

FINANCIAL AUDIT
OF THE

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION
(A Component Unit of the State of Michigan)

October 1, 2001 through September 30, 2003

“...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.”

– Article IV, Section 53 of the Michigan Constitution

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Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit

Report Number:
07-403-04

Michigan Economic Development Corporation

October 1, 2001 through September 30, 2003

Released:
August 2004

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 report any findings related to 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, as amended) between a participating local economic development corporation formed under Act 338, P.A. 1974, as amended, and the Michigan Strategic Fund.

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<http://audgen.michigan.gov>



Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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

August 17, 2004

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

Dear Mr. Jakeway:

This is our report on the financial audit of the Michigan Economic Development Corporation (MEDC) for the period October 1, 2001 through September 30, 2003.

This report contains our report summary, independent auditor's report on the financial statements, the MEDC management's discussion and analysis, and the MEDC 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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INDEPENDENT AUDITOR'S REPORT



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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

Independent Auditor's Report on the Financial Statements

February 5, 2004

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

Dear Mr. Jakeway:

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, 2003 and September 30, 2002, as identified in the table of contents. 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 financial statements present only the Michigan Economic Development Corporation and do not purport to, and do not, present fairly the financial position of the State of Michigan or its component units as of September 30, 2003 and September 30, 2002 and the changes in financial position and cash flows thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

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, 2003 and September 30, 2002 and the changes in financial position and cash flows thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis for the fiscal year ended September 30, 2003 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. The management's discussion and analysis for the fiscal year ended September 30, 2002 was not presented because this information was presented in the Michigan Economic Development Corporation's prior year's audit financial statements.

In accordance with *Government Auditing Standards*, we have also issued a report dated February 5, 2004 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

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, 2003. 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, notes to the financial statements, and this discussion.

Using the Financial Report

This financial report is prepared in accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*.

The 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).

This financial report includes the reports of independent auditors, management's discussion and analysis, the basic financial statements, 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 appropriations 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 and 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

	2003	2002
Current assets	\$ 167,090,807	\$ 194,884,652
Noncurrent assets:		
Investments	35,298,130	50,695,027
Loans receivable	26,103,269	27,129,212
Capital assets	13,229,654	14,652,484
Other noncurrent assets	7,689,002	11,693,622
Total Assets	<u>\$ 249,410,863</u>	<u>\$ 299,054,997</u>
Current liabilities	\$ 21,747,688	\$ 26,829,438
Long-term liabilities	6,811,404	7,868,642
Total Liabilities	<u>\$ 28,559,091</u>	<u>\$ 34,698,081</u>
Net Assets		
Capital assets	\$ 13,229,654	\$ 14,652,484
Unrestricted net assets	207,622,117	249,704,432
Total Net Assets	<u><u>\$ 220,851,772</u></u>	<u><u>\$ 264,356,916</u></u>

Current assets primarily consist of amounts retained by the State of Michigan in its equity in common cash for the unspent appropriations (details are provided at the end of this discussion and analysis), cash and cash equivalents, amounts due from the Michigan Strategic Fund (MSF), short-term investments, and loans receivable. Interest earned on funds retained in the common cash pool is the income for the State and does not get transferred to MEDC.

Current assets declined significantly primarily because of a change in the amount retained by the State of Michigan in its equity in common cash from \$145.7 million at September 30, 2002 to \$130.5 million at September 30, 2003. The decline was due to

amounts committed in fiscal year 2001-02 for the Life Sciences Program, Economic Development Job Training Program, and Michigan Core Community Fund Program but not disbursed until fiscal year 2002-03. There was also a significant drop in short-term notes in fiscal year 2002-03 due to liquidation necessary to pay for the NextEnergy Program commitment.

Investments include long-term securities and program investments. During fiscal year 2002-03, total investments (short-term and long-term) declined by \$8.5 million compared with fiscal year 2001-02 primarily because of the liquidation of investments necessary to pay for program grant commitments made in earlier years by MSF and recognition of unrealized program investment loss (\$9.3 million) netted against unrealized securities gain (\$1.9 million) and conversion of a loan to investment (\$1.5 million).

Loans receivable include only the long-term portion of the outstanding loans net of loan loss provisions. Total loans receivable (short-term and long-term) increased by \$405,000 in fiscal year 2002-03 when compared with fiscal year 2001-02 because of repayments of program loans (\$3.6 million) and conversion of a loan to investment (\$1.5 million) netted against new program loans made (\$4.1 million) and conversion of a investment to loan (\$0.5 million).

Capital assets at September 30, 2003 include the cost of MEDC headquarter building, furniture, and information technology equipment net of depreciation. During the year, capital assets worth \$77,307 were added.

Other noncurrent assets consist of Capital Access Program loan guarantee reserves. The Program ended on September 30, 2002 and no new loans are enrolled. However, MEDC will continue to process claims and recoveries until the reserves are exhausted.

Current liabilities primarily consist of accounts payable.

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

Overall, **net assets** were reduced by approximately \$43.5 million during fiscal year 2002-03 as a result of the activities stated above.

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

	2003	2002
Operating Revenues		
Operating grants and contributions	\$ 102,450,094	\$ 117,268,457
Interest and investment earnings	542,948	(1,237,647)
Other operating revenues	3,407,354	3,167,496
Total Operating Revenues	\$ 106,400,397	\$ 119,198,306
Operating Expenses		
Salaries, wages, and other administrative	\$ 42,726,031	\$ 43,578,143
Payment to MSF	12,775	2,937,913
Operating grants	107,166,735	114,437,511
Total Operating Expenses	\$ 149,905,541	\$ 160,953,567
Change in net assets	\$ (43,505,144)	\$ (41,755,261)
Total net assets - Beginning	264,356,916	306,112,177
Total net assets - Ending	\$ 220,851,772	\$ 264,356,916

Operating grants and contributions include grants received from the National Institute of Standards and Technology (NIST), a federally funded program; the amount received from State appropriations for the economic development functions; and tribal gaming revenue, fees, etc., received by MSF and transferred to MEDC.

Interest and investment earnings increased during fiscal year 2002-03 due to recovery of overall stock and bond market conditions compared to fiscal year 2001-02 and the recognition of the difference between cost and market value of the investments as of September 30, 2003 compared with October 1, 2002. As of September 30, 2003, the market value of MEDC investments was \$9.7 million lower than the cost. As of September 30, 2002, the market value of MEDC investments was \$11.6 million lower than the cost. As a result, \$1.9 million was recorded as revenue to reflect the market value of MEDC investments on September 30, 2003.

Other operating revenues primarily consisted of tribal 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 receives 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 2002-03, MEDC received \$2.6 million compared to \$2.3 million received in fiscal year 2001-02.

Salaries, wages, and other administrative expenses decreased because of budget cuts, staffing reduction, and early retirements.

Operating grants primarily include grants for the Life Sciences Program, Economic Development Job Training Program, Michigan Core Community Fund Program, and technical training programs.

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

	2003	(Restated) 2002
Cash provided (used) by:		
Operating activities	\$ (50,625,854)	\$ (66,137,159)
Capital and related financing activities	(77,307)	(664,544)
Investing activities	8,507,410	14,818,472
Net increase (decrease) in cash	\$ (42,195,751)	\$ (51,983,230)
Cash and cash equivalents at beginning of year	185,811,208	237,794,439
Cash and cash equivalents at end of year	\$ 143,615,457	\$ 185,811,208

The decline in cash and cash equivalents from fiscal year 2001-02 was due to amounts committed in fiscal year 2001-02 for the Life Sciences Program, Economic Development Job Training Program, Michigan Core Community Fund Program, and NextEnergy Program and disbursed during fiscal year 2002-03.

Cash and cash equivalents at the end of fiscal year 2002-03 (\$143.6 million) included \$130.5 million equity in the State of Michigan common cash. It is earmarked for the following obligations of MEDC:

<u>Program</u>	<u>Amount</u>
Life Sciences Program	\$ 60,634,143
Michigan Core Community Fund	16,370,742
Economic Development Job Training	15,521,897
Biosciences Research and Commercialization	10,000,000
Technology Centers (M-TECS)	3,022,107
Automotive Technological Accelerator	2,200,000
Michigan Growth Fund	1,904,875
Michigan Promotion Program	409,953
Miscellaneous	4,707,891
Accounts payable*	15,772,583
Total Equity in State of Michigan Common Cash	<u>\$ 130,544,190</u>

* This amount represents payments made after September 30, 2003 against the obligations of fiscal year 2002-03.

The balance of the cash on hand (\$13.1 million) represented investments in instruments with maturity dates of less than 12 months.

Other Pertinent Information

Contingent upon the opening of the remaining two casinos approved under a 1998 compact, MEDC may receive additional revenues from MSF in future years. The opening dates of these casinos and the amounts to be received are not certain.

FINANCIAL STATEMENTS

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

	2003	2002
ASSETS		
Current Assets:		
Cash	\$ 51,285	\$ 638,006
Equity in common cash (Note 3)	130,544,190	145,729,217
Capital Access Program - Cash	414,979	351,394
Short-term notes (Note 3)	4,916,001	27,398,970
Tribal gaming revenue receivable	1,330,000	1,200,000
Amounts due from MSF	6,366,057	4,600,000
Amounts due from federal agencies	171,467	
Investments (Note 3)	20,928,238	14,052,297
Other Current Assets:		
Loans receivable (Note 5)	1,906,128	475,289
Interest receivable	364,481	219,812
Miscellaneous	97,982	219,668
Total Current Assets	\$ 167,090,807	\$ 194,884,652
Noncurrent Assets:		
Capital Access Program - Reserve	\$ 7,689,002	\$ 11,693,622
Loans receivable (Note 5)	26,103,269	27,129,212
Investments (Note 3)	35,298,130	50,695,027
Capital assets (net) (Note 6)	13,229,654	14,652,484
Total Noncurrent Assets	\$ 82,320,056	\$ 104,170,345
Total Assets	\$ 249,410,863	\$ 299,054,997
LIABILITIES		
Current Liabilities:		
Accounts payable and other liabilities	\$ 16,711,271	\$ 20,642,278
Compensated absences (Notes 7 and 8)	942,345	1,114,062
Amounts due to primary government	94,072	66,779
Capital Access Program (Note 7)	4,000,000	5,000,000
Deferred revenues		6,319
Total Current Liabilities	\$ 21,747,688	\$ 26,829,438
Long-Term Liabilities:		
Capital Access Program (Note 7)	\$ 3,689,002	\$ 6,703,134
Compensated absences (Notes 7 and 8)	821,502	1,137,609
Other long-term liabilities	2,300,899	27,899
Total Long-Term Liabilities	\$ 6,811,404	\$ 7,868,642
Total Liabilities	\$ 28,559,091	\$ 34,698,081
NET ASSETS		
Invested in capital assets	\$ 13,229,654	\$ 14,652,484
Unrestricted net assets	207,622,117	249,704,432
Total Net Assets (Note 10)	\$ 220,851,772	\$ 264,356,916

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 Years Ended September 30

	2003	2002
OPERATING REVENUES		
<u>Operating Grants and Contributions</u>		
Federal revenue - NIST	\$ 2,223,078	\$ 1,576,568
Payments from MSF - State appropriations (Note 4)	85,937,508	105,232,185
Payments from MSF - Tribal gaming revenue, fees, etc. (Note 4)	14,289,508	10,459,705
Total Operating Grants and Contributions	\$ 102,450,094	\$ 117,268,457
<u>Interest and Investment Earnings</u>		
Investment earnings	\$ 2,806,188	\$ 7,346,040
Net increase (decrease) in fair value of investments	(2,883,335)	(8,982,985)
Interest income on loans	556,494	258,452
Interest income	63,602	140,846
Total Interest and Investment Earnings	\$ 542,948	\$ (1,237,647)
<u>Other Operating Revenues</u>		
Tribal gaming revenue (Note 9)	\$ 2,609,780	\$ 2,349,131
Other operating revenues	797,574	818,365
Total Other Operating Revenues	\$ 3,407,354	\$ 3,167,496
Total Operating Revenues	\$ 106,400,397	\$ 119,198,306
OPERATING EXPENSES		
Salaries, wages, and other administrative	\$ 43,213,855	\$ 43,570,821
Compensated absences (Note 8)	(487,824)	7,322
Payment to MSF	12,775	2,937,913
Operating grants	107,166,735	114,437,511
Total Operating Expenses	\$ 149,905,541	\$ 160,953,567
Operating Income (Loss)	\$ (43,505,144)	\$ (41,755,261)
Nonoperating Revenues (Expenses)	\$ 0	\$ 0
Transfers	\$ 0	\$ 0
Change in net assets	\$ (43,505,144)	\$ (41,755,261)
Total net assets - Beginning	264,356,916	306,112,177
Total net assets - Ending	\$ 220,851,772	\$ 264,356,916

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

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION
Statement of Cash Flows
For the Fiscal Years Ended September 30

	<u>2003</u>	<u>(Restated) 2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Payments to employees	\$ (18,544,999)	\$ (22,226,752)
Payments to suppliers	(24,116,793)	(23,967,007)
Tribal gaming revenue	2,479,780	2,394,875
Other operating revenue	1,354,068	1,076,817
Grants received from federal government	2,051,611	1,944,133
Operating grants	(112,863,015)	(138,811,233)
Payment to MSF	(12,775)	(2,937,913)
Payments from MSF	99,026,269	116,389,921
Net cash provided (used) by operating activities	<u>\$ (50,625,854)</u>	<u>\$ (66,137,159)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Net cash provided (used) by noncapital financing activities	<u>\$ 0</u>	<u>\$ 0</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets (Note 6)	<u>\$ (77,307)</u>	<u>\$ (664,544)</u>
Net cash provided (used) by capital and related financing activities	<u>\$ (77,307)</u>	<u>\$ (664,544)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale and maturities of investment securities (Note 3)	\$ 5,637,621	\$ 7,331,586
Interest and dividends on investments	2,869,789	7,486,886
Net cash provided (used) by investing activities	<u>\$ 8,507,410</u>	<u>\$ 14,818,472</u>
Net cash provided (used) - all activities	\$ (42,195,751)	\$ (51,983,230)
Cash and cash equivalents at beginning of year	185,811,208	237,794,439
Cash and cash equivalents at end of year	<u>\$ 143,615,457</u>	<u>\$ 185,811,208</u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS		
Per statement of net assets classifications:		
Cash	\$ 51,285	\$ 638,006
Equity in common cash	130,544,190	145,729,217
Capital Access Program	8,103,981	12,045,016
Short-term notes	4,916,001	27,398,970
Cash and cash equivalents at end of year	<u>\$ 143,615,457</u>	<u>\$ 185,811,208</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:		
Operating income (loss)	\$ (43,505,144)	\$ (41,755,261)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Interest (nonprogram) and investment income	(2,869,789)	(7,486,886)
Depreciation	1,500,137	1,419,471
Net increase (decrease) in fair value of investments	2,883,335	8,982,985
Changes in assets and liabilities:		
Amounts due from component unit (MSF)	(1,766,057)	698,031
Mortgages and loans receivable (program loans)	(404,897)	(1,516,412)
Amount due from federal agencies	(171,467)	61,944
Other assets	(152,982)	517,137
Accounts payable and other liabilities	(6,138,989)	(27,058,169)
Net cash provided (used) by operating activities	<u>\$ (50,625,854)</u>	<u>\$ (66,137,159)</u>
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Loan converted to investment	\$ 1,510,396	\$ 4,177,997
Investment converted to loan	(545,896)	
Increase/(decrease) in fair market value of investments	(2,883,335)	(8,982,985)
Net noncash provided (used) by investing, capital, and financing activities	<u>\$ (1,918,835)</u>	<u>\$ (4,804,988)</u>

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, as amended) 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 20 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. Financial Statement Presentation

Under 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 in 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.

MEDC is a proprietary fund. Proprietary funds are accounted for using a flow of economic resources measurement focus and the accrual basis of accounting. 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. Accordingly, they do not purport to, and do not, present fairly the financial position and the changes in financial position and cash flows of the State of Michigan or its component units in conformity with generally accepted accounting principles.

c. Measurement Focus and Basis of Accounting

The financial statements contained in this report are presented using the economic resources measurement focus and the accrual basis of accounting as provided by generally accepted accounting principles applicable to governments. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows.

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 Services grant are received by MSF and transferred to MEDC to fund program expenditures.

MEDC financial statements primarily present the following:

- (1) Cash and Cash Equivalents: The amount reported as "Cash and cash equivalents at end of year" on the statement of cash flows is equal to the total of the amounts reported on the statement of net assets for the line items entitled "Cash," "Equity in common cash," "Capital Access Program - Cash," "Short-term notes," and "Capital Access Program - Reserve."
- (2) Operating Revenues: Revenues from federal grants, other restricted sources, amounts available to MEDC from State appropriations, tribal gaming revenue (see Notes 4 and 9), and investment earnings. Also included in operating revenues are IDRB issuance fees and Michigan Economic Growth Authority (MEGA) and Brownfield fees collected by MSF and transferred to MEDC during the year.
- (3) 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 Restatements

MEDC restated the statement of cash flows for the fiscal year ended September 30, 2002 to reclassify program income of \$258,452 to cash flows from operating activities (other operating revenue) from cash flows from investment activities (interest and dividends on investments); to eliminate noncash fair market value adjustments of \$8,982,984 from investing activities (proceeds from sale and maturities of investment securities and interest and dividends on investments); and to report noncash investing activities of \$4,177,997 related to a loan converted to an investment.

Note 3 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, 2003 were:

	<u>Deposits</u>	<u>Investments</u>
Current Deposits and Investments:		
Equity in State of Michigan common cash	\$ 130,544,190	\$
Checking	60,498	(9,212)
Capital Access Program - Cash	414,979	
Capital Access Program - Reserve	7,689,002	
Short-term notes		4,916,001
Marketable securities		20,928,238
Total Current Deposits and Investments	<u>\$ 138,708,669</u>	<u>\$ 25,835,026</u>
Long-term securities		35,298,130
Total Deposits and Investments	<u><u>\$ 138,708,669</u></u>	<u><u>\$ 61,133,157</u></u>

Deposits included in MEDC's bank accounts (without recognition of outstanding checks or deposits in transit) were \$8,787,453 at September 30, 2003 (\$12,869,698 at September 30, 2002). Of that amount, \$3,120,381 (\$3,859,918 at September 30, 2002) was covered by federal depository insurance and was classified in GASB credit risk category 1. The remaining \$5,667,072 (\$9,009,780 at September 30, 2002) was uninsured and uncollateralized at September 30, 2003 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 Sciences Program) that were committed for several grant programs but not spent (disbursed) at the end of the fiscal year.

As of September 30, 2002, MEDC's total deposits and investments were \$158,412,239 and \$92,146,293, 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, 2003 by investment type and in total and does not include the checking account balances:

Investment Type	GASB Credit Risk Category			Not Categorized	Fair Value
	1	2	3		
Corporate securities	\$	\$	\$ 26,623,736	\$	\$ 26,623,736
Cash and cash equivalents			(9,212)		(9,212)
Government securities			5,707,441		5,707,441
Equity	2,368,707				2,368,707
Mutual funds				15,139,237	15,139,237
Other nonmarketable investments				11,303,249	11,303,249
Total Investments	<u>\$ 2,368,707</u>	<u>\$ 0</u>	<u>\$ 32,321,964</u>	<u>\$ 26,442,486</u>	<u>\$ 61,133,157</u>

The fair value of investments at September 30, 2002 was \$92,146,293, of which \$1,052,827 and \$60,330,449 were recorded in GASB credit risk category 1 and category 3, respectively, and \$30,763,017 was not categorized in any risk category.

MEDC makes grant commitments as a part of its economic development mission. These commitments are paid from the proceeds of the investments held in short-term and long-term securities. The timing of cash required for program commitments is dependent upon the completion of projects. Investments held in long-term securities are made to maximize the earnings. However, the intent of the investment is not to hold it long term considering the cash flow needs to meet grant commitments. For this reason, investments have frequent turnover. Therefore, the proceeds from sales and purchases of all investments are shown as a net balance on the statement of cash flows.

Note 4 Revenues From MSF

Revenues from MSF consisted of the following:

	Fiscal Year	
	2002-03	2001-02
Tribal gaming revenue, fees, etc.	\$ 14,289,508	\$ 10,459,705
State's General Fund appropriation	52,154,078	59,173,859
State's restricted appropriation	1,283,430	1,058,326
State's tobacco revenue appropriation	32,500,000	45,000,000
Total Revenues From MSF	<u>\$ 100,227,016</u>	<u>\$ 115,691,890</u>

Note 5 Loans Receivable

Loans receivable consisted of the following:

	As of September 30	
	2003	2002
Urban Land Assembly Fund loans	\$ 6,530,786	\$ 4,309,306
Seed capital loans	3,400,000	3,400,000
BIDCO	997,365	2,722,854
Life Sciences Program	6,829,728	5,469,903
Michigan Core Community Fund	9,276,518	8,561,240
Other loans	12,896,102	15,091,198
Total	<u>\$ 39,930,499</u>	<u>\$ 39,554,500</u>
Less: Allowance for uncollectible loans	(11,921,102)	(11,950,000)
Total Loans Receivable	<u>\$ 28,009,397</u>	<u>\$ 27,604,500</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.

Loans included in the "Other loans" category 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, 2003 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 6 Capital Assets

MEDC recorded its capital assets at cost and depreciates them over their useful lives using the straight-line depreciation method. Capital asset activities for the fiscal year ended September 30, 2003 were as follows:

Capital Assets	Beginning Balance	Increases	Decreases	Ending Balance
Building and improvement	\$ 13,053,793	\$ 33,177	\$	\$ 13,086,970
Furniture	2,430,971			2,430,971
Non-EDP equipment	78,265			78,265
EDP equipment	664,851	44,130		708,981
Capital assets (cost)	<u>\$ 16,227,881</u>	<u>\$ 77,307</u>	<u>\$ 0</u>	<u>\$ 16,305,188</u>
Less accumulated depreciation for:				
Building and improvement	\$ (462,356)	\$ (435,978)	\$	\$ (898,335)
Furniture	(849,552)	(810,324)		(1,659,876)
Non-EDP equipment	(28,262)	(26,088)		(54,351)
EDP equipment	(235,226)	(227,746)		(462,972)
Total Accumulated Depreciation	<u>\$ (1,575,397)</u>	<u>\$ (1,500,137)</u>	<u>\$ 0</u>	<u>\$ (3,075,533)</u>
Capital assets (net)	<u>\$ 14,652,484</u>	<u>\$ (1,422,830)</u>	<u>\$ 0</u>	<u>\$ 13,229,654</u>

Capital asset activities for the fiscal year ended September 30, 2002 were as follows:

Capital Assets	Beginning Balance	Increases	Decreases	Ending Balance
Building and improvement	\$12,589,351	\$ 464,442	\$	\$ 13,053,793
Furniture	2,285,438	145,533		2,430,971
Non-EDP equipment	78,265	0		78,265
EDP equipment	610,283	54,568		664,851
Capital assets (cost)	<u>\$15,563,337</u>	<u>\$ 664,544</u>	<u>\$ 0</u>	<u>\$ 16,227,881</u>
Less accumulated depreciation for:				
Building and improvement	\$ (34,970)	\$ (427,386)	\$	\$ (462,356)
Furniture	(63,484)	(786,068)		(849,552)
Non-EDP equipment	(2,174)	(26,088)		(28,262)
EDP equipment	(55,297)	(179,929)		(235,226)
Total Accumulated Depreciation	<u>\$ (155,926)</u>	<u>\$ (1,419,471)</u>	<u>\$ 0</u>	<u>\$ (1,575,397)</u>
Capital assets (net)	<u>\$15,407,411</u>	<u>\$ (754,928)</u>	<u>\$ 0</u>	<u>\$14,652,484</u>

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 for the fiscal year ended September 30, 2003:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$11,703,134	\$2,285,972	\$6,300,104	\$7,689,002	\$4,000,000
Compensated absences	\$ 2,251,672	\$ 776,484	\$1,264,309	\$1,763,847	\$ 942,345

The following table summarizes Capital Access Program and compensated absences liabilities of MEDC for the fiscal year ended September 30, 2002:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$13,897,752	\$3,550,959	\$5,745,577	\$11,703,134	\$5,000,000
Compensated absences	\$ 2,244,350	\$1,264,765	\$1,257,443	\$ 2,251,672	\$1,114,062

Note 8 Pension Plans

State classified employees detailed to MEDC are covered by the plans offered by the State of Michigan. Detailed information 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, Department of Management and Budget.

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, 2003, 30 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, 2003, 28 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 9 Tribal Gaming 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 receives 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 2002-03, MEDC received \$2.6 million in such revenue (\$2.3 million in fiscal year 2001-02).

Note 10 Commitments

Of the total net assets (\$220,851,772), a portion is committed for the following economic development projects:

Access Technology - North Coast	\$ 450,000
Automotive Technological Accelerator	1,800,000
Biosciences Research and Commercialization	10,000,000
Center for Michigan's Renaissance	824,718
Detroit Downtown Development Authority	2,050,858
Economic Development Job Training	15,521,897
Emerging Technology Fund	1,355,802
Life Sciences Program	60,634,143
Marketing	6,000,000
Michigan Core Community Fund	16,370,742
Michigan Growth Fund	1,904,875
Minority Investments	3,795,008
SmartZones Initiatives	3,140,000
Technology Centers (M-TECS)	3,022,106
Technology Transfer Program	300,000
Technology Tri-corridor	10,000,000
Urban Land Development	1,944,291
Total	<u>\$ 139,114,440</u>

Note 11 Related Party Transactions

When MEDC was created, it assumed ownership of an investment in a venture capital firm from MSF. One of the members on the MEDC Executive Committee is also a general partner of that venture capital firm. The investment was made through the ordinary course of business prior to that member's appointment to the MEDC Executive Committee. As of September 30, 2003 and September 30, 2002, the investment was recorded on the statement of net assets as a noncurrent asset in the amount of \$2,700,055 and \$7,565,203, respectively. There have been no related party transactions with this firm during the year.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND INTERNAL CONTROL



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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

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

February 5, 2004

Mr. Donald Jakeway, President and Chief Financial Officer
Michigan Economic Development Corporation
300 North Washington Square
Lansing, Michigan

Dear Mr. Jakeway:

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, 2003 and September 30, 2002, as identified in the table of contents, and have issued our report thereon dated February 5, 2004. 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 internal control over financial reporting. Our consideration of internal control over financial reporting would not necessarily disclose all matters in 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 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

Glossary of Acronyms and Terms

BIDCO	business and industrial development corporation.
CDBG	Community Development Block Grant.
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 misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.
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.
SOMCAFR	<i>State of Michigan Comprehensive Annual Financial Report.</i>