

**MARYLAND SMALL BUSINESS DEVELOPMENT
FINANCING AUTHORITY (MSBDF)
(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



S B & COMPANY, LLC
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JUNE 30, 2018 AND 2017

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of the
Maryland Small Business Development
Financing Authority and
Secretary of the Maryland Department of Commerce

Report on the Financial Statements

We have audited the accompanying statements of net position of the Maryland Small Business Development Financing Authority (MSBDFFA or the Fund), an enterprise fund of the State of Maryland, as of June 30, 2018 and 2017 and the related 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

MSBDFFA'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 changes 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 Supplemental Information

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

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 SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDFA)**

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

Overview of the Financial Statements and Financial Analysis

In accordance with Governmental 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 Small Business Development Financing Authority (MSBDFA or the Fund) for the years ended June 30, 2018 and 2017, as compared to the year ended June 30, 2016.

The report discusses the Statements of Net Position, the Statements of Revenue, Expenses and Change in Net Position, and the Statements of Cash Flows, which together provide an overview of the Fund's activities.

Statements of Net Position

The Statements of Net Position present the assets, liabilities, and net position of MSBDFA as of the end of each fiscal year computed in conformity with generally accepted accounting principles. The aim of these statements is to present to the readers a fiscal snapshot of the MSBDFA program. The statements are composed of three major categories namely assets, liabilities, and net position, using the accrual basis of accounting, which is similar to the accounting used by most private sector companies. The assets section includes the monetary resources owned by the program. Here, assets are classified as current or non-current according to their order of liquidity and timing by which their receipt will be realized. The liability section of the statements are made up of all the program's debts. The liabilities are classified according to their due date as either current or non-current liabilities. The third category, net position, is the residual interest in the assets of the program that remains after deducting the amount required to satisfy the liabilities. The net position is generally separated into three broad components, namely investments in capital assets - net of related debt, restricted net position, and unrestricted net position.

From the data presented, readers of the statements of net position should be able to reasonably determine the amount of assets available to pay the expenditures necessary to continue the operations of the MSBDFA programs.

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDF)**

**Management’s Discussion and Analysis
June 30, 2018 and 2017**

Statements of Net Position (continued)

	<u>2018</u>	<u>2017</u>	<u>2016</u>
ASSETS			
Current assets	\$ 10,583,781	\$ 12,382,750	\$ 15,162,969
Non-current assets	6,803,055	5,597,483	4,172,705
Total Assets	<u>17,386,836</u>	<u>17,980,233</u>	<u>19,335,674</u>
LIABILITIES AND NET POSITION			
Current liabilities	558,145	476,127	355,996
Total Liabilities	<u>558,145</u>	<u>476,127</u>	<u>355,996</u>
Net Position			
Net position, unrestricted	16,828,691	17,504,106	18,979,678
Total Net Position	<u>\$ 16,828,691</u>	<u>\$ 17,504,106</u>	<u>\$ 18,979,678</u>

Fiscal Year 2018 compared to 2017

Current assets decreased by \$1,798,969 in fiscal year 2018 compared to fiscal year 2017. The decrease occurred due an increase in cash disbursements for long term investment purchases and loan disbursements, and disbursements for management and administrative costs. Non-current assets in fiscal year 2018 increased by \$1,205,572 or 21.5% over fiscal year 2017. The notable drivers for the aforementioned increase in 2018 include an increase in loans receivable and purchase of investments.

Current liabilities increased by \$82,018 or 17.2% in fiscal year 2018 compared to fiscal year 2017 primarily because of increase in reserves for guaranty losses. Unrestricted net position decreased by \$675,415 or 3.9% in fiscal year 2018 compared to fiscal year 2017 as a direct result of the culmination of all unrestricted operating activities.

Fiscal Year 2017 compared to 2016

Current assets decreased by \$2,780,219, in fiscal year 2017 compared to fiscal year 2016. The decrease occurred due an increase in cash disbursements for long term investment purchases and loan disbursements, and disbursements for management and administrative costs. Non-current assets in fiscal year 2017 increased by \$1,424,778 or 34.1% over fiscal year 2016. The notable drivers for the aforementioned increase in 2017 include an increase in loans receivable and purchase of investments.

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDF)**

**Management’s Discussion and Analysis
June 30, 2018 and 2017**

Statements of Net Position (continued)

Fiscal Year 2017 compared to 2016 (continued)

Current liabilities increased by \$120,131 or 33.7% in fiscal year 2017 compared to fiscal year 2016 primarily because of increases in accounts payable, and reserves for guaranty losses. Unrestricted net position decreased by \$1,475,572 or -7.8% in fiscal year 2017 compared to fiscal year 2016 as a direct result of the culmination of all unrestricted operating activities.

Statements of Revenue, Expenses, and Change in Net Position

The Statements of Revenue, Expenses, and Change in Net Position are the operating statements for the Maryland Small Business Development Financing Authority. The general components displayed here are operating revenue, operating expenses, non-operating revenue and expenses, fund transfers, change in net position and beginning and ending balances of net position.

The objective of this statement is threefold:

- To present revenue generated by program operations and those received from non-operating activities.
- To show monies expended to operate the program, including losses on bad debts, claims paid as a result of a customer’s default under a loan guaranty or a surety bond, and funds derived from the State Treasury.
- Finally, this statement’s bottom line objective is to display the total change (increase or decrease) in net position during a particular period.

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Operating revenue	\$ 865,271	\$ 733,091	\$ 428,130
Operating expenses	<u>3,099,474</u>	<u>3,531,854</u>	<u>3,209,799</u>
Net operating loss	(2,234,203)	(2,798,763)	(2,781,669)
Non-operating revenue (expense), net	<u>58,788</u>	<u>(176,809)</u>	<u>31,624</u>
Net loss before transfer	(2,175,415)	(2,975,572)	(2,750,045)
Total transfers	<u>1,500,000</u>	<u>1,500,000</u>	<u>1,500,000</u>
Change in net position	(675,415)	(1,475,572)	(1,250,045)
Net position, beginning of year	<u>17,504,106</u>	<u>18,979,678</u>	<u>20,229,723</u>
Net Position, End of Year	<u>\$ 16,828,691</u>	<u>\$ 17,504,106</u>	<u>\$ 18,979,678</u>

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDFa)**

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

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

Fiscal Year 2018 compared to 2017

MSBDFa's overall financial operating results show the following:

Operating revenue increased by \$132,180 or 18% in fiscal year 2018 compared to the preceding year. The increase in revenue is primarily due to increases in interest income on loans receivable and recoveries. Operating expenses decreased by \$432,380 during the fiscal year 2018, because of decreased in management fees and provisions for guaranteed loan losses.

Non-operating activity increased by \$235,597 during the year, which is the result of an impairment in the long-term investments. The State appropriations for fiscal year 2018 remained the same at \$1,500,000, which was the same as the amount received by the program in fiscal 2017.

Fiscal Year 2017 compared to 2016

MSBDFa's overall financial operating results show the following:

Operating revenue increased by \$304,961, or 71.2% in fiscal year 2017 compared to the preceding year. The increase in revenue is primarily due to increases in interest income on loans receivable and recoveries. Operating expenses increased by \$322,055 during the fiscal year 2017, because of increased provisions for guaranteed loan losses.

Non-operating activity decreased by \$208,433, during the year, which is the result of an impairment in the long-term investments. The State appropriations for fiscal year 2017 remained the same at \$1,500,000, which was the same as the amount received by the program in fiscal 2016.

Statements of Cash Flows

The Statements of Cash Flows are the third financial statements presented by the Maryland Small Business Development Financing Authority. These statements provide relevant information about the cash receipts and cash payments of the MSBDFa program during the fiscal years ended June 30, 2018, 2017, and 2016.

The Statements of Cash Flows classify cash receipts and cash payments of the Fund into four broad components. The major components of the statements are as follows: cash flows from operating activities, cash flows from non-capital financing activities, cash flows from investing activities, and the reconciliation of the net cash flows from operating activities to operating income or loss displayed on the statements of revenue, expenses, and change in net position.

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDF)**

**Management’s Discussion and Analysis
June 30, 2018 and 2017**

Statements of Cash Flows (continued)

The first component, cash flows from operating activities, is generally the cash effects of transactions and other events that enter into the determination of net income. The second component, cash flows from non-capital financing activities, reflects the cash received and spent for non-operating, non-investing and non-capital purposes. The third component, cash flows from investing activities, deals with cash resulting from purchases, proceeds, and investment interest income. The final component, reconciles net cash provided (used) by operating activities to operating income or loss displayed on the statements of revenue, expenses, and change in net position.

Below is extracted financial data from the statements of cash flows for the years ended June 30, 2018, 2017, and 2016:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Net cash flows from operating activities	\$ (2,275,965)	\$ (2,522,546)	\$ (3,179,884)
Net cash flows from non-capital financing activities	1,500,000	1,500,000	1,500,000
Net cash flows from investing activities	<u>(1,517,319)</u>	<u>(2,023,822)</u>	<u>(1,377,946)</u>
Net decrease in cash	(2,293,284)	(3,046,368)	(3,057,830)
Cash, beginning of year	<u>10,755,320</u>	<u>13,801,688</u>	<u>16,859,518</u>
Cash, End of Year	<u>\$ 8,462,036</u>	<u>\$ 10,755,320</u>	<u>\$ 13,801,688</u>

Fiscal Year 2018 compared to 2017

Net cash flows from operating activities was negative \$2,275,965, due to management service fees and other administrative allocations which are significantly higher than current year cash inflows from operations. Net cash flows from non-capital financing activities did not change in fiscal year 2018. Net cash flows from investing activities was negative \$1,517,319, because of new investments totaling \$400,770, offset by interest income earned on cash held by the State Treasurer as well as decreases in loan disbursements which outpaced repayments into the program.

Fiscal Year 2017 compared to 2016

Net cash flows from operating activities was negative \$2,522,546, due to management service fees and other administrative allocations which are significantly higher than current year cash inflows from operations. Net cash flows from non-capital financing activities did not change in fiscal year 2017. Net cash flows from investing activities was negative \$2,023,822, because of two new investments totaling \$365,000, offset by interest income earned on cash held by the State Treasurer as well as increases in loan disbursements which outpaced repayments into the program.

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDFa)**

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

Economic Outlook

The Department anticipates that MSBDFa will continue to be a primary resource for businesses owned by economically and socially disadvantaged entrepreneurs, and small businesses that do not meet the credit criteria of financial institutions, and consequently are unable to qualify for loans through normal financing channels.

The program anticipates managing ninety-one (91) accounts with maximum exposure of \$21.4 million in fiscal year 2019. There were thirty-nine (39) approvals in fiscal year 2018 for \$11,697,850. Six of those approvals were loan guarantees insured for \$862,859.50. Settlements in fiscal year 2018 were \$6,032,050 which made up twenty (23) transactions. Of the twenty three, two (2) were loan guarantees with insurance of \$203,599.50. The portfolio has grown from eighty-five (85) accounts in fiscal year 2017 to ninety-one (91), which represents a 7% increase. The demand is primarily in the equity participation component, which made up 59% of the approvals and 60% of the settlements in fiscal year 2018. The fund balance continues to decline in the most active components of the program, contract finance and equity participation. The program eventually will need an infusion of increased general funds to maintain current activity levels and sufficient cash reserves for the loan guaranty and surety bond component of the program.

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDFA)**

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

	<u>2018</u>	<u>2017</u>
ASSETS		
Current Assets		
Cash	\$ 8,462,036	\$ 10,755,320
Accounts receivable	-	3,944
Loans receivable, net of allowance of \$112,273 and \$230,686, respectively	2,036,795	1,540,214
Accrued interest receivable	84,950	83,272
Total Current Assets	<u>10,583,781</u>	<u>12,382,750</u>
Non-Current Assets		
Loans receivable, net of current portion and allowance of \$306,264 and \$234,023, respectively	5,316,699	4,511,897
Due from economic development investments	1,486,356	1,085,586
Total Non-Current Assets	<u>6,803,055</u>	<u>5,597,483</u>
Total Assets	<u>17,386,836</u>	<u>17,980,233</u>
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable	-	17,415
Unearned insurance fees	10,731	16,880
Reserve for guaranty losses	421,464	315,882
Reserve for guaranty losses - Federal	125,950	125,950
Total Liabilities	<u>558,145</u>	<u>476,127</u>
Net Position		
Unrestricted	16,828,691	17,504,106
Total Net Position	<u>\$ 16,828,691</u>	<u>\$ 17,504,106</u>

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

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDFA)**

**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 income on loans receivable	\$ 384,101	\$ 321,921
Insurance/guarantee fees	28,738	36,208
Recoveries	384,702	367,212
Other income	13,993	7,750
Other income/claim recovery	6,608	-
Capitalized interest	47,129	-
Total Operating Revenue	<u>865,271</u>	<u>733,091</u>
Operating Expenses		
Management fees	1,583,051	1,713,533
Other direct expenses	7,489	19,301
Administrative allocations	1,099,246	1,194,729
Provision for loan losses	303,508	481,951
Provision for insurance losses	106,180	122,341
Total Operating Expenses	<u>3,099,474</u>	<u>3,531,854</u>
Net Operating Loss	<u>(2,234,203)</u>	<u>(2,798,763)</u>
Non-Operating Revenue (Expense)		
Treasury interest income	58,788	103,192
Decrease in fair value of investment	-	(280,001)
Total Non-Operating Expense, net	<u>58,788</u>	<u>(176,809)</u>
Net Loss Before Transfers	<u>(2,175,415)</u>	<u>(2,975,572)</u>
Transfers		
State appropriation	<u>1,500,000</u>	<u>1,500,000</u>
Change in net position	(675,415)	(1,475,572)
Net position, beginning of year	<u>17,504,106</u>	<u>18,979,678</u>
Net Position, End of Year	<u>\$ 16,828,691</u>	<u>\$ 17,504,106</u>

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

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDFA)**

**Statements of Cash Flows
For the Years Ended June 30, 2018 and 2017**

	<u>2018</u>	<u>2017</u>
Cash Flows from Operating Activities		
Insurance/guarantee fees	\$ 22,589	\$ 42,839
Recoveries	391,310	367,212
Other income	17,937	3,806
Management service fees	(1,583,051)	(1,696,117)
Other direct expenses	(24,904)	(19,301)
Administrative allocations	(1,099,246)	(1,194,729)
Claims paid	(600)	(26,256)
Net Cash Flows from Operating Activities	<u>(2,275,965)</u>	<u>(2,522,546)</u>
Cash Flows from Non-Capital Financing Activities		
State general fund appropriation	1,500,000	1,500,000
Net Cash Flows from Non-Capital Financing Activities	<u>1,500,000</u>	<u>1,500,000</u>
Cash Flows from Investing Activities		
Interest income	441,213	427,799
Loans receivable disbursements	(6,697,705)	(12,102,909)
Proceeds from collection of principal on loans receivable	5,139,943	10,016,288
Purchase of economic development investments	(400,770)	(365,000)
Net Cash Flows from Investing Activities	<u>(1,517,319)</u>	<u>(2,023,822)</u>
Net increase in cash	(2,293,284)	(3,046,368)
Cash, beginning of year	10,755,320	13,801,688
Cash, End of Year	<u>\$ 8,462,036</u>	<u>\$ 10,755,320</u>
Reconciliation of Operating Loss to Net Cash from Operating Activities		
Operating loss	\$ (2,234,203)	\$ (2,798,763)
Interest income on loans receivable	(384,101)	(321,921)
Capitalized interest	(47,129)	-
Provision for loan losses	303,508	481,951
Effect of net changes in non-cash assets and liabilities:		
Accounts receivable	3,944	(3,944)
Accounts payable	(17,415)	17,415
Reserve for guarantee losses	105,580	96,085
Unearned insurance premiums and issuance fees	(6,149)	6,631
Net Cash from Operating Activities	<u>\$ (2,275,965)</u>	<u>\$ (2,522,546)</u>

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

MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY (MSBDFA)

Notes to the Financial Statements June 30, 2018 and 2017

1. AUTHORIZING LEGISLATION

The Maryland Small Business Development Financing Authority (MSBDFA or the Fund) was established by the State of Maryland in 1978 and is governed by the Economic Development Article and the MSBDFA programs are contained in Sections 5-501 through 5-575. MSBDFA is administered by the Department of Commerce (the Department). MSBDFA's purpose is to assist socially or economically disadvantaged entrepreneurs and small businesses in the creation and expansion of Maryland businesses. The programs can extend financial assistance to small businesses that are unable to obtain adequate business financing on reasonable terms through normal financing channels.

During the 2002 session of the Maryland General Assembly, the statutes concerning eligibility were broadened to include businesses other than those that are determined to be socially or economically disadvantaged. More specifically, the new law allowed MSBDFA to extend financial assistance to small businesses that are unable to obtain adequate business financing on reasonable terms through normal financing channels.

MSBDFA currently offers assistance through the following programs:

- *Contract Financing Fund Program* - This program offers financial assistance through direct loans and guarantees of loans to provide working capital to eligible businesses to complete work on contracts, for which the majority of funding is provided by Federal, state or local government agencies or utilities regulated by the Public Service Commission.
- *Long-Term Guaranty Fund Program* - This program offers financial institutions loan guarantees and payments of interest subsidies on loans made to eligible businesses to be used for working capital, the acquisition of machinery and equipment and real property (if such property is to be used in the applicant's business) and improvements to real property owned or leased by the applicant.
- *Surety Bond Fund Program* - Under this program, MSBDFA provides bonding assistance to eligible small businesses to qualify for and complete work on contracts, for which the majority of funding is provided by state or local government agencies or utilities regulated by the Public Service Commission. The Program may also provide assistance for contracts with private entities that display the financial capacity to fund a proposed contract. MSBDFA can directly issue bid, performance or payment bonds or guaranty a surety's losses incurred as a result of the contractor's breach of a bid, performance, or payment bond.
- *Equity Participation Investment Program (EPIP)* - This program was created with the explicit purpose of encouraging and aiding in the creation, development, expansion, and retention of franchises, technology-based and other traditional businesses and in the acquisition of existing businesses to be located in Maryland. The EPIP provides equity investments, loans and loan guarantees to achieve its objectives.

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDFA)**

**Notes to the Financial Statements
June 30, 2018 and 2017**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

MSBDFA is an enterprise fund of the State of Maryland.

Basis of Presentation

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.

MSBDFA is one of many programs administered by the Department. MSBDFA has no direct employees and are entirely supported by staff at the Department to perform all necessary functions of MSBDFA. The Department allocated certain operating, general, and administrative costs to MSBDFA, which is the Department's estimate of its cost to manage and administer MSBDFA's operations. This allocation from the Department is not necessarily representative of MSBDFA's cost as if it was a stand-alone entity and could significantly change in the future. The Department allocated expenses to MSBDFA of \$1,099,246 and \$1,194,731, for the years ended June 30, 2018 and 2017, respectively.

MSBDFA's accompanying financial statements are not indicative of MSBDFA 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 of MSBDFA 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 stated at the amount of unpaid principal, reduced by an allowance for loan losses. Loans that are due within one year are classified as current assets, and all other loans are classified as non-current assets. Interest on loans is calculated using the simple interest method on daily balances of the principal amount outstanding. The allowance for loan losses is established through a provision for loan losses charged to expense.

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDFA)**

**Notes to the Financial Statements
June 30, 2018 and 2017**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Loans Receivable (continued)

Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible because of present conditions, based on evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, portfolio quality, review of specific problems regarding the loans, and current economic conditions that may affect the borrower's ability to pay. The allowance for loan losses is based on estimates, and ultimate losses may vary from the current estimates. The allowance for loan losses has been allocated between current and non-current loan balances.

These estimates are reviewed periodically and, as adjustments become necessary, they are reported through the provision for loan losses in the periods in which they become known. Accrual of interest is discontinued on a loan when management believes that, after considering economic and business conditions and collection efforts, the borrower's financial condition is such that collection of interest is doubtful. For the years ended June 30, 2018 and 2017, the provision for loan losses was \$457,543 and \$481,951, respectively.

Reserve for Guaranty Losses

MSBDFA has provided partial guaranties on loans and bonds. Outstanding guaranties range from 20% to 80% of the outstanding loan and bond balances. The reserve for guaranty losses is estimated to provide losses on existing insured loans. The amount of such reserve is estimated based on a continuing review of outstanding guaranties, loss experience, and estimated liquidation values of underlying collateral and economic conditions, which may affect each borrower's ability to pay. Such estimates are susceptible to change in the near term due to changing economic conditions, the value of the collateral and paying capacity of the borrower and, where applicable, guarantors. Therefore, actual results could differ significantly from those estimates. As of June 30, 2018 and 2017, MSBDFA had a reserve for guaranty losses of \$547,414, and \$441,832, respectively.

Unearned Insurance Fees

Unearned Insurance fees represent premiums paid for loan guaranty insurance that has not been earned. Revenue is recognized monthly on a straight-line basis. As of June 30, 2018 and 2017, MSBDFA had unearned insurance fees of \$10,731 and \$16,880, respectively.

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDF)**

**Notes to the Financial Statements
June 30, 2018 and 2017**

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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, insurance premiums and guaranty fees, and investment income from small business investments. Operating expenses include expenses related to provisions for loan and guaranty losses and administrative expenses. Non-operating revenues primarily represent interest income earned on the funds in the State Treasury and changes to the fair market value of economic development investments. Transfers consisted of annual appropriations from the State of Maryland.

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 U.S. Treasury and agency obligations. In addition, investments may be made directly in U.S. Treasury or agency obligations.

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDF)**

**Notes to the Financial Statements
June 30, 2018 and 2017**

3. CASH (continued)

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.

All of the Fund's investments are measured at fair value using valuation hierarchy. Valuation hierarchy's three levels include, Level 1 – quoted prices in active markets for identical assets, Level 2 – inputs are observable for the asset, either directly or indirectly, but exclude quoted prices, Level 3 – inputs are unobservable and may be based on valuation techniques such as market, cost, or income.

Custodial Credit Risk - Deposits

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

As of June 30, 2018 and 2017, the Fund had cash deposits of \$6,986,296 and \$9,008,791 with the State Treasury, respectively. The Fund also had cash deposits outside of the State Treasury of 1,475,740 and \$1,746,529 as of June 30, 2018 and 2017, respectively. The Fund had \$1,230,561 and \$1,496,529 of deposits outside of the State Treasury in excess of FDIC limits as of June 30, 2018 and 2017, respectively.

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4. LOANS RECEIVABLE

Loans receivable as of June 30, 2018 and 2017, were summarized as follows:

	<u>2018</u>	<u>2017</u>
Loans receivable, beginning of year	\$ 6,516,820	\$ 4,677,071
Loan disbursements	6,697,705	12,102,909
Loans written off	(349,668)	(246,872)
Proceeds from collections	(5,139,943)	(10,016,288)
Capitalized interest	47,129	-
Loans Receivable, End of Year	<u>\$ 7,772,043</u>	<u>\$ 6,516,820</u>

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

	<u>2018</u>	<u>2017</u>
Balance, Beginning of Year	\$ 464,709	\$ 229,630
Loans written off	(349,668)	(246,872)
Provision for loan loss	303,508	481,951
Balance, End of Year	<u>\$ 418,549</u>	<u>\$ 464,709</u>

5. DUE FROM ECONOMIC DEVELOPMENT INVESTMENTS

MSBDFA provides loan and equity investments to small businesses through the Equity Participation Investment Program (EPIP). The values of these investments are stated at fair value. Management assesses investments for impairment based on financial condition, operating results and other factors on an annual basis. Based on management’s analysis of MSBDFA’s investments portfolio, the fair value of the assets was \$1,085,586 and \$1,486,356 as of June 30, 2018 and 2017, respectively. MSBDFA made two (2) new investments totaling \$400,770 during fiscal year 2018. The programs made several follow-on investments totaling \$224,288 in an existing portfolio company during fiscal year 2018. There were no returns of any of its investments in either fiscal year.

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDFA)**

**Notes to the Financial Statements
June 30, 2018 and 2017**

5. DUE FROM ECONOMIC DEVELOPMENT INVESTMENTS (continued)

Economic development investments as of June 30, 2018 and 2017, were comprised of the following:

<u>Security</u>	<u>Cost</u>	<u>Fair Value</u>	
		<u>June 30, 2018</u>	<u>June 30, 2017</u>
Mid Atlantic Broadband	\$ 500,000	\$ 500,000	\$ 500,000
Mid Atlantic Metro Broadband	394,600	194,973	194,973
Mid Atlantic Metro Broadband	62,956	25,613	25,613
Teleport Enterprises, Inc.	135,675	130,770	100,000
N&C, Inc.	265,000	265,000	265,000
Lessoncast Learning LLC	220,000	220,000	-
Reciprocall Health, Inc.	150,000	150,000	-
Total	\$ 1,728,231	\$ 1,486,356	\$ 1,085,586

6. RESERVE FOR GUARANTY LOSSES

A summary of outstanding loans and bonds and the applicable insurance as of June 30, 2018 and 2017, were as follows:

	<u>2018 Original Balance</u>	<u>2018 Outstanding Balance</u>	<u>2017 Original Balance</u>	<u>2017 Outstanding Balance</u>
Loans and bonds	<u>\$ 26,687,056</u>	<u>\$ 15,411,292</u>	<u>\$ 26,478,757</u>	<u>\$ 15,158,889</u>
Insurance	<u>\$ 2,782,250</u>	<u>\$ 2,036,131</u>	<u>\$ 3,430,250</u>	<u>\$ 1,972,177</u>

The maximum exposure to MSBDFA, including available borrowings under lines of credit agreements as of June 30, 2018 and 2017, were \$21,430,522 and \$21,248,375, respectively.

Changes in the reserve for guaranty losses for the years ended June 30, 2018 and 2017, were as follows:

	<u>2018</u>	<u>2017</u>
Balance, beginning of year	\$ 441,832	\$ 345,747
Claim payment	(600)	(26,256)
Provision for guaranty losses	106,180	122,341
Balance, End of Year	\$ 547,412	\$ 441,832

**MARYLAND SMALL BUSINESS DEVELOPMENT FINANCING AUTHORITY
(MSBDFA)**

**Notes to the Financial Statements
June 30, 2018 and 2017**

7. MANAGEMENT AGREEMENT

The Department has entered into a contract with Meridian Management Group, Inc. (MMG), a Maryland corporation, to provide management services to MSBDFA. Such services include marketing and public relations, underwriting, loan closing, and certain loan administration. MSBDFA retains approval authority over all proposed transactions under its different programs, and the Department will continue to provide certain accounting and administrative functions subsequent to loan closing. During the year ended June 30, 2012, the Department exercised its option to extend the management contract with MMG for an additional five-year period. The Department has entered into extension with MMG until end of calendar year 2022, and expect to renew the contact. Minimum annual payments on this contract, which expired on June 30, 2018, were approximately \$1.30 million, including monitoring fees.

8. PENSION AND OTHER POSTEMPLOYMENT BENEFITS

Eligible employees who perform services for MSBDFA 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. MSBDFA'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 MSBDFA'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.

9. COMMITMENTS AND CONTINGENCIES

In the normal course of operations, certain claims may be brought against MSBDFA. Management believes that the ultimate resolution of such claims would not have a material adverse effect on MSBDFA's financial position. As of June 30, 2018 and 2017, MSBDFA had outstanding funding commitments in the amount of \$929,000, and \$804,776, respectively.