



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

Audit report information can be accessed at:

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Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit

Report Number:
271-0401-10

Michigan Strategic Fund

(A Discretely Presented Component Unit of the State of Michigan)

October 1, 2007 through September 30, 2009

Released:
January 2010

A financial audit determines if the financial statements are fairly presented; considers internal control over financial reporting; and determines compliance with requirements material to the financial statements. This financial audit of the Michigan Strategic Fund (MSF) was required by Act 270, P.A. 1984, as amended.

Financial Statements:

Auditor's Report Issued

We issued an unqualified opinion on MSF's basic financial statements.

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Internal Control Over Financial Reporting

We did not report any findings related to internal control over financial reporting.

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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*.

Background:

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.

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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

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Deputy Auditor General



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

January 20, 2010

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 of the Michigan Strategic Fund (MSF), a discretely presented component unit of the State of Michigan, for the period October 1, 2007 through September 30, 2009.

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, and required supplementary information. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters 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 governmental activities and each major fund 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, 2009 and September 30, 2008, which collectively comprise the Michigan Strategic Fund's basic financial statements 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 opinions 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 opinions.

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, 2009 and September 30, 2008 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 respective financial position of the governmental activities and each major fund of the Michigan Strategic Fund as of September 30, 2009 and September 30, 2008 and the respective 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 January 12, 2010 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 11 through 15 and the budgetary comparison schedule and budget-to-GAAP reconciliation and corresponding notes on pages 44 through 50 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, 2008 and September 30, 2007 was not presented because this information was presented with the Michigan Strategic Fund's prior year audited financial statements.

AUDITOR GENERAL

January 12, 2010

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, 2008 through September 30, 2009. 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, 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, and required supplementary information.

Major Changes

1. Effective March 2008, the State of Michigan settled a tribal gaming lawsuit. As part of the settlement, the State 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 the 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.

2. The Legislature appropriated \$394.0 million (subsequently reduced to \$338.0 million) in fiscal year 2005-06, \$125.0 million in fiscal year 2007-08, and \$62.0 million (subsequently reduced to \$53.0 million) in fiscal year 2008-09 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 total reimbursement for \$118 million for expenditures, loans, and investments during fiscal year 2008-09. This \$118 million was disbursed using \$35.3 million, \$70.0 million, and \$12.7 million from appropriation years 2006, 2008, and 2009, respectively.

Analysis of Financial Activities

The assets of MSF exceeded its liabilities by \$134.2 million at September 30, 2009 and by \$110.5 million at September 30, 2008. Total net assets increased by \$23.7 million during fiscal year 2008-09.

Condensed Financial Information **Statement of Net Assets** As of September 30

	<u>2009</u>	<u>2008</u>
Cash and equity in common cash	\$ 24,600,522	\$ 22,405,295
Amounts due from federal government	18,574,600	13,942,736
Other current assets	18,417,619	30,675,082
Total current assets	<u>\$ 61,592,741</u>	<u>\$ 67,023,115</u>
Noncurrent assets	204,434,603	185,945,861
Total assets	<u>\$ 266,027,344</u>	<u>\$ 252,968,976</u>
Current liabilities	\$ 45,215,461	\$ 55,687,732
Long-term liabilities	86,592,718	86,763,792
Total liabilities	<u>\$ 131,808,179</u>	<u>\$ 142,451,525</u>
Net assets	<u>\$ 134,219,165</u>	<u>\$ 110,517,451</u>

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 increased by \$4.6 million during fiscal year 2008-09.

Other current assets primarily consist of short-term loans receivable and accounts receivable for the tribal gaming revenue. Short-term loans receivable increased by \$4.0 million because of prior year long-term loan payments due within a year. The tribal gaming receivable decreased by \$17.8 million because the first payment due from one tribe in 2008 was recorded as revenues receivable at September 30, 2008. However, the same tribe paid the 2009 payment prior to the end of the fiscal year, thus having no need to record the receivable.

Noncurrent assets include the Capital Access Program cash available for long-term obligations of the Capital Access Program, capital lease receivable, loans receivable, interest receivable, and investments. The total increase in noncurrent assets was \$18.5 million primarily due to new loans and investments for the Michigan Jobs for Investment Fund program.

The total amount of loans and investments (net of loss provisions of \$9.1 million) included in the current and noncurrent assets category is \$117.2 million.

Current liabilities primarily consist of accounts payable, amounts due to component units, and interest payable related to the limited obligation revenue bonds. Total current liabilities decreased by \$10.5 million during fiscal year 2008-09. This change was primarily related to a decrease in amounts due to the Michigan Economic Development Corporation (MEDC), a component unit of the State of Michigan, for the casino revenues as well as an increase in accounts payable.

Long-term liabilities primarily consist of bonds payable and obligations of the Capital Access Program.

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

	2009	2008
Expenses		
Community Development Block Grants (CDBG)	\$ 35,500,991	\$ 45,320,957
Jobs for Michigan Investment Fund	92,749,536	73,687,968
Payments to MEDC	56,150,015	66,958,093
Other	7,165,288	4,867,248
Total program expenses	\$ 191,565,830	\$ 190,834,266
Program revenues		
Charges for services	\$ 2,870,737	\$ 3,120,375
Operating grants and contributions	35,292,346	45,208,208
Total program revenues	\$ 38,163,083	\$ 48,328,583
Net program expenses	\$ 153,402,747	\$ 142,505,683
General revenues		
Payments from the State of Michigan	\$ 145,752,853	\$ 123,174,112
Other	31,351,608	42,057,615
Total general revenues	\$ 177,104,461	\$ 165,231,727
Increase in net assets	\$ 23,701,714	\$ 22,726,044
Net assets - Beginning	110,517,451	87,791,407
Net assets - Ending	\$ 134,219,165	\$ 110,517,451

CDBG expenses decreased by \$9.8 million in fiscal year 2008-09 because of slower project activities.

Jobs for Michigan Investment Fund expenses increased by \$19.1 million in fiscal year 2008-09 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 primarily consist of MSF State appropriations transferred to fund programs administered by MEDC and tribal gaming revenue. The payments to MEDC decreased by \$10.8 million in fiscal year 2008-09 primarily because of an overall spending reduction in State appropriated funds.

Operating grants and contributions primarily reflect the funds received from the federal government for the CDBG Program. The reduction in CDBG federal pass-through grant expenditures by the subgrantees corresponds to decreased federal revenues to MSF.

Payments from the State of Michigan primarily consist of appropriations from the State General Fund of \$27.7 million and reimbursements from the 21st Century Jobs Trust Fund of \$118 million. The revenue from the 21st Century Jobs Trust Fund for grants, loans, investments, and promotion programs increased by \$27.8 million as a result of increased program expenditures as well as loans made using these funds.

Other revenues decreased by \$10.7 million during fiscal year 2008-09 as a result of low interest and investment earnings.

Other Pertinent Information

From fiscal year 1996-97 through fiscal year 2008-09, 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, 2009, local governmental entities had earned \$20.3 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 \$6.7 million of federal funds from local governmental 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

	2009	2008
ASSETS		
Current assets:		
Cash (Note 2)	\$ 2,157,985	\$ 2,515,105
Equity in common cash (Note 2)	21,826,185	19,776,020
Capital Access Program - Cash (Note 2)	167,352	114,170
Michigan Supplier Diversification Fund - Collateral Deposit	449,000	
Amounts due from federal government	18,574,600	13,942,736
Amount due from component unit		29,622
Loans receivable (Note 3)	5,834,735	1,866,076
Capital lease receivable (Note 4)	323,770	309,973
Other current assets	12,259,114	28,469,411
Total current assets	\$ 61,592,741	\$ 67,023,115
Noncurrent assets:		
Capital Access Program (Notes 2 and 5)	\$ 5,366,875	\$ 5,588,589
Capital lease receivable (Note 4)	83,657,180	83,980,950
Loans receivable (Note 3)	70,718,324	58,387,654
Interest receivable (Note 3)	4,009,910	4,922,302
Investments (Note 2)	40,682,314	33,066,366
Total noncurrent assets	\$ 204,434,603	\$ 185,945,861
Total assets	\$ 266,027,344	\$ 252,968,976
LIABILITIES		
Current liabilities:		
Accounts payable and other liabilities	\$ 30,759,199	\$ 23,765,307
Amounts due to component units	10,656,636	27,730,013
Capital Access Program (Note 5)	1,300,000	1,500,000
Compensated absences (Note 5)	268,440	154,751
Amounts due to primary government	39,118	25,026
Interest payable	1,861,642	2,222,687
Bonds payable (Note 7)	233,841	218,841
Deferred revenue	96,585	71,108
Total current liabilities	\$ 45,215,461	\$ 55,687,732
Long-term liabilities:		
Bonds payable (Note 7)	\$ 82,333,214	\$ 82,552,055
Deferred revenue		
Capital Access Program (Note 5)	4,066,875	4,088,589
Compensated absences (Note 5)	192,629	123,148
Total long-term liabilities	\$ 86,592,718	\$ 86,763,792
Total liabilities	\$ 131,808,179	\$ 142,451,525
NET ASSETS		
Unrestricted net assets	\$ 134,219,165	\$ 110,517,451
Total net assets	\$ 134,219,165	\$ 110,517,451

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

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

	<u>2009</u>	<u>2008</u>
EXPENSES (Note 1)		
Administrative	\$ 771,236	\$ 597,600
Community Development Block Grants	35,500,991	45,320,957
Michigan Film Office	646,414	273,548
Jobs for Michigan Investment Fund - Operations	43,553,028	29,518,914
Jobs for Michigan Investment Fund - Pass-through funds	2,245,349	6,852,150
Jobs for Michigan Investment Fund - Programs	46,951,159	37,316,904
Payments to MEDC	56,150,015	66,958,093
Payments to General Fund (indirect and refund)	152,588	228,626
Other interest	3,862,798	2,113,877
Miscellaneous and receivable write-off	1,732,252	1,653,597
Total program expenses	<u>\$ 191,565,830</u>	<u>\$ 190,834,266</u>
PROGRAM REVENUES (Note 1)		
<u>Charges for services</u>		
PAB issuance fees	\$ 230,756	\$ 916,409
Other fees	2,639,981	2,203,966
<u>Operating grants and contributions</u>		
Community Development Block Grants (federal)	33,836,748	42,766,390
Community Development Block Grants (local and others)	1,455,598	2,441,818
Total program revenues	<u>\$ 38,163,083</u>	<u>\$ 48,328,583</u>
Net program expenses	<u>\$ 153,402,747</u>	<u>\$ 142,505,683</u>
GENERAL REVENUES (Note 1)		
<u>Payments from the State of Michigan</u>		
Payments from General Fund	\$ 27,704,072	\$ 32,962,448
Payments from 21st Century Trust Fund	118,048,781	90,211,664
<u>Other</u>		
Payments from MEDC - Other	49,159	27,275
Interest and investment earnings	1,858,592	8,461,685
Net increase (decrease) in fair value of investments	(4,209,434)	(2,172,610)
Tribal gaming	28,363,103	30,186,919
Lease revenue	3,751,790	1,887,129
Miscellaneous and payable write-off	1,538,398	3,667,217
Total general revenues	<u>\$ 177,104,461</u>	<u>\$ 165,231,727</u>
Increase in net assets	<u>\$ 23,701,714</u>	<u>\$ 22,726,044</u>
Net assets - Beginning	<u>110,517,451</u>	<u>87,791,407</u>
Net assets - Ending	<u>\$ 134,219,165</u>	<u>\$ 110,517,451</u>

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

MICHIGAN STRATEGIC FUND
Governmental Fund Balance Sheet
As of September 30

	2009			
	General Operations	Jobs for Michigan Investment Fund	Debt Service Fund	Total
ASSETS				
Current assets:				
Cash (Note 2)	\$ 116,410	\$	\$ 2,041,575	\$ 2,157,985
Equity in common cash (Note 2)	488,991	21,337,194		21,826,185
Capital Access Program - Cash (Note 2)	167,352			167,352
Michigan Supplier Diversification Fund - Collateral Deposit	449,000			449,000
Amounts due from federal government	18,574,600			18,574,600
Amounts due from general operations (Note 9)				0
Amounts due from component unit				0
Loans receivable (Note 3)		5,834,735		5,834,735
Other current assets	10,174,233	2,084,881		12,259,114
Total current assets	<u>\$ 29,970,586</u>	<u>\$ 29,256,810</u>	<u>\$ 2,041,575</u>	<u>\$ 61,268,971</u>
Noncurrent assets:				
Capital Access Program (Note 2)	\$ 5,366,875	\$	\$	\$ 5,366,875
Loans receivable (Note 3)		70,718,324		70,718,324
Interest receivable (Note 3)		4,009,910		4,009,910
Investments (Note 2)		40,682,314		40,682,314
Total noncurrent assets	<u>\$ 5,366,875</u>	<u>\$ 115,410,548</u>	<u>\$ 0</u>	<u>\$ 120,777,423</u>
Total assets	<u>\$ 35,337,461</u>	<u>\$ 144,667,358</u>	<u>\$ 2,041,575</u>	<u>\$ 182,046,394</u>
LIABILITIES				
Current liabilities:				
Accounts payable and other liabilities	\$ 18,256,439	\$ 12,502,760	\$	\$ 30,759,199
Amounts due to Jobs for Michigan Investment Fund (Note 9)				0
Amounts due to component units	4,550,227	81,409		4,631,636
Capital Access Program (Note 5)	1,300,000			1,300,000
Amounts due to primary government	14,624	24,495		39,119
Deferred revenue	6,121,585	1,730,000		7,851,585
Total current liabilities	<u>\$ 30,242,875</u>	<u>\$ 14,338,664</u>	<u>\$ 0</u>	<u>\$ 44,581,539</u>
Long-term liabilities:				
Deferred revenue (Note 3)	\$	\$ 4,009,910	\$	\$ 4,009,910
Capital Access Program (Note 5)	4,066,875			4,066,875
Total long-term liabilities	<u>\$ 4,066,875</u>	<u>\$ 4,009,910</u>	<u>\$ 0</u>	<u>\$ 8,076,785</u>
Total liabilities	<u>\$ 34,309,750</u>	<u>\$ 18,348,574</u>	<u>\$ 0</u>	<u>\$ 52,658,324</u>
FUND BALANCE				
Reserved fund balance (Note 11)	\$	\$ 114,187,535	\$ 2,041,575	\$ 116,229,110
Unreserved fund balance	1,027,711	12,131,249		13,158,960
Total fund balance	<u>\$ 1,027,711</u>	<u>\$ 126,318,784</u>	<u>\$ 2,041,575</u>	<u>\$ 129,388,070</u>
Total liabilities and fund balance	<u>\$ 35,337,461</u>	<u>\$ 144,667,358</u>	<u>\$ 2,041,575</u>	<u>\$ 182,046,394</u>

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

2008

General Operations	Jobs for Michigan Investment Fund	Debt Service Fund	Total
\$ 111,210	\$ 19,776,019	\$ 2,403,895	\$ 2,515,105
114,170			19,776,019
			114,170
			0
13,942,736			13,942,736
	566,557		566,557
4,017	25,605		29,622
	1,866,076		1,866,076
27,973,927	495,484		28,469,411
<u>\$ 42,146,061</u>	<u>\$ 22,729,742</u>	<u>\$ 2,403,895</u>	<u>\$ 67,279,698</u>
\$ 5,588,589	\$ 58,387,654	\$	\$ 5,588,589
	4,922,302		58,387,654
	33,066,366		4,922,302
			33,066,366
<u>\$ 5,588,589</u>	<u>\$ 96,376,322</u>	<u>\$ 0</u>	<u>\$ 101,964,911</u>
<u>\$ 47,734,650</u>	<u>\$ 119,106,063</u>	<u>\$ 2,403,895</u>	<u>\$ 169,244,609</u>
\$ 13,525,799	\$ 10,239,508	\$	\$ 23,765,307
566,557			566,557
21,526,640			21,526,640
1,500,000			1,500,000
8,788	16,238		25,026
6,274,480			6,274,480
<u>\$ 43,402,265</u>	<u>\$ 10,255,746</u>	<u>\$ 0</u>	<u>\$ 53,658,011</u>
\$	\$ 4,922,302	\$	\$ 4,922,302
4,088,589			4,088,589
<u>\$ 4,088,589</u>	<u>\$ 4,922,302</u>	<u>\$ 0</u>	<u>\$ 9,010,890</u>
<u>\$ 47,490,854</u>	<u>\$ 15,178,047</u>	<u>\$ 0</u>	<u>\$ 62,668,901</u>
\$	\$ 98,201,099	\$ 2,403,895	\$ 100,604,995
243,796	5,726,917		5,970,713
<u>\$ 243,796</u>	<u>\$ 103,928,016</u>	<u>\$ 2,403,895</u>	<u>\$ 106,575,707</u>
<u>\$ 47,734,650</u>	<u>\$ 119,106,063</u>	<u>\$ 2,403,895</u>	<u>\$ 169,244,609</u>

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

	2009	2008
Total fund balance	\$ 129,388,070	\$ 106,575,707
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.	83,980,950	84,290,923
Compensated absences are not due and payable in the current period and therefore are not reported in the governmental fund statement.	(461,069)	(277,899)
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	(82,567,055)	(82,770,896)
Interest payable	(1,861,642)	(2,222,687)
Amounts due to component units are not due and payable in the current period and therefore are not reported in the governmental fund statement.	(6,025,000)	
Deferred revenue is not available for the current period and therefore is not recognized as revenue in the governmental fund statement.	11,764,910	4,922,302
Net assets of governmental activities	\$ 134,219,165	\$ 110,517,451

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

	2009			Total
	General Operations	Jobs for Michigan Investment Fund	Debt Service Fund	
REVENUES (Note 1)				
<u>Charges for services</u>				
PAB issuance fees	\$ 230,756	\$	\$	\$ 230,756
Other fees	2,639,981			2,639,981
<u>Operating grants and contributions</u>				
Community Development Block Grants (federal)	33,836,748			33,836,748
Community Development Block Grants (local and others)	1,455,598			1,455,598
<u>Payments from the State of Michigan</u>				
Payments from General Fund	27,704,072			27,704,072
Payments from 21st Century Jobs Trust Fund		118,048,781		118,048,781
<u>Other</u>				
Tribal gaming	26,811,476			26,811,476
Payments from MEDC - Other	49,159			49,159
Interest and investment earnings	14,284	1,840,708	3,600	1,858,592
Net increase (decrease) in fair value of investments		(4,209,434)		(4,209,434)
Lease revenue			4,061,763	4,061,763
Miscellaneous and receivable/payable write-off	1,160,402	377,996		1,538,398
Total revenues	<u>\$ 93,902,476</u>	<u>\$ 116,058,051</u>	<u>\$ 4,065,363</u>	<u>\$ 214,025,890</u>
EXPENDITURES (Note 1)				
Administrative	\$ 588,067	\$	\$	\$ 588,067
Building and renovation - Capitalized purchases				0
Other interest			4,422,683	4,422,683
Debt service principal redemption			5,000	5,000
Community Development Block Grants	35,500,991			35,500,991
Michigan Film Office	646,414			646,414
Jobs for Michigan Investment Fund - Operations		43,553,028		43,553,028
Jobs for Michigan Investment Fund - Pass-through funds		2,245,349		2,245,349
Jobs for Michigan Investment Fund - Programs	(449,000)	47,400,159		46,951,159
Payments to MEDC	56,328,388			56,328,388
Payments to General Fund (indirect and refund)	152,588			152,588
Miscellaneous and receivable write-off	819,860			819,860
Total expenditures	<u>\$ 93,587,308</u>	<u>\$ 93,198,536</u>	<u>\$ 4,427,683</u>	<u>\$ 191,213,527</u>
Excess of revenues over/(under) expenditures	<u>\$ 315,168</u>	<u>\$ 22,859,515</u>	<u>\$ (362,320)</u>	<u>\$ 22,812,363</u>
OTHER FINANCING SOURCES (USES) (Note 10)				
Bond proceeds	\$	\$	\$	\$ 0
Bond premium				0
Transfer from Jobs for Michigan Investment Fund	468,747			468,747
Transfer to General Operations Fund		(468,747)		(468,747)
Other financing sources (uses)	<u>\$ 468,747</u>	<u>\$ (468,747)</u>	<u>\$ 0</u>	<u>\$ 0</u>
Net change in fund balances	\$ 783,915	\$ 22,390,768	\$ (362,320)	\$ 22,812,363
Fund balance - Beginning	243,796	103,928,016	2,403,895	106,575,707
Fund balance - Ending	<u>\$ 1,027,711</u>	<u>\$ 126,318,784</u>	<u>\$ 2,041,575</u>	<u>\$ 129,388,070</u>

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

2008

General Operations	Jobs for Michigan Investment Fund	Debt Service Fund	Total
\$ 916,409	\$	\$	\$ 916,409
2,203,966			2,203,966
42,766,390			42,766,390
2,441,818			2,441,818
32,962,448			32,962,448
	90,211,664		90,211,664
50,863,547			50,863,547
27,275			27,275
1,801,806	1,725,609	11,969	3,539,383
	(2,172,610)		(2,172,610)
		2,391,927	2,391,927
3,629,373	37,844		3,667,217
<u>\$ 137,613,031</u>	<u>\$ 89,802,507</u>	<u>\$ 2,403,895</u>	<u>\$ 229,819,434</u>
\$ 724,972	\$	\$	\$ 724,972
84,795,722			84,795,722
45,320,957			45,320,957
273,548			273,548
	29,518,914		29,518,914
	6,852,150		6,852,150
	37,316,904		37,316,904
87,634,721			87,634,721
228,626			228,626
1,653,597			1,653,597
<u>\$ 220,632,143</u>	<u>\$ 73,687,968</u>	<u>\$ 0</u>	<u>\$ 294,320,111</u>
<u>\$ (83,019,111)</u>	<u>\$ 16,114,539</u>	<u>\$ 2,403,895</u>	<u>\$ (64,500,677)</u>
\$ 79,780,000	\$	\$	\$ 79,780,000
3,099,706			3,099,706
196,712			196,712
	(196,712)		(196,712)
<u>\$ 83,076,418</u>	<u>\$ (196,712)</u>	<u>\$ 0</u>	<u>\$ 82,879,706</u>
\$ 57,307	\$ 15,917,827	\$ 2,403,895	\$ 18,379,029
186,489	88,010,189		88,196,678
<u>\$ 243,796</u>	<u>\$ 103,928,016</u>	<u>\$ 2,403,895</u>	<u>\$ 106,575,707</u>

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

	2009	2008
Net change in fund balance	\$ 22,812,363	\$ 18,379,029
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.	1,551,627	(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.	(309,973)	(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.	178,373	20,676,628
Other interest expense for bonds payable is not recorded in the governmental fund statement.	559,885	(2,113,877)
Debt service principal redemption is reported as an expenditure in the governmental fund statement.	5,000	
Miscellaneous and receivable/payable write-offs were not recorded in the governmental fund statement for receivables recorded in the statement of activities.	(912,392)	
Compensated absences is not reported in the governmental fund statement because payments are not due and do not use current financial resources.	(183,169)	127,372
Change in net assets of governmental activities	\$ 23,701,714	\$ 22,726,044

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 the 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 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, PAB issuance fees (private activity bond [PAB] was previously known as industrial development revenue bond [IDRB]), and other fees (including 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 PAB, MEGA, and Brownfield; and State appropriations for programs administered by MEDC. Expenditures also include administrative and other miscellaneous costs.
- (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	
	2009	2008
State of Michigan's equity in common cash	\$ 21,826,185	\$ 19,776,020
Deposits	2,325,337	2,629,275
Capital Access Program	5,366,875	5,588,589
Michigan Supplier Diversification Program	449,000	
Total deposits	\$ 29,967,397	\$ 27,993,884

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 \$8,670,680 at September 30, 2009 and \$8,795,300 at September 30, 2008. The majority of these balances are from the various bank accounts within the Capital Access Program. Of these amounts, \$3,913,919 as of September 30, 2009 and \$5,886,796 as of September 30, 2008 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, 2009 and September 30, 2008, 99.96% and 99.9%, 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

* See glossary at end of report for definition.

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.

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	
	2009	2008
Venture capital - Limited partner	\$14.1	\$12.2
Venture capital - Stockholder	15.9	12.8
Mezzanine funds	6.4	6.3
Private equity	4.3	1.8
Total investments	<u>\$40.7</u>	<u>\$33.1</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 US Trust - Bank of America 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, 2009 and September 30, 2008:

Name of Issuer	September 30, 2009		September 30, 2008	
	Amount (millions)	Percentage of Investment	Amount (millions)	Percentage of Investment
Pronai	\$5.8	14.3%	\$5.8	17.6%
Integrated Sensing Systems, Inc.	\$4.9	12.0%	\$1.8	5.5%
Midwest Mezzanine	\$4.8	11.9%	\$5.3	16.0%
Venture Investors IV	\$3.7	9.2%	\$2.3	6.8%
Arboretum	\$3.3	8.1%	\$2.9	8.8%
Nth Power	\$2.8	6.8%	\$2.7	8.2%
Quad Partners	\$2.6	6.3%		
Relativity			\$1.7	5.2%

Note 3 Loans and Interest Receivable

Loans receivable totaled \$76,553,059 at September 30, 2009 and \$60,253,731 at September 30, 2008 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 \$4.0 million (\$4.9 million at September 30, 2008) 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 the fiscal year

* See glossary at end of report for definition.

2007-08 financial statements different from the *SOMCAFR* because the interest receivable and deferred revenue were recorded after the issuance of the *SOMCAFR*.

Loan Category	Loans Receivable as of September 30	
	2009	2008
Technology Tri-Corridor	\$10,315,036	\$11,118,410
Life Sciences	2,767,349	4,458,235
Competitive Edge Technology:		
Advanced Automotive, Manufacturing, and Materials Technology	10,234,194	6,139,643
Life Sciences Technology	38,418,580	26,988,049
Homeland Security and Defense Technology	7,550,786	4,882,900
Alternative Energy Technology	7,267,114	6,666,494
Total	<u>\$76,553,059</u>	<u>\$60,253,731</u>

Note 4 Capital 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.

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, 2009:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$ 5,588,589	\$1,322,034	\$1,543,747	\$ 5,366,875	\$ 1,300,000
Compensated absences	\$ 277,899	\$ 291,213	\$ 108,044	\$ 461,069	\$ 268,440
Bonds payable	\$79,780,000		\$ 5,000	\$79,775,000	\$ 35,000
Unamortized premium	\$ 2,990,896		\$ 198,841	\$ 2,792,055	\$ 198,841

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

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 plus the State's share of social security and retirement contributions and a portion of the sick leave, based on the pay rates in effect as of September 30, 2009 and September 30, 2008, respectively.

Liabilities for the Capital Access Program consist of an obligation to reimburse financial institutions for possible future loan defaults on high-risk business loans. An asset for the same amount represents the available cash balance that can be used to reimburse the financial institutions for future loan defaults.

Additions to the Capital Access Program liabilities 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, 2009 there were 45 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 30.6% (\$392,284) and 26.5% (\$352,580) of its payroll costs for pension charges and retiree postemployment benefits in fiscal years 2008-09 and 2007-08, 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 \$14,589 and \$12,104 for fiscal years 2008-09 and 2007-08, 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, 2009 and September 30, 2008, MSF reimbursed MEDC for contributions to the plan of \$67,983 and \$62,488, 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, 2009 and September 30, 2008, employees contributed \$78,553 and \$76,237, 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:

Fiscal Year	Principal	Interest	Total
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	50,025,000	8,449,631	58,474,631
Total	\$79,775,000	\$40,945,994	\$120,720,994
Unamortized premium	2,792,055		2,792,055
Total	\$82,567,055	\$40,945,994	\$123,513,049

* See glossary at end of report for definition.

Note 8 Limited Obligation Debt - Private Activity Bonds (PABs)

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 PABs issued by MSF and its predecessor entity for the period January 1, 1979 through September 30, 2009 was \$8,652,893,525 (\$8,285,983,525 through September 30, 2008). The amount of tax-exempt bonds issued during fiscal year 2008-09 was \$324,535,000 (\$104,648,949 for fiscal year 2007-08). There were \$42,375,000 bonds issued by MSF under the Taxable Bond Program for fiscal year 2008-09 (\$2,360,000 for fiscal year 2007-08).

Note 9 Interfund Receivable and Payable and Interfund Eliminations

As of September 30, 2008, an interfund payable for \$566,557 (none as of September 30, 2009) was recorded in general operations and an interfund receivable for \$566,557 (none as of September 30, 2009) 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 for fiscal year 2007-08.

Note 10 Other Financing Sources

There were no "Other Financing Sources" during fiscal year 2008-09. 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).

Note 11 Reserved Fund Balance

Reserved fund balance (in millions) consists of:

	As of September 30	
	2009	2008
Noncurrent loans	\$ 70.7	\$ 58.4
Noncurrent investments	40.7	33.1
Encumbrances	2.8	6.7
Debt service	2.0	2.4
Total reserved fund balance	<u>\$116.2</u>	<u>\$100.6</u>

REQUIRED SUPPLEMENTARY INFORMATION

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

Budgetary Comparison Schedule (Statutory/Budgetary Basis)	2009			Variance With Final Budget
	Original Budget	Final Budget	Actual	
Beginning budgetary fund balance	\$ 15,121,687	\$ 15,121,687	\$ 15,121,687	\$ 0
Resources (inflows):				
Revenues and other sources:				
Charges for services (Note 2)	\$ 85,500	\$ 85,500	\$ 2,870,737	\$ (2,785,237)
Operating grants and contributions	55,438,800	64,738,800	35,292,346	29,446,454
Payments from the State of Michigan:				
From General Fund	29,603,800	27,741,100	27,704,072	37,028
From 21st Century Jobs Trust Fund (Note 3)	323,668,209	309,668,209	118,048,781	191,619,428
Other miscellaneous (Note 4)	3,042,304	3,042,304	30,109,954	(27,067,650)
Other financing sources (Note 6)				
Total revenues and other sources	<u>\$ 411,838,613</u>	<u>\$ 405,275,913</u>	<u>\$ 214,025,890</u>	<u>\$ 191,250,023</u>
Total resources available	<u>\$ 426,960,300</u>	<u>\$ 420,397,600</u>	<u>\$ 229,147,577</u>	<u>\$ 191,250,023</u>
Charges (outflows):				
Expenditures, transfers out, and encumbrances:				
Administrative (Note 2)	\$	\$	\$ 588,067	\$ (588,067)
Community Development Block Grants	55,744,054	65,044,054	35,500,991	29,543,063
Other Interest			4,422,683	(4,422,683)
Debt service principal redemption			5,000	(5,000)
Building and renovation - Capitalized purchases (Note 6)				
Jobs for Michigan Investment Fund - Appropriation Year 2006	155,926,187	150,976,187	35,285,435	115,690,752
Jobs for Michigan Investment Fund - Appropriation Year 2008	105,742,022	105,742,022	70,018,491	35,723,531
Jobs for Michigan Investment Fund - Appropriation Year 2009	62,000,000	52,950,000	12,744,855	40,205,145
Jobs for Michigan Investment Fund - Permanent Fund	1,250,000	1,250,000	435,000	815,000
Payments to MEDC:				
Administration	2,555,100	2,518,600	2,518,382	218
Job creation services	14,324,946	14,118,946	13,363,392	755,555
Michigan Promotion Program	5,717,500	5,717,500	5,717,500	0
Economic Development Job Training Grants	7,320,500	5,704,600	5,704,600	0
Michigan State University Bioenergy Research Center				
Human resources optimization user charges				
PAB, MEGA, and tribal gaming revenue (Notes 2 and 4)			29,024,514	(29,024,514)
Michigan Film Office	731,600	727,300	646,414	80,886
Payments to General Fund			152,588	(152,588)
Miscellaneous and receivable write-off	526,704	526,704	819,860	(293,156)
Total charges	<u>\$ 411,838,613</u>	<u>\$ 405,275,913</u>	<u>\$ 216,947,772</u>	<u>\$ 188,328,142</u>
Reconciling items:				
Changes in noncurrent assets	<u>\$ 0</u>	<u>\$ 4,869,880</u>	<u>\$ 4,869,880</u>	<u>\$ 0</u>
Net reconciling items	<u>\$ 0</u>	<u>\$ 4,869,880</u>	<u>\$ 4,869,880</u>	<u>\$ 0</u>
Ending budgetary fund balance	<u>\$ 15,121,687</u>	<u>\$ 19,991,567</u>	<u>\$ 17,069,685</u>	<u>\$ 2,921,881</u>

This schedule continued on next page.

2008

Original Budget	Final Budget	Actual	Variance With Final Budget
\$ 21,245,560	\$ 21,245,560	\$ 21,245,560	\$ 0
\$ 85,200	\$ 85,200	\$ 3,120,375	\$ (3,035,175)
55,430,700	55,430,700	45,208,208	10,222,492
29,493,100	33,072,272	32,962,448	109,824
301,879,873	351,879,873	90,211,664	261,668,209
8,066,397	8,116,397	58,316,739	(50,200,343)
		83,076,418	(83,076,418)
<u>\$ 394,955,270</u>	<u>\$ 448,584,442</u>	<u>\$ 312,895,852</u>	<u>\$ 135,688,590</u>
\$ 416,200,829	\$ 469,830,001	\$ 334,141,411	\$ 135,688,590
\$ 55,729,256	\$ 55,729,256	\$ 724,972	\$ (724,972)
		45,320,957	10,408,298
		84,795,722	(84,795,722)
226,879,873	226,879,873	70,953,686	155,926,187
75,000,000	125,000,000	19,257,978	105,742,022
5,700,000	5,700,000	5,700,000	0
2,542,400	2,542,400	2,493,450	48,950
14,273,844	14,273,844	13,500,865	772,980
5,717,500	5,717,500	5,717,500	0
7,441,000	7,441,000	7,427,109	13,891
	3,500,000	3,500,000	0
17,800	17,800	14,388	3,412
		54,981,409	(54,981,409)
	129,172	273,548	(144,376)
		228,626	(228,626)
1,653,597	1,653,597	1,653,597	0
<u>\$ 394,955,270</u>	<u>\$ 448,584,442</u>	<u>\$ 316,543,807</u>	<u>\$ 132,040,635</u>
\$	\$ (2,475,918)	\$ (2,475,918)	\$ 0
\$ 0	\$ (2,475,918)	\$ (2,475,918)	\$ 0
<u>\$ 21,245,560</u>	<u>\$ 18,769,642</u>	<u>\$ 15,121,687</u>	<u>\$ 3,647,955</u>

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

Budget-to-GAAP Reconciliation	2009		Actual	Variance With Final Budget
	Original Budget	Final Budget		
Resources (inflows):				
Actual amount (budgetary basis) of "Total resources available"			\$ 229,147,577	
Differences - Budget to GAAP:				
Beginning budgetary fund balance is a budgetary resource but is not a current year revenue for financial reporting purposes			(15,121,687)	
Other financing sources are inflows of budgetary resources but are not revenues for financial reporting purposes				
Total revenues (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance			\$ 214,025,890	
Charges (outflows):				
Actual amount (budgetary basis) of "Total charges"			\$ 216,947,772	
Differences - Budget to GAAP:				
Other financing uses are outflows of budgetary resources but are not expenditures for financial reporting purposes			(468,747)	
Loans and investments are outflows for budgetary reporting purposes but are not expenditures for financial reporting purposes			(25,265,498)	
Total expenditures (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance			\$ 191,213,527	

See accompanying notes to required supplementary information.

2008

<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance With Final Budget</u>
		\$ 334,141,411	
		(21,245,560)	
		(83,076,418)	
		<u>\$ 229,819,434</u>	
		\$ 316,543,807	
		(196,712)	
		(22,026,984)	
		<u>\$ 294,320,111</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, the Jobs for Michigan Investment Fund, and other State programs. 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 2008-09 and 2007-08, 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 from annual appropriations bills, as amended, for the years 2005 through 2009 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, private activity bonds (formerly known as industrial development revenue bonds), 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 expenditure.

Note 3 Payments From the 21st Century Jobs Trust Fund

Act 225, P.A. 2005, appropriated \$394.0 million (subsequently reduced to \$338.0 million) in fiscal year 2005-06; Act 127, P.A. 2007, and Act 98, P.A. 2008, appropriated \$125.0 million in fiscal year 2007-08; and Act 261, P.A. 2008, appropriated \$62.0 million (subsequently reduced to \$53.0 million) in fiscal year 2008-09 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 \$118 million and \$90.2 million from the 21st Century Jobs Trust Fund for fiscal years 2008-09 and 2007-08, respectively.

Note 4 Tribal Gaming

The other miscellaneous revenues in the actual column include tribal gaming revenue of \$ 26.8 million. The payments to MEDC include the tribal gaming revenue transferred to MEDC per the interlocal government agreement.

Note 5 Jobs for Michigan Investment Fund Charges for Appropriation Years 2006, 2008, and 2009

MSF has received a work project authorization for all Jobs for Michigan Investment Fund related appropriations and is thus permitted to spend unspent appropriations over multiple years. The original budget amount for appropriation year 2006 and appropriation year 2008 reflects the carryforward of unspent appropriation from these years.

Charges are financed by the funds appropriated by enabling acts stated in Note 3. Total charges for fiscal year 2008-09 were \$118 million, of which \$25.3 million was disbursed for investments and loans. Total charges for fiscal year 2007-08 were \$90.2 million, of which \$22.0 million was disbursed for investments and loans. Investments and loans are not expenditures for financial reporting purposes and are thus listed as a budget-to-GAAP reconciling item.

Note 6 Other Financing Sources and Building and Renovation - Capitalized Purchases
Other financing sources in fiscal year 2007-08 included one time 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. No such activity took place during fiscal year 2008-09.

INDEPENDENT AUDITOR'S REPORT ON
INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN
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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 governmental activities and each major fund 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, 2009 and September 30, 2008, which collectively comprise the Michigan Strategic Fund's basic financial statements, and have issued our report thereon dated January 12, 2010. 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 opinions 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.

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.

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 or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined in the preceding paragraph.

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*.

This report is intended solely for the information and use of the Governor, the Legislature, the Michigan Strategic Fund Board of Directors, management, and others within the entity 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

January 12, 2010

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.
DELEG	Department of Energy, Labor & Economic Growth.
DLJ	DLJ MB Advisors, Inc.
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.

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.
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.
PAB	private activity bond.
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.
<i>SOMCAFR</i>	<i>State of Michigan Comprehensive Annual Financial Report.</i>
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.

unqualified opinion

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

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.

