MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

FINANCIAL AUDIT
OF THE

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION

(A Discretely Presented Component Unit of the State of Michigan)

October 1, 2008 through September 30, 2010

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

271-0406-11

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 can be accessed at:
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Michigan

Office of the Auditor General

REPORT SUMMARY

Financial Audit

Michigan Economic Development Corporation

(A Discretely Presented Component Unit of the State of Michigan)

October 1, 2008 through September 30, 2010

Report Number:
271-0406-11

Released:
February 2011

A financial audit determines if the financial statements are fairly presented; considers internal control over financial reporting; and determines compliance with 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 identified a significant deficiency in internal control over financial reporting (Finding 1). We do not consider this significant deficiency to be a material weakness.

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Noncompliance and Other Matters Material to the Financial Statements

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

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Background:

Article VII, Section 28 of the Michigan Constitution and Act 7, P.A. 1967, provided for the creation of MEDC as a public body corporate. MEDC was created in April 1999 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). Article VI of the interlocal agreement provides for the automatic renewal of this initial 10-year term for two renewal periods of five years each. As of April 2009, this interlocal agreement has been automatically renewed for another five years. 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.

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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: 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

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

February 11, 2011

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

Dear Mr. Finney and Mr. Rothwell:

This is our report on the financial audit of the Michigan Economic Development Corporation (MEDC), a discretely presented component unit of the State of Michigan, for the period October 1, 2008 through September 30, 2010.

This report contains our report summary, our independent auditor's report on the financial statements, the MEDC management's discussion and analysis, and the MEDC basic financial statements. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters; our finding, recommendation, and agency preliminary response; and a glossary of acronyms and terms.

The agency preliminary response was taken from the agency's response subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a plan to address the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

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

AUDITOR GENERAL

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

Independent Auditor's Report on the Financial Statements

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

Dear Mr. Finney and Mr. Rothwell:

We have audited the accompanying financial statements of the Michigan Economic Development Corporation, a discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2010 and September 30, 2009, 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 1, 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, 2010 and September 30, 2009 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, 2010 and September 30, 2009 and the changes in financial position and cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 28, 2011 on our consideration of the Michigan Economic Development Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 11 through 15 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 required supplementary information. However, we did not audit the information and express no opinion on it. The management's discussion and analysis for the comparison between the fiscal years ended September 20, 2009 and September 30, 2008 was not presented because this information was presented with the Michigan Economic Development Corporation's prior year audited financial statements.

AUDITOR GENERAL

January 28, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Michigan Economic Development Corporation's (MEDC's) management has prepared this discussion and analysis of the financial performance of MEDC for the period October 1, 2009 through September 30, 2010. MEDC is a public body corporate and a discretely presented component unit of the financial reporting entity of the State of Michigan. MEDC's management is responsible for the basic 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 notes to the financial statements. Amounts reported in the financial statements include both the MEDC corporate funds as well as the State funds made available to MEDC.

The financial statements are interrelated and represent the financial status of MEDC. The statement of net assets presents assets and liabilities as of the end of the fiscal year. The statement of revenues, expenses, and changes in fund net assets presents the revenues earned and expenses incurred during the fiscal year. The statement of cash flows presents information related to cash in-flows and out-flows summarized by operating, capital and related financing, and investing activities.

Analysis of Financial Activities

The assets of MEDC exceeded its liabilities by $118.0 million at September 30, 2010, and by $136.5 million at September 30, 2009. As of September 30, 2010, $20.3 million of this amount was in equity in common cash of the State of Michigan.

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

	2010	2009
Current assets	$ 82,512,668	$ 96,359,811
Noncurrent assets		
Loans receivable	$ 13,458,109	$ 17,339,888
Investments	25,031,843	24,458,251
Capital assets (net)	9,426,209	9,972,925
Advances to primary government	1,500,000	1,359,737
Interest receivable	12,034	
Total noncurrent assets	$ 49,428,194	$ 53,130,801
Total assets	$ 131,940,863	$ 149,490,612
Current liabilities	$ 12,902,421	$ 11,865,861
Long-term liabilities	1,038,190	1,122,859
Total liabilities	$ 13,940,612	$ 12,988,720
Net assets		
Invested in capital assets	$ 9,426,209	$ 9,972,925
Unrestricted net assets	108,574,042	126,528,967
Total net assets	$ 118,000,251	$ 136,501,892

Current assets primarily consist of amounts held in cash, money market accounts, and short-term investments by MEDC; funds in the State of Michigan's equity in common cash; short-term loans receivable; amounts due from the Michigan Strategic Fund (MSF); and receivables for gaming revenues. Interest earned on funds retained in the common cash pool of the State of Michigan is the income of the State and is not transferred to MEDC.

Current assets decreased by $13.8 million in fiscal year 2009-10 due to an increase in program expenses.

Loans receivable include the long-term portion of the outstanding loans, net of loan loss provisions. Long-term loans receivable had a net reduction of $3.9 million in fiscal year 2009-10, primarily due to some loans being paid in full, some loans being converted to investments, some loans being recategorized from long-term to short-term as their maturities were coming due within 12 months, and the issuance of new loans.

Capital assets (net) at September 30, 2010 included the cost of the MEDC headquarters building, furniture, and information technology equipment, net of depreciation. During fiscal year 2009-10, capital assets worth $124,918 were added.

Advances to primary government at September 30, 2010 represent the amount given to the Department of Treasury as an advance to implement the Public Private Partnership Program.

Current liabilities at September 30, 2010 increased by $1.0 million, primarily consisting of accounts payable at year-end including payroll obligations.

Long-term liabilities represent long-term compensated absences.

Overall, **net assets** decreased by $18.5 million during fiscal year 2009-10 as a result of the preceding activities and funds spent for the operations.

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

	2010	2009
Operating revenues		
Operating grants and contributions	$ 60,507,652	$ 57,420,392
Interest and investment earnings	2,413,854	1,717,536
Other operating revenues	8,966,609	8,291,595
Total operating revenues	$ 71,888,115	$ 67,429,523
Operating expenses		
Salaries, wages, and other administrative expenses	$ 46,748,967	$ 37,292,044
Payments to MSF and primary government	244,623	113,240
Operating grants	43,396,166	24,032,038
Total operating expenses	$ 90,389,756	$ 61,437,322
Operating income (loss)	($ 18,501,641)	$ 5,992,200
Change in net assets	($ 18,501,641)	$ 5,992,200
Total net assets - Beginning	136,501,892	130,509,692
Total net assets - Ending	$118,000,251	$136,501,892

Operating grants and contributions included $1.1 million for federal grants, $34.6 million received from State funding for the economic development programs, and $24.8 million in tribal gaming revenue and miscellaneous fees transferred from MSF. Gaming revenue and fees decreased by $4.0 million compared to fiscal year 2008-09. The State General Fund revenue increase of $7.3 million is net of the one-time Michigan Promotion Program appropriation of $9.5 million and the decrease in other State revenues.

Other operating revenues primarily consist of $4.5 million from the Michigan Department of Transportation for the operations of Welcome Centers, $0.6 million from the Department of Technology, Management & Budget for the Call Center operations, and $2.4 million in tribal gaming revenue from the Keweenaw Bay Indian Community.

Salaries, wages, and other administrative expenses for fiscal year 2009-10 increased by $9.5 million, primarily representing one-time Michigan Promotion Program expenditures.

Operating grants for fiscal year 2009-10 included grant commitments for the Economic Development Job Training Program, Michigan Manufacturing Technical Institute, Alternative Energy Program, Urban Loan Program, Pre-Seed Fund Competition, Small Business Technical Development Center grants, and marketing program expenses. Operating grants increased by $19.4 million. MEDC increased its spending for business marketing and initiated new programs, such as the Closing Fund and other similar programs, to promote economic development in the State.

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

	2010	2009
Cash provided (used) by:		
Operating activities	$ (19,792,289)	$29,338,374
Capital and related financing activities	(124,918)	(229,472)
Investing activities	(7,651,726)	(29,918,172)
Net increase (decrease) in cash	$ (27,568,934)	$ (809,270)
Cash and cash equivalents at beginning of fiscal year	69,064,650	69,873,920
Cash and cash equivalents at end of fiscal year	$ 41,495,716	$69,064,650

Cash and cash equivalents at the end of fiscal year 2009-10 ($41.5 million) primarily included $21.1 million in checking and money market accounts in Bank of America and $20.3 million equity in the State of Michigan common cash.

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BASIC FINANCIAL STATEMENTS

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

	2010	2009
ASSETS		
Current assets:		
Cash (Note 2)	$ 21,136,502	$ 41,037,540
Equity in common cash (Note 2)	20,291,500	27,672,468
Money market fund (Note 2)	67,714	354,642
Tribal gaming receivable	1,266,000	1,303,688
Amounts due from MSF	11,647,659	10,656,636
Amounts due from federal agencies	702,912	
Loans receivable (net) (Note 3)	5,460,432	2,671,026
Investments (Note 2)	20,737,585	11,763,435
Other current assets:		
Interest receivable	270,548	219,580
Miscellaneous	931,816	680,796
Total current assets	$ 82,512,668	$ 96,359,811
Noncurrent assets:		
Loans receivable (net) (Note 3)	$ 13,458,109	$ 17,339,888
Investments (Note 2)	25,031,843	24,458,251
Capital assets (net) (Note 4)	9,426,209	9,972,925
Advances to primary government	1,500,000	1,359,737
Interest receivable	12,034	
Total noncurrent assets	$ 49,428,194	$ 53,130,801
Total assets	$ 131,940,863	$ 149,490,612
LIABILITIES		
Current liabilities:		
Accounts payable and other liabilities	$ 11,281,155	$ 9,671,692
Compensated absences (Note 5)	1,522,727	1,295,243
Amounts due to primary government	98,540	898,926
Amounts due to MSF		
Deferred revenues		
Total current liabilities	$ 12,902,421	$ 11,865,861
Long-term liabilities:		
Compensated absences (Note 5)	$ 1,038,190	$ 1,122,859
Total long-term liabilities	$ 1,038,190	$ 1,122,859
Total liabilities	$ 13,940,612	$ 12,988,720
NET ASSETS		
Invested in capital assets	$ 9,426,209	$ 9,972,925
Unrestricted net assets	108,574,042	126,528,967
Total net assets	$ 118,000,251	$ 136,501,892

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

	2010	2009
OPERATING REVENUES (Note 1)		
Operating grants and contributions		
Federal revenue	$ 1,077,370	$ 1,270,377
Payments from MSF - State appropriations (Note 7)	34,632,819	27,303,873
Payments from MSF - Tribal gaming and fees (Note 7)	24,797,462	28,846,142
Total operating grants and contributions	$ 60,507,652	$ 57,420,392
Interest and investment earnings		
Investment earnings	$ 1,602,859	$ 888,285
Net increase (decrease) in fair value of investments	356,159	401,487
Interest income on loans	454,836	427,764
Total interest and investment earnings	$ 2,413,854	$ 1,717,536
Other operating revenues		
Tribal gaming	$ 2,448,415	$ 2,474,012
Other operating revenues	6,518,195	5,817,583
Total other operating revenues	$ 8,966,609	$ 8,291,595
Total operating revenues	$ 71,888,115	$ 67,429,523
OPERATING EXPENSES (Note 1)		
Salaries, wages, and other administrative expenses	$ 46,748,967	$ 37,292,044
Payment to MSF	171,375	49,159
Payments to primary government	73,248	64,081
Operating grants	43,396,166	24,032,038
Total operating expenses	$ 90,389,756	$ 61,437,322
Operating income (loss)	$ (18,501,641)	$ 5,992,200
Change in net assets	$ (18,501,641)	$ 5,992,200
Total net assets - Beginning	136,501,892	130,509,692
Total net assets - Ending	$ 118,000,251	$ 136,501,892

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

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Payments to employees	$ (23,557,616)	$ (22,617,559)
Payments to suppliers	(23,177,288)	(13,448,426)
Tribal gaming revenue	2,486,103	3,296,409
Other operating revenue	6,722,011	6,289,811
Grants received from federal government	374,458	1,338,881
Operating grants	(40,834,593)	(18,626,877)
Payment to MSF	(171,375)	(49,159)
Payments to primary government	(73,248)	(64,081)
Payments from MSF	58,439,258	73,219,375
Net cash provided (used) by operating activities	$ (19,792,289)	$ 29,338,374
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets (Note 4)	$ (124,918)	$ (229,472)
Net cash provided (used) by capital and related financing activities	$ (124,918)	$ (229,472)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale and maturities of investment securities (net) (Note 2)	$ (9,191,583)	$ (30,899,469)
Interest and dividends on investments	1,539,857	981,297
Net cash provided (used) by investing activities	$ (7,651,726)	$ (29,918,172)
Net cash provided (used) - All activities	$ (27,568,934)	$ (809,270)
Cash and cash equivalents at beginning of fiscal year	69,064,650	69,873,920
Cash and cash equivalents at end of fiscal year	$ 41,495,716	$ 69,064,650
RECONCILIATION OF CASH AND CASH EQUIVALENTS		
Per statement of net assets classifications:		
Cash	$ 21,136,502	$ 41,037,540
Equity in common cash	20,291,500	27,672,468
Money market fund	67,714	354,642
Cash and cash equivalents at end of fiscal year	$ 41,495,716	$ 69,064,650
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:		
Operating income (loss)	$ (18,501,641)	$ 5,992,200
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Interest (nonprogram) and investment income	(1,539,857)	(981,297)
Depreciation	671,634	677,298
Net increase (decrease) in fair value of investments	(356,159)	(401,487)
Changes in assets and liabilities:		
Amounts due from MSF and tribal gaming revenue receivable	(953,335)	17,891,757
Loans receivable (program loans)	952,111	3,245,551
Amounts due from federal agencies	(702,912)	68,504
Other assets	(314,022)	137,476
Accounts payable and other liabilities	951,891	2,708,372
Net cash provided (used) by operating activities	$ (19,792,289)	$ 29,338,374
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Loans converted to equity	$ 1,171,544	$ 557,198
Increase (decrease) in fair value of investments	708,019	596,955
Net noncash provided (used) by investing, capital, and financing activities	$ 1,879,563	$ 1,154,153

The accompanying notes are an integral part of 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 (GAAP) as applicable to governmental units. The following is a summary of the more significant policies:

a. Reporting Entity

Article VII, Section 28 of the Michigan Constitution and Act 7, P.A. 1967, provided for the creation of MEDC as a public body corporate. MEDC was created in April 1999 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). Article VI of the interlocal agreement provides for the automatic renewal of this initial 10-year term for two renewal periods of five years each. As of April 2009, this interlocal agreement has been automatically renewed for another five years. 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 discretely presented component unit of the financial reporting entity of the State of Michigan. MEDC is a component unit in the State of Michigan reporting entity because the primary government appoints the governing board of MEDC and there is a potential for MEDC to provide specific financial benefits to, or impose specific financial burdens on, the State.

b. Financial Statement Presentation

The basic financial statements have been prepared in accordance with GAAP as prescribed by the Governmental Accounting Standards Board (GASB).

MEDC follows the business type activities reporting requirements of GASB Statement No. 34, which provides for a statement of net assets; a statement of revenues, expenses, and changes in fund net assets; and a statement of cash flows.

MEDC's operations 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.

MEDC follows the accounting rules promulgated by GASB. In addition, MEDC follows all Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, unless pronouncements conflict with or contradict GASB Statements.

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 GAAP.

c. Measurement Focus and Basis of Accounting

The financial statements contained in this report are presented using the economic resources measurement focus and the full accrual basis of accounting as provided by GAAP applicable to governments. Under the full 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 by MSF from tribal gaming, private activity bond (PAB) (previously known as industrial development revenue bond [IDRB]) issuance fees, and Michigan Economic Growth Authority and Brownfield fees 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 primarily present the following:

(1) Cash and Cash Equivalents: The amount reported as "Cash and cash equivalents at end of fiscal 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," and "Money market fund."

(2) Amounts Due From MSF: Amounts due from MSF include the tribal gaming revenue.

(3) Investments: MEDC reports investments in the money market fund, government securities, corporate securities, exchange-traded funds (ETFs), and equities at fair value and venture capital investments using cost-based measures unless fair value is readily determinable.

(4) Loans Receivable: Loans receivables are reported net of allowance for losses.

(5) Capital Assets: Capital assets, which mainly include a building, furniture, and equipment, are reported at historical cost, net of depreciation.

(6) Current Liabilities: Current liabilities primarily include accounts payable established for program and administrative expenses and the current portion of compensated absences.

(7) Long-Term Liabilities: Long-term liabilities include compensated absences for employees' unused sick, banked, and annual leave payable when employees terminate employment.

(8) Operating Revenues: Operating revenues include revenues from federal grants, other restricted sources, amounts available to MEDC from State appropriations, tribal gaming revenue, and investment earnings. Also included in operating revenues are tribal gaming and fees collected by MSF and transferred to MEDC for PAB issuance, the Michigan Economic Growth Authority, and Brownfield programs during the fiscal year.

(9) Operating Expenses: Operating expenses include expenses related to program grants funded by State appropriations transferred to MEDC and MEDC nonappropriated funds. Also included in operating expenses are administrative expenses incurred from State appropriations transferred to MEDC.

Note 2 Deposits and Investments

a. Deposits

	As of September 30	
	2010	2009
Equity in common cash	$20,291,500	$27,672,468
Checking account	12,531,591	5,539,859
Money market account	8,604,911	35,497,681
Total deposits	$41,428,002	$68,710,008

Custodial Credit Risk: Governmental accounting standards require disclosures related to custodial credit risks for deposits. Custodial credit risk for deposits is the risk that, in the event of a bank failure, MEDC's deposits may not be returned to it. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent but not in MEDC's name.

Deposits included in MEDC's bank accounts (without recognition of outstanding checks or deposits in transit) were $25,742,150 at September 30, 2010 ($41,153,779 at September 30, 2009). Of that amount, $24,640,865 at September 30, 2010 ($34,747,681 at

September 30, 2009) was uninsured and uncollateralized. There were no deposits collateralized with securities held by the pledging financial institution or by the pledging financial institution's trust department or agent but not in MEDC's name. MEDC has no policy for controlling custodial credit risk.

MEDC's deposits included in the State of Michigan's equity in common cash are managed by the State Treasurer. The State Treasurer's policy requires financial institutions to secure State funds with collateral, to be organized under federal or State law, and to maintain an office in Michigan. The policy also restricts deposits to a maximum of 50% of the financial institution's net worth. As of September 30, 2010 and September 30, 2009, 100% and 99.96%, respectively, of the State's common cash was either covered by federal depository insurance or collateralized with securities held in the State's name by the State's agent. Additional details on this policy are described in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*.

b. Investments

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, 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.

MEDC investments in the money market fund, government securities, corporate securities, ETFs, and equities are reported at fair value. The fair value is determined by the investment custodian and provided to MEDC in monthly statements. MEDC investments in venture capital are generally reported using cost-based measures unless fair value is readily determinable.

MEDC makes grant and loan 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, and MEDC attempts to match investment maturities with its cash flow needs to meet grant commitments. For this reason, investments have frequent turnover and the proceeds from sales and maturities of all investments are shown as a net balance on the statement of cash flows.

The following table shows the fair value of investments at September 30, 2010 by investment type and in total:

Investment Type	Fair Value	Investment Maturities Less Than 1 Year	1 to 5 Years	6 to 10 Years	More Than 10 Years
Money market fund	$ 67,714	$ 67,714	$	$	$
Corporate securities	25,408,131	20,737,585	4,670,546		
Equities	180,373		180,373		
Mutual funds (ETFs)	13,367,544		13,367,544		
Venture capital - Limited partner	2,956,119			2,956,119	
Venture capital - Stocks	3,857,260			3,857,260	
Total investments	$45,837,141	$20,805,299	$18,218,463	$6,813,379	$ 0

The following table shows the fair value of investments at September 30, 2009 by investment type and in total:

Investment Type	Fair Value	Investment Maturities Less Than 1 Year	1 to 5 Years	6 to 10 Years	More Than 10 Years
Money market fund	$ 354,642	$ 354,642	$	$	$
Corporate securities	24,665,060	11,763,435	12,901,625		
Equities	238,310		238,310		
Mutual funds (ETFs)	6,255,694			6,255,694	
Venture capital - Limited partner	3,017,333			3,017,333	
Venture capital - Stocks	2,045,287			2,045,287	
Total investments	$36,576,326	$12,118,077	$13,139,935	$11,318,314	$ 0

Governmental accounting standards require disclosures for investments for interest rate risk, custodial credit risk, credit risk, foreign currency risk, and concentration of credit risk:

1) Interest Rate Risk: Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of those investments. MEDC does not have a policy regarding interest rate risk. As of September 30, 2010, investments in the money market fund and corporate securities with a market value of $25.5 million were exposed to interest rate risk. As of September 30, 2009, investments in the money market fund and corporate securities

with a market value of $25.0 million were exposed to interest rate risk.

2) <u>Custodial Credit Risk</u>: Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, MEDC will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of MEDC, and are held by either the counterparty or the counterparty's trust department or agent but not in MEDC's name.

   As of September 30, 2010 and September 30, 2009, MEDC's investments in corporate securities, mutual funds, equities, and venture capital stocks were not exposed to custodial credit risk because they are registered in MEDC's name and held by the U.S. Trust - Bank of America. MEDC's investments in venture capital limited partnerships were excluded from custodial credit risk because they were not an investment security.

3) <u>Credit Risk</u>: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. GAAP requires disclosures of the credit quality ratings of investments in debt securities. MEDC had the following policy for controlling credit risk of debt securities in fiscal years 2009-10 and 2008-09. Short-term investments (less than one year) shall have a credit rating of not less than A-1/P-1. Long-term investments shall have a credit rating equal to BBB or better. The average quality rating of the fixed income portfolio shall have a credit rating of BBB or better.

The following table shows the credit quality ratings of investments in debt securities as of September 30, 2010:

Investment Type	Fair Value	Credit Quality Rating: Standard & Poor's	Credit Quality Rating: Moody's Investors Service
Corporate securities	$ 1,548,345	AA+	AA2
	1,520,475	AA	AA2
	2,067,970	AA	A1
	4,545,560	AA-	AA3
	2,551,595	AA-	A1
	501,360	A+	AA3
	1,016,910	A+	A2
	2,545,625	A+	A1
	508,065	A	A3
	8,602,225	A	A2
Mutual funds (ETFs)	13,367,544	NR	NR
Money market fund	67,714	NR	NR
Total investments	$38,843,388		

The following table shows the credit quality ratings of investments in debt securities as of September 30, 2009:

Investment Type	Fair Value	Credit Quality Rating: Standard & Poor's	Credit Quality Rating: Moody's Investors Service
Corporate securities	$ 2,074,500	AAA	AA2
	1,021,860	AA+	AA2
	1,544,495	AA	AA1
	1,033,760	AA	AA2
	523,605	AA	A1
	3,021,810	AA-	AA3
	1,555,585	AA-	A1
	1,543,080	A+	AA1
	505,180	A+	AA2
	1,030,320	A+	AA3
	1,581,060	A+	A1
	7,714,700	A	A2
	1,515,105	A	A3
Mutual funds (ETFs)	6,255,694	NR	NR
Money market fund	354,642	NR	A
Total investments	$31,275,396		

4) Foreign Currency Risk: Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments or

deposits. As of September 30, 2010 and September 30, 2009, MEDC did not have any investments in foreign securities.

5) Concentration of Credit Risk: Concentration of credit risk is the risk of loss attributable to the magnitude of MEDC's investments with a single issuer. MEDC does not have a policy limiting the dollar value of investments with a single issuer.

At September 30, 2010, MEDC had investments in the following fixed income corporate securities for more than 5% of MEDC's total investments:

Name of Issuer	Amount	Percent of Investments
Cisco Systems Inc.	$2,545,625	5.6%
Hewlett Packard Co.	$2,532,775	5.5%
Merck & Co.	$2,528,600	5.5%

At September 30, 2009, MEDC had investments in the following issuer for more than 5% of MEDC's total investments:

Name of Issuer	Amount	Percent of Investments
Onset BIDCO	$2,000,000	6%

Note 3 Loans Receivable

Loans receivable consisted of the following:

	As of September 30	
	2010	2009
Urban Land Assembly Fund loans	$ 2,680,496	$ 3,841,620
Seed capital loan	3,400,000	3,400,000
BIDCO loans	0	48,071
Life Sciences Program	1,992,165	2,844,663
Michigan Core Community Fund Program	10,878,442	11,109,421
Follow-on Fund	1,479,275	0
Other loans	8,253,445	8,532,421
Total	$ 28,683,823	$ 29,776,196
Less: Allowance for uncollectible loans	(9,765,282)	(9,765,282)
Total loans receivable	$ 18,918,541	$ 20,010,914

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

Note 4 Capital Assets

MEDC recorded its capital assets at cost and depreciates them over their useful lives using the straight-line depreciation method (30 years for building and improvement, 3 years for furniture and equipment). Capital asset activities for the fiscal year ended September 30, 2010 were as follows:

Capital Assets	Beginning Balance	Increases	Decreases	Ending Balance
Building and improvement	$13,086,970	$	$	$13,086,970
Furniture	2,943,459	9,509		2,952,968
Non-information technology equipment	78,265			78,265
Information technology equipment	1,199,222	115,409		1,314,631
Capital assets (cost)	$17,307,917	$ 124,918	$ 0	$17,432,835
Less accumulated depreciation for:				
Building and improvement	$ (3,517,982)	$ (436,608)	$	$ (3,954,590)
Furniture	(2,728,083)	(117,350)		(2,845,433)
Non-information technology equipment	(78,265)			(78,265)
Information technology equipment	(1,010,662)	(117,676)		(1,128,338)
Total accumulated depreciation	$ (7,334,992)	$ (671,634)	$ 0	$ (8,006,626)
Capital assets (net)	$ 9,972,925	$ (546,716)	$ 0	$ 9,426,209

Capital asset activities for the fiscal year ended September 30, 2009 were as follows:

Capital Assets	Beginning Balance	Increases	Decreases	Ending Balance
Building and improvement	$13,086,970	$	$	$13,086,970
Furniture	2,756,398	187,061		2,943,459
Non-information technology equipment	78,265			78,265
Information technology equipment	1,156,811	42,411		1,199,222
Capital assets (cost)	$17,078,445	$ 229,472	$ 0	$17,307,917
Less accumulated depreciation for:				
Building and improvement	$ (3,081,374)	$ (436,608)	$	$ (3,517,982)
Furniture	(2,596,898)	(131,185)		(2,728,083)
Non-information technology equipment	(78,265)			(78,265)
Information technology equipment	(901,157)	(109,505)		(1,010,662)
Total accumulated depreciation	$ (6,657,694)	$ (677,298)	$ 0	$ (7,334,992)
Capital assets (net)	$10,420,751	$ (447,826)	$ 0	$ 9,972,925

Note 5 Long-Term Liabilities

Long-term liabilities are accrued when incurred. The following table summarizes compensated absences liabilities of MEDC for the fiscal years ended September 30, 2010 and September 30, 2009, respectively:

	Fiscal Year 2009-10				
	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Compensated absences	$2,418,102	$1,344,632	$1,201,817	$2,560,917	$1,522,727

	Fiscal Year 2008-09				
	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Compensated absences	$2,566,904	$ 993,281	$1,142,083	$2,418,102	$1,295,243

Note 6 Pension Plans and Other Postemployment Benefits

a. Classified Employees

State classified employees detailed to MEDC are covered by one of two single employer plans offered by the State of Michigan: the State Employees' Defined Benefit Retirement Plan or the State Employees' Defined Contribution Retirement Plan (Plans). Detailed information regarding the Plans' 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 Plans' detailed financial reports.

In addition to the Plans, State classified employees have the option to invest a portion of their salaries into 401(k) and 457 deferred compensation plans. Generally, MEDC does not make any contributions to the deferred compensation plans.

State statutes provide retired employees with other postemployment benefits, such as health, dental, vision, and life insurance coverage based on vesting and other requirements. The cost of retiree health care and other benefits is allocated by the Office of Retirement Services and funded on a pay-as-you-go basis.

For the State Employees' Defined Benefit Retirement Plan, MEDC was billed and paid an average 33.26% ($2,602,622) and 30.6% ($2,391,795) of its payroll costs for pension charges and retiree postemployment benefits in fiscal years 2009-10 and 2008-09, respectively. For the State Employees' Defined Contribution Retirement Plan, MEDC is required to make a contribution of 4% of the annual payroll and to match employee contributions up to 3% of annual covered payroll. MEDC's contributions for the Plan were $302,608 and $294,397 for fiscal years 2009-10 and 2008-09, respectively. The Plans' detailed financial statements can be obtained from the Office of Retirement Services, Department of Technology, Management & Budget, 7150 Harris Drive, P.O. Box 30171, Lansing, Michigan 48909.

b. Nonclassified Employees

MEDC offers a retirement plan (under Section 401(a) of the Internal Revenue Code) to nonclassified employees after one year of service. MEDC also offers a deferred compensation plan (under Section 457 of the Internal Revenue Code) to nonclassified employees upon employment. Both plans are administered by Pension Trend, a third party administrator, and the employees manage their own investments. Other than making contributions to the 401(a) retirement plan, MEDC does not have any other pension benefit obligation liability. Nonclassified employees do not have any other postemployment benefits.

On August 5, 1999, the MEDC Executive Committee approved an employer contribution rate of 8% of an employee's gross wages to the 401(a) retirement plan for eligible employees. Vesting of the benefits occurs over a five-year period. During fiscal year 2007-08, the MEDC Executive Committee approved a 12% contribution rate for employees in senior vice president positions. All contributions are made on a biweekly basis. Employees cannot contribute to this plan. For the fiscal years ended September 30, 2010 and September 30, 2009, MEDC made contributions to the plan of $366,925 and $305,429, respectively.

MEDC makes no contributions to the 457 deferred compensation plan. Only employees make contributions to the plan. For the fiscal years ended September 30, 2010 and September 30, 2009, MEDC employees contributed $234,943 and $235,352, respectively, to the plan.

Note 7 Revenues From MSF

Revenues from MSF consisted of the following:

	Fiscal Year	
	2009-10	2008-09
Tribal gaming and fees	$24,797,462	$28,846,142
State's General Fund programs	34,609,577	27,221,518
Other State restricted programs	23,242	82,355
Total revenues from MSF	$59,430,281	$56,150,015

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE

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

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

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

Dear Mr. Finney and Mr. Rothwell:

We have audited the financial statements of the Michigan Economic Development Corporation, a discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2010 and September 30, 2009, as identified in the table of contents, and have issued our report thereon dated January 28, 2011. 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.

<u>Internal Control Over Financial Reporting</u>
In planning and performing our audit, we considered the Michigan Economic Development Corporation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Michigan Economic Development Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Michigan Economic Development Corporation's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined in the preceding paragraph. However, we identified a deficiency in internal control over financial reporting, as described in Finding 1, that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

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 grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

The agency preliminary response to the finding identified in our audit is included in the body of our report. We did not audit the agency preliminary response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Governor, the Legislature, management, the Michigan Economic Development Corporation Executive Committee, and others within the entity 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

January 28, 2011

FINDING, RECOMMENDATION, AND AGENCY PRELIMINARY RESPONSE

FINDING

1. Payroll Controls

The Michigan Economic Development Corporation's (MEDC's) internal control did not ensure that supervisors approved Welcome Center employee time sheets. The lack of appropriate approval could result in unauthorized payroll expenditures.

Management is responsible for developing and maintaining a system of controls to ensure proper authorization and recordkeeping procedures to control expenditures. MEDC processed $24.3 million in payroll expenditures in fiscal year 2009-10, of which $3.7 million was for Welcome Center employees.

We reviewed a sample of 11 time sheets and noted that 1 (9%) of the time sheets was not approved by a supervisor on the Data Collection and Distribution System* (DCDS) or on a hard-copy time sheet. We determined that the 1 time sheet was for a Welcome Center employee. We reviewed an additional sample of 26 Welcome Center employee time sheets and noted that 8 (31%) of the time sheets were not approved by a supervisor on DCDS or on a hard copy time sheet. Supervisory approval provides assurance that employees' time is accurate and sick and annual leave is appropriate and authorized.

RECOMMENDATION

We recommend that MEDC improve its internal control to ensure that supervisors approve Welcome Center employee time sheets.

AGENCY PRELIMINARY RESPONSE

MEDC agrees with the recommendation. MEDC informed us that it does have procedures in place to ensure that supervisors approve time entered into DCDS for all business units. MEDC also informed us that the problem was limited to the Welcome Center business unit, which has been transferred back to the Michigan Department of Transportation as of October 1, 2010. MEDC does not expect this problem to recur.

MEDC informed us that, until 2010, it was responsible for the operations of 14 Welcome Centers around the State. MEDC also informed us that, until recently, none of the Welcome Centers were connected to DCDS to enter employees' time

** See glossary at end of report for definition.*

so MEDC had to wait for the fax transmittal of the time sheets and then a staff person in Lansing would enter the data into the on-line system. In addition, MEDC informed us that, at times, the Welcome Centers were staffed with as many as 100 temporary and permanent staff and, thus, it was a challenge that resulted in the lack of supervisory approval a few times during the year.

GLOSSARY

BIDCO	business and industrial development corporation.
Data Collection and Distribution System (DCDS)	The State's client/server system that records, allocates, and distributes payroll costs within the accounting system.
deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.
ETF	exchange-traded fund.
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 presented fairly in all material respects in conformity with the disclosed basis of accounting.
GAAP	accounting principles generally accepted in the United States of America.
GASB	Governmental Accounting Standards Board.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to 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 changes in financial position or cash flows in conformity with the disclosed basis of accounting.
material weakness in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the financial schedules and/or financial statements will not be prevented, or detected and corrected, on a timely basis.
MEDC	Michigan Economic Development Corporation.
MSF	Michigan Strategic Fund.
PAB	private activity bond.
significant deficiency in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.
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.

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STATE OF MICHIGAN

OFFICE of the AUDITOR GENERAL