

**MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)
(AN ENTERPRISE FUND OF THE
STATE OF MARYLAND)**

**Financial Statements Together with
Report of Independent Public Accountants**

For the Years Ended June 30, 2013 and 2012



SB & COMPANY, LLC
EXPERIENCE • QUALITY • CLIENT SERVICE

JUNE 30, 2013 AND 2012

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS INDEPENDENT AUDITOR'S REPORT

To the Secretary of
Maryland Department of Business and Economic Development

Report on the Financial Statements

We have audited the accompanying financial statements of the Maryland Economic Adjustment Fund (the Fund), an enterprise fund of the State of Maryland, as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

The Fund's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2013 and 2012, and the respective changes in its financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

As discussed in Note 2, the accompanying financial statements present only the transactions of the *Maryland Economic Adjustment Fund* of the Maryland Department of Business and Economic Development (the Department), and are not intended to present fairly the financial position of the Department or the State of Maryland as of June 30, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

SB & Company, LLC

Hunt Valley, Maryland
November 22, 2013

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Management's Discussion and Analysis June 30, 2013 and 2012

Overview of the Financial Statements and Financial Analysis

In accordance with Government Accounting Standards Board (GASB), the Maryland Department of Business and Economic Development (the Department) presents this Management's Discussion and Analysis of the financial statements of the Maryland Economic Adjustment Fund (the Fund) for the years ended June 30, 2013 and 2012, as compared to the year ended June 30, 2011.

The report format consists of three components: the Statements of Net Position, the Statements of Revenue, Expenses, and Changes in Net Position, and the Statements of Cash Flows, which provide an overview of the Fund's activities.

Statements of Net Position

The Statements of Net Position present a fiscal overview of the Fund's assets, liabilities, and net position. These statements use the accrual basis of accounting, which is similar to generally accepted accounting principles used by most private sector companies.

- Assets are the economic resources of the program classified into current and non-current according to their order of liquidity and intended use.
- Liabilities are claims against assets, classified as current or non-current according to their due date.
- Net position is the residual after deducting the liabilities and are typically classified into: invested in capital assets net of related debt, restricted net position, and unrestricted net position.

The following are the Fund's summarized statements of net position as of June 30, 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Total assets	\$ 832,724	\$ 818,043	\$ 1,063,026
Unrestricted net position	\$ 832,724	\$ 818,043	\$ 1,063,026

Total assets increased by \$14,681 or 2% in fiscal year 2013, compared to fiscal year 2012, primarily due to an increase in cash caused by loan repayments and decreased administrative expenses.

Total assets decreased by \$244,983 or 23% in fiscal year 2012, compared to fiscal year 2011, primarily due to a decrease in cash caused by payment of administrative expenses in fiscal year 2012, as well as a loan receivable written off in the amount of \$148,541 during fiscal year 2012.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Management's Discussion and Analysis June 30, 2013 and 2012

Statements of Net Position (continued)

Unrestricted net position increased by \$14,681 in fiscal year 2013, compared to fiscal year 2012, as a direct result of total operating expenses of \$265,210 that exceeded total operating revenue of \$14,392 during fiscal year 2012. The administrative expense allocation decreased substantially due to the minimal activity in 2013. The program did not receive General or Special Fund appropriations for fiscal year 2013. The program did not disburse grants or loans during fiscal year 2013.

The program did not utilize program funds during fiscal year 2011. The program did not approve and disburse grants or loans during fiscal year 2011, but had operating expenses. The amount of total assets declined because of paying operating expenses for the year.

Statements of Revenue, Expenses, and Changes in Net Position

The Statements of Revenue, Expenses, and Changes in Net Position present the annual operating revenues, operating expenses, non-operating revenues and expenses, and changes in net position.

- Operating revenues are interest and fees earned on loans provided to clients of the program.
- Operating expenses consist of salaries, administrative costs, loan losses, and Revolving Loan Fund grants.
- Non-operating revenues consist of interest earned due to the State Treasurer's fund investment decisions.

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating revenue	\$ 5,751	\$ 14,392	\$ 29,342
Operating expenses	<u>(4,345)</u>	<u>265,210</u>	<u>255,170</u>
Net operating income/(loss)	10,096	(250,818)	(225,828)
Non-operating revenue	<u>4,585</u>	<u>5,835</u>	<u>10,644</u>
Change in net position	14,681	(244,983)	(215,184)
Net position, beginning of year	<u>818,043</u>	<u>1,063,026</u>	<u>1,278,210</u>
Net Position, End of Year	<u>\$ 832,724</u>	<u>\$ 818,043</u>	<u>\$ 1,063,026</u>

Operating revenue decreased by \$8,641 in fiscal year 2013, compared to fiscal year 2012, primarily as a consequence of a reduction in the amount of loans receivable in fiscal year 2013, which contributed to a decrease in interest income. Operating expenses decreased by \$269,555 in fiscal year 2013, compared to fiscal year 2012, as a result of the reduction in allocated and administrative expenses.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Management's Discussion and Analysis June 30, 2013 and 2012

Statements of Revenue, Expenses, and Changes in Net Position (continued)

Operating revenue decreased by \$14,950 in fiscal year 2012, compared to fiscal year 2011, primarily as a consequence of a reduction in the amount of loans receivable in fiscal year 2012, which contributed to a decrease in interest income. Operating expenses increased by \$10,040 in fiscal year 2012, compared to fiscal year 2011. The increase in operating expenses was primarily due to an increase in provision for loan loss and an increase in direct expenses in the amounts of \$11,475 and \$17,068, respectively.

Statements of Cash Flows

The Statements of Cash Flows summarizes the effects of cash receipts and cash payments.

- Net cash flows from operating activities are generally the cash effects of transactions and other events that enter into the determination of the change in net position.
- Net cash flows from non-capital financing activities reflect the cash received and spent for non-operating, non-investing, and non-capital purposes.
- Net cash flows from investing activities represent investment purchases, proceeds from sales of investments, and interest income.

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Net cash flows from operating activities	\$ 226,464	\$ (68,628)	\$ (77,379)
Net cash flows from non-capital activities	-	-	(1,193)
Net cash flows from investing activities	<u>4,585</u>	<u>5,835</u>	<u>11,837</u>
Net increase (decrease) in cash	231,049	(62,793)	(66,735)
Cash, beginning of year	<u>484,681</u>	<u>547,474</u>	<u>614,209</u>
Cash, End of Year	<u>\$ 715,730</u>	<u>\$ 484,681</u>	<u>\$ 547,474</u>

Cash from operating activities increased by \$231,049 in fiscal year 2013, compared to a decrease of \$62,793 in fiscal year 2012, primarily as a result of receiving full payment on an outstanding loan receivable in 2013.

Cash from fund activities decreased by \$62,793 in fiscal year 2012, compared to a decrease of \$66,735 in fiscal year 2011, primarily as a result of a decrease in interest income earned as well as increases in operating expenses incurred by the Fund.

Economic Outlook

At the time of the fiscal year 2013, budget formation process, the Department estimated that the available balance in the Fund would be insufficient to support loans and grants in fiscal year 2013. As a result, the Department did not request and Maryland's General Assembly did not authorize a Special Fund appropriation for program activity.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Management's Discussion and Analysis June 30, 2013 and 2012

Economic Outlook (continued)

Demand for small business loans continues to be prominent. The Department anticipates that the Fund will continue to be an active statewide small business resource. The Department is engaged in discussions with the U.S. Economic Development Administration (EDA) for preparation to submit an application for new funds to re-capitalize the program. The submission of an application for new funds is pending resolution of certain EDA program reporting requirements.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Statements of Net Position As of June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
Current Assets		
Cash	\$ 715,730	\$ 484,681
Loan receivable, net of allowance of \$6,604 and \$25,078, respectively	5,886	57,375
Accrued interest receivable	1,294	10,352
Total Current Assets	<u>722,910</u>	<u>552,408</u>
Non-Current Assets		
Loans receivable, net of current and allowance of \$123,218 and \$114,246, respectively	109,814	265,635
Total Assets	<u>832,724</u>	<u>818,043</u>
Total Net Position	<u>\$ 832,724</u>	<u>\$ 818,043</u>

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

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

**Statements of Revenue, Expenses, and Changes in Net Position
For the Years June 30, 2013 and 2012**

	<u>2013</u>	<u>2012</u>
Operating Revenue		
Interest and other income	<u>\$ 5,751</u>	<u>\$ 14,392</u>
Operating Expenses		
Allocation of salaries and benefits	-	26,293
Administrative allocations	5,157	102,969
Provision for loan losses	<u>(9,502)</u>	<u>135,948</u>
Total Operating Expenses	<u>(4,345)</u>	<u>265,210</u>
Net Operating Income (Loss)	10,096	(250,818)
Non-operating Revenue		
Interest income from State treasury	<u>4,585</u>	<u>5,835</u>
Change in net position	14,681	(244,983)
Net position, beginning of year	<u>818,043</u>	<u>1,063,026</u>
Net Position, End of Year	<u><u>\$ 832,724</u></u>	<u><u>\$ 818,043</u></u>

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

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

**Statements of Cash Flows
For the Years June 30, 2013 and 2012**

	<u>2013</u>	<u>2012</u>
Cash Flows from Operating Activities		
Interest and other income	\$ 14,809	\$ 18,583
Proceeds from collection of principal on loans receivable	216,812	55,456
Loan disbursements	-	(13,405)
Allocation of salaries and benefits	-	(26,293)
Administrative allocations	(5,157)	(102,969)
Net Cash flows from Operating Activities	<u>226,464</u>	<u>(68,628)</u>
 Cash Flows from Investing Activities		
State Treasury interest allocation	<u>4,585</u>	<u>5,835</u>
 Net increase (decrease) in cash	<u>231,049</u>	<u>(62,793)</u>
Cash, beginning of year	<u>484,681</u>	<u>547,474</u>
Cash, End of Year	<u>\$ 715,730</u>	<u>\$ 484,681</u>
 Reconciliation of Operating Income (Loss) to Net Cash from Operating Activities		
Operating income (loss)	\$ 10,096	\$ (250,818)
Provision for loan loss	(9,502)	135,948
Effect of changes in assets and liabilities:		
Loan receivables	216,812	42,051
Interest receivable	9,058	4,191
Net Cash from Operating Activities	<u>\$ 226,464</u>	<u>\$ (68,628)</u>

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

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Notes to the Financial Statements June 30, 2013 and 2012

1. ORGANIZATION

Authorizing Legislation

The Maryland Economic Adjustment Fund (the Fund) is codified in the Economic Development Article Sections 5-201 through 5-209 of the Annotated Code of Maryland. The Fund was created in 1994. The Maryland Department of Business and Economic Development (the Department) must report annually to the Governor and the General Assembly on the financial status of the Fund and its operations for the preceding fiscal year.

In order to enhance the economic welfare of Maryland's citizens, the Department was created to promote the expansion of local economies, regulatory reform, workforce training, and the preservation and expansion of business opportunities.

Description of the Fund

The Fund is comprised of both Federal funds from the U.S. Economic Development Administration and State resources. The Fund was created to provide loans to eligible businesses and grants to Revolving Loan Funds administered by local government or not-for-profit economic development organizations in the State of Maryland (the State) to assist with the modernization of manufacturing operations, the development of commercial applications for technology, and exploring and entering new markets. Federal funds are administered in accordance with the guidelines imposed by the Federal Government's Economic Development Act (EDA). The maximum loan amount is \$500,000, and applicants must be creditworthy but must not be able to obtain affordable financing through normal lending channels. Targeted eligible locations for Federal funds are Baltimore, Howard, Anne Arundel, Harford, Queen Anne's, Somerset, Worcester, Dorchester, Allegany, and Washington counties, and Baltimore City. Loans cannot be used to relocate jobs from one commuting area to another. The State funds are accessible to all counties in Maryland.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Fund is an enterprise fund of the State of Maryland.

Basis of Presentation

The Fund is an enterprise fund of the State of Maryland and utilizes the enterprise fund accounting method for financial reporting purposes in accordance with governmental accounting principles generally accepted in the United States of America.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Notes to the Financial Statements June 30, 2013 and 2012

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Basis of Presentation (continued)

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, and Statement No. 66, *Technical Corrections – 2012 – an amendment of GASB Statements No. 10 and No. 62*, effective for periods beginning after December 15, 2012. In June 2012, the GASB issued Statement No. 67, *Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25*, and Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*, effective for periods beginning after June 15, 2013, and 2014, respectively. In January 2013, GASB issued Statement No. 69, *Government Combination and Disposals of Government Operations*, effective for periods beginning after December 15, 2013. In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Non-exchange Guarantees*, effective for periods beginning after June 15, 2013. The Fund will implement these statements as of their effective dates. While the Fund is still in the process of determining the effect of implementing these GASB statements, it is expected that Statement No. 68 will have a material effect on the financial position of the Fund.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies as of the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Relationship with the Department

The Fund is one of many programs administered by the Department. The Fund has no direct employees and are entirely supported by staff at the Department to perform all necessary functions of the Fund. The Department allocated certain operating, general and administrative costs to the Fund, which is the Department's estimate of its cost to manage and administer the Fund's operations. This allocation from the Department is not necessarily representative of the Fund's costs as if they were a stand-alone entity and could significantly change in the future.

The Fund's accompanying financial statements are not indicative of the Fund as if it were a stand-alone entity.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Notes to the Financial Statements June 30, 2013 and 2012

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Loans Receivable

Loans receivable are recorded at cost, net of the allowance for loan losses. Loans are evaluated for impairment as part of the Fund's internal asset review process. All of the Fund's loans are subject to review for impairment. A loan is impaired when, based on current information and events, a creditor will be unable to collect all amounts contractually due

according to the terms of the agreement. When a loan is determined to be impaired, a valuation allowance is established based upon the difference between the Fund's investment and the fair value of the collateral securing the loan, as well as other factors.

Subsequent collection of cash may be applied as a reduction to the principal balance or recorded as income, depending upon management's assessment of the ultimate collectability of the loan. Interest income on impaired loans is recognized only to the extent that cash payments are received.

The allowance for loan losses is maintained at an amount management considers adequate to cover losses on loans receivable, which are deemed probable. The allowance is based upon a number of factors, including asset classifications, economic and industry trends, industry and geographic concentrations, estimated collateral values, management's assessment of credit risk inherent in the portfolio, historical loss experience, and the Fund's underwriting standards. As a result of changes in economic conditions and other factors, future additions to the allowance may be necessary.

3. CASH

Cash receipts and disbursements of the Fund are made through a cash pool maintained by the State Treasurer. The State Treasurer has statutory responsibility for the State's cash management activities. The State Treasurer maintains these and other State agency funds on a pooled basis in accordance with State statutes. For additional information on the risk of cash, see the State of Maryland Comprehensive Annual Financial Report (CAFR). Listed below is information related to the State's cash pool.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Fund adheres to the State Treasurer's policy for managing its exposure to fair value loss arising from increasing interest rates.

The State Treasurer's investment policy states that to the extent possible, it will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the State Treasurer will not directly invest in securities maturing more than five years from the date of purchase.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Notes to the Financial Statements June 30, 2013 and 2012

3. CASH (continued)

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Fund's policy for reducing its exposure to credit risk is to comply with the State Treasurer's policy, which requires that the State Treasurer's investments in repurchase agreement be collateralized by U.S. Treasury and agency obligations. In addition, investments may be made directly in U.S. Treasuries or agency obligations.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Fund's policy for reducing this risk of loss is to comply with the State Treasurer's policy, which limits the amount of repurchase agreements to be invested with a particular institution to 30% of the portfolio. Otherwise, there is no limit on the amount that may be invested in any one issuer.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the Fund's deposits may not be returned to it. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are (a) uncollateralized, (b) collateralized with securities held by the pledging financial institution, or (c) collateralized with securities held by the pledging financial institution's trust department or agent but not in the Fund's name. The Fund does not have a formal deposit policy for custodial credit risk, but follow the State Treasurer's policy which states the Treasurer may deposit in a financial institution in the State, any unexpended or surplus money in which the State Treasurer has custody. As of June 30, 2013 and 2012, all of the Fund's cash was deposited with the State Treasury and this was not subject to custodial risk.

4. LOANS RECEIVABLE

The Fund provides loans and grants to promote and encourage the development of new and existing businesses within the State.

Loans that are due within one year of June 30, 2013 and 2012, are classified as current assets; all other loans are classified as non-current assets.

The Fund has outstanding interest-bearing loans, with interest rates ranging from 3% to 10%.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

**Notes to the Financial Statements
June 30, 2013 and 2012**

4. LOANS RECEIVABLE (continued)

Activity in the allowance for loan losses is as follows for the years ended of June 30, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Balance, beginning of year	\$ 139,324	\$ 151,917
Write-off of uncollectible accounts	-	(148,541)
Current year provision	(9,502)	135,948
Ending Balance	<u>\$ 129,822</u>	<u>\$ 139,324</u>

As of June 30, 2013 and 2012, the Fund had no outstanding funding commitments.

5. PENSION AND OTHER POSTEMPLOYMENT BENEFITS

Eligible employees who perform services for the Fund and employees of the State are covered under the retirement plans of the State Retirement and Pension System of Maryland (the System) and are also entitled to certain healthcare benefits upon retirement. The Fund's only liability for retirement and post-employment benefits is its required annual contribution to the Department, which in turn was paid in full to the State of Maryland prior to year end. The System is considered part of the State's financial reporting entity, and is not considered a part of the Fund's reporting entity. The System prepares a separate Comprehensive Annual Financial Report, which can be obtained from the State Retirement and Pension System of Maryland at 120 East Baltimore Street, Baltimore, Maryland 21202.