

FINANCIAL AUDIT  
OF THE  
MICHIGAN BROADBAND DEVELOPMENT AUTHORITY

March 14, 2002 through September 30, 2002



Michigan  
Office of the Auditor General  
**REPORT SUMMARY**

*Financial Audit*

*Michigan Broadband Development Authority*  
March 14, 2002 through September 30, 2002

Report Number:  
27-285-02

Released:  
February 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 identify any material weaknesses in internal control over financial reporting. However, we did identify a reportable condition related to the internal control over financial reporting (Finding 1).

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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/](http://www.state.mi.us/audgen/)



Michigan Office of the Auditor General  
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Auditor General

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

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

February 28, 2003

Mr. William Rosenberg, President and Chief Executive Officer  
Michigan Broadband Development Authority  
455 East Eisenhower Parkway  
Ann Arbor, Michigan

Dear Mr. Rosenberg:

This is our report on the financial audit of the Michigan Broadband Development Authority for the period March 14, 2002 through September 30, 2002.

This report contains our report summary, our independent auditor's report on the financial statements, management's discussion and analysis, and the Michigan Broadband Development Authority 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; a finding, recommendation, and entity preliminary response; and a glossary of acronyms and terms.

The entity preliminary response was taken from the entity's response subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited entity develop a formal response within 60 days after release of the audit report.

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

AUDITOR GENERAL

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

## Independent Auditor's Report on the Financial Statements

January 3, 2003

Mr. William Rosenberg, President and Chief Executive Officer  
Michigan Broadband Development Authority  
455 East Eisenhower Parkway  
Ann Arbor, Michigan

Dear Mr. Rosenberg:

We have audited the accompanying statement of net assets of the Michigan Broadband Development Authority, a component unit of the State of Michigan, as of September 30, 2002 and the related statement of revenues, expenses, and changes in net assets and the statement of cash flows for the period March 14, 2002 through September 30, 2002. 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 accompanying financial statements present only the Michigan Broadband Development Authority and are not intended to present fairly the financial position and results of operations and cash flows of the State of Michigan or its component units.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Michigan Broadband Development Authority as of September 30, 2002 and the results of its operations and cash flows for

the period March 14, 2002 through September 30, 2002 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 January 3, 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.

AUDITOR GENERAL



## 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 March 14, 2002 through September 30, 2002. 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**

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

- The new reporting standards require a statement of net assets; a statement of revenues, expenses, and changes in net assets; and a statement of cash flows (direct method).
- The financial statements for the period March 14, 2002 through September 30, 2002 comply with GASB Statement No. 34.

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

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 period.

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. Financial statements are normally presented on a comparison basis; however, because MBDA was initiated on March 14, 2002, comparative financial information is not available.

**Condensed Financial Information  
From the Statement of Net Assets  
As of September 30, 2002**

Current assets	\$ 17,642,518
Noncurrent investments	15,154,688
Total Assets	<u>\$ 32,797,206</u>
Current liabilities	\$ 844,156
Noncurrent liabilities	33,395,921
Total Liabilities	<u>\$ 34,240,077</u>
Net Assets	
Unrestricted net assets (deficit)	\$ (1,442,871)
Total Net Assets	<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 investments** consist of government securities.

**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 and recorded in the financial statements; the final payment was received on November 1, 2002 and was not included in the financial statements.

**Condensed Financial Information**  
**From the Statement of Revenues,**  
**Expenses, and Changes in Net Assets**  
For the Period March 14, 2002 through September 30, 2002

Operating Expenses	
Salaries, wages, and other administrative expenses	\$ 1,208,514
Interest on bonds	583,400
Total Operating Expenses	<u>\$ 1,791,914</u>
Nonoperating revenues	
Investment and interest income	\$ 173,109
Net income in the fair value of investments	175,934
Total Nonoperating Revenues	<u>\$ 349,043</u>
Change in net assets	\$ (1,442,871)
Total net assets - Beginning	<u>0</u>
Total net assets - Ending	<u><u>\$ (1,442,871)</u></u>

**Salaries, wages, and other administrative expenses** increased during the period because of increased staffing and program expansion. MBDA initiates and approves expenses and payments are made through the State of Michigan's warrant processing system.

**Investment and interest income** relates to the earnings from the sale of investments and the interest earned. As of September 30, 2002, the market value of MBDA investments was \$175,934 higher than the cost.

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

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

For the Period March 14, 2002 through September 30, 2002

Cash provided (used) by:

Operating activities	\$ (885,171)
Noncapital financing activities	33,333,333
Investing activities	<u>(30,763,506)</u>
Net increase (decrease) in cash	\$ 1,684,656
Cash - Beginning	<u>0</u>
Cash - Ending	<u>\$ 1,684,656</u>

The **net cash** increased primarily because of the \$33.3 million bond issue proceeds.

MICHIGAN BROADBAND DEVELOPMENT AUTHORITY  
Statement of Net Assets  
As of September 30, 2002

**ASSETS**

Current Assets:

Cash and cash equivalents (Note 2)	\$ 1,684,657
Investments (Note 2)	15,882,773
Interest receivable	<u>75,088</u>
Total Current Assets	<u>\$ 17,642,518</u>

Noncurrent Assets:

Investments (Note 2)	<u>\$ 15,154,688</u>
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Total Assets	<u>\$ 32,797,206</u>
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**LIABILITIES**

Current Liabilities:

Accounts payable	\$ 257,669
Compensated absences (Note 4)	3,087
Interest payable	<u>583,400</u>
Total Current Liabilities	<u>\$ 844,156</u>

Noncurrent Liabilities:

Bonds payable (Note 3)	\$ 33,333,333
Compensated absences (Note 4)	<u>62,588</u>
Total Noncurrent Liabilities	<u>\$ 33,395,921</u>

Total Liabilities	<u>\$ 34,240,077</u>
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**NET ASSETS**

Unrestricted net assets (deficit)	<u>\$ (1,442,871)</u>
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Total Net Assets	<u><u>\$ (1,442,871)</u></u>
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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 March 14, 2002 through September 30, 2002

**OPERATING EXPENSES**

Salaries and wages	\$ 62,685
Employee benefits (Note 6)	31,412
Contractual services employee compensation	322,601
Contractual services	29,509
Compensated absences (Note 4)	65,674
Interest on bonds	583,400
Administrative and general	696,633
Total Operating Expenses	<u>\$ 1,791,914</u>

Operating Income (Loss) \$ (1,791,914)

**NONOPERATING REVENUES**

Investment income	\$ 171,171
Interest income	1,938
Net increase in the fair value of investments	175,934
Total Nonoperating Revenues	<u>\$ 349,043</u>

Change in net assets \$ (1,442,871)

Total net assets - Beginning 0

Total net assets - Ending \$ (1,442,871)

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

MICHIGAN BROADBAND DEVELOPMENT AUTHORITY  
Statement of Cash Flows  
For the Period March 14, 2002 through September 30, 2002

**CASH FLOWS FROM OPERATING ACTIVITIES**

Payments to employees for services	\$ (94,097)
Payments to suppliers for goods and services	<u>(791,075)</u>
Net cash provided (used) by operating activities	<u><u>\$ (885,171)</u></u>

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES**

Bond receipts	<u>\$ 33,333,333</u>
Net cash provided (used) by noncapital financing activities	<u><u>\$ 33,333,333</u></u>

**CASH FLOWS FROM INVESTING ACTIVITIES**

Purchase of investments	\$ (64,134,268)
Proceeds from the sale and maturity of investments	33,370,000
Interest and dividends on investments	763
Net cash provided (used) by investing activities	<u><u>\$ (30,763,505)</u></u>

Net increase (decrease) in cash - all activities	\$ 1,684,657
Cash and cash equivalents - Beginning	0
Cash and cash equivalents - Ending	<u><u>\$ 1,684,657</u></u>

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

Operating income (loss)	\$ (1,791,914)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:	
Compensated absences	65,674
Changes in assets and liabilities:	
Accounts payable	257,669
Interest payable	583,400
Net cash provided (used) by operating activities	<u><u>\$ (885,171)</u></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. Basis of Presentation

- (1) Fund Accounting: The accounts of the component units of the State of Michigan are organized on the basis of funds, each of which is considered a separate accounting entity. 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 and are not intended to present fairly the financial position and results of operations and cash flows of the State of Michigan or its component units.

c. Basis of Accounting

Proprietary fund types use the accrual basis of accounting. The accrual basis emphasizes the measurement of "net income" (i.e., "capital maintenance" focus). Using this basis, revenues are recognized when "earned" and expenses are recognized when "incurred." Revenues are

considered to be available when collected within the current period or soon enough thereafter to pay liabilities of the current period. Generally, this is within 12 months. Operating revenues and expenses generally result from providing services to the public and to State and local units of government. All financial resources and obligations of a fund, whether current or noncurrent, are recorded in the fund. 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.

MBDA adopted GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and modified by Statement No. 38, *Certain Financial Statement Note Disclosures*. Statement No. 34, as amended and modified, commonly referred to as the new reporting model, retained much of the old reporting and disclosure requirements under the prior reporting model, with certain modifications and newly added information.

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) Nonoperating Revenues: Revenues consist of investment earnings and the increase in the fair value of investments.
- (3) Cash Equivalents: MBDA considers U.S. government money market funds to be cash equivalents.
- (4) 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.

(5) Equipment: Purchases of equipment by MBDA for use in its operations that meet the requirements of the State of Michigan's capitalization policy are capitalized in accordance with GASB Statement No. 34. For the period ended September 30, 2002, 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.

MBDA's total deposits as of September 30, 2002 were:

U.S. government money market funds	\$ 1,502,181
Equity in State of Michigan Common Cash	182,476
Total deposits	<u>\$ 1,684,657</u>

Deposits included in MBDA's bank accounts (without recognition of outstanding checks or deposits in transit) were \$1,502,181 at September 30, 2002. Of that amount, \$100,000 was covered by federal depository insurance and was classified as GASB credit risk category 1. The remaining \$1,402,181 held in money market funds was 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, 2002 by investment type and in total:

Investment Type	GASB Credit Risk Category			Not Categorized	Fair Value
	1	2	3		
Government securities	\$31,037,461	\$	\$	\$	\$31,037,461
Total Investments	\$31,037,461	\$ 0	\$ 0	\$ 0	\$31,037,461

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 March 14, 2002 through September 30, 2001:

Beginning bonds payable	\$	0
Additional proceeds and borrowings		33,333,333
Repayments		0
Ending bonds payable	\$	<u>33,333,333</u>

MBDA limited obligations outstanding as of September 30, 2002 were:

Michigan Broadband Development Authority Purposes Funding Taxable Subordinate Bond Series 2002A, payable through May 1, 2022 with an interest rate of 6%	\$ 33,333,333
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The annual requirements to amortize all debt outstanding, including interest, as of September 30, 2002, are as follows:

Fiscal Year	Principal	Interest	Total
2002-03		\$ 2,000,000	\$ 2,000,000
2003-04		2,000,000	2,000,000
2004-05		2,000,000	2,000,000
2005-06		2,000,000	2,000,000
2006-07		2,000,000	2,000,000
Total for fiscal years 2002-03 through 2006-07	\$ 0	\$10,000,000	\$10,000,000
2007-08 through 2011-12		10,000,000	10,000,000
2012-13 through 2016-17		10,000,000	10,000,000
2017-18 through 2021-22	\$ 33,333,333	9,166,667	42,500,000
Total	<u>\$ 33,333,333</u>	<u>\$39,166,667</u>	<u>\$72,500,000</u>

**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	\$ 0	\$ 65,674	\$ 0	\$ 65,674	\$ 3,087

**Note 5 Leases**

MBDA has entered into a lease that constitutes a rental agreement and is classified as an operating lease. The lease has a cancellation clause but, for reporting purposes, such a cancellation clause is not considered because the likelihood that it will be exercised is considered remote. The resulting

expenditures are recognized as incurred over the lease term. The summary of the operating lease commitments to maturity follows:

Fiscal Year Ended September 30	Lease Commitments
2003	\$ 140,450
2004	143,630
2005	121,900
Total	<u>\$ 405,980</u>

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 bi-weekly 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 ten-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 equal installment payments from MSHDA of \$16,666,667 on May 1, 2002, August 1, 2002, and the final installment payment on November 1, 2002, subsequent to the end of MBDA's fiscal year.



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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

January 3, 2003

Mr. William Rosenberg, President and Chief Executive Officer  
Michigan Broadband Development Authority  
455 East Eisenhower Parkway  
Ann Arbor, Michigan

Dear Mr. Rosenberg:

We have audited the financial statements of the Michigan Broadband Development Authority, a component unit of the State of Michigan, for the period March 14, 2002 through September 30, 2002 and have issued our report thereon dated January 3, 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 the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design



or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Michigan Broadband Development Authority's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in Finding 1.

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not believe that the reportable condition identified in the previous paragraph is a material weakness.

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.

AUDITOR GENERAL

# **FINDING, RECOMMENDATION, AND ENTITY PRELIMINARY RESPONSE**

## **FINDING**

### **1. Internal Control Over Financial Reporting**

MBDA needs to improve its internal control over its financial operations to ensure that accounting transactions are properly recorded and that account balances are accurately reported in its financial statements.

MBDA did not reconcile its internal accounting system records to the State's accounting system, the Michigan Administrative Information Network (MAIN), to ensure accurate financial reporting. MBDA maintains its own accounting system separate from MAIN; however, MBDA's expense transactions and related payments to vendors are processed through MAIN.

MBDA reported accounts payable of approximately \$8,000 as of September 30, 2002 on its internal accounting system; however, MAIN reported MBDA accounts payable of approximately \$250,000. The difference occurred because MBDA reported expenses as paid prior to the end of the fiscal year; MAIN indicated that the expenses were not paid and should be classified as accounts payable.

Sound internal control requires the agency to reconcile its internal accounting system records with MAIN to ensure the accuracy of information recorded on both systems. The reconciliation reduces the risk that accounts payable balances may not be correctly stated in the financial records or that vendors may not be appropriately paid.

The financial statements in this report contain the correct balances after adjustment for the reconciled differences.

## **RECOMMENDATION**

We recommend that MBDA improve its internal control over financial operations to ensure that accounting transactions are properly recorded and that account balances are accurately reported in its financial statements.

## **ENTITY PRELIMINARY RESPONSE**

MBDA agreed with the finding and has taken the necessary steps to comply with the recommendation. MBDA was a new authority created in 2002. The timing of the audit coincided with the creation of MBDA's own accounting system. Prior to the establishment of MBDA's accounting system, all of MBDA's recordkeeping and reconciliations were performed by the Department of Treasury. With MBDA's accounting system in place, MBDA has established a schedule of periodic reconciliations that will ensure the accuracy of information reported on both its accounting system and MAIN.

## Glossary of Acronyms and Terms

<b>financial audit</b>	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.
<b>GASB</b>	Governmental Accounting Standards Board.
<b>internal control</b>	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.
<b>MAIN</b>	Michigan Administrative Information Network.
<b>material misstatement</b>	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.
<b>material weakness</b>	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.
<b>MBDA</b>	Michigan Broadband Development Authority.
<b>MSHDA</b>	Michigan State Housing Development Authority.

**reportable condition**

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

**SOMCAFR**

*State of Michigan Comprehensive Annual Financial Report.*

**unqualified opinion**

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