



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

– Article IV, Section 53 of the Michigan Constitution

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Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit
Including the Provisions of the Single Audit Act

Report Number:
271-0400-09

Michigan Strategic Fund
(A Discretely Presented Component Unit of the State of Michigan)
October 1, 2006 through September 30, 2008

Released:
May 2009

A Single Audit is designed to meet the needs of all financial report users, including an entity's federal grantor agencies. The audit determines if the financial schedules and/or financial statements are fairly presented; considers internal control over financial reporting and internal control over federal program compliance; determines compliance with requirements material to the financial schedules and/or financial statements; and assesses compliance with direct and material requirements of the major federal programs.

Financial Statements:

Auditor's Report Issued

We issued an unqualified opinion on the Michigan Strategic Fund's (MSF's) financial statements.

~ ~ ~ ~ ~

Internal Control Over Financial Reporting

We identified significant deficiencies in internal control over financial reporting (Findings 1 through 3). We do not consider these significant deficiencies to be material weaknesses.

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**Noncompliance and Other Matters
Material to the Financial Statements**

We did not identify any instances of noncompliance or other matters applicable to the financial statements that are required to be reported under *Government Auditing Standards*.

~ ~ ~ ~ ~

Federal Awards:

Auditor's Reports Issued on Compliance

We audited one program as a major program and issued an unqualified opinion. MSF expended a total of \$88.0 million in federal awards during the two-year period ended September 30, 2008. The federal program audited as a major program is identified on the back of this summary.

~ ~ ~ ~ ~

Internal Control Over Major Programs

We identified a significant deficiency in internal control over federal program compliance (Finding 4). We do not consider this significant deficiency to be a material weakness.

~ ~ ~ ~ ~

Required Reporting of Noncompliance

We identified an instance of noncompliance that is required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133 (Finding 4).

~ ~ ~ ~ ~

We audited the following program as a major program:

| <u><i>CFDA Number</i></u> | <u><i>Program Title</i></u> | <u><i>Compliance Opinion</i></u> |
|---------------------------|---|----------------------------------|
| 14.228 | Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii | Unqualified |

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: <http://audgen.michigan.gov>



Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General



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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

May 1, 2009

Mr. D. Gregory Main
President, Michigan Strategic Fund
Chair, Michigan Strategic Fund Board of Directors
300 North Washington Square
Lansing, Michigan

Dear Mr. Main:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Michigan Strategic Fund (MSF), a discretely presented component unit of the State of Michigan, for the period October 1, 2006 through September 30, 2008.

This report contains our report summary, our independent auditor's report on the financial statements, the MSF management's discussion and analysis, the MSF basic financial statements, required supplementary information, and the schedule of expenditures of federal awards. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters, our independent auditor's report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133, and our schedule of findings and questioned costs. In addition, the report contains MSF's summary schedule of prior audit findings, its corrective action plan, and a glossary of acronyms and terms.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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INDEPENDENT AUDITOR'S REPORT



STATE OF MICHIGAN
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Statements

Mr. D. Gregory Main
President, Michigan Strategic Fund
Chair, Michigan Strategic Fund Board of Directors
300 North Washington Square
Lansing, Michigan

Dear Mr. Main:

We have audited the accompanying financial statements of the Michigan Strategic Fund, a discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2008 and September 30, 2007, as identified in the table of contents. These financial statements are the responsibility of the Michigan Strategic Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements present only the Michigan Strategic Fund and do not purport to, and do not, present fairly the financial position of the State of Michigan or its component units as of September 30, 2008 and September 30, 2007 and the changes in financial position thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Michigan Strategic Fund as of September 30, 2008 and September 30, 2007 and the changes in financial position for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 21, 2009 on our consideration of the Michigan Strategic Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 13 through 18 and the budgetary comparison schedule and budget-to-GAAP reconciliation and corresponding notes on pages 42 through 48 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it. The management's discussion and analysis for the comparison between the fiscal years ended September 30, 2007 and September 30, 2006 was not presented because this information was presented with the Michigan Strategic Fund's prior year audited financial statements.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the Michigan Strategic Fund's financial statements referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

AUDITOR GENERAL

April 21, 2009

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Michigan Strategic Fund (MSF) management has prepared this discussion and analysis of the financial performance of MSF for the period October 1, 2007 through September 30, 2008. Act 270, P.A. 1984, created MSF. Executive Order No. 1999-1, effective April 5, 1999, transferred MSF to the Department of Management and Budget as an autonomous agency, governed by a Board of Directors. Executive Order No. 2003-18, effective December 7, 2003, transferred MSF as an autonomous agency to the Department of Energy, Labor & Economic Growth (DELEG). Effective November 21, 2005, Act 225, P.A. 2005, transferred MSF as an autonomous agency from DELEG to the Department of Treasury. MSF is a discretely presented component unit of the financial reporting entity of the State of Michigan. MSF's management is responsible for the basic financial statements, required supplementary information, supplemental financial schedule, and this discussion.

Using the Financial Report

This financial report is prepared in accordance with Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*.

The reporting standards require a statement of net assets; a statement of activities; a fund balance sheet; and a statement of revenues, expenditures, and changes in fund balance. The financial statements are interrelated and represent the financial status of MSF.

This financial report includes the reports of independent auditors, management's discussion and analysis, the basic financial statements, required supplementary information, and a supplemental financial schedule.

Major Changes

1. Effective March 2008, the State of Michigan settled a tribal gaming lawsuit that resulted in MSF recognizing \$26.9 million in tribal gaming revenue during fiscal year 2006-07. As part of the settlement, the State of Michigan amended its terms with American Indian tribes operating casinos under the 1998 compact. Under the amended compact, all tribes with existing casinos will contribute 6% of their net win from electronic gaming to MSF. The new terms also allow tribes to adjust future payments up or down based on three-year averages as well as opening of new casinos in their regions. The State also agreed to extend the tribes' right to operate casinos through October 2028. In return for this rate adjustment and time

extension, the tribes have agreed to changes in the revenue sharing terms that will make these payments much more stable in the future. Under the new compact:

- The Michigan Lottery and other similar activities by the State will not be treated as new commercial gaming unless they involve large scale use of electronic games.
- Gaming exclusivity will not be Statewide but will be a limited regional market as defined in each compact.

In addition, a new casino (Four Winds Casino: Pokagon - New Buffalo) made a payment of \$18.6 million under the amended compact for fiscal year 2007-08.

2. During fiscal year 2007-08, MSF issued limited obligation revenue bonds Series 2008 A and 2008 B for \$79,780,000 to acquire ownership in the Michigan House of Representatives facilities. The bonds are secured by and payable from rental payments from the Michigan House of Representatives under the lease and funds pledged under the indenture. The lease payments are contingent upon annual appropriations by the State of Michigan, and neither the full faith and credit nor the taxing power of the State are pledged to the rentals coming due under the lease.
3. The Legislature appropriated \$394.0 million (subsequently reduced to \$343.0 million) in fiscal year 2005-06 and \$125.0 million in fiscal year 2007-08 to MSF for the purpose of diversifying Michigan's economy and creating jobs in competitive edge technologies. These appropriations are financed from the tobacco securitization settlement funds retained in the 21st Century Jobs Trust Fund at the Department of Treasury. Act 225, P.A. 2005, requires the MSF Board of Directors to oversee the programs. MSF requested reimbursement for \$90.2 million for expenditures, loans, and investments during fiscal year 2007-08 from the carry-forward of the remaining fiscal year 2005-06 appropriations.

Analysis of Financial Activities

The assets of MSF exceeded its liabilities by \$110.5 million at September 30, 2008 and by \$87.8 million at September 30, 2007. Total net assets increased by \$22.7 million during fiscal year 2007-08.

Condensed Financial Information

Statement of Net Assets

As of September 30

| | 2008 | 2007 |
|-------------------------------------|----------------|----------------|
| Cash and equity in common cash | \$ 22,405,295 | \$ 23,266,305 |
| Amounts due from federal government | 13,942,736 | 17,695,136 |
| Other current assets | 30,675,082 | 27,872,555 |
| Total current assets | \$ 67,023,115 | \$ 68,833,996 |
| Noncurrent assets | 185,945,861 | 72,481,417 |
| Total assets | \$ 252,968,976 | \$ 141,315,413 |
| Current liabilities | \$ 55,687,732 | \$ 48,786,897 |
| Long-term liabilities | 86,763,792 | 4,737,109 |
| Total liabilities | \$ 142,451,525 | \$ 53,524,006 |
| Net assets | \$ 110,517,451 | \$ 87,791,407 |

Amounts due from federal government primarily consist of receivables for federal pass-through funds for the Community Development Block Grants (CDBG) Program to subrecipients*. These receivables vary from year to year and are dependent on the project activity of the subrecipients. This line item decreased by \$3.8 million during fiscal year 2007-08.

Other current assets primarily consist of short-term loans receivable and accounts receivable for the tribal gaming revenue settlement. Short-term loans receivable increased by \$0.9 million because of long-term loan payments due within a year. The tribal gaming receivable increased by \$1.1 million as a result of the tribal settlements as described under "Major Changes."

* See glossary at end of report for definition.

Noncurrent assets include the Capital Access Program, capital lease receivable, loans receivable, interest receivable, and investments. The total increase in noncurrent assets of \$113.5 million primarily relates to a new capital lease receivable of \$84.0 million and loans receivable of \$4.1 million, interest receivable of \$4.9 million, and additional investments of \$20.4 million in the Jobs for Michigan Investment Fund.

Current liabilities primarily consist of accounts payable, amounts due to component units, and interest payable related to the limited obligation revenue bonds as described under "Major Changes." Total current liabilities increased by \$6.9 million during fiscal year 2007-08. This change was primarily related to interest payable on the limited obligation revenue bonds of \$2.2 million and an increase in accounts payable for the Jobs for Michigan Investment Fund of \$4.7 million.

Long-term liabilities primarily consist of bonds payable and the reserves for the Capital Access Program. The increase of \$82.0 million is primarily attributable to the issuance of the limited obligation revenue bonds described in "Major Changes."

Condensed Financial Information
Statement of Activities
For the Fiscal Year Ended September 30

| | 2008 | 2007 |
|---|----------------|----------------|
| Expenses | | |
| Community Development Block Grants (CDBG) | \$ 45,320,957 | \$ 43,036,987 |
| Jobs for Michigan Investment Fund | 73,687,968 | 67,147,402 |
| Payments to MEDC | 66,958,093 | 57,893,473 |
| Other | 4,867,248 | 3,489,252 |
| Total program expenses | \$ 190,834,266 | \$ 171,567,114 |
| Program revenues | | |
| Charges for services | \$ 3,120,375 | \$ 2,618,719 |
| Operating grants and contributions | 45,208,208 | 42,838,996 |
| Total program revenues | \$ 48,328,583 | \$ 45,457,715 |
| Net program expenses | \$ 142,505,683 | \$ 126,109,399 |
| General revenues | | |
| Payments from the State of Michigan | \$ 123,174,112 | \$ 125,512,812 |
| Other | 42,057,615 | 30,631,331 |
| Total general revenues | \$ 165,231,727 | \$ 156,144,144 |
| Increase in net assets | \$ 22,726,044 | \$ 30,034,744 |
| Net assets - Beginning | 87,791,407 | 57,756,663 |
| Net assets - Ending | \$ 110,517,451 | \$ 87,791,407 |

CDBG expenses increased by \$2.3 million in fiscal year 2007-08 because of increased project activities.

Jobs for Michigan Investment Fund expenses increased by \$6.5 million in fiscal year 2007-08 primarily because of increases in the Jobs for Michigan Investment Fund operations. The Jobs for Michigan Investment Fund consists of grants for Life Sciences Technology; Advanced Automotive, Manufacturing, and Materials Technology; Alternative Energy Technology; and Homeland Security and Defense Technology and expenses for travel promotion, business marketing, administration, and pass-through payments to the Department of Natural Resources; Department of History, Arts and Libraries; and Department of Agriculture.

Payments to MEDC (Michigan Economic Development Corporation) primarily consist of MSF State appropriations transferred to fund programs administered by MEDC and tribal gaming revenue. The payments to MEDC increased by \$9.1 million in fiscal year 2007-08 primarily because of a supplemental appropriation for the Michigan State University Bioenergy Research Center and increases in tribal gaming revenue transferred to MEDC.

Operating grants and contributions increased by \$2.4 million during fiscal year 2007-08 primarily because of a \$2.3 million increase in CDBG federal pass-through grant expenditures to the subgrantees and a corresponding increase in reimbursed federal revenues to MSF.

Payments from the State of Michigan primarily consist of appropriations from the State General Fund of \$33.0 million and reimbursements from the 21st Century Jobs Trust Fund of \$90.2 million. The revenue from the 21st Century Jobs Trust Fund for grants, loans, investments, and promotion programs in the Jobs for Michigan Investment Fund decreased by \$6.1 million. The revenue from the General Fund increased by \$3.7 million primarily because of a \$3.5 million grant for the Michigan State University Bioenergy Research Center.

Other revenues increased by \$11.4 million during fiscal year 2007-08 primarily because of an increase in tribal gaming revenue of \$3.3 million, an increase in new lease revenue of \$1.9 million (as explained under "Major Changes"), and an increase in revenue related to investments and interest of \$5.5 million.

Other Pertinent Information

From fiscal year 1996-97 through fiscal year 2007-08, MSF disbursed \$39.3 million of CDBG federal funds for Industrial Park Loans/Grants to various local governmental entities. According to the agreement, local governmental entities would need to return the funds to MSF if they did not create a specific number of jobs. As of September 30, 2008, local governmental entities had earned \$19.6 million and repaid \$12.3 million. In the event that no further jobs are created by these local governmental entities, MSF may receive a return of \$7.4 million of federal funds from local government entities in future years. Returned funds are treated as program income and allowed to be redistributed by MSF for allowable CDBG projects. Any returned funds for projects that failed to meet a CDBG program objective are treated as recaptured funds and, in accordance with federal regulation, are returned to the federal grantor to be placed in the State's letter of credit to be used for future grants.

BASIC FINANCIAL STATEMENTS

MICHIGAN STRATEGIC FUND

Statement of Net Assets

As of September 30

| | <u>2008</u> | <u>2007</u> |
|--|-----------------------|-----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash (Note 2) | \$ 2,515,105 | \$ 76,550 |
| Equity in common cash (Note 2) | 19,776,020 | 23,115,791 |
| Capital Access Program - Cash (Note 2) | 114,170 | 73,964 |
| Amounts due from federal government | 13,942,736 | 17,695,136 |
| Amount due from component unit | 29,622 | |
| Loans receivable (Note 3) | 1,866,076 | 918,215 |
| Capital lease receivable (Note 4) | 309,973 | |
| Other current assets | <u>28,469,411</u> | <u>26,954,340</u> |
| Total current assets | <u>\$ 67,023,115</u> | <u>\$ 68,833,996</u> |
| Noncurrent assets: | | |
| Capital Access Program (Note 2) | \$ 5,588,589 | \$ 5,530,299 |
| Capital lease receivable (Note 4) | 83,980,950 | |
| Loans receivable (Note 3) | 58,387,654 | 54,300,700 |
| Interest receivable (Note 3) | 4,922,302 | |
| Investments (Note 2) | <u>33,066,366</u> | <u>12,650,418</u> |
| Total noncurrent assets | <u>\$ 185,945,861</u> | <u>\$ 72,481,417</u> |
| Total assets | <u>\$ 252,968,976</u> | <u>\$ 141,315,413</u> |
| LIABILITIES | | |
| Current liabilities: | | |
| Accounts payable and other liabilities | \$ 23,765,307 | \$ 20,613,062 |
| Amounts due to component units | 27,730,013 | 26,880,000 |
| Capital Access Program (Note 5) | 1,500,000 | 1,000,000 |
| Compensated absences (Note 5) | 154,751 | 198,461 |
| Amounts due to primary government | 25,026 | 6,713 |
| Interest payable | 2,222,687 | |
| Bonds payable (Note 7) | 218,841 | |
| Deferred revenue | <u>71,108</u> | <u>88,661</u> |
| Total current liabilities | <u>\$ 55,687,732</u> | <u>\$ 48,786,897</u> |
| Long-term liabilities: | | |
| Bonds payable (Note 7) | \$ 82,552,055 | \$ |
| Capital Access Program (Note 5) | 4,088,589 | 4,530,299 |
| Compensated absences (Note 5) | <u>123,148</u> | <u>206,810</u> |
| Total long-term liabilities | <u>\$ 86,763,792</u> | <u>\$ 4,737,109</u> |
| Total liabilities | <u>\$ 142,451,525</u> | <u>\$ 53,524,006</u> |
| NET ASSETS | | |
| Unrestricted net assets | <u>\$ 110,517,451</u> | <u>\$ 87,791,407</u> |
| Total net assets | <u>\$ 110,517,451</u> | <u>\$ 87,791,407</u> |

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

MICHIGAN STRATEGIC FUND
Statement of Activities
For the Fiscal Year Ended September 30

| | 2008 | 2007 |
|--|----------------|----------------|
| EXPENSES (Note 1) | | |
| Administrative | \$ 597,600 | \$ 662,050 |
| Community Development Block Grants | 45,320,957 | 43,036,987 |
| Michigan Film Office | 273,548 | |
| Jobs for Michigan Investment Fund - Operations | 29,518,914 | 21,940,880 |
| Jobs for Michigan Investment Fund - Pass-through funds | 6,852,150 | 5,311,426 |
| Jobs for Michigan Investment Fund - Programs | 37,316,904 | 39,895,096 |
| Payments to MEDC | 66,958,093 | 57,893,473 |
| Payments to General Fund (indirect and refund) | 228,626 | 277,537 |
| Other interest | 2,113,877 | |
| Miscellaneous and receivable write-off | 1,653,597 | 2,549,665 |
| Total program expenses | \$ 190,834,266 | \$ 171,567,114 |
| PROGRAM REVENUES (Note 1) | | |
| <u>Charges for services</u> | | |
| IDRB issuance fees | \$ 916,409 | \$ 657,683 |
| Other fees | 2,203,966 | 1,961,036 |
| <u>Operating grants and contributions</u> | | |
| Community Development Block Grants (federal) | 42,766,390 | 40,776,397 |
| Community Development Block Grants (local and others) | 2,441,818 | 2,062,599 |
| Total program revenues | \$ 48,328,583 | \$ 45,457,715 |
| Net program expenses | \$ 142,505,683 | \$ 126,109,399 |
| GENERAL REVENUES (Note 1) | | |
| <u>Payments from the State of Michigan</u> | | |
| Payments from General Fund | \$ 32,962,448 | \$ 29,249,923 |
| Payments from 21st Century Trust Fund | 90,211,664 | 96,262,889 |
| <u>Other</u> | | |
| Payments from MEDC - Other | 27,275 | 183,359 |
| Interest and investment earnings | 8,461,685 | 791,293 |
| Net increase (decrease) in fair value of investments | (2,172,610) | |
| Tribal gaming | 30,186,919 | 26,880,000 |
| Lease revenue | 1,887,129 | |
| Miscellaneous and payable write-off | 3,667,217 | 2,776,679 |
| Total general revenues | \$ 165,231,727 | \$ 156,144,144 |
| Increase in net assets | \$ 22,726,044 | \$ 30,034,744 |
| Net assets - Beginning | 87,791,407 | 57,756,663 |
| Net assets - Ending | \$ 110,517,451 | \$ 87,791,407 |

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

MICHIGAN STRATEGIC FUND
Governmental Fund Balance Sheet
As of September 30

| | 2008 | | | | 2007 |
|---|-----------------------|--------------------------------------|----------------------|-----------------------|-----------------------|
| | General Operations | Jobs for Michigan Investment Fund | Debt Service Fund | Total | |
| ASSETS | | | | | |
| Current assets: | | | | | |
| Cash (Note 2) | \$ 111,210 | | \$ 2,403,895 | \$ 2,515,105 | \$ 76,550 |
| Equity in common cash (Note 2) | | 19,776,019 | | 19,776,019 | 23,115,791 |
| Capital Access Program - Cash (Note 2) | 114,170 | | | 114,170 | 73,964 |
| Amounts due from federal government | 13,942,736 | | | 13,942,736 | 17,695,136 |
| Amounts due from general operations (Note 9) | | 566,557 | | 566,557 | 2,504,633 |
| Amounts due from component unit | 4,017 | 25,605 | | 29,622 | |
| Loans receivable (Note 3) | | 1,866,076 | | 1,866,076 | 918,215 |
| Other current assets | 27,973,927 | 495,484 | | 28,469,411 | 26,954,340 |
| Total current assets | <u>\$ 42,146,061</u> | <u>\$ 22,729,742</u> | <u>\$ 2,403,895</u> | <u>\$ 67,279,698</u> | <u>\$ 71,338,629</u> |
| Noncurrent assets: | | | | | |
| Capital Access Program (Note 2) | \$ 5,588,589 | | | \$ 5,588,589 | \$ 5,530,299 |
| Loans receivable (Note 3) | | 58,387,654 | | 58,387,654 | 54,300,700 |
| Interest receivable (Note 3) | | 4,922,302 | | 4,922,302 | |
| Investments (Note 2) | | 33,066,366 | | 33,066,366 | 12,650,418 |
| Total noncurrent assets | <u>\$ 5,588,589</u> | <u>\$ 96,376,322</u> | <u>\$ 0</u> | <u>\$ 101,964,911</u> | <u>\$ 72,481,417</u> |
| Total assets | <u>\$ 47,734,650</u> | <u>\$ 119,106,063</u> | <u>\$ 2,403,895</u> | <u>\$ 169,244,609</u> | <u>\$ 143,820,046</u> |
| LIABILITIES | | | | | |
| Current liabilities: | | | | | |
| Accounts payable and other liabilities | \$ 13,525,799 | \$ 10,239,508 | | \$ 23,765,307 | \$ 20,613,062 |
| Amounts due to Jobs for Michigan Investment Fund (Note 9) | 566,557 | | | 566,557 | 2,504,633 |
| Amounts due to component units | 21,526,640 | | | 21,526,640 | |
| Capital Access Program (Note 5) | 1,500,000 | | | 1,500,000 | 1,000,000 |
| Amounts due to primary government | 8,788 | 16,238 | | 25,026 | 6,713 |
| Deferred revenue | 6,274,480 | | | 6,274,480 | 26,968,661 |
| Total current liabilities | <u>\$ 43,402,265</u> | <u>\$ 10,255,746</u> | <u>\$ 0</u> | <u>\$ 53,658,011</u> | <u>\$ 51,093,069</u> |
| Long-term liabilities: | | | | | |
| Deferred revenue (Note 3) | \$ 4,088,589 | \$ 4,922,302 | | \$ 4,922,302 | \$ 4,530,299 |
| Capital Access Program (Note 5) | 4,088,589 | | | 4,088,589 | 4,530,299 |
| Total long-term liabilities | <u>\$ 4,088,589</u> | <u>\$ 4,922,302</u> | <u>\$ 0</u> | <u>\$ 9,010,890</u> | <u>\$ 4,530,299</u> |
| Total liabilities | <u>\$ 47,490,854</u> | <u>\$ 15,178,047</u> | <u>\$ 0</u> | <u>\$ 62,668,901</u> | <u>\$ 55,623,368</u> |
| FUND BALANCE | | | | | |
| Reserved fund balance (Note 11) | \$ 243,796 | \$ 98,201,099 | \$ 2,403,895 | \$ 100,604,995 | \$ 79,124,574 |
| Unreserved fund balance | 243,796 | 5,726,917 | | 5,970,713 | 9,072,105 |
| Total fund balance | <u>\$ 243,796</u> | <u>\$ 103,928,016</u> | <u>\$ 2,403,895</u> | <u>\$ 106,575,707</u> | <u>\$ 88,196,678</u> |
| Total liabilities and fund balance | <u>\$ 47,734,650</u> | <u>\$ 119,106,063</u> | <u>\$ 2,403,895</u> | <u>\$ 169,244,609</u> | <u>\$ 143,820,046</u> |

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

MICHIGAN STRATEGIC FUND

Reconciliation of the Governmental Fund Balance Sheet
to the Statement of Net Assets
As of September 30

| | <u>2008</u> | <u>2007</u> |
|---|-----------------------|-----------------------------|
| Total fund balance | \$ 106,575,707 | \$ 88,196,678 |
| Amounts reported for governmental activities in the statement of net assets are different because: | | |
| Capital lease receivable is not available to pay for current period expenditures and therefore is not reported in the governmental fund statement. | 84,290,923 | |
| Compensated absences are not due and payable in the current period and therefore are not reported in the governmental fund statement. | (277,899) | (405,271) |
| Bonds payable and interest payable are not due and payable in the current period and therefore are not reported in the governmental fund statement. | | |
| Bonds payable | (82,770,896) | |
| Interest payable | (2,222,687) | |
| Deferred revenue is not available for the current period and therefore is not recognized as revenue in the governmental fund statement. | <u>4,922,302</u> | <u> </u> |
| Net assets of governmental activities | <u>\$ 110,517,451</u> | <u>\$ 87,791,407</u> |

MICHIGAN STRATEGIC FUND
 Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balance
 For the Fiscal Year Ended September 30

| | 2008 | | | Total | 2007 |
|--|------------------------|---|----------------------|------------------------|-----------------------|
| | General Operations | Jobs for Michigan Investment Fund | Debt Service Fund | | |
| REVENUES (Note 1) | | | | | |
| <u>Charges for services</u> | | | | | |
| IDRB issuance fees | \$ 916,409 | \$ | \$ | \$ 916,409 | \$ 657,683 |
| Other fees | 2,203,966 | | | 2,203,966 | 1,961,036 |
| <u>Operating grants and contributions</u> | | | | | |
| Community Development Block Grants (federal) | 42,766,390 | | | 42,766,390 | 40,776,397 |
| Community Development Block Grants (local and others) | 2,441,818 | | | 2,441,818 | 2,062,599 |
| <u>Payments from the State of Michigan</u> | | | | | |
| Payments from General Fund | 32,962,448 | | | 32,962,448 | 29,249,923 |
| Payments from 21st Century Jobs Trust Fund | | 90,211,664 | | 90,211,664 | 96,262,889 |
| <u>Other</u> | | | | | |
| Tribal gaming | 50,863,547 | | | 50,863,547 | |
| Payments from MEDC - Other | 27,275 | | | 27,275 | 183,359 |
| Interest and investment earnings | 1,801,806 | 1,725,609 | 11,969 | 3,539,383 | 791,293 |
| Net increase (decrease) in fair value of investments | | (2,172,610) | | (2,172,610) | |
| Lease revenue | | | 2,391,927 | 2,391,927 | |
| Miscellaneous and payable write-off | 3,629,373 | 37,844 | | 3,667,217 | 2,776,679 |
| Total revenues | <u>\$ 137,613,031</u> | <u>\$ 89,802,507</u> | <u>\$ 2,403,895</u> | <u>\$ 229,819,434</u> | <u>\$ 174,721,858</u> |
| EXPENDITURES (Note 1) | | | | | |
| Administrative | \$ 724,972 | \$ | \$ | \$ 724,972 | \$ 662,050 |
| Building and renovation - Capitalized purchases | 84,795,722 | | | 84,795,722 | |
| Community Development Block Grants | 45,320,957 | | | 45,320,957 | 43,073,036 |
| Michigan Film Office | 273,548 | | | 273,548 | |
| Jobs for Michigan Investment Fund - Operations | | 29,518,914 | | 29,518,914 | 21,940,880 |
| Jobs for Michigan Investment Fund - Pass-through funds | | 6,852,150 | | 6,852,150 | 5,311,426 |
| Jobs for Michigan Investment Fund - Programs | | 37,316,904 | | 37,316,904 | 39,895,096 |
| Payments to MEDC | 87,634,721 | | | 87,634,721 | 31,013,473 |
| Payments to General Fund (indirect and refund) | 228,626 | | | 228,626 | 277,537 |
| Miscellaneous and receivable write-off | 1,653,597 | | | 1,653,597 | 2,549,665 |
| Total expenditures | <u>\$ 220,632,143</u> | <u>\$ 73,687,968</u> | <u>\$ 0</u> | <u>\$ 294,320,111</u> | <u>\$ 144,723,163</u> |
| Excess of revenues over/(under) expenditures | <u>\$ (83,019,111)</u> | <u>\$ 16,114,539</u> | <u>\$ 2,403,895</u> | <u>\$ (64,500,677)</u> | <u>\$ 29,998,696</u> |
| OTHER FINANCING SOURCES (USES) (Note 10) | | | | | |
| Bond proceeds | \$ 79,780,000 | \$ | \$ | \$ 79,780,000 | \$ |
| Bond premium | 3,099,706 | | | 3,099,706 | |
| Transfer from Jobs for Michigan Investment Fund | 196,712 | | | 196,712 | |
| Transfer to General Operations Fund | | (196,712) | | (196,712) | |
| Other financing sources (uses) | <u>\$ 83,076,418</u> | <u>\$ (196,712)</u> | <u>\$ 0</u> | <u>\$ 82,879,706</u> | <u>\$ 0</u> |
| Net change in fund balances | \$ 57,307 | \$ 15,917,827 | \$ 2,403,895 | \$ 18,379,029 | \$ 29,998,696 |
| Fund balance - Beginning | 186,489 | 88,010,189 | | 88,196,678 | 58,197,983 |
| Fund balance - Ending | <u>\$ 243,796</u> | <u>\$ 103,928,016</u> | <u>\$ 2,403,895</u> | <u>\$ 106,575,707</u> | <u>\$ 88,196,678</u> |

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

MICHIGAN STRATEGIC FUND

Reconciliation of the Governmental Fund Statement of Revenues, Expenditures,
and Changes in Fund Balance to the Statement of Activities
For the Fiscal Year Ended September 30

| | <u>2008</u> | <u>2007</u> |
|--|----------------------|----------------------|
| Net change in fund balance | \$ 18,379,029 | \$ 29,998,696 |
| Amounts reported for governmental activities in the statement of activities are different because: | | |
| Bond proceeds and bond premium provide current financial resources to the governmental fund by issuing debt which increases long-term bonded debt in the statement of net assets. | (82,879,706) | |
| Net gaming revenues are recognized in different fiscal years because they were unavailable and deferred at the governmental fund level but are recognized in the statement of activities. | (20,676,628) | |
| Certain interest and investment earnings are delayed and not available and have been deferred at the governmental fund level but are recognized in the statement of activities. | 4,922,302 | |
| Lease revenue is recorded as a resource in the governmental fund statement; however, a portion of the lease revenue is applied to the lease receivable in the statement of activities. | (504,798) | |
| Building and renovation is reported as an expenditure in the governmental fund statement but was converted to a capital lease in the statement of activities. | 84,795,722 | |
| Payments to MEDC that were reported as expenditures in the governmental fund statement but were due and payable in the prior fiscal year are not reported in the statement of activities. | 20,676,628 | |
| Other interest expense for bonds payable is not recorded in the governmental fund statement. | (2,113,877) | |
| Compensated absences is not reported in the governmental fund statement because payments are not due and do not use current financial resources. | <u>127,372</u> | <u>36,049</u> |
| Change in net assets of governmental activities | <u>\$ 22,726,044</u> | <u>\$ 30,034,744</u> |

Notes to the Financial Statements

Note 1 Significant Accounting Policies

The accounting policies of the Michigan Strategic Fund (MSF) conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the more significant policies:

a. Reporting Entity

MSF was created by Act 270, P.A. 1984, to help diversify the economy of the State of Michigan and to provide for economic development, primarily by assisting business enterprises in obtaining additional sources of financing. Under the provisions of this Act, MSF succeeded to the rights, properties, obligations, and duties of the Michigan Job Development Authority and the Michigan Economic Development Authority.

Executive Order No. 1999-1 further authorized MSF to enter into an interlocal agreement with local public agencies. Under this authority, MSF entered into an interlocal agreement and created the Michigan Economic Development Corporation (MEDC) as a new public entity in 1999 to help administer the programs transferred to MSF. The interlocal agreement provided that any economic development programs transferred to MSF could be transferred, along with the relevant personnel and funding, to MEDC.

Executive Order No. 2003-18, effective December 7, 2003, transferred MSF as an autonomous agency from the Department of Management and Budget to the Department of Energy, Labor & Economic Growth (DELEG). Subsequently, Act 225, P.A. 2005, effective November 21, 2005, transferred MSF as an autonomous agency from DELEG to the Department of Treasury.

MSF is governed by an 11-member Board of Directors that consists of MEDC's chief executive officer, the State Treasurer, the director of DELEG, and 8 members who are appointed by the Governor with the advice and consent of the Senate.

MSF is a discretely presented component unit of the financial reporting entity of the State of Michigan. MSF is a discretely presented component unit in the reporting entity because the primary government appoints a voting majority of the MSF Board of Directors and the State is able to impose its will upon MSF (fiscal independence test).

b. Financial Statement Presentation

MSF's financial statements include the entity-wide and governmental fund financial statements. The entity-wide financial statements include the statement of net assets and the statement of activities and report on MSF as a whole.

MSF's governmental fund financial statements include MSF's general operating fund, Jobs for Michigan Investment Fund, and debt service fund. MSF's three funds are accounted for in a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues, and expenditures. The general operating fund accounts for all of the activities of MSF except those accounted for in the Jobs for Michigan Investment Fund and debt service fund. The Jobs for Michigan Investment Fund accounts for the investment, loan, and grant activity provided for in Act 225, P.A. 2005. The debt service fund accounts for the accumulation of resources for, and the payment of, principal and interest for limited obligation revenue bonds issued to acquire ownership in the Michigan House of Representatives facilities.

The accompanying financial statements present only MSF. Accordingly, they do not purport to, and do not, present fairly the financial position and the changes in financial position of the State of Michigan or its component units in conformity with GAAP.

c. Measurement Focus and Basis of Accounting

The entity-wide financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows.

The governmental fund financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting, as provided by GAAP. Under the modified accrual basis of accounting, revenues are recognized as they become susceptible to accrual, generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when a liability is incurred; however, certain expenditures related to long-term obligations are recorded only when payment is due and payable.

GAAP requires a reconciliation between the entity-wide and governmental fund financial statements.

d. Financial Data

MSF's General Operations column includes the following:

- (1) Revenues: Revenues primarily include Community Development Block Grants (CDBG) from the U.S. Department of Housing and Urban Development, State appropriations, tribal gaming, interest and investment earnings, industrial development revenue bond (IDRB) issuance fees, Michigan Economic Growth Authority (MEGA) fees, and Brownfield fees.
- (2) Expenses/Expenditures: CDBG expenditures primarily consist of pass-through grants to local governmental units. Payments to MEDC include tribal gaming; fees from IDRBs, MEGA, and Brownfield; and State appropriations for programs administered by MEDC. Expenditures also include administrative and other miscellaneous costs. The expenditure for building and renovation - capitalized purchases was for acquiring ownership in the Michigan House of Representatives facilities and was converted to a capital lease in the statement of activities.
- (3) Other Financing Sources: Bond proceeds and bond premium are related to limited obligation revenue bonds issued to acquire ownership in the Michigan House of Representatives facilities (see Note 7).

MSF's Jobs for Michigan Investment Fund column primarily includes the following:

- (1) Revenues: Revenues include payments from the 21st Century Jobs Trust Fund and interest and investment earnings from loans and investments transferred from MEDC.
- (2) Expenses/Expenditures: Jobs for Michigan Investment Fund expenditures primarily consist of grants to Life Sciences Technology; Advanced Automotive, Manufacturing, and Materials Technology; Alternative Energy Technology; and Homeland Security and Defense Technology and expenditures for travel promotion, business marketing, and administration.

MSF's Debt Service Fund column includes revenues. Revenues include lease revenues and interest earned on the lease payments deposited in the bank for the accumulation of resources for, and the payment of, principal and interest for limited obligation revenue bonds.

Note 2 Deposits and Investments

a. Deposits

| | As of September 30 | |
|---|--------------------|-------------------|
| | 2008 | 2007 |
| State of Michigan's equity in common cash | \$ 19,776,019 | \$ 23,115,791 |
| Deposits | 2,629,275 | 150,514 |
| Capital Access Program | 5,588,589 | 5,530,299 |
| Total deposits | \$ 27,993,883 | \$ 28,796,605 |

Custodial Credit Risk: Custodial credit risk for deposits is the risk that, in the event of a bank failure, MSF deposits may not be returned to it. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent but not in MSF's name.

MSF's bank account balances, without recognition of outstanding checks or deposits in transit, were \$8,795,300 at September 30, 2008 and \$5,780,183 at September 30, 2007. The majority of these balances are from the various bank accounts within the Capital Access Program. Of these amounts, \$5,886,796 as of September 30, 2008 and \$2,956,321 as of September 30, 2007 were uninsured and uncollateralized and, therefore, exposed to custodial credit risk. MSF has no policy for controlling custodial credit risk.

MSF's deposits included in the State of Michigan's equity in common cash are managed by the State Treasurer. The State Treasurer's policy requires financial institutions to secure State funds with collateral, to be organized under federal or State law, and to maintain an office in Michigan. The policy also restricts deposits to a maximum of 50% of each financial institution's net worth. As of September 30, 2008 and September 30, 2007, 99.9% and 99.8%, respectively, of the State's common cash was either covered by federal depository insurance or collateralized with securities held in the State's name by the State's agent. Additional details on this policy are described in the *State of Michigan Comprehensive Financial Report (SOMCAFR)*.

b. Investments

MSF invests directly, or through investment funds, to strengthen and diversify Michigan's economy by providing financial assistance to businesses to create jobs or new businesses and industries. Act 225, P.A. 2005, authorized MSF to invest in venture capital*, mezzanine*, and private equity* funds. The MSF Board of Directors approves new investments.

In 2006, MSF entered into a contract with DLJ MB Advisors, Inc. (DLJ), an affiliate of the Credit Suisse Group, to facilitate these investments in new businesses and industries or new products and processes, which may have a higher risk than investments in established businesses or industries. The Michigan 21st Century Investment Fund, a limited partnership, was established for these investments. DLJ is the general partner, and MSF is a limited partner.

* See glossary at end of report for definition.

In addition, MSF has venture capital investments in Life Sciences, Advanced Automotive, and Alternative Energy (transferred from MEDC by Act 225, P.A. 2005). These venture capital investments were previously approved by the Life Sciences and Technology Tri-Corridor steering committees in MEDC.

MSF reported investments at fair value if it was readily determinable or used cost-based measures if fair value was not readily determinable. The fair values were estimated by the partnerships, using the most recent reports and financial statements of the partnership investments:

| Type of Investment | Fair Value (in millions) as of September 30 | |
|-----------------------------------|--|---------------|
| | 2008 | 2007 |
| Venture capital - Limited partner | \$12.2 | \$ 6.4 |
| Venture capital - Stockholder | 12.8 | 6.2 |
| Mezzanine funds | 6.3 | |
| Private equity | 1.8 | |
| Total investments | <u>\$33.1</u> | <u>\$12.6</u> |

Custodial credit risk, credit risk, interest rate risk, foreign currency risk, and concentration of credit risk are discussed in the following paragraphs:

- (1) Custodial Credit Risk: Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, MSF will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of MSF, and are held by either the counterparty or the counterparty's trust department or agent but not in MSF's name.

MSF's investments in venture capital limited partnerships, mezzanine funds, and private equity are excluded from custodial credit risk because they are not an investment security. MSF's investments in venture capital stocks are not exposed to custodial credit risk

because they are held by LaSalle Bank's trust department in MSF's name.

- (2) Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. GAAP requires disclosure of the credit quality ratings of investments in debt securities. MSF does not have any investments in debt securities.
- (3) Interest Rate Risk: Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of those investments. MSF does not have interest-bearing investments and is not subject to this risk.
- (4) Foreign Currency Risk: Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments or deposits. MSF does not have any investments in foreign securities.
- (5) Concentration of Credit Risk: Concentration of credit risk is the risk of loss attributable to the magnitude of MSF's investments with a single issuer. MSF does not have a policy limiting the dollar value of investments with a single issuer. MSF had investments in the following companies for more than 5% of MSF's total investments at September 30, 2008 and September 30, 2007:

| Name of Issuer | September 30, 2008 | | September 30, 2007 | |
|----------------------------------|----------------------|-----------------------------|----------------------|-----------------------------|
| | Amount (millions) | Percentage of Investment | Amount (millions) | Percentage of Investment |
| Pronai | \$5.8 | 17.6% | | |
| Midwest Mezzanine | \$5.3 | 16.0% | | |
| Arboretum | \$2.9 | 8.8% | \$1.6 | 12.5% |
| Nth Power | \$2.7 | 8.2% | \$1.5 | 11.9% |
| Venture Investors IV | \$2.3 | 6.8% | \$1.4 | 10.8% |
| Integrated Sensing Systems, Inc. | \$1.8 | 5.5% | \$1.8 | 14.5% |
| Relativity | \$1.7 | 5.2% | | |
| Rubicon Genomics | | | \$1.4 | 11.5% |
| DNA Software | | | \$1.3 | 10.3% |
| Accumed Systems, Inc. | | | \$1.3 | 10.2% |
| Apjohn | | | \$0.9 | 7.5% |
| Seneca Partners | | | \$0.7 | 5.4% |

Note 3 Loans and Interest Receivable

Loans receivable totaled \$60,253,731 at September 30, 2008 and \$55,218,915 at September 30, 2007 for the Jobs for Michigan Investment Fund. These are high-risk loans issued for the purpose of diversifying Michigan's economy and helping to create jobs in competitive edge technologies. The loans were issued to organizations that research or commercialize (transition from research to market) products, processes, or services in the competitive edge technologies. These loans may be converted to investments at MSF's option with MSF Board of Directors and Strategic Economic Investment and Commercialization (SEIC) Board* approval.

The loans are for varying lengths and interest rates. Interest and loan repayments may be initially delayed for several years to provide the borrower an opportunity to substantially complete the project. Delayed interest receivable of \$4.9 million was reported as revenue on the entity-wide financial statements, but as deferred revenue on the governmental fund balance sheet because the revenue was not available. In accordance with State policy, the Office of Financial Management, Department of Management and Budget, issued a waiver to MSF to present financial statements different from the *SOMCAFR* because the interest receivable and deferred revenue were recorded after the issuance of the *SOMCAFR*.

| Loan Category | Fiscal Years | |
|---|---------------------|---------------------|
| | 2007-08 | 2006-07 |
| Technology Tri-Corridor | \$11,118,410 | \$13,629,405 |
| Life Sciences | 4,458,235 | 7,412,828 |
| Competitive Edge Technology: | | |
| Advanced Automotive, Manufacturing, and Materials Technology | 6,139,643 | 4,603,043 |
| Life Sciences Technology | 26,988,049 | 19,543,294 |
| Homeland Security and Defense Technology | 4,882,900 | 4,010,850 |
| Alternative Energy Technology | 6,666,494 | 6,019,495 |
| Total | <u>\$60,253,731</u> | <u>\$55,218,915</u> |

* See glossary at end of report for definition.

Note 4 Lease Receivable

As described in Note 7, MSF issued limited obligation revenue bonds to acquire ownership in the Michigan House of Representatives facilities. MSF entered into a capital lease agreement with the House of Representatives to lease the facilities until October 15, 2023. At the end of the lease, the House of Representatives may purchase the facilities for a nominal amount. The lease payments are paid to a trustee and will be used to pay the bonds issued to purchase the facilities. The lease payments are contingent upon annual appropriation by the State of Michigan, and neither the full faith and credit nor the taxing power of the State are pledged to the rentals coming due under the lease.

| | |
|---|----------------------|
| Total lease payments to be received | \$123,142,625 |
| Less: Unearned interest income | <u>38,851,701</u> |
| Net lease receivable | <u>\$ 84,290,923</u> |
| Statement of net assets classification: | |
| Current portion of lease receivable | \$ 309,973 |
| Long-term portion of lease receivable | <u>83,980,950</u> |
| Total | <u>\$ 84,290,923</u> |

Lease payments to be received from the House of Representatives as of September 30, 2008:

| <u>Fiscal Year</u> <u>Ending September 30</u> | <u>Lease</u> <u>Receivable</u> |
|--|-----------------------------------|
| 2009 | \$ 4,061,763 |
| 2010 | 4,061,762 |
| 2011 | 6,401,763 |
| 2012 | 6,675,262 |
| 2013 | 6,960,513 |
| 2014 - 18 | 43,468,812 |
| 2019 - 23 | <u>51,512,750</u> |
| Total | <u>\$ 123,142,625</u> |

In accordance with State policy, the Office of Financial Management, Department of Management and Budget, issued a waiver to MSF to present financial statements different from the *SOMCAFR* for fiscal year 2007-08 because lease receivables, lease revenue, and cash were revised by \$1.6 million to reflect the lease agreement schedule.

Note 5 Long-Term Liabilities

The following table summarizes the Capital Access Program, compensated absences, and bonds payable liabilities of MSF for the fiscal year ended September 30, 2008:

| | Beginning Balance | Additions | Reductions | Ending Balance | Due Within One Year |
|------------------------|----------------------|--------------|-------------|-------------------|------------------------|
| Capital Access Program | \$5,530,299 | \$ 2,829,215 | \$2,770,926 | \$ 5,588,589 | \$1,500,000 |
| Compensated absences | \$ 405,271 | \$ 147,369 | \$ 274,741 | \$ 277,899 | \$ 154,751 |
| Bonds payable | | \$79,780,000 | | \$79,780,000 | \$ 20,000 |
| Unamortized premium | | \$ 3,099,706 | \$ 108,810 | \$ 2,990,896 | \$ 198,841 |

The following table summarizes the Capital Access Program and compensated absences liabilities of MSF for the fiscal year ended September 30, 2007:

| | Beginning Balance | Additions | Reductions | Ending Balance | Due Within One Year |
|------------------------|----------------------|-------------|-------------|-------------------|------------------------|
| Capital Access Program | \$4,154,840 | \$2,537,555 | \$1,162,095 | \$5,530,299 | \$1,000,000 |
| Compensated absences | \$ 441,320 | | \$ 36,049 | \$ 405,271 | \$ 198,461 |

Liabilities for compensated absences were included in the statement of net assets, which is on the accrual basis, and not on the governmental fund balance sheet, which is on the modified accrual basis. These liabilities represent unused sick, banked, and annual leave accrued, which will be paid when the employees terminate employment. The liability is calculated using 100% of the employees' annual and banked leave and a portion of the sick leave, based on the pay rates in effect as of September 30, 2008 and September 30, 2007, respectively.

Liabilities for the Capital Access Program consist of an obligation to reimburse financial institutions for future loan defaults on high-risk business loans. An asset for the same amount represents the available balance that can be used to reimburse the financial institutions. Additions to the Capital Access Program are fees paid by the financial institution, MSF, and the borrower to fund the program and recoveries of defaulted loans. Reductions are payments to the financial institutions for defaulted loans. As of September 30, 2008 and September 30, 2007, there were 50 financial institutions participating in the Capital Access Program.

Detailed information on bonds payable and unamortized premium is provided in Note 7.

Note 6 Pension Plans and Other Postemployment Benefits

a. Classified Employees

State classified employees who work on MSF programs are covered by two single employer pension plans offered by the State of Michigan: the State Employees' Defined Benefit Retirement Plan and the State Employees' Defined Contribution Retirement Plan (Plans). Detailed information regarding the Plans' descriptions, accounting policies, vesting and eligibility requirements, actuarial cost methods and assumptions, funding status and requirements, and 10-year historical trend information are provided in the Plans' detailed financial reports.

In addition to the Plans, State classified employees have the option to invest a portion of their salaries into 401(k) and 457 deferred compensation plans. Generally, MSF does not make any contributions to the deferred compensation plans.

State statutes provide retired employees with other postemployment benefits, such as health, dental, vision, and life insurance coverage based on vesting and other requirements. The cost of retiree health care and other benefits is allocated by the Office of Retirement Services and funded on a pay-as-you-go basis.

For the State Employees' Defined Benefit Retirement Plan, MSF was billed and paid an average of 26.5% (\$352,580) and 21.0% (\$230,223) of

its payroll costs for pension charges and retiree postemployment benefits in fiscal years 2007-08 and 2006-07, respectively. For the State Employees' Defined Contribution Retirement Plan, MSF is required to make a contribution of 4% of the annual payroll and to match employee contributions up to 3% of annual covered payroll, totaling \$12,104 and \$6,148 for fiscal years 2007-08 and 2006-07, respectively. The Plans' detailed financial statements can be obtained from the Office of Retirement Services, Department of Management and Budget, 7150 Harris Drive, P.O. Box 30171, Lansing, Michigan 48909.

b. Nonclassified Employees

MSF reimburses MEDC for MEDC nonclassified employees working on MSF programs. MEDC offers these nonclassified employees a retirement plan (under Section 401(a) of the Internal Revenue Code) after one year of service. MEDC also offers a deferred compensation plan (under Section 457 of the Internal Revenue Code) to these nonclassified employees upon employment. Both plans are administered by Pension Trend, a third party administrator, and the employees manage their own investments. Other than making contributions to the 401(a) retirement plan, neither MEDC nor MSF has any other pension benefit obligation liability. Nonclassified employees do not have any other postemployment benefits.

MSF reimburses MEDC for an employer contribution rate of 8% of an employee's gross wages to the 401(a) retirement plan for eligible employees. The MEDC Executive Committee approved the contribution and rate on August 5, 1999. Employees cannot contribute to this plan. For the fiscal years ended September 30, 2008 and September 30, 2007, MSF reimbursed MEDC for contributions to the plan of \$62,488 and \$29,037, respectively.

MSF makes no contributions to the 457 deferred compensation plan. Only employees make contributions to the plan. For the fiscal years ended September 30, 2008 and September 30, 2007, employees contributed \$76,237 and \$38,057, respectively.

Note 7 Limited Obligation Revenue Bonds - Michigan House of Representatives Facilities

MSF issued limited obligation revenue bonds Series 2008 A and 2008 B in the total amount of \$79,780,000 to acquire ownership in the Michigan House of Representatives facilities, known as the Anderson House Office Building, located on Capitol Avenue in Lansing, Michigan. The bonds are secured by and payable from rent to be paid by the Michigan House of Representatives under the lease and other revenues and funds pledged under the indenture. The lease is not a general obligation of the issuer or the State. Neither the full faith and credit nor the taxing power of the State are pledged to the rentals coming due under the lease.

The proceeds of the bonds were used, together with other available funds, to (a) acquire an office building containing offices for the members of the House of Representatives and their staff through (i) the defeasance of the prior owner's outstanding Certificates of Participation* and (ii) the discharge of a prior loan, (b) finance the acquisition and construction of improvements to the facilities, and (c) pay costs of issuing and insuring the bonds.

The scheduled payments of principal and interest on the bonds when due are guaranteed under the financial guarantee insurance policy issued concurrently with the delivery of the bonds by Assured Guaranty Corp. The Series A bonds (\$78,650,000) have a maturity schedule starting in 2011 and ending in 2023 with an interest rate yield in the range of 3.33% to 5.19%. The Series B bonds (\$1,130,000) will mature in 2011 with an interest rate yield of 4.00%. The following table summarizes debt service requirements for outstanding bonds:

| <u>Fiscal Year</u> | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|---------------------|---------------------|---------------------|----------------------|
| 2009 | \$ 20,000 | \$ 4,422,308 | \$ 4,442,308 |
| 2010 | 35,000 | 4,059,888 | 4,094,888 |
| 2011 | 35,000 | 4,058,138 | 4,093,138 |
| 2012 | 2,410,000 | 4,014,763 | 6,424,763 |
| 2013 | 2,780,000 | 3,902,763 | 6,682,763 |
| 2014 - 18 | 24,490,000 | 16,460,813 | 40,950,813 |
| 2019 - 24 | 50,010,000 | 8,449,631 | 58,459,631 |
| Total | <u>\$79,780,000</u> | <u>\$45,368,302</u> | <u>\$125,148,302</u> |
| Unamortized premium | 2,990,896 | | 2,990,896 |
| Total | <u>\$82,770,896</u> | <u>\$45,368,302</u> | <u>\$128,139,198</u> |

* See glossary at end of report for definition.

Note 8 Limited Obligation Debt - Industrial Development Revenue Bonds

MSF and a predecessor entity (the Michigan Job Development Authority) issued industrial development revenue bonds. In addition, MSF issued bonds under its Taxable Bond Program. The bonds issued are payable solely from the net revenues of the project and are not an obligation of MSF or the State of Michigan. After the bonds are issued, all financial activities are assumed by a trustee, depository, or paying agent. Accordingly, these obligations are not reported in the MSF financial statements. Information regarding the status of such bond issues must be obtained from the trustee or depository for bonds, the industrial or commercial enterprise benefited by the bonds, or some other knowledgeable source.

The total amount of industrial development revenue bonds issued by MSF and its predecessor entity for the period January 1, 1979 through September 30, 2008 was \$8,285,983,525 (\$7,442,811,576 through September 30, 2007). The amount of tax-exempt bonds issued during fiscal year 2007-08 was \$104,648,949 (\$328,526,237 for fiscal year 2006-07). There were \$2,360,000 bonds issued by MSF under the Taxable Bond Program for fiscal year 2007-08 (none issued for fiscal year 2006-07).

Note 9 Interfund Receivable and Payable and Interfund Eliminations

As of September 30, 2008, an interfund payable for \$566,557 (\$2,504,633 as of September 30, 2007) was recorded in general operations and an interfund receivable for \$566,557 (\$2,504,633 as of September 30, 2007) was recorded in the Jobs for Michigan Investment Fund for borrowing to eliminate a negative balance in equity in common cash in general operations. The interfund receivable and payable were eliminated in the statement of net assets.

Note 10 Other Financing Sources

In fiscal year 2007-08, bond proceeds (\$79.8 million) and bond premium (\$3.1 million) from the issuance of limited obligation revenue bonds were recorded in MSF's general operations as "Other Financing Sources" (see Note 7 for details on the bonds). These "Other Financing Sources" were eliminated in MSF's entity-wide financial statements. There were no "Other Financing Sources" during fiscal year 2006-07.

Note 11 Reserved Fund Balance

Reserved fund balance (in millions) consists of:

| | As of September 30 | |
|-----------------------------|--------------------|---------------|
| | <u>2008</u> | <u>2007</u> |
| Noncurrent loans | \$ 58.4 | \$54.3 |
| Noncurrent investments | 33.1 | 12.7 |
| Encumbrances | 6.7 | 12.2 |
| Debt service | 2.4 | |
| Total reserved fund balance | <u>\$100.6</u> | <u>\$79.1</u> |

REQUIRED SUPPLEMENTARY INFORMATION

MICHIGAN STRATEGIC FUND
Budgetary Comparison Schedule and Budget-to-GAAP Reconciliation
For the Fiscal Years Ended September 30

| Statutory/Budgetary Basis | 2008 | | | Variance With Final Budget |
|--|---------------------------|---------------------------|---------------------------|-------------------------------|
| | Original Budget | Final Budget | Actual | |
| Beginning budgetary fund balance | \$ 21,245,560 | \$ 21,245,560 | \$ 21,245,560 | \$ 0 |
| Resources (inflows): | | | | |
| Revenues and other sources: | | | | |
| Charges for services (Note 2) | \$ 85,200 | \$ 85,200 | \$ 3,120,375 | \$ (3,035,175) |
| Operating grants and contributions | 55,430,700 | 55,430,700 | 45,208,208 | 10,222,492 |
| Payments from the State of Michigan: | | | | |
| From General Fund | 29,493,100 | 33,072,272 | 32,962,448 | 109,824 |
| From 21st Century Jobs Trust Fund (Note 3) | 301,879,873 | 351,879,873 | 90,211,664 | 261,668,209 |
| Other miscellaneous (Note 4) | 8,066,397 | 8,116,397 | 58,316,739 | (50,200,343) |
| Other financing sources (Note 6) | | | 83,076,418 | (83,076,418) |
| Total revenues and other sources | <u>\$ 394,955,270</u> | <u>\$ 448,584,442</u> | <u>\$ 312,895,852</u> | <u>\$ 135,688,590</u> |
| Total resources available | <u>\$ 416,200,829</u> | <u>\$ 469,830,001</u> | <u>\$ 334,141,411</u> | <u>\$ 135,688,590</u> |
| Charges (outflows): | | | | |
| Expenditures, transfers out, and encumbrances: | | | | |
| Administrative (Note 2) | \$ | \$ | \$ 724,972 | \$ (724,972) |
| Community Development Block Grants | 55,729,256 | 55,729,256 | 45,320,957 | 10,408,298 |
| Building and renovation - Capitalized purchases (Note 6) | | | 84,795,722 | (84,795,722) |
| Jobs for Michigan Investment Fund - Operations (Note 5): | | | | |
| Administration | 11,342,987 | 11,342,987 | 3,544,514 | 7,798,473 |
| Business Development and Business Marketing | 5,005,292 | 5,005,292 | 4,994,452 | 10,840 |
| Michigan Promotion Program | 6,355,031 | 56,355,031 | 18,899,723 | 37,455,308 |
| Competitive Edge Technology Research | | | | |
| Defense Contractor Coordination Center | 8,815,846 | 8,815,846 | 2,080,224 | 6,735,622 |
| Jobs for Michigan Investment Fund - Pass-through (Note 5): | | | | |
| Michigan Forest Finance Authority Grant | 5,950,495 | 5,950,495 | 602,122 | 5,348,372 |
| Good Manufacturing Facility | 700,000 | 700,000 | 350,000 | 350,000 |
| Automotive Technology Business Accelerator | 4,000,000 | 4,000,000 | 2,000,000 | 2,000,000 |
| Michigan Film Office | 1,918,590 | 1,918,590 | 293,378 | 1,625,212 |
| Agriculture Development Fund | 4,043,046 | 4,043,046 | 3,803,362 | 239,683 |
| Jobs for Michigan Investment Fund - Programs (Note 5): | | | | |
| Capital Access Program | 2,119,170 | 2,119,170 | 800,000 | 1,319,170 |
| Competitive Edge Technology grants and loans | 102,753,953 | 89,067,401 | 30,835,470 | 58,231,931 |
| Investments, loans, and grants | 135,075,464 | 148,762,016 | 27,208,418 | 121,553,598 |
| Centers for Energy Excellence | 18,100,000 | 18,100,000 | | 18,100,000 |
| SBIR/STTR grants and loans | 1,400,000 | 1,400,000 | 500,000 | 900,000 |
| Payments to MEDC: | | | | |
| Administration | 2,542,400 | 2,542,400 | 2,493,450 | 48,950 |
| Job creation services | 14,273,844 | 14,273,844 | 13,500,865 | 772,980 |
| Michigan Promotion Program | 5,717,500 | 5,717,500 | 5,717,500 | 0 |
| Economic Development Job Training Grants | 7,441,000 | 7,441,000 | 7,427,109 | 13,891 |
| Michigan State University Bioenergy Research Center | | 3,500,000 | 3,500,000 | 0 |
| Human resources optimization user charges | 17,800 | 17,800 | 14,388 | 3,412 |
| IDRB, MEGA, and tribal gaming revenue (Notes 2 and 4) | | | 54,981,409 | (54,981,409) |
| Michigan Film Office | | 129,172 | 273,548 | (144,376) |
| Payments to General Fund | | | 228,626 | (228,626) |
| Miscellaneous and receivable write-off | 1,653,597 | 1,653,597 | 1,653,597 | 0 |
| Total charges | <u>\$ 394,955,270</u> | <u>\$ 448,584,442</u> | <u>\$ 316,543,807</u> | <u>\$ 132,040,635</u> |
| Reconciling items: | | | | |
| Changes in noncurrent assets | \$ | \$ (2,475,918) | \$ (2,475,918) | \$ 0 |
| Net reconciling items | <u>\$ 0</u> | <u>\$ (2,475,918)</u> | <u>\$ (2,475,918)</u> | <u>\$ 0</u> |
| Ending budgetary fund balance | <u>\$ 21,245,560</u> | <u>\$ 18,769,642</u> | <u>\$ 15,121,687</u> | <u>\$ 3,647,955</u> |

This schedule continued on next page.

2007

| Original Budget | Final Budget | Actual | Variance With Final Budget |
|-----------------------|-----------------------|-----------------------|-------------------------------|
| \$ 33,495,991 | \$ 33,495,991 | \$ 33,495,991 | \$ 0 |
| \$ 78,600 | \$ 78,600 | \$ 2,618,719 | \$ (2,540,119) |
| 47,687,000 | 55,584,900 | 42,838,996 | 12,745,904 |
| 32,009,200 | 29,457,700 | 29,249,923 | 207,777 |
| 373,142,761 | 323,142,761 | 96,262,889 | 226,879,872 |
| 3,254,665 | 3,254,665 | 3,751,332 | (496,667) |
| | | | 0 |
| <u>\$ 456,172,226</u> | <u>\$ 411,518,626</u> | <u>\$ 174,721,858</u> | <u>\$ 236,796,768</u> |
| \$ 489,668,217 | \$ 445,014,617 | \$ 208,217,849 | \$ 236,796,768 |
| \$ 47,750,093 | \$ 55,724,693 | \$ 662,050 | \$ (662,050) |
| | | 43,073,036 | 12,651,657 |
| | | | 0 |
| 10,906,256 | 10,906,256 | 2,563,270 | 8,342,987 |
| 10,037,236 | 10,037,236 | 8,781,944 | 1,255,292 |
| 10,555,980 | 10,555,980 | 9,900,950 | 655,031 |
| 2,000,000 | | | |
| 9,510,563 | 9,510,563 | 694,717 | 8,815,846 |
| 26,000,000 | 6,000,000 | 49,505 | 5,950,495 |
| 3,000,000 | 3,000,000 | 2,300,000 | 700,000 |
| 6,000,000 | 6,000,000 | 2,000,000 | 4,000,000 |
| 2,000,000 | 2,000,000 | 81,410 | 1,918,590 |
| 4,923,556 | 4,923,556 | 880,510 | 4,043,046 |
| 3,169,170 | 3,169,170 | 1,050,000 | 2,119,170 |
| 135,000,000 | 135,000,000 | 62,246,047 | 72,753,953 |
| 150,040,000 | 122,040,000 | 5,714,536 | 116,325,464 |
| | | | 0 |
| | | | 0 |
| 2,451,000 | 2,362,200 | 2,353,456 | 8,744 |
| 14,745,907 | 13,826,107 | 12,824,505 | 1,001,603 |
| 5,717,500 | 5,717,500 | 5,717,500 | 0 |
| 9,798,000 | 8,178,400 | 8,084,047 | 94,353 |
| | | | 0 |
| 17,300 | 17,300 | 13,847 | 3,453 |
| | | 2,020,119 | (2,020,119) |
| | | 277,537 | (277,537) |
| 2,549,665 | 2,549,665 | 2,549,665 | 0 |
| <u>\$ 456,172,226</u> | <u>\$ 411,518,626</u> | <u>\$ 173,838,650</u> | <u>\$ 237,679,976</u> |
| \$ | \$ (13,133,639) | \$ (13,133,639) | \$ 0 |
| \$ 0 | \$ (13,133,639) | \$ (13,133,639) | \$ 0 |
| <u>\$ 33,495,991</u> | <u>\$ 20,362,352</u> | <u>\$ 21,245,560</u> | <u>\$ (883,208)</u> |

MICHIGAN STRATEGIC FUND
 Budgetary Comparison Schedule and Budget-to-GAAP Reconciliation
 For the Fiscal Years Ended September 30
 Continued

| Budget-to-GAAP Reconciliation | 2008 | | | Variance With Final Budget |
|---|-----------------|--------------|-----------------------|-------------------------------|
| | Original Budget | Final Budget | Actual | |
| Resources (inflows): | | | | |
| Actual amount (budgetary basis) of "Total resources available" | | | \$ 334,141,411 | |
| Differences - Budget to GAAP: | | | | |
| Beginning budgetary fund balance is a budgetary resource but is not a current year revenue for financial reporting purposes | | | (21,245,560) | |
| Other financing sources are inflows of budgetary resources but are not revenues for financial reporting purposes | | | (83,076,418) | |
| Total revenues (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance | | | <u>\$ 229,819,434</u> | |
| Charges (outflows): | | | | |
| Actual amount (budgetary basis) of "Total charges" | | | \$ 316,543,807 | |
| Differences - Budget to GAAP: | | | | |
| Other financing uses are outflows of budgetary resources but are not expenditures for financial reporting purposes | | | (196,712) | |
| Loans and investments are outflows for budgetary reporting purposes but are not expenditures for financial reporting purposes | | | (22,026,984) | |
| Total expenditures (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance | | | <u>\$ 294,320,111</u> | |

See accompanying notes to required supplementary information.

2007

| <u>Original Budget</u> | <u>Final Budget</u> | <u>Actual</u> | <u>Variance With Final Budget</u> |
|------------------------|---------------------|-----------------------|---------------------------------------|
| | | \$ 208,217,849 | |
| | | (33,495,991) | |
| | | <u>\$ 174,721,858</u> | |
| | | \$ 173,838,650 | |
| | | (29,115,487) | |
| | | <u>\$ 144,723,163</u> | |

Notes to Required Supplementary Information

Note 1 Statutory Budgetary Presentation

The State of Michigan provides annual legislative appropriations to the Michigan Strategic Fund (MSF) for the Community Development Block Grants (CDBG) Program and for other State programs. The State of Michigan also provided an appropriation for the Jobs for Michigan Investment Fund. MSF administers the CDBG Program and the Jobs for Michigan Investment Fund. The Michigan Economic Development Corporation (MEDC) administers the other State programs. MSF transfers the funding for the State programs to MEDC as required by an interlocal agreement between MSF and MEDC.

For programs financed from restricted revenues, spending authorization is generally contingent upon recognition of the related revenue.

The budgetary comparison schedule presents both the original and final appropriated budgets for fiscal years 2007-08 and 2006-07, as well as the actual resource inflows, outflows, and fund balance stated on the budgetary basis.

The original budget and related estimated revenues represent the spending authority enacted into law as of October 1, 2005; November 21, 2005; October 1, 2006; October 1, 2007; April 18, 2008; and April 29, 2008 and include encumbrances and multi-year projects' budgetary carry-forwards from the prior year.

The budgetary fund balance represents the total fund balance, net of reserves for noncurrent assets. Reserves for noncurrent assets do not represent current financial resources available for appropriations and are not included for budgetary purposes.

Note 2 Charges for Services

The revenue amounts in the actual column include charges for services collected by MSF for the Brownfield, industrial development revenue bond (IDRB), and Michigan Economic Growth Authority (MEGA) programs. The corresponding cost of administering those programs is recorded as

administrative expenditures. All excess fees collected are transferred to MEDC pursuant to the interlocal agreement as a payment to MEDC expenditures.

Note 3 Payments From the 21st Century Jobs Trust Fund

Act 225, P.A. 2005, appropriated \$394.0 million (subsequently reduced to \$343.0 million) in fiscal year 2005-06 and Act 127, P.A. 2007, and Act 98, P.A. 2008, appropriated \$125 million in fiscal year 2007-08 to MSF. These appropriations are financed from the tobacco securitization settlement funds retained in the 21st Century Jobs Trust Fund at the Department of Treasury.

MSF received revenue of \$90.2 million and \$96.3 million from the 21st Century Jobs Trust Fund for fiscal years 2007-08 and 2006-07, respectively.

Note 4 Tribal Gaming

The other miscellaneous revenues in the actual column include tribal gaming revenue of \$50.9 million. Effective March 2008, the State of Michigan settled a tribal gaming lawsuit that resulted in MSF recognizing \$26.9 million in revenue during fiscal year 2007-08 in the governmental fund financial statements. Also, during fiscal year 2007-08, the State amended its agreement with American Indian tribes operating casinos under the 1998 compact (as explained in the management's discussion and analysis). Under the same agreement a new casino (Four Winds Casino: Pokagon - New Buffalo) made a payment of \$18.6 million for fiscal year 2007-08. The payments to MEDC include the tribal gaming revenue transferred to MEDC per the interlocal government agreement.

Note 5 Jobs for Michigan Investment Fund - Operations, Pass-Through, and Programs

Charges for operations, pass-through, and programs are financed by the funds appropriated in Act 225, P.A. 2005; Act 127, P.A. 2007; and Act 98, P.A. 2008. Charges for fiscal year 2007-08 include expenditures of \$68.2 million and disbursements for investments and loans of \$22.0 million for a total of \$90.2 million for budgetary reporting purposes. Charges for fiscal year 2006-07 include expenditures of \$67.1 million and disbursements for investments and loans of \$29.1 million for a total of \$96.2 million for budgetary reporting purposes. However, investments and loans are not expenditures for financial reporting purposes and are a reconciling item.

MSF intends to spend these appropriations, which are designated as work projects with carry-forward authorization, over multiple years. Variances with the final budget in fiscal year 2006-07 were carried over to the original budget for fiscal year 2007-08.

- Note 6 Other Financing Sources and Building and Renovation - Capitalized Purchases
Other financing sources include revenue from the limited obligation revenue bonds issued to acquire ownership in the Michigan House of Representatives facilities. The cost of acquiring the building is recorded as an expenditure under building and renovation - capitalized purchases.

SUPPLEMENTAL
FINANCIAL SCHEDULE

MICHIGAN STRATEGIC FUND
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2006 Through September 30, 2008

| Federal Agency/Program | CFDA (2) Program Number | Pass-Through Identification Number | For the Fiscal Year Ended September 30, 2007 | | |
|--|-------------------------------|--|--|---------------------------------|-----------------------------------|
| | | | Directly Expended | Distributed to Subrecipients | Total Expended and Distributed |
| <u>U.S. Department of Housing and Urban Development</u> | | | | | |
| Direct Programs: | | | | | |
| Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii (3) (4) | 14.228 | | \$ 1,126,756 | \$ 40,655,922 | \$ 41,782,678 |
| Community Development Block Grants/Brownfields Economic Development Initiative | 14.246 | | | 1,056,318 | 1,056,318 |
| Total U.S. Department of Housing and Urban Development | | | \$ 1,126,756 | \$ 41,712,240 | \$ 42,838,996 |
| Total Expenditures of Federal Awards | | | <u>\$ 1,126,756</u> | <u>\$ 41,712,240</u> | <u>\$ 42,838,996</u> |

- (1) Basis of Presentation: This schedule presents the federal grant activity of the Michigan Strategic Fund on the modified accrual basis of accounting and in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements.
- (2) CFDA is defined as *Catalog of Federal Domestic Assistance*.
- (3) Program income increases the federal award; federal regulations allow for the entity to retain and spend program income according to the federal guidelines.
- (4) CFDA 14.228 has open grants from program years 2000 through 2008.

For the Fiscal Year Ended September 30, 2008

| <u>Directly Expended</u> | <u>Distributed to Subrecipients</u> | <u>Total Expended and Distributed</u> | <u>Total Expended and Distributed for the Two-Year Period</u> |
|------------------------------|---|---|---|
| \$ 1,358,471 | \$ 43,637,236 | \$ 44,995,707 | \$ 86,778,385 |
| | 212,501 | 212,501 | 1,268,819 |
| \$ 1,358,471 | \$ 43,849,737 | \$ 45,208,208 | \$ 88,047,204 |
| <u>\$ 1,358,471</u> | <u>\$ 43,849,737</u> | <u>\$ 45,208,208</u> | <u>\$ 88,047,204</u> |

INDEPENDENT AUDITOR'S REPORTS ON
INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters

Mr. D. Gregory Main
President, Michigan Strategic Fund
Chair, Michigan Strategic Fund Board of Directors
300 North Washington Square
Lansing, Michigan

Dear Mr. Main:

We have audited the financial statements of the Michigan Strategic Fund, a discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2008 and September 30, 2007, as identified in the table of contents, and have issued our report thereon dated April 21, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Michigan Strategic Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Michigan Strategic Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Michigan Strategic Fund's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed in the next paragraph, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in Findings 1 through 3 in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described in the third paragraph of this section are a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Michigan Strategic Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Michigan Strategic Fund's responses to the findings identified in our audit are described in the accompanying corrective action plan. We did not audit the Michigan Strategic Fund's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Michigan Strategic Fund Board of Directors, others within the entity, the Governor, the Legislature, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

April 21, 2009



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Compliance With
Requirements Applicable to Each Major Program
and on Internal Control Over Compliance in
Accordance With OMB Circular A-133

Mr. D. Gregory Main
President, Michigan Strategic Fund
Chair, Michigan Strategic Fund Board of Directors
300 North Washington Square
Lansing, Michigan

Dear Mr. Main:

Compliance

We have audited the compliance of the Michigan Strategic Fund with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each major federal program for the two-year period ended September 30, 2008. The Michigan Strategic Fund's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Michigan Strategic Fund's management. Our responsibility is to express an opinion on the Michigan Strategic Fund's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the preceding paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Michigan Strategic Fund's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Michigan Strategic Fund's compliance with those requirements.

In our opinion, the Michigan Strategic Fund complied, in all material respects, with the requirements referred to in the first paragraph that are applicable to each of its major federal programs for the two-year period ended September 30, 2008. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Finding 4.

Internal Control Over Compliance

The management of the Michigan Strategic Fund is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Michigan Strategic Fund's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Michigan Strategic Fund's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the Michigan Strategic Fund's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified a deficiency in internal control over compliance that we consider to be a significant deficiency.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as Finding 4 to be a significant deficiency.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We did not consider the deficiency described in the preceding paragraph to be a material weakness.

The Michigan Strategic Fund's responses to the findings identified in our audit are described in the accompanying corrective action plan. We did not audit the Michigan Strategic Fund's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Michigan Strategic Fund Board of Directors, others within the entity, the Governor, the Legislature, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

April 21, 2009

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I: Summary of Auditor's Results

Financial Statements

| | |
|---|--------------|
| Type of auditor's report issued: | Unqualified* |
| Internal control* over financial reporting: | |
| Material weaknesses* identified? | No |
| Significant deficiencies* identified that are not considered to be material weaknesses? | Yes |
| Noncompliance or other matters material to the financial statements? | No |

Federal Awards

| | |
|---|-------------|
| Internal control over major programs: | |
| Material weaknesses* identified? | No |
| Significant deficiencies* identified that are not considered to be material weaknesses? | Yes |
| Type of auditor's report issued on compliance for major programs: | Unqualified |
| Any audit findings disclosed that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, Section 510(a)? | Yes |

Identification of major programs:

| <u>CFDA Number</u> | <u>Name of Federal Program</u> |
|--------------------|---|
| 14.228 | Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii |

Dollar threshold used to distinguish between type A and type B programs: \$2,641,416

Auditee qualified as a low-risk auditee*? No

* See glossary at end of report for definition.

Section II: Findings Related to the Financial Statements

FINDING (2710901)

1. Year-End Accruals

The Michigan Strategic Fund's (MSF's) accrual methodology did not ensure that it recorded accrued expenditures and revenues at year-end in accordance with generally accepted accounting principles. As a result, MSF did not record expenditures and revenues in the appropriate fiscal year and understated liabilities and receivables at year-end.

The Governmental Accounting Standards Board (GASB) establishes the recognition of expenditures in the time period that the liability has been incurred. GASB establishes the recognition of revenues when the underlying event occurs on the accrual basis for the entity-wide financial statements. On the modified accrual basis, for the governmental fund level financial statements, revenues are recognized when they are measurable and available. Revenues that are not available to meet current obligations are deferred on the balance sheet.

MSF provides grants to subrecipients for the Community Development Block Grants (CDBG) federal program and grants and loans to recipients from the Jobs for Michigan Investment Fund. We noted the following internal control deficiencies in MSF's procedures for evaluating and estimating accrued expenditure and revenue transactions at year-end:

- a. MSF's payable methodology did not ensure that it established a reasonable payable for one CDBG subrecipient in fiscal year 2006-07. As a result, \$3.3 million of MSF's CDBG expenditures and federal revenue were recorded in the wrong fiscal year. MSF's policy is to recognize expenditures in the period that the subrecipient has incurred the liabilities, regardless of whether invoices have been received by the subrecipient. We noted from our sample of transactions that MSF staff had questioned the subrecipient on its unbilled project costs based on MSF's knowledge of the project status. The subrecipient did not respond and MSF did not estimate a payable for the incurred but unbilled project costs for that subrecipient. MSF recorded the expenditure in the subsequent fiscal year when it received the subrecipient payment reimbursement request.

- b. MSF's payable methodology did not ensure that expenditures and revenue were recorded in the proper fiscal year for grants issued in the Jobs for Michigan Investment Fund. As a result, MSF did not accrue \$2.3 million and \$1.8 million in payables and expenditures and related receivables and revenues for fiscal years 2006-07 and 2007-08, respectively. MSF's policy was to recognize the expenditures after it had approved and paid recipient reimbursement requests in accordance with its grant agreement. However, MSF should recognize expenditures in the fiscal year when it incurs the liability, regardless of the timing of the approvals and payments, in accordance with GASB. Subsequent to our review, MSF made the appropriate adjusting entries to the fiscal year 2007-08 financial statements.

- c. MSF's accrual methodology did not ensure the accrual of interest revenue in the proper fiscal year on certain loans issued in the Jobs for Michigan Investment Fund. As a result, MSF did not record \$4.9 million in loan interest receivable and revenue in the entity-wide financial statements and loan interest receivable and deferred revenue in the governmental fund financial statements for fiscal year 2007-08. MSF's loan agreements may allow for the delay in loan repayments and earned interest from the borrower for several years to provide the borrower an opportunity to substantially complete the project. MSF's methodology was to record the interest in the fiscal year that loan repayments began. However, MSF should have recorded the interest in the fiscal year that it was earned in the statement of activities and defer the revenue in the governmental fund balance sheet. The delay in recording the interest revenue to subsequent years results in recognition of revenue in the wrong fiscal year. Subsequent to our review, MSF made the appropriate adjusting entries prior to issuance of the fiscal year 2007-08 financial statements.

RECOMMENDATION

We recommend that MSF improve its accrual methodology to ensure that it records accrued expenditures and revenues at year-end in accordance with generally accepted accounting principles.

FINDING (2710902)

2. Supporting Documentation

MSF's internal control did not ensure that it obtained and reviewed sufficient supporting documentation for amounts calculated by another State agency prior to processing transactions. As a result, MSF did not detect misstatements that affected the balances in cash held by a custodian and lease revenue of \$1.6 million in the governmental fund financial statements and a misstatement in the capital lease receivable of \$1.4 million in the entity-wide financial statements. Subsequent to our review, MSF made the appropriate adjusting entries prior to the issuance of the financial statements.

Section 18.1485 of the *Michigan Compiled Laws* (a section of Act 431, P.A. 1984, as amended) provides that State agencies are responsible for developing and maintaining a system of controls over the preparation of financial statements in accordance with generally accepted accounting principles.

MSF purchased a building, issued bonds, and entered into a 15-year capital lease in fiscal year 2007-08 with the Michigan House of Representatives. The Office of Financial Management, Department of Management and Budget, assisted MSF by calculating amounts for several complex accounting entries related to the purchase, lease, and issuance of the bonds. However, the amounts calculated for the lease transactions did not agree with the lease agreement or actual cash held by the custodian because the Office of Financial Management used an average lease payment rather than the actual lease payment. MSF did not obtain and review sufficient supporting documentation to detect the misstatements in cash and lease transactions prior to processing the transaction in December 2008.

RECOMMENDATION

We recommend that MSF improve its internal control to ensure that it obtains and reviews sufficient supporting documentation for amounts calculated by another State agency prior to processing transactions.

FINDING (2710903)

3. Payroll Controls

MSF's internal control did not ensure that supervisors approved employee time sheets. In addition, MSF did not ensure that payroll costs charged to federal

programs were properly documented in accordance with federal compliance requirements.

Lack of appropriate approval and documentation could result in unauthorized payroll expenditures. Noncompliance with federal requirements could result in sanctions, disallowances, and/or future reductions in federal awards. Subsequent to our audit fieldwork, MSF obtained payroll certifications from its employees to demonstrate compliance with the federal regulations; therefore, we are not questioning costs for the CDBG federal program.

Section 18.1485 of the *Michigan Compiled Laws* (a section of Act 431, P.A. 1984, as amended) provides that State agencies are responsible for developing and maintaining a system of controls in accordance with generally accepted accounting principles, including a system of authorization and record-keeping procedures to control expenditures. In addition, Data Collection and Distribution System* (DCDS) Procedures Manual section 5.2.1 requires supervisors to approve employees' time sheets. MSF processed \$2.1 million in payroll expenditures through DCDS in fiscal year 2007-08.

We reviewed a sample of 40 time sheets on DCDS and noted that 9 (23%) of the time sheets were not approved by a supervisor. Supervisory approval provides assurance that employees' time is accurate and properly allocated to federal programs.

In addition, MSF did not have the appropriate semiannual payroll certifications or supervisor approval of time sheets in accordance with OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments* (Title 2, Part 225 of the *Code of Federal Regulations*). Federal regulations require employees working 100% on a federal program to complete a semiannual certification. In lieu of a semiannual certification, MSF can use supervisory approval of time sheets if employees work in a dedicated function and cannot be reassigned to another program. MSF relies on the supervisory approval of time sheets and does not complete semiannual certifications to support its allocation of federal funds. However, our sample of 40 time sheets included 34 time sheets for employees charged to the CDBG federal program and 7 (21%) time sheets that were not

* See glossary at end of report for definition.

approved by a supervisor. Therefore, MSF cannot rely on time sheets in lieu of semiannual certifications to support its allocation of federal funds.

RECOMMENDATIONS

We recommend that MSF ensure that supervisors approve employee time sheets.

We also recommend that MSF ensure that payroll costs charged to federal programs are properly documented in accordance with federal compliance requirements.

Section III: Findings and Questioned Costs* Related to Federal Awards

FINDING (2710904)

4. Payroll Controls

| | |
|--|---|
| U.S. Department of Housing and Urban Development | CFDA 14.228: Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii |
| Award Number: B-02-DC-26-0001 B-03-DC-26-0001 B-04-DC-26-0001 B-05-DC-26-0001 B-06-DC-26-0001 | Award Period: 01/01/2002 - Depletion 01/01/2003 - Depletion 01/01/2004 - Depletion 01/01/2005 - Depletion 01/01/2006 - Depletion |
| | Known Questioned Costs: \$0 |

This finding is included in Section II of the schedule of findings and questioned costs (2710903).

* See glossary at end of report for definition.

OTHER SCHEDULES

MICHIGAN STRATEGIC FUND
Summary Schedule of Prior Audit Findings
As of April 21, 2009

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL STATEMENTS

There were no findings related to the financial statements in the prior Single Audit*.

PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

There were no findings related to federal awards in the prior Single Audit.

* See glossary at end of report for definition.

MICHIGAN STRATEGIC FUND

Corrective Action Plan

As of April 22, 2009

FINDINGS RELATED TO THE FINANCIAL STATEMENTS

Finding Number: 2710901
Finding Title: Year-End Accruals

- Management Views:**
- a. The Michigan Strategic Fund (MSF) agrees with the Community Development Block Grant (CDBG) payables recommendation. MSF has worked in the past with the Office of the Auditor General and the Office of Financial Management and has established a procedure that has been in place for a number of years to record year-end payables for the CDBG program. MSF records payables based on the information provided by the grantee. In the current situation, MSF staff not only received the initial estimate but also followed up to get a better estimate for potential obligation. Absent response from the grantee, MSF staff did not estimate an additional payable amount for the grantee.
 - b. MSF agrees that payables for the Jobs for Michigan Investment Fund were not recorded. MSF did not consider them as an obligation until its portfolio management staff had an opportunity to review milestones and approve progress as required by the grant agreement.
 - c. MSF has a system in place to accrue interest on all of its outstanding loans. The majority of these loans allow borrowers to accumulate interest and then restate the principal by adding this accrued interest at the end of the stated period. The Jobs

for Michigan Investment Fund is a relatively new program and MSF wanted to evaluate repayment experience over a few years prior to recording such a large receivable.

Corrective Action:

- a. In the future, MSF will instruct staff to estimate the payable amount based on grantee budget and site visit progress reports if the situation warrants so. However, MSF stated that recording an estimated number could potentially result in the overrecording or underrecording of material obligation that could result in an audit citation in future years.
- b. MSF has recorded the payables for the Jobs for Michigan Investment Fund for the audit period and it will put a system in place similar to the CDBG program where MSF will record an estimated payable amount on all open grants at fiscal year-end based on the billings or estimates received from grantees.
- c. Based on this recommendation, MSF has recorded the interest through the end of the year and will now have a procedure in place to record accrued interest at fiscal year-end.

Anticipated Completion Date: February 2009

Responsible Individual: Minesh Mody

Finding Number: 2710902

Finding Title: Supporting Documentation

Management Views: MSF agrees with the recommendation. This was a unique transaction of a nonrecurring nature for MSF.

Corrective Action: MSF has made proper accounting entries to correct the situation and will ensure independent verification of funds held in trust by third parties for future years.

Anticipated Completion Date: February 2009

Responsible Individual: Minesh Mody

Finding Number: 2710903

Finding Title: Payroll Controls

Management Views: MSF agrees with the recommendation. MSF has been using supervisory approval of time sheets as a substitute for semiannual certifications to support its allocation of federal funds.

Corrective Action: MSF has had the appropriate supervisor sign a separate semiannual certification for employees charged to CDBG federal funds during the audit period. MSF has also instituted training and a policy requiring all managers to approve time in the Data Collection and Distribution System (DCDS) on a biweekly basis. This will also comply with federal regulation of semiannual certification for employees working on the CDBG program.

Anticipated Completion Date: April 2009

Responsible Individual: Minesh Mody

FINDINGS RELATED TO FEDERAL AWARDS

Finding Number: 2710904

Finding Title: Payroll Controls

See Finding 2710903 with the findings related to the financial statements.

GLOSSARY

Glossary of Acronyms and Terms

| | |
|--|---|
| CDBG | Community Development Block Grants. |
| Certificate of Participation | Financing in which an individual buys a share of the lease revenues of an agreement made by a municipal or governmental entity, rather than the bond being secured by those revenues. |
| control deficiency in internal control over federal program compliance | The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis noncompliance with a type of compliance requirement of a federal program. |
| control deficiency in internal control over financial reporting | The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. |
| Data Collection and Distribution System (DCDS) | The State's client/server system that records, allocates, and distributes payroll costs within the accounting system for the Michigan Administrative Information Network (MAIN) Human Resource System. |
| DELEG | Department of Energy, Labor & Economic Growth. |
| financial audit | An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are presented fairly in all material respects in conformity with the disclosed basis of accounting. |
| GAAP | accounting principles generally accepted in the United States of America. |

| | |
|---|---|
| GASB | Governmental Accounting Standards Board. |
| IDRB | industrial development revenue bond. |
| internal control | A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. |
| low-risk auditee | As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee. |
| material misstatement | A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting. |
| material noncompliance | Violations of laws, regulations, contracts, and grants that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts. |
| material weakness in internal control over federal program compliance | A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected. |

| | |
|--|---|
| material weakness in internal control over financial reporting | A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material misstatement of the financial schedules and/or financial statements will not be prevented or detected. |
| MEDC | Michigan Economic Development Corporation. |
| MEGA | Michigan Economic Growth Authority. |
| mezzanine fund | A type of investment fund that is primarily engaged in a hybrid of debt and equity financing that is typically used to finance the expansion of existing companies. It is generally used as an intermediate stage financing, preceding a company's initial public offering, and is considered less risky than start-up financing. |
| MSF | Michigan Strategic Fund. |
| private equity fund | A type of investment fund that buys majority interest in companies to restructure their capital, management, and organization. Usually, the companies are privately held for two to five years. |
| questioned cost | A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances. |

significant deficiency
in internal control over
federal program
compliance

A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of federal program that is more than inconsequential will not be prevented or detected.

significant deficiency
in internal control over
financial reporting

A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial schedules and/or financial statements that is more than inconsequential will not be prevented or detected.

Single Audit

A financial audit, performed in accordance with the Single Audit Act Amendments of 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in accordance with the requirements of auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, a Single Audit requires the assessment of compliance with requirements that could have a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with OMB Circular A-133.

SOMCAFR

State of Michigan Comprehensive Annual Financial Report.

Strategic Economic
Investment and
Commercialization
(SEIC) Board

A board that awards grants, loans, and investments from the 21st Century Jobs Trust Fund for basic research, applied research, university technology transfer, and commercialization of products, processes, and services to

encourage the development of competitive edge technologies to create jobs in Michigan.

subrecipient

A nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.

unqualified opinion

An auditor's opinion in which the auditor states that:

- a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or
- b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules and/or financial statements to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules and/or financial statements taken by themselves; or
- c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.

venture capital fund

A type of investment fund that invests in high-risk companies or small companies specializing in new technologies, often in return for an equity position in the firm.

