

FINANCIAL AUDIT
OF THE

MICHIGAN BROADBAND DEVELOPMENT AUTHORITY
(A Component Unit of the State of Michigan)

October 1, 2002 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

Audit report information may be accessed at:
<http://www.state.mi.us/audgen/>



Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit

Report Number:
27-285-04

Michigan Broadband Development Authority

Fiscal Year Ended September 30, 2003

Released:
December 2003

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 Broadband Development Authority (MBDA) 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 MBDA'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:

MBDA was created by Act 49, P.A. 2002, to assist in the development and utilization of high-speed broadband Internet services and infrastructure across Michigan. MBDA is governed by an 11-member board of directors that consists of the president and chief executive officer of the Michigan Economic Development Corporation, the State Treasurer, the executive director of the Michigan State Housing Development Authority, and 8 members appointed by the Governor with the advice and consent of the Senate.

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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/



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

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

James S. Neubecker, C.P.A., C.I.A., D.P.A.
Executive Deputy Auditor General

Scott M. Strong, C.P.A., C.I.A.
Director of Audit Operations

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

December 23, 2003

Mr. Jay B. Rising, State Treasurer
Acting Chairperson
Michigan Broadband Development Authority Board
Treasury Building
Lansing, Michigan
and
Mr. James W. Butler III, Vice President
Michigan Broadband Development Authority
735 East Michigan Avenue
Lansing, Michigan

Dear Mr. Rising and Mr. Butler:

This is our report on the financial audit of the Michigan Broadband Development Authority (MBDA) for the period October 1, 2002 through September 30, 2003.

This report contains our report summary, our independent auditor's report on the financial statements, the MBDA management's discussion and analysis, and the MBDA 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.

Sincerely,

A handwritten signature in black ink that reads "Thomas H. McTavish". The signature is written in a cursive style with a long horizontal line extending to the left.

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

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INDEPENDENT AUDITOR'S REPORT



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

Independent Auditor's Report on the Financial Statements

November 19, 2003

Mr. Jay B. Rising, State Treasurer
Acting Chairperson
Michigan Broadband Development Authority Board
Treasury Building
Lansing, Michigan
and
Mr. James W. Butler III, Vice President
Michigan Broadband Development Authority
735 East Michigan Avenue
Lansing, Michigan

Dear Mr. Rising and Mr. Butler:

We have audited the financial statements of the Michigan Broadband Development Authority, a component unit of the State of Michigan, as of and for the fiscal year ended September 30, 2003, as identified in the table of contents. These financial statements are the responsibility of the Michigan Broadband Development Authority'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 Broadband Development Authority 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

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

The management's discussion and analysis is not a required part of the 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 November 19, 2003 on our tests of the Michigan Broadband Development Authority'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.

Sincerely,

A handwritten signature in black ink, appearing to read "Thomas H. McTavish". The signature is fluid and cursive, with a long horizontal stroke at the beginning.

Thomas H. McTavish, C.P.A.
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 Broadband Development Authority (MBDA) for the period October 1, 2002 through September 30, 2003. Act 49, P.A. 2002, which created MBDA, was enacted on March 14, 2002. MBDA is a public body corporate and a component unit of the financial reporting entity of the State of Michigan. MBDA'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 net assets; and a statement of cash flows (direct method).

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

Bond and note financing is the source of funding for MBDA's loan programs. There are no State appropriations for the administration of MBDA's programs.

The financial statements are interrelated and represent the financial status of MBDA. 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 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, noncapital financing, and investing activities.

Analysis of Financial Activities

The MBDA Board of Directors approves an annual budget and the investment policy. The president and chief executive officer and the vice president are responsible for implementing the programs approved by the MBDA Board of Directors.

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

	<u>2003</u>	<u>2002</u>
Current assets	\$ 45,764,231	\$ 17,642,518
Noncurrent assets	120,212	15,154,688
Total Assets	<u>\$ 45,884,443</u>	<u>\$ 32,797,206</u>
Current liabilities	\$ 3,523,057	\$ 844,156
Noncurrent liabilities	50,096,768	33,395,921
Total Liabilities	<u>\$ 53,619,824</u>	<u>\$ 34,240,077</u>
Net Assets		
Unrestricted net assets (deficit)	<u>\$ (7,735,381)</u>	<u>\$ (1,442,871)</u>
Total Net Assets	<u>\$ (7,735,381)</u>	<u>\$ (1,442,871)</u>

Current assets primarily consist of government securities, U.S. government money market funds, and amounts retained by the State of Michigan in its equity in Common Cash for the payment of future expenses. Interest earned on funds retained in the Common Cash pool is the income for the State and does not get transferred to MBDA.

Noncurrent assets consist of loans receivable.

Current liabilities primarily consist of accounts payable and interest payable.

Noncurrent liabilities primarily consist of one \$50 million bond issued by MBDA and purchased by the Michigan State Housing Development Authority (MSHDA). Terms of the agreement call for MBDA to receive three equal installments of \$16.7 million. Two of the payments were received in fiscal year 2001-02 and the final payment was received on November 1, 2002 and was included in the fiscal year 2002-03 financial statements.

Condensed Financial Information
From the Statement of Revenues, Expenses, and Changes in Net Assets

	Fiscal Year Ended September 30, 2003	Fiscal Period March 14, 2002* through September 30, 2002
Operating Revenues		
Interest income from loans	\$ 3,445	\$ 0
Commitment fees and closing costs	17,692	0
Miscellaneous income	2,026	0
Income from grants	45,875	0
Total Operating Revenues	\$ 69,038	\$ 0
Operating Expenses		
Salaries, wages, and other administrative expenses	\$ 4,121,435	\$ 1,208,514
Interest on bonds	2,931,933	583,400
Total Operating Expenses	\$ 7,053,368	\$ 1,791,914
Operating income (loss)	\$ (6,984,330)	\$ (1,791,914)
Nonoperating Revenues		
Investment and interest income	\$ 701,188	\$ 173,109
Net increase (decrease) in the fair value of investments	(9,368)	175,934
Total Nonoperating Revenues	\$ 691,820	\$ 349,043
Change in net assets	\$ (6,292,510)	\$ (1,442,871)
Total net assets - Beginning	(1,442,871)	0
Total net assets - Ending	\$ (7,735,381)	\$ (1,442,871)

* MBDA was created on March 14, 2002.

Salaries, wages, and other administrative expenses increased during the period because of a full year of activity, increased staffing, and program expansion. MBDA initiates and approves expenses and some payments are made through the State of Michigan's warrant processing system. MBDA also issues checks and makes payments directly to vendors.

Investment and interest income relates to the earnings from the sale of investments and the interest earned. As of September 30, 2003, the market value of MBDA investments was \$166,566 higher than the cost. As of September 30, 2002, the market value of MBDA investments was \$175,934 higher than the cost. As a result, \$9,368 was recorded as a reduction in revenues to reflect the market value of MBDA investments on September 30, 2003.

Change in net assets reflects the effect of the start of operations. In subsequent years, revenues should increase as MBDA continues to provide financing to broadband developers and operators.

**Condensed Financial Information
From the Statement of Cash Flows**

	Fiscal Year Ended September 30, 2003	Fiscal Period March 14, 2002* through September 30, 2002
Cash provided (used) by:		
Operating activities	\$ (4,191,463)	\$ (885,171)
Noncapital financing activities	16,466,667	33,333,333
Investing activities	16,602,822	(30,763,505)
Net increase (decrease) in cash	\$ 28,878,026	\$ 1,684,657
Cash - Beginning	1,684,657	0
Cash - Ending	\$ 30,562,683	\$ 1,684,657

* MBDA was created on March 14, 2002.

FINANCIAL STATEMENTS

MICHIGAN BROADBAND DEVELOPMENT AUTHORITY
Statement of Net Assets
As of September 30, 2003

ASSETS

Current Assets:	
Cash and cash equivalents (Note 2)	\$ 30,562,683
Investments (Note 2)	15,145,320
Interest receivable	<u>56,228</u>
Total Current Assets	\$ 45,764,231
Noncurrent Assets:	
Loans receivable	<u>120,212</u>
Total Assets	<u>\$ 45,884,443</u>

LIABILITIES

Current Liabilities:	
Accounts payable	\$ 169,046
Amounts due to primary government	34,657
Compensated absences (Note 4)	4,021
Interest payable	<u>3,315,333</u>
Total Current Liabilities	<u>\$ 3,523,057</u>
Noncurrent Liabilities:	
Bonds payable (Note 3)	\$ 50,000,000
Compensated absences (Note 4)	81,527
Loan reserves payable	<u>15,241</u>
Total Noncurrent Liabilities	<u>\$ 50,096,768</u>
Total Liabilities	<u>\$ 53,619,824</u>

NET ASSETS

Unrestricted net assets (deficit)	<u>\$ (7,735,381)</u>
Total Net Assets	<u><u>\$ (7,735,381)</u></u>

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

MICHIGAN BROADBAND DEVELOPMENT AUTHORITY
Statement of Revenues, Expenses, and Changes in Net Assets
For the Period October 1, 2002 through September 30, 2003

OPERATING REVENUES

Interest income from loans	\$ 3,445
Commitment fees	11,710
Closing costs	5,982
Miscellaneous income	2,026
Income from grants	45,875
Total Operating Revenues	<u>\$ 69,038</u>

OPERATING EXPENSES

Salaries and wages	\$ 337,956
Employee benefits (Note 6)	172,985
Contractual services employee compensation	662,462
Contractual services	2,449,178
Compensated absences (Note 4)	19,873
Interest on bonds	2,931,933
Administrative and general	478,981
Total Operating Expenses	<u>\$ 7,053,368</u>

Operating income (loss)	<u>\$ (6,984,330)</u>
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NONOPERATING REVENUES

Investment income	\$ 625,573
Interest income	75,615
Net increase (decrease) in the fair value of investments	(9,368)
Total Nonoperating Revenues	<u>\$ 691,820</u>

Change in net assets	\$ (6,292,510)
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Total Net Assets - Beginning	<u>(1,442,871)</u>
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Total Net Assets - Ending	<u><u>\$ (7,735,381)</u></u>
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The accompanying notes are an integral part of the financial statements.

MICHIGAN BROADBAND DEVELOPMENT AUTHORITY
Statement of Cash Flows
For the Period October 1, 2002 through September 30, 2003

CASH FLOWS FROM OPERATING ACTIVITIES

Fees	\$ 32,933
Operating grants	45,875
Other operating revenue	2,026
Loans to customers	(121,645)
Principal and interest payments on loans	4,877
Payments to employees	(510,940)
Payments to suppliers	(3,644,589)
Net cash provided (used) by operating activities	<u>\$ (4,191,463)</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Interest paid	\$ (200,000)
Proceeds from issuance of bonds	16,666,667
Net cash provided (used) by noncapital financing activities	<u>\$ 16,466,667</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Purchase of investments	\$ (35,811,468)
Proceeds from the sale and maturity of investments	52,000,000
Interest on investments	414,290
Net cash provided (used) by investing activities	<u>\$ 16,602,822</u>

Net increase (decrease) in cash - all activities	\$ 28,878,026
Cash and cash equivalents - Beginning	1,684,657
Cash and cash equivalents - Ending	<u>\$ 30,562,683</u>

**RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED)
BY OPERATING ACTIVITIES:**

Operating income (loss)	\$ (6,984,330)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:	
Loans to customers and principal on loans reported as cash flows from operating activities	(120,212)
Interest payments on debt reported as cash flows from financing activities	200,000
Change in assets and liabilities:	
Accounts payable	(53,967)
Interest payable	2,731,933
Compensated absences	19,873
Loan reserves payable	15,241
Net cash provided (used) by operating activities	<u>\$ (4,191,463)</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 Broadband Development Authority (MBDA) 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

MBDA was created by Act 49, P.A. 2002, to assist in the development and utilization of high-speed broadband Internet services and infrastructure across Michigan. MBDA has the responsibility to remain self-sufficient by generating revenues from project lending and joint venture activity. MBDA came into existence on March 14, 2002.

MBDA is governed by an 11-member board of directors that consists of the president and chief executive officer of the Michigan Economic Development Corporation, the State Treasurer, the executive director of the Michigan State Housing Development Authority (MSHDA), and 8 members appointed by the Governor with the advice and consent of the Senate.

MBDA 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 MBDA; the legal separation of the State and MBDA; the fiscal independence of MBDA; whether exclusion of the unit would make the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)* misleading; and whether there is a potential for MBDA to provide specific financial benefits to, or impose financial burdens on, the State.

b. Measurement Focus and 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. MBDA'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: MBDA is a proprietary fund. Proprietary funds are accounted for using 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 the proprietary fund activities are included on the statement of net assets.

Proprietary funds are used to account for the 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 MBDA. 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. 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. MBDA 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.

d. Financial Data

MBDA financial statements primarily present the following:

- (1) Operating Expenses: Expenses related to the administration of MBDA and bond interest expenses.
- (2) Operating Revenues: Revenues consist of interest income and fees on loans and grant revenue used for operations.
- (3) Nonoperating Revenues: Revenues consist of investment earnings and the decrease in the fair value of investments.
- (4) Cash Equivalents: MBDA considers U.S. government money market funds to be cash equivalents.
- (5) Investments: MBDA reports all marketable investments at fair value with gains and losses included in the statement of revenues, expenses, and changes in net assets.
- (6) Equipment: Purchases of equipment by MBDA for use in its operations that meet the requirements of the State of Michigan's capitalization policy (a value of over \$5,000) are capitalized in accordance with GASB Statement No. 34. For the period ended September 30, 2003, MBDA had no equipment purchases capitalized.

Note 2 Deposits and Investments

a. General Information

Act 49, P.A. 2002, allows MBDA to invest funds at its discretion, in any obligations that it determines to be proper. Deposits of MBDA are held in a financial institution approved by the State Treasurer.

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.

Certain types of deposits and investments are not categorized because they are not evidenced by securities that exist in physical or book entry form. In general, deposits and investments in pools managed by other governments or in mutual funds should be disclosed but not categorized.

As of September 30, 2003, the reported amount of MBDA's deposits was \$30,562,683 and the bank balance was \$30,693,802, consisting of the following:

U.S. government money market funds	\$ 28,272,034
Cash in bank	2,421,768
Total Deposits	<u>\$ 30,693,802</u>

Of this amount, \$200,000 was covered by federal depository insurance (GASB credit risk category 1), \$2,221,768 was uninsured and uncollateralized (GASB credit risk category 3), and \$28,272,034 was held in money market funds which are not categorized.

c. Investments

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:

Investment Type	GASB Credit Risk Category			Not Categorized	Fair Value
	1	2	3		
Government securities	\$15,145,320	\$	\$	\$	\$15,145,320
Total Investments	<u>\$15,145,320</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$15,145,320</u>

Note 3 Bonds Payable

MBDA is authorized to issue bonds to fund its operations and to finance or refinance the private and public sectors' development of the broadband infrastructure. Such bonds constitute a general obligation of MBDA and are not a debt of the State of Michigan. Bonds are secured by the pledge to repay the principal and interest related to those bonds. Interest on such debt is payable annually, and the bonds are subject to optional redemption provisions as set forth in the official statement for the bond issue. See Note 7 for additional information related to bonds issued.

The following table displays the aggregate changes in bonds payable for the period October 1, 2002 through September 30, 2003:

Beginning bonds payable	\$ 33,333,333
Additional proceeds and borrowings	16,666,667
Repayments	0
Ending bonds payable	<u>\$ 50,000,000</u>

MBDA limited obligations outstanding as of September 30, 2003 were:

Michigan Broadband Development Authority Purposes Funding Taxable Subordinate Bond Series 2002A, payable through May 1, 2022 with an interest rate of 6%	\$ 50,000,000
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The annual requirements to amortize all debt outstanding, including interest, as of September 30, 2003, are as follows:

Fiscal Year	Principal	Interest	Total
2003-04	\$	\$3,000,000	\$3,000,000
2004-05		3,000,000	3,000,000
2005-06		3,000,000	3,000,000
2006-07		3,000,000	3,000,000
2007-08		3,000,000	3,000,000
Total for fiscal years 2003-04 through 2007-08	\$ 0	\$15,000,000	\$15,000,000
2008-09 through 2012-13		15,000,000	15,000,000
2013-14 through 2017-18		15,000,000	15,000,000
2018-19 through 2021-22	50,000,000	10,750,000	60,750,000
Total	<u>\$ 50,000,000</u>	<u>\$55,750,000</u>	<u>\$105,750,000</u>

The outstanding principal balance on the bonds bears interest at a fixed rate of 6% per year compounded annually. A minimum interest payment is calculated based on the investment agreement and due each February 1. Interest continues to accrue on the difference between the interest calculated at the fixed rate and the minimum interest payment.

Effective October 16, 2003, MBDA restructured the existing bond payable with the Michigan State Housing Development Authority (MSHDA) to a line of credit. MBDA repaid \$42,925,987 to MSHDA with available assets to reduce the bond payable. The remaining debt of \$7,074,013 is due May 1, 2022 and bears interest at a fixed rate of 6% per year compounded annually. MBDA may make additional draws on the line of credit as long as the maximum principal amount does not exceed \$50 million. MBDA has the option of taking short-term advances on the line of credit, which bear an interest rate at the lower of the prime rate or 6% per year.

Note 4 Compensated Absences

Noncurrent liabilities are accrued when incurred in proprietary funds (using the accrual basis of accounting). The following table summarizes compensated absences liabilities of MBDA:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Compensated absences	\$ 65,675	\$ 19,873	\$ 0	\$ 85,548	\$ 4,021

Note 5 Leases

MBDA canceled its lease effective July 18, 2003 and moved to the MSHDA building. MBDA did not pay any rent to MSHDA during the year. The lease has not been finalized as the lease terms and duration have not been determined and costs have not been calculated.

Note 6 Employee Benefits

The employer's share of life, health, optical, dental, and long-term disability insurance premiums are charged by the State of Michigan to MBDA biweekly for each State employee's selected coverage.

State employees are also enrolled in a noncontributory defined benefit plan or a defined contribution plan through the State Employees' Retirement System upon meeting certain eligibility requirements. Details 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.

Note 7 Related Party Transactions

The MBDA Board of Directors includes the executive director of MSHDA. MBDA entered into an investment agreement with MSHDA for the sale of a bond to MSHDA. The total amount of the bond issue was \$50,000,000, with MBDA receiving three equal installment payments from MSHDA of \$16,666,667 on May 1, 2002, August 1, 2002, and November 1, 2002.

INDEPENDENT AUDITOR'S REPORT ON
COMPLIANCE AND INTERNAL CONTROL



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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

November 19, 2003

Mr. Jay B. Rising, State Treasurer
Acting Chairperson
Michigan Broadband Development Authority Board
Treasury Building
Lansing, Michigan
and
Mr. James W. Butler III, Vice President
Michigan Broadband Development Authority
735 East Michigan Avenue
Lansing, Michigan

Dear Mr. Rising and Mr. Butler:

We have audited the financial statements of the Michigan Broadband Development Authority, a component unit of the State of Michigan, as of and for the fiscal year ended September 30, 2003, as identified in the table of contents, and have issued our report thereon dated November 19, 2003. 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 Broadband Development Authority'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 Broadband Development Authority'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 Broadband Development Authority's Board of Directors 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.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is written in a cursive style with a long horizontal stroke at the beginning.

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

GLOSSARY

Glossary of Acronyms and Terms

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.
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.
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 results of operations 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.
MBDA	Michigan Broadband Development Authority.
MSHDA	Michigan State Housing Development Authority.
reportable condition	A matter coming to the auditor's attention relating to a significant 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.