



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

Michigan Strategic Fund

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

October 1, 2009 through September 30, 2011

Report Number:
271-0401-12

Released:
April 2012

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 unqualified opinions on MSF's basic financial statements.

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Internal Control Over Financial Reporting

We identified a material weakness in internal control over financial reporting (Finding 1).

MSF's internal control over financial reporting did not ensure that accounting transactions and financial statement balances were properly recorded and reported in accordance with generally accepted accounting principles. As a result, we identified several financial statement errors during our audit that, when brought to MSF's attention, were corrected (Finding 1).

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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*.

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Agency Response:

Our audit report includes 1 finding and 1 corresponding recommendation. MSF's preliminary response indicates that it agrees with the recommendation.

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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

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



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

April 13, 2012

Mr. Michael A. Finney
President and Chief Executive Officer, Michigan Strategic Fund
Chair, Michigan Strategic Fund Board of Directors
300 North Washington Square
Lansing, Michigan

Dear Mr. Finney:

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, 2009 through September 30, 2011.

This report contains our report summary; our independent auditor's report on the financial statements; the MSF management's discussion and analysis; and 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; our finding, recommendation, and agency preliminary response; and a glossary of acronyms and terms.

The agency preliminary response was taken from the agency's response subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a plan to comply with the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

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

Sincerely,


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

TABLE OF CONTENTS

MICHIGAN STRATEGIC FUND

	<u>Page</u>
INTRODUCTION	
Report Summary	1
Report Letter	3
INDEPENDENT AUDITOR'S REPORT	
Independent Auditor's Report on the Financial Statements	8
MANAGEMENT'S DISCUSSION AND ANALYSIS	
Management's Discussion and Analysis	11
BASIC FINANCIAL STATEMENTS	
Entity-Wide Financial Statements	
Statement of Net Assets	18
Statement of Activities	19
Governmental Fund Financial Statements	
Governmental Fund Balance Sheet	20
Reconciliation of the Governmental Fund Balance Sheet to the Statement of Net Assets	23
Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balance	24

Reconciliation of the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balance to the Statement of Activities	27
Notes to the Financial Statements	28

REQUIRED SUPPLEMENTARY INFORMATION

Budgetary Comparison Schedule and Budget-to-GAAP Reconciliation	48
Notes to Required Supplementary Information	52

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters	56
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FINDING, RECOMMENDATION, AND AGENCY PRELIMINARY RESPONSE

1. Controls Over Financial Reporting	59
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GLOSSARY

Glossary of Acronyms and Terms	64
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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. Michael A. Finney
President and Chief Executive Officer, Michigan Strategic Fund
Chair, Michigan Strategic Fund Board of Directors
300 North Washington Square
Lansing, Michigan

Dear Mr. Finney:

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, 2011 and September 30, 2010, 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 discussed 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, 2011 and September 30, 2010 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, 2011 and September 30, 2010 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.

As discussed in Note 10 to the basic financial statements, the Michigan Strategic Fund implemented Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. Also, as discussed in Note 10, MSF restated its restricted and unrestricted net asset amounts and its unreserved and restricted fund balance amounts as of September 30, 2010.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 9, 2012 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 16 and the budgetary comparison schedule and budget-to-GAAP reconciliation and corresponding notes on pages 48 through 54 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, 2010 and September 30, 2009 was not presented because this information was presented with the Michigan Strategic Fund's prior year audited financial statements.

Sincerely,


Thomas H. McTavish, C.P.A.
Auditor General
March 9, 2012

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, 2010 through September 30, 2011. 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. Executive Order No. 2011-04, effective April 24, 2011, transferred the Bureau of Workforce Transformation and energy programs from DELEG and the Land Bank Fast Track Authority and the Michigan State Housing Development Authority from the Department of Treasury to MSF. 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 (GASB) 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. During fiscal year 2010-11, Gun Lake Casino opened and started contributing to MSF. Revenues collected from this casino are transferred to the Michigan Economic Development Corporation (MEDC) per the interlocal agreement. This casino will contribute at least 8% of its net winnings to MSF.

2. During fiscal year 2010-11, MSF received a \$79.2 million federal grant award for the State Small Business Credit Initiative (SSBCI) program, of which \$26.1 million was advanced to MSF. With the use of this grant award, MSF implemented the Michigan Business Growth Fund (MBGF) program, which is similar to the Michigan Supplier Diversification Fund (MSDF) program.
3. During fiscal year 2010-11, MSF issued limited obligation revenue bonds Series 2011 to acquire ownership in the Cadillac Place building in Detroit. This building primarily houses State offices. The bonds are secured by and payable from rental payments from the Department of Technology, Management, and Budget 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 payments coming due under the lease.
4. During fiscal year 2010-11, MSF implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The objective of GASB Statement No. 54 is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This statement established fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to honor constraints imposed upon the use of the resources reported in governmental funds.

Analysis of Financial Activities

The assets of MSF exceeded its liabilities by \$239.8 million at September 30, 2011 and by \$156.7 million at September 30, 2010. Total net assets increased by \$83.1 million during fiscal year 2010-11.

Condensed Financial Information
Statement of Net Assets
As of September 30

	2011	2010
Cash and equity in common cash	\$ 89,737,441	\$ 33,231,033
Amounts due from federal government	36,947,777	32,510,366
Other current assets	43,694,234	29,268,917
Total current assets	\$170,379,452	\$ 95,010,316
Noncurrent assets	351,780,539	206,979,457
Total assets	\$522,159,992	\$301,989,773
Current liabilities	\$ 74,264,948	\$ 57,500,382
Long-term liabilities	208,120,034	87,815,639
Total liabilities	\$282,384,983	\$145,316,021
Net assets	\$239,775,009	\$156,673,752

Cash and equity in common cash increased significantly as a result of \$6.3 million in Debt Service Fund cash reserves for future lease payments, \$21.7 million in unspent cash from the federal SSBCI program, and \$26.4 million of additional amounts received in the Jobs for Michigan Investment Fund from the 21st Century Jobs Trust Fund and FireKeepers Casino.

Amounts due from federal government primarily consist of receivables for federal pass-through funds for the Community Development Block Grants (CDBG) to subrecipients. This line item increased by \$4.4 million during fiscal year 2010-11. These receivables vary from year to year as they are dependent on the project activity of the subrecipients.

Other current assets primarily consist of loans receivable, capital lease receivable, and the tribal gaming revenue receivables. There is an overall increase of \$14.4 million in other current assets primarily related to an \$8.9 million increase in casino revenue receivable, of which \$6.2 million is attributable to the Gun Lake Casino for six months, a \$597,428 increase in capital lease receivable, and a \$788,078 reduction in loans receivable.

Noncurrent assets include the Capital Access Program, capital lease receivable, loans receivable, interest receivable, investments, and MSDF and MBGF collateral deposits and participation loans. The total increase in noncurrent assets was \$144.8 million. Loan receivables decreased by \$10.4 million and investments increased by \$23.3 million. MSDF and MBGF were created in 2009 and 2011, respectively. Both funds participate in the Michigan Collateral Support Program (MCSP) and the Michigan Loan Participation Program (MLPP). MCSP is designed to assist lenders and borrowers in acquiring the financing necessary due to a collateral shortfall. Current and noncurrent collateral funding increased by \$10.5 million during fiscal year 2010-11. MLPP is designed to assist lenders and borrowers in acquiring the necessary financing that might otherwise be unavailable due to cash flow shortages. Current and noncurrent loan participation funding increased by \$7.0 million during fiscal year 2010-11.

During fiscal year 2010-11, loans worth \$4.8 million were converted into investments. Also, the loan loss provision for doubtful loans was increased by \$0.8 million, and \$6.7 million was written off for uncollectible loans. The total amount of loans and investments (net of loss provisions of \$25.5 million) included in current and noncurrent assets category is \$127.9 million.

Current liabilities primarily consist of accounts payable and other liabilities, amounts due to component units, and bond interest payable related to the limited obligation revenue bonds. Total current liabilities increased by \$16.8 million during fiscal year 2010-11 primarily related to amounts due to component unit for gaming revenues, and CDBG program payables.

Long-term liabilities primarily consist of bonds payable for two buildings MSF has acquired in the last three years and the reserves for the Capital Access Program.

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

	2011	2010
Expenses		
Community Development Block Grants (CDBG)	\$ 66,147,248	\$ 47,735,535
Jobs for Michigan Investment Fund	56,707,401	59,275,936
Payments to the Michigan Economic Development Corporation (MEDC)	59,532,962	59,428,277
Arts and Cultural Grants	2,522,655	2,277,999
Other	20,942,477	8,992,349
Total program expenses	\$ 205,852,743	\$ 177,710,096
Program revenues		
Charges for services	\$ 3,130,661	\$ 2,359,944
Operating grants and contributions	93,134,039	48,412,294
Total program revenues	\$ 96,264,700	\$ 50,772,238
Net program expenses	\$ 109,588,043	\$ 126,937,858
General revenues		
Payments from the State of Michigan	\$ 122,047,476	\$ 96,433,293
Other	70,641,824	52,959,152
Total general revenues	\$ 192,689,300	\$ 149,392,445
Increase in net assets	\$ 83,101,257	\$ 22,454,588
Net assets - Beginning	156,673,752	134,219,165
Net assets - Ending	\$ 239,775,009	\$ 156,673,752

CDBG expenses increased by \$18.4 million in fiscal year 2010-11 because of accelerated project activities and reimbursement requests submitted by subrecipients. CDBG is a federal pass-through grant program.

Payments to MEDC primarily consist of MSF State appropriations transferred to fund programs administered by MEDC and tribal gaming revenue. There is no significant change from fiscal year 2009-10 because \$8.3 million in additional income from Gun Lake Casino in fiscal year 2010-11 helped to offset a decrease from one-time additional funding in fiscal year 2009-10 for Michigan tourism promotion.

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

Payments from the State of Michigan primarily consist of appropriations from the State General Fund of \$32.1 million and reimbursements from the 21st Century Jobs Trust Fund of \$89.9 million. The revenue from the 21st Century Jobs Trust Fund for grants, loans, investments, and promotion programs increased by \$20.6 million as a result of increased appropriations for program expenditures.

Other revenues increased by \$17.7 million during fiscal year 2010-11 as a result of a \$15.4 million overall increase in casino revenue, including fees from a new casino and increased investment income.

Other Pertinent Information

From fiscal year 1996-97 through fiscal year 2010-11, MSF disbursed \$41.1 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, 2011, local governmental entities had earned \$21.2 million and repaid \$15.0 million. In the event that no further jobs are created by these local governmental entities, MSF may receive a return of \$4.3 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 program 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

	2011	2010 (Restated - Note 10)
ASSETS		
Current assets:		
Cash (Note 2)	\$ 9,415,140	\$ 2,751,059
Equity in common cash (Note 2)	58,239,584	30,263,488
SSBCI checking account (Note 2)	21,706,309	
Capital Access Program - Cash (Note 2)	2,615	177,233
Michigan Supplier Diversification Fund - Collateral Deposit (Note 2)	373,534	39,253
Michigan Supplier Diversification Fund - Participation Loan	1,489,259	499,000
Michigan Business Growth Fund - Collateral Deposit (Note 2)	260	
Michigan Business Growth Fund - Participation Loan	2,500,000	
Amounts due from federal government	36,947,777	32,510,366
Loans receivable (Note 3)	6,264,714	7,052,793
Capital lease receivable (Note 4)	3,275,609	2,678,181
Other current assets	30,164,652	19,038,943
Total current assets	\$ 170,379,452	\$ 95,010,317
Noncurrent assets:		
Capital Access Program (Notes 2 and 5)	\$ 5,790,488	\$ 5,718,483
Michigan Supplier Diversification Fund - Collateral Deposit (Note 2)	17,666,648	9,102,100
Michigan Supplier Diversification Fund - Participation Loan	3,112,377	
Michigan Business Growth Fund - Collateral Deposit (Note 2)	1,555,250	
Michigan Business Growth Fund - Participation Loan	374,250	
Capital lease receivable (Note 4)	200,912,825	80,978,999
Loans receivable (Note 3)	43,087,924	53,480,701
Interest receivable (Note 3)	769,517	2,502,764
Investments (Note 2)	78,511,261	55,196,411
Total noncurrent assets	\$ 351,780,539	\$ 206,979,457
Total assets	\$ 522,159,992	\$ 301,989,773
LIABILITIES		
Current liabilities:		
Accounts payable and other liabilities	\$ 48,334,267	\$ 43,158,830
Amounts due to component units	18,675,434	11,647,659
Capital Access Program (Note 5)	800,000	500,000
Compensated absences (Note 5)	145,802	209,628
Amounts due to primary government	30,220	16,515
Bond interest payable	3,798,117	1,861,642
Bonds payable (Note 7)	2,410,000	35,000
Deferred revenue	71,108	71,108
Total current liabilities	\$ 74,264,948	\$ 57,500,382
Long-term liabilities:		
Bonds payable (Note 7)	\$ 202,923,809	\$ 82,323,214
Capital Access Program (Note 5)	4,990,488	5,218,483
Compensated absences (Note 5)	159,396	273,942
Amounts due to primary government	46,341	
Total long-term liabilities	\$ 208,120,034	\$ 87,815,639
Total liabilities	\$ 282,384,983	\$ 145,316,021
NET ASSETS (Note 10)		
Restricted for:		
Debt service	\$ 1,347,044	\$ 1,520,087
Other purposes	235,301,930	154,766,063
Unrestricted	3,126,036	387,602
Total net assets	\$ 239,775,009	\$ 156,673,752

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

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

	2011	2010
EXPENSES (Note 1)		
Administrative	\$ 698,817	\$ 1,324,651
Community Development Block Grants	66,147,248	47,735,535
Arts and Cultural Grants	2,522,655	2,277,999
Michigan Film Office	712,235	895,734
Detroit Institute of Arts	10,000,000	
Jobs for Michigan Investment Fund - Operations	4,879,872	12,222,009
Jobs for Michigan Investment Fund - Pass-through funds		392,671
Jobs for Michigan Investment Fund - Programs	51,827,529	46,661,256
Payments to MEDC	59,532,962	59,428,277
Payments to General Fund (indirect and refund)	156,974	329,707
Other interest	5,731,966	3,861,733
Miscellaneous and receivable write-off	3,642,484	2,580,524
Total program expenses	\$ 205,852,743	\$ 177,710,096
 PROGRAM REVENUES (Note 1)		
<u>Charges for services</u>		
PAB issuance fees	\$ 386,345	\$ 255,376
Other fees	2,744,316	2,104,568
<u>Operating grants and contributions</u>		
Community Development Block Grants (federal)	64,537,860	46,002,702
Community Development Block Grants (local and others)	1,454,379	1,570,437
Arts and Cultural Grants (federal)	1,019,745	839,155
SSBCI (federal)	26,122,055	
Total program revenues	\$ 96,264,700	\$ 50,772,238
Net program expenses	\$ 109,588,043	\$ 126,937,858
 GENERAL REVENUES (Note 1)		
<u>Payments from the State of Michigan</u>		
Payments from General Fund	\$ 32,104,465	\$ 27,067,964
Payments from 21st Century Jobs Trust Fund	89,943,012	69,365,329
<u>Other</u>		
Use taxes (4%)		9,499,596
Payments from MEDC - Other		171,375
Interest and investment earnings	3,495,598	1,772,451
Net increase (decrease) in fair value of investments	5,513,357	1,064,566
Tribal gaming	48,546,591	33,106,769
Lease revenue	5,943,795	3,787,992
Miscellaneous and payable write-off	7,142,482	3,556,402
Total general revenues	\$ 192,689,300	\$ 149,392,445
Increase in net assets	\$ 83,101,257	\$ 22,454,588
Net assets - Beginning	156,673,752	134,219,165
Net assets - Ending	\$ 239,775,009	\$ 156,673,752

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

MICHIGAN STRATEGIC FUND
Governmental Fund Balance Sheet
As of September 30

	2011			
	Major Funds			Total
	General Operations	Jobs for Michigan Investment Fund	Debt Service Fund	
ASSETS				
Current assets:				
Cash (Note 2)	\$ 3,124,604	\$	\$ 6,290,536	\$ 9,415,140
Equity in common cash (Note 2)	1,436,122	56,803,462		58,239,584
SSBCI checking account (Note 2)	21,706,309			21,706,309
Capital Access Program - Cash (Note 2)	2,615			2,615
Michigan Supplier Diversification Fund - Collateral Deposit (Note 2)	373,534			373,534
Michigan Supplier Diversification Fund - Participation Loan	1,489,259			1,489,259
Michigan Business Growth Fund - Collateral Deposit (Note 2)	260			260
Michigan Business Growth Fund - Participation Loan	2,500,000			2,500,000
Amounts due from federal government	36,947,777			36,947,777
Amounts due from general operations				0
Loans receivable (Note 3)		6,264,714		6,264,714
Other current assets	17,901,896	12,262,756		30,164,652
Total current assets	\$ 85,482,376	\$ 75,330,932	\$ 6,290,536	\$167,103,843
Noncurrent assets:				
Capital Access Program (Notes 2 and 5)	\$ 5,790,488	\$	\$	\$ 5,790,488
Michigan Supplier Diversification Fund - Collateral Deposit (Note 2)	17,666,648			17,666,648
Michigan Supplier Diversification Fund - Participation Loan	3,112,377			3,112,377
Michigan Business Growth Fund - Collateral Deposit (Note 2)	1,555,250			1,555,250
Michigan Business Growth Fund - Participation Loan	374,250			374,250
Loans receivable (Note 3)		43,087,924		43,087,924
Interest receivable (Note 3)		769,517		769,517
Investments (Note 2)		78,511,261		78,511,261
Total noncurrent assets	\$ 28,499,013	\$ 122,368,701	\$ 0	\$150,867,715
Total assets	\$113,981,389	\$ 197,699,633	\$ 6,290,536	\$317,971,558
LIABILITIES				
Current liabilities:				
Accounts payable and other liabilities	\$ 37,917,695	\$ 10,416,572	\$	\$ 48,334,267
Amounts due to Jobs for Michigan Investment Fund				0
Amounts due to component units	12,424,275	751,159		13,175,434
Capital Access Program (Note 5)	800,000			800,000
Amounts due to primary government	8,102	7,859		15,961
Deferred revenue	5,571,108	9,100,000		14,671,108
Total current liabilities	\$ 56,721,180	\$ 20,275,591	\$ 0	\$ 76,996,770
Long-term liabilities:				
Deferred revenue (Note 3)	\$	\$ 769,517	\$	\$ 769,517
Capital Access Program (Note 5)	4,990,488			4,990,488
Total long-term liabilities	\$ 4,990,488	\$ 769,517	\$ 0	\$ 5,760,005
Total liabilities	\$ 61,711,668	\$ 21,045,108	\$ 0	\$ 82,756,775
FUND BALANCE (Notes 9 and 10)				
Restricted fund balance	\$ 48,777,887	\$ 176,654,526	\$ 6,290,536	\$231,722,949
Unassigned fund balance	3,491,834			3,491,834
Total fund balance	\$ 52,269,721	\$ 176,654,526	\$ 6,290,536	\$235,214,783
Total liabilities and fund balance	\$113,981,389	\$ 197,699,633	\$ 6,290,536	\$317,971,558

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

2010 (Restated - Note 10)

Major Funds			
General Operations	Jobs for Michigan Investment Fund	Debt Service Fund	Total
\$ 668,295	\$ 30,263,488	\$ 2,082,764	\$ 2,751,059
			30,263,488
			0
177,233			177,233
39,253			39,253
499,000			499,000
			0
			0
32,510,366			32,510,366
	401,214		401,214
	7,052,793		7,052,793
10,887,156	8,151,787		19,038,943
<u>\$44,781,303</u>	<u>\$ 45,869,282</u>	<u>\$ 2,082,764</u>	<u>\$ 92,733,349</u>
\$ 5,718,483	\$	\$	\$ 5,718,483
9,102,100			9,102,100
			0
			0
			0
	53,480,701		53,480,701
	2,502,764		2,502,764
	55,196,411		55,196,411
<u>\$14,820,583</u>	<u>\$ 111,179,875</u>	<u>\$ 0</u>	<u>\$126,000,458</u>
<u>\$59,601,886</u>	<u>\$ 157,049,157</u>	<u>\$ 2,082,764</u>	<u>\$218,733,807</u>
\$32,078,234	\$ 11,080,596	\$	\$ 43,158,830
401,214			401,214
6,373,268	832,391		7,205,659
500,000			500,000
6,055	10,459		16,515
4,513,108	7,250,000		11,763,108
<u>\$43,871,879</u>	<u>\$ 19,173,447</u>	<u>\$ 0</u>	<u>\$ 63,045,326</u>
\$	\$ 2,502,764	\$	\$ 2,502,764
5,218,483			5,218,483
<u>\$ 5,218,483</u>	<u>\$ 2,502,764</u>	<u>\$ 0</u>	<u>\$ 7,721,246</u>
<u>\$49,090,361</u>	<u>\$ 21,676,211</u>	<u>\$ 0</u>	<u>\$ 70,766,572</u>
\$ 9,640,353	\$ 135,372,947	\$ 2,082,764	\$147,096,063
871,172			871,172
<u>\$10,511,525</u>	<u>\$ 135,372,947</u>	<u>\$ 2,082,764</u>	<u>\$147,967,235</u>
<u>\$59,601,886</u>	<u>\$ 157,049,157</u>	<u>\$ 2,082,764</u>	<u>\$218,733,807</u>

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

	2011	2010
Total fund balance	\$ 235,214,783	\$ 147,967,235
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.	204,188,434	83,657,180
Compensated absences are not due and payable in the current period and therefore are not reported in the governmental fund statement.	(305,198)	(483,570)
Bonds payable and bond interest payable are not due and payable in the current period and therefore are not reported in the governmental fund statement.		
Bonds payable	(205,333,809)	(82,358,214)
Bond interest payable	(3,798,117)	(1,861,642)
Amounts due to primary government that are not due and payable in the current period are not reported in the governmental fund statement.	(60,600)	
Amounts due to component units that are not due and payable in the current period are not reported in the governmental fund statement.	(5,500,000)	(4,442,000)
Deferred revenue that is not available for the current period is not recognized as revenue in the governmental fund statement.	15,369,517	14,194,764
Net assets of governmental activities	\$ 239,775,009	\$ 156,673,752

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

	2011			Total
	Major Funds			
	General Operations	Jobs for Michigan Investment Fund	Debt Service Fund	
REVENUES (Note 1)				
<u>Charges for services</u>				
PAB issuance fees	\$ 386,345	\$	\$	\$ 386,345
Other fees	2,744,316			2,744,316
<u>Operating grants and contributions</u>				
Community Development Block Grants (federal)	64,537,860			64,537,860
Community Development Block Grants (local and others)	1,454,379			1,454,379
Arts and Cultural Grants (federal)	1,019,745			1,019,745
SSBCI (federal)	26,122,055			26,122,055
<u>Payments from the State of Michigan</u>				
Payments from General Fund	32,104,465			32,104,465
Payments from 21st Century Jobs Trust Fund		89,943,012		89,943,012
<u>Other</u>				
Use taxes (4%)				0
Tribal gaming	35,790,987	9,723,309		45,514,296
Payments from MEDC - Other				0
Interest and investment earnings	95,242	5,133,602		5,228,844
Net increase (decrease) in fair value of investments		5,513,357		5,513,357
Lease revenue	334,920		8,338,237	8,673,157
Miscellaneous and payable write-off	2,601,908	4,049,565	366,714	7,018,187
Total revenues	<u>\$ 167,192,221</u>	<u>\$ 114,362,846</u>	<u>\$ 8,704,951</u>	<u>\$ 290,260,018</u>
EXPENDITURES (Note 1)				
Administrative	\$ 816,589	\$	\$	\$ 816,589
Building and renovation - Capitalized purchases	123,260,616			123,260,616
Other interest			4,045,513	4,045,513
Debt service principal redemption			35,000	35,000
Community Development Block Grants	66,147,248			66,147,248
Arts and Cultural Grants	2,522,655			2,522,655
Michigan Film Office	712,235			712,235
Detroit Institute of Arts	10,000,000			10,000,000
Jobs for Michigan Investment Fund - Operations		4,879,872		4,879,872
Jobs for Michigan Investment Fund - Pass-through funds				0
Jobs for Michigan Investment Fund - Programs		51,827,529		51,827,529
Payments to MEDC	58,350,667			58,350,667
Payments to General Fund (indirect and refund)	156,974			156,974
Miscellaneous and receivable write-off	3,101,522		416,667	3,518,189
Total expenditures	<u>\$ 265,068,506</u>	<u>\$ 56,707,401</u>	<u>\$ 4,497,179</u>	<u>\$ 326,273,086</u>
Excess of revenues over/(under) expenditures	<u>\$ (97,876,285)</u>	<u>\$ 57,655,445</u>	<u>\$ 4,207,772</u>	<u>\$ (36,013,068)</u>
OTHER FINANCING SOURCES (USES)				
Bond proceeds	\$ 119,115,000	\$	\$	\$ 119,115,000
Bond premium	4,145,616			4,145,616
Transfer from Jobs for Michigan Investment Fund	16,373,866			16,373,866
Transfer to General Operations Fund		(16,373,866)		(16,373,866)
Other financing sources (uses)	<u>\$ 139,634,482</u>	<u>\$ (16,373,866)</u>	<u>\$ 0</u>	<u>\$ 123,260,616</u>
Net change in fund balances	\$ 41,758,197	\$ 41,281,579	\$ 4,207,772	\$ 87,247,548
Fund balance - Beginning	10,511,525	135,372,947	2,082,764	147,967,235
Fund balance - Ending	<u>\$ 52,269,721</u>	<u>\$ 176,654,526</u>	<u>\$ 6,290,536</u>	<u>\$ 235,214,783</u>

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

2010

2010			
Major Funds			
General Operations	Jobs for Michigan Investment Fund	Debt Service Fund	Total
\$ 255,376	\$	\$	\$ 255,376
2,104,568			2,104,568
46,002,702			46,002,702
1,570,437			1,570,437
839,155			839,155
			0
27,067,964			27,067,964
	69,365,329		69,365,329
9,499,596			9,499,596
23,600,520	3,867,367		27,467,887
171,375			171,375
49,562	3,230,035		3,279,597
	1,064,566		1,064,566
		4,111,763	4,111,763
891,131	563,390	400,000	1,854,520
<u>\$ 112,052,386</u>	<u>\$ 78,090,687</u>	<u>\$ 4,511,762</u>	<u>\$ 194,654,836</u>
\$ 1,302,150	\$	\$	\$ 1,302,150
			0
		4,060,574	4,060,574
		10,000	10,000
47,735,535			47,735,535
2,277,999			2,277,999
895,734			895,734
			0
	12,222,009		12,222,009
	392,671		392,671
	46,661,256		46,661,256
59,309,395			59,309,395
329,707			329,707
478,642		400,000	878,642
<u>\$ 112,329,161</u>	<u>\$ 59,275,936</u>	<u>\$ 4,470,574</u>	<u>\$ 176,075,671</u>
<u>\$ (276,775)</u>	<u>\$ 18,814,751</u>	<u>\$ 41,189</u>	<u>\$ 18,579,165</u>
\$	\$	\$	\$ 0
			0
9,760,589			9,760,589
	(9,760,589)		(9,760,589)
<u>\$ 9,760,589</u>	<u>\$ (9,760,589)</u>	<u>\$ 0</u>	<u>\$ 0</u>
\$ 9,483,814	\$ 9,054,162	\$ 41,189	\$ 18,579,165
1,027,711	126,318,784	2,041,575	129,388,070
<u>\$ 10,511,525</u>	<u>\$ 135,372,947</u>	<u>\$ 2,082,764</u>	<u>\$ 147,967,235</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 Years Ended September 30

	<u>2011</u>	<u>2010</u>
Net change in fund balance	\$ 87,247,548	\$ 18,579,165
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.	(123,260,616)	
Tribal gaming revenue that was unavailable and, therefore, deferred at the governmental fund level was recognized in the statement of activities.	3,032,295	5,638,882
Certain interest and investment earnings are delayed and not available and, therefore, have been deferred at the governmental fund level but are recognized in the statement of activities.	(1,733,247)	(1,507,146)
Lease revenue is recorded in the governmental fund statement; however, this portion of the lease revenue is applied to the lease receivable in the statement of activities.	(2,729,362)	(323,770)
Building and renovation - Capitalized purchases is reported as an expenditure in the governmental fund statement but was reported as a capital lease receivable in the statement of net assets. Therefore, this amount is not recognized as an expense in the statement of activities.	123,260,616	
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.	(1,182,295)	(118,882)
Other interest expense for bonds payable that is not due and payable in the current period is not recorded in the governmental fund statement.	(1,686,454)	198,841
Debt service principal redemption was due and payable in the current period and was reported as an expenditure in the governmental fund statement.	35,000	10,000
Miscellaneous and payable write-off were not recorded in the governmental fund statement for payables recorded in the statement of activity.	(124,295)	(1,701,882)
Miscellaneous and receivable write-off were not recorded in the governmental fund statement for receivables recorded in the statement of activity.	124,295	1,701,882
Compensated absences is not reported in the governmental fund statement because payments are not due and do not use current financial resources.	117,772	(22,501)
Change in net assets of governmental activities	<u>\$ 83,101,257</u>	<u>\$ 22,454,588</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.

Executive Order No. 2011-04, effective April 24, 2011, transferred the Bureau of Workforce Transformation and energy programs from DELEG and the Land Bank Fast Track Authority and the Michigan State Housing

Development Authority from the Department of Treasury to MSF. However, all accounting and reporting responsibilities will be transferred effective October 1, 2011.

MSF is governed by an 11-member Board of Directors that consists of MEDC's chief executive officer, the State Treasurer, the director of the Department of Licensing and Regulatory Affairs, 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: 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 Operations Fund, Jobs for Michigan Investment Fund (a special revenue 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 Operations 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 Anderson House Office Building and the Cadillac Place building.

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. 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, generally within 60 days. 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.

d. Financial Data

(1) MSF's general operations include the following:

- (a) Revenues: Revenues include Community Development Block Grants (CDBG) from the U.S. Department of Housing and Urban Development; State appropriations; tribal gaming; interest and investment earnings; private activity bond (PAB) issuance fees; and other fees, including Michigan Economic Growth Authority (MEGA) fees and Brownfield fees.

During fiscal year 2010-11, Gun Lake Casino opened and started contributing to MSF. This casino will contribute at least

8% of its net winnings. MSF also received \$26.1 million from the U.S. Department of Treasury as part of a \$79.2 million grant award for the State Small Business Credit Initiative (SSBCI) program.

- (b) Expenses/Expenditures: Building and renovation expenditures were incurred for the purchase of the Cadillac Place building during fiscal year 2010-11. CDBG expenditures primarily consist of pass-through grants to local governmental units. Payments to MEDC include tribal gaming; fees from PABs, MEGA, and Brownfield; and State appropriations for programs administered by MEDC. Expenditures also include administrative and other miscellaneous costs.
- (c) Other Financing Sources: Other financing sources primarily include (1) amounts transferred from the Jobs for Michigan Investment Fund to fund the Michigan Supplier Diversification Fund's (MSDF's) Collateral Support Program and Loan Participation Program and (2) bond proceeds and premium related to limited obligation revenue bonds issued to acquire ownership in the Cadillac Place building located in Detroit, Michigan.

(2) MSF's Jobs for Michigan Investment Fund primarily includes the following:

- (a) Revenues: Revenues include payments from the 21st Century Jobs Trust Fund, tribal gaming, and interest and investment earnings from loans and investments.
- (b) Expenses/Expenditures: 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.

- (3) MSF's Debt Service Fund primarily includes lease revenue 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.

e. Fund Balance Classifications

- (1) Restricted fund balance includes amounts that are restricted when constraints placed on the use of the resources are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. MSF's restricted fund balance consists of the entire fund balance in the Jobs for Michigan Investment Fund, collateral deposits and participation loans of the MSDF and Michigan Business Growth Fund (MBGF) programs, the unspent amount of the cash advance from the SSBCI program, and the limited obligation revenue bond cash remaining in the Debt Service Fund at year-end (Note 9).
- (2) Unassigned fund balance is the residual classification for the General Operations Fund and represents fund balance that has not been assigned to other funds and that has not been restricted, committed, or assigned to specific purposes within the General Operations Fund.
- (3) MSF's policy is that restricted amounts are spent first when an expenditure is incurred for purposes for which both restricted or unrestricted (assigned) resources are available.

Note 2 Deposits and Investments

a. Deposits

	As of September 30	
	2011	2010
Equity in common cash	\$ 58,239,584	\$30,263,488
Deposits	31,124,063	2,928,292
Capital Access Program	5,790,488	5,718,483
MSDF - Collateral Deposit	18,040,181	9,141,353
MBGF - Collateral Deposit	1,555,510	
Total deposits	<u>\$114,749,826</u>	<u>\$48,051,616</u>

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.

Without recognition of outstanding checks or deposits in transit, MSF's bank statement shows a balance of \$56,978,259 at September 30, 2011 and \$18,352,936 at September 30, 2010. The majority of these balances are from the various bank accounts within the Capital Access Program, the MSDF program, and the SSBCI checking account. Of these amounts, \$50,032,579 as of September 30, 2011 and \$11,932,285 as of September 30, 2010 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, 2011 and September 30, 2010, 99.7% and 100%, 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 Annual 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 MSF's 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.

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

* See glossary at end of report for definition.

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	
	2011	2010
Venture capital - Limited partner	\$28.3	\$17.8
Venture capital - Stockholder	27.7	23.4
Mezzanine funds	10.6	7.7
Private equity	11.9	6.3
Total investments	\$78.5	\$55.2

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, 2011 and September 30, 2010:

Name of Issuer	September 30, 2011		September 30, 2010	
	Amount (in millions)	Percentage of Investments	Amount (in millions)	Percentage of Investments
Midwest Mezzanine	\$6.2	7.9%	\$5.6	10.0%
ProNAi Therapeutics, Inc.	\$5.0	6.4%	\$5.0	9.0%
Integrated Sensing Systems, Inc.	\$4.9	6.2%	\$4.9	8.8%
Quad Partners	\$8.7	11.0%	\$4.8	8.7%
Venture Investors IV	\$5.5	7.0%	\$4.0	7.3%
Nth Power	\$4.0	5.1%	\$3.4	6.2%
Arboretum	\$5.6	7.1%	\$3.4	6.1%
Maranon Mezzanine	\$4.3	5.4%	\$2.1	3.8%

Note 3 Loans and Interest Receivable

Loans receivable totaled \$49,352,638 at September 30, 2011 and \$60,533,494 at September 30, 2010 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. Interest receivable of \$769,517 (\$2.5 million at September 30, 2010) 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.

Loans Receivable

Loan Category	As of September 30	
	2011	2010
Technology Tri-Corridor	\$ 2,727,299	\$ 4,608,712
Life Sciences	88,260	121,856
Choose Michigan Fund	9,000,000	2,000,000
Competitive Edge Technology:		
Advanced Automotive, Manufacturing, and Materials Technology	12,082,262	11,724,323
Life Sciences Technology	18,371,551	24,633,425
Homeland Security and Defense Technology	4,554,413	8,643,413
Alternative Energy Technology	2,528,853	8,801,765
Total	\$49,352,638	\$60,533,494

Note 4 Capital Lease Receivable

As described in Note 7, MSF issued limited obligation revenue bonds to acquire ownership in the Anderson House Office Building and the Cadillac Place building. MSF's capital lease agreements with the Michigan House of Representatives (Anderson House Office Building) and the Department of Technology, Management, and Budget (DTMB) (Cadillac Place building) contained lease maturity dates of October 15, 2023 and September 1, 2031,

* See glossary at end of report for definition.

respectively. At the end of the leases, the House of Representatives and DTMB may purchase the buildings for nominal amounts. The lease payments are paid to a trustee and will be used to pay the bonds issued to purchase the buildings. 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 payments coming due under the leases.

Capital Lease Receivable

	As of September 30	
	2011	2010
Total lease payments to be received	\$310,371,451	\$115,019,100
Less: Unearned interest income	106,183,017	31,361,920
Net lease receivable	<u>\$204,188,434</u>	<u>\$ 83,657,180</u>
Statement of net assets classification:		
Current portion of lease receivable	\$ 3,275,609	\$ 2,678,181
Long-term portion of lease receivable	200,912,825	80,978,999
Total	<u>\$204,188,434</u>	<u>\$ 83,657,180</u>

Lease payments to be received from the House of Representatives and DTMB as of September 30, 2011:

Fiscal Year Ended September 30	Lease Receivable
2012	\$ 12,844,563
2013	13,129,813
2014	17,054,063
2015	17,569,313
2016	18,100,813
2017 - 26	176,639,501
2027 - 32	55,033,388
Total	<u>\$310,371,451</u>

Note 5 Long-Term Liabilities

The following tables summarize the long-term liabilities of MSF for the fiscal years ended September 30, 2011 and September 30, 2010:

Fiscal Year 2010-11	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$ 5,718,483	\$ 1,145,477	\$1,073,472	\$ 5,790,488	\$ 800,000
Compensated absences	\$ 483,570	\$ 166	\$ 178,537	\$ 305,198	\$ 145,802
Bonds payable	\$79,765,000	\$119,115,000	\$ 35,000	\$198,845,000	\$2,410,000
Unamortized premium	\$ 2,593,214	\$ 4,145,616	\$ 250,021	\$ 6,488,809	\$ 403,562

Fiscal Year 2009-10	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$ 5,366,875	\$ 1,058,235	\$ 706,627	\$ 5,718,483	\$ 500,000
Compensated absences	\$ 461,069	\$ 173,533	\$ 151,032	\$ 483,570	\$ 209,628
Bonds payable	\$79,775,000		\$ 10,000	\$ 79,765,000	\$ 35,000
Unamortized premium	\$ 2,792,055		\$ 198,841	\$ 2,593,214	\$ 0

a. Capital Access Program

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, 2011, there were 38 financial institutions participating in the Capital Access Program.

b. Compensated Absences

Liabilities for compensated absences were included in the statement of net assets, which is on the accrual basis, and not in 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, 2011 and September 30, 2010, respectively.

c. Bonds Payable

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 37.38% (\$388,618) and 33.26% (\$464,405) of its payroll costs for pension charges and retiree postemployment benefits in fiscal years 2010-11 and 2009-10, 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 \$18,769 and \$14,473 for fiscal years 2010-11 and 2009-10, respectively. The Plans' detailed financial statements can be obtained from the Office of Retirement Services, Department of Technology, 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, 2011 and September 30, 2010, MSF reimbursed MEDC for contributions to the plan of \$142,130 and \$126,481, 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, 2011 and September 30, 2010, employees contributed \$109,434 and \$92,996, respectively.

Note 7 Limited Obligation Revenue Bonds

a. Michigan House of Representatives, Anderson House Office Building

MSF issued limited obligation revenue bonds Series 2008A and 2008B in the total amount of \$79,780,000 to acquire ownership in the Anderson House Office Building, located on Capitol Avenue in Lansing, Michigan. The bonds are secured by and payable from lease payments 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 payments 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%

* See glossary at end of report for definition.

to 5.19%. The Series B bonds (\$1,130,000) will mature on October 15, 2011 with an interest rate yield of 4.00%. The following table summarizes debt service requirements for outstanding bonds:

Fiscal Year	Principal	Interest	Total
2012	\$ 2,410,000	\$ 4,014,763	\$ 6,424,763
2013	2,780,000	3,902,763	6,682,763
2014	3,205,000	3,753,138	6,958,138
2015	4,475,000	3,561,138	8,036,138
2016	5,015,000	3,323,888	8,338,888
2017 - 21	33,825,000	12,020,031	45,845,031
2022 - 24	28,020,000	2,252,250	30,272,250
Total	<u>\$79,730,000</u>	<u>\$32,827,969</u>	<u>\$112,557,969</u>
Unamortized premium	2,394,374		2,394,374
Total	<u><u>\$82,124,374</u></u>	<u><u>\$32,827,969</u></u>	<u><u>\$114,952,342</u></u>

b. Cadillac Place

MSF issued limited obligation revenue bonds Series 2011 in the total amount of \$119,115,000, of which \$71,235,000 were serial bonds and \$47,880,000 were term bonds, to acquire ownership in the Cadillac Place in Detroit, Michigan. The bonds are secured by and payable from lease payments to be paid by DTMB under the lease and other revenues and funds pledged under the indenture. The lease is not a general obligation of the issuer or of the State. Neither the full faith and credit nor the taxing power of the State are pledged to the payments 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 several State departments and also some private tenants, (b) the defeasance of the prior owner's outstanding Certificates of Participation and (c) pay costs of issuing the bonds.

The serial bonds (\$71,235,000) have a maturity schedule starting in fiscal year 2015 and ending in 2027 with an interest rate yield in the range of 2.13% to 5.02%. The term bonds (\$47,880,000) have a maturity schedule starting in 2028 and ending in 2032 with an interest yield of 5.30%. The following table summarizes debt service requirements for outstanding bonds:

Fiscal Year	Principal	Interest	Total
2012	\$	\$ 5,021,125	\$ 5,021,125
2013		6,169,300	6,169,300
2014		6,169,300	6,169,300
2015	2,830,000	6,098,550	8,928,550
2016	3,180,000	5,948,300	9,128,300
2017 - 26	56,425,000	46,527,775	102,952,775
2027 - 32	56,680,000	8,641,238	65,321,238
Total	<u>\$119,115,000</u>	<u>\$84,575,587</u>	<u>\$203,690,587</u>
Unamortized premium	4,094,435		4,094,435
Total	<u><u>\$123,209,435</u></u>	<u><u>\$84,575,587</u></u>	<u><u>\$207,785,022</u></u>

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, 2011 was \$9,238,290,304 (\$8,827,798,525 through September 30, 2010). The amount of tax-exempt bonds issued during fiscal year 2010-11 was \$393,356,679 (\$143,860,000 for

fiscal year 2009-10). There were \$17,135,100 taxable bonds issued by MSF under the Taxable Bond Program for fiscal year 2010-11 (no taxable bonds issued for fiscal year 2009-10).

Note 9 Fund Balance

Restricted fund balance (in millions) consists of:

	As of September 30	
	2011	2010
Restricted by enabling legislation:		
Jobs for Michigan Investment Fund	\$176.7	\$135.4
MSDF - Collateral Deposit	18.0	9.1
MSDF - Participation Loan	4.6	0.5
Other restricted fund balance:		
MBGF - Collateral Deposit	1.6	
MBGF - Participation Loan	2.9	
SSBCI checking account	21.7	
Debt Service Fund	6.3	2.1
Total restricted fund balance	<u>\$231.7</u>	<u>\$147.1</u>

Remaining fund balance is considered unassigned.

Note 10 Accounting Changes and Restatements

During fiscal year 2010-11, MSF implemented Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The objective of GASB Statement No. 54 is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This statement established fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to honor constraints imposed upon the use of the resources reported in governmental funds. MSF's fund balance classification policies and procedures are described in Note 1, and the details of its aggregated balances using the new classifications are

described in Note 9. As required by GASB Statement No. 54, MSF restated fund balance classifications for September 30, 2010 from those previously reported. GASB Statement No. 54 did not have any impact on MSF's reported levels of total governmental fund balances or net assets.

In addition, MSF restated \$26.4 million of previously reported unreserved fund balance as of September 30, 2010 to \$26.4 million of restricted fund balance; and \$156.3 million of previously reported unrestricted net assets as of September 30, 2010 to \$1.5 million of restricted net assets for debt service and \$154.8 million of restricted net assets for other purposes.

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)	2011			Variance With Final Budget
	Original Budget	Final Budget	Actual	
Beginning budgetary fund balance	\$ 21,478,968	\$ 21,478,968	\$ 21,478,968	\$ 0
Resources (inflows):				
Revenues and other sources:				
Charges for services (Note 2)	\$ 86,700	\$ 86,700	\$ 3,130,661	\$ (3,043,961)
Operating grants and contributions	65,881,134	75,881,134	93,134,039	(17,252,906)
Payments from the State of Michigan:				
From General Fund	22,781,500	9,350,700	32,104,465	(22,753,765)
From 21st Century Jobs Trust Fund (Note 3)	225,754,098	225,754,098	89,943,012	135,811,087
Other miscellaneous (Note 4)	6,738,040	6,738,040	71,947,842	(65,209,802)
Other financing sources (Note 6)			123,260,616	(123,260,616)
Total revenues and other sources	<u>\$ 321,241,472</u>	<u>\$ 317,810,672</u>	<u>\$ 413,520,634</u>	<u>\$ (95,709,962)</u>
Total resources available	<u>\$ 342,720,440</u>	<u>\$ 339,289,640</u>	<u>\$ 434,999,602</u>	<u>\$ (95,709,962)</u>
Charges (outflows):				
Expenditures, transfers out, and encumbrances:				
Administrative (Note 2)	\$	\$	816,589	\$ (816,589)
Community Development Block Grants	64,731,134	74,731,134	66,147,248	8,583,886
Building and renovation - Capitalized purchases (Note 6)			123,260,616	(123,260,616)
Other interest			4,045,513	(4,045,513)
Debt service principal redemption			35,000	(35,000)
Jobs for Michigan Investment Fund - Appropriation Year 2006	87,621,793	87,621,793	23,645,294	63,976,499
Jobs for Michigan Investment Fund - Appropriation Year 2008	13,660,239	13,660,239	10,131,257	3,528,982
Jobs for Michigan Investment Fund - Appropriation Year 2009	30,368,798	30,368,798	14,555,549	15,813,249
Jobs for Michigan Investment Fund - Appropriation Year 2010	19,103,269	19,103,269	11,896,950	7,206,318
Jobs for Michigan Investment Fund - Appropriation Year 2011	75,000,000	75,000,000	29,713,962	45,286,038
Jobs for Michigan Investment Fund - Permanent Fund			2,926,160	(2,926,160)
Payments to MEDC:				
Administration	2,505,200	2,505,200	2,505,073	127
Job creation services	13,830,282	13,180,982	12,325,391	855,591
Michigan Promotion Program	5,402,800	5,402,800	5,402,800	0
Economic Development Job Training Grants				0
Michigan Promotion Fund				0
IDRB, MEGA, and tribal gaming revenue (Notes 2 and 4)			38,117,403	(38,117,403)
Michigan Film Office	742,800	742,800	712,235	30,565
Detroit Institute of Arts		10,000,000	10,000,000	0
Arts and Cultural Grants	2,567,400		2,522,655	(2,522,655)
Payments to General Fund			156,974	(156,974)
Miscellaneous and receivable write-off	2,400,780	2,400,780	3,518,189	(1,117,408)
Total charges	<u>\$ 317,934,494</u>	<u>\$ 334,717,794</u>	<u>\$ 362,434,857</u>	<u>\$ (27,717,062)</u>
Reconciling items:				
Changes in noncurrent assets	\$	\$ (6,865,832)	\$ (6,865,832)	\$ 0
Net reconciling items	<u>\$ 0</u>	<u>\$ (6,865,832)</u>	<u>\$ (6,865,832)</u>	<u>\$ 0</u>
Ending budgetary fund balance	<u>\$ 24,785,946</u>	<u>\$ (2,293,986)</u>	<u>\$ 65,698,913</u>	<u>\$ (67,992,900)</u>

This schedule continued on next page.

2010

Original Budget	Final Budget	Actual	Variance With Final Budget
\$ 17,069,686	\$ 17,069,686	\$ 17,069,686	\$ 0
\$ 86,500	\$ 86,500	\$ 2,359,944	\$ (2,273,444)
65,616,500	65,599,400	48,412,294	17,187,106
27,135,700	27,008,400	27,067,964	(59,564)
220,119,428	220,119,428	69,365,329	150,754,098
13,096,342	13,096,342	47,449,304	(34,352,962)
<u>\$ 326,054,470</u>	<u>\$ 325,910,070</u>	<u>\$ 194,654,836</u>	<u>\$ 131,255,234</u>
<u>\$ 343,124,155</u>	<u>\$ 342,979,755</u>	<u>\$ 211,724,521</u>	<u>\$ 131,255,234</u>
\$ 64,746,797	\$ 64,729,697	\$ 1,302,150	\$ (1,302,150)
		47,735,535	16,994,162
		4,060,574	(4,060,574)
		10,000	(10,000)
115,690,752	115,690,752	28,068,959	87,621,793
35,723,531	35,723,531	22,063,292	13,660,239
40,205,145	40,205,145	9,836,347	30,368,798
28,500,000	28,500,000	9,396,732	19,103,269
1,765,000	1,765,000	514,079	1,250,921
2,413,100	2,389,600	2,388,622	978
13,529,205	13,427,005	12,638,070	788,935
5,402,800	5,402,800	5,402,800	0
4,705,800	4,705,800	4,705,800	0
	9,500,000	9,497,524	2,476
		24,676,580	(24,676,580)
721,400	719,800	895,734	(175,934)
2,267,400	2,346,400	2,277,999	68,401
		329,707	(329,707)
478,642	478,642	878,642	(400,000)
<u>\$ 316,149,571</u>	<u>\$ 325,584,171</u>	<u>\$ 186,679,143</u>	<u>\$ 138,905,028</u>
\$	\$ (3,566,410)	\$ (3,566,410)	\$ 0
\$ 0	\$ (3,566,410)	\$ (3,566,410)	\$ 0
<u>\$ 26,974,584</u>	<u>\$ 13,829,174</u>	<u>\$ 21,478,968</u>	<u>\$ (7,649,794)</u>

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

Budget-to-GAAP Reconciliation	2011			Variance With Final Budget
	Original Budget	Final Budget	Actual	
Resources (inflows):				
Actual amount (budgetary basis) of "Total resources available"			\$ 434,999,602	
Differences - Budget to GAAP:				
Beginning budgetary fund balance is a budgetary resource but is not a current year revenue for financial reporting purposes			(21,478,968)	
Other financing sources are inflows of budgetary resources but are not revenues for financial reporting purposes			<u>(123,260,616)</u>	
Total revenues (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance			<u>\$ 290,260,018</u>	
Charges (outflows):				
Actual amount (budgetary basis) of "Total charges"			\$ 362,434,857	
Differences - Budget to GAAP:				
Other financing uses are outflows of budgetary resources but are not expenditures for financial reporting purposes			(123,506)	
Loans and investments are outflows for budgetary reporting purposes but are not expenditures for financial reporting purposes			<u>(36,038,265)</u>	
Total expenditures (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance			<u>\$ 326,273,086</u>	

See accompanying notes to required supplementary information.

2010

<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance With Final Budget</u>
		\$ 211,724,521	
		(17,069,686)	
		<hr/>	
		<u>\$ 194,654,836</u>	
		\$ 186,679,143	
		(608,789)	
		<hr/>	
		<u>(9,994,684)</u>	
		<hr/>	
		<u>\$ 176,075,671</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 2010-11 and 2009-10, 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 2011 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 private activity bonds (PABs), Michigan Economic Growth Authority (MEGA), and Brownfield 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.

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) for fiscal year 2005-06; Act 127, P.A. 2007, and Act 98, P.A. 2008, appropriated \$125.0 million for fiscal year 2007-08; Act 261, P.A. 2008, appropriated \$65.0 million (subsequently reduced to \$53.0 million) for fiscal year 2008-09; Act 128, P.A. 2009, appropriated \$28.5 million for fiscal year 2009-10; and Act 191, P.A. 2010, appropriated \$75 million for fiscal year 2010-11 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 \$89.9 million and \$69.4 million from the 21st Century Jobs Trust Fund for fiscal years 2010-11 and 2009-10, respectively.

Note 4 Tribal Gaming

The other miscellaneous revenues in the actual column include tribal gaming revenue of \$45.5 million. The payments to MEDC expenditures 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, 2009, 2010, and 2011

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 amounts for appropriation year 2006 through appropriation year 2010 reflect 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 2010-11 were \$89.9 million, of which \$36.2 million was disbursed for investments and loans. Total charges for fiscal year 2009-10 were \$69.4 million, of which \$10.9 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 include revenue from limited obligation revenue bonds issued to acquire ownership of the Cadillac Place building. The cost of acquiring the building is recorded as an expenditure under building and renovation - capitalized purchases.

INDEPENDENT AUDITOR'S REPORT ON
INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
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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. Michael A. Finney
President and Chief Executive Officer, Michigan Strategic Fund
Chair, Michigan Strategic Fund Board of Directors
300 North Washington Square
Lansing, Michigan

Dear Mr. Finney:

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, 2011 and September 30, 2010, which collectively comprise the Michigan Strategic Fund's basic financial statements as identified in the table of contents, and have issued our report thereon dated March 9, 2012. 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

Management of the Michigan Strategic Fund is responsible for establishing and maintaining effective 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.

Our consideration of internal control over financial reporting was for the limited purpose discussed in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed in Finding 1, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness.

A deficiency in internal control 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 and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency discussed in Finding 1 to be 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 preliminary response to the finding identified in our audit is included in the body of our report. We did not audit the Michigan Strategic Fund's preliminary response and, accordingly, we express no opinion on it.

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.

Sincerely,



Thomas H. McTavish, C.P.A.
Auditor General
March 9, 2012

FINDING, RECOMMENDATION,
AND AGENCY PRELIMINARY RESPONSE

FINDING

1. Controls Over Financial Reporting

The Michigan Strategic Fund's (MSF's) internal control over financial reporting did not ensure that accounting transactions and financial statement balances were properly recorded and reported in accordance with generally accepted accounting principles*. As a result, we identified several financial statement errors during our audit that, when brought to MSF's attention, were corrected.

Our audit disclosed that MSF had misclassified the following transactions:

- a. MSF did not properly record the advance received from the U.S. Department of Treasury for the State Small Business Credit Initiative (SSBCI) agreement.

Sections N50.116-118 and N50.127 of the *Codification of Governmental Accounting and Financial Reporting Standards* (Codification), published by the Governmental Accounting Standards Board (GASB), require that, for voluntary nonexchange transactions, revenues should be recognized in the period when all applicable eligibility requirements have been met and the resources are available.

MSF recorded the portion of the advance that was used in accordance with the federal agreement during the fiscal year as revenue; however, it recorded the unused portion as deferred revenue. As a result, deferred revenue was overstated and revenue, fund balance, and restricted net assets were understated by \$21.6 million.

- b. MSF did not properly record the net assets and fund balance of the Jobs for Michigan Investment Fund, the Michigan Supplier Diversification Fund (MSDF) program, and the Michigan Business Growth Fund (MBGF) program and did not properly report the net assets of the Debt Service Fund. We noted:

- (1) Section 125.2088h of the *Michigan Compiled Laws* created the Jobs for Michigan Investment Fund and requires that the money in the Fund, including the related net income, shall remain in the Fund, not lapse to the General Fund, and be invested only as authorized. In addition,

* See glossary at end of report for definition.

Section 125.2088h(5)(b) of the *Michigan Compiled Laws* requires that money received by or payable to MSF under agreements related to grants, loans, investments, or expenditures by MSF are assets of the Jobs for Michigan Investment Fund. Therefore, in conjunction with MSF, we determined that this would include all reimbursements of the MSDF program collateral deposits and participation loans. GASB Codification Sections 1800.134 and 1800.145 provide that amounts that are restricted to specific purposes (net assets and fund balance) should be reported as restricted when constraints placed on them are imposed by law through enabling legislation.

- (2) During fiscal year 2010-11, the State of Michigan entered into an SSBCI allocation agreement with the U.S. Department of Treasury. The agreement stipulates that the State of Michigan will use the allocated funds for specific programs, all of which are administered by MSF. MSF used \$4.4 million of the allocation and entered into collateral support and loan guarantee arrangements within the MBGF program. GASB Codification Sections 1800.134 and 1800.145 provide that amounts that are restricted to specific purposes (net assets and fund balance) should be reported as restricted when constraints placed on them are externally imposed by grantors, contributors, or laws or regulations of other governments.
- (3) MSF reported the fund balance of its Debt Service Fund as restricted fund balance on its governmental fund balance sheet; however, it did not report the related net assets as restricted on its statement of net assets. GASB Codification Section 1800.134 provides that net assets should be reported as restricted when constraints placed on them are externally imposed by creditors (such as through debt covenants).

As a result, we noted the following misclassifications (in millions):

	Fiscal Year	
	2010-11	2009-10
<u>Entity-Wide - Statement of Net Assets:</u>		
Restricted net assets - Understated	\$214.9	\$156.3*
Unrestricted net assets - Overstated	\$214.9	\$156.3*
 <u>Fund Level - Jobs for Michigan Investment Fund:</u>		
Restricted fund balance - Understated	\$176.7	\$135.4
Committed fund balance - Overstated	\$122.5	\$109.5
Assigned fund balance - Overstated	\$ 54.2	\$ 25.9*
 <u>Fund Level - General Operations Fund:</u>		
Restricted fund balance - Understated	\$ 27.1	\$ 9.6
Committed fund balance - Overstated	\$ 22.7	\$ 9.1*
Assigned fund balance - Overstated	\$ 7.9	\$ 1.4
Unassigned fund balance - Understated	\$ 3.6	\$ 0.9

* These line items were restated in the current financial statements to correctly report the amounts misclassified in the previously issued and audited financial statements. Also, all of the net assets and a portion of the fund balance of the Jobs for Michigan Investment Fund have been erroneously reported as unrestricted net assets and as unreserved fund balance, respectively, since the Jobs for Michigan Investment Fund was created in fiscal year 2005-06. In addition, the net assets of the Debt Service Fund have been erroneously reported as unrestricted net assets since MSF issued bonds in fiscal year 2007-08.

RECOMMENDATION

We recommend that MSF improve its internal control over financial reporting to ensure that accounting transactions and financial statement balances are properly recorded and reported in accordance with generally accepted accounting principles.

AGENCY PRELIMINARY RESPONSE

MSF agrees with the recommendation and, as stated in the finding, made the corrections to the financial statements. However, these misstatements of net assets and fund balance classifications did not overstate or understate MSF's total net assets.

MSF informed us that the Jobs for Michigan Investment Fund was created in 2006 and, from fiscal year 2005-06 through fiscal year 2009-10, the Fund's balance has been classified as unrestricted net assets on the statement of net assets and only a portion of its fund balance was classified as reserved on the governmental fund balance sheet during that same time period. MSF also informed us that it has always used the Jobs for Michigan Investment Fund in accordance with enabling legislation.

In addition, MSF informed us that it has had a Debt Service Fund since 2008 when it issued bonds to acquire ownership of the Anderson House Office Building. From fiscal year 2007-08 through fiscal year 2009-10, the Fund's balance has been classified as unrestricted net assets on the statement of net assets.

GLOSSARY

Glossary of Acronyms and Terms

CDBG	Community Development Block Grant.
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.
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 and correct, misstatements on a timely basis.
DELEG	Department of Energy, Labor & Economic Growth.
DLJ	DLJ MB Advisors, Inc.
DTMB	Department of Technology, Management, and Budget.
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.
generally accepted accounting principles (GAAP)	A technical accounting term that encompasses the conventions, rules, guidelines, and procedures necessary to define accepted accounting practice at a particular time; also cited as "accounting principles generally accepted in the United States of America."
Governmental Accounting Standards Board (GASB)	An arm of the Financial Accounting Foundation established to promulgate standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities.

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.
material weakness in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the financial schedules and/or financial statements will not be prevented, or detected and corrected, on a timely basis.
MBGF	Michigan Business Growth Fund.
MCSP	Michigan Collateral Support Program.
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.
MLPP	Michigan Loan Participation Program.

MSDF	Michigan Supplier Diversification Fund.
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.
significant deficiency in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.
SSBCI	State Small Business Credit Initiative.
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. Executive Order No. 2010-8 abolished the board and transferred all of the authority, powers, duties, functions, responsibilities, records, personnel, property, unexpended balances of appropriations, allocations, or other funds to the Michigan Strategic Fund Board of Directors effective October 18, 2010.
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.

