

**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, 2018 and 2017



SB & COMPANY, LLC
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JUNE 30, 2018 AND 2017

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Secretary of
Maryland Department of Commerce

Report on the Financial Statements

We have audited the accompanying statements of net position of the Maryland Economic Adjustment Fund (the Fund), an enterprise fund of the State of Maryland, as of June 30, 2018 and 2017, and the statements of revenue, expenses, and change in net position and cash flows, for the years then ended 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 controls 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 controls 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 controls. 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, 2018 and 2017, and the respective change in its financial position and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis 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.

Other

As discussed in Note 2, the accompanying financial statements present only the transactions of the Fund of the Maryland Department of Commerce (the Department), and are not intended to present fairly the financial position of the Department or the State of Maryland as of June 30, 2018 and 2017, and the changes in their financial position and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Hunt Valley, Maryland
September 28, 2018

SB & Company, LLC

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Management's Discussion and Analysis June 30, 2018 and 2017

Overview of the Financial Statements and Financial Analysis

In accordance with Government Accounting Standards Board (GASB), the Maryland Department of Commerce (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, 2018 and 2017, as compared to the year ended June 30, 2016.

The report format consists of three components: the Statements of Net Position, the Statements of Revenue, Expenses, and Change 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 is 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, 2018, 2017 and 2016.

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Total assets	<u>\$ 933,718</u>	<u>\$ 912,216</u>	<u>\$ 888,188</u>
Unrestricted Net Position	<u>\$ 933,718</u>	<u>\$ 912,216</u>	<u>\$ 888,188</u>

Total assets and unrestricted net position increased by \$21,502, or 2% in fiscal year 2018 compared to fiscal year 2017, primarily due to an increase in loan receivable.

Total assets and unrestricted net position increased by \$24,028, or 3% in fiscal year 2017, compared to 2016, primarily due to an increase in loan interest income.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Management's Discussion and Analysis June 30, 2018 and 2017

Statements of Revenue, Expenses, and Change in Net Position

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

- Operating revenue is 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 revenue consists of interest earned due to the State Treasurer's fund investment decisions.

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Operating revenue	\$ 15,661	\$ 18,814	\$ 7,360
Operating expenses	<u>(671)</u>	<u>2,117</u>	<u>(1,641)</u>
Net operating income	16,332	16,697	9,001
Non-operating revenue	<u>5,170</u>	<u>7,331</u>	<u>8,056</u>
Changes in net position	21,502	24,028	17,057
Net position, beginning of year	<u>912,216</u>	<u>888,188</u>	<u>-</u>
Net Position, End of Year	<u>\$ 933,718</u>	<u>\$ 912,216</u>	<u>\$ 17,057</u>

Operating revenue decreased by \$3,153 or 17%, in fiscal year 2018, compared to 2017 as a result of a decrease in loan interest income. Operating expenses decreased by \$2,788, in fiscal year 2018, compared to 2017, as a result of a decrease in the provision for loan losses. Non-operating revenue decreased by 30 % in fiscal year 2018, compared to 2017 primarily due to a decrease in earned interest allocation which was calculated based on a decreased cash balance held at the State Treasurer.

Operating revenue increased by \$11,454, in fiscal year 2017, compared to 2016 as a result of an increase in loan interest income. Operating expenses increased by \$3,758, in fiscal year 2017, compared to 2016, as a result of an increase in the provision for loan losses. Non-operating revenue decreased by 9% in fiscal year 2017, compared to 2016 primarily due to a decrease in earned interest allocation which was calculated based on a decreased cash balance held at the State Treasurer.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Management's Discussion and Analysis June 30, 2018 and 2017

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>2018</u>	<u>2017</u>	<u>2016</u>
Net cash flows from operating activities	\$ -	\$ -	\$ -
Net cash flows from investing activities	<u>(25,725)</u>	<u>(372,026)</u>	<u>24,435</u>
Net change in cash	(25,725)	(372,026)	24,435
Cash, beginning of year	<u>402,434</u>	<u>774,460</u>	<u>750,025</u>
Cash, End of Year	<u>\$ 376,709</u>	<u>\$ 402,434</u>	<u>\$ 774,460</u>

There were no cash from operating activities in fiscal years 2018 or 2017. The net cash flows from investing activities was a negative \$25,725, which was comprised of interest earned and collection of principal on loans, offset by an increase in loan disbursements of \$65,809.

The Fund's 2017 cash flows from operations are fairly consistent with the prior year. Net cash flows from investing activities was a negative \$372,026, which was comprised of interest earned on loans receivable and deposits held by State Treasury, offset by an increase in loan disbursements which were \$406,993.

Economic Outlook

The Fund had no new loan approved in fiscal year 2018 but one settlement for \$107,961. The Fund continues to utilize its Special Fund appropriation and had an ending fund balance of \$669,293 as of June 30, 2018. The demand for small business loans continues to improve as the State's economy emerges from the recent economic downturn. The Department anticipates that the Fund will continue to be an active small business resource. However, without a new injection of funds, the program funds will continue to decline and likely run out of money by 2020.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Statements of Net Position As of June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
ASSETS		
Current Assets		
Cash	\$ 376,709	\$ 402,434
Current loan receivable, net of allowance of \$16,684 and \$14,566, respectively	74,554	27,090
Accrued interest receivable	<u>6,905</u>	<u>6,471</u>
Total Current Assets	<u>458,168</u>	<u>435,995</u>
Non current loan receivable, net of allowance of \$102,501 and \$107,517, respectively	<u>475,550</u>	<u>476,221</u>
Total Assets	<u>933,718</u>	<u>912,216</u>
Net Position, Unrestricted	<u>\$ 933,718</u>	<u>\$ 912,216</u>

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

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Statements of Revenue, Expenses, and Change in Net Position For the Years Ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Operating Revenue		
Interest and other income	<u>\$ 15,661</u>	<u>\$ 18,814</u>
Operating Expenses		
Provision (benefit) for loan losses	(2,895)	2,117
Other expenses	<u>2,224</u>	<u>-</u>
Total Operating Expenses	<u>(671)</u>	<u>2,117</u>
Net Operating Income	16,332	16,697
Non-Operating Revenue		
Interest income from State Treasury	<u>5,170</u>	<u>7,331</u>
Change in net position	21,502	24,028
Net position, beginning of year	<u>912,216</u>	<u>888,188</u>
Net Position, End of Year	<u><u>\$ 933,718</u></u>	<u><u>\$ 912,216</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 Ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash Flows from Operating Activities	<u>\$ -</u>	<u>\$ -</u>
Cash Flows from Investing Activities		
Proceeds from collection of principal on loans receivable	21,911	14,327
Loan disbursements	(65,809)	(406,993)
Interest income	18,173	20,640
Net Cash Flows from Investing Activities	<u>(25,725)</u>	<u>(372,026)</u>
Net change in cash	(25,725)	(372,026)
Cash, beginning of year	402,434	774,460
Cash, End of Year	<u><u>\$ 376,709</u></u>	<u><u>\$ 402,434</u></u>
Reconciliation of Operating Income to Net Cash from Operating Activities		
Operating income	\$ 16,332	\$ 16,697
Interest income on loans receivable	(15,661)	(18,814)
Provision for loan loss	(2,895)	2,117
Other expenses	2,224	-
Net Cash from Operating Activities	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>

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

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Notes to the Financial Statements June 30, 2018 and 2017

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 Commerce (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 \$732,818, 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.

Measurement Focus and Basis of Accounting

The accompanying financial statements of the Fund are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The Fund is one of many programs administered by the Department. The Fund has no direct employees and is entirely supported by staff at the Department to perform all necessary functions of the Fund.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Notes to the Financial Statements June 30, 2018 and 2017

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Measurement Focus and Basis of Accounting (continued)

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

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.

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.

Revenue and Expenses

The Fund distinguishes operating revenue and expenses from non-operating items. Operating revenue and expenses generally result from providing services in connection with the Fund's principal ongoing operations. The main operating revenue is interest income on loans. Operating expenses include expenses relating to the servicing of the loans, provision for loan losses, and administrative expenses. Non-operating revenue represents interest earned from the State Treasury.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Notes to the Financial Statements

June 30, 2018 and 2017

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).

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.

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 agreements be collateralized by the 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 follows 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.

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Notes to the Financial Statements June 30, 2018 and 2017

3. CASH (continued)

Custodial Credit Risk – Deposits (continued)

As of June 30, 2018 and 2017, 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, 2018 and 2017, 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 4% to 6%.

The loan activities for the years ended June 30, 2018 and 2017, were as follows:

	<u>2018</u>	<u>2017</u>
Loans receivable, beginning of year	\$ 625,394	\$ 232,728
Loan disbursements	65,809	406,993
Proceeds from collections	<u>(21,911)</u>	<u>(14,327)</u>
Gross loans receivable	669,292	625,394
Allowance for loan losses	119,188	122,083
Loans Receivable, Net	<u><u>\$ 550,104</u></u>	<u><u>\$ 503,311</u></u>

Activities in the allowance for loan losses was as follows for the years ended of June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Balance, beginning of year	\$ 122,083	\$ 119,966
Provision for loan loss	<u>(2,895)</u>	<u>2,117</u>
Balance, End of Year	<u><u>\$ 119,188</u></u>	<u><u>\$ 122,083</u></u>

MARYLAND ECONOMIC ADJUSTMENT FUND (MEAF)

Notes to the Financial Statements June 30, 2018 and 2017

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 (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.

6. COMMITMENTS AND CONTINGENCIES

In the normal course of operations, certain claims may be brought against the Fund. Management believes that the ultimate resolution of such claims would not have a material adverse effect on the Fund's financial position. As of June 30, 2018, the Fund had outstanding funding commitments for loans in the amount of \$25,197.