



# MICHIGAN

OFFICE OF THE AUDITOR GENERAL

## AUDIT REPORT



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

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

– Article IV, Section 53 of the Michigan Constitution

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

*Financial Audit*

*Michigan Economic Development Corporation  
 (A Component Unit of the State of Michigan)*

*October 1, 2003 through September 30, 2005*

Report Number:  
 64-806-06

Released:  
 July 2006

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

**Financial Statements:**

**Auditor's Report Issued**

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

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**Internal Control Over Financial Reporting**

We did not report any findings related to internal control over financial reporting.

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**Noncompliance or 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:**

MEDC's mission is to promote smart economic growth by developing strategies and providing services to create and retain good jobs and a high quality of life for Michigan residents. Article VII, Section 28 of the State Constitution and Act 7, P.A. 1967, provided for the creation of MEDC as a public body corporate. MEDC was created 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.

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<http://audgen.michigan.gov>



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

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

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Deputy Auditor General



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

July 12, 2006

Mr. James C. Epolito, President and Chief Executive Officer  
Michigan Economic Development Corporation  
300 North Washington Square  
Lansing, Michigan

Dear Mr. Epolito:

This is our report on the financial audit of the Michigan Economic Development Corporation (MEDC), a component unit of the State of Michigan, for the period October 1, 2003 through September 30, 2005.

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

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

AUDITOR GENERAL



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# INDEPENDENT AUDITOR'S REPORT



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

## Independent Auditor's Report on the Financial Statements

Mr. James C. Epolito, President and Chief Executive Officer  
Michigan Economic Development Corporation  
300 North Washington Square  
Lansing, Michigan

Dear Mr. Epolito:

We have audited the accompanying financial statements of the Michigan Economic Development Corporation, a component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2005 and September 30, 2004, 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, 2005 and September 30, 2004 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, 2005 and September 30, 2004 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 12, 2006 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 16 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 fiscal year ended September 30, 2004 was not presented because this information was presented in the Michigan Economic Development Corporation's prior year audited financial statements.

AUDITOR GENERAL

January 12, 2006

# MANAGEMENT'S DISCUSSION AND ANALYSIS

This is a discussion and analysis of the financial performance of the Michigan Economic Development Corporation (MEDC) for the period October 1, 2004 through September 30, 2005. MEDC is a public body corporate and a component unit of the financial reporting entity of the State of Michigan. MEDC's management is responsible for the financial statements, notes to the financial statements, and this discussion.

### **Using the Financial Report**

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

The reporting standards require a statement of net assets; a statement of revenues, expenses, and changes in fund net assets; and a statement of cash flows (direct method).

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

Amounts reported in the financial statements include both the MEDC corporate funds as well as the 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 acquisition, and investing activities.

### **Analysis of Financial Activities**

The assets of MEDC exceeded its liabilities at September 30, 2005 by \$164.9 million and by \$166.6 million at September 30, 2004. As of September 30, 2005, \$75.3 million of this amount was in equity in common cash of the State of Michigan.

MEDC's total net assets decreased by \$1.7 million during the course of fiscal year 2004-05 operations.

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

	2005	2004
Current assets	\$ 117,083,470	\$ 104,727,759
Noncurrent assets:		
Investments	14,999,333	31,239,900
Loans receivable	40,899,235	35,944,925
Capital assets (net)	11,463,257	11,941,209
Other noncurrent assets	4,317,956	5,614,856
Total Assets	<u>\$ 188,763,251</u>	<u>\$ 189,468,649</u>
Current liabilities	\$ 20,613,670	\$ 16,292,804
Long-term liabilities	3,267,964	6,547,386
Total Liabilities	<u>\$ 23,881,634</u>	<u>\$ 22,840,190</u>
Net Assets		
Invested in capital assets	\$ 11,463,257	\$ 11,941,209
Unrestricted net assets	153,418,361	154,687,251
Total Net Assets	<u>\$ 164,881,618</u>	<u>\$ 166,628,460</u>

**Current assets** primarily consist of amounts retained by the State of Michigan in its equity in common cash, cash and cash equivalents, short-term investments, loans receivable, and receivables for gaming revenues (received directly from the Keweenaw Bay Indian Community under a consent agreement reached by the Keweenaw Bay Indian Community, the federal government, and the State government).

Interest earned on funds retained in the common cash pool is the income of the State and is not transferred to MEDC.

**Current assets** increased by \$12.4 million in fiscal year 2004-05 compared with fiscal year 2003-04 primarily because of increases in short-term notes, investments, and loans receivable.

**Investments** include long-term securities and program investments. During fiscal year 2004-05, total investments (short-term and long-term) declined compared with fiscal year 2003-04 primarily because MEDC liquidated investments to cover the shortfall in tribal gaming revenues to pay for MEDC non-State employees' salaries and wages and other operating expenses.

**Loans receivable** include only the long-term portion of the outstanding loans, net of loan loss provisions. Total loans receivable (short-term and long-term) increased by \$9.3 million in fiscal year 2004-05 when compared with fiscal year 2003-04 because of new program loans and reversal of the loan loss provisions on loans now expected to be collected netted against program loan repayments.

**Capital assets (net)** at September 30, 2005 include the cost of the MEDC headquarters building, furniture, and information technology equipment, net of depreciation. During fiscal year 2004-05, capital assets worth \$93,992 were added.

**Other noncurrent assets** consist of Capital Access Program loan guarantee reserves. The Program ended on September 30, 2002 and no new loans are enrolled. MEDC will continue to process claims and recoveries on existing loans until the reserves are exhausted. However, effective November 21, 2005, Act 225, P.A. 2005, has provided appropriation in the Michigan Strategic Fund to restart the Program.

**Current liabilities** primarily consist of accounts payables and the current portion of the liability for the Capital Access Program loan guarantee. The current liabilities increased by \$4.3 million during fiscal year 2004-05 because of an early payoff of a pass-through loan, an increase in accounts payable for the Life Sciences Program grants awarded late in the fiscal year, and increased liability for improved reporting of compensated absences.

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

Overall, **net assets** were reduced by approximately \$1.7 million during fiscal year 2004-05 as a result of the preceding activities.

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

	2005	2004 (Restated)
	<hr/>	<hr/>
Operating Revenues		
Operating grants and contributions	\$ 67,642,621	\$ 53,842,540
Interest and investment earnings	1,721,340	2,595,052
Other operating revenues	9,770,704	6,322,286
Total Operating Revenues	<hr/> \$ 79,134,666	<hr/> \$ 62,759,878
 Operating Expenses		
Salaries, wages, and other administrative expenses	\$ 38,069,678	\$ 39,215,881
Payment to MSF	52,637	15,210
Operating grants	42,759,192	77,752,099
Total Operating Expenses	<hr/> \$ 80,881,508	<hr/> \$ 116,983,190
 Change in net assets	\$ (1,746,842)	\$ (54,223,312)
Total net assets - Beginning	<hr/> 166,628,460	<hr/> 220,851,772
 Total net assets - Ending	<hr/> \$ 164,881,618	<hr/> \$ 166,628,460

**Operating grants and contributions** include grants received from the National Institute of Standards and Technology (NIST), a federally funded program; the amount received from State appropriations for the economic development functions; and tribal gaming revenue, fees, etc., received by the Michigan Strategic Fund (MSF) and transferred to MEDC. Operating grants and contributions increased by \$13.8 million mainly because of the increase in funding available to MEDC from State appropriations for the Technology Tri-Corridor for Life Sciences Initiative.

**Interest and investment earnings** for fiscal year 2004-05 were lower because of a reduced investment portfolio and investment of a larger portion in short-term investments when compared with fiscal year 2003-04.

**Other operating revenues** primarily consisted of revenue reimbursed by the Michigan Department of Transportation for Welcome Center operations (see Note 11), refund of

prior year expenses for reversal of a loan loss provision, and tribal gaming revenues. The \$3.4 million increase in other operating revenues is mainly attributed to reversal of the loan loss provision. Tribal gaming revenue is received as a result of a consent judgment reached by the Keweenaw Bay Indian Community, the U.S. Department of the Interior, the U.S. Department of Justice, and the Governor during fiscal year 2000-01. MEDC receives a semiannual payment from the Keweenaw Bay Indian Community in an amount equal to 8% of the net win derived from all class III electronic games of chance. MEDC received tribal gaming revenue of \$2.5 million in each of fiscal years 2004-05 and 2003-04.

**Operating grants** primarily include grants for the Life Sciences Program, Economic Development Job Training Program, and Michigan Core Community Fund Program. There was a significant decrease of \$35.0 million in grant requests and disbursements for these programs in fiscal year 2004-05.

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

	2005	2004
Cash provided (used) by:		
Operating activities	\$ (11,833,485)	\$ (63,511,886)
Capital and related financing activities	(93,992)	(116,376)
Investing activities	14,574,025	4,507,709
Net increase (decrease) in cash	\$ 2,646,548	\$ (59,120,553)
Cash and cash equivalents at beginning of year	84,494,904	143,615,457
Cash and cash equivalents at end of year	\$ 87,141,452	\$ 84,494,904

Cash and cash equivalents at the end of fiscal year 2004-05 (\$87.1 million) included \$75.3 million equity in the State of Michigan common cash. It is earmarked for the following obligations of MEDC:

<u>Program</u>	<u>Amount</u>
Life Sciences Program	\$ 44,298,900
Economic Development Job Training Program	12,829,876
Michigan Core Community Fund Program	2,966,501
Automotive Technological Accelerator	807,250
Michigan Promotion Program	524,168
Miscellaneous	3,557,735
Accounts payable*	<u>10,316,317</u>
 Total Equity in State of Michigan Common Cash	 \$ <u><u>75,300,747</u></u>

\* This amount represents payments made after September 30, 2005 against the obligations of fiscal year 2004-05.

The balance of the cash on hand (\$11.8 million) represented investments in instruments with maturity dates of less than 12 months.

# FINANCIAL STATEMENTS

**MICHIGAN ECONOMIC DEVELOPMENT CORPORATION**

Statement of Net Assets

As of September 30

	2005	2004
<b>ASSETS</b>		
Current Assets:		
Cash (Note 2)	\$ 189,787	\$ 70,041
Equity in common cash (Note 2)	75,300,747	74,124,915
Capital Access Program - Cash (Note 2)	474,351	442,399
Short-term notes (Note 2)	6,858,610	4,242,693
Tribal gaming revenue receivable (Note 8)	1,823,793	1,349,829
Amounts due from MSF		
Amounts due from federal agencies	621,555	375,129
Investments (Note 2)	25,740,118	22,796,477
Other Current Assets:		
Loans receivable (Note 4)	5,285,229	956,164
Interest receivable	211,629	169,208
Miscellaneous	577,651	200,904
Total Current Assets	\$ 117,083,470	\$ 104,727,759
Noncurrent Assets:		
Capital Access Program - Reserve (Note 2)	\$ 4,317,956	\$ 5,614,856
Loans receivable (Note 4)	40,899,235	35,944,925
Investments (Note 2)	14,999,333	31,239,900
Capital assets (net) (Note 5)	11,463,257	11,941,209
Total Noncurrent Assets	\$ 71,679,781	\$ 84,740,890
Total Assets	\$ 188,763,251	\$ 189,468,649
<b>LIABILITIES</b>		
Current Liabilities:		
Accounts payable and other liabilities	\$ 15,712,800	\$ 12,150,512
Compensated absences (Notes 6 and 7)	2,437,253	1,541,810
Amounts due to primary government	178,669	125,957
Capital Access Program (Note 6)	2,000,000	2,000,000
Deferred revenues	284,947	474,524
Total Current Liabilities	\$ 20,613,670	\$ 16,292,804
Long-Term Liabilities:		
Capital Access Program (Note 6)	\$ 2,317,956	\$ 3,614,856
Compensated absences (Notes 6 and 7)	783,104	675,822
Other long-term liabilities	166,904	2,256,708
Total Long-Term Liabilities	\$ 3,267,964	\$ 6,547,386
Total Liabilities	\$ 23,881,634	\$ 22,840,190
<b>NET ASSETS</b>		
Invested in capital assets	\$ 11,463,257	\$ 11,941,209
Unrestricted net assets	153,418,361	154,687,251
Total Net Assets (Note 9)	\$ 164,881,618	\$ 166,628,460

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

	2005	2004 (Restated)
<b>OPERATING REVENUES</b>		
<u>Operating Grants and Contributions</u>		
Federal revenue - Manufacturing Extension Partnership (NIST)	\$ 2,483,000	\$ 2,335,445
Payments from MSF - State appropriations (Note 3)	64,281,460	48,692,604
Payments from MSF - Tribal gaming revenue, fees, etc. (Note 3)	878,162	2,814,491
Total Operating Grants and Contributions	\$ 67,642,621	\$ 53,842,540
<u>Interest and Investment Earnings</u>		
Investment earnings	\$ (7,306,020)	\$ 1,569,932
Net increase (decrease) in fair value of investments	8,586,425	525,093
Interest income on loans	401,820	472,608
Interest income	39,115	27,420
Total Interest and Investment Earnings	\$ 1,721,340	\$ 2,595,052
<u>Other Operating Revenues</u>		
Tribal gaming revenue (Note 8)	\$ 2,499,306	\$ 2,527,044
Other operating revenues (Note 11)	7,271,399	3,795,242
Total Other Operating Revenues	\$ 9,770,704	\$ 6,322,286
Total Operating Revenues	\$ 79,134,666	\$ 62,759,878
<b>OPERATING EXPENSES</b>		
Salaries, wages, and other administrative expenses (Note 11)	\$ 37,066,953	\$ 38,762,096
Compensated absences (Note 7)	1,002,725	453,785
Payment to MSF	52,637	15,210
Operating grants	42,759,192	77,752,099
Total Operating Expenses	\$ 80,881,508	\$ 116,983,190
Operating Income (Loss)	\$ (1,746,842)	\$ (54,223,312)
Nonoperating Revenues (Expenses)	\$ 0	\$ 0
Transfers	\$ 0	\$ 0
Change in net assets	\$ (1,746,842)	\$ (54,223,312)
Total net assets - Beginning	166,628,460	220,851,772
Total net assets - Ending	\$ 164,881,618	\$ 166,628,460

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

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

	<u>2005</u>	<u>2004</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Payments to employees	\$ (21,764,918)	\$ (17,865,598)
Payments to suppliers	(16,767,184)	(16,136,641)
Tribal gaming revenue	2,025,341	2,507,216
Other operating revenue	7,296,472	797,586
Grants received from federal government	2,236,574	2,131,783
Operating grants	(49,966,755)	(92,804,173)
Payment to MSF	(52,637)	(15,210)
Payments from MSF	65,159,622	57,873,151
Net cash provided (used) by operating activities	<u>\$ (11,833,485)</u>	<u>\$ (63,511,886)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Net cash provided (used) by noncapital financing activities	<u>\$ 0</u>	<u>\$ 0</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Acquisition and construction of capital assets (Note 5)	<u>\$ (93,992)</u>	<u>\$ (116,376)</u>
Net cash provided (used) by capital and related financing activities	<u>\$ (93,992)</u>	<u>\$ (116,376)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sale and maturities of investment securities (Note 2)	\$ 21,883,350	\$ 2,715,085
Interest and dividends on investments	(7,309,325)	1,792,624
Net cash provided (used) by investing activities	<u>\$ 14,574,025</u>	<u>\$ 4,507,709</u>
Net cash provided (used) - all activities	\$ 2,646,548	\$ (59,120,553)
Cash and cash equivalents at beginning of year	<u>84,494,904</u>	<u>143,615,457</u>
Cash and cash equivalents at end of year	<u>\$ 87,141,452</u>	<u>\$ 84,494,904</u>
<b>RECONCILIATION OF CASH AND CASH EQUIVALENTS</b>		
Per statement of net assets classifications:		
Cash	\$ 189,787	\$ 70,041
Equity in common cash	75,300,747	74,124,915
Capital Access Program	4,792,308	6,057,255
Short-term notes	<u>6,858,610</u>	<u>4,242,693</u>
Cash and cash equivalents at end of year	<u>\$ 87,141,452</u>	<u>\$ 84,494,904</u>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:</b>		
Operating income (loss)	\$ (1,746,842)	\$ (54,223,312)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Interest (nonprogram) and investment income	7,309,325	(1,792,624)
Depreciation	571,944	1,404,821
Net increase (decrease) in fair value of investments	(8,586,425)	(525,093)
Changes in assets and liabilities:		
Amounts due from MSF and tribal gaming revenue receivable	(473,964)	6,366,057
Mortgages and loans receivable (program loans)	(9,283,374)	(8,891,693)
Amounts due from federal agencies	(246,426)	(203,662)
Other assets	(419,168)	72,522
Accounts payable and other liabilities	<u>1,041,444</u>	<u>(5,718,902)</u>
Net cash provided (used) by operating activities	<u>\$ (11,833,485)</u>	<u>\$ (63,511,886)</u>
<b>SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES</b>		
Loan converted to investment		\$ 1,260,828
Loans converted to grants	727,822	
Increase/(decrease) in fair market value of investments	<u>8,586,425</u>	<u>525,093</u>
Net noncash provided (used) by investing, capital, and financing activities	<u>\$ 9,314,247</u>	<u>\$ 1,785,921</u>

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

## Notes to the Financial Statements

### Note 1 Significant Accounting Policies

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

#### a. Reporting Entity

Article VII, Section 28 of the State Constitution and Act 7, P.A. 1967, provided for the creation of MEDC as a public body corporate. MEDC was created 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). MEDC is a separate legal entity created to promote smart economic growth by developing strategies and providing services to create and retain good jobs and a high quality of life for Michigan residents. Under the terms of the agreement, the governance of MEDC resides in an Executive Committee of 20 members appointed to eight-year, staggered terms by the Governor.

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

#### b. Financial Statement Presentation

Under fund accounting, the accounts of the component units of the State of Michigan are organized on the basis of funds, each of which is considered a separate accounting entity. MEDC's operations are

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

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

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

The accompanying financial statements present only MEDC. Accordingly, they do not purport to, and do not, present fairly the financial position and the changes in financial position and cash flows of the State of Michigan or its component units in conformity with generally accepted accounting principles.

c. Measurement Focus and Basis of Accounting

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

d. Financial Data

The MSF Board of Directors entered into an interlocal agreement with a local unit of government to create MEDC. MEDC came into existence on

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

MEDC financial statements primarily present the following:

- (1) Cash and Cash Equivalents: The amount reported as "Cash and cash equivalents at end of year" on the statement of cash flows is equal to the total of the amounts reported on the statement of net assets for the line items entitled "Cash," "Equity in common cash," "Capital Access Program - Cash," "Short-term notes," and "Capital Access Program - Reserve."
- (2) Investments: Generally, marketable investments are reported at fair value, consistent with the provision of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Other nonmarketable investments are reported at cost.
- (3) Loan Receivables: Loan receivables are reported net of allowance for losses.
- (4) Capital Assets: Capital assets, which mainly include a building, furniture, and equipment, are reported at historical cost, net of depreciation.
- (5) Operating Revenues: Revenues from federal grants, other restricted sources, amounts available to MEDC from State appropriations, tribal

gaming revenue (see Notes 3 and 8), and investment earnings. Also included in operating revenues are IDRB issuance fees and Michigan Economic Growth Authority (MEGA) and Brownfield fees collected by MSF and transferred to MEDC during the fiscal year.

- (6) Operating Expenses: Expenses related to program grants funded by State appropriations and MEDC nonappropriated funds. Also included in operating expenses are administrative expenses (including payables) incurred out of appropriated funds, except for the CDBG Program.

## Note 2 Deposits and Investments

### a. General Information

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

- (1) Securities issued or guaranteed by the U.S. government or its agencies.
- (2) Bonds or other obligations of any U.S. state or any local unit of government of any such state.
- (3) Preferred stock issued by U.S. corporations.
- (4) Repurchase agreements fully collateralized by U.S. government securities.
- (5) Corporate and bank debt including, but not limited to, commercial paper, banker's acceptances, and other short-term obligations.
- (6) Corporate notes and bonds.
- (7) Taxable bond funds.
- (8) Money market mutual fund shares that offer daily purchase and redemption and maintain a constant share price.

(9) Common stock of U.S. corporations.

(10) Stock mutual funds with portfolios highly concentrated in securities of U.S. corporations.

b. Deposits

	Deposits
Equity in State of Michigan common cash	\$ 75,300,747
Checking	189,787
Capital Access Program - Cash	474,351
Capital Access Program - Reserve	4,317,956
	<hr/>
Total Deposits	\$ 80,282,842
	<hr/>

GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, an amendment of GASB Statement No. 3, requires certain disclosures regarding policies and practices with respect to deposits and investments and the custodial credit risk associated with them. 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 \$7,498,894 at September 30, 2005 (\$8,559,082 at September 30, 2004). Of that amount, \$5,254,272 (\$5,907,916 at September 30, 2004) was uninsured and uncollateralized at September 30, 2005. 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. Custodial credit risk

disclosures and policies for controlling the risks regarding these deposits are described in Note 5 of the fiscal year 2004-05 *SOMCAFR*.

c. Investments

All marketable investments are carried at fair value.

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

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

The following table shows the fair value of investments at September 30, 2005 by investment type and in total:

	Fair Market Value	Investment Maturities			
		Less Than 1 Year	1 to 5 Years	6 to 10 Years	More Than 10 Years
<u>Investments Type</u>					
Commercial paper	25,150,180	25,150,180			
Short-term notes	6,858,610	6,858,610			
Government securities	776,174				776,174
Corporate bonds/notes	638,295	589,938			48,357
Equities	2,470,260		2,470,260		
Mutual funds					
Venture capital	11,704,543			11,704,543	
<b>Total Investments</b>	<b>47,598,062</b>	<b>32,598,728</b>	<b>2,470,260</b>	<b>11,704,543</b>	<b>824,531</b>

GASB Statement No. 40 requires certain disclosures regarding policies and practices with respect to the risks associated with the investments. The custodial credit risk, credit risk, interest rate risk, foreign currency risk, and concentration of credit risk are discussed in the following paragraphs:

(1) Custodial Credit Risk

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, 2005, investments in commercial paper, short-term notes, corporate bonds and notes, and government securities with a market value of \$33.4 million were exposed to custodial credit risk. These securities were held by the counterparty. MEDC does not have a policy for limiting custodial credit risk.

The fair value of investments at September 30, 2004 was \$58,279,070, of which \$30,235,591 were exposed to custodial credit risk.

(2) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. MEDC had the following practices for controlling credit risk in fiscal year 2004-05. 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.

Investment Type	Fair Value	Rating From Standard & Poor's	Fair Value	Rating From Moody's Investors Service
Commercial paper	\$19,547,759	A-1+	\$25,150,180	P-1
Commercial paper	5,602,421	A-1		
Total Commercial Paper	\$25,150,180		\$25,150,180	
Government securities - U.S. agencies	776,174	AAA	776,174	Aaa
Corporate bonds and notes	289,140	AAA	289,140	Aaa
Corporate bonds and notes	349,155	NR	349,155	NR
Money market funds	6,858,610	AAA	6,858,610	Aaa
Total Investments	\$33,423,259		\$33,423,259	

(3) 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.

(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. MEDC does 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. At September 30, 2005, MEDC did not have investments in any single issuer totaling more than 5% of MEDC's investments.

Note 3 Revenues From MSF

Revenues from MSF consisted of the following:

	Fiscal Year	
	2004-05	2003-04
Tribal gaming revenue, fees, etc.	\$ 878,162	\$ 2,814,491
Federal revenue - employment service	440,976	659,741
State's General Fund programs	53,339,734	37,687,759
State's restricted bonded programs	500,750	345,104
State's tobacco revenue appropriation	10,000,000	10,000,000
	<hr/>	<hr/>
Total Revenues From MSF	\$ 65,159,622	\$ 51,507,095

Tribal gaming revenue, received from MSF, decreased significantly during fiscal years 2004-05 and 2003-04 because the two tribes remitting funds to MSF under the 1998 compact agreement with the State placed these revenues into an escrow account rather than submitting them to MSF. The tribes contend that the Club Keno game, introduced by the State Lottery, violates the terms of the compact agreement. Based on information provided by the tribes, MSF estimated that the tribes placed a total of approximately \$22.1 million into the escrow account relating to both fiscal years 2003-04 and 2004-05.

Note 4 Loans Receivable

Loans receivable consisted of the following:

	As of September 30	
	2005	2004
Urban Land Assembly Fund loans	\$ 5,976,557	\$ 6,362,820
Seed capital loan	3,400,000	3,400,000
BIDCO loans	2,266,366	873,734
Life Sciences Program	19,093,513	12,867,357
Michigan Core Community Fund Program	13,246,474	13,309,679
Other loans	11,601,554	12,006,400
Total	\$ 55,584,464	\$ 48,819,990
Less: Allowance for uncollectible loans	(9,400,000)	(11,918,900)
	<hr/>	<hr/>
Total Loans Receivable	\$ 46,184,464	\$ 36,901,090

Loans included in the "Other loans" category are collateralized, for qualifying projects, on the basis of participating up to 50% with other public or private

lenders. The loans are due under varying repayment terms, including interest at predominantly 9.5% per annum.

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

MEDC provided no additional allowance for losses during the fiscal year ended September 30, 2005 for loans receivable that may be converted to grants or uncollectible in future years. Allowances for loan losses are reduced for the amounts recovered, BIDCO credits, and write-offs for the nonperforming loans. These loans generally provide for no principal or interest payments during the term of the loans. Some of these loans are expected to be converted to grants at the end of their term provided that certain conditions are met by the borrowers. The conditions generally require the borrowers to continue to conduct their principal business activities in the State of Michigan and submit specified reports to MEDC.

Note 5 Capital Assets

MEDC recorded its capital assets at cost and depreciates them over their useful lives using the straight-line depreciation method. Capital asset activities for the fiscal year ended September 30, 2005 were as follows:

Capital Assets	Beginning Balance	Increases	Decreases	Ending Balance
Building and improvement	\$ 13,086,970	\$	\$	\$ 13,086,970
Furniture	2,482,763	14,667		2,497,430
Non-EDP equipment	78,265			78,265
EDP equipment	773,565	79,325		852,890
Capital assets (cost)	<u>\$ 16,421,564</u>	<u>\$ 93,992</u>	<u>\$ 0</u>	<u>\$ 16,515,555</u>
Less accumulated depreciation for:				
Building and improvement	\$ (1,334,942)	\$ (436,608)	\$	\$ (1,771,550)
Furniture	(2,415,347)	(43,964)		(2,459,311)
Non-EDP equipment	(78,265)			(78,265)
EDP equipment	(651,800)	(91,372)		(743,172)
Total Accumulated Depreciation	<u>\$ (4,480,355)</u>	<u>\$ (571,944)</u>	<u>\$ 0</u>	<u>\$ (5,052,299)</u>
Capital assets (net)	<u>\$ 11,941,209</u>	<u>\$ (477,952)</u>	<u>\$ 0</u>	<u>\$ 11,463,257</u>

Capital asset activities for the fiscal year ended September 30, 2004 were as follows:

Capital Assets	Beginning Balance	Increases	Decreases	Ending Balance
Building and improvement	\$ 13,086,970	\$	\$	\$ 13,086,970
Furniture	2,430,971	51,792		2,482,763
Non-EDP equipment	78,265			78,265
EDP equipment	708,981	64,584		773,565
Capital assets (cost)	\$ 16,305,188	\$ 116,376	\$ 0	\$ 16,421,564
Less accumulated depreciation for:				
Building and improvement	\$ (898,335)	\$ (436,608)	\$	\$ (1,334,942)
Furniture	(1,659,876)	(755,471)		(2,415,347)
Non-EDP equipment	(54,351)	(23,914)		(78,265)
EDP equipment	(462,972)	(188,828)		(651,800)
Total Accumulated Depreciation	\$ (3,075,533)	\$ (1,404,821)	\$ 0	\$ (4,480,355)
Capital assets (net)	\$ 13,229,654	\$ (1,288,445)	\$ 0	\$ 11,941,209

Note 6 Long-Term Liabilities

Long-term liabilities are accrued when incurred in proprietary funds (using the accrual basis of accounting). The following table summarizes Capital Access Program and compensated absences liabilities of MEDC for the fiscal year ended September 30, 2005:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$5,614,856	\$ 431,734	\$1,728,634	\$4,317,956	\$2,000,000
Compensated absences	\$2,217,632	\$2,460,053	\$1,457,328	\$3,220,357	\$2,437,253

The following table summarizes Capital Access Program and compensated absences liabilities of MEDC for the fiscal year ended September 30, 2004:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$7,689,002	\$ 858,773	\$2,932,919	\$5,614,856	\$2,000,000
Compensated absences	\$1,763,847	\$1,454,220	\$1,000,436	\$2,217,632	\$1,541,810

Note 7 Pension Plans

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

MEDC offers a defined contribution plan (under Internal Revenue Service Code Section 401(A)) for the non-detailed employees. MEDC contributes 8% of the gross wages to the accounts of eligible employees. As of September 30, 2005, 41 employees were eligible to receive contributions. MEDC's contributions to the plan were current. MEDC also offers a 457 deferred compensation plan to these employees. As of September 30, 2005, 24 employees participated in this plan. MEDC does not make any contributions to the 457 plan. Both plans are administered by a third party administrator and the employees manage their own investments.

Note 8 Tribal Gaming Revenue

Under a consent judgment reached between the Keweenaw Bay Indian Community, the U.S. Department of the Interior, the U.S. Department of Justice, and the Governor, MEDC receives a semiannual payment from the Keweenaw Bay Indian Community in an amount equal to 8% of the net win derived from all class III electronic games of chance. MEDC received tribal gaming revenue of \$2.5 million in each of fiscal years 2004-05 and 2003-04.

## Note 9 Commitments

Of the total net assets (\$164,881,618 and \$166,628,460, respectively), a portion is committed for the following economic development projects as of September 30, 2005 and September 30, 2004:

	2005	2004
Access Technology - North Coast	\$ 250,000	\$ 350,000
Automotive Technological Accelerator	807,250	1,310,000
Center for Michigan's Renaissance		260,256
Core Communities II	1,046,375	10,621,000
Detroit Downtown Development Authority	2,050,858	2,050,858
Economic Development Job Training Program	12,829,876	12,986,098
Emerging Technology Fund	359,375	797,448
Life Sciences Program	48,051,371	50,134,879
Marketing	619,120	1,090,011
Michigan Core Community Fund Program	2,966,501	3,366,774
Michigan Growth Fund	56,358	477,993
Minority Investments	2,003,564	3,824,719
Small Business/Technology		6,897,500
SmartZone Initiatives	312,400	939,000
Technology Transfer Program		100,000
University Matching Research	300,000	1,388,000
Urban Land Development	2,587,036	2,139,078
	<hr/>	<hr/>
Total	\$ 74,240,083	\$ 98,733,614

## Note 10 Related Party Transactions

When MEDC was created, it assumed ownership of an investment in a venture capital firm from MSF. One of the members on the MEDC Executive Committee is also a general partner of that venture capital firm. The investment was made through the ordinary course of business prior to that member's appointment to the MEDC Executive Committee. As of September 30, 2005 and September 30, 2004, the investment was recorded on the statement of net assets as a noncurrent asset in the amount of \$24,202 and \$2,418,476, respectively. There have been no related party transactions with this firm during fiscal years 2004-05 and 2003-04.

## Note 11 Restatement

The statement of revenues, expenses, and changes in fund net assets for the fiscal year ended September 30, 2005 reports other operating revenues and salaries, wages, and administrative expenses for the operation of Michigan

Department of Transportation Welcome Centers. In prior years, these were netted and not disclosed in the statement. The statement of revenues, expenses, and changes in fund net assets for the fiscal year ended September 30, 2004 was restated to correctly report other operating revenues and salaries, wages, and administrative expenses of \$3,367,342 for the operation of the Michigan Department of Transportation Welcome Centers.

INDEPENDENT AUDITOR'S REPORT ON  
INTERNAL CONTROL AND COMPLIANCE



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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. James C. Epolito, President and Chief Executive Officer  
Michigan Economic Development Corporation  
300 North Washington Square  
Lansing, Michigan

Dear Mr. Epolito:

We have audited the financial statements of the Michigan Economic Development Corporation, a component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2005 and September 30, 2004, as identified in the table of contents, and have issued our report thereon dated January 12, 2006. 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.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Michigan Economic Development Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

### 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*.

This report is intended solely for the information and use of the Michigan Economic Development Corporation's 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

January 12, 2006

# GLOSSARY

## Glossary of Acronyms and Terms

BIDCO	business and industrial development corporation.
CDBG	Community Development Block Grant
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
GASB	Governmental Accounting Standards Board.
IDRB	industrial development revenue bond.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
material misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.
material weakness	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and/or financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
MEDC	Michigan Economic Development Corporation.

MSF	Michigan Strategic Fund.
NIST	National Institute of Standards and Technology.
reportable condition	A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the entity's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements.
<i>SOMCAFR</i>	<i>State of Michigan Comprehensive Annual Financial Report.</i>
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.



