

**ENTERPRISE FUND
(AN ENTERPRISE FUND OF THE STATE OF
MARYLAND)**

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

For the Years Ended June 30, 2013 and 2012



SB & COMPANY, LLC
EXPERIENCE • QUALITY • CLIENT SERVICE

JUNE 30, 2013 AND 2012

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Secretary of
Maryland Department of Business and Economic Development

Report on the Financial Statements

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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



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Opinion

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

Other Matters

As discussed in Note 2, the accompanying financial statements present only the transactions of the Enterprise Fund, a fund of the State of Maryland, and are not intended to present fairly the financial position of the State of Maryland as of June 30, 2013 and 2012, and the representative changes in its financial position and its cash flows for the years then ended in accordance with accounting principles general accepted in the United States of America.

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

Hunt Valley, Maryland
November 22, 2013

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ENTERPRISE FUND

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

Overview of the Financial Statements and Financial Analysis

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

The report discusses the Statements of Net Position, the Statements of Revenue, Expenses and Changes 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 presents a fiscal snapshot of the Fund's assets, liabilities and net position. This statement uses the accrual basis of accounting, which is similar to generally accepted accounting principles used by most private sector companies.

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

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

Assets	2013	2012	2011
Total Assets	\$ 99,247,529	\$ 102,101,965	\$ 17,710,253
Total Liabilities	-	-	25
Unrestricted Net Position	\$ 99,247,529	\$ 102,101,965	\$ 17,710,228

Total assets decreased by \$2,854,436 during fiscal year 2013, or 3% and increased \$84,391,712 during fiscal year 2012, or 477%. The decrease in assets in 2013 is due to increased operating expenses. The increase in assets in 2012 is due to receipt of cash and receivable of the InvestMaryland funds from the sale of tax credits. Total liabilities remained the same in 2013 and 2012 at a zero balance, and 2011 with a \$25 balance.

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

Statements of Revenue, Expenses and Changes in Net Position

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

- Operating revenue consists of investment income, royalty fees, grant recovery, and other income.
- Operating expenses consist of grants, salaries, and administrative costs.
- Non-operating revenue consists of investment interest income, challenge grant recovery as equity, transfers to the State general fund, State appropriation, and increases or decreases in the fair value of investments.

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating Revenue	\$ 406,402	\$ 220,613	\$ 544,921
Operating Expenses	<u>2,194,954</u>	<u>991,469</u>	<u>750,854</u>
Net Operation Loss	(1,788,552)	(770,856)	(205,933)
Net Non-Operating Revenue/ Expenses and Transfer	<u>(1,065,884)</u>	<u>85,162,593</u>	<u>(1,861,872)</u>
Changes in net position	(2,854,436)	84,391,737	(2,067,805)
Unrestricted net position, beginning of year	<u>102,101,965</u>	<u>17,710,228</u>	<u>19,778,033</u>
Total Net Position, End of Year	<u><u>\$ 99,247,529</u></u>	<u><u>\$ 102,101,965</u></u>	<u><u>\$ 17,710,228</u></u>

Operating revenues increased 84% from \$220,613 in fiscal year 2012 to \$406,402 in fiscal year 2013. An overall increase in interest income and royalty income, accounted for the increase in revenue. Operating expenses increased from \$991,469 in fiscal year 2012 to \$2,194,954 in 2013, an increase of 121%. An increase in direct expenses due to increases in grant expenditures, allocated administrative expenses and the loan loss provision. The resulting operating loss increased from \$770,856 in fiscal year 2012 to \$1,788,552 in fiscal year 2013, or by 132% as a result of the increase in operating expenses. Net non-operating revenues/expenses and transfer decreased from \$85,162,593 in fiscal year 2012 to negative \$1,065,884, the significant change reflecting the sales of tax credits in 2012 and the transfer of funds to support the Department. The change in net position totaled \$84,391,737 in fiscal year 2012 versus (\$2,854,436) in fiscal year 2013. The majority of the change in net position is due to the receipt of \$84,000,000 from the sale of tax credits in 2012. Total net position decreased from \$102,101,965 in fiscal year 2012 to \$99,247,529 in fiscal year 2013, a decrease of 3%.

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

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

Operating revenues decreased from \$544,921 in fiscal year 2011 to \$220,613 in fiscal year 2012, or 60%. An overall decrease in royalty income, grant recovery and other income accounted for the decrease in revenue. Operating expenses increased from \$750,854 in fiscal year 2011 to \$991,469 in fiscal year 2012, an increase of 32%. An increase in direct expenses due to fees paid to consultants for InvestMaryland was the primary causes for the increase from 2011 to 2012. The resulting operating loss increased from \$205,933 in fiscal year 2011 to \$770,856 in fiscal year 2012, or by 274% as a result of the decrease in loan recoveries and the increase in grant expenses. Net non-operating revenues/expenses and transfer decreased from \$(1,861,872) in fiscal year 2011 to \$85,162,593 in 2012, this is primarily due from the sale of tax credits in fiscal year 2012. The change in net position totaled (\$2,067,805) in fiscal year 2011 versus \$84,391,737 in fiscal year 2012. The majority of the change in net position is due to the receipt of \$84,000,000 from the sale of tax credits in fiscal year 2012. Total net position increased from \$17,710,228 in fiscal year 2011 to \$102,101,965 in fiscal year 2012, an increase of 477%.

Statements of Cash Flows

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

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

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Net Cash Flows from Operating Activities	\$ (4,082,352)	\$ (2,012,283)	\$ (699,691)
Net Cash Flows Noncapital Financing Activities	26,778,540	28,502,500	(15,422)
Net Cash Flows from Investing Activities	<u>(4,404,881)</u>	<u>1,401,025</u>	<u>(808,615)</u>
Net increase(decrease) in cash	18,291,307	27,891,242	(1,523,728)
Cash, beginning of year	<u>31,526,261</u>	<u>3,635,019</u>	<u>5,158,747</u>
Cash, End of Year	<u>\$ 49,817,568</u>	<u>\$ 31,526,261</u>	<u>\$ 3,635,019</u>

Net cash flows from operating activities significantly decreased from fiscal year 2012 to fiscal year 2013 as the result of the increase in staff to support InvestMaryland and setup cost for the InvestMaryland program including consulting fees paid to execute the tax credit auction and the selection of venture funds to receive investments from the InvestMaryland program.

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

Statements of Cash Flows (continued)

Proceeds from the sale of investments were \$1,526,697, up from \$1,031,487 in fiscal year 2012. In addition, purchase of investments in fiscal year 2013 totaled \$7,888,094, up \$6,913,364 from fiscal year 2012 purchases of \$974,730, which had resulted in positive cash flow from investing activities.

Net cash flows from operating activities significantly increased from fiscal year 2011 to fiscal year 2012 as the result of the setup cost for the InvestMaryland program including consulting fees paid to execute the tax credit auction and the selection of venture funds to receive investments from the InvestMaryland program. Proceeds from the sale of investments were \$1,031,485, up from \$64,408 in fiscal year 2011. In addition, purchase of investments in fiscal year 2012 totaled \$974,730, down \$201,089 from fiscal year 2011 purchases of \$1,175,819, which had resulted in positive cash flow from investing activities.

Economic Outlook

During FY 2013, the Fund closed twenty-two (22) transactions of which fifteen (15) InvestMaryland investments for \$5,918,789; four (4) State Small Business Credit Initiative (SSBCI) for \$1,950,000; two (2) Enterprise investments for \$640,000 and one (1) conversion of a Challenge investment into an Enterprise investment. During fiscal year 2013, the Fund received \$3,182,844 in distributions and the 2nd tranche of \$28,000,000 from the sale of premium tax credits.

Lastly, during fiscal year 2013 the Fund substantially increased its staff capacity with the addition of four investment professionals including a Managing Director of Equity Funds, two Principals, and an Investment Analyst.

As a result of the influx of capital from the InvestMaryland Program and the SSBCI Program, fiscal year 2014 will see catalytic changes in how the Fund operates. The Governor's InvestMaryland Initiative resulted in a total of \$84 million being infused into the Fund over a three-year period. The Fund is charged with executing on investment of \$54 million of the InvestMaryland dollars into other venture funds that in turn will invest that amount in Maryland. In addition, the Fund will provide post-investment oversight of the venture fund investments. It is anticipated that all of the \$54 million will be committed by the end of the 2013 calendar year. Investment returns will occur over the succeeding years and are required to be paid over the State's general fund.

The Fund is also responsible for directly investing \$21.7 million of the InvestMaryland funds (which will be received over a three-year period). The Fund's pool of funds for direct investment was further augmented by monies received from the U.S. Treasury's SSBCI program and by an influx of proceeds from the sales of the Fund's portfolio. As a result, the total available for direct investment is approximately \$40 million. We expect to deploy those funds (invested and encumbered reserves for follow-ons) over the next three fiscal years.

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

Economic Outlook (continued)

Investment returns on InvestMaryland direct investments will occur over the succeeding years and are available to be re-invested by the Fund into new investments.

The Fund's portfolio maintenance requirements have continued to grow as the number of portfolio of companies has steadily increased. Additionally, historically the program has considered over 250 companies annually for CIP or EIF funding.

With respect to current Venture Capital Limited Partnership (VCLP) investments in the Fund's portfolio, it is anticipated that the VCLP investments made before fiscal year 2000 are close to the end of their expected lives and, accordingly, a declining number of distributions of stock/cash to the limited partners, including DBED, are expected. Over the past few years, the market for initial public offerings has halted. Unsteady real estate markets and inflationary pressures due to rising energy and commodity prices put a damper on the overall financial markets. However, the merger and acquisition market will continue to provide the best opportunity for liquidation. Our expectation is that there may be a few exits over the next 24 months.

ENTERPRISE FUND

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

	<u>2013</u>	<u>2012</u>
ASSETS		
Current Assets		
Cash	\$ 49,817,568	\$ 31,526,261
Interest receivable	47,584	229
Promissory note receivable, net of allowance for loan loss reserve of \$15,830 and \$14,000, respectively	116,910	26,976
Due from Invest Maryland insurance receivable, net	<u>28,000,000</u>	<u>56,000,000</u>
Total Current Assets	<u>77,982,062</u>	<u>87,553,466</u>
Non-Current Assets		
Investment	18,066,831	12,806,373
Promissory note receivable, net of current portion and allowance for loan loss reserve of \$179,536 and \$21,553 respectively	3,198,636	1,742,126
Total Non-Current Assets	<u>21,265,467</u>	<u>14,548,499</u>
Total Assets	<u>99,247,529</u>	<u>102,101,965</u>
Total Net Position	<u>\$ 99,247,529</u>	<u>\$ 102,101,965</u>

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

ENTERPRISE FUND

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

	<u>2013</u>	<u>2012</u>
Operating Revenue		
Royalty fees	\$ 178,884	\$ 1,589
Grant recovery and loan recovery	72,207	179,331
Interest on promissory note	94,534	2,192
Other income	60,777	37,501
Total Operating Revenue	<u>406,402</u>	<u>220,613</u>
Operating Expenses		
Grant disbursements	150,000	(400,000)
Direct expenses	252,534	498,270
Administrative expenses	849,197	712,334
Allocation of salaries and fringe benefits	583,413	145,311
Loan loss expenses	359,810	35,554
Total Operating Expenses	<u>2,194,954</u>	<u>991,469</u>
Net Operating Loss	<u>(1,788,552)</u>	<u>(770,856)</u>
Non-Operating Revenue and Expenses		
Treasury interest allocation	300,369	37,982
Gain on sale of investment	-	1,031,487
Realized loss on disposal of investments	-	(1,138,436)
(Decreases) increases in fair value of investments, net	(144,792)	729,060
Net Non-Operating Revenue (Expenses)	<u>155,577</u>	<u>660,093</u>
Income Before Transfer	<u>(1,632,975)</u>	<u>(110,763)</u>
Inter-program transfer	-	(2,497,500)
Federal grant revenue	1,066,257	3,000,000
Invest Maryland tax credit insurance revenue	-	84,000,000
Transfer to MSBDFEA EPIP sub-program	(2,287,718)	-
Total Transfer	<u>(1,221,461)</u>	<u>84,502,500</u>
Change in net position	(2,854,436)	84,391,737
Unrestricted net position, beginning of year	102,101,965	17,710,228
Total Net Position, End of Year	<u>\$ 99,247,529</u>	<u>\$ 102,101,965</u>

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

ENTERPRISE FUND

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

	<u>2013</u>	<u>2012</u>
Cash Flows from Operating Activities		
Grant recoveries and loan recovery	\$ 72,207	\$ 179,331
Royalty fees	178,884	1,589
Interest income on promissory note/loan receivable	47,178	4,194
Promissory note principal repayments	121,446	71,043
Other receipts - Miscellaneous income	33,077	37,500
Grant	(300,000)	-
Loan Disbursement	(2,550,000)	(950,000)
Direct expenses	(252,534)	(498,270)
Administrative expenses	(849,197)	(712,359)
Salaries and fringe benefits	(583,413)	(145,311)
Net Cash Flows from Operating activities	<u>(4,082,352)</u>	<u>(2,012,283)</u>
Cash Flow from Noncapital Financing Activities		
Transfer from investMD and Federal	26,778,540	28,502,500
Net Cash Flows Noncapital Financing Activities	<u>26,778,540</u>	<u>28,502,500</u>
Cash Flows from Investing Activities		
Purchase of investments	(7,888,094)	(974,730)
Return of investment	1,656,147	1,306,288
Proceeds from sale of investments	1,526,697	1,031,485
Interest allocation from treasury	300,369	37,982
Net Cash Flows from Investing Activities	<u>(4,404,881)</u>	<u>1,401,025</u>
Net increase in cash	18,291,307	27,891,242
Cash, beginning of year	31,526,261	3,635,019
Cash, End of Year	<u>\$ 49,817,568</u>	<u>\$ 31,526,261</u>
Supplemental Disclosure for Non-cash Transactions		
Investment converted to loan receivable	-	500,000
Reconciliation of Operating Loss to Net Cash from Operating Activities		
Operating (loss)	\$ (1,788,552)	\$ (770,857)
Loan loss expenses	359,810	35,554
Capitalized interest	(27,701)	-
Effect of changes in assets and liabilities:		
Loan receivables	(2,428,554)	(878,957)
Interest receivable	(47,355)	2,002
Account payable	-	(25)
Challenge investment converted to Enterprise Investment	(150,000)	(400,000)
Net Cash from Operating Activities	<u>\$ (4,082,352)</u>	<u>\$ (2,012,283)</u>

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

ENTERPRISE FUND

Notes to the Financial Statements June 30, 2013 and 2012

1. ORGANIZATION

Authorizing Legislation

The Enterprise Fund (the Fund) is codified in the Economic Development Article, Sections 5-601 through 5-603 of the Annotated Code of Maryland. The Fund was formed in July 1993 and is administered by the Maryland Department of Business and Economic Development (the Department).

The Fund invests primarily in emerging high-tech businesses. These businesses do not have a proven history of profitability. As such, the future financial condition and operating results of the businesses are uncertain, and the market value of the Fund's investments could be significantly affected.

The Economic Development Article, Sections 5-601 through 5-603 allows for investment in a particular company for up to fifteen years; therefore, from time to time the Fund's management evaluates the operating performance of the portfolio companies and makes adjustments to the fair value of those companies. While the future financial condition and corresponding operating result may be uncertain, the Fund's demonstrated intent is to invest in emerging high technology companies and start-up ventures for a sustained period of time.

Description of the Enterprise Investment Capability

The Enterprise Investment Capability is an investment-financing tool, which enables the Fund to make direct equity investments, primarily in emerging high-technology businesses either located in or relocating to the State of Maryland. Investments, generally ranging between \$150,000 and \$500,000, may be in the form of equity, convertible debt, or limited partnership interests. There are no limitations on investments in small business investment companies under State law. The Fund is also authorized to make grants.

Description of the Challenge Investment Capability

The Challenge Investment Capability offers financial assistance through grants up to \$150,000, with an initial investment of \$50,000, for eligible small start-up companies to cover a portion of the initial costs associated with bringing new products to market. Additional investments beyond the initial \$50,000 are made based upon performance and specific milestone achievements. Applicants are limited to high-technology companies with its principal place of business in Maryland.

ENTERPRISE FUND

Notes to the Financial Statements June 30, 2013 and 2012

1. ORGANIZATION (continued)

Description of InvestMaryland Program

The InvestMaryland program was passed by the general assembly in FY2011 to provide a significant source of funding to make venture capital investments into emerging high tech companies through investments directly into venture capital funds and into the State's existing venture investment programs (1) the Enterprise Fund (Maryland Venture Fund) and (2) MSBDFA's EPIP (Equity Participation Investment Programs). These public programs enable the State to make investments into early stage technology companies where there is a significant lack of private capital being deployed.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

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

Basis of Presentation

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

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

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Notes to the Financial Statements June 30, 2013 and 2012

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of Estimates

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

Relationship with the Department

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

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

Investments

Investments of the Fund are included in the statements of net position at fair value as determined by the management of the Fund. For investments that are not publicly traded, fair values are determined by management after consideration of, among other factors, the financial condition, operating results significant recent events and other security offerings of the investors. For publicly traded investments, fair values are determined by quoted market price for publicly traded companies at the last reported sale price.

3. CASH

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

ENTERPRISE FUND

Notes to the Financial Statements June 30, 2013 and 2012

3. CASH (continued)

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

Concentration of Credit Risk

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

Custodial Credit Risk-Deposits

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

ENTERPRISE FUND

Notes to the Financial Statements June 30, 2013 and 2012

4. NOTES RECEIVABLE

Notes receivable are recorded at cost, net of an allowance for loan losses. Those portions of notes that are due within one year of June 30, 2013 and 2012, are classified as current assets with those portions due beyond one year being classified as non-current assets.

All of the Fund's notes are subject to review for impairment as part of management's internal asset review process. A loan is considered impaired when, based on current information and events, the borrower is deemed unable to repay the outstanding amount of the obligation under the loan. When a loan is determined to be impaired, a valuation allowance is established based upon the difference between the outstanding amount due under the loan and the amount considered recoverable given the existing financial condition of the borrower and the underlying collateral. Subsequent collections of cash may be applied as a reduction to the principal balance or recorded as income, depending upon management's assessment of the ultimate collectability of the loan. Interest income on impaired loans is recognized only to the extent that cash payments are received.

An allowance for loan losses is maintained at an amount that management considers adequate to cover foreseeable loan losses. The allowance is based upon a number of factors, including economic/industry trends and historical loss experience. The allowance is comprised of specific valuation allowances on impaired loans as well as general valuation allowance, if considered necessary. Management believes that the current valuation allowance is adequate given the current risk level of the portfolio; however, future changes in economic conditions and other factors may lead to future increases in the allowance.

As of June 30, 2013 and 2012, there were notes receivable, net of allowances, in the amounts of \$3,315,546, and \$1,769,102, respectively.

5. INVESTMENTS

As of June 30, 2013 and 2012, the Fund owned the following equity and debt securities and limited partnership interests:

<u>As of June 30,</u>	<u>Cost</u>	<u>Fair Value</u>
2013	\$ 47,812,370	\$ 18,066,831
2012	42,058,675	12,806,373

Investments are stated at fair value that is based upon either the quoted market price for publicly traded companies or management's estimate for non-publicly traded companies.

ENTERPRISE FUND

Notes to the Financial Statements June 30, 2013 and 2012

5. INVESTMENTS (continued)

The change in investments values for the years ended June 30, 2013 and 2012, is as follows:

	<u>2013</u>	<u>2012</u>
Balance beginning year	\$ 12,806,373	\$ 13,047,305
Realized loss	-	(1,138,434)
Return on investments	(1,656,147)	(1,306,288)
Purchases of investments	7,888,094	974,730
Loan converted to investment	700,000	500,000
Unrealized (loss) gain on investments	(1,671,489)	729,060
Balance, End of Year	<u>\$ 18,066,831</u>	<u>\$ 12,806,373</u>

The calculation of realized gains and losses is independent of the calculation of the net decrease in the fair value investments.

6. CHALLENGE GRANTS

The Fund, under the Challenge Investment Capability, disburses grants generally up to \$150,000 to eligible small start-up technology companies. The grant agreement may, under certain circumstances, allow the Fund to receive royalty payments or to receive shares in the recipient. Due to the high risk involved in the success of these start-ups, (these disbursements are expensed unless there is share ownership that can be valued). As of June 30, 2013 the Fund had \$7,560,000 of such disbursements expensed since inception.

7. COMMITMENTS

As of June 30, 2013 and 2012, the Fund had \$24,044,782 and \$1,589,897 in outstanding investment commitments, respectively.

8. PENSION AND OTHER POSTEMPLOYMENT BENEFITS

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