

FINANCIAL AUDIT
OF THE
MICHIGAN ECONOMIC DEVELOPMENT CORPORATION

October 1, 2000 through September 30, 2001



Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit

*Michigan Economic Development Corporation
Fiscal Year Ended September 30, 2001*

Report Number:
07-403-02

Released:
June 2002

A financial audit determines if the financial statements are fairly presented; considers internal control over financial reporting; and determines compliance with State compliance requirements material to the financial statements. This financial audit of the Michigan Economic Development Corporation (MEDC) was conducted as part of the constitutional responsibility of the Office of the Auditor General.

Financial Statements:

Auditor's Report Issued

We issued an unqualified opinion on MEDC's financial statements.

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Internal Control Over Financial Reporting

We did not identify any material weaknesses in the internal control over financial reporting.

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Noncompliance Material to the Financial Statements

We did not identify any instances of noncompliance applicable to the financial statements that are required to be reported under *Government Auditing Standards*.

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Background:

MEDC's mission is to promote smart economic growth by developing strategies and providing services to create and retain good jobs and a high quality of life for Michigan residents. Article VII, Section 28 of the State Constitution and Act 7, P.A. 1967, provided for the creation of MEDC as a public body corporate. MEDC was created by a 10-year contract (interlocal agreement) between a participating local economic development corporation formed under Act 338, P.A. 1974, and the Michigan Strategic Fund.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: www.state.mi.us/audgen/



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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

June 27, 2002

Mr. Doug Rothwell, President and Chief Executive Officer
Michigan Economic Development Corporation
300 North Washington Square
Lansing, Michigan

Dear Mr. Rothwell:

This is our report on the financial audit of the Michigan Economic Development Corporation for the period October 1, 2000 through September 30, 2001.

This report contains our report summary, our independent auditor's report on the financial statements, management's discussion and analysis, and the Michigan Economic Development Corporation financial statements and notes to the financial statements. This report also contains our independent auditor's report on compliance and on internal control over financial reporting and a glossary of acronyms and terms.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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TABLE OF CONTENTS

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION

INTRODUCTION

	<u>Page</u>
Report Summary	1
Report Letter	3

INDEPENDENT AUDITOR'S REPORTS AND FINANCIAL STATEMENTS

Independent Auditor's Report on the Financial Statements	6
Management's Discussion and Analysis	8
Michigan Economic Development Corporation Financial Statements	
Statement of Net Assets	15
Statement of Revenues, Expenses, and Changes in Fund Net Assets	16
Statement of Cash Flows	17
Notes to the Financial Statements	18
Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting	30

GLOSSARY

Glossary of Acronyms and Terms	32
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Statements

February 15, 2002

Mr. Doug Rothwell, President and Chief Executive Officer
Michigan Economic Development Corporation
300 North Washington Square
Lansing, Michigan

Dear Mr. Rothwell:

We have audited the accompanying statement of net assets of the Michigan Economic Development Corporation, a component unit of the State of Michigan, as of September 30, 2001 and September 30, 2000 and the related statement of revenues, expenses, and changes in fund net assets and the statement of cash flows for the fiscal years then ended. These financial statements are the responsibility of the Michigan Economic Development Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As described in Note 1b, the accompanying financial statements present only the Michigan Economic Development Corporation and are not intended to present fairly the financial position and results of operations and cash flows of the State of Michigan or its component units.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Michigan Economic Development Corporation as of September 30, 2001 and September 30, 2000 and the results of its operations and the cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 1c and 3 to the financial statements, the Michigan Economic Development Corporation adopted Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*; Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*; and Statement No. 38, *Certain Financial Statement Note Disclosures*.

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

In accordance with *Government Auditing Standards*, we have also issued a report dated February 15, 2002 on our tests of the Michigan Economic Development Corporation's compliance with certain provisions of laws, regulations, contracts, and grants and on our consideration of its internal control over financial reporting. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

AUDITOR GENERAL

Management's Discussion and Analysis

This is a discussion and analysis of the financial performance of the Michigan Economic Development Corporation (MEDC) for the fiscal year ended September 30, 2001. MEDC is a public body corporate and a component unit of the financial reporting entity of the State of Michigan. MEDC's management is responsible for the financial statements, footnotes, and this discussion.

Using the Financial Report

In June 1999, the Governmental Accounting Standards Board (GASB) released Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*.

- The new reporting standards require a statement of net assets; a statement of revenues, expenses, and changes in fund net assets; and a statement of cash flows (direct method).
- The fiscal year 2000-01 financial statements differ in form compared with prior years' financial statements. The fiscal year 1999-2000 statements have been restated to comply with GASB Statement No. 34.

This financial report includes the report of independent auditors, management's discussion and analysis, the basic financial statements in the new format, and the notes to the financial statements.

Amounts reported in the financial statements include both the MEDC corporate funds as well as the portion of the State appropriation made available to MEDC.

The financial statements are interrelated and represent the financial status of MEDC. The balance sheet is now referred to as the statement of net assets, which includes assets and liabilities.

The statement of revenues, expenses, and changes in fund net assets presents the revenues earned and expenses incurred during the year.

The statement of cash flows presents information related to cash in-flows and out-flows summarized by operating, capital acquisition, and investing activities.

Analysis of Financial Activities

The MEDC Executive Committee approves an annual budget and the investment policy. The President/Chief Executive Officer and Chief Operating Officer are responsible for implementing the programs approved by the Executive Committee.

**Condensed Financial Information
From the Statement of Net Assets
As of September 30**

	2001	2000
Current assets	\$ 243,040,169	\$ 237,751,856
Investments	77,407,896	90,489,139
Loans receivable	18,124,711	16,439,738
Capital assets	15,407,411	5,808,807
Other noncurrent assets	13,888,239	15,076,125
Total Assets	\$ 367,868,426	\$ 365,565,665
Current liabilities	\$ 52,184,525	\$ 22,770,533
Long-term liabilities	9,571,724	17,150,802
Total Liabilities	\$ 61,756,249	\$ 39,921,335
Net Assets		
Capital assets	\$ 15,407,411	\$ 5,808,807
Unrestricted net assets	290,704,766	319,835,523
Total Net Assets	\$ 306,112,177	\$ 325,644,330

Current assets primarily consist of amounts retained by the State of Michigan in its equity in Common Cash for the unspent appropriations. Short-term investments and loans receivable are included with appropriate categories. Interest earned on funds retained in the Common Cash pool is the income for the State and does not get transferred to MEDC.

Investments include long-term securities and program investments. During fiscal year 2000-01, total investments declined by \$26.0 million compared with fiscal year

1999-2000 because of the liquidation of investments necessary to pay for program grant commitments made in earlier years by the Michigan Strategic Fund (MSF). This also resulted in reduced investment income during the year.

Loans receivable include only the long-term portion of the outstanding loans net of loan loss provisions. Total loans receivable increased by \$5.1 million for fiscal year 2000-01 when compared with fiscal year 1999-2000 because of new loans made from the Life Science and Core Community funding. Both of these programs are State funded.

Capital assets at September 30, 2001 include the cost of a new building, new furniture, and information technology equipment. During the year, construction of the new building was completed.

Other noncurrent assets primarily consist of Capital Access Program reserves.

Current liabilities primarily consist of accounts payable. Concentrated efforts were made by MEDC in requesting grantees to submit their reimbursement requests for the fiscal year soon after the year-end in order to record accounts payable. This was particularly true for the obligations of Economic Development Job Training and Life Science grant payments made after September 30, 2001.

Long-term liabilities primarily consist of Capital Access Program loan guarantee reserves.

Overall, **net assets** were reduced by approximately \$19.5 million during fiscal year 2000-01.

Condensed Financial Information
From the Statement of Revenues, Expenses, and Changes in Fund Net Assets
For the Fiscal Year Ended September 30

	2001	2000
Operating Revenues		
Operating grants and contributions	\$ 129,964,517	\$ 179,043,266
Interest and investment earnings	3,991,128	13,841,252
Other	6,691,104	4,632,107
Total Operating Revenues	<u>\$ 140,646,749</u>	<u>\$ 197,516,626</u>
Operating Expenses		
Salaries, wages, and other administrative	\$ 49,246,713	\$ 38,683,897
Operating grants	110,932,188	76,226,275
Total Operating Expenses	<u>\$ 160,178,901</u>	<u>\$ 114,910,172</u>
Change in net assets	\$ (19,532,152)	\$ 82,606,454
Net Assets - Beginning	325,644,329	243,037,876
Net Assets - Ending	<u>\$ 306,112,177</u>	<u>\$ 325,644,330</u>

Operating grants and contributions include the amount received from State appropriations for the economic development functions; grants received from the National Institute of Standards and Technology (NIST), a federally funded program; and gaming revenues, fees, etc., received by MSF and transferred to MEDC. MSF's State appropriations decreased in fiscal year 2000-01 because the fiscal year 1999-2000 amounts included a one-time State appropriation of \$50 million for the Michigan Core Community Fund.

Interest and investment earnings declined significantly because of (1) overall bear stock and bond market conditions and lower yields during fiscal year 2000-01, (2) a reduction in the total amount available for investments, and (3) the recognition of the difference between cost and market value of the investments as of September 30, 2001 compared with October 1, 2000. As of September 30, 2000, the market value of MEDC investments was \$3.2 million higher than the cost. As of September 30, 2001, the market value of MEDC investments was \$2.7 million lower compared with the cost. As

a result, \$5.9 million was recorded as expenses to reflect the true market value of MEDC investments on September 30, 2001.

Other operating revenues primarily consisted of gaming revenue. As a result of a consent judgment reached between the Keweenaw Bay Indian Community (KBIC), the U.S. Department of the Interior, the U.S. Department of Justice, and the Governor during fiscal year 2000-01, MEDC will receive a semi-annual payment from KBIC in an amount equal to 8% of the net win derived from all class III electronic games of chance. During fiscal year 2000-01, MEDC received \$5.1 million in such revenue covering the period from June 1999 through September 2001. This is a new source of revenue for MEDC.

Salaries, wages, and other administrative expenses increased because of increased staffing and program expansions. During the year, two major initiatives, Life Science and Core Community Programs, were implemented. These expenses also include a one-time charge of \$3.6 million to write off the amounts receivable from MSF that are not collectible. This charge was recorded as a result of the judgment rendered by the U.S. Court of Appeals for the Sixth Circuit releasing all casinos from their obligation under 1993 compacts to pay MSF beyond February 1999. Because MSF will not be receiving these funds from gaming revenues, MEDC will also not be able to receive funds from MSF.

Operating grants increased by \$34.7 million, mainly because of the addition of grants made from Life Science funding during fiscal year 2000-01.

Condensed Financial Information
From the Statement of Cash Flows
For the Fiscal Year Ended September 30

	2001	2000
Cash provided (used) by:		
Operating activities	\$ (4,598,029)	\$ 143,436,443
Capital and related financing activities	(9,754,530)	(5,808,807)
Investing activities	29,995,594	(31,487,604)
Net increase (decrease) in cash	<u>\$ 15,643,034</u>	<u>\$106,140,032</u>
Cash - Beginning of the year	222,151,405	116,011,373
Cash - End of the year	<u><u>\$237,794,439</u></u>	<u><u>\$222,151,405</u></u>

The **net cash** decreased from \$106.1 million in fiscal year 1999-2000 to \$15.6 million in fiscal year 2000-01 primarily because of the reduction of \$50.0 million in appropriations from MSF for the Core Community Program and the \$35.0 million increase in grant payments compared with fiscal year 1999-2000.

The cash on hand at year-end included \$200.3 million equity in Common Cash with the State of Michigan treasury. It is earmarked for the following obligations of MEDC:

Program	Amount
Life Science	\$ 64,251,880
Michigan Core Community Fund	43,846,608
Technology Centers (M-TECS)	9,939,136
Economic Development Job Training	29,012,317
Michigan Growth Fund	5,000,000
Michigan Promotion Program	386,977
Miscellaneous	5,510,521
Accounts payable*	42,302,774
Total Cash in State of Michigan Treasury	<u><u>\$200,250,213</u></u>

* This amount represents payments made after September 30, 2001 against the obligations of fiscal year 2000-01.

The balance of the cash on hand represented investments in instruments with maturity dates of less than 12 months.

Other Pertinent Information

Contingent upon the opening of the remaining casinos approved under a 1998 compact, MEDC may receive additional revenues from MSF in fiscal years 2002-03 and 2003-04. The opening date of these casinos and the amounts to be received are not certain.

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION
Statement of Net Assets
As of September 30

	2001	2000 (RESTATED)
ASSETS		
Current Assets:		
Cash	\$ 200,994,666	\$ 181,021,775
Capital Access Program - Cash	599,927	331,159
Short-term notes (Note 2)	22,311,606	25,722,345
Gaming revenue receivable	1,245,744	
Amounts due from MSF	5,298,031	8,319,275
Amounts due from federal agencies	61,944	61,943
Investments (Note 2)	3,654,000	16,577,223
Other Current Assets:		
Loans receivable (Note 4)	7,963,378	4,498,360
Interest receivable	356,910	1,047,209
Miscellaneous	553,963	172,567
Total Current Assets	\$ 243,040,169	\$ 237,751,856
Noncurrent Assets:		
Capital Access Program - Reserve	\$ 13,888,239	\$ 15,076,125
Loans receivable (Note 4)	18,124,711	16,439,738
Investments (Note 2)	77,407,896	90,489,139
Capital assets (net) (Note 6)	15,407,411	5,808,807
Total Noncurrent Assets	\$ 124,828,257	\$ 127,813,809
Total Assets	\$ 367,868,426	\$ 365,565,665
LIABILITIES AND NET ASSETS		
Current Liabilities:		
Accounts payable and other liabilities	\$ 45,563,266	\$ 22,729,701
Compensated absences (Notes 5 and 7)	1,167,615	
Capital Access Program	5,402,762	
Deferred revenues	50,882	40,832
Total Current Liabilities	\$ 52,184,525	\$ 22,770,533
Long-Term Liabilities:		
Capital Access Program	\$ 8,494,990	\$ 15,085,636
Compensated absences (Notes 5 and 7)	1,076,734	2,065,166
Total Long-Term Liabilities	\$ 9,571,724	\$ 17,150,802
Total Liabilities	\$ 61,756,249	\$ 39,921,335
Net Assets:		
Invested in capital assets	\$ 15,407,411	\$ 5,808,807
Unrestricted net assets	290,704,766	319,835,523
Total Net Assets	\$ 306,112,177	\$ 325,644,330
Total Liabilities and Net Assets	\$ 367,868,426	\$ 365,565,665

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

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION
Statement of Revenues, Expenses, and Changes in Fund Net Assets
For the Fiscal Year Ended September 30

	<u>2001</u>	<u>2000 (RESTATED)</u>
OPERATING REVENUES		
<u>Operating Grants and Contributions</u>	\$	\$
Federal revenue - NIST	3,084,498	4,102,090
Payments from MSF - State appropriations	116,203,382	166,366,396
Payments from MSF - Gaming revenues, fees, etc.	<u>10,676,636</u>	<u>8,574,780</u>
Total Operating Grants and Contributions	<u>\$ 129,964,516</u>	<u>\$ 179,043,266</u>
<u>Interest and Investment Earnings</u>		
Investment earnings	\$ 8,875,142	\$ 13,774,030
Net increase (decrease) in fair value of investments	(5,902,457)	(1,018,387)
Interest income on loans	745,374	727,827
Interest income	<u>273,069</u>	<u>357,783</u>
Total Interest and Investment Earnings	<u>\$ 3,991,128</u>	<u>\$ 13,841,252</u>
<u>Other Revenues</u>		
Casino revenue	\$ 5,052,001	\$
Other operating revenue	<u>1,639,103</u>	<u>4,632,107</u>
Total Other Revenues	<u>\$ 6,691,104</u>	<u>\$ 4,632,107</u>
Total Operating Revenues	<u>\$ 140,646,749</u>	<u>\$ 197,516,626</u>
 OPERATING EXPENSES		
Salaries, wages, and other administrative	\$ 49,067,530	\$ 38,167,754
Compensated absences (Note 7)	179,183	516,143
Operating grants	<u>110,932,188</u>	<u>76,226,275</u>
Total Operating Expenses	<u>\$ 160,178,901</u>	<u>\$ 114,910,172</u>
 Operating Income (Loss)	<u>\$ (19,532,152)</u>	<u>\$ 82,606,454</u>
 Change in net assets	\$ (19,532,152)	\$ 82,606,454
 Total net assets - Beginning	<u>325,644,329</u>	<u>243,037,876</u>
 Total net assets - Ending	<u>\$ 306,112,177</u>	<u>\$ 325,644,330</u>

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

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION

Statement of Cash Flows
For the Fiscal Year Ended September 30

	2001	2000 (RESTATED)
CASH FLOWS FROM OPERATING ACTIVITIES		
Payments to employees	\$ (18,130,554)	\$ (17,320,658)
Payments to suppliers	(26,786,755)	(14,558,991)
Receipts from casino revenue	3,806,257	
Other operating receipts	1,639,103	1,461,279
Grants received from federal government	2,716,932	4,102,090
Payments for operating grants	(94,136,148)	(76,226,275)
Receipts from component unit (MSF)	126,293,135	245,978,998
Net cash provided (used) by operating activities	\$ (4,598,029)	\$ 143,436,443
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Net cash provided (used) by noncapital financing activities	\$ 0	\$ 0
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	\$ (9,754,530)	\$ (5,808,807)
Net cash provided (used) by capital and related financing activities	\$ (9,754,530)	\$ (5,808,807)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale and maturities of investment securities	\$ 26,004,465	\$
Purchase/Sale of investment securities		(45,328,856)
Interest and dividends on investments	3,991,128	13,841,252
Net cash provided (used) by investing activities	\$ 29,995,594	\$ (31,487,604)
Net cash provided (used) - all activities	\$ 15,643,034	\$ 106,140,032
Cash and cash equivalents at beginning of year	222,151,405	116,011,373
Cash and cash equivalents at end of year	\$ 237,794,439	\$ 222,151,405
RECONCILIATION OF CASH AND CASH EQUIVALENTS		
Per balance sheet classifications:		
Cash and cash equivalents	\$ 37,544,226	\$ 42,724,513
Equity in Common Cash	200,250,213	179,426,892
Cash and cash equivalents at end of year	\$ 237,794,439	\$ 222,151,405
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:		
Operating income (loss)	\$ (19,532,152)	\$ 82,606,454
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Interest (nonprogram) and investment income	(3,991,128)	(13,841,252)
Depreciation	155,926	
Changes in assets and liabilities:		
Amounts due from component unit (MSF)	3,021,244	71,037,821
Loans receivable (program loans)	(5,149,992)	(1,963,946)
Amounts due from federal agencies		(61,944)
Other assets	(936,841)	60,488
Accounts payable and other liabilities	21,834,915	5,598,822
Net cash provided (used) by operating activities	\$ (4,598,029)	\$ 143,436,443
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
	\$ 0	\$ 0

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

Notes to the Financial Statements

Note 1 Significant Accounting Policies

The accounting policies of the Michigan Economic Development Corporation (MEDC) conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant policies:

a. Reporting Entity

Article VII, Section 28 of the State Constitution and Act 7, P.A. 1967, provided for the creation of MEDC as a public body corporate. MEDC was created by a 10-year contract (interlocal agreement) between a participating local economic development corporation formed under Act 338, P.A. 1974, as amended, and the Michigan Strategic Fund (MSF). MEDC is a separate legal entity created to promote smart economic growth by developing strategies and providing services to create and retain good jobs and a high quality of life for Michigan residents. Under the terms of the agreement, the governance of MEDC resides in an executive committee of 17 members appointed to eight-year, staggered terms by the Governor.

MEDC is a component unit of the financial reporting entity of the State of Michigan. The decision to include a potential component unit in the reporting entity is made by applying the criteria set forth in Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*. The basic criteria include the appointment of a voting majority of the governing board of MEDC; the legal separation of the State and MEDC; the fiscal independence of MEDC; whether exclusion of the unit would make the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)* misleading; and whether there is a potential for MEDC to provide specific financial benefits to, or impose specific financial burdens on, the State.

b. Basis of Presentation

(1) Fund Accounting: The accounts of the component units of the State of Michigan are organized on the basis of funds, each of which is

considered a separate accounting entity. MEDC's operations are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, net assets, revenues, and expenses. Government resources are allocated to and accounted for in separate funds, based upon the purposes for which they are to be spent and the means by which spending activities are controlled.

- (2) Proprietary Funds: MEDC is a proprietary fund. Proprietary funds are accounted for on a flow of economic resources measurement focus. The accounting objectives are a determination of net income, financial position, and cash flow. All assets and liabilities associated with proprietary fund activities are included on the statement of net assets.

Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises, i.e., where the intent of the governing body is that the costs (expenses) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accompanying financial statements present only MEDC and are not intended to present fairly the financial position and results of operations and cash flows of the State of Michigan or its component units.

c. Basis of Accounting

Proprietary fund types use the accrual basis of accounting. The accrual basis emphasizes the measurement of "net income" (i.e., "capital maintenance" focus). Using this basis, revenues are recognized when "earned" and expenses are recognized when "incurred." Revenues are considered to be available when collected within the current period or soon enough thereafter to pay liabilities of the current period. Generally, this is within 12 months. Operating revenues and expenses generally result from providing services to the public and to State and local units of government. All financial resources and obligations of a fund, whether

current or noncurrent, are recorded in the fund. MEDC follows all GASB pronouncements and those Financial Accounting Standards Board Statements, Interpretations, Opinions, and Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

New accounting standards were adopted in fiscal year 2000-01. MEDC adopted GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and modified by Statement No. 38, *Certain Financial Statement Note Disclosures*. Statement No. 34, as amended and modified, commonly referred to as the new reporting model, retained much of the old reporting and disclosure requirements under the prior reporting model, with certain modifications and newly added information. The most significant effect on MEDC's financial statements was the reclassification of operating transfers to operating revenues and the addition of the management's discussion and analysis as required supplementary information.

d. Financial Data

The MSF Board of Directors entered into an interlocal agreement with a local unit of government to create MEDC. MEDC came into existence on April 5, 1999. In accordance with the terms of the agreement, substantial assets, liabilities, and fund balances of MSF were transferred to MEDC on May 1, 1999. All revenues received from tribal gaming, industrial development revenue bond (IDRB) issuance fees, and other sources are transferred to MEDC on a monthly basis. This interlocal agreement also detailed all of MSF's State classified employees to MEDC. State appropriations available to MSF for this purpose are also made available to MEDC, as needed. MEDC financial statements include transactions recorded using all appropriated funds, except the Community Development Block Grant (CDBG) Program transactions as required by the federal granting agency. Revenues from the U.S. Department of Labor for the Employment Service grant are received by MSF and transferred to MEDC to fund program expenditures.

MEDC financial statements primarily present the following:

- (1) Operating Revenues: Revenues from federal grants, other restricted sources, amounts available to MEDC from State appropriations, casino revenues (see Note 10), and investment earnings. Also included in operating revenues are tribal gaming revenue and IDRB issuance fees collected by MSF and transferred to MEDC during the year.
- (2) Operating Expenses: Expenses related to program grants funded by State appropriations and MEDC nonappropriated funds. Also included in operating expenses are administrative expenses (including payables) incurred out of appropriated funds, except for the CDBG Program.

Note 2 Deposits and Investments

a. General Information

MEDC's investment policy allows investments in the following investment types:

- (1) Securities issued or guaranteed by the U.S. government or its agencies.
- (2) Bonds or other obligations of any U.S. state or any local unit of government of any such state.
- (3) Preferred stock issued by U.S. corporations.
- (4) Repurchase agreements fully collateralized by U.S. government securities.
- (5) Corporate and bank debt including, but not limited to, commercial paper, certificates of deposit, banker's acceptances, and other short-term obligations.
- (6) Corporate notes and bonds.

- (7) Taxable bond funds.
- (8) Money market mutual fund shares that offer daily purchase and redemption and maintain a constant share price.
- (9) Common stock of U.S. corporations.
- (10) Stock mutual funds with portfolios highly concentrated in securities of U.S. corporations.

b. Deposits

GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, requires certain disclosures regarding policies and practices with respect to deposits and investments and the custodial credit risk associated with them.

In accordance with GASB Statement No. 3, deposits are classified into three categories of credit risk as follows:

Category 1: Insured or collateralized with securities held by the entity or by its agent in the entity's name.

Category 2: Collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name.

Category 3: Uncollateralized, including bank balances that are collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the entity's name.

MEDC's deposits and investments at September 30, 2001 were:

	Deposits	Investments
Current Deposits and Investments:		
Checking	\$ 744,453	\$
Capital Access Program - Cash	599,927	
Capital Access Program - Reserve	13,888,239	
Equity in State of Michigan Common Cash	200,250,213	
Short-term notes		22,311,606
Marketable securities		3,654,000
Total Current Deposits and Investments	\$ 215,482,832	\$ 25,965,606
Long-term securities		77,407,896
Total Deposits and Investments	\$ 215,482,832	\$103,373,502

Deposits included in MEDC's bank accounts (without recognition of outstanding checks or deposits in transit) were \$15,232,620 at September 30, 2001 (\$17,002,167 at September 30, 2000). Of that amount, \$4,098,490 (\$4,202,524 at September 30, 2000) was covered by federal depository insurance and was classified in GASB credit risk category 1. The remaining \$11,134,130 (\$12,799,644 at September 30, 2000) was uninsured and uncollateralized at September 30, 2001 and was classified in GASB credit risk category 3.

The equity in Common Cash, which is managed by the State Treasurer, represents State appropriated funds (General Fund and tobacco revenues for the Life Science Program) that were committed for several grant programs but not spent (disbursed) at the end of the fiscal year.

As of September 30, 2000, MEDC's total deposits and investments were \$222,151,404 and \$107,066,360 respectively.

c. Investments

All marketable investments are carried at fair value.

Equity investments in business and industrial development corporations (BIDCOs) are carried at the lower of aggregate cost or fair value. MEDC has determined that cost will be used to approximate fair value.

In accordance with GASB Statement No. 3, investments are also classified into three categories of credit risk as follows:

Category 1: Investments that are insured or registered or for which the securities are held by the entity or its agent in the entity's name.

Category 2: Uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the entity's name.

Category 3: Uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent but not in the entity's name.

The following table shows the fair value of investments at September 30, 2001 by investment type and in total and does not include the checking account balances:

Investment Type	GASB Credit Risk Category			Not	Fair Value
	1	2	3	Categorized	
Corporate securities	\$	\$	\$ 42,040,551	\$	\$ 42,040,551
Government securities			26,257,513		26,257,513
Equity	6,604,414				6,604,414
Mutual funds				15,735,812	15,735,812
Other nonmarketable investments				12,735,211	12,735,211
Total Investments	<u>\$ 6,604,414</u>	<u>\$ 0</u>	<u>\$ 68,298,064</u>	<u>\$ 28,471,024</u>	<u>\$ 103,373,502</u>

The fair value of investments at September 30, 2000 was \$ 132,788,705, of which \$6,359,630 and \$93,516,508 were recorded in GASB credit risk category 1 and category 3, respectively. The balance of \$32,912,568 was not categorized in any risk category.

Note 3 Revenues From MSF

In accordance with GASB Statement No. 34, the following items, which were formerly reported as operating transfers from MSF, were reclassified as revenues:

	Fiscal Year	
	2000-01	1999-2000
Tribal gaming revenue and IDRB fees	\$ 10,676,636	\$ 8,574,780
State's General Fund appropriation	64,890,718	114,905,079
State's restricted appropriation	1,312,664	1,461,317
State's tobacco revenue appropriation	50,000,000	50,000,000
Total Revenues From MSF	<u>\$ 126,880,018</u>	<u>\$ 174,941,176</u>

During fiscal year 1998-99, a \$170,792,948 equity transfer (as restated) was made from MSF to MEDC. This represented the transfer of net assets of MSF.

Note 4 Loans Receivable

Loans receivable consisted of the following:

	Fiscal Year	
	2000-01	1999-2000
Urban Land Assembly Fund loans	\$ 4,381,945	\$ 3,312,184
Seed capital loans	7,800,000	7,800,000
BIDCO	4,015,354	6,494,610
Life Science	2,687,672	
Core Community	3,828,036	
Other loans	26,485,000	26,441,221
Total	<u>\$ 49,198,007</u>	<u>\$ 44,048,015</u>
Less: Allowance for uncollectible loans	<u>(23,109,918)</u>	<u>(23,109,918)</u>
Total Loans Receivable	<u>\$ 26,088,089</u>	<u>\$ 20,938,097</u>

Seed capital loans are uncollateralized, 10-year term loans (which can be extended) bearing interest at 9% per annum with a balloon payback required at the end of the loan period.

BIDCO and other loans are collateralized loans bearing varying rates of interest and repayment terms.

Inducement loans are collateralized loans bearing interest at predominantly 5% per annum with varying repayment terms.

Loans issued by the Michigan Economic Development Authority, a predecessor entity to MEDC, are included in the "Other loans" category. The loans are collateralized, for qualifying projects, on the basis of participating up to 50% with other public or private lenders. The loans are due under varying repayment terms, including interest at predominantly 9.5% per annum.

The current portion of loans receivable includes those payments expected to be received during the next fiscal year.

MEDC provided no additional allowance during the fiscal year ended September 30, 2001 for loans receivable that MEDC expected to be converted to grants or uncollectible. Loan provisions are reduced for the amounts recovered, BIDCO credits, and write-offs for the nonperforming loans. The loans generally provide for no principal or interest payments during the term of the loans. These loans are expected to be converted to grants at the end of their term provided that certain conditions are met by the borrowers. The conditions generally require the borrowers to continue to conduct their principal business activities in the State of Michigan and submit specified reports to MEDC.

Note 5 Differences From the SOMCAFR

Certain differences exist between these financial statements and those issued as part of the *SOMCAFR*. These differences result from the need to reclassify compensated absences and Capital Access Program liabilities between short-term and long-term on the MEDC statement of net assets after the issuance of the *SOMCAFR*. The corrections did not result in any changes in total *SOMCAFR*-reported net assets. MEDC requested and received approval from the Office of Financial Management, Department of Management and Budget, to deviate from the *SOMCAFR*.

Note 6 Capital Assets

MEDC recorded its capital assets at cost and depreciates them over their useful lives using the straight-line depreciation method.

Capital Assets	Beginning Balance	Increases	Decreases	Ending Balance
Construction in progress	\$5,808,807	\$	\$5,808,807	\$ 0
Building and improvement		12,589,351		12,589,351
Furniture		2,285,438		2,285,438
Non-EDP equipment		78,265		78,265
EDP equipment		610,283		610,283
Capital assets (cost)	\$5,808,807	\$ 15,563,337	\$5,808,807	\$ 15,563,337
Less accumulated depreciation for:				
Building and improvement		\$ (34,970)		\$ (34,970)
Furniture		(63,484)		(63,484)
Non-EDP equipment		(2,174)		(2,174)
EDP equipment		(55,297)		(55,297)
Total Accumulated Depreciation		\$ (155,926)		\$ (155,926)
Capital assets (net)	\$5,808,807	\$ 15,407,411	\$5,808,807	\$ 15,407,411

Note 7 Long-Term Liabilities

Long-term liabilities are accrued when incurred in proprietary funds (using the accrual basis of accounting). The following table summarizes Capital Access Program and compensated absences liabilities of MEDC:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$15,085,636	\$3,707,678	\$4,895,563	\$13,897,752	\$5,402,762
Compensated absences	\$ 2,065,166	\$1,187,304	\$1,008,120	\$ 2,244,350	\$1,167,615

Note 8 Restatement

The beginning retained earnings for fiscal year 1999-2000 was restated to include \$170,792,948 for contributed capital from MSF. The "Contributed Capital" line was discontinued with the implementation of GASB Statement No. 34. There was no impact on the total net assets on the statement of net assets for fiscal year 2000-01 and fiscal year 1999-2000.

Note 9 Pension Plans

State classified employees detailed to MEDC are covered by the plans offered by the State of Michigan. Detail and data regarding the plan descriptions, accounting policies, vesting and eligibility requirements, actuarial cost methods and assumptions, funding status and requirements, and 10-year historical trend information are provided in the SOMCAFR and the plans' detailed financial reports, issued by the Office of Retirement Services.

MEDC offers a defined contribution plan (under the Internal Revenue Service Code Section 401(A)) for the non-detailed employees. MEDC contributes 8% of the gross wages to the accounts of eligible employees. As of September 30, 2001, 26 employees were eligible to receive contributions. MEDC's contributions to the plan were current. MEDC also offers a 457 deferred compensation plan to these employees. As of September 30, 2001, 41 employees participated in this plan. MEDC does not make any contributions to the 457 plan. Both plans are administered by a third party administrator and the employees manage their own investments.

Note 10 Casino Revenue

Under a consent judgment reached between the Keweenaw Bay Indian Community (KBIC), the U.S. Department of the Interior, the U.S. Department of Justice, and the Governor, MEDC will receive a semi-annual payment from KBIC in an amount equal to 8% of the net win derived from all class III electronic games of chance. During fiscal year 2000-01, MEDC received \$5.1 million in such revenue covering the period from June 1999 through September 2001.

Note 11 Commitments

Of the total net assets (\$306,112,177), a portion is committed for the following economic development projects:

Access Technology - North Coast	\$ 500,000
Capital Access Fund	458,514
Center for Career Training	4,650,571
Center for Michigan's Renaissance	4,066,651
Center for Virtual Learning	7,516,605
Detroit Downtown Development Authority	4,811,861
Economic Development Job Training	29,012,317
Emerging Technology Fund	2,705,048
Life Science Program	64,251,880
Michigan Core Community Fund	43,846,608
Minority Investments	3,925,707
Research	86,941
Technology Centers (M-TECS)	9,939,136
Technology Transfer Program	700,000
Urban Land Development	4,006,855
Total	<u><u>\$180,478,694</u></u>



STATE OF MICHIGAN
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting

February 15, 2002

Mr. Doug Rothwell, President and Chief Executive Officer
Michigan Economic Development Corporation
300 North Washington Square
Lansing, Michigan

Dear Mr. Rothwell:

We have audited the financial statements of the Michigan Economic Development Corporation, a component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2001 and September 30, 2000 and have issued our report thereon dated February 15, 2002. 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.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Michigan Economic Development Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material

weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Michigan Economic Development Corporation's Executive Committee and management and the Legislature and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

Glossary of Acronyms and Terms

BIDCO	business and industrial development corporation.
CDBG	Community Development Block Grant.
detailed employees	The temporary assignment of employees from a governmental entity to another business entity. Employees in this capacity continue to receive the same compensation and benefits of the original employer, but receive day-to-day direction (work assignments and supervision) from the entity they are detailed to.
EDP	electronic data processing.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
GASB	Governmental Accounting Standards Board.
IDRB	industrial development revenue bond.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
KBIC	Keeweenaw Bay Indian Community.
material weakness	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial

schedules and/or financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

MEDC

Michigan Economic Development Corporation.

MSF

Michigan Strategic Fund.

NIST

National Institute of Standards and Technology.

reportable condition

A matter coming to the auditor's attention relating to a deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements.

SOMCAFR

State of Michigan Comprehensive Annual Financial Report.

unqualified opinion

An auditor's opinion in which the auditor states that the financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting.