The Delaware Economic Development Authority

A Component Unit of the State of Delaware

Financial Statements

Years Ended June 30, 2012 and 2011

Report Issued: June 25, 2014

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Independent Auditors' Report

We have audited the accompanying balance sheets of The Delaware Economic Development Authority (the Authority), as of June 30, 2012 and 2011, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following two paragraphs, we conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. 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 audits provide a reasonable basis for our opinion.

As discussed in Note 5 to the financial statements, the financial statements include investments of $2,683,433 and $2,703,623 as of June 30, 2012 and 2011, respectively, representing approximately 2.7% and 2.4% of net assets as of June 30, 2012 and 2011, respectively, whose fair values have been estimated by the Authority's management in the absence of readily ascertainable market values. Management's estimates are based on annual Schedule K-1 information provided by each respective private equity firm, or based on cost for other equity investments. These methods may not represent fair market value, in accordance with the *Governmental Accounting Standards Board* (GASB) authoritative guidance, codified in GASB Codification Section I50, *Investments*.

As discussed in Note 6 to the financial statements, the financial statements include capital assets, non-depreciable of $1,377,100 as of June 30, 2012 and 2011, representing approximately 1.4% and 1.2% of net assets as of June 30, 2012 and 2011, respectively, whose fair market values have been estimated by the Authority's management using county property assessment values in the absence of fair market values from the date of donation for each property. These methods may not represent fair market value, in accordance with GASB authoritative guidance, codified in GASB Codification Section 1400, *Reporting Capital Assets*.

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In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to audit the records related to the valuation of investments and capital assets, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2012 and 2011, and the changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13 to the financial statements, the June 30, 2011 financial statements have been restated to record $1,377,100 in properties owned by the Authority and ($37,177) in adjustments to cash accounts – other. The impact of the restatement changed net assets from $114,918,578 to $116,258,501 at June 30, 2011.

In accordance with *Government Auditing Standards,* we have also issued our report dated March 24, 2014 on our consideration of the Authority'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 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.

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 3-11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB 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 audits 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.

March 24, 2014
Newark, Delaware

The Delaware Economic Development Authority

Management's Discussion and Analysis

Years Ended June 30, 2012 and 2011

This section of The Delaware Economic Development Authority's (the Authority) annual financial report presents management's discussion and analysis of the financial position and performance during the Fiscal Year. Please read in conjunction with the Authority's financial statements, which follow this section.

Background

The Authority is a public corporation created pursuant to 29 *Del. C.* 50 and is empowered by the statute to administer economic development programs of the State of Delaware (the State). The Authority is primarily funded by State appropriations for the Delaware Economic Development Office's (DEDO) Strategic Fund, as mandated by the annual bond bill (which authorizes specific capital improvement projects and the use of the proceeds of bonds issued to fund projects) as well as explicitly indicated pass-through funds.

The Authority was established to assist in the mission of DEDO to be responsible for attracting new investors and businesses to the State, for promoting the expansion of existing industry, for assisting small and minority-owned businesses, for promoting and developing tourism, and for creating new and improved employment opportunities for all citizens in Delaware.

Grants

The Authority is empowered to make financial assistance in the form of Strategic Fund grants to qualified applicants. Proceeds of a grant can be used for, but are not limited to, the acquisition of land, buildings, machinery and equipment, the expansion of an existing building, or the renovation of fixed assets and buildings. Proceeds can also be used to augment working capital.

In addition to the Strategic Fund grants, the Authority has established the following specific grant programs:

- **Brownfield Assistance Grants**

  The Authority is empowered to provide financial assistance in the form of matching grants to applicants for the costs of conducting environmental assessments and remediation at Certified Brownfield sites.

- **Clean Energy Grants**

  The Authority participated in the Clean Energy Partnership in Fiscal Year 2011 for qualifying research and development projects that directly supported the commercial or industrial application of clean energy technologies. This program will be rolled into the Strategic Fund during Fiscal Year 2013.

- **Small Business Innovation Research and Small Business Technology Transfer Transitional Grant Assistance Program**

  In order to encourage Delaware small businesses to participate in the federal Small Business Innovation Research (SBIR) program and the Small Business Technology Transfer (STTR) program, the Authority has set forth criteria to help maintain continuing SBIR/STTR program research and development. The purposes of the program are to (1) stimulate technological innovation; (2) use small business to meet federal research and development needs; (3) encourage the participation by disadvantaged persons in technological innovation; and (4) increase private sector commercialization of program participants.

Loans

The Authority is empowered to make direct Strategic Fund loans to qualified applicants. Proceeds of a loan can be used for, but are not limited to, the acquisition of land, buildings, machinery and equipment, the expansion of an existing building, or the renovation of fixed assets and buildings. Proceeds can also be used to augment working capital.

In addition to these Strategic Fund loans, the Authority has established the following specific loan programs and incentives:

- **Delaware Capital Access Program (DCAP)**

  The DCAP is designed to give banks a flexible and non-bureaucratic tool to make business loans that are somewhat riskier than a conventional bank loan in a manner consistent with safety and soundness. It is designed to use a small amount of public resources to generate a large amount of private bank financing, thus providing access to bank financing for many Delaware businesses that might otherwise not be able to obtain such access.

  The DCAP is based on a risk-pooling concept. When a bank makes a loan under the program, the borrower and/or the bank must make a one-time premium charge. The Authority then matches the combined total of the borrower's payment and the bank's payment at a minimum of 2.5:1. The borrower's portion of the premium payment is one of the terms of the loan to be negotiated as a private transaction between the bank and the borrower.

- **Delaware Rural Irrigation Program (DRIP)**

  This loan program is administered collaboratively through the Delaware Department of Agriculture and DEDO. DRIP is a revolving, no-interest loan fund available to qualified Delaware farmers to add new irrigation systems including center pivot, linear move, towable systems, span angle systems, corner arm systems, single phase systems, or wells and filters associated with drip irrigation systems. The loan fund finances up to 25 percent of the total project cost, not to exceed $25,000, at zero percent interest for a term of no longer than seven years, with repayment of principal beginning in year three of the loan.

- **Economic Development Administration (EDA) Revolving Loan Fund**

  The Authority applied for economic assistance to the EDA to establish a revolving loan fund in February of 2010. The fund was capitalized by $500,000 from the Strategic Fund and $500,000 from the EDA. The revolving loan fund is intended to provide low-interest, longer-term loans to Delaware companies engaged in manufacturing.

- **Limited Investment for Financial Traction (LIFT)**

  This loan program allows participating small businesses to defer interest payments on their line of credit for up to a two-year period. The participating bank recommends the small business borrower to DEDO. Once approved, the Authority will begin paying the interest on the existing line of credit for up to two years. After the two years expire, the business will have five years to repay the Authority the amount borrowed at zero percent interest. LIFT transactions may not exceed $25,000 per entity. This loan program has sunset during the Fiscal Year ended June 30, 2013.

- **State Small Business Credit Initiative (SSBCI)**

  On September 27, 2010, President Obama signed into law the Small Business Jobs Act of 2010 (Act) to help increase credit availability for small businesses. The Act created the State Small Business Credit Initiative (SSBCI) and appropriated $1.5 billion to be used by the U.S. Department of the Treasury (Treasury) to provide direct support to states for use in programs designed to increase access to credit for small businesses.

  In 2011, the Authority was allotted $13,168,350. Of the allotment, $1,000,000 has been dedicated to the DCAP and $12,168,350 has been allocated to a revolving participation loan fund. In August 2011, the Authority received its first tranche of $4,345,555. In March 2013, the Authority received its second tranche of $4,345,556. The Authority must follow policy and procedures as set forth by the Treasury. The program matures in 2016 and is subject to audits and/or program termination. If the Authority has successfully complied with Treasury standards, it may retain the funds for future program use.

Tax-Exempt Industrial Revenue Bond Financing

The Authority provides statewide financial assistance to new or expanding businesses, governmental units, and certain organizations that are exempt from federal income taxation (collectively, assisted persons) by issuing tax-exempt Industrial Revenue Bonds (IRBs) and lending the proceeds of such bonds to these assisted persons. IRBs bear lower interest rates than comparable taxable bonds, because the interest paid to bondholders is exempt from federal and Delaware income taxes. The Authority is able to pass on this lower interest rate to the assisted persons.

The Authority does not guarantee the payment of principal or interest on the bonds, and the bonds are not backed by the full faith and credit of the State.

Overview of Financial Statements

The annual financial statements consist of two parts: management's discussion and analysis and the basic financial statements.

- The Authority's financial statements provide information about the overall financial position and results of operations. These statements, which are presented on an accrual basis, consist of the balance sheets, statements of revenues, expenses, and changes in net assets, and statements of cash flows.

- The basic financial statements also include the notes to the financial statements, which provide additional information and disclosures related to the amounts reported in the financial statements.

Financial Highlights

- Total assets exceeded total liabilities by $98,863,400 in Fiscal Year 2012 and $116,258,501 in Fiscal Year 2011 (net assets). Of the total net assets reported for each Fiscal Year, $1,377,100 was invested in capital assets and the balance of the total net assets were unrestricted and may be used to meet the Authority's general operating requirements. Included in the Authority's unrestricted net assets were $5,022,628 and $3,315,146 of funds that have been designated for specific programs as of June 30, 2012 and 2011, respectively.

- From Fiscal Year 2011 to Fiscal Year 2012, net assets decreased by $17,395,101. The primary cause for the decrease in net assets was related to the 269% increase in grant expenses and the 8074% increase in bad debt expense in Fiscal Year 2012 as compared to 2011. Program payments related to the DCAP and decreases in the Authority's investments also contributed to the decrease in net assets.

- The Authority reported an operating loss of $23,310,465 for Fiscal Year 2012 compared to operating income of $1,820,666 in Fiscal Year 2011. The operating loss in Fiscal Year 2012 primarily represents the Authority's significant increase in bad debt expense, resulting from a change in the allowance for loan losses methodology in Fiscal Year 2012 and the Authority's general and administrative costs of $511,290. Changes in the allowance for loan losses were solely based on the increase in loan loss provision by $13,956,835 due to the revised allowance for doubtful accounts methodology used in 2012 as compared to 2011, and an additional $9,375,000 increase in the loan loss provision to reserve 100% for receivables not expected to be collectible. The Authority reevaluated its allowance for loan losses methodology in order to take into consideration the risks presented in its target market. The Authority also reported a 72% decrease in operating revenues, which is related predominantly to a decrease in the interest received on loans.

- For the years ended June 30, 2012 and 2011, the Authority made grants, loans, and equity investments as follows:

  - The Authority's grant payments consisted of the following at June 30,:

	2012	2011 (restated)
Brownfield grants	$ 100,000	$ -
Clean Energy fund grants	-	2,500
SBIR/STTR transitional grants	190,000	340,000
Strategic fund grants	31,075,622	8,146,610
	$31,365,622	$8,489,110

  - The Authority issued the following loans:

DRIP loans	$ 356,067	$ -
LIFT loans	73,279	272,992
Other loans	171,182	-
SSBCI loans	2,538,250	-
Strategic Fund loans	-	1,293,796
	$3,138,778	$1,566,788

  - The Authority made equity investments of $80,000 in Fiscal Year ended June 30, 2011 and no additional investments in 2012.

Financial Summary and Analysis

The table below summarizes the Authority's net asset positions as of June 30,:

Summary of Balance Sheets

	2012	2011 (restated)
Assets		
Cash and cash equivalents	$ 68,936,477	$ 62,728,457
Other current assets	3,050,205	934,425
Total current assets	71,986,682	63,662,882
Noncurrent assets	29,176,544	53,247,104
Total assets	$101,163,226	$116,909,986
Liabilities		
Current liabilities	$ 618,026	$ 209,898
Noncurrent liabilities	1,681,800	441,587
Total liabilities	2,299,826	651,485
Net assets		
Unrestricted	$ 97,486,300	$114,881,401
Invested in capital assets	1,377,100	1,377,100
Total net assets	98,863,400	116,258,501
Total liabilities and net assets	$101,163,226	$116,909,986

The Authority, by nature of its activities, is primarily comprised of cash and cash equivalents, loans receivable, some investments, and certain liabilities.

The majority of the Authority's cash and cash equivalents is controlled by the State of Delaware, Office of the State Treasurer. Pooled cash and investments managed by the Office of the State Treasurer include cash and cash equivalents, as well as short-term and long-term investments. The Authority's portion is included as pooled cash and investments on the statements of net assets. The majority of the remaining assets of the Authority consisted of loans provided for new or expanding businesses within Delaware and are included within current or noncurrent assets based upon the terms of the loans. Investments, consisting of both venture capital investments in private equity firms and other equity investments, are included within noncurrent assets.

Cash and cash equivalents increased primarily from the State appropriations of $58,069,500, and SSBCI and EDA federal grant income of $2,664,883. The increase was offset by the Authority's transfers to other State agencies of $23,742,500 and grant payments of $31,365,622.

While cash and cash equivalents increased during Fiscal Year 2012, the Authority reported a decrease in noncurrent assets. Noncurrent assets decreased by $24,070,560, or 45.2%, due to the maturity of several loans in Fiscal Year 2012 that were outstanding loans as of June 30, 2011 and to the increase in the allowance for loan losses in Fiscal Year 2012, resulting from a change in the allowance methodology.

The Authority's liabilities consisted of $547,904 and $441,587 in DCAP nonrefundable premiums as of June 30, 2012 and 2011, respectively, which represent premiums paid into the DCAP bank accounts by participating banks that the Authority may reclaim if not fully utilized. The Authority also recorded $1,751,922 in grant advances from the SSBCI loan program as of June 30, 2012.

Total net assets for the Fiscal Year ended June 30, 2012 decreased by $17,395,101. A summary of changes in net assets is included in the table below.

The Authority is still highly liquid as of June 30, 2012 although its liquidity has decreased slightly from June 30, 2011. The Authority also had outstanding commitments of $79,741,082, which have been approved by the Council on Development Finance (CDF) and are awaiting disbursement. In addition, another $15,259,959 of commitment offers have been extended, but they have not yet been presented to the CDF for final approval.

The table below summarizes the Authority's revenues, expenses, and changes in net assets during the years ended June 30,:

Summary Statements of Revenues, Expenses, and Changes in Net Assets

	2012	2011 (restated)
Total operating revenues	$ 532,660	$ 1,926,672
Total operating expenses	23,843,125	106,006
Operating income (loss)	(23,310,465)	1,820,666
Total nonoperating revenues	61,194,258	44,350,369
Total nonoperating expenses and transfers	(55,278,894)	22,120,086
Nonoperating income	5,915,364	22,230,283
Changes in net assets	(17,395,101)	24,050,949
Net assets – beginning of year	116,258,501	92,207,552
Net assets – end of year	$ 98,863,400	$116,258,501

The decrease in net assets of $17,395,101 in Fiscal Year 2012 is comprised of both nonoperating and operating activities.

Nonoperating activities include receipts and transfers of State appropriations to other state agencies, as mandated by the Bond Bill. In Fiscal Year 2012, the Authority received $58,069,500 and transferred $23,742,500 to other agencies. Nonoperating activities also include Strategic Fund activity including grant and loan transactions. Nonoperating revenues increased by $16.8 million or 38% during Fiscal Year 2012 compared to Fiscal Year 2011. Nonoperating revenues are comprised of grant income received from the EDA and SSBCI loan programs, interest earned on invested cash, and State appropriations received from both the Bond and Budget bills. State appropriations were approximately 95% of total nonoperating revenues and grant income was 4% of total nonoperating revenues. The remaining 1% of nonoperating revenue was comprised of the interest earned on invested cash and deposits.

The Authority's grant expenses increased by 269%, the largest change in Fiscal Year 2012, contributing to the overall increase in nonoperating expenses.

Operating revenues consisted of interest income on notes and fee income, representing 2% of the operating activity in Fiscal Year 2012. Operating revenues decreased overall by 72% in Fiscal Year 2012 compared to 2011, due to a decrease in interest income received as a result of maturing loans. While the interest income on loans decreased, fee income increased by 142% due to an increased amount of grant applications fees received along with annual fees related to IRBs.

Operating expenses increased by approximately $23.7 million during Fiscal Year 2012 and represented 98% of the operating activity in Fiscal Year 2012. Operating expenses consist of the Authority's general and administrative expenses and bad debt expenses. The Authority reported bad debt expense of $23,331,835 for Fiscal Year 2012. The Authority reevaluated its allowance for loan losses methodology in order to take into consideration the risks presented in its target market. The Authority reported a 28% increase in general and administrative expenses overall.

The Delaware Economic Development Authority

Balance Sheets

June 30, 2012 and 2011

Assets	2012	2011 (restated)
Current assets		
Cash and cash equivalents - unrestricted		
Pooled cash and investments	$ 67,735,156	$ 61,581,875
Other	1,201,321	1,146,582
Current portion of loans receivable, net	2,996,145	924,741
Loan interest receivable	39,660	5,684
Fee income receivable	14,400	4,000
Total current assets	71,986,682	63,662,882
Noncurrent assets		
Investments	2,683,433	2,703,623
Capital assets, non-depreciable	1,377,100	1,377,100
Loans receivable, net of current portion	25,116,011	49,166,381
Total noncurrent assets	29,176,544	53,247,104
Total assets	$ 101,163,226	$ 116,909,986

Liabilities and Net Assets	2012	2011 (restated)
Current liabilities		
Grants payable	$ —	$ 209,898
State Small Business Credit Initiative - grant advance	618,026	—
Total current liabilities	618,026	209,898
Noncurrent liabilities		
Delaware Capital Access Program - nonrefundable premiums	547,904	441,587
State Small Business Credit Initiative - grant advance	1,133,896	—
Total noncurrent liabilities	1,681,800	441,587
Total liabilities	2,299,826	651,485
Net assets		
Unrestricted	97,486,300	114,881,401
Invested in capital assets	1,377,100	1,377,100
Total net assets	98,863,400	116,258,501
Total liabilities and net assets	$ 101,163,226	$ 116,909,986

See accompanying notes to financial statements.

The Delaware Economic Development Authority

Statements of Revenues, Expenses, and Changes in Net Assets

Years Ended June 30, 2012 and 2011

	2012	2011 (restated)
Operating revenues		
Interest on loans	$ 335,439	$ 1,845,061
Fee income	197,221	81,611
Total operating revenues	532,660	1,926,672
Operating expenses		
Salaries and benefits	279,782	266,126
General and administrative	231,508	132,474
Bad debt expense (recoveries)	23,331,835	(292,594)
Total operating expenses	23,843,125	106,006
Operating income (loss)	(23,310,465)	1,820,666
Nonoperating revenues (expenses)		
Interest on invested cash and deposits	459,875	339,069
Grant expenses	(31,365,622)	(8,489,110)
Program payments	(150,582)	(380,695)
Net decrease in investments	(20,190)	(703,241)
EDA grant income	71,250	—
SSBCI grant income	2,593,633	—
State appropriations	58,069,500	44,011,300
Excess of nonoperating revenues over nonoperating expenses	29,657,864	34,777,323
Income before transfers	6,347,399	36,597,989
Appropriations transferred to other State agencies	(23,742,500)	(12,547,040)
Change in net assets	(17,395,101)	24,050,949
Total net assets – beginning of year	116,258,501	92,207,552
Total net assets – end of year	$ 98,863,400	$ 116,258,501

See accompanying notes to financial statements.

The Delaware Economic Development Authority

Statements of Cash Flows

Years Ended June 30, 2012 and 2011

		2012		2011 (restated)
Cash flows from operating activities				
Interest from loans	$	301,463	$	1,839,377
Fee income		186,821		79,611
Operating expenses paid		(511,290)		(124,592)
Loan repayments		1,471,062		1,577,580
Loan disbursements		(3,138,778)		(1,566,788)
Net cash provided by (used in) operating activities		(1,690,722)		1,805,188
Cash flows from noncapital financing activities				
Grant expenses		(31,260,673)		(8,279,212)
EDA grant income		71,250		—
SSBCI grant income		4,345,555		—
State appropriations		58,069,500		44,011,300
Transfers to other State agencies		(23,742,500)		(12,547,040)
Net cash provided by noncapital financing activities		7,483,132		23,185,048
Cash flows from investing activities				
Program payments from banks		106,317		51,617
Program payments to banks		(150,582)		(380,695)
Purchase of investments		—		(117,177)
Repayment from investments		—		145,863
Interest received		459,875		339,069
Net cash provided by investing activities		415,610		38,677
Net increase in cash and cash equivalents		6,208,020		25,028,913
Cash and cash equivalents – beginning of year		62,728,457		37,699,544
Cash and cash equivalents – end of year	$	68,936,477	$	62,728,457

Noncash items:				
Allowance for (recoveries of) bad debts	$	23,331,835	$	(292,594)
Conversion of loans to grants		314,847		—
Net decrease in investments		20,190		703,241

See accompanying notes to financial statements.

The Delaware Economic Development Authority

Statements of Cash Flows (Continued)

Years Ended June 30, 2012 and 2011

	2012	2011 (restated)
Reconciliation of operating income to net cash provided by (used in) operating activities		
Operating income (loss)	$ (23,310,465)	$ 1,820,666
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities		
Bad debt expense (recoveries)	23,331,835	(292,594)
Changes in assets and liabilities		
Increase in loan interest receivable	(33,976)	(5,684)
Increase in fee income receivable	(10,400)	(2,000)
Increase in loans receivable	(1,667,716)	—
Decrease in prepaid expenses	—	284,800
Net cash provided by (used in) operating activities	$ (1,690,722)	$ 1,805,188

See accompanying notes to financial statements.

Note 1 <u>Reporting Entity</u>

The Delaware Economic Development Authority (the Authority) was established by 29 *Del. C.* 50, Subchapter IV to assist the State of Delaware (the State), the Delaware Economic Development Office (DEDO), and its citizens in matters such as stable employment, protection of public health and welfare, and the construction, acquisition, rehabilitation, modernization, and renovation of facilities related to industrial, commercial, and agricultural businesses. Furthermore, the Authority is tasked with encouraging the development of the State as a banking and financial center and assisting in the financing of facilities and activities of exempt persons in order to contribute to the prosperity, health, and general welfare of the citizens of the State.

While DEDO is responsible for attracting new investors and business to the State, for promoting the expansion of existing industry, for assisting small and minority-owned businesses, for promoting and developing tourism, and for creating new and improved employment opportunities for all citizens of Delaware, the Authority is the financing vehicle for carrying out the majority of those activities.

The Authority is a blended component unit of the State and is accounted for as a proprietary fund - an enterprise fund. An enterprise fund is used to account for operations that are financed and operated in a manner similar to private business enterprises. The Authority operates primarily from budget appropriations from the State.

In order to achieve its objectives, the Authority offers the following funding and services:

<u>Grants</u>

The Authority is empowered to make financial assistance in the form of Strategic Fund grants to qualified applicants. Proceeds of a grant can be used for, but are not limited to, the acquisition of land, buildings, machinery and equipment, the expansion of an existing building, or the renovation of fixed assets and buildings. Proceeds can also be used to augment working capital. In addition, the Authority has specific grant programs such as the Small Business Innovation Research/Small Business Technology Transfer Transitional Grant Assistance program and the Brownfield Assistance Grants program.

<u>Loans</u>

The Authority is empowered to make direct Strategic Fund loans to qualified applicants. Proceeds of a loan can be used for, but are not limited to, the acquisition of land, buildings, machinery and equipment, the expansion of an existing building, or the renovation of fixed assets and buildings. Proceeds can also be used to augment working capital. In addition, the Authority has specific loan programs such as the Limited Investment for Financial Traction (LIFT) program, the Delaware Capital Access Program (DCAP), the Delaware Rural Irrigation

Program (DRIP), the State Small Business Credit Initiative (SSBCI) grant program, and the Economic Development Administration (EDA) grant program.

Investments

The Authority is empowered to make both venture capital and equity investments to qualified applicants. Proceeds of the investments can be used for, but are not limited to, financing expenses, working capital, office space, patent filings, or prototyping.

Tax-Exempt Industrial Revenue Bond (IRB) Financing

The Authority provides statewide financial assistance to new or expanding businesses, governmental units, and certain organizations that are exempt from federal income taxation (collectively, assisted persons) by issuing tax-exempt IRBs and lending the proceeds of such bonds to these assisted persons. IRBs bear lower interest rates than comparable taxable bonds because the interest paid to bondholders is exempt from federal and Delaware income taxes. The Authority is able to pass on this lower interest rate to the assisted persons.

The Authority does not guarantee the payment of principal or interest on the bonds, and the bonds are not backed by the full faith and credit of the State.

Note 2 Summary of Significant Accounting Policies

Basis of Presentation

The Authority's activities are financed and operated as an enterprise fund. The accompanying financial statements of the Authority have been prepared using the economic resources measurement focus and the accrual basis of accounting in conformity with U.S. generally accepted accounting principles applicable to governmental entities as prescribed by the Governmental Accounting Standard Board (GASB). Under this method, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred, regardless of the timing of the related cash flows. When an expense is incurred that can be paid using either restricted or unrestricted resources, it is the Authority's policy to first apply the expense towards restricted resources and then toward unrestricted resources.

The Authority has elected to apply all applicable GASB pronouncements, as well as any applicable pronouncements of the Financial Accounting Standards Board (FASB), the Accounting Principles Board, or any Accounting Research Bulletins issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Authority has elected not to follow subsequent private-sector FASB guidance.

Cash and Cash Equivalents

For financial statement purposes, the Authority considers any short-term investments with an original maturity of three months or less to be cash equivalents. The majority of the Authority's cash and cash equivalents is controlled by the Office of the State Treasurer. Pooled cash and investments managed by the Office of the State Treasurer include cash and cash equivalents, as well as short-term and long-term investments. The Authority's portion is included as pooled cash and investments on the balance sheets.

Loans

Loans are reported as their principal amount outstanding less any charge-offs and an allowance for loan losses. The borrowers pay principal and interest to the Authority based on their respective loan terms. The current portion of loans receivable includes the portion of principal to be collected during the next Fiscal Year, and the long-term portion consists of the remaining principal.

Allowance for Loan Losses

The allowance for loan losses is established based upon the following scale:

Level Rating	Allowance Percentage	Number of Days Past Due
1	25%	0-30
2	50%	31-60
3	75%	61-90
4	100%	90+

Loan losses are charged against the allowance when management believes the balance is uncollectible. Subsequent recoveries, if any, are credited as received.

The allowance for loan losses is monitored and evaluated on a regular basis by management based upon repayment history, estimated value of any underlying collateral, and prevailing economic conditions. Management adjusts the allowance, as necessary, based upon any information identified in the monitoring and evaluation process.

Investments

Investments consist of both venture capital investments in private equity firms, which have been valued based upon their annual Schedule K-1, and other equity investments, which have been valued at cost.

Capital Assets

The Authority follows State capital asset policies. Capital assets are defined by the State as assets with estimated useful lives in excess of one year at the date of acquisition. Such assets are recorded at estimated historical cost if the original cost is not determinable. Donated capital assets are recorded at estimated fair market value at the date of donation. For donated properties where the estimated fair market value at the date of donation is not available, the Authority has recorded the land at the 1983 county property assessment value.

All land and buildings are capitalized, regardless of cost. Equipment and vehicles are capitalized when the cost of individual items exceeds $25,000. Building and land improvements are capitalized when the cost of the project exceeds $100,000. Infrastructure and software are capitalized when the costs of individual items or projects exceed $1.0 million. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized, but rather expensed as incurred.

Property, plant, and equipment, and software of the primary government is depreciated using the straight line method over the following estimated useful lives:

Asset	**Years**
Buildings and Building Improvements	10-40
Land Improvements	20
Furniture and Equipment	3-12
Vehicles	7
Software	5

Nonrefundable Premiums

Deposits made and interest earned by participating banks in the DCAP are considered DCAP nonrefundable premiums to the Authority and may be realized upon the account closing if the Authority determines that a participating bank should be withdrawn from the program. Until the account is closed, the funds are at the disposal of participating banks.

Fee Income

Fee income includes application fees, modification fees, and conduit bond service fees. Application fees are due prior to project approval. Fees receivable are the balance of annual conduit bond maintenance fees.

Operating and Nonoperating Revenues

Operating revenues consist of fee income and interest income on loans resulting from the Authority's service activities. Nonoperating revenues include income earned on the Authority's cash and cash equivalents, investment gains, SSBCI and EDA grant income, and State appropriations.

Operating and Nonoperating Expenses

Operating expenses result from the Authority's service activities and bad debt expenses (recoveries). Nonoperating expenses consist of grant expense, program payments for the DCAP, and investment losses. The program payments represent the Authority's payments for the DCAP loan defaults.

Transfers

Transfers represent general funds appropriated to the Authority by the State legislature, which are required to be passed through to other State agencies.

Net Assets

The Authority has $1,377,100 of net assets that are classified as invested in capital assets. All the Authority's remaining net assets are considered unrestricted because such funds have not been legislatively restricted, but rather the Authority has designated certain funds be maintained for a specific purpose or program. The Authority had designated its unrestricted net assets as follows at June 30,:

	2012	2011
LIFT Program	$ 1,162,750	$ 2,100,000
Clean Energy Program	68,564	68,564
Loan control account	-	163,704
DCAP	1,201,321	982,878
DRIP	819,552	-
SSBCI	1,770,441	-
	$ 5,022,628	$ 3,315,146

Estimates

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

Note 3 Cash and Cash Equivalents

The Authority's cash and cash equivalents consisted of the following at June 30,:

	2012	2011
Pooled cash and investments (a)	$ 67,735,156	$ 61,581,875
County Bank control account (b)	-	163,704
DCAP accounts (c)	1,201,321	982,878
	$ 68,936,477	$ 62,728,457

(*a*) *Pooled Cash and Investments*

A portion of the cash and cash equivalents, as reported on the balance sheet, represents the Authority's allocated share of cash, cash equivalents, and investments under the control of the Office of the State Treasurer. These cash, cash equivalents, and investments are deposited with the Office of the State Treasurer by State agencies and maintained in various pooled funds. The Office of the State Treasurer invests the deposited cash, including cash float in short-term securities and other investments. Interest income is credited to the Authority based on the weighted average rate of return on the State's monies applied to the Authority's average monthly spending authority. Pooled investments represent those investments in units of a pool rather than specific securities. As a result, such investments are not categorized as to risk because they are not evidenced by securities that exist in a physical or book-entry form.

The Cash Management Policy Board

The State Treasurer maintains the majority of the deposits and investments of the primary government and uses professional money managers to invest the State's deposits according to the guidelines set forth in the *Statement of Objectives and Guidelines for the Investment of State of Delaware Funds* (the Policy) by the State's Cash Management Policy Board (the Board). The Board, created by State law, establishes polices for, and the terms, conditions, and other matters relating to, the investment of all money belonging to the State except money in the Delaware Pension Employee Retirement System (DPERS), the Other Post-Employment Benefits (OPEB) Trust and money held under the State deferred compensation program. By law, all deposits and investments belonging to the State are under the control of the State Treasurer in various pooled investment funds (State Investment Pool) except for those that, by specific authority, are under the control of other agencies or component units, as determined by the Board.

As mandated by State statutes, the State's funds shall be invested pursuant to the prudent person standard as defined in the Policy. The prudent person standard allows the Board to establish investment policies based on investment criteria that it defines, and it allows the Board to delegate investment authority to investment professionals. This standard of care not only permits, but also encourages diversifying investments across various asset classes.

Investment Guidelines and Management

The Policy specifies the type of investments these managers can make; the maximum percentage of assets that may be invested in particular instruments; the minimum credit quality of these investments; and the maximum length of time the assets can be invested. The Policy provides, among other things, that no more than 10% of the entire portfolio may be invested in obligations of any one issuer other than the U.S. government. The following investments are permissible for all funds under the review of the Board, subject to the percentage limitations of the account:

- U.S. government securities
- Government agency securities
- Certificates of deposit, time deposits, and bankers acceptances
- Corporate debt instruments
- Repurchase agreements
- Reverse repurchase agreements
- Money market funds
- Canadian treasury bills
- Canadian agency securities
- Mortgage-backed and asset-backed securities
- Municipal obligations

Additional permissible investments for special-purpose accounts only:

- Guaranteed investment contracts
- Asset-backed securities and trust certificates

The primary government's accounts are categorized as "authority accounts". At June 30, 2012, the investments of the primary government were primarily in commercial paper, corporate obligations, government agency bonds and notes, and municipal obligations. All of these meet the objectives defined by the Policy. The State's *Statement of Objectives and Guidelines for the Investment of State of Delaware Funds* is available on the Office of the State Treasurer website at http://treasurer.delaware.gov.

Custodial Credit Risk and Collateralization Requirements

Deposits

For deposits, custodial credit risk is the risk that, in the event of the failure of a depository financial institution, the deposits or collateral securities may not be recovered from an outside party.

All State deposits are required by law to be collateralized by direct obligations of, or obligations that are guaranteed by the United States of America or other suitable obligations as determined by the Board, unless the Board shall find such collateralization not in the best interest of the State. The Board has determined that certificates of deposit and time deposits must be collateralized unless the bank issuing the certificate has assets of not less than $5 billion and is rated not lower than "B" by Fitch, Inc. Bank Watch. The Board has also determined that State demand deposits need not be collateralized, provided that any bank that holds these funds has, for the last two years, a return on average assets of 0.5% or greater and an average equity - capital ratio of at least 1:20.

If the bank does not meet the above criteria, collateral must consist of one or more of the following:

- U.S. government securities;
- U.S. government agency securities;
- Federal Home Loan Board letters of credit;
- State of Delaware securities; or
- Securities of a political subdivision of the State with a Moody's Investors Service rating of "A" or better.

State law permits the Treasurer to deposit in a financial institution in the State in which the Treasurer has custody if the deposit is interest bearing, the financial institution provides collateral that has a market value that exceeds the amount by which a deposit exceeds the deposit insurance, and a custodian holds the collateral.

Investments

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the value of the investment or collateral securities that are in the possession of an outside party may not be recovered. Investments are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government, and are held by either the counterparty or the counterparty’s trust department or agent but not in the government’s name.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Also, the terms of a debt investment may cause its fair value to be highly sensitive to interest rate changes. The State manages interest rates using the segmented time distribution and effective duration methods. The State approves and contracts with different investment managers of fixed income securities in order to manage the exposure to interest rate risk with each different manager focusing on different goals of yield periods or duration of maturities of their particular portion of the investment pool. The Policy provides either maturity or duration limitations for the various investment pools. The interest rate risk inherent in the portfolio is monitored by measuring the weighted average maturity and/or duration.

Credit Risk

Credit risk of investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

The Policy requires that the State's investments in asset-backed securities be rated AAA by a major rating agency. Corporate debt instruments must be rated by Standard and Poor's Ratings Services (S&P) and/or Moody's Investor Service (Moody's) and/or Fitch Ratings (Fitch) as follows:

Investment	**S&P**	**Moody's**	**Fitch**
Commercial Paper	A-1	P-1	F-1
Senior Long-Term Debt	A	A	A
Corporate Bonds	AA	Aa	AA

Additionally, the State has multiple, non-rated/pooled accounts that represent immaterial amounts when treated individually. The Board permits the types of investments that are held in these accounts.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the State's investments in a single issuer (5% of more of total investments). When investments are concentrated in one issuer, this concentration represents heightened risk of potential loss. No specific percentage identifies when concentration risk is present. The investments in obligations explicitly guaranteed by the U.S. government, mutual funds, and other pooled investments are exempt from disclosure.

The Policy provides percentage of account limitations, valued at market. Investments due to mature in one business day may be excluded from the computation of said limitations.

At June 30, 2012, the State's investments have met the requirement of all the State's laws and policies, when applicable. There were no obligations that represented 5% or more of the primary government's investments, except for U.S. government securities, pooled, and mutual funds.

Foreign Currency Risk

Foreign currency risk is the risk that changes in the foreign exchange rate will adversely impact the fair value of an investment or deposit.

The Policy only permits investments denominated in U.S. dollars; therefore, the State's investments are not exposed to foreign currency risk.

Commitments

At June 30, 2012, the State did not enter into any commitment agreements with any investment managers for future funding of various asset classes.

(b) County Bank Control Account

In addition to the cash and cash equivalents held by the Office of the State Treasurer, the Authority had deposits with County Bank during the years ended June 30, 2012 and 2011. The account was utilized by the Authority to control certain borrower disbursements that must be approved before the Authority can issue the loan. This account was fully disbursed in August 2011.

(c DCAP Accounts

The remaining cash and cash equivalents balance consists of funds for the DCAP, which consist of reserve accounts at various banks. The Authority owns the funds in the bank's earmarked reserve; however, these funds are pledged to cover losses or pay claims on loans made by the bank under the program. Of the DCAP bank balances, $772,514 is insured by the Federal Deposit Insurance Corporation (FDIC) and $428,807 is uninsured.

Note 4 **Loans Receivable and Allowance for Loan Losses**

The Authority's loans receivable consisted of the following at June 30,:

	2012	2011
Strategic Fund loans	$ 49,162,444	$ 50,718,480
SSBCI loans	2,538,250	-
LIFT loans	524,125	509,537
DRIP loans	356,067	-
	52,580,886	51,228,017
Allowance for loan losses	(24,468,730)	(1,136,895)
Loans receivable, net of allowance	28,112,156	50,091,122
Current portion of loans receivable, net	(2,996,145)	(924,741)
Long-term portion of loans receivable, net	$ 25,116,011	$ 49,166,381

Changes in the allowance for loan losses are solely based on the increase in loan loss provision by $13,956,835 due to the revised allowance for doubtful accounts methodology used in 2012 as compared to 2011, and an additional $9,375,000 increase in the loan loss provision to reserve 100% for receivables not expected to be collectible. The allowance method was re-evaluated due to the nature of the Authority's lending practices based on the market it strives to serve. This method was approved by the Council on Development Finance in June 2013.

Note 5 **Investments**

The Authority's investments consisted of the following at June 30,:

	2012	2011
Venture capital investments:		
Innovation Ventures, L.P.	$ 1,503,433	$ 1,523,623
Other capital investments:		
Collections Marketing	580,000	580,000
Information Assurance Corporation	500,000	500,000
Sky-Trax	100,000	100,000
	$ 2,683,433	$ 2,703,623

During the years ended June 30, 2012 and 2011, the Authority's venture capital investments decreased by $20,190 and $703,241, respectively, based on the decline of the Authority's allocation of the underlying K-1 or financial reports. The Authority's other equity investments have been valued at cost. The changes in the value of its venture capital investments are summarized as follows at June 30,:

	2012	2011
Innovation Ventures, L.P.	$ (20,190)	$ (147,102)
Blue Rock	-	(332,000)
Maverick	-	(224,139)
	$ (20,190)	$ (703,241)

Note 6 Capital Assets

On December 1, 1983, 3.49 acres of land located in New Castle, Delaware, was donated to the Authority. Information supporting fair market value as of the date of donation is not available. The land is recorded at the 1983 county property assessment value.

On February 2, 1980, 3.50 acres of land located in Newark, Delaware, was donated to the Authority. Information supporting fair market value as of the date of donation is not available. The land is recorded at the 1983 county property assessment value.

On January 24, 1985, 1.088 acres of land located in the Town of Dewey Beach, Delaware, was donated to the Authority. Information supporting fair market value as of the date of donation is not available. The land is recorded at the 1983 county property assessment value.

On May 8, 1984, 2.1 acres of land located in Wilmington, Delaware, was donated to the Authority. Information supporting fair market value as of the date of donation is not available. The land is recorded at the 1983 county property assessment value.

On April 18, 1978, 0.56 acres of land located in Wilmington, Delaware, was donated to the Authority. Information supporting fair market value as of the date of donation is not available. The land is recorded at the 1983 county property assessment value.

The total property assessment value of the land donated to the Authority was $1,377,100 as of June 30, 2012 and 2011.

Note 7 Grants

The Authority was awarded two federal grants in Fiscal Year 2012: the EDA Revolving Loan Fund and the SSBCI grant.

EDA Revolving Loan Fund

The Authority applied for economic assistance to the EDA to establish a revolving loan fund in February of 2010. The fund was capitalized by $500,000 from the Strategic Fund and $500,000 from the EDA. The revolving loan fund is intended to provide low-interest, longer-term loans to Delaware companies engaged in manufacturing.

State Small Business Credit Initiative (SSBCI) Grant

On September 27, 2010, President Obama signed into law the Small Business Jobs Act of 2010 (Act) to help increase credit availability for small businesses. The Act created the State Small Business Credit Initiative (SSBCI) and appropriated $1.5 billion to be used by the U.S. Department of the Treasury (Treasury) to provide direct support to states for use in programs designed to increase access to credit for small businesses.

In Fiscal Year 2011, the Authority was allotted $13,168,350. Of the allotment, $1,000,000 has been dedicated to the DCAP and $12,168,350 has been allocated to a revolving participation loan fund. In August 2011, the Authority received its first tranche of $4,345,555. The Authority must follow policy and procedures as set forth by the Treasury. The program matures in 2016 and is subject to audits and/or program termination. If the Authority has successfully complied with Treasury standards, it may retain the funds for future program use.

Note 8 Employee Benefits

All DEDO personnel of the State are covered by pension, health insurance, and other employee benefit programs administered by the State. DEDO positions are assigned to the Authority's personnel appropriation in the Budget Bills and not funded by the State's Strategic Fund appropriation. During the years ended June 30, 2012 and 2011, these positions incurred $279,782 and $266,126, respectively, of payroll and benefit costs, including pension, health insurance, and other employee benefit costs paid to the State agencies responsible for the administration of benefit programs.

The Authority contributes to the State Employees' Pension Plan (the Pension Plan) established by the State to provide benefits for state employees. The Pension Plan is a cost-sharing single employer defined benefit plan that covers virtually all full-time or regular part-time employees of the State, including employees of other affiliated entities. There are two tiers within this plan: 1) employees hired prior to January 1, 2012 (Pre-2012) and 2) employees hired on or after January 1, 2012 (Post-2011).

Certain significant plan provisions include:

Service Benefits - Final average monthly compensation (employee hired Post-2011 may not include overtime in pension compensation) multiplied by 2.0% and multiplied by years of credited service prior to January 1, 1997, plus final average monthly

compensation multiplied by 1.85% and multiplied by years of credited service after December 31, 1996, subject to minimum limitations. For this plan, final average monthly compensation is the monthly average of the highest three periods of twelve consecutive months of compensation.

Vesting – Pre-2012 date of hire: Five years of credited service. Post-2011 date of hire: ten years of credited service.

Retirement - Pre-2012 date of hire: Age 62 with five years of credited service; age 60 with 15 years of credited service; or after 30 years of credited service at any age. Post-2011 date of hire: Age 65 with at least ten consecutive years of credited service; Age 60 with 20 years of credited service; or after 30 years of credited service at any age.

Disability Benefits – Pre-2012 date of hire: Same as Service Benefits. Employee must have five years of credited service. In lieu of disability pension benefits, over 90% of the members of this plan opted into a disability insurance program offered by the State effective January 1, 2006. Post 2011 date of hire: In the disability insurance program.

Survivor Benefits - If the employee is receiving a pension, the eligible survivor receives 50% (or 75% with 3% reduction of benefit). If the employee is active with at least five years of credited service, the eligible survivor receives 75% of the benefit the employee would have received at age 62.

Contributions – Employer: Determined by Board of Pension Trustees. Pre-2012 date of hire member: 3% of earnings in excess of $6,000. Post-2011 date of hire: 5% of earnings in excess of $6,000.

Burial Benefit - $7,000 per member.

All full-time DEDO personnel are covered under the State of Delaware Other Post-Retirement Employee Benefit (OPEB) Fund Trust (OPEB Trust), which was established pursuant to Section 115 of the Internal Revenue Code and administered by the Delaware Public Employees' Retirement System Board of Directors. Policy for and management of the OPEB benefits provided to retirees are the responsibility of the State.

The State does not maintain the Pension Plan or any OPEB information by agency, and therefore, the Authority's portion of the Pension Plan's net assets available for benefits, percentage of annual pension cost contributed, and the actuarial present value of vested and non-vested accumulated plan benefits is not readily determinable.

Detailed information concerning the Pension Plan is presented in the DPERS publicly available comprehensive annual financial report, which can be obtained by writing the State Board of Pension Trustees and Office of Pensions, McArdle Building, Suite #1, 860 Silver Lake Boulevard, Dover, DE 19904-2402.

Information regarding the OPEB Trust is presented in the State of Delaware's comprehensive annual financial report, which is available on the Division of Accounting's website (http://accounting.delaware.gov/).

Note 9 Conduit Debt Obligations

The Authority has issued IRBs to provide statewide financial assistance to new or expanding businesses, governmental units, and certain organizations that are exempt from federal income taxation. The bonds are secured by the property financed and revenues generated with the bond proceeds and are payable solely from payments received on the underlying obligations. Upon repayment of the bonds, ownership of the acquired facilities transfers to the private sector or governmental entity served by the bond issuance. Neither the Authority, the State, nor any political subdivision thereof is obligated in any manner for the repayment of the bonds. Accordingly, the bonds are not reported as liabilities in the accompanying financial statements.

The Authority completes IRB principal balance schedules at the end of each calendar year. The aggregate principal amount payable of IRBs outstanding was $696,155,587 and $1,222,535,765 as of December 31, 2012 and 2011, respectively.

Note 10 Commitments and Contingencies

As of June 30, 2012, the Authority had committed to making $79,741,082 in loans and grants. In addition, another $15,259,959 of commitment offers have been extended, but they have not yet been presented to the CDF for final approval. As of June 30, 2011, the Authority had committed to making $55,565,428 in loans and grants. In addition, another $33,735,126 of commitment offers had been extended, but they had not yet been presented to the CDF for final approval.

Commitments to make grants or extend credit are agreements between the Authority and the applicants that generally require the applicants meet certain conditions and make certain certifications regarding the grant or extension of credit that may expire within a specified time period.

In connection with the DCAP, the Authority guarantees repayment of certain loans made for economic development purposes. During the years ended June 30, 2012 and 2011, the Authority paid $150,582 and $380,695, respectively, to the third-party lenders for defaults under the program.

Note 11 Risk Management

The Authority is covered by the risk management policy of the State. The State is exposed to various risks of loss related to workers' compensation, employee health care and accident, automobile accident, police professional malpractice, and property and casualty claims. It is the policy of the State not to purchase commercial insurance to cover these risks. Instead, State

management believes it is more economical to manage its risk internally and, thus, covers all claim settlements and judgments out of its general fund. The State continues to carry commercial insurance for all other risks of loss, including general liability and the remainder of property and casualty liability. There have been no significant reductions in insurance coverage

from prior years. In the past three years of insured coverage, settled claims have not exceeded commercial coverage.

Note 12 Subsequent Events

Events and transactions subsequent to year end have been evaluated for recognition in the financial statements or disclosure in the notes to the financial statements through the date of the auditors' report, which is the date the financial statements were available to be issued.

Note 13 Prior Period Adjustment

A prior period adjustment was made to record $1,377,100 in properties owned by the Authority, and ($37,177) in adjustments to cash accounts – other, restating net assets from $114,918,578 to $116,258,501 at June 30, 2011.

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Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

We have audited the financial statements of the Delaware Economic Development Authority (the Authority) for the years ended June 30, 2012 and 2011, and have issued our report thereon dated March 24, 2014. We conducted our audits 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

Management of the Authority is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audits, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses, and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as items 2012-01, 2012-2, and 2012-3 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority'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 statements 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*.

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The Authority's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit the Authority's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Council on Development Finance and management of the Delaware Economic Development Authority, and is not intended to be and should not be used by anyone other than these specified parties. However, under 29 *Del. C.*, Section 10002(l), this report is public record and its distribution is not limited. This report, as required by statute, was provided to the Office of the Governor, Office of the Controller General, Office of the Attorney General, and Office of Management and Budget.

Santora CPA Group

March 24, 2014
Newark, Delaware

<u>Finding 2012-1: Inadequate Controls Over Financial Reporting</u>

Condition

In performing the 2012 audit, we found that the Authority does not have the necessary expertise to prepare generally accepted accounting principles (GAAP) basis financial statements, or to ensure that the financial statements, including footnotes, are complete and in accordance with the requirements of GAAP. However, as a result, the Authority contracted with an outside CPA firm to compile its financial statements for the Fiscal Year ended June 30, 2012.

There is no established, documented internal management review process to ensure that the financial statements are accurate, complete, and that presentation and disclosure is proper. The process used to obtain account balances and supporting documentation relies heavily on one individual to provide information requested by the contractor for compilation purposes.

Additionally, audit procedures in 2012 identified five Authority-owned properties not previously disclosed or reported in the Authority's financial statements, resulting in a prior period adjustment. We also identified several audit adjustments necessary to correctly state account balances in the Authority's financial statements.

Criteria

According to the National Council on Government Accounting Concept Statement No. 1, *Objectives of Financial Reporting*, "The overall goal of accounting and financial reporting for governmental units is to provide: 1) financial information useful for making economic, political and social decisions, and demonstrating accountability and stewardship; and 2) information useful for evaluating managerial and Departmental performance."

Internal Control – Integrated Framework, published by COSO, defines financial reporting objectives as follows: "Financial reporting objectives address the preparation of reliable published financial statements, including interim and condensed financial statements and selected financial data derived from such statements…Reliable financial statements are a prerequisite to obtaining investor or creditor capital, and may be critical to the award of certain contracts or to dealing with certain suppliers. Investors, creditors, customers, and suppliers often rely on financial statements to assess management's performance and to compare it with peers and alternative investments. The term 'reliability' as used with financial reporting objectives involves the preparation of financial statements that are fairly presented in conformity with generally accepted or other relevant and appropriate accounting principles and regulatory requirements for external purposes."

The financial statements are the responsibility of management. A proper system of internal controls over financial reporting is essential in order to prevent, detect, and correct misstatements and to ensure that such information is useful in decision-making and evaluating managerial and departmental performance, as well as demonstrating accountability and stewardship. Controls must be properly designed, in place, and operating effectively to ensure that the Authority's accounting and financial information is fairly stated in accordance with GAAP.

Cause

There is no independent review of the information for completeness and accuracy prior to its being provided to the contractor. Further, there is no process in place, either internally or contracted, to identify, evaluate, and implement new accounting pronouncements and their impact on the Authority's financial statements. The absence of these processes increases the risk of potential undetected misstatements, errors, or omissions.

The personnel assigned to complete the financial statements are not formally-trained accountants, and therefore, do not have the necessary skills and experience to accurately prepare the Authority's financial statements, including footnotes, in accordance with the requirements of GAAP.

Effect

Due to the deficiencies noted in the processes used to compile financial statement information, even with the assistance of a compilation contractor, and the reliance on the audit process to detect and correct such errors, material misstatements to the financial statements could go undetected.

Recommendation

We recommend that the Authority develop a process that:

- Delegates responsibility for specific reports, schedules, and documentation to personnel throughout the Authority (i.e., cross-training),
- Provides for an independent review of information for completeness and accuracy prior to its receipt by the compilation contractor, and
- Provides for review, evaluation, and implementation of new accounting pronouncements that impact the Authority.

View of Responsible Officials

Management of the Authority voluntarily engages a third party to audit its annually compiled financial statements. The Authority's initial audit was conducted for the 2011 Fiscal Year. Management is hopeful the information disclosed in both the Fiscal Year 2011 and 2012 audit reports will assist in enhancing its reports in future years.

Compilation of the financial statements entails reconciling and compiling information from both the First State Financials (FSF) accounting system and reporting for accounts held outside of FSF. Staff is delegated and cross-trained to perform specific financial transactions with appropriate separation of powers. Strategic fund disbursements require management approval, and transactions are internally audited and reconciled on a monthly basis. Two staff members are cross-trained on the compilation of the annual financial statements. To prevent future audit adjustments, management is currently identifying automated accounting and financial software that will streamline reporting, standardize calculations, and help to eliminate human error.

Additionally, in an effort to ensure information compiled is complete and accurate, management will continue to develop and formalize its existing review processes. Management did review Fiscal Year 2012 financial statements prepared by staff, but recognizes that it did not sign or date that review. As a result of this report, management will redesign its review process to require the preparer(s) to obtain approval and signature more frequently throughout the compilation process. The process will also require the preparer(s) to present internal draft statements to the CDF for its review prior to submitting to the third-party contractor. These added layers will help to deter adjustments after reports have been submitted to third-party contractors.

Management recognizes that although its advisory board, the CDF, provides GAAP expertise, its staff does not. To enhance its GAAP presentation, the Authority has also contracted a compilation firm to present the financial statements under GAAP guidelines before presenting to the private auditing firm. For the Fiscal Year 2013 compilation, management will work with the compilation firm to examine additional consultation services it can secure to further enhance its GAAP presentation. The Authority will rely on the contracted compilation consultant to review, evaluate, and implement new accounting pronouncements that impact the Authority.

Auditor Comment

The Authority's informal process is not properly documented or formalized to demonstrate that management review occurred. In addition, the Authority's informal process was not effective to catch errors in supporting documentation for account balances or errors and omissions from their financial statements. The Authority does not have a review process, formal or informal, to ensure that the compiled financial statements are presented in accordance with GAAP or that new accounting pronouncements that impact the Authority are reviewed, evaluated, and implemented properly.

The completeness, accuracy, and presentation of the financial statements are the responsibility of management.

<u>Finding 2012-2: Improper Valuation of Investments</u>

Condition

Investments consist both of venture capital investments in private equity firms, which have been valued based upon their annual Schedule K-1, and other equity investments, which have been valued at cost. No information was available to determine the proper valuation for these investments, and there is no control or process in place at the Authority to ensure that investments are properly valued and recorded in the Authority's financial statements. In addition, we noted no controls in place to perform due diligence to monitor the performance and value of investments throughout the year.

Criteria

GASB Codification Section I50, *Investments* states:

".105 Except as provided in paragraphs .107, .108, and .111 of this section and in paragraph .102 of Section In5, "Investment Pools (External), governmental entities, including governmental external investment pools, should report investments at fair value in their basic financial statements. Fair value is the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. If a quoted market price is available for an investment, the fair value to be used in applying this section is the total of the number of trading units of the instrument times the market price per unit."

Cause

No information was available to determine the proper market value of the Authority's investments. The Authority was unable to obtain or provide the estimated fair value for each of the investments.

Effect

Fair values have been estimated by the Authority's management in the absence of readily ascertainable market values. Management's estimates are based on annual Schedule K-1 information provided by each respective private equity firm, or based on cost for other equity investments. These methods may not represent fair market value in accordance with the *Governmental Accounting Standards Board* (GASB) authoritative guidance, codified in GASB Codification Section I50.

Recommendation

We recommend that the Authority develop a process to obtain information from invested entities, or contract with external valuation specialists for valuation estimates, to ensure that investments are properly valued and recorded in the Authority's financial statements, and to monitor the performance and value of investments throughout the year.

View of Responsible Officials

Previously, the Authority used K-1 reports to determine the value of its investments. The Authority believes it will be able to monitor the fair market value of its investments by analyzing each entity's audited financial statements, including Changes in Stockholders' Equity reports, and tying these reports to each entity's fair market value calculation. Investments amount to 3% of total assets.

Finding 2012-3: Lack of Controls to Identify and Value Capital Assets

Condition

Capital assets – nondepreciable, as reported on the Authority's statements of net assets, includes five properties donated to the Authority. The properties were not identified or included by the Authority in the financial statements presented for audit; instead, these properties were identified through the audit process. There is no control or process in place at the Authority to ensure that the properties are properly valued and recorded in the Authority's financial statements. Properties have been recorded in the Authority's financial statements based upon 1983 county property assessment values.

Criteria

GASB Codification Section 1400, *Reporting Capital Assets* states:

"Capital assets should be reported at historical cost. The cost of a capital asset should include ancillary charges necessary to place the asset into its intended location and condition for useDonated capital assets should be reported at their estimated fair value at the time of acquisition plus ancillary charges, if any."

Cause

The properties owned by the Authority were identified during the 2012 audit. No information was available to determine the proper market value as of the date of donation. The Authority was unable to obtain or provide the estimated fair value (plus any ancillary costs) at the date of receipt for each of the properties.

Effect

Fair market values have been estimated by the Authority's management using county property assessment values in the absence of fair market values from the date of donation for each property. These methods may not represent fair market value in accordance with GASB authoritative guidance, codified in GASB Codification Section 1400.

Recommendation

We recommend that the Authority develop a process to ensure that properties are properly valued and recorded in the Authority's financial statements.

View of Responsible Officials

Capital assets represent 1% of total net assets. These properties are transferred to the Authority from debtors or governmental entities. These transfers occurred in previous decades, between 1978 and 1985, with little or no documentation left with current management within the Authority. Due to a lack of historical documentation and no annual transactional activity, it can be difficult to identify offline assets that may have been donated to the Authority in the past. Compilation reporting and third-party audits, which first commenced in 2011, help identify necessary adjustments.

For the Fiscal Year 2012 compilation, the Authority used the assessment value of properties donated to the Authority to determine the value of properties at the time of donation. The Authority will continue to report the value of properties donated at the assessment value given the fact that the properties were obtained between 1978 and 1985, and the assessment value is as of 1983. The Authority will consider having an appraisal completed on any new properties donated to the Authority going forward in order to assess the proper market value as of the date of the donation.