1,338,995	\$ 60,420	4.5 %
Intergovernmental	134,730	91,685	43,045	46.9
Charges for Services	93,798	118,121	(24,323)	(20.6)
Interest	9,773	13,972	(4,199)	(30.1)
Miscellaneous	143,123	131,776	11,347	8.6
Total General Fund Revenue	<u>\$ 1,780,839</u>	<u>\$ 1,694,549</u>	<u>\$ 86,290</u>	5.1

Total General Fund revenue increased by \$86,290, or (5%), from the previous year. This is due primarily to an increase in tax revenues and intergovernmental revenue.

The following schedule presents a summary of General Fund Expenditures:

**Table A-5
General Fund Expenditures**

	Year Ended		Change	
	December 31,	December 31,	Increase	Percent
	2011	2010	(Decrease)	
General Government	\$ 406,898	\$ 436,416	\$ (29,518)	(6.8)%
Public Safety	667,664	727,298	(59,634)	(8.2)
Highways and Streets	278,897	468,172	(189,275)	(40.4)
Sanitation	13,128	10,884	2,244	20.6
Culture and Recreation	35,472	54,099	(18,627)	(34.4)
Economic Development	3,475	1,179	2,296	194.7
Debt Service	98,680	53,215	45,465	85.4
Total Expenditures	<u>\$ 1,504,214</u>	<u>\$ 1,751,263</u>	<u>\$ (247,049)</u>	(14.1)

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2011**

GENERAL FUND (CONTINUED)

General Fund Budgetary Highlights

Over the course of the year, the City did not revise the annual operating budget. Historically, the City has not made budget amendments during the year.

- ◆ Actual revenues were \$110,624 more than expected due to an increase in charges for services, intergovernmental revenue, gifts and contributions received to pay off debt, and miscellaneous revenue.
- ◆ The actual expenditures were \$141,001 less than budgeted due to budgeted capital outlays in the highways and streets that did not occur.

CONSTRUCTION PROJECTS AND DEBT SERVICE

Tax revenues and charges for utility services are used to fund the bond payments for all previous bond issues. The City did not have any major construction projects in 2011.

CAPITAL ASSETS

By the end of 2011, the City had invested approximately \$13,700,000 in a broad range of capital assets, including buildings, computers, improvements, equipment, and infrastructure. (See Table A-6). (More detailed information about capital assets can be found in Note 3.A.2 to the financial statements.) Total depreciation expense for the year was \$410,059 (including the enterprise funds).

Table A-6
The City's Capital Assets

	Governmental Activities		Percent Change	Business-Type Activities		Percent Change	Total		Percent Change
	2011	2010		2011	2010		2011	2010	
Land	\$ 535,893	\$ 535,893	- %	\$ 178,167	\$ 178,167	- %	\$ 714,060	\$ 714,060	- %
Construction-in-Progress	28,757	-	100.0	-	-	-	28,757	-	100.0
Infrastructure	4,925,170	4,925,170	-	393,117	393,117	-	5,318,287	5,318,287	-
Buildings	1,488,758	1,488,758	-	1,088,469	1,088,469	-	2,577,227	2,577,227	-
Machinery, Equipment, and Vehicles	1,715,073	1,677,434	2.2	3,411,893	3,411,893	-	5,126,966	5,089,327	0.7
Less: Accumulated Depreciation	(3,243,589)	(2,935,346)	10.5	(2,972,159)	(2,884,852)	3.0	(6,215,748)	(5,820,198)	6.8
Total	\$ 5,450,062	\$ 5,691,909	(4.2)	\$ 2,099,487	\$ 2,186,794	(4.0)	\$ 7,549,549	\$ 7,878,703	(4.2)

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2011**

LONG-TERM LIABILITIES

At year-end, the City had \$2,012,850 (net of related discounts and premiums) in long-term liabilities outstanding.

- ◆ The City's governmental activities total long-term debt decreased \$81,775 due primarily to paying off a capital lease and the taxable library revenue bonds. The City's business-type activities total long-term debt decreased \$28,146 due primarily to the repayment of general obligation bonds in 2011. Additional information on the City's long-term liabilities can be found in note 3 on pages 40-44.

**Table A-7
The City's Long-Term Liabilities**

	2011	2010	Percentage Change
GOVERNMENTAL ACTIVITIES			
Equipment Certificates	\$ 102,000	\$ 115,000	(11.3)%
Capital Leases	317,276	365,526	(13.2)
Loans Payable	35,617	52,338	(31.9)
Taxable Revenue Bonds Payable	-	35,778	(100.0)
Compensated Absences Payable	36,091	33,363	8.2
Other Postemployment Benefit Payable	82,664	53,418	54.7
Total	<u>\$ 573,648</u>	<u>\$ 655,423</u>	(12.5)
BUSINESS-TYPE ACTIVITIES			
General Obligation Bonds	\$ 1,428,198	\$ 1,451,999	(1.6)%
Compensated Absences Payable	366	5,930	(93.8)
Other Postemployment Benefit Payable	10,638	9,419	12.9
Total	<u>\$ 1,439,202</u>	<u>\$ 1,467,348</u>	(1.9)

FACTORS BEARING ON THE CITY'S FUTURE

Highway 371 Expansion

Municipal consent was granted in December 2010 for the Highway 371 expansion project. The highway will go around the City of Pequot Lakes with an entrance on County Road 11. The Highway expansion project is expected to begin in 2018.

County Road 11 Project

The Highway 371 ramp entrance onto County Road 11 will create a major entrance into the City of Pequot Lakes. The Council and Planning Commission are aware of the fact that improvements will be necessary on County Road 11 to create an aesthetically appealing entrance into the City. The planning for this future project has already begun.

**CITY OF PEQUOT LAKES, MINNESOTA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED DECEMBER 31, 2011**

FACTORS BEARING ON THE CITY'S FUTURE (CONTINUED)

Government Drive

The City began planning a major Government Drive improvement project in 2011. Following completion of the planning and public input process, the Council determined that the cost of the project was not feasible at the present time due to the state of the economy. The Council then authorized a scaled down version of the project. The project now consists of mainly road reconstruction and excludes most of the amenities such as sidewalks, planters, park benches, etc.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Sandy Peine, City Clerk-Treasurer, Nancy Malecha, Finance Administrator, or Nancy Adams, Mayor at (218) 568-5222.

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BASIC FINANCIAL STATEMENTS

GOVERNMENT-WIDE FINANCIAL STATEMENTS

CITY OF PEQUOT LAKES, MINNESOTA
STATEMENT OF NET ASSETS
DECEMBER 31, 2011

	Governmental Activities	Business-Type Activities	Total
ASSETS			
Cash and Pooled Investments	\$ 1,895,635	\$ 1,278,800	\$ 3,174,435
Petty Cash and Change Funds	1,636	-	1,636
Taxes Receivable			
Unapportioned	52,382	-	52,382
Delinquent	131,994	-	131,994
Special Assessments Receivable			
Delinquent	2,262	-	2,262
Deferred	850	619	1,469
Accounts Receivable, Net of Allowance	25,425	169,218	194,643
Accrued Interest Receivable	299	-	299
Due from Other Governments	3,142	-	3,142
Loans Receivable	67,481	-	67,481
Land Held for Resale	25,784	-	25,784
Capital Assets not Being Depreciated			
Land	535,893	178,167	714,060
Construction in Progress	28,757	-	28,757
Capital Assets Being Depreciated			
Building (Net)	1,114,657	41,465	1,156,122
Machinery, Vehicles, Furniture and Equipment (Net)	518,350	1,536,474	2,054,824
Infrastructure (Net)	3,252,405	343,381	3,595,786
Total Assets	7,656,952	3,548,124	11,205,076
LIABILITIES			
Accounts Payable	107,944	140,400	248,344
Salaries Payable	9,005	334	9,339
Due to Other Governments	1,515	50	1,565
Accrued Interest Payable	3,278	64,269	67,547
Compensated Absences Payable - Due Within One Year	16,447	310	16,757
Loans Payable - Due Within One Year	17,436	-	17,436
General Obligation Bonds Payable - Due Within One Year	-	24,872	24,872
Equipment Certificates - Due Within One Year	24,000	-	24,000
Capital Leases Payable - Due Within One Year	19,325	-	19,325
Compensated Absences Payable - Due in More than One Year	19,644	56	19,700
Loans Payable - Due in More than One Year	18,181	-	18,181
General Obligation Bonds Payable - Due in More than One Year	-	1,403,326	1,403,326
Equipment Certificates - Due in More than One Year	78,000	-	78,000
Capital Leases Payable - Due in More than One Year	297,951	-	297,951
Other Postemployment Benefits Payable - Due in More than One Year	82,664	10,637	93,301
Total Liabilities	695,390	1,644,254	2,339,644
NET ASSETS			
Invested in Capital Assets, Net of Related Debt	4,966,411	671,289	5,637,700
Restricted for Library	71,481	-	71,481
Unrestricted	1,923,670	1,232,581	3,156,251
Total Net Assets	\$ 6,961,562	\$ 1,903,870	\$ 8,865,432

See accompanying Notes to Financial Statements.

**CITY OF PEQUOT LAKES, MINNESOTA
STATEMENT OF ACTIVITIES
YEAR ENDED DECEMBER 31, 2011**

<u>Functions/Programs</u>	Program Revenues			
	Expenses	Fees, Charges, Fines, and Other	Operating Grants and Contributions	Capital Grants and Contributions
Primary Government				
Governmental Activities				
General Government	\$ 486,359	\$ 38,075	\$ 2,720	\$ -
Public Safety	845,715	257,522	143,029	-
Highways and Streets	446,630	-	-	26,144
Sanitation	11,906	449	23,000	-
Culture and Recreation	53,486	18,948	14,629	35,003
Economic Development	69,347	-	-	14,225
Interest	21,597	-	-	-
Total Governmental Activities	1,935,040	314,994	183,378	75,372
Business-Type Activities				
Water	233,980	240,856	-	-
Sewer	117,544	224,608	-	-
Total Business-Type Activities	351,524	465,464	-	-
Total Primary Government	\$ 2,286,564	\$ 780,458	\$ 183,378	\$ 75,372

General Revenues
 Property Taxes
 Grants and Contributions not Restricted for a Particular Purpose
 Investment Earnings
 Miscellaneous
 Gain on Sale of Capital Assets
 Transfers

 Total General Revenues and Transfers

CHANGE IN NET ASSETS

Net Assets - Beginning of Year

NET ASSETS - END OF YEAR

Net (Expense) Revenue and
Changes in Net Assets

Governmental Activities	Business-Type Activities	Total
\$ (445,564)	\$ -	\$ (445,564)
(445,164)	-	(445,164)
(420,486)	-	(420,486)
11,543	-	11,543
15,094	-	15,094
(55,122)	-	(55,122)
(21,597)	-	(21,597)
(1,361,296)	-	(1,361,296)
-	6,876	6,876
-	107,064	107,064
-	113,940	113,940
(1,361,296)	113,940	(1,247,356)
1,512,450	-	1,512,450
3,367	-	3,367
14,767	10,323	25,090
63,702	3,800	67,502
8,069	-	8,069
5,191	(5,191)	-
1,607,546	8,932	1,616,478
246,250	122,872	369,122
6,715,312	1,780,998	8,496,310
\$ 6,961,562	\$ 1,903,870	\$ 8,865,432

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FUND FINANCIAL STATEMENTS

**CITY OF PEQUOT LAKES, MINNESOTA
BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2011**

	Major Funds	
	General	Fire Department
ASSETS		
Cash and Pooled Investments	\$ 1,264,196	\$ 147,853
Petty Cash and Change Funds	1,636	-
Taxes Receivable		
Current	51,299	-
Delinquent	131,994	-
Special Assessments Receivable		
Delinquent	2,262	-
Deferred	-	850
Accounts Receivable, Net of Allowance	5,275	4,240
Accrued Interest Receivable	299	-
Due from Other Governments	3,142	-
Interfund Receivable	50,804	-
Land Held for Resale	-	-
Loans Receivable	-	-
Total Assets	\$ 1,510,907	\$ 152,943
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Accounts Payable	\$ 54,509	\$ 20,757
Due to Other Governments	1,515	-
Salaries Payable	9,005	-
Interfund Payable	-	-
Deferred Revenue - Unavailable	134,256	850
Total Liabilities	199,285	21,607
FUND BALANCES (DEFICITS)		
Restricted for Forfeiture	42	-
Restricted for Park Dedication	38,308	-
Restricted for Fire Protection Services	-	13,009
Restricted for Loans Receivable	-	-
Restricted for Other Governmental Funds	-	-
Committed for Library	71,481	-
Committed for Capital Outlay	354,500	63,874
Committed for Fire Protection Services	-	54,453
Committed for Business Park	-	-
Committed for Other Governmental Funds	-	-
Assigned for Bobber Water Tower	11,369	-
Unassigned	835,922	-
Total Fund Balances (Deficits)	1,311,622	131,336
Total Liabilities and Fund Balances	\$ 1,510,907	\$ 152,943

See accompanying Notes to Financial Statements.

Business Park	Other Governmental Funds	Total Governmental Funds
\$ 169,438	\$ 314,148	\$ 1,895,635
-	-	1,636
-	1,083	52,382
-	-	131,994
-	-	2,262
-	-	850
-	15,910	25,425
-	-	299
-	-	3,142
-	-	50,804
25,784	-	25,784
67,481	-	67,481
<u>\$ 262,703</u>	<u>\$ 331,141</u>	<u>\$ 2,257,694</u>

\$ -	\$ 32,678	\$ 107,944
-	-	1,515
-	-	9,005
-	50,804	50,804
25,784	15,850	176,740
<u>25,784</u>	<u>99,332</u>	<u>346,008</u>

-	-	42
-	-	38,308
-	-	13,009
67,481	-	67,481
-	48,858	48,858
-	-	71,481
-	-	418,374
-	-	54,453
169,438	-	169,438
-	245,571	245,571
-	-	11,369
-	(62,620)	773,302
<u>236,919</u>	<u>231,809</u>	<u>1,911,686</u>
<u>\$ 262,703</u>	<u>\$ 331,141</u>	<u>\$ 2,257,694</u>

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**CITY OF PEQUOT LAKES, MINNESOTA
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE
GOVERNMENT-WIDE STATEMENT OF NET ASSETS
GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2011**

FUND BALANCES - TOTAL GOVERNMENTAL FUNDS		\$ 1,911,686
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets, net of accumulated depreciation, used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.		5,450,062
Other long-term assets are not available to pay for current-period expenditures and, therefore, are deferred in the governmental funds.		176,740
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the governmental funds.		
Equipment Certificates	\$ (102,000)	
Loans Payable	(35,617)	
Capital Leases	(317,276)	
Compensated Absences	(36,091)	
Other Postemployment Benefits	(82,664)	
Accrued Interest Payable	(3,278)	
	(576,926)	(576,926)
NET ASSETS OF GOVERNMENTAL ACTIVITIES		\$ 6,961,562

See accompanying Notes to Financial Statements.

CITY OF PEQUOT LAKES, MINNESOTA
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
YEAR ENDED DECEMBER 31, 2011

	Major Funds	
	General Fund	Fire Department
REVENUES		
Taxes	\$ 1,398,996	\$ -
Special Assessments	419	250
Licenses and Permits	13,850	-
Intergovernmental	134,730	38,000
Charges for Services	93,798	177,230
Fines and Forfeits	26,690	-
Gifts and Contributions	49,332	1,402
Interest on Investments	9,773	1,239
Miscellaneous	53,251	10,226
Total Revenues	1,780,839	228,347
EXPENDITURES		
CURRENT		
General Government	402,087	-
Public Safety	618,956	150,788
Highways and Streets	278,897	-
Sanitation	13,128	-
Culture and Recreation	32,872	-
Economic Development	3,475	-
CAPITAL OUTLAY		
General Government	4,811	-
Public Safety	48,708	16,745
Culture and Recreation	2,600	-
DEBT SERVICE		
Principal	84,028	16,721
Interest	14,652	2,039
Total Expenditures	1,504,214	186,293
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	276,625	42,054
OTHER FINANCING SOURCES (USES)		
Transfers In	5,791	-
Transfers Out	-	(600)
Proceeds from Sale of Assets	3,575	-
Total Other Financing Sources (Uses)	9,366	(600)
NET CHANGE IN FUND BALANCES	285,991	41,454
Fund Balance (Deficit) - Beginning of Year	1,025,631	89,882
FUND BALANCE (DEFICIT) - END OF YEAR	\$ 1,311,622	\$ 131,336

See accompanying Notes to Financial Statements.

Business Park	Other Governmental Funds	Total Governmental Funds
\$ -	\$ 113,454	\$ 1,512,450
14,225	-	14,894
-	-	13,850
-	-	172,730
-	425	271,453
-	-	26,690
-	-	50,734
1,371	2,384	14,767
-	225	63,702
<u>15,596</u>	<u>116,488</u>	<u>2,141,270</u>
-	84	402,171
-	-	769,744
-	-	278,897
-	-	13,128
-	-	32,872
448	65,523	69,446
-	-	4,811
-	-	65,453
-	-	2,600
-	13,000	113,749
-	5,426	22,117
<u>448</u>	<u>84,033</u>	<u>1,774,988</u>
15,148	32,455	366,282
-	-	5,791
-	-	(600)
4,494	-	8,069
<u>4,494</u>	<u>-</u>	<u>13,260</u>
19,642	32,455	379,542
<u>217,277</u>	<u>199,354</u>	<u>1,532,144</u>
<u>\$ 236,919</u>	<u>\$ 231,809</u>	<u>\$ 1,911,686</u>

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**CITY OF PEQUOT LAKES, MINNESOTA
RECONCILIATION OF THE STATEMENTS OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO
THE GOVERNMENT-WIDE STATEMENT OF ACTIVITIES
GOVERNMENTAL ACTIVITIES
YEAR ENDED DECEMBER 31, 2011**

NET CHANGE IN FUND BALANCES - TOTAL GOVERNMENTAL FUNDS **\$ 379,542**

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

Governmental funds report capital outlay as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

Expenditures for General Capital Assets, Infrastructure, and Other Related Capital Assets Adjustments	\$ 81,666	
Current Year Depreciation	<u>(322,752)</u>	(241,086)

In the statement of activities, only the gain or loss on the disposal of capital assets are reported whereas in the governmental funds, the proceeds from the disposal increase financial resources. Therefore, the change in net assets differs from the change in fund balance by the net cost of the disposed capital assets. (3,779)

The fair value of capital asset donations are reported as revenues in the statement of activities, but are not in governmental funds. 3,018

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the governmental funds. 26,260

Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.

Principal Repayments		
Equipment Certificates	13,000	
Taxable Library Revenue Bonds	35,778	
Loans Payable	16,721	
Capital Leases	<u>48,250</u>	113,749

Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.

Change in Accrued Interest Payable	520	
Change in Compensated Absences	(2,728)	
Change in Other Postemployment Benefits	<u>(29,246)</u>	<u>(31,454)</u>

CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES **\$ 246,250**

**CITY OF PEQUOT LAKES, MINNESOTA
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
DECEMBER 31, 2011**

	Water Fund	Sewer Fund	Total
ASSETS			
CURRENT ASSETS			
Cash and Pooled Investments	\$ 702,852	\$ 575,948	\$ 1,278,800
Special Assessments			
Deferred	475	144	619
Accounts Receivable (Net)	84,473	84,745	169,218
Total Current Assets	<u>787,800</u>	<u>660,837</u>	<u>1,448,637</u>
NONCURRENT ASSETS			
Capital Assets			
Land	21,198	156,969	178,167
Building (Net)	-	41,465	41,465
Machinery, Vehicles, Furniture and Equipment (Net)	1,410,136	126,338	1,536,474
Infrastructure (Net)	85,554	257,827	343,381
Total Noncurrent Assets	<u>1,516,888</u>	<u>582,599</u>	<u>2,099,487</u>
Total Assets	2,304,688	1,243,436	3,548,124
LIABILITIES			
CURRENT LIABILITIES			
Accounts Payable	71,398	69,002	140,400
Salaries Payable	167	167	334
Due to Other Governments	25	25	50
Accrued Interest Payable	64,269	-	64,269
Compensated Absences Payable	155	155	310
General Obligation Bonds Payable - Due Within One Year	24,872	-	24,872
Total Current Liabilities	<u>160,886</u>	<u>69,349</u>	<u>230,235</u>
NONCURRENT LIABILITIES			
General Obligation Bonds Payable - Due in More than One Year	1,403,326	-	1,403,326
Compensated Absences Payable - Due in More than One Year	28	28	56
Other Postemployment Benefits Payable - Due in More than One Year	5,319	5,318	10,637
Total Noncurrent Liabilities	<u>1,408,673</u>	<u>5,346</u>	<u>1,414,019</u>
Total Liabilities	<u>1,569,559</u>	<u>74,695</u>	<u>1,644,254</u>
NET ASSETS			
Invested in Capital Assets, Net of Related Debt	88,690	582,599	671,289
Unrestricted	646,439	586,142	1,232,581
Total Net Assets	<u>\$ 735,129</u>	<u>\$ 1,168,741</u>	<u>\$ 1,903,870</u>

See accompanying Notes to Financial Statements.

CITY OF PEQUOT LAKES, MINNESOTA
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
PROPRIETARY FUNDS
YEAR ENDED DECEMBER 31, 2011

	Water Fund	Sewer Fund	Total
OPERATING REVENUES			
Charges for Services	\$ 232,408	\$ 223,856	\$ 456,264
Miscellaneous Operating	8,402	731	9,133
Total Operating Revenues	240,810	224,587	465,397
OPERATING EXPENSES			
Personal Services	24,505	24,503	49,008
Professional Services	23,789	22,052	45,841
Other Services and Charges	7,386	3,209	10,595
Supplies	11,291	8,463	19,754
Repairs and Maintenance	14,669	11,823	26,492
Utilities	14,097	13,851	27,948
Insurance	6,063	5,739	11,802
Dues and Subscriptions	4,520	2,980	7,500
Miscellaneous	438	282	720
Depreciation	62,953	24,354	87,307
Total Operating Expenses	169,711	117,256	286,967
OPERATING INCOME (LOSS)	71,099	107,331	178,430
NONOPERATING REVENUES (EXPENSES)			
Intergovernmental	21	21	42
Special Assessment Charges	25	-	25
Interest Income	5,725	4,598	10,323
Rent	-	3,800	3,800
Interest Expense	(64,269)	(288)	(64,557)
Total Nonoperating Revenues (Expenses)	(58,498)	8,131	(50,367)
CHANGE IN NET ASSETS BEFORE TRANSFERS	12,601	115,462	128,063
Transfers Out	(2,938)	(2,253)	(5,191)
CHANGE IN NET ASSETS	9,663	113,209	122,872
Net Assets - Beginning of Year	725,466	1,055,532	1,780,998
NET ASSETS - END OF YEAR	<u>\$ 735,129</u>	<u>\$ 1,168,741</u>	<u>\$ 1,903,870</u>

See accompanying Notes to Financial Statements.

**CITY OF PEQUOT LAKES, MINNESOTA
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
YEAR ENDED DECEMBER 31, 2011**

	Water Fund	Sewer Fund	Total
CASH FLOWS FROM OPERATING ACTIVITIES			
Receipts from Customers and Users	\$ 238,324	\$ 221,956	\$ 460,280
Payments to Suppliers	(76,727)	(64,787)	(141,514)
Payments to Employees	(27,362)	(27,360)	(54,722)
Net Cash Provided (Used) by Operating Activities	134,235	129,809	264,044
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Intergovernmental	21	21	42
Rent Deposits	-	3,800	3,800
Transfer Out	(2,938)	(2,253)	(5,191)
Net Cash Provided (Used) by Noncapital Financing Activities	(2,917)	1,568	(1,349)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Principal Paid on Long-Term Debt	(23,801)	-	(23,801)
Interest Paid on Long-Term Debt	(65,340)	(288)	(65,628)
Special Assessments	(436)	(133)	(569)
Net Cash Provided (Used) by Capital and Related Financing Activities	(89,577)	(421)	(89,998)
CASH FLOWS FROM INVESTING ACTIVITIES			
Investment Earnings Received	5,725	4,598	10,323
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS			
	47,466	135,554	183,020
Cash and Cash Equivalents - Beginning of Year	655,386	440,394	1,095,780
CASH AND CASH EQUIVALENTS - END OF YEAR			
	<u>\$ 702,852</u>	<u>\$ 575,948</u>	<u>\$ 1,278,800</u>
Reconciliation of Operating Income (Loss) to			
Net Cash Provided (Used) by Operating Activities			
Operating Income (Loss)	\$ 71,099	\$ 107,331	\$ 178,430
Adjustments to Reconcile Operating Income (Loss) to			
Net Cash Provided (Used) by Operating Activities			
Depreciation Expense	62,953	24,354	87,307
(Increase) Decrease in Accounts Receivable	(2,486)	(2,631)	(5,117)
Increase (Decrease) in Accounts Payable	5,626	3,712	9,338
Increase (Decrease) in Salaries Payable	(684)	(684)	(1,368)
Increase (Decrease) in Due to Other Governments	(100)	(100)	(200)
Increase (Decrease) in Compensated Absences Payable	(2,782)	(2,782)	(5,564)
Increase (Decrease) in Other Postemployment Benefits Payable	609	609	1,218
Total Adjustments	63,136	22,478	85,614
Net Cash Provided (Used) by Operating Activities	<u>\$ 134,235</u>	<u>\$ 129,809</u>	<u>\$ 264,044</u>

See accompanying Notes to Financial Statements.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Pequot Lakes' (City) financial statements are prepared in accordance with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (statements and interpretations). Governments are also required to follow the pronouncements of the Financial Accounting Standards Board (FASB) issued through November 30, 1989, (when applicable) that do not conflict with or contradict GASB pronouncements. Although the City has the option to apply FASB pronouncements issued after that date to its business-type activities and enterprise funds, the City has chosen not to do so. The more significant accounting policies established in GAAP and used by the City are discussed below.

A. Financial Reporting Entity

The City of Pequot Lakes was formed and operates pursuant to applicable Minnesota laws. The City operates under a Mayor-Council form of government with a full-time City Clerk-Treasurer and provides the following services: public safety (police and fire), public works, culture-recreation, public improvements, planning and zoning, and general administrative services. The City also operates public water and sewer utilities.

As required by generally accepted accounting principles, these financial statements present City of Pequot Lakes (primary government) and its component units for which the City is financially accountable. There is financial accountability if the Primary Government appoints a voting majority of an organization's governing body and has the ability to impose its will on that governing body; or there is the potential for the organization to provide specific financial benefits or to impose specific financial burden on the Primary Government. Based on the criteria for determining component units, the City is not required to include any component units.

B. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information about the Primary Government. These statements include the financial activities of the overall City government. Eliminations have been made to minimize the double-counting of internal activities. 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 to external parties for support.

The statement of activities demonstrates the degree to which the direct expenses of each function of the City's governmental activities and different business-type activity are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or activity. Program revenues include: (1) fees, fines, and charges paid by the recipients of goods, services, or privileges provided by a given function or activity; and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or activity. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Government-Wide and Fund Financial Statements (Continued)

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

The City reports the following major governmental funds:

General Fund - The General Fund is the general operating fund of the City. It accounts for all the financial resources of the general government, except those required to be accounted for in another fund.

Fire Department Fund - The Fire Fund, a special revenue fund, is used to account for charges for services, grants, and contributions that are restricted and committed for the operation and maintenance of the fire service to the City and surrounding areas.

Business Park Fund - The Business Park Fund, a special revenue fund, is used to account for special assessments and other revenue committed to the fund.

The City reports the following major proprietary funds:

Water Fund - The Water Fund accounts for the activities of the City's water wells' operations.

Sewer Fund - The Sewer Fund accounts for the activities of the City's sewer system.

C. Measurement Focus and Basis of Accounting

The government-wide and proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. The City considers all revenues to be available if they are collected within 60 days after the end of the current period. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, and compensated absences, which are recognized as expenditures to the extent that they have matured. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Measurement Focus and Basis of Accounting (Continued)

Property taxes, franchise taxes, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the government.

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.

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 revenue of the City's enterprise funds are charges to customers for sales of goods and services. Operating expenses for enterprise 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. Assets, Liabilities, and Net Assets or Equity

1. Cash and Investments (Including Cash Equivalents)

Cash balances are invested to the extent available in various securities as authorized by *Minnesota Statutes*. Investment earnings are recorded in the individual fund carrying the investment. Investments are stated at fair value.

Cash equivalents are considered to be short-term, highly liquid investments that are readily convertible to cash and have original maturities of three months or less.

For the purposes of the statement of cash flows of the proprietary fund types, the City considers all cash and investments under the classifications current assets to be cash and cash equivalents, except those held with fiscal agent. Cash and cash equivalents consist of checking and saving certificate accounts, cash on hand, and money market savings accounts.

2. Short-Term Interfund Receivables/Payables

During the course of operations, numerous transactions occur between individual funds for goods provided or services rendered. These receivables and payables are classified as "due from other funds" or "due to other funds" on the fund financial statements. Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as internal balances.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Assets, Liabilities, and Net Assets or Equity (Continued)

3. Accounts Receivable

The City has provided an allowance for uncollectable accounts receivable based on specific identification method. An allowance is estimated for these loans based on the historical experience of the City and knowledge of TIF District 1-13's operations. At December 31, 2011, the allowance for uncollectable accounts receivable in TIF 1-13 fund is \$47,550.

4. Special Assessments

Special assessments are levied against the benefited properties for the assessable costs of improvement projects in accordance with *Minnesota Statutes*. Assessments are collectible over a term of years at an interest rate established by the City Council upon adoption of each assessment roll. Any annual installments remaining unpaid as of November 30th of each year are certified to the County for collection with property taxes during the following year.

Special assessments receivable represents the past six years of uncollected special assessments. Property owners are allowed to prepay future installments without interest or prepayment penalties.

In the governmental fund financial statements, special assessment levies are recorded as a receivable and as deferred revenue at the time of the levy. Deferred revenue is recognized as current revenue as the annual assessment installments become measurable and available. Interest on special assessments is also recognized when it becomes measurable and available.

5. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items) are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. In the case of the initial capitalization of infrastructure, the City retroactively implemented the reporting of this item when GASB #34 was implemented. Capital assets are defined by the government as assets with an initial, individual cost of more than \$2,500 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. 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. 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, when applicable, is included as part of the capitalized value of the assets constructed.

**CITY OF PEQUOT LAKES, MINNESOTA
 NOTES TO THE FINANCIAL STATEMENTS
 DECEMBER 31, 2011**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Assets, Liabilities, and Net Assets or Equity (Continued)

5. Capital Assets (Continued)

Capital assets of the Primary Government are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings	25-75
Infrastructure	15-75
Machinery, Furniture, and Equipment	3-15

6. Compensated Absences

Compensated absences include accumulated vacation, compensatory time, and sick leave. All full time employees of the City are entitled to annual vacation and sick leave with pay. Employees are allowed to accumulate 120 hours of vacation time to carry over to the following year. Employees earn vacation from 40 to 160 hours per year, depending on length of service. Sick leave of one day per month is earned with a 960 hour maximum. Upon retirement the employee is paid for all accumulated, unused vacation and a portion of the unused sick leave. Unused sick leave is paid out at termination for full-time employees as follows: 10% of total unused sick leave if five to nine years of service and 25% of unused sick leave if more than ten years of service with the City.

Compensated absences (including sick leave payments) are accrued when incurred in the government-wide financial statements. A liability and related expenditure for these amounts is reported in the governmental funds only if they have matured, for example, as a result of known employee resignations and retirements.

In the City's proprietary funds, amounts earned but unused for vacation leave and that portion of earned but unused sick leave estimated to be payable upon retirement are reflected under the accrual basis of accounting.

7. Other Postemployment Benefits

In the government-wide financial statements, and proprietary fund types in the fund financial statements, other postemployment benefit obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. These other postemployment benefit liabilities are an estimate based on an actuarial valuation.

8. Long-Term Obligations

In the government-wide financial statements, and proprietary fund types in the fund 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. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds or loans payable using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Assets, Liabilities, and Net Assets or Equity (Continued)

8. Long-Term Obligations (Continued)

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.

9. Fund Balance

At December 31, 2011, the City adopted Governmental Accounting Standards Board (GASB) Statement No. 54 *Fund Balance Reporting and Governmental Fund Type Definitions*.

In the fund financial statements, governmental funds report components of fund balance to provide information about fund balance availability for appropriation. Nonspendable fund balance represents amounts that are inherently nonspendable or assets that will never be converted to cash or will be converted to cash soon enough to affect the current period. Restricted fund balance represents amounts available for appropriation but intended for a specific use and is legally restricted by outside parties. Committed fund balance represents constraints on spending that the government imposes upon itself by high-level formal action prior to the close of the fiscal period. Assigned fund balance represents resources intended for spending for a purpose set by the government body itself or by some person or body delegated to exercise such authority in accordance with policy established by the board. Unassigned fund balance is the residual classification for the City's general fund and includes all spendable amounts not contained in the other classifications. It is the City's policy that at the end of each fiscal, the City will set aside fund balance in the general fund up to 50% of the following year's general fund budgeted expenditures for cash flow purposes.

10. Revenues

In the fund financial statements, property taxes are recognized to the extent they are collected and received in the current period or within 60 days after year-end. Portions paid by the State in the form of market value credit aid, and other state tax credits are included in intergovernmental revenues. Delinquent property taxes receivable which have not been recognized as revenue are equally offset in the financial statements by deferred revenues.

Licenses and permits, charges for services, fines, forfeits, and miscellaneous revenues are recorded as revenues when measurable and available.

Special assessments principal and interest earnings are recorded as revenues in the same manner as property taxes.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Revenues, Expenditures, and Expenses (Continued)

10. Revenues (Continued)

Property Tax Collection Calendar

The City levies its property taxes for the subsequent year during the month of December. In Minnesota, the lien date and assessment date is January 2. The property tax is recorded as revenue when it becomes available. Crow Wing County is the collecting agency for the levy and then remits the collection to the City. All taxes not collected as of December 31 are shown as delinquent taxes receivable.

The County Auditor prepares the tax list for all taxable property in the City, applying the applicable tax capacity rate to the tax capacity value of individual properties, to arrive at the actual tax for each property. The County Auditor also collects all special assessments, except for certain payments paid directly to the City.

The County Auditor provides a list of taxes and special assessments to be collected on each parcel of property to the County Treasurer in January of each year.

Property owners are required to pay one-half of their real estate taxes by May 15 and the balances by October 15.

Within 30 days after the May settlement, the County Treasurer is required to pay 70 percent of the estimated collections of taxes and special assessments to the City Treasurer. The County Treasurer must pay the balance to the City Treasurer within 60 days after the settlement, provided that after 45 days interest begins to accrue.

Current year property tax revenues represent the tax levy certified to the County Auditor in December of 2010 which was collected during the year ended December 31, 2011. Any adjustments or abatements to either the current, or any prior year, levy are adjusted through the current year general property tax revenues. Property taxes not collected by the County and remitted to the City within 60 days of year end are classified as delinquent and not considered measurable and available and are fully offset by deferred revenue in the governmental fund financial statements. Delinquent taxes receivable represent the past six years of uncollected tax years. No allowance for uncollectible taxes has been provided because such amounts are not expected to be material.

Within ten business days after November 15, the County Treasurer shall pay to each taxing district, except any school district, 100 percent of the estimated collections arising from taxes levied by and belonging to each taxing district from May 20 to November 20.

11. Expenditures

Expenditures recognition for governmental fund types includes only amounts represented by current liabilities. Since noncurrent liabilities do not affect net current assets, they are not recognized as governmental fund expenditures or liabilities. They are reported as liabilities on the statement of net assets.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Revenues, Expenditures, and Expenses (Continued)

12. Expenses

Proprietary funds recognize expenses, including compensated absences, when they are incurred.

NOTE 2 STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Deficit Fund Balance

The TIF 1-13 Lonesome Cottage Special Revenue Fund has a deficit fund balance as of December 31, 2011. The amount of the deficit is \$63,493 and is due to timing of when the expenditures occurred for this project and when the revenues will be received in the future. This deficit will be corrected through normal government operations as taxes are collected in the future.

NOTE 3 DETAILED NOTES ON ALL FUNDS

A. Assets

1. Deposits and Investments

The cash balances of substantially all funds are pooled by the City Clerk-Treasurer for the purpose of increasing earning through investment activities. Pooled and fund investments are reported at their fair value at December 31, 2011, based on market prices. Investment earnings on cash and pooled investments are credited to the general fund. In addition other funds received investment earnings based on other state statutes, grant agreements, contracts, and bond covenants.

Deposits and Investments In accordance with applicable Minnesota State Statutes, the City maintains deposits at financial institutions authorized by the City Council. All such deposits are members of the Federal Reserve System. *Minnesota Statutes* require that all deposits be protected by insurance, surety bond, or collateral. The market value of collateral pledged must equal 110% of the deposits not covered by insurance or corporate surety bonds.

Custodial Credit Risk – Deposits – In the case of deposits, custodial credit risk is the risk that in the event of bank failure, the City's deposits may not be returned to it. The City's deposit policy does not provide additional restrictions beyond Minnesota State Statutes to the type of risk.

Authorized collateral includes: U.S. government treasury bills, notes, and or bonds; issued of the U.S. government agency; general obligation of local government related "A" or better; revenue obligations of a state or local government rated "AA" or better; irrevocable standby letters of credit issued by a Federal Home Loan Bank; and time deposits insured by a federal agency. *Minnesota Statutes* required securities pledged as collateral be held in safekeeping in a restricted account at the Federal Reserve Bank or at an account at a trust department of a commercial bank or other financial institution not owned or controlled by the depository. As of December 31, 2011, no City deposits were subject to custodial credit risk.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

A. Assets (Continued)

1. Deposits and Investments (Continued)

Minnesota Statutes §§ 118A.04 and 118A.05 generally authorize the following types of investments as available to the City:

- a) securities which are direct obligations or are guaranteed or insured issues of the United States, its agencies, its instrumentalities, or organizations created by an act of Congress, except mortgage-backed securities defined as "high risk" by *Minnesota Statutes* §118A.04, subd. 6;
- b) mutual funds through shares of registered investment companies provided the mutual fund receives certain ratings depending on its investments;
- c) general obligations of the state of Minnesota and its municipalities, and in certain state agency and local obligations of Minnesota and other states provided such obligations have certain specified bond ratings by a national bond rating service;
- d) bankers' acceptances of United States banks;
- e) commercial paper issued by United States corporations or their Canadian subsidiaries that is rated in the highest quality category by two nationally recognized rating agencies and matures in 270 days or less; and
- f) with certain restrictions, in repurchase agreements, securities lending agreements, joint powers investment trusts, and guaranteed investment contracts.

At December 31, 2011, the City did not have any investments.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

A. Assets (Continued)

2. Capital Assets

Capital asset activity for the governmental activities of the City for the year ended December 31, 2011, is as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
Capital Assets, not Being				
Depreciated				
Land and Right of Way	\$ 535,893	\$ -	\$ -	\$ 535,893
Construction in Progress	-	28,757	-	28,757
Total Capital Assets not Being				
Depreciated	535,893	28,757	-	564,650
Capital Assets Being				
Depreciated				
Buildings	1,488,758	-	-	1,488,758
Machinery, Furniture, and				
Equipment	1,677,434	55,927	18,288	1,715,073
Infrastructure	4,925,170	-	-	4,925,170
Total Capital Assets Being				
Depreciated	8,091,362	55,927	18,288	8,129,001
Less: Accumulated				
Depreciation for				
Buildings	321,137	52,964	-	374,101
Machinery, Furniture, and				
Equipment	1,108,441	102,791	14,509	1,196,723
Infrastructure	1,505,768	166,997	-	1,672,765
Total Accumulated Depreciation	2,935,346	322,752	14,509	3,243,589
Total Capital Assets,				
Depreciated, Net	5,156,016	(266,825)	3,779	4,885,412
Governmental Activities Capital				
Assets, Net	\$ 5,691,909	\$ (238,068)	\$ 3,779	\$ 5,450,062

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

A. Assets (Continued)

2. Capital Assets (Continued)

The following is a summary of the proprietary fund capital assets for the year ended December 31, 2011:

	Beginning Balance	Additions	Deletions	Ending Balance
Capital Assets, not Being Depreciated				
Land	\$ 178,167	\$ -	\$ -	\$ 178,167
Capital Assets Being Depreciated				
Buildings	1,088,469	-	-	1,088,469
Machinery and Vehicles	3,411,893	-	-	3,411,893
Infrastructure	393,117	-	-	393,117
Total Capital Assets Being Depreciated	4,893,479	-	-	4,893,479
Less: Accumulated Depreciation for:				
Buildings	1,044,414	2,592	-	1,047,006
Machinery and Vehicles	1,803,393	72,024	-	1,875,417
Infrastructure	37,045	12,691	-	49,736
Total Accumulated Depreciation	2,884,852	87,307	-	2,972,159
Total Capital Assets, Depreciated, Net	2,008,627	(87,307)	-	1,921,320
Business-Type Activities Capital Assets, Net	\$ 2,186,794	\$ (87,307)	\$ -	\$ 2,099,487

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

A. Assets (Continued)

2. Capital Assets (Continued)

Depreciation expense was charged to functions/programs of the Primary Government as follows:

Governmental Activities		
General Government	\$	64,715
Public Safety		46,201
Highways and Streets, Including Depreciation of Infrastructure Assets		185,704
Culture and Recreation		26,132
Total Depreciation Expense - Governmental Activities	<u>\$</u>	<u>322,752</u>
Business-Type Activity		
Water Fund	\$	62,953
Sewer Fund		24,354
Total Depreciation Expense - Business-Type Activities	<u>\$</u>	<u>87,307</u>

B. Interfund Receivables, Payables, and Transfers

Transfer to	Transfer From	Amount	Reason
General Fund	Fire Fund	\$ 600	Transfer of Office Equipment
General Fund	Sewer Fund	2,253	Maintenance Department Services
General Fund	Water Fund	2,938	Maintenance Department Services
Total Interfund Transfers		<u>\$ 5,791</u>	

Receivable Fund	Payable Fund	Amount
Major Funds		
General	TIF 1-13 Lonesome Cottage	<u>\$ 50,804</u>

The above payable relates to a negative pooled cash balance.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

C. Liabilities

1. Long-Term Debt

General Obligation Bonds

The City issues general obligation bonds to provide funds for the acquisition and construction of major capital facilities including infrastructure. General obligation bonds have been issued for both general government and proprietary activities. Bonds issued to provide funds for proprietary activities are reported in proprietary funds if they are expected to be repaid from proprietary revenues.

General obligation bonds are direct obligations and pledge the full faith and credit of the City. Assets of the general fund and the enterprise funds, together with scheduled future ad valorem tax levies, tax increments and special assessments, are dedicated for the retirement of these bonds.

Equipment Certificates

The City issued \$115,000 of equipment certificates on May 12, 2010 to provide funds for the acquisition of four police cars. Repayment of the principal will be five annual installments, plus a fixed interest rate of 5%, commencing February 1, 2011.

Taxable Revenue Bonds

The City issued library taxable revenue bonds, Series 2009A and B to provide funds for the acquisition of a new library building. Donations received for the library are dedicated for the retirement of these bonds.

The Series 2009B Taxable Revenue Library Bonds are special limited obligations of the City, payable solely from and secured by a pledge of library donations to be received from various donors. The bonds do not constitute a debt or pledge of the faith and credit of the City and accordingly have not been reported in the accompanying financial statements. At December 31, 2011, the Series 2009B Taxable Revenue Library Bonds outstanding totaled \$6,000.

Capital Lease Obligations

The City issued capital leases for the City Hall building and the Chamber of Commerce building. Certain assets of the general fund, together with scheduled future ad valorem levies are dedicated for the retirement of these obligations.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

C. Liabilities (Continued)

2. Components of Long-Term Debt

Types of Indebtedness	Final Maturity	Installment Amounts	Interest Rates (%)	Original Issued Amount	Outstanding Balance December 31, 2011	Due Within One Year
Business-Type Activities						
Water Fund						
General Obligation Bonds of 2000	2040	\$20,000 - \$85,000	4.5%	\$ 1,625,000	\$ 1,428,198	\$ 24,872
Governmental Activities						
General Obligation Bonds						
Equipment Certificates, Series 2010	2015	\$13,000- \$27,000	5.0%	\$ 115,000	\$ 102,000	\$ 24,000
Loans						
American National Bank	2013	\$18,760	4.2%	151,300	35,617	17,436
Capital Leases						
City Hall Building	2024	\$34,583	4.25%	1,097,442	317,276	19,325
Total Governmental Activities Long-Term Debt				1,363,742	454,893	60,761
Total Long-Term Debt				<u>\$ 3,180,742</u>	<u>\$ 1,883,091</u>	<u>\$ 85,633</u>

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

C. Liabilities (Continued)

3. Changes in Long-Term Liabilities

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Governmental Activities:					
Equipment Certificates	\$ 115,000	\$ -	\$ 13,000	\$ 102,000	\$ 24,000
Taxable Library Revenue Bonds	35,778	-	35,778	-	-
Capital Leases	365,526	-	48,250	317,276	19,325
Loans Payable	52,338	-	16,721	35,617	17,436
Compensated Absences	33,363	81,596	78,868	36,091	16,447
Other Postemployment Benefits	53,418	29,685	439	82,664	-
Governmental Activities Long-Term Debt	<u>\$ 655,423</u>	<u>\$ 111,281</u>	<u>\$ 193,056</u>	<u>\$ 573,648</u>	<u>\$ 77,208</u>
Business-Type Activities:					
General Obligation Bonds	\$ 1,451,999	\$ -	\$ 23,801	\$ 1,428,198	\$ 24,872
Compensated Absences	5,930	6,311	11,875	366	310
Other Postemployment Benefits	9,419	1,237	18	10,638	-
Business-Type Activities Long-Term Debt	<u>\$ 1,467,348</u>	<u>\$ 7,548</u>	<u>\$ 35,694</u>	<u>\$ 1,439,202</u>	<u>\$ 25,182</u>

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

C. Liabilities (Continued)

4. Minimum Debt Payments

The annual requirements to amortize general obligation debt outstanding are as follows:

Year Ending December 31,	Business-Type Activities		
	General Obligation		
	Principal	Interest	Total
2012	\$ 24,872	\$ 64,269	\$ 89,141
2013	25,991	63,150	89,141
2014	27,160	61,980	89,140
2015	28,383	60,758	89,141
2016	29,660	59,481	89,141
2017-2021	169,561	276,141	445,702
2022-2026	211,302	234,393	445,695
2027-2031	263,324	182,379	445,703
2032-2036	328,150	117,554	445,704
2037-2041	319,795	36,769	356,564
Total	<u>\$1,428,198</u>	<u>\$1,156,874</u>	<u>\$ 2,585,072</u>

Year Ending December 31,	Governmental Activities					
	Capital Leases			Loans		
	Principal	Interest	Total	Principal	Interest	Total
2012	\$ 19,325	\$ 13,111	\$ 32,436	\$ 17,436	\$ 1,324	\$ 18,760
2013	20,162	12,273	32,435	18,181	579	18,760
2014	21,036	11,399	32,435	-	-	-
2015	21,948	10,488	32,436	-	-	-
2016	22,899	9,537	32,436	-	-	-
2017-2021	130,270	31,908	162,178	-	-	-
2022-2024	81,636	4,859	86,495	-	-	-
Total	<u>\$ 317,276</u>	<u>\$ 93,575</u>	<u>\$ 410,851</u>	<u>\$ 35,617</u>	<u>\$ 1,903</u>	<u>\$ 37,520</u>

Year Ending December 31,	Governmental Activities		
	Equipment Certificates		
	Principal	Interest	Total
2012	\$ 24,000	\$ 4,500	\$ 28,500
2013	25,000	3,275	28,275
2014	26,000	2,000	28,000
2015	27,000	675	27,675
2016	-	-	-
2017-2021	-	-	-
2022-2026	-	-	-
Total	<u>\$ 102,000</u>	<u>\$ 10,450</u>	<u>\$ 112,450</u>

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 3 DETAILED NOTES ON ALL FUNDS (CONTINUED)

C. Liabilities (Continued)

4. Minimum Debt Payments (Continued)

At year-end, included in capital assets related to these capital leases are assets recorded at \$1,056,200 for the City Hall building and \$142,663 for the Chamber building. There was accumulated depreciation of \$282,911 for the City Hall and \$53,499 for the Chamber building.

5. Operating Leases

The City leases a copier and a postage machine under operating leases. Total costs for these leases were \$6,139 for the year ended December 31, 2011. The future minimum lease obligations as of December 31, 2011, were as follows:

<u>Year Ended</u>	<u>Amount</u>
2012	\$ 5,726
2013	1,122
Total	<u>\$ 6,848</u>

NOTE 4 RISK MANAGEMENT

The City is exposed to various risks of loss related to: torts, theft of, damage to, or destruction of assets; errors or omissions; injuries to employees; or natural disasters. The City has entered into a joint powers agreement with the League of Minnesota Cities Insurance Trust (LMCIT). The LMCIT is a public entity risk pool currently operating as common risk management and insurance program for Minnesota cities. The agreement for formation of the LMCIT provides that the pool will be self-sustaining through member assessments and will reinsure through commercial companies for claims in excess of reserved amounts for each insured event. The pool can make additional assessments to make the pool self-sustaining. The City has determined that it is not possible to estimate the amount of such additional assessments; however, they are not expected to be material to the financial statements.

The City also carries commercial insurance for certain other risks of loss, including employee health insurance. There were no significant reductions in insurance coverage from the previous year or settlements in excess of insurance coverage for any of the past three fiscal years.

NOTE 5 RELATED-PARTY TRANSACTION

Two council member's spouses purchased portions of the Series 2009B Taxable Library Revenue Bonds, totaling \$45,000. The City will repay these individuals, interest free, as library donations become available. As of December 31, 2011, the amount remaining on these bonds is \$6,000.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 6 PENSION PLANS

A. Public Employees Retirement Association

Plan Description

All full-time and certain part-time employees of the City of Pequot Lakes are covered by defined benefit plans administered by the Public Employees Retirement Association of Minnesota (PERA). The PERA administers the General Employees Retirement Fund (GERF) and the Public Employees Police and Fire Fund (PEPFF) which are a cost-sharing, multiple-employer retirement plans. The plan is established and administered in accordance with *Minnesota Statutes*, Chapters 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. All police officers, fire-fighters and peace officers who qualify for membership by statute are covered by the PEPFF.

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 ten 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 ten 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 PEPFF members, the annuity accrual rate is 3.0 percent for each year of service. For all PEPFF members and 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 55 for PEPFF and 65 for Basic and Coordinated members hired prior to July 1, 1989. Normal retirement age is the age for unreduced Social Security benefits capped at 66 for Coordinated members hired on or after July 1, 1989. A reduced retirement annuity is also available to eligible members seeking early retirement.

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

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 6 PENSION PLANS (CONTINUED)

A. Public Employees Retirement Association (Continued)

Plan Description (Continued)

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 and PEPFF. 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 (651) 296-7460 or 1-800-652-9026.

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. PEPFF members are required to contribute 9.6% of their annual covered salary in 2011. The City of Pequot Lakes is required to contribute the following percentages of annual covered payroll: 11.78% for Basic Plan GERF members, 7.25% for Coordinated Plan GERF members and 14.4% for PEPFF members. The City's contributions to the General Employees Retirement Fund and the Public Employees Police and Fire Fund for the years ending December 31, 2011, 2010, and 2009 were:

	General Employees Retirement Fund	Public Employees Police and Fire Fund
2011	\$ 22,625	\$ 39,359
2010	25,800	41,908
2009	25,006	44,015

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

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 6 PENSION PLANS (CONTINUED)

B. Defined Contribution Plan

Three elected officials of the City are 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 the employee and employer contribution rates for those qualified personnel who elect to participate. An eligible elected official who decides to participate contributes 5% of salary which is matched by the elected official's employer. Employees who are paid for their 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% of employer contributions and twenty-five hundredths of one percent of the assets in each member's account annually.

The employer's contribution amounts for the years ending December 31, 2011, 2010, and 2009 were \$474, \$894, and \$933, respectively, equal to the contractually required contributions for each year as set by state statute.

C. Pequot Lakes Fire Department Relief Association

Plan Description

The Public Employee Retirement System (PERS) Plan is a single-employer defined benefit pension plan administered by the Pequot Lakes Fire Department Relief Association. The Plan provides retirement, disability, and death benefits to plan members and beneficiaries. Benefits are established by state statute. The Pequot Lakes Fire Department issues a publicly available financial report that includes financial statements and required supplementary information for the plan. That report may be obtained by contacting the City's Fire Department.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 6 PENSION PLANS (CONTINUED)

C. Pequot Lakes Fire Department Relief Association (Continued)

Funding Policy

Minnesota Statutes specify minimum contributions that may be required from the City on an annual basis. These minimum contributions are determined based on the amount required to meet the normal cost plus amortizing any prior year's service cost over a ten year period. A contribution was not required from the City for the year ended December 31, 2011. The Pequot Lakes Fire Department Relief Association also receives funding from the State of Minnesota as a two percent fire premium tax. The City receives the contributions and is required by statute to pass this through as payment to the Fire Relief Association. Investment earnings also add to the resources available for benefits.

Annual Pension Cost and Net Pension Obligation

The City's annual pension cost and net pension obligation to PERS for the current year were as follows:

Annual Required Contribution	\$ -
Interest on Net Pension Obligation	-
Adjustment to Annual Required Contribution	<u>35,500</u>
Annual Pension Cost	35,500
Less Contribution Made	<u>(35,500)</u>
Increase (Decrease) in Net Pension Obligation	-
Net Pension Obligation - Beginning of Year	<u>-</u>
Net Pension Obligation - End of Year	<u><u>\$ -</u></u>

The annual required contribution for the current year was determined as part of December 31, 2010, actuarial valuation using the entry age actuarial cost method. The actuarial assumptions included (a) 5% investment rate of return and (b) age and service retirement was assumed to occur at age 50. Pension benefit obligations on an actuarial basis are not calculated for individual volunteer fire relief associations since state statutes permit alternate calculation of required reserves based on overall actuarial assumptions.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 6 PENSION PLANS (CONTINUED)

C. Pequot Lakes Fire Department Relief Association (Continued)

The City's net pension obligation for the Fire Relief Association (Association) for the years ended December 31, 2011, 2010, and 2009 are as follows:

<u>December 31,</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
2011	\$ 35,500	100.0 %	N/A
2010	53,671	100.0	N/A
2009	30,399	100.0	N/A

Contributions Required and Made

The City makes contributions to the Association annually in an amount equal to the fire aid received from the State of Minnesota as required by state statutes. The City is required to make additional contributions to the Association in the following year if the following years anticipated administrative expenses plus the anticipated increase in the required reserves plus amortization of the original unfunded accrued liability exceeds the anticipated revenues. The City was required to make a contribution in excess of fire aid for 2010 in the amount of \$14,384 and none for 2011 or 2009.

Funding Progress

As of December 31, 2010 (the most recent available information), the plan was overfunded by \$132,072. Additional information on the funding progress is included in the required supplementary information section of this report.

Related-Party Investments

As of December 31, 2010 (the most recent information available) and for the year then ended, the Association held no securities issued by the City or other related-parties.

D. OPEB Disclosure

The City provides health insurance benefits for certain retired employees under a single-employer fully-insured plan. The City provides benefits for retirees as required by *Minnesota Statutes* §471.61 subdivision 2b. Active employees who retire from the City when eligible to receive a retirement benefit from the Public Employees Retirement Association (PERA) of Minnesota (or similar plan) and do not participate in any other health benefits program providing coverage similar to that herein described, will be eligible to continue coverage with respect to both themselves and their eligible dependent(s) under the City's health benefits program. Pursuant to the provisions of the plan, retirees are required to pay varying percentages of the total premium cost. As of January 1, 2009, no retirees were receiving health benefits from the City's health plan.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 6 PENSION PLANS (CONTINUED)

D. OPEB Disclosure

1. Annual OPEB Cost and Net OPEB Obligation

The City's annual other post employment benefit (OPEB) cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of fund that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The following table shows the components of the City's annual OPEB cost for 2011, the amount actually contributed to the plan, and changes in the City's net OPEB obligation:

Annual Required Contribution	\$ 31,899
Interest on Net OPEB Obligation	2,828
Adjustment to ARC	<u>(4,262)</u>
Annual OPEB Cost	30,465
Contributions During the Year	<u>-</u>
Increase in Net OPEB Obligation	30,465
Net OPEB - Beginning of Year	<u>62,837</u>
Net OPEB - End of Year	<u><u>\$ 93,302</u></u>
Governmental Activities	\$ 82,664
Business-Type Activities	<u>10,638</u>
Total OPEB Payable	<u><u>\$ 93,302</u></u>

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 6 PENSION PLANS (CONTINUED)

D. OPEB Disclosure (Continued)

1. Annual OPEB Cost and Net OPEB Obligation (Continued)

The City's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for December 31, 2011 and 2010 were as follows:

Year Ended	Annual OPEB Cost	Employer Contribution	Percentage Contributed	Net OPEB Obligation
December 31, 2011	\$ 30,465	\$ -	- %	\$ 93,302
December 31, 2010	31,099	-	-	62,837
December 31, 2009	31,738	-	-	31,738

2. Funding Status and Funding Progress

The City currently has no assets that have been deposited into an irrevocable trust for future health benefits. Therefore, the actuarial value of assets is zero. No separate stand-alone financial report is issued for this plan.

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
1/1/2009	\$ -	\$ 118,698	\$ 118,698	- %	\$ 616,864	19.2%

The schedule of funding progress, presented as required supplementary information following the notes to the basic financial statements presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

3. Actuarial Methods and Assumptions

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of the occurrence of events far into the future. Examples include assumptions about future employment, mortality, and healthcare cost trends. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

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

**CITY OF PEQUOT LAKES, MINNESOTA
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2011**

NOTE 6 PENSION PLANS (CONTINUED)

D. OPEB Disclosure (Continued)

3. Actuarial Methods and Assumptions (Continued)

In the January 1, 2009 actuarial valuation, the entry age normal actuarial cost method was used. The actuarial assumptions included a 4.50% discount rate, which is based on the estimated long-term investment yield on the general assets of the City using an underlying long-term inflation assumption of 3.00%. The annual healthcare cost trend rate is 9.00% initially, reduced incrementally to an ultimate rate of 5.00% after eight years. The unfunded actuarial accrued liability is being amortized as a level dollar amount over a closed 30-year period.

NOTE 7 RELATED-ORGANIZATION

The Pequot Lakes Fire Relief Association (Association) is excluded from the financial reporting entity because the City's financial accountability does not extend beyond making appointments. The purpose of the Association is to provide lump-sum retirement benefits for City firefighters. The City has no significant influence over the management, budget, or policies of the association. Audited financial statements are available from the Association.

**CITY OF PEQUOT LAKES, MINNESOTA
BUDGETARY COMPARISON SCHEDULE
GENERAL FUND
YEAR ENDED DECEMBER 31, 2011**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
REVENUES				
Taxes	\$ 1,428,645	\$ 1,428,645	\$ 1,398,996	\$ (29,649)
Special Assessments	1,400	1,400	419	(981)
Licenses and Permits	14,350	14,350	13,850	(500)
Intergovernmental	61,200	61,200	134,730	73,530
Charges for Services	87,250	87,250	93,798	6,548
Fines and Forfeits	28,200	28,200	26,690	(1,510)
Gifts and Contributions	25,200	25,200	49,332	24,132
Investment Earnings	14,000	14,000	9,773	(4,227)
Miscellaneous	9,970	9,970	53,251	43,281
Total Revenues	1,670,215	1,670,215	1,780,839	110,624
EXPENDITURES				
CURRENT				
GENERAL GOVERNMENT				
Council	26,495	26,495	33,441	(6,946)
Clerk	193,820	193,820	187,109	6,711
Planning and Zoning	97,180	97,180	90,415	6,765
Buildings and Plant	33,880	33,880	32,474	1,406
Other General Government	61,860	61,860	58,648	3,212
Total General Government	413,235	413,235	402,087	11,148
PUBLIC SAFETY				
Police	524,670	524,670	546,580	(21,910)
Fire	77,300	77,300	72,060	5,240
Civil Defense	790	790	316	474
Total Public Safety	602,760	602,760	618,956	(16,196)
HIGHWAYS AND STREETS				
Public Works	219,100	219,100	258,967	(39,867)
Street Lighting	14,400	14,400	13,552	848
Traffic Signs and Signals	7,050	7,050	6,378	672
Total Highways and Streets	240,550	240,550	278,897	(38,347)
SANITATION				
Recycling	18,000	18,000	13,128	4,872
CULTURE AND RECREATION				
Parks	18,450	18,450	25,116	(6,666)
Regional Library	9,400	9,400	7,756	1,644
Total Culture and Recreation	27,850	27,850	32,872	(5,022)

The Notes to the Required Supplementary Information are an Integral Part of this Schedule.

**CITY OF PEQUOT LAKES, MINNESOTA
BUDGETARY COMPARISON SCHEDULE
GENERAL FUND (CONTINUED)
YEAR ENDED DECEMBER 31, 2011**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
EXPENDITURES (CONTINUED)				
CURRENT (CONTINUED)				
ECONOMIC DEVELOPMENT				
Housing and Redevelopment Authority	\$ 1,300	\$ 1,300	\$ 3,475	\$ (2,175)
CAPITAL OUTLAY				
General Government	7,800	7,800	4,811	2,989
Public Safety	10,000	10,000	48,708	(38,708)
Highways and Streets	260,000	260,000	-	260,000
Culture and Recreation	1,000	1,000	2,600	(1,600)
Total Capital Outlay	278,800	278,800	56,119	222,681
DEBT SERVICE				
Principal Retirement	46,340	46,340	84,028	(37,688)
Interest	16,380	16,380	14,652	1,728
Total Debt Service	62,720	62,720	98,680	(35,960)
Total Expenditures	1,645,215	1,645,215	1,504,214	141,001
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	25,000	25,000	276,625	251,625
OTHER FINANCING SOURCES (USES)				
Transfers In	-	-	5,791	5,791
Proceeds from Sale of Assets	-	-	3,575	3,575
TOTAL OTHER FINANCING SOURCES (USES)	-	-	9,366	9,366
NET CHANGE IN FUND BALANCE	<u>\$ 25,000</u>	<u>\$ 25,000</u>	285,991	<u>\$ 260,991</u>
Fund Balance - Beginning of Year			1,025,631	
FUND BALANCE - END OF YEAR			<u>\$ 1,311,622</u>	

The Notes to the Required Supplementary Information are an Integral Part of this Schedule.

**CITY OF PEQUOT LAKES, MINNESOTA
BUDGETARY COMPARISON SCHEDULE
FIRE DEPARTMENT SPECIAL REVENUE FUND
YEAR ENDED DECEMBER 31, 2011**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
REVENUES				
Licenses and Permits	\$ -	\$ -	\$ 250	\$ 250
Intergovernmental	-	-	38,000	38,000
Charges for Services	175,500	175,500	177,230	1,730
Gifts and Contributions	-	-	1,402	1,402
Investments Earnings	1,400	1,400	1,239	(161)
Miscellaneous	-	-	10,226	10,226
Total Revenues	<u>176,900</u>	<u>176,900</u>	<u>228,347</u>	<u>51,447</u>
EXPENDITURES				
CURRENT				
Public Safety				
Fire	130,130	130,130	150,788	(20,658)
CAPITAL OUTLAY				
Public Safety	28,000	28,000	16,745	11,255
DEBT SERVICE				
Principal Retirement	16,720	16,720	16,721	(1)
Interest	<u>2,040</u>	<u>2,040</u>	<u>2,039</u>	<u>1</u>
Total Expenditures	<u>176,890</u>	<u>176,890</u>	<u>186,293</u>	<u>(9,403)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES				
	10	10	42,054	42,044
Transfers Out	-	-	(600)	600
NET CHANGE IN FUND BALANCE	<u>\$ 10</u>	<u>\$ 10</u>	<u>41,454</u>	<u>\$ 42,644</u>
Fund Balance - Beginning of Year			<u>89,882</u>	
FUND BALANCE - END OF YEAR			<u>\$ 131,336</u>	

The Notes to the Required Supplementary Information are an Integral Part of this Schedule.

**CITY OF PEQUOT LAKES, MINNESOTA
NOTE TO THE REQUIRED SUPPLEMENTARY INFORMATION
DECEMBER 31, 2011**

I. BUDGETARY INFORMATION

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

- a. Prior to September 1, the City Clerk-Treasurer submits to the City Council a proposed operating budget for the fiscal year commencing the following January 1. The operating budget includes proposed expenditures and the means of financing them. The City Council adopts the proposed budget as amended and adjusted by the Council and certifies the proposed property tax levy to the County Auditor according to *Minnesota Statutes*.
- b. Public hearings are conducted in the Council's chambers.
- c. On or before December 28, the final budget is legally enacted by Council resolution and the final property tax levy certified to the County Auditor.
- d. Management is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total expenditures of any fund must be approved by the City Council. Reported budget amounts are as originally adopted or amended by the City Council.
- e. The City has legally adopted budgets for the general fund, and the fire fund special revenue funds. Expenditures may not legally exceed budgeted appropriations at the total fund level. Monitoring of budgets is maintained at the expenditure category level (i.e., personal services, supplies, charges for services, and capital outlay) within each program. All amounts over budget have been approved by the City Council through the disbursement process.
- f. Budgets for the general, and certain special revenue funds are adopted on a basis consistent with generally accepted accounting principles (GAAP). Budgeted amounts are as originally adopted, or as amended by the city council. All annual appropriations lapse at fiscal year-end.

II. EXPENDITURES IN EXCESS OF BUDGET

The Fire Department special revenue fund expenditures exceeded appropriations by \$9,403. However total revenues also exceeded budgeted amounts by \$51,447. The overage was mainly caused from the receipt and payment of fire state aid which is not budgeted.

**CITY OF PEQUOT LAKES, MINNESOTA
SCHEDULE OF FUNDING PROGRESS
PEQUOT LAKES FIREMAN'S RELIEF ASSOCIATION
DECEMBER 31, 2011**

Fiscal Year Ending	Value of Assets (a)	Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Benefit Per Year of Service
12/31/2010	\$ 949,834	\$ 817,762	\$ (132,072)	116.2 %	\$ 2,900
12/31/2009	831,439	773,518	(57,921)	107.5	2,900
12/31/2008	734,308	725,088	(9,220)	101.3	2,900
12/31/2007	747,773	661,774	(85,999)	113.0	2,500

Additional information relating to the pension plan is provided in Note 6C.

The December 31, 2011 report is not yet available.

**CITY OF PEQUOT LAKES, MINNESOTA
 SCHEDULE OF FUNDING PROGRESS
 OTHER POSTEMPLOYMENT HEALTH CARE BENEFITS
 DECEMBER 31, 2011**

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
1/1/2009	\$ -	\$ 118,698	\$ 118,698	- %	\$ 616,864	19.2%

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SUPPLEMENTARY INFORMATION

**CITY OF PEQUOT LAKES, MINNESOTA
 COMBINING BALANCE SHEET
 NONMAJOR GOVERNMENTAL FUNDS
 DECEMBER 31, 2011**

	<u>Cemetery Perpetual Care</u>	<u>TIF 1-7 Babinsky</u>	<u>TIF 1-9 Lime Greenery</u>
ASSETS			
Cash and Pooled Investments	\$ 27,532	\$ 29,920	\$ 8,085
Accounts Receivable	60	-	-
Taxes Receivable			
Current	-	-	-
Total Assets	<u>27,592</u>	<u>29,920</u>	<u>8,085</u>
 LIABILITIES AND FUND BALANCES			
LIABILITIES			
Accounts Payable	-	14,891	5,971
Interfund Payable	-	-	-
Deferred Revenue - Unavailable	-	-	-
Total Liabilities	<u>-</u>	<u>14,891</u>	<u>5,971</u>
 FUND BALANCES			
Restricted for Economic Development	-	15,029	2,114
Restricted for Debt Repayment	-	-	-
Committed for Cemetery Perpetual Care	27,592	-	-
Committed for Highway 371 Project	-	-	-
Unassigned	-	-	-
Total Fund Balances (Deficits)	<u>27,592</u>	<u>15,029</u>	<u>2,114</u>
 Total Liabilities and Fund Balances	 <u>\$ 27,592</u>	 <u>\$ 29,920</u>	 <u>\$ 8,085</u>

TIF 1-10 Vet Clinic	TIF 1-13 Lonesome Cottage	Highway 371 Project	2010 Equipment Certificates	Total Nonmajor Special Revenue Funds
\$ -	\$ -	\$ 216,896	\$ 31,715	\$ 314,148
-	15,850	-	-	15,910
-	-	1,083	-	1,083
-	15,850	217,979	31,715	331,141
-	11,816	-	-	32,678
-	50,804	-	-	50,804
-	15,850	-	-	15,850
-	78,470	-	-	99,332
-	-	-	-	17,143
-	-	-	31,715	31,715
-	-	-	-	27,592
-	-	217,979	-	217,979
-	(62,620)	-	-	(62,620)
-	(62,620)	217,979	31,715	231,809
\$ -	\$ 15,850	\$ 217,979	\$ 31,715	\$ 331,141

CITY OF PEQUOT LAKES, MINNESOTA
COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
NONMAJOR GOVERNMENTAL FUNDS
YEAR ENDED DECEMBER 31, 2011

	Cemetery Perpetual Care	TIF 1-7 Babinsky	TIF 1-9 Lime Greenery
REVENUES			
Taxes	\$ -	\$ 30,911	\$ 6,529
Charges for Services	425	-	-
Interest on Investments	245	164	37
Miscellaneous	225	-	-
Total Revenues	895	31,075	6,566
EXPENDITURES			
CURRENT			
General Government	84	-	-
Economic Development	-	32,325	7,222
DEBT SERVICE			
Principal	-	-	-
Interest	-	-	-
Total Expenditures	84	32,325	7,222
NET CHANGE IN FUND BALANCES	811	(1,250)	(656)
Fund Balance - Beginning of Year	26,781	16,279	2,770
FUND BALANCE - END OF YEAR	\$ 27,592	\$ 15,029	\$ 2,114

TIF 1-11 Telemarketing	TIF 1-13 Lonesome Cottage	Highway 371 Project	2010 Equipment Certificates	Total Nonmajor Special Revenue Funds
\$ -	\$ 26,259	\$ 19,200	\$ 30,555	\$ 113,454
-	-	-	-	425
3	-	1,838	97	2,384
-	-	-	-	225
<u>3</u>	<u>26,259</u>	<u>21,038</u>	<u>30,652</u>	<u>116,488</u>
-	-	-	-	84
590	25,386	-	-	65,523
-	-	-	13,000	13,000
-	-	-	5,426	5,426
<u>590</u>	<u>25,386</u>	<u>-</u>	<u>18,426</u>	<u>84,033</u>
(587)	873	21,038	12,226	32,455
587	(63,493)	196,941	19,489	199,354
<u>\$ -</u>	<u>\$ (62,620)</u>	<u>\$ 217,979</u>	<u>\$ 31,715</u>	<u>\$ 231,809</u>

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REPORTS RELATED TO *GOVERNMENT AUDITING STANDARDS*



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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***

Honorable Mayor and
Members of the City Council
City of Pequot Lakes
Pequot Lakes, 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 the City of Pequot Lakes, Minnesota as of and for the year ended December 31, 2011, which collectively comprise the City of Pequot Lakes' basic financial statements and have issued our report thereon dated April 3, 2012. We conducted our audit in accordance with U.S. generally accepted auditing standards 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 City'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 Pequot Lakes' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and 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 discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses 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 or performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider deficiencies 2006-01 and 2006-02 described in the accompanying Schedule of Findings and Recommendations to be material weaknesses.

Honorable Mayor and
Members of the City Council
City of Pequot Lakes

Internal Control Over Financial Reporting (Continued)

A significant deficiency is a deficiency, or 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 deficiency 2006-03 as described in the accompanying Schedule of Findings and Recommendations to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City'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 test disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The City of Pequot Lakes' responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Recommendations. We did not audit the City's responses, and accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, City Council, others within the entity, and state and federal grantor agencies and is not intended to be and should not be used by anyone other than these specified parties.



CliftonLarsonAllen LLP

Brainerd, Minnesota
April 3, 2012

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**CITY OF PEQUOT LAKES, MINNESOTA
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
YEAR ENDED DECEMBER 31, 2011**

MATERIAL WEAKNESSES

2006-01 FINANCIAL STATEMENT PRESENTATION

Criteria: The City of Pequot Lakes (the City) management is responsible for establishing and maintaining internal controls, including monitoring, and for the fair presentation in the financial statements in accordance with Governmental Accounting Standards Board Statement No. 34.

Condition: As part of the audit, management requested us to prepare a draft of your financial statements, including the related notes to the financial statements.

Cause: The City has a limited number of personnel with financial reporting experience.

Effect: The design of the controls over the financial reporting process would affect the ability of the City to report its financial data consistently with the assertions of the management in the financial statements.

Recommendation: We recommend that the City be aware of the requirements for fair presentation of the financial statements in accordance with the Governmental Accounting Standards Board Statement No. 34. Should the City elect, based upon an analysis of costs and benefits, to establish the full oversight of the financial statement preparation of an appropriate level, we suggest management establish effective review policies and procedures including but not limited to the following functions: reconciling general ledger amounts to the draft financial statements; review of all supporting documentation and explanations for journal entries proposed by us; complete the disclosure checklist; review and approval of schedules and calculations supporting the amounts included in the notes to the financial statements; apply analytic procedures to the draft financial statements; and perform other procedures considered necessary by management.

CLIENT'S RESPONSE:

The City understands that this is required communications for the preparation of the financial statements.

**CITY OF PEQUOT LAKES, MINNESOTA
SCHEDULE OF FINDINGS AND RECOMMENDATIONS (CONTINUED)
YEAR ENDED DECEMBER 31, 2011**

MATERIAL WEAKNESSES (CONTINUED)

2006-02 AUDIT ADJUSTMENTS

Criteria: The City of Pequot Lakes' management is responsible for establishing and maintaining internal controls for the proper recording of all the City's accounting transactions, including account coding, reporting of accruals and net assets, and cash flows.

Condition: As part of the audit, we proposed material adjustments for recording of receivables, recording of some capital assets, reclassifying transactions to the proper accounts and preparing note disclosures.

Cause: The City has a limited number of personnel with financial reporting experience.

Effect: The design of the internal controls over recording transactions and year-end accruals limits the ability of the City to provide accurate accrual basis financial information.

Recommendation: We recommend City management be constantly aware of all procedures and processes involved in recording transactions, accruals, and reclassifications and develop internal control policies to ensure proper recording of these items.

CLIENT'S RESPONSE:

The City will continue to work at eliminating the need for audit adjustments.

SIGNIFICANT DEFICIENCY

2006-03 SEGREGATION OF DUTIES

Criteria: City management should constantly be aware of the need to have adequate segregation of duties regarding the processing of transactions for the City. In addition, City management should be aware that the concentration of duties and responsibilities in one or a very few individuals is not desirable from an internal control perspective.

Condition: Adequate segregation of the accounting functions necessary to ensure adequate internal accounting control, is not in place. The City has reassigned a number of the previously identified responsibilities, however due to the number of employees available to assign responsibilities, some weaknesses still exist.

Cause: The City has a limited number of personnel.

Effect: The design of the internal controls over financial reporting could affect the ability of the City to record, process, summarize and report financial data consistently with the assertions of management in the financial statements. In addition, this lack of segregation of duties may result in the City's inability to prevent/detect misappropriation of assets.

Recommendation: We recommend City management be aware of the lack of segregation of duties within the accounting functions and provide oversight to ensure the internal control policies and procedures are being implemented by City staff.

CLIENT'S RESPONSE:

The City will review the accounting functions and segregate them if it is possible with limited staff.

**CITY OF PEQUOT LAKES, MINNESOTA
SCHEDULE OF FINDINGS AND RECOMMENDATIONS (CONTINUED)
YEAR ENDED DECEMBER 31, 2011**

OTHER ITEM FOR CONSIDERATION – MINNESOTA LEGAL COMPLIANCE

None Noted.

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REPORT ON MINNESOTA LEGAL COMPLIANCE

Honorable Mayor and
Members of the City Council
City of Pequot Lakes
Pequot Lakes, 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 the City of Pequot Lakes (the City), Minnesota, as of and for the year ended December 31, 2011, and have issued our report thereon dated April 3, 2012.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Audit Guide for Political Subdivisions*, promulgated by the State Auditor pursuant to *Minnesota Statutes* §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 seven main categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, miscellaneous provisions, and tax increment financing. Our study included all of the listed categories.

The results of our tests indicate that for the items tested, the City complied with the material terms and conditions of applicable legal provisions.

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

CliftonLarsonAllen LLP

Brainerd, Minnesota
April 3, 2012

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