Susan Montee, CPA
Missouri State Auditor

March 2007

Missouri Development Finance Board

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Office Of
Missouri State Auditor
Susan Montee, CPA

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YELLOW SHEET

The following report is our audit of the Missouri Development Finance Board (MDFB).

The MDFB's mission is to assist businesses and public entities in obtaining financing through the issuance of conduit revenue bonds, direct loans, and issuance of tax credits. The MDFB currently has 25 active Business Use Incentives for Large-Scale Development (BUILD) projects with authorized tax credits of about $101 million. The MDFB needs to improve monitoring for BUILD projects by verifying employment and average annual wage information reported by participating companies with state wage information. For example, the audit identified one company that had submitted erroneous employment and wage information. Based on this information, the company would have received about $389,000 more in tax credits than the company was due. It is uncertain the extent to which the MDFB would have identified the erroneous information and reduced the tax credit amounts. In addition, the current BUILD program structure is overly complex and increases the amount of state tax credits issued.

Effective fiscal year 2007, the MDFB, in conjunction with the Department of Economic Development (DED) and the Missouri Housing Development Commission (MHDC), established the Downtown Revitalization and Economic Assistance for Missouri (DREAM) Initiative. The state made awards under the DREAM Initiative without ensuring that the best applicants were selected. The 89 eligible applications were subjectively reviewed by the evaluation team to identify cities meeting certain criteria. DED selected 24, MHDC 20, and MDFB 22 cities resulting in 10 cities (Cape Girardeau, Hannibal, Kennett, Neosho, Sedalia, St. Joseph, Washington, West Plains, Maryville and Chillicothe) receiving a yes vote from all three agencies and 9 cities receiving a yes vote from two of the three agencies. The DED selected eight of the ten cities that had received a unanimous yes vote from all three agencies and replaced the cities of Maryville and Chillicothe with Excelsior Springs and Hermann which had received yes votes from two of the three agencies. No documentation or analysis was available to support the decision to replace two cities having unanimous support from all three agencies on the evaluation team.

State law authorizes the MDFB to assess fees to generate the operating funds necessary to carry out the board's purposes. Effective January 2006, the MDFB raised the board fee imposed upon Tax Credits for Contribution projects. The estimated additional fee revenue will total about $4.5 million over the next three fiscal years if all authorized contributions are remitted. The increase in the fee will negatively impact projects financed through the Tax Credit for Contributions program because less monies will be available to fund projects. Additionally, since fiscal year 2000, the MDFB has collected over $1.9 million in BUILD fees, an average of $381,000 annually, while the MDFB

(over)

estimates annual program costs of about $100,000, substantially less than the average fees collected each year. At June 30, 2006, the MDFB reported unrestricted cash and investments of about $24.7 million and the fiscal year 2006 board operating expenses are about $1.8 million. As cash and investments were over 13 times the annual operating expenses, it appears the MDFB had adequate funds available to continue operations without increasing any existing fees.

During fiscal years 2006 and 2005, the MDFB recorded bad debt expense of $3,498,074 and $9,448,681, respectively. These expenses were primarily related to three loans totaling $17.8 million. For one of these loans, the MDFB began recognizing bad debt expense the year after the loan was made. The audit recommended the MDFB reevaluate its loan approval process.

The MDFB paid over $101,000 for chartered air service to fly board members, board counsel, and staff to board meetings during the three years ended June 30, 2006. Most meetings are held in Jefferson City, with occasional meetings held in other major cities. State law requires members to be reimbursed for reasonable and necessary expenses incurred in the performance of their official duties. During the three fiscal years ended June 30, 2006, there were 18 board meetings for which chartered air travel was provided. The estimated cost of chartered air service exceeded the cost of mileage reimbursement by over $5,000 per meeting. As a result, the MDFB could have saved about $90,000 over the three year period by eliminating chartered air service for board members and staff to attend board meetings.

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MISSOURI DEVELOPMENT FINANCE BOARD

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SUSAN MONTEE, CPA
Missouri State Auditor

Honorable Matt Blunt, Governor
and
Members of the Board of Directors
and
Robert V. Miserez, Executive Director
Missouri Development Finance Board
Jefferson City, MO 65102

We have audited the Missouri Development Finance Board. The board engaged Williams Keepers LLC, Certified Public Accountants (CPAs), to audit the board's financial statements for the years ended June 30, 2006, 2005, and 2004. We reviewed the reports and substantiating working papers of the CPA firm and performed such other procedures as we considered necessary in the circumstances. The scope of our audit included, but was not necessarily limited to, the years ended June 30, 2006, 2005, and 2004. The objectives of this audit were to:

1. Review compliance with certain legal provisions.

2. Evaluate the economy and efficiency of certain management practices and operations.

Our methodology to accomplish these objectives included reviewing minutes of meetings, written policies, financial records, and other pertinent documents; interviewing various personnel of the board, as well as certain external parties; and testing selected transactions.

In addition, we obtained an understanding of internal controls significant to the audit objectives and considered whether specific controls have been properly designed and placed in operation. We also performed tests of certain controls to obtain evidence regarding the effectiveness of their design and operation. However, providing an opinion on internal controls was not an objective of our audit and accordingly, we do not express such an opinion.

We also obtained an understanding of legal provisions significant to the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of contract, grant agreement, or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting significant instances of noncompliance with the provisions. 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.

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Our audit was conducted in accordance with applicable standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and included such procedures as we considered necessary in the circumstances. The work for this audit was substantially completed by October 2006.

The accompanying History, Organization, and Statistical Information is presented for informational purposes. This information was obtained from the board's management and was not subjected to the procedures applied in the audit of the board.

The accompanying Management Advisory Report presents our findings arising from our audit of the Missouri Development Finance Board.

Susan Montee, CPA
State Auditor

The following auditors participated in the preparation of this report:

Director of Audits:	Kenneth W. Kuster, CPA
Audit Manager:	John Luetkemeyer, CPA
In-Charge Auditor:	Dennis Lockwood, CPA
Audit Staff:	Melissa McCoin

MANAGEMENT ADVISORY REPORT -
STATE AUDITOR'S FINDINGS

1. BUILD Tax Credit Program

The Business Use Incentives for Large-Scale Development (BUILD) program is operated by the Missouri Development Finance Board (MDFB) under Sections 100.700 to 100.850, RSMo. This program is an economic development incentive program offered to companies that are considering locating or expanding their investment and employment in Missouri. To qualify for the BUILD program, companies must agree to make minimum investments in property, plant, and equipment of $10 to $15 million, and create between 100 and 500 new jobs, depending on the type of industry involved. Companies must also receive an offer of economic assistance from another state to be eligible for the program.

The Department of Economic Development (DED) accepts applications from companies, determines if the companies meet the criteria to participate in the BUILD program, negotiates the amount of tax credits that will be offered to the company, and makes recommendations to the MDFB to accept or reject a company's application. The MDFB staff also reviews the application to ensure companies meet the investment and job creation criteria. The MDFB board makes the final decision to accept companies into the BUILD program. Once accepted, companies that comply with project agreement terms are issued state tax credits. These tax credits can be used to offset state taxes due or receive tax refunds if the amount of the tax credits exceeds the amount of taxes due.

As of June 30, 2006, the MDFB had authorized BUILD tax credits totaling approximately $101 million, including $33.9 million already issued as of June 30, 2006, with $67.1 million authorized to be issued over the next 15 state fiscal years. The issuance of BUILD tax credits is limited to $15 million each fiscal year.

As of June 30, 2006, there were 25 companies participating in the BUILD program. Those companies agreed to make investments totaling over $1.68 billion and to create 9,560 new jobs, with a total annual payroll of over $355 million and to sustain those jobs for 10 to 15 years. (The 25 current BUILD projects are listed in Appendix D.) In addition to these 25 companies, 8 other companies had participated in the program but dropped out because business plans had changed or the company filed bankruptcy. No tax credits were issued to 5 of these companies, tax credits issued to 2 companies have been recouped, and recovery of the tax credits for the remaining company is being pursued.

We noted the following concerns during our review of the BUILD program.

A. The MDFB needs to improve its monitoring of compliance with BUILD program agreements by verifying employee and average wage information reported by participating companies with state wage information.

The MDFB, DED, and the applicable company negotiate the terms of the BUILD program agreements, including investment, job creation, and minimum average employee salary. The MDFB requires companies to file periodic reports certifying the amount of investment, number of employees, and average wage as of the initial and subsequent annual certification dates. The initial certification is statutorily set three years following the bond issue date, and the annual certification date is the same in each subsequent year through the end of the BUILD project. The MDFB also receives detailed listings of employees and current or annualized wage rates at the end of the company's business quarter or fiscal year end.

We reviewed the most recent annual or quarterly certification report on file with the MDFB for the twenty five companies participating in the BUILD program as of June 30, 2006, and also recalculated the tax credit reductions imposed by the MDFB. Concerns were noted involving two companies:

1. One company reported 796 employees with an average annual wage of $55,472 on its October 15, 2005 annual certification report. The company was required to have created 532 jobs with an average annual salary of $56,348. Based on this information, the company would have been entitled to the full amount of the tax credits, $788,802, for calendar year 2006. In March 2006, the company submitted a detailed employee listing to the MDFB. In September 2006, we reviewed the detailed listing and noted 417 employees who had been terminated before the certification date, 70 employees who had been hired after the certification date, and three part-time employees that should not have been included in the jobs created total. In addition, the average annual wage for many employees did not appear to be reasonable. For example, one employee was reported as having year-to-date earnings of about $57,000 through November 8, 2005, while the annualized average wage for that employee was listed at over $342,000.

   After bringing the employment and annualized average wage discrepancies to the attention of the MDFB, the MDFB contacted the company and requested a corrected detailed employment listing. The MDFB also placed a hold on the issuance of the 2006 tax credits. After receiving revised information from the company which indicated there were 304 qualifying employees as of the test date, the MDFB recalculated and notified the company the pending tax credit amount was reduced by $350,000. However, we subsequently obtained state wage information and noted 28 employees included on the revised employment listing were not listed on the state wage information. As a result, it appears the company actually had a total of 276 employees with an annualized average salary of $59,411 as of the certification date. As a result, the correct amount of the tax credit reduction should be $389,285.

2. Another company was required to create 514 jobs under their BUILD agreement. The company certified 454 jobs had been created and submitted a detailed employment listing that also reported 454 employees. However, the employment listing noted 22 vacant, open, or ineligible jobs. We used the BUILD reduction formula and determined that even though the company had over reported 22 jobs and did not meet the required employment, no reduction of tax credits was required because the average annual wage of the employees significantly exceeded the required annual average wage offsetting the lower than necessary employment totals.

Because the MDFB had not completed its tax credit approval process, it is uncertain the extent to which it would have identified the erroneous information and reduced the tax credit amounts. However, since the MDFB did not verify reported employment or average annual wage information with state wage information, it is not likely the correct amount of the tax credit would have been identified. Under Section 100.850(2), RSMo, the MDFB is allowed access to the participating companies payroll books and records. However, the MDFB has not reviewed participating company payroll records. The MDFB should increase monitoring efforts to ensure companies are in compliance with the BUILD program agreements.

B. The current BUILD program structure unnecessarily increases the amount of state tax credits issued and is overly complex. The MDFB operates the program as a private activity revenue bond issue program, as specified by state law. The MDFB issues private activity revenue bonds which are purchased by the company. The bond issuance fee, legal fees and initial bond trustee fees are paid from the bond proceeds. The balance of the bond proceeds are then returned to the company in the form of a loan as the company supplies documentation that the required investments have been made. Usually the investment has been made by the time the bonds are issued which results in the bond proceeds being immediately returned to the company. The company then makes semi-annual loan payments to the bond trustee equal to the principal and interest cost due on the bonds. The funds from the loan payments are immediately returned to the company as payment of principal and interest since the company owns the bonds.

The payment of principal, interest and related fees qualify for tax credit issuance over the life of the project. Approximately $29 million of $101 million in tax credits authorized through June 30, 2006, will be issued related to bond interest payments. Legal services are performed by the MDFB's legal counsel and are based upon 0.6 percent of the BUILD principal with a minimum of $7,500. Legal fees imposed upon the twenty five companies actively participating in the BUILD program as of June 30, 2006, have totaled just over $406,000. We estimate bond trustee fees will total about $250,000 over the life of the projects authorized as of June 30, 2006.

The MDFB should evaluate the benefits, including the reduction in the amount of tax credits issued, of changing the BUILD program from a bond issue/loan program to a tax credit program. The MDFB should report the results of that evaluation to the legislature for their consideration of possible changes to state law to enhance the program's effectiveness. In November 2005, the Incentives Review Committee appointed by the Director of the DED issued the Report on Missouri Incentives Programs which included a similar recommendation.

C. The MDFB did not always use consistent criteria in its formula to reduce tax credits and did not index the average wage factor for wage inflation. BUILD program agreements include project specific formulas used to determine any reduction in the amount of tax credits issued if companies fail to create the projected number of jobs and/or fail to meet the projected annual wage. This practice results in inconsistent application of program requirements as noted below:

1. The MDFB did not always use consistent criteria in reduction formulas for BUILD program agreements. The MDFB included criteria for the actual versus projected investment in only one reduction formula. We noted other projects that could have resulted in tax credit reductions if an investment criteria would have been used. For example, one company reported investing about $15.8 million while the BUILD agreement required an investment of about $20.2 million. In this case, no tax credit reduction occurred since the BUILD agreement did not include a reduction factor for failing to meet the required investment level.

   In more recent BUILD agreements, the MDFB has required companies to create and maintain a minimum number of jobs, usually 90 percent of the projected number of jobs, or the tax credits for that year will be suspended, and to create and maintain a minimum number of jobs, usually 75 percent, or face termination from the BUILD program. However, for one large recently approved project, the MDFB set the suspension and termination thresholds at 100 new jobs and 1,221 retained jobs even though the company had agreed to create 364 new jobs and retain 1,221 existing jobs.

2. The projected annual average wage factor is set at the beginning of the project and is not indexed for wage inflation. This tends to result in a positive average annual wage element of the reduction formula that increases over the project life. As a result, any reduction due to creation of less than the required number of jobs is offset to some degree and may result in companies having less incentive to create the required number of jobs.

The MDFB should use consistent criteria to ensure all companies receive equal treatment if they fail to abide by the BUILD program agreements for job creation, average annual wage, and required investment. The MDFB should also include a wage inflation factor in its tax credit reduction formula.

WE RECOMMEND the MDFB:

A. Increase monitoring efforts to ensure companies are in compliance with the BUILD program agreements by verifying employment and wage information to state wage information or by conducting periodic reviews of company payroll records.

B. Evaluate alternative methods for the delivery of tax credits under the BUILD program to eliminate credits issued for unnecessary interest and related fees, and report the results of that evaluation to the legislature for its consideration.

C. Use consistent criteria for the reduction, suspension, and termination of BUILD tax credits. In addition, MDFB should develop and consistently apply a tax credit reduction formula that contains a wage inflation factor.

AUDITEE'S RESPONSE

A. We appreciate the Auditor's Office pointing out a discrepancy between the number of jobs reported by one company compared to the number of jobs obtained by the Auditor's Office from records of the Division of Employment Security. MDFB has not previously had access to records of the Division of Employment Security but is now in the process of contracting with the Division for access to such records to cross-reference job employment reports submitted under the BUILD Program. This information is highly confidential and adequate procedures must be followed to assure the privacy of the reports.

B. The current program structure is based upon the BUILD Act and regulations of the Department of Economic Development. We will again support statutory changes enacted by the legislature to allow a simpler structure for implementing the BUILD Program.

C. *To the best of MDFB's knowledge, we believe consistent criteria have been used in the formula to reduce tax credits. For one project a modified formula was included in the program agreement in consideration for the company's agreement to increase the number of jobs at the project site over and above the number of jobs initially stated at the time the Department made its original recommendation to MDFB. We do not believe this constitutes use of inconsistent criteria but rather is intended to address the unique set of facts of this job creation project. The BUILD Act emphasizes job creation so long as minimum investment thresholds are achieved. MDFB believes that so long as a company meets the minimum investment and job creation requirements, the company should not be penalized for completing its project under budget particularly where the cost savings* *could result in greater job creation. However, MDFB will consult with DED for their recommendations as to any further legislative changes to the BUILD Act.*

2. DREAM Initiative Selection Process

The state made awards under the new Downtown Revitalization and Economic Assistance for Missouri (DREAM) Initiative without ensuring the best possible applicants were selected to participate.

Effective in fiscal year 2007 and at the request of the Governor's Office, the MDFB, in conjunction with the DED and the Missouri Housing Development Commission (MHDC), established the DREAM Initiative. According to the program website, www.dream.mo.gov, the "DREAM Initiative is a comprehensive, streamlined approach to downtown revitalization that provides a one-stop shop of technical and financial assistance for select communities to more efficiently and effectively engage in the downtown revitalization process." The MDFB approved an annual budget of $400,000 and received funding commitments of $100,000 from both the DED and the MHDC. For fiscal year 2007, ten cities were selected for participation in the DREAM Initiative. Tentative plans are for ten additional cities to be selected in fiscal years 2008 and 2009.

The selection process was conducted in 3 phases; eligibility, preliminary review of local efforts, and final review for "best partnerships", with geographic distribution also considered as a factor. In each phase of the review, the evaluation team of MDFB, DED, and MHDC each rated the individual applicants with a yes or no result to determine whether the applicant moved to the next phase. A total of 101 applications were received, but 12 cities were determined to be ineligible because the application was received after the deadline, the application was not signed by an authorized official, or the city did not submit a local resolution supporting the application.

During the preliminary review phase, the remaining 89 applications were subjectively reviewed by staff of the three agencies on the evaluation team to identify cities meeting certain criteria, including viable population and demographic trends, downtown area had a historic core, and issues related to the city's interest level and potential outcomes. Forty-five cities were selected for further consideration during the "best partnerships" phase. Under this phase, the evaluation team scored the applications in areas such as need, specific opportunities including housing and historic preservation, barriers to redevelopment, existing downtown revitalization, and the ability to attract private investment. In this phase, DED selected 24, MHDC 20, and MDFB 22 cities. This resulted in 10 cities receiving a yes vote from all three agencies and 9 cities receiving a yes vote from two of the three agencies.

According to a DED official, the DED compiled results of the agencies' votes and selected eight of the ten cities that had received unanimous yes votes from all three agencies. These cities were Cape Girardeau, Hannibal, Kennett, Neosho, Sedalia, St. Joseph, Washington, and West Plains. The DED replaced the cities of Maryville and

Chillicothe that had received unanimous votes with Excelsior Springs and Hermann that had received yes votes from two of the three agencies. According to DED officials, the final selections were made to provide better geographic distribution and to make awards to those cities with the greatest chance of success. However, no documentation or analysis was available to support the decision to replace two cities having unanimous support from all three agencies on the evaluation team.

The selection process may not have resulted in the best qualified cities being selected for participation in the DREAM Initiative. The DED has several grant programs, such as the Community Development Block Grant Program, in which applications are reviewed using a formal scoring system rather than the more general yes/no voting system. Under the scoring system, applicants are awarded points for specific award criteria with the highest scoring applicants awarded grants. A DED official indicated DED requested a formal scoring system be utilized but the MDFB and the MHDC were not comfortable with this approach. In the future, MDFB, as the lead funding source, should implement a formal system which includes scoring various criteria to ensure the best possible applicants are selected.

WE RECOMMEND the MDFB develop and use a formal scoring system to make DREAM Initiative awards. If awards are not made in accordance with the results of this scoring system, sufficient and detailed documentation should be retained to support the awards that are made.

AUDITEE'S RESPONSE

The Auditor's Office conclusion that two communities were "replaced in the top ten" or somehow "should have been in the top ten" is incorrect, and is inconsistent with the actual process of selection that was used.

MDFB believes the Auditor's Office recommendation that MDFB impose a numerical ranking system on this program would not serve the best interests of the smaller cities and towns the program is designed to assist. Such an approach could not account for the wide differences in obstacles to redevelopment faced by these communities throughout the state. The current approach seeks to account for such factors as statewide geographic balance and distribution of communities; community capacity; development sustainability; economic and tourism development potential; local involvement, participation and support including volunteerism and ability to attract investment of private financial and non-financial resources; diversity of local economies and tax base; and numerous other factors that are directly involved in the community and economic development process. The partnering agencies believe ranking individual capital investment project applications can be numerically ranked against each other, but individual communities that are of widely diverse size and at widely different points along the development continuum cannot and should not be.

MDFB would recommend to DED and MHDC that we evaluate any statistical measuring system proposed by the Auditor's Office that takes into account relevant factors that could predict and determine a community's opportunities for successful development for this program.

3. Cash Balance and Board Fees

The MDFB has established a fee structure that appears higher than necessary and was increased even though ample cash reserves already existed.

A. The MDFB is authorized under Section 100.270, RSMo, to assess or charge fees as the board determines to be reasonable to generate operating funds necessary to carry out its purposes. Our review of board fees noted the following concerns:

1. Effective January 2006, the MDFB raised the board fee imposed upon Tax Credits for Contribution projects from 2 percent of the first $1 million and 1 percent for contributions in excess of $1 million to 4 percent on all contributions. The increased fee affected nine projects with a total authorized contribution limit of $155.8 million. The estimated additional fee revenue will total about $4.5 million over the next three fiscal years if all authorized contributions are remitted. As additional projects are approved and related contributions are received, additional fee revenue will be generated.

   The increase in the fee will negatively impact projects financed through the Tax Credit for Contributions program because less monies will be available to fund projects. To maintain the same level of project funding, additional contributions will be required to offset the increased fees. The increased contributions will then result in additional state tax credits being issued.

2. The MDFB imposes an issuance fee equal to 2.5 percent of the bond principal amount on each BUILD project when bonds are issued, and an annual board fee of 0.5 percent of the outstanding principal amount at the end of each program year. The BUILD revenues fluctuate significantly from year to year, primarily based upon the amount of BUILD bonds issued in the year. Since fiscal year 2000, the MDFB has collected over $1.9 million in BUILD fees, an average of $381,000 annually. The MDFB estimates an annual program cost of about $100,000, substantially less than the average fees collected each year. The board fees imposed upon the BUILD program also results in the issuance of tax credits equal to the fees and reduces the monies available to companies to make investments and create or sustain jobs.

B. At June 30, 2006, the MDFB reported unrestricted cash and current investments of about $24.7 million. The fiscal year 2006 board operating expense (net of bad debt expense and depreciation) was about $1.8 million. Cash and current investments were over 13 times the annual operating expenses. It appears the MDFB had adequate funds available to continue operations without increasing any existing fees.

The MDFB has established the new DREAM Initiative program and committed at least $200,000 annually over the next three fiscal years to that program. However, the MDFB has no other long-range plans that require additional fee revenue and indicated the additional revenues not used to fund the DREAM program would be used to increase their unrestricted cash balances while developing possible new or enhanced programs.

The MDFB should examine its current fee structures to ensure fees are reasonable and necessary to carry out its purposes as established in state law. In addition, the MDFB should identify specific funding needs prior to increasing fees on existing programs.

WE RECOMMEND the MDFB re-evaluate its fee structure to ensure fees are reasonable and necessary to carry out its purposes. In addition, the MDFB should identify specific funding needs prior to increasing fees on existing programs.

AUDITEE'S RESPONSE

MDFB evaluates its fees on an annual basis. The last evaluation occurred beginning at the September 2005 meeting and cumulated with changes to the fee schedule at the December 2005 meeting. This resulted in a reduction of fees for most programs, maintenance of the existing fee for one program, and an increase in the Tax Credit for Contribution program.

MDFB believes the fee increase will have minimal if any impact on projects financed through the Tax Credits for Contributions Program. MDFB intends to use the additional revenue from the fee increase to target and fund programs for non-metropolitan areas throughout the state.

MDFB provides numerous services and products to the state and local governments and political subdivision without the imposition of fees. On other programs it assesses fees to fund its operational costs, including the above services, and provide adequate reserves to assure repayment of its debt. This approach allows MDFB to provide certain services and products at no charge to the state and local political municipalities and complete major development and redevelopment projects.

MDFB's purpose is to finance private capital investments and public infrastructure in the state which have a high probability of success but are not feasible without MDFB's assistance. To fulfill this mission MDFB needs adequate cash reserves and liquidity. MDFB does not believe that a determination of the appropriate level of reserves should be limited by comparison to prior years operating expense. The appropriate amount of reserves must take into account the adequate security for its debt, the risk of projects assumed by MDFB and the role MDFB seeks to play in bridging gaps for projects deemed of significant value to the State and to the communities of the State.

MDFB will continue to evaluate its fees based upon the marketplace it operates in, its policy considerations and the needs it determines necessary to fulfill its mission to those public and private entities that use its programs and services.

4. Loans to Other Entities

In fiscal year 2005, the MDFB implemented a formal loan review process to recognize an allowance for loan loss for financial reporting purposes. During fiscal years 2006 and 2005, the MDFB recorded bad debt expense of $3,498,074 and $9,448,681, respectively. These expenses were primarily related to three loans totaling $17.8 million. In each of these loans, the debt was subordinate to other debt of the borrowers. Details concerning these loans were as follows:

- Periodically, the State of Missouri will appropriate funds for a specific project to the DED for the MDFB, and the board will then loan the funds. The MDFB is responsible for loan administration and is allowed to keep any principal and interest from loan repayment. In 1998, the MDFB received such an appropriation and loaned $2.5 million to the American National Fish and Wildlife Museum District located in Springfield, Missouri. The terms of the loan included no interest or principal for 5 years and a 3 percent interest rate for the remaining 10 year payback period. In 2003, the museum district requested and the MDFB approved deferral of interest and principal payments for an additional 4 years. The museum district has not been able to generate sufficient revenues to cover ongoing operating expenses and the MDFB determined that it is likely the loan will not be repaid in the foreseeable future. Therefore, the MDFB established an allowance for loan loss and recognized $2.5 million in bad debt expense during fiscal year 2005.

- In 2001, the MDFB loaned $2.5 million to the developer of a historic building renovation project in mid-town St. Louis. The sources of monies loaned were $1,250,000 in contributions from the Tax Credit for Contribution Program, $500,000 from the City of St. Louis that was originally funded under the Community Development Block Grant program, and $750,000 of board funds. The terms of the loan included no interest over a 40 year payback period. In addition, repayment was only required if the project generated sufficient revenues to pay operating expenses, interest and principal due on superior first and second mortgages, and any other debt the developer or his partners incurred in completing or operating the project. Since the project has not generated sufficient revenues, the MDFB increased the allowance for loan loss and recognized bad debt expense of $2 million during fiscal 2005. The remaining $500,000 is due to be repaid to the City of St. Louis Community Development Block Grant program and was therefore removed from the MDFB's balance sheet.

- In 2004, the MDFB loaned approximately $12.8 million to the developer restoring the Old Post Office in St. Louis. The source of the monies loaned were $12.3 million in contributions from the Tax Credit for Contribution Program and $500,000 in other MDFB funds. The terms of the loan included 0.5 percent interest and an additional 0.5 percent interest if the project was able to generate net cash flow for the first 10 years, and 1 percent interest for the remaining 40 year payback period of the loan with principal payments beginning after 10 years. In addition, the MDFB retained ownership of the building and granted a 99-year lease to the developer. However, the terms of the lease also allow the MDFB to terminate the lease after 10 years and take full possession of the building.

The MDFB determined it was not likely the full amount of the loan would be repaid, and as a result, increased the allowance for loan loss and recognized bad debt expense of about $8.35 million during fiscal years 2006 and 2005. In the event the loan is not repaid and the lease is terminated, the MDFB would take possession of the building.

The MDFB indicated it was necessary to make the loans subordinate to other developer debt or the other sources of financing would not have been possible, and the below market terms of the loans were necessary to complete the overall financing of each project. The MDFB also indicated the two loans associated with the Tax Credit for Contribution Program were supported by analysis showing the projects resulted in a positive economic benefit.

As noted above, the Old Post Office loan was entered into in Fiscal year 2004 and the MDFB began recognizing bad debt expense for the loan in the next fiscal year, suggesting the loan approval process was not adequate to ensure funding was available to repay the loan. The MDFB should continue to monitor the outstanding loans in the event unexpected project funds become available that may provide a source for repayment.

WE RECOMMEND the MDFB reevaluate its loan approval process to ensure adequate funding exists for loan repayment, continue to monitor the outstanding loans, and seek repayment if funds become available.

AUDITEE'S RESPONSE

MDFB's loan approval process is comparable to that used by commercial banks in the state. Similarly, MDFB's ongoing evaluation and monitoring procedures are similar to those used by commercial banks. What is not comparable is the loan underwriting criteria. If MDFB were to utilize the underwriting criteria used by private banks it would substantially negate its ability to assist the type of redevelopment projects the state and many local municipalities look to MDFB to facilitate. MDFB will continue to monitor its outstanding loans and will continue to seek repayment if and when funds become available.

5. Board Air Travel

The MDFB paid over $101,000 for chartered air service to fly board members, board counsel, and staff to board meetings during the three years ended June 30, 2006. The MDFB usually holds monthly board meetings throughout the year. Most meetings are held in Jefferson City, with occasional meetings held in other major cities. The board is comprised of nine private citizen members and three ex-officio members. Section 100.265, RSMo, requires members to be reimbursed for reasonable and necessary expenses incurred in the performance of their official duties.

The members of the board live in various locations throughout the state, such as Kansas City, St. Louis, Neosho, and Sikeston as well as Lebanon and Jefferson City. The MDFB provided chartered air service to board members unless those members are located in or near the city in which the meetings are held, or the member refuses those services. Members from the same area were scheduled for the same flight and in some instances those flights involve stops in two or more cities. When meetings are scheduled for cities other than Jefferson City, members from Jefferson City, ex-officio members and MDFB staff may be provided air travel. The MDFB executive director indicated that chartered air service is necessary to minimize the overall time required of board members to conduct board business. The executive director also indicated that use of chartered air service allows some board members to serve who otherwise could not serve if air travel was not provided.

During the three fiscal years ended June 30, 2006, there were 18 board meetings for which chartered air travel was provided. The estimated cost of chartered air service exceeded the cost of mileage reimbursement by over $5,000 per meeting. As a result, the MDFB could have saved about $90,000 (excluding any additional costs due to overnight stay) over the three year period by eliminating chartered air service for board members and staff to attend board meetings.

The MDFB should consider revising its current travel policy to reduce or eliminate the use of chartered air services to transport board members and staff to board meetings.

WE RECOMMEND the MDFB reevaluate the costs and necessity of regularly providing chartered air service for transportation of board members and staff to board meetings.

AUDITEE'S RESPONSE

Balancing the need to hold public meetings with as many members as possible in attendance, the value of having volunteer board members who are leaders in their respective communities attend these meetings, and fiscal responsibility requires ongoing evaluation. MDFB considers all three factors to be important. MDFB will continue to evaluate the costs and benefits of providing chartered air service to facilitate attendance of volunteer board members at its meetings.

HISTORY, ORGANIZATION, AND STATISTICAL INFORMATION

MISSOURI DEVELOPMENT FINANCE BOARD
HISTORY, ORGANIZATION, AND
STATISTICAL INFORMATION

The Missouri Development Finance Board (MDFB) was originally created with the enactment of the Industrial Development Funding Act by the General Assembly in 1982. That board consisted of seven members appointed by the Governor with the advice and consent of the Senate. The members were appointed for four year terms. Along with the adoption of this act, the Economic Development Act was enacted. This act created the Economic Development Commission. The commission consisted of nine members serving six-year terms. The commission was authorized to guarantee up to 90 percent of the value of privately obtained loans up to $1 million and up to 100 percent of revenue bonds issued by eligible local agencies. The commission was also authorized to grant 50 percent tax credits to taxpayers making contributions to its reserve fund.

In 1985, legislation was enacted which merged the commission into the board. Membership of the board was expanded to nine. Subsequent legislation broadened the board’s powers into the areas of export financing and public infrastructure financing with the resultant name change of the board to the Missouri Economic Development, Export and Infrastructure Board.

In 1993, the legislature authorized the board’s third name change to the Missouri Development Finance Board. The directors of the Department of Economic Development and the Department of Agriculture, along with the Lieutenant Governor, were designated as voting members of the board. The addition of these officials increased the board’s membership to twelve. In August 2006, new legislation added the director of the Department of Natural Resources to the board replacing a seat for a private citizen.

The board was created to promote the economic development of the state of Missouri. This is accomplished primarily by the issuance of revenue bonds, direct loans, and tax credits for projects which will benefit the economy or infrastructure of the state and its political subdivisions. The authority and activities of the board are set forth in Sections 100.250 to 100.297, RSMo, the Missouri Development Finance Board Act and Sections 100.700 to 100.850, RSMo, the Missouri Business Use Incentives for Large-Scale Development Act (BUILD).

The MDFB's mission is to assist businesses and public entities in obtaining financing through the issuance of conduit revenue bonds, direct loans, and issuance of tax credits. Since 1988, the board has participated in 73 Tax Credit for Contribution projects and authorized a total of $306.5 million in tax credits. At June 30, 2006, the board had issued conduit revenue bonds for 187 projects with original principal totaling about $2.1 billion, of which about $1.1 billion was outstanding. The conduit bonds are not an obligation of the board nor the State of Missouri. The MDFB currently has 25 active BUILD projects with authorized tax credits of about $101 million.

The MDFB owns and operates a public parking garage near the Kansas City Public Library, one adjacent to the St. Louis Conference Center Hotel, and is building another parking garage in St. Louis adjacent to the Old Post Office Project. In fiscal year 2006, at the request of the Office of Administration, the board issued revenue bonds totaling about $38.9 million to purchase 4 office buildings in the St. Louis area leased to the State of Missouri.

The eight private citizen members of the board are appointed by the Governor with the advice and consent of the Senate. The Lieutenant Governor and the directors of the Departments of Agriculture, Economic Development, and Natural Resources serve as ex-officio members with voting power.

The members of the board at June 30, 2006, were:

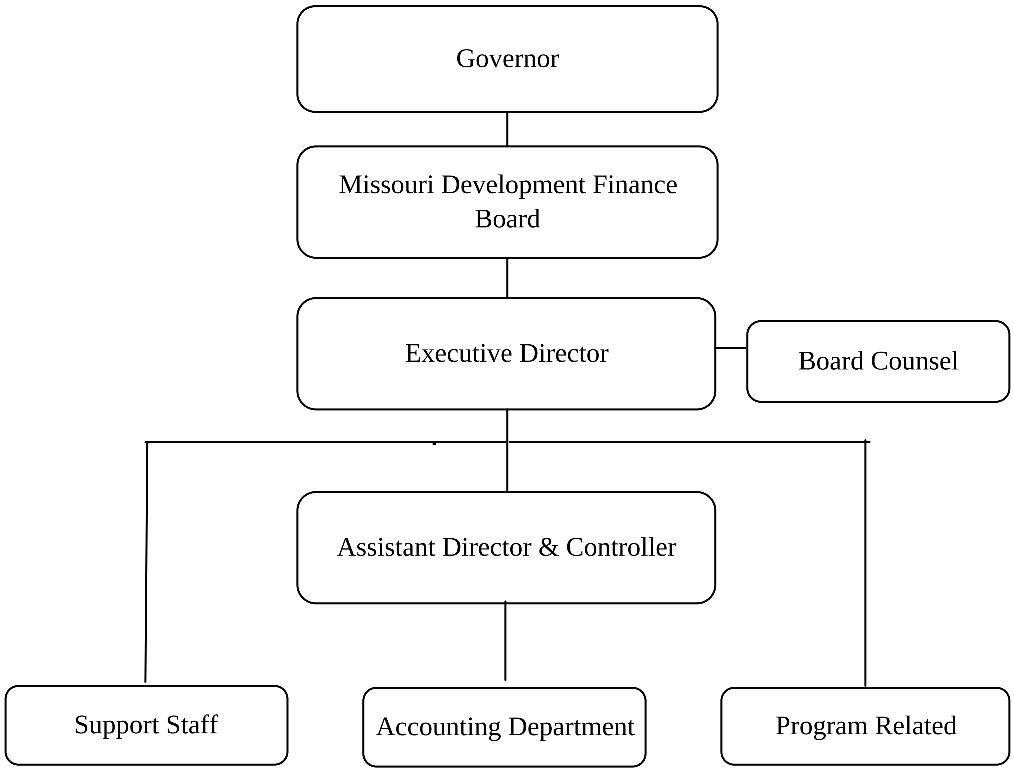
	Term Expires September 14,
Honorable Peter D. Kinder, Lieutenant Governor, Chairman	
John D. Starr, Vice Chairman	2007
Larry D. Neff, Secretary	2006
Nelson C. Grumney, Jr., Treasurer	2008
Paul S. Lindsey *	2003
Elizabeth T. Solberg **	2006
James D. Hill	2007
L. B. Eckelkamp	2007
Richard J. Wilson	2008
Troy L. Wilson ***	2008
Fred Ferrell, Director, Department of Agriculture	
Gregory A. Steinhoff, Director, Department of Economic Development	

* Member continues to serve until a replacement is named
** Replaced by Mary Meek November 13, 2006
*** Resigned July 1, 2006. Replaced by Doyle Childers, Director, Department of Natural Resources

Other private citizens serving on the board during the three years ended June 30, 2006, were James O'Mara, Bill M. Burch, and Susan L. Constance.

The board employs an executive director and six staff to conduct the day to day business of the board. An organization chart of the MDFB follows. The included appendices summarize the MDFB's statement of net assets; revenues, expenses and change in net assets; and cash flows for the three years ended June 30, 2006.

MISSOURI DEVELOPMENT FINANCE BOARD
ORGANIZATION CHART
JUNE 30, 2006



Appendix A

MISSOURI DEVELOPMENT FINANCE BOARD
COMPARATIVE STATEMENT OF NET ASSETS, ALL FUNDS

		June 30,		
		2006	2005	2004
ASSETS				
Current Assets:				
Cash	$	2,404,455	2,518,792	1,208,977
Investments		22,282,492	16,121,353	18,349,454
Current portion of loans and notes receivable		604,191	2,365,559	1,863,850
Accrued interest on investments		283,747	141,635	128,272
Accrued interest on loans and notes receivable		120,878	123,800	103,966
Prepaid expense and other assets		124,170	67,557	108,019
Total current assets		25,819,933	21,338,696	21,762,538
Noncurrent Assets:				
Board designated investment		935,588	881,566	0
Restricted assets		51,243,621	66,342,501	44,263,530
Long-term portions of loans and notes receivable		6,146,868	4,986,948	8,530,207
Bond issuance costs, net of accumulated amortization		5,044	9,032	13,202
Capital assets not being depreciated		25,619,144	19,691,922	13,248,025
Capital assets being depreciated		25,548,446	24,401,866	24,886,651
Total noncurrent assets		109,498,711	116,313,835	90,941,615
Total assets		135,318,644	137,652,531	112,704,153
LIABILITIES				
Current Liabilities:				
Accounts payable and other accrued liabilites		134,502	2,054,408	646,715
Accrued bond interest payable		118,286	71,200	16,300
Total current liabilities		252,788	2,125,608	663,015
Noncurrent Liabilities:				
Long-term debt		31,850,000	34,600,000	18,100,000
Loan guarantee default reserve		0	0	17,960
Payable from restricted assets				
Tax credit for contribution and other deposits		31,865,794	31,438,923	20,697,178
Deferred revenue				15,800,000
Total noncurrent liabilities		63,715,794	66,038,923	54,615,138
Total liabilities		63,968,582	68,164,531	55,278,153
NET ASSETS				
Invested in capital assets, net of related debt		19,317,590	9,493,788	20,034,676
Restricted				
Tax credit and second loss reserve		2,025,001	2,533,002	2,555,000
Project accounts		17,352,825	32,370,576	4,354,733
Board action		0	0	856,619
Unrestricted		32,654,646	25,090,634	29,624,972
Total net assets		71,350,062	69,488,000	57,426,000
Total liabilities and net assets	$	135,318,644	137,652,531	112,704,153

Source: Missouri Development Finance Board Audited Financial Statements

Appendix B

MISSOURI DEVELOPMENT FINANCE BOARD
COMPARATIVE STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS, ALL FUNC

		Year Ended June 30,		
		2006	2005	2004
OPERATING REVENUES				
Participation fees	$	1,080,859	1,098,353	1,373,659
Interest income from loans and notes receivable		325,338	232,851	223,954
Rental income		25,008	25,057	25,008
Contractual income		61,342	60,648	56,934
Other income		119,272	54,010	14,552
Parking garage revenues		2,259,686	1,815,481	1,573,553
Total operating revenues		3,871,505	3,286,400	3,267,660
OPERATING EXPENSES				
Personnel services		623,541	603,068	534,550
Professional fees		56,754	544,589	102,686
Travel		59,265	70,375	35,881
Supplies and other		110,242	222,613	125,957
Depreciation and amortization		743,372	683,016	544,707
Parking garage operating expense		883,789	813,265	568,394
Bad debt expense		3,498,074	9,448,681	0
Miscellaneous		29,752	43,621	21,094
Total operating expenses		6,004,789	12,429,228	1,933,269
Operating income (loss)		(2,133,284)	(9,142,828)	1,334,391
NON-OPERATING REVENUE (EXPENSE)				
Interest on cash and investments		2,129,169	1,241,632	576,685
Bond interest expense		(551,858)	(350,978)	(210,760)
Bond Expense		(181,965)	(199,968)	(249,137)
Total non-operating revenue (expense)		1,395,346	690,686	116,788
Income (loss) before contributed revenue		(737,938)	(8,452,142)	1,451,179
CONTRIBUTED REVENUE		2,600,000	20,514,142	5,799,361
GAIN ON SALE OF ASSET		0	0	24,500
Change in net assets		1,862,062	12,062,000	7,275,040
Total net assets - beginning		69,488,000	57,426,000	50,150,960
Total net assets - ending	$	71,350,062	69,488,000	57,426,000

Source: Missouri Development Finance Board Audited Financial Statements

Appendix C

MISSOURI DEVELOPMENT FINANCE BOARD
COMPARATIVE STATEMENT OF CASH FLOWS, ALL FUNDS

	Year Ended June 30, 2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES			
Receipts from customers and users	$ 4,060,437	3,185,508	6,580,147
Receipts from tax credit projects	17,668,860	24,802,597	18,738,450
Payments to suppliers	(3,143,248)	(1,988,298)	(1,078,228)
Payments to tax credit projects	(16,913,477)	(14,060,852)	(10,023,707)
Payments to employees	(623,541)	(542,420)	(534,550)
Net cash provided (used) by operating activities	1,049,031	11,396,535	13,682,112
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Loans and notes receivable principal payments	2,424,380	897,357	1,087,132
Loans and notes receivable issued	(5,321,006)	(5,716,043)	(1,542,000)
Net cash provided (used) by noncapital financing activities	(2,896,626)	(4,818,686)	(454,868)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Bond principal received	0	16,500,000	0
Bond principal paid	(2,750,000)	0	(3,000,000)
Bond interest paid	(682,146)	(496,048)	(459,897)
Acquisition of land	(2,827)	(1,204,197)	(27,354)
Acquisition of buildings and equipment	(7,745,796)	(5,280,217)	(10,529,849)
Proceeds from sale of assets	0	0	24,500
Contributed revenue	2,600,000	4,714,142	5,799,361
Net cash provided (used) by capital and related financing activities	(8,580,769)	14,233,680	(8,193,239)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of investments	(73,167,926)	(205,914,853)	(118,163,007)
Maturities of investments	117,625,144	197,966,069	111,599,283
Interest on cash and investments	2,027,581	1,174,848	669,145
Net cash provided (used) by investing activities	46,484,799	(6,773,936)	(5,894,579)
Net increase in cash and cash equivalents	36,056,435	14,037,593	(860,574)
Cash and cash equivalents - July 1	27,851,838	13,814,245	14,674,819
Cash and cash equivalents - June 30	$ 63,908,273	27,851,838	13,814,245
Reconciliation of operating income (loss) to net cash provided (used) by operating acitvities			
Operating income (loss)	$ (2,133,284)	(9,142,828)	1,334,391
Adjustments to reconcile operating income (loss) to net cash provided by operating activities			
Depreciation and amortization expenses	743,372	683,016	544,707
Increase (decrease) in allowance for bad debt	3,498,074	9,448,681	0
(Increase) decrease in accrued interest on loans and notes receivable	2,919	(22,284)	(87,251)
(Increase) decrease in prepaid expenses and other assets	(87,530)	52,589	384,989
Increase in deferred revenues	0	0	10,800,000
Increase (decrease) in accounts payable and accrued liabilities	(1,919,904)	(346,424)	181,834
Increase (decrease) in tax credit for contributions deposits	433,396	10,741,745	537,743
Increase (decrease) in debt service charges	508,000	0	0
Increase (decrease) in deferred charges	3,988	0	0
Increase (decrease) in loan guarantee default reserve	0	(17,960)	(14,301)
Total adjustments	3,182,315	20,539,363	12,347,721
Net cash provided (used) by operating activities	1,049,031	11,396,535	13,682,112
Reconciliation of cash and cash equivalents to the statement of net assets			
Cash	2,404,455	2,518,792	1,208,977
Investments	20,736,492	0	0
Less: Portion maturing in 90 days or more	(4,736,738)	0	0
Less: Portions attributable to accrued interest	(14,670)	0	0
Board designated investment	16,780,266	0	0
Restricted assets	35,398,942	67,224,067	44,263,530
Less: restricted investments	0	(41,891,021)	(31,658,262)
Less: Portion maturing in 90 days or more	(6,392,694)	0	0
Less: Protion attributable to accrued interest	(267,780)	0	0
Total cash and cash equivalents	$ 63,908,273	27,851,838	13,814,245

Source: Missouri Development Finance Board Audited Financial Statements

Appendix D

MISSOURI DEVELOPMENT FINANCE BOARD
ACTIVE BUILD PROJECTS AS OF JUNE 30, 2006

Project Name	**Locations**	**Bond Closing**	**BUILD Principal**	**Total BUILD Tax Credits Authorized**	**Project Life**	**Investment**	**Projected Jobs**	**Projected Wage**
Unigroup, Inc., Series 1997	Fenton	August 1997	$ 5,156,000	$ 8,589,639	15	$ 20,230,164	514	$ 27,456
Schreiber Foods, Inc, Series 1998	Mt. Vernon	February 1998	1,753,700	2,855,308	15	16,700,000	157	21,700
Copeland Corporation, Series 1998	Ava, MO	February 1998	513,825	717,634	10	44,833,000	152	17,350
Caterpillar Inc, Series 1998	West Plains	April 1998	489,250	686,020	10	15,000,000	100	24,960
American National Can Co (dba Pechiney Grp), Series 1998	Joplin/Webb City	December 1998	830,000	1,113,439	10	35,000,000	120	31,200
Winghaven/MasterCard Interchange, Series 1999B	St. Charles County	August 1999	8,774,500	11,555,309	10	134,000,000	500	52,000
The Procter & Gamble Paper Products Co, Series 1999	Cape Girardeau	September 1999	6,000,000	8,620,150	10	500,000,000	437	38,839
AMDOCS, Inc, Series 1999	St. Louis	September 1999	1,549,000	2,182,482	10	15,000,000	300	50,000
Quintiles, Inc., Series 1999	Kansas City	October 1999	5,613,300	7,920,175	10	19,000,000	532	56,348
Sara Lee Corporation, Series 1999	St. Joseph	November 1999	625,600	873,657	10	92,480,000	250	20,800
Lockton Companies, Inc, Series 2000	Kansas City	April 2000	2,221,300	3,159,562	10	20,177,901	500	37,678
Northstar Battery Company, LLC, Series 2000	Springfield	December 2000	1,620,000	2,599,239	15	27,000,000	200	30,000
Siegel-Robert, Inc, Series 2001	Farmington	September 2001	1,036,000	1,563,855	15	35,000,000	100	19,670
GKN Aerospace North America, Inc, Series 2001	Hazelwood	December 2001	2,582,500	3,416,574	10	33,000,000	300	49,920
Harley-Davidson Motor Co Group, Inc., Series 2002	Kansas City	February 2002	2,273,000	3,617,068	15	15,000,000	300	37,086
CitiMortgage, Inc., Series 2003	O'Fallon	January 2003	5,290,500	7,744,864	15	84,691,600	1500	27,000
General Mills Operations, Inc., Series 2003	Hannibal	June 2003	1,550,000	2,251,432	15	50,000,000	140	27,040
Systems & Services Technology, Inc, Series 2004	Joplin	October 2004	1,036,000	1,527,997	15	16,562,968	500	28,267
Centocor, Inc, Series 2005	Berkeley	May 2005	1,550,600	2,286,080	15	45,500,000	300	58,240
Triumph Foods, LLC Series 2005	St. Joseph	May 2005	3,820,950	5,641,661	15	155,665,000	1000	26,395
KV Pharmaceutical, Series 2005	St. Louis	November 2005	1,036,000	1,533,976	15	105,000,000	319	66,560
Copeland Corporation II , Series 2005	Lebanon & Ava	November 2005	1,500,000	2,206,757	15	43,000,000	375	22,880
Harman Becker Automotive Systems, Series 2006	Washington	January 2006	1,036,000	1,359,097	10	26,100,000	200	28,080
Cerner Corporation, Series 2006	Kansas City	January 2006	3,160,000	4,655,385	15	30,000,000	400	50,000
H & R Block, Series 2006	Kansas City	February 2006	8,259,000	12,142,152	15	100,000,000	364	70,000
		Total	$ 69,277,025	$ 100,819,512	n/a	$ 1,678,940,633	9,560	n/a
		Average	$ 2,771,081	$ 4,032,780	12.80	$ 67,157,625	382	$ 37,202 (1)

(1) Weighted average wage