



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:

<http://audgen.michigan.gov>



Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit

Michigan Strategic Fund

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

Fiscal Year Ended September 30, 2012

Report Number:
271-0401-13

Released:
March 2013

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 did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, we did identify significant deficiencies (Findings 1 and 2).

MSF's internal control over loans receivable data did not ensure that loss provisions were properly excluded from loans receivable balances before recording transactions in its financial accounting systems (Finding 1).

MSF had not established effective access controls over the Management of Awards to Recipients System (MARS). Also, MSF, in conjunction with the Department of Technology, Management, and

Budget, did not obtain assurances regarding internal control over MARS from its service provider (Finding 2).

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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 2 findings and 3 corresponding recommendations. MSF's preliminary response indicates that it agrees with the recommendations.

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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



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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

March 19, 2013

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 fiscal year ended September 30, 2012.

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 findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

The agency preliminary responses were 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	20
Statement of Activities	21
Governmental Fund Financial Statements	
Governmental Fund Balance Sheet	22
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	25
Notes to the Financial Statements	26

REQUIRED SUPPLEMENTARY INFORMATION

Budgetary Comparison Schedule and Budget-to-GAAP Reconciliation	46
Notes to Required Supplementary Information	48

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	52
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FINDINGS, RECOMMENDATIONS, AND
AGENCY PRELIMINARY RESPONSES

1. Controls Over Loans Receivable Data	55
2. Management of Awards to Recipients System (MARS) Controls	56

GLOSSARY

Glossary of Acronyms and Terms	60
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INDEPENDENT AUDITOR'S REPORT



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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 year ended September 30, 2012, which collectively comprise the Michigan Strategic Fund's basic financial statements as identified in the table of contents. These financial statements are the responsibility of the Michigan Strategic Fund's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

As described in Note 1 to the basic financial statements, 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, 2012, the changes in its financial position, or, where applicable, its cash flows for the fiscal year 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, 2012 and the respective changes in financial position for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 10 to the basic financial statements, beginning fund balance and net assets were restated to report a change in reporting entity and to correct prior period errors.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 21, 2013 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 11 through 18 and the budgetary comparison schedule and budget-to-GAAP reconciliation and corresponding notes on pages 46 through 49 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Sincerely,


Thomas H. McTavish, C.P.A.
Auditor General
February 21, 2013

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, 2011 through September 30, 2012. 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. 2011-4, 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, in accordance with governmental accounting and financial reporting standards, the Land Bank Fast Track Authority and the Michigan State Housing Development Authority are not considered component units of MSF and continue to be reported as discretely presented component units of the State of Michigan.

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. Pursuant to Executive Order No. 2011-4, all accounting and reporting responsibilities related to the Bureau of Workforce Transformation and energy programs were transferred from DELEG to MSF effective October 1, 2011. Fiscal year 2011-12 beginning net assets have been restated to transfer cash and loans receivable balances for the Energy Efficiency and Renewable Energy Revolving Loan Fund from DELEG to MSF. The beginning net assets also have been restated to reflect compensated absences and supplemental pension liabilities for Workforce Development Agency and Michigan Energy Office staff.
2. The Michigan Economic Growth Authority tax credit program and the Brownfield Tax Incentive Programs were eliminated effective December 31, 2011. The Legislature appropriated \$100 million in the Business Attraction and Economic Gardening line item to fund the two replacement programs that began January 1, 2012: the Michigan Business Development Program and the Community Revitalization Program. The Business Attraction and Economic Gardening Program will be used to provide incentives to businesses for job growth and economic development in the State.
3. The Film Office Tax Credit Program was also eliminated as of December 31, 2011 and replaced with the Film Digital Media Production Assistance Program, which is funded with the \$25 million appropriated in the Film Incentive Funding line item. This Program reimburses direct production expenses to eligible companies for specified production work as described in statute.

Analysis of Financial Activities

The assets of MSF exceeded its liabilities by \$336.9 million at September 30, 2012 and by \$239.8 million at September 30, 2011. Total net assets increased by \$97.1 million during fiscal year 2011-12.

Condensed Financial Information
Statement of Net Assets
As of September 30

	2012	2011
Cash and equity in common cash	\$148,911,251	\$ 89,737,441
Amounts due from federal government	53,006,651	36,947,777
Other current assets	58,431,786	43,694,234
Total current assets	\$260,349,687	\$170,379,452
Noncurrent assets	391,188,266	351,780,539
Total assets	\$651,537,952	\$522,159,992
Current liabilities	\$108,425,757	\$ 74,264,948
Long-term liabilities	206,243,390	208,120,034
Total liabilities	\$314,669,147	\$282,384,983
Net assets:		
Restricted	\$336,807,338	\$236,648,974
Unrestricted	61,467	3,126,036
Total net assets	\$336,868,805	\$239,775,009

Cash and equity in common cash increased significantly as a result of \$25.0 million in additional appropriated amounts transferred from the General Fund to the Michigan Film Promotion Fund, \$20.5 million increase in the Jobs for Michigan Investment Fund due to loan interest, principal and fee payments and additional revenue received from tribal gaming, and \$10.9 million of additional amounts received in the Jobs for Michigan Investment Fund from the 21st Century Jobs Trust Fund.

Amounts due from federal government primarily consist of receivables for federal pass-through funds for the Community Development Block Grants (CDBGs), Workforce Development Agency grants, and Michigan Energy Office grants to subrecipients. This line item increased by a net amount of \$16 million during fiscal year 2011-12. Receivables increased by \$37 million due to the transfer of Workforce Development Agency grants and Michigan Energy Office grants to MSF pursuant to Executive

Order No. 2011-4. Receivables for the CDBG program decreased by \$22 million due to a decrease in project activities. 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, amounts due from local units, the tribal gaming revenue receivables, and the Michigan Supplier Diversification Fund (MSDF) and the Michigan Business Growth Fund (MBGF) collateral deposits and participation loans. There is an overall increase of \$14.7 million in other current assets primarily related to a \$5.8 million increase in loans receivable; a \$4.7 million increase in amounts due from local units for the Workforce Development Agency Fund programs, which were not part of MSF's financial statements in fiscal year 2010-11; and a \$5.6 million increase in MBGF - Participation Loan. 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. MLPP is designed to assist lenders and borrowers in acquiring the necessary financing that might otherwise be unavailable due to cash flow shortages.

Noncurrent assets include the Capital Access Program, capital lease receivable, loans receivable, interest receivable, investments, Michigan Energy Office Loan Loss Reserve, and MSDF and MBGF collateral deposits and participation loans. The total increase in noncurrent assets was \$39.4 million. Investments increased by \$14.0 million in fiscal year 2011-12. The Michigan Energy Office recorded a \$7.5 million Loan Loss Reserve to guarantee certain energy loans. The Michigan Energy Office was not part of MSF's financial statements in fiscal year 2010-11. Noncurrent MSDF and MBGF collateral funding increased by \$12.9 million during fiscal year 2011-12. Noncurrent MSDF and MBGF loan participation funding increased by \$5.6 million during fiscal year 2011-12. The collateral and loan participation program increases are primarily due to the MBGF programs being in place for the entire 2011-12 fiscal year. The programs began in July 2011.

During fiscal year 2011-12, the loan loss provision for doubtful loans was increased by \$7.1 million to a total of \$32.6 million. Also, during fiscal year 2011-12, uncollectible loans of \$1.6 million were written off. The total amount of investments and loans receivable (net of loss provisions) included in the current and noncurrent assets categories is \$151.1 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 \$34.2 million during fiscal year 2011-12 primarily related to an increase of \$2.1 million in Michigan Energy Office payables, an increase of \$11.6 million in the 21st Century Jobs Trust Fund payables due to the timing of payment requests, an increase of \$37.1 million in Workforce Development Agency Fund payables, and a decrease of \$21.9 million in CDBG program payables due to a decrease in project activities. Workforce Development Agency Fund and Michigan Energy Office payables were not part of MSF's financial statements in fiscal year 2010-11.

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

Restricted net assets represent resources that are subject to external restrictions, constitutional provisions, or enabling legislation limiting how they can be used. Total restricted net assets increased by \$100.2 million primarily related to an increase of \$26.7 million in the Jobs for Michigan Investment Fund; an increase of \$25.7 million in the Michigan Film Promotion Fund; an increase of \$23.7 million in the Energy Efficiency and Renewable Energy Revolving Loan Fund, which was not part of MSF's financial statements in fiscal year 2010-11; and an increase of \$26.3 million in the MBGF collateral and participation loan programs net assets.

Unrestricted net assets represent resources that are not included in restricted net assets. The fiscal year 2010-11 unrestricted net assets primarily represent funds held in escrow for the maintenance of the Cadillac Place. In fiscal year 2011-12, the Department of Technology, Management, and Budget became responsible for directly handling the maintenance of the building, and therefore, these funds are no longer included in MSF's net assets.

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

	2012	2011
Expenses		
Community Development Block Grants (CDBG)	\$ 34,054,171	\$ 66,147,248
Jobs for Michigan Investment Fund	85,380,959	56,707,401
Workforce Development Agency Fund	333,955,227	
Michigan Energy Office	34,041,072	
Payments to the Michigan Economic Development Corporation (MEDC)	60,190,118	59,532,962
Arts and Cultural Grants	2,257,293	2,522,655
Other	23,045,423	20,942,477
Total program expenses	\$572,924,264	\$205,852,743
Program revenues		
Charges for services	\$ 4,211,930	\$ 3,130,661
Operating grants and contributions	414,798,907	93,134,039
Total program revenues	\$419,010,837	\$ 96,264,700
Net program expenses	\$153,913,426	\$109,588,043
General revenues		
Payments from the State of Michigan	\$154,908,317	\$122,047,476
Other	80,968,029	70,641,824
Total general revenues	\$235,876,346	\$192,689,300
Change in net assets	\$ 81,962,919	\$ 83,101,257
Net assets - Beginning (Restated in 2012)	254,905,886	156,673,752
Net assets - Ending	\$336,868,805	\$239,775,009

CDBG expenses decreased by \$32.1 million in fiscal year 2011-12 because, during fiscal year 2011-12, very few awards were made from the CDBG program and thus expenses reflect payments against prior year awards. CDBG is a federal pass-through grant program.

Jobs for Michigan Investment Fund expenses increased by \$28.7 million in fiscal year 2011-12 primarily due to a \$25.0 million appropriation for Pure Michigan®, which resulted in an increase in contractual payments for this program. Also, grant payments totaling \$2.6 million occurred in the Business Attraction and Economic Gardening Program, which was a new program in fiscal year 2011-12.

Workforce Development Agency Fund and **Michigan Energy Office** expenses primarily consist of pass-through grants to local governmental units, private entities, and universities. These were not part of MSF's financial statements in fiscal year 2010-11.

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 2010-11.

Operating grants and contributions primarily reflect the funds received from the federal government for the CDBG, State Small Business Credit Initiative (SSBCI), Workforce Development Agency, and Michigan Energy Office programs. The increase is due to the inclusion of the federal pass-through programs for the Workforce Development Agency and the Michigan Energy Office, which were not part of MSF's financial statements in fiscal year 2010-11. This increase corresponds to the increased federal program expenses.

Payments from the State of Michigan primarily consist of transfers of MSF appropriations from the State General Fund of \$62.7 million and reimbursements of MSF expenditures from the 21st Century Jobs Trust Fund of \$92.3 million. The revenue from the General Fund increased by \$43.9 million as a result of the authorized expansion of the Film Incentive Program and transfers of Workforce Development Agency Fund appropriations to MSF in fiscal year 2011-12. This increase in revenue from the General Fund was partially offset by a decrease of \$15.4 million due to the elimination of the Detroit Institute of Arts and Michigan Promotion Program General Fund appropriations. The Michigan Promotion Program was replaced with Pure Michigan®, which is funded by the 21st Century Jobs Trust Fund.

Other revenues increased by \$10.3 million during fiscal year 2011-12 as a result of an increase in tribal gaming revenue, investment income, and lease revenue related to capital lease agreements.

Other Pertinent Information

From fiscal year 1996-97 through fiscal year 2011-12, MSF disbursed \$40.5 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, 2012, local governmental entities had earned \$21.2 million and repaid \$16.4 million. In the event that no further jobs are created by these local governmental entities, MSF may receive a return of \$2.9 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, 2012

ASSETS

Current assets:	
Cash (Note 2)	\$ 10,880,091
Equity in common cash (Note 2)	115,703,430
SSBCI checking account (Note 2)	21,587,768
Capital Access Program - Cash (Note 2)	8,449
Michigan Supplier Diversification Fund - Collateral Deposit (Note 2)	447,088
Michigan Supplier Diversification Fund - Participation Loan	1,420,043
Michigan Business Growth Fund - Collateral Deposit (Note 2)	284,425
Michigan Business Growth Fund - Participation Loan	8,145,736
Amounts due from federal government	53,006,650
Amounts due from local units	4,735,644
Loans receivable (Note 3)	12,079,794
Capital lease receivable (Note 4)	3,697,544
Other current assets	28,353,024
Total current assets	<u>\$ 260,349,687</u>
Noncurrent assets:	
Capital Access Program (Notes 2 and 5)	\$ 5,998,320
Michigan Supplier Diversification Fund - Collateral Deposit (Note 2)	15,240,762
Michigan Supplier Diversification Fund - Participation Loan	3,737,928
Michigan Business Growth Fund - Collateral Deposit (Note 2)	16,868,929
Michigan Business Growth Fund - Participation Loan	5,395,952
Capital lease receivable (Note 4)	197,215,281
Loans receivable (Note 3)	46,573,365
Interest receivable (Note 3)	185,872
Investments (Note 2)	92,471,857
Other noncurrent assets	7,500,000
Total noncurrent assets	<u>\$ 391,188,266</u>
Total assets	<u>\$ 651,537,952</u>

LIABILITIES

Current liabilities:	
Accounts payable and other liabilities	\$ 78,355,883
Amounts due to component units	19,257,630
Capital Access Program (Note 5)	800,000
Compensated absences (Note 5)	1,159,339
Amounts due to primary government	241,914
Bond interest payable	4,651,883
Bonds payable (Note 7)	2,780,000
Deferred revenue	1,179,108
Total current liabilities	<u>\$ 108,425,757</u>
Long-term liabilities:	
Bonds payable (Note 7)	\$ 199,825,246
Capital Access Program (Note 5)	5,198,320
Compensated absences (Note 5)	1,001,399
Amount due to primary government	218,425
Total long-term liabilities	<u>\$ 206,243,390</u>
Total liabilities	<u>\$ 314,669,147</u>

NET ASSETS

Restricted for:	
Debt service	\$ 1,410,754
Other purposes	335,396,585
Unrestricted	61,467
Total net assets	<u>\$ 336,868,805</u>

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

MICHIGAN STRATEGIC FUND
Statement of Activities
For the Fiscal Year Ended September 30, 2012

EXPENSES (Note 1)	
Administrative	\$ 771,476
Community Development Block Grants	34,054,171
Arts and Cultural Grants	2,257,293
Michigan Energy Office	34,041,072
Jobs for Michigan Investment Fund	85,380,959
Workforce Development Agency Fund	333,955,227
Other programs	2,963,808
Payments to MEDC	60,190,118
Payments to General Fund (indirect and refund)	1,103,211
Other interest	9,505,591
Miscellaneous and receivable write-off	8,701,337
Total program expenses	<u>\$ 572,924,264</u>
 PROGRAM REVENUES (Note 1)	
<u>Charges for services</u>	
Program fees	\$ 4,211,930
<u>Operating grants and contributions</u>	
Federal revenues	413,770,092
Revenues from local units	1,028,815
Total program revenues	<u>\$ 419,010,837</u>
 Net program expenses	 <u>\$ 153,913,426</u>
 GENERAL REVENUES (Note 1)	
<u>Payments from the State of Michigan</u>	
Payments from General Fund	\$ 62,655,492
Payments from 21st Century Jobs Trust Fund	92,252,825
<u>Other</u>	
Interest and investment earnings	7,579,086
Net increase (decrease) in fair value of investments	1,579,397
Tribal gaming	52,411,996
Lease revenue	9,568,894
Miscellaneous and payable write-off	9,828,657
Total general revenues	<u>\$ 235,876,346</u>
 Change in net assets	 \$ 81,962,919
 Net assets - Beginning Restated (Note 10)	 <u>254,905,886</u>
 Net assets - Ending	 <u>\$ 336,868,805</u>

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

MICHIGAN STRATEGIC FUND
Governmental Fund Balance Sheet
As of September 30, 2012

	Major Funds				Total
	General Operations Fund	Workforce Development Agency Fund	Jobs for Michigan Investment Fund	Debt Service Fund	
ASSETS					
Current assets:					
Cash (Note 2)	\$ 2,426,494	\$	\$ 698,600	\$ 7,754,997	\$ 10,880,091
Equity in common cash (Note 2)	24,575,977	2,946,395	88,181,058		115,703,430
SSBCI checking account (Note 2)	21,587,768				21,587,768
Capital Access Program - Cash (Note 2)	8,449				8,449
Michigan Supplier Diversification Fund - Collateral Deposit (Note 2)			447,088		447,088
Michigan Supplier Diversification Fund - Participation Loan			1,420,043		1,420,043
Michigan Business Growth Fund - Collateral Deposit (Note 2)	284,425				284,425
Michigan Business Growth Fund - Participation Loan	8,145,736				8,145,736
Amounts due from federal government	21,895,040	31,111,611			53,006,650
Amounts due from local units		4,735,644			4,735,644
Loans receivable (Note 3)	1,504,341		10,575,453		12,079,794
Other current assets	17,530,224	381	10,822,358	61	28,353,024
Total current assets	<u>\$ 97,958,454</u>	<u>\$38,794,031</u>	<u>\$ 112,144,599</u>	<u>\$ 7,755,058</u>	<u>\$256,652,142</u>
Noncurrent assets:					
Capital Access Program (Notes 2 and 5)	\$ 5,998,320	\$	\$	\$	\$ 5,998,320
Michigan Supplier Diversification Fund - Collateral Deposit (Note 2)			15,240,762		15,240,762
Michigan Supplier Diversification Fund - Participation Loan			3,737,928		3,737,928
Michigan Business Growth Fund - Collateral Deposit (Note 2)	16,868,929				16,868,929
Michigan Business Growth Fund - Participation Loan	5,395,952				5,395,952
Loans receivable (Note 3)	12,219,031		34,354,334		46,573,365
Interest receivable (Note 3)			185,872		185,872
Investments (Note 2)			92,471,857		92,471,857
Other noncurrent assets	7,500,000				7,500,000
Total noncurrent assets	<u>\$ 47,982,231</u>	<u>\$ 0</u>	<u>\$ 145,990,754</u>	<u>\$ 0</u>	<u>\$193,972,985</u>
Total assets	<u>\$145,940,685</u>	<u>\$38,794,031</u>	<u>\$ 258,135,353</u>	<u>\$ 7,755,058</u>	<u>\$450,625,127</u>
LIABILITIES					
Current liabilities:					
Accounts payable and other liabilities	\$ 19,251,535	\$37,642,631	\$ 21,461,717	\$	\$ 78,355,883
Amounts due to component units	12,856,551	107,915	613,163		13,577,630
Capital Access Program (Note 5)	800,000				800,000
Amounts due to primary government	16,548	124,171	4,118		144,836
Deferred revenue	5,955,672	903,437	10,629,990		17,489,099
Total current liabilities	<u>\$ 38,880,306</u>	<u>\$38,778,154</u>	<u>\$ 32,708,988</u>	<u>\$ 0</u>	<u>\$110,367,447</u>
Long-term liabilities:					
Deferred revenue (Note 3)	\$	\$	\$ 185,872	\$	\$ 185,872
Capital Access Program (Note 5)	5,198,320				5,198,320
Total long-term liabilities	<u>\$ 5,198,320</u>	<u>\$ 0</u>	<u>\$ 185,872</u>	<u>\$ 0</u>	<u>\$ 5,384,192</u>
Total liabilities	<u>\$ 44,078,626</u>	<u>\$38,778,154</u>	<u>\$ 32,894,860</u>	<u>\$ 0</u>	<u>\$115,751,639</u>
FUND BALANCE (Notes 9 and 10)					
Restricted fund balance	\$ 101,816,469	\$	\$ 225,240,494	\$ 7,755,058	\$334,812,021
Committed fund balance	23,587				23,587
Assigned fund balance	2,100	15,877			17,977
Unassigned fund balance	19,902				19,902
Total fund balance	<u>\$101,862,059</u>	<u>\$ 15,877</u>	<u>\$ 225,240,494</u>	<u>\$ 7,755,058</u>	<u>\$334,873,488</u>
Total liabilities and fund balance	<u>\$145,940,685</u>	<u>\$38,794,031</u>	<u>\$ 258,135,353</u>	<u>\$ 7,755,058</u>	<u>\$450,625,127</u>

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

MICHIGAN STRATEGIC FUND
 Reconciliation of the Governmental Fund Balance Sheet
 to the Statement of Net Assets
As of September 30, 2012

Total fund balance	\$334,873,488
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.	200,912,825
Compensated absences are not due and payable in the current period and, therefore, are not reported in the governmental fund statement.	(2,160,737)
Bond interest payable and bonds payable are not due and payable in the current period and, therefore, are not reported in the governmental fund statement.	
Bond interest payable	(4,651,883)
Bonds payable	(202,605,246)
Amounts due to primary government are not due and payable in the current period and, therefore, are not reported in the governmental fund statement.	(315,503)
Amounts due to component units that are not due and payable in the current period are not reported in the governmental fund statement.	(5,680,000)
Deferred revenue is not available for the current period and, therefore, is not recognized as revenue in the governmental fund statement. This includes:	
Tribal gaming revenue	14,420,000
Loan interest revenue	2,075,862
	2,075,862
Net assets of governmental activities	\$336,868,805

MICHIGAN STRATEGIC FUND
 Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balance
 For the Fiscal Year Ended September 30, 2012

	Major Funds				Total
	General Operations Fund	Workforce Development Agency Fund	Jobs for Michigan Investment Fund	Debt Service Fund	
REVENUES (Note 1)					
<u>Charges for services</u>					
Program fees	\$ 4,211,930	\$	\$	\$	\$ 4,211,930
<u>Operating grants and contributions</u>					
Federal revenues	100,554,543	313,215,549			413,770,092
Revenues from local units	1,028,815				1,028,815
<u>Payments from the State of Michigan</u>					
Payments from General Fund	43,798,600	18,856,892			62,655,492
Payments from 21st Century Jobs Trust Fund			92,252,825		92,252,825
<u>Other</u>					
Tribal gaming	39,595,270		12,601,122		52,196,393
Interest and Investment earnings	1,542,577		4,730,164		6,272,741
Net increase (decrease) in fair value of investments			1,579,397		1,579,397
Lease revenue				12,844,503	12,844,503
Miscellaneous and payable write-off	5,930,082	2,872,428	230,136	400,407	9,433,053
Total revenues	<u>\$ 196,661,818</u>	<u>\$ 334,944,869</u>	<u>\$ 111,393,644</u>	<u>\$ 13,244,910</u>	<u>\$ 656,245,241</u>
EXPENDITURES (Note 1)					
Administrative	\$ 816,019	\$	\$	\$	\$ 816,019
Other interest				9,055,387	9,055,387
Debt service principal redemption				2,325,000	2,325,000
Community Development Block Grants	34,054,171				34,054,171
Arts and Cultural Grants	2,257,293				2,257,293
Michigan Energy Office	34,041,072				34,041,072
Jobs for Michigan Investment Fund			85,380,959		85,380,959
Workforce Development Agency Fund		333,955,227			333,955,227
Other programs	2,963,808				2,963,808
Payments to MEDC	59,614,515				59,614,515
Payments to General Fund (indirect and refund)	129,447	973,764			1,103,211
Miscellaneous and receivable write-off	7,905,734			400,000	8,305,734
Total expenditures	<u>\$ 141,782,059</u>	<u>\$ 334,928,992</u>	<u>\$ 85,380,959</u>	<u>\$ 11,780,387</u>	<u>\$ 573,872,397</u>
Excess of revenues over/(under) expenditures	<u>\$ 54,879,760</u>	<u>\$ 15,877</u>	<u>\$ 26,012,684</u>	<u>\$ 1,464,522</u>	<u>\$ 82,372,844</u>
OTHER FINANCING SOURCES (USES)					
Transfer from Jobs for Michigan Investment Fund	\$ 68,535	\$	\$	\$	\$ 68,535
Transfer to General Operations Fund			(68,535)		(68,535)
Other financing sources (uses)	<u>\$ 68,535</u>	<u>\$ 0</u>	<u>\$ (68,535)</u>	<u>\$ 0</u>	<u>\$ 0</u>
Net change in fund balances	\$ 54,948,295	\$ 15,877	\$ 25,944,150	\$ 1,464,522	\$ 82,372,844
Fund balance - Beginning Restated (Note 10)	46,913,765		199,296,344	6,290,536	252,500,644
Fund balance - Ending	<u>\$ 101,862,059</u>	<u>\$ 15,877</u>	<u>\$ 225,240,494</u>	<u>\$ 7,755,058</u>	<u>\$ 334,873,488</u>

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

MICHIGAN STRATEGIC FUND
 Reconciliation of the Governmental Fund Statement of Revenues, Expenditures,
 and Changes in Fund Balance to the Statement of Activities
For the Fiscal Year Ended September 30, 2012

Net change in fund balance \$ 82,372,844

Amounts reported for governmental activities in the statement of activities are different because:

Tribal gaming revenue that was unavailable and, therefore, deferred at the governmental fund level was recognized in the statement of activities. 215,603

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. 1,306,345

Lease revenue is recorded as a resource in the governmental fund statement; however, this portion of the lease revenue is applied to the lease receivable in the statement of activities. (3,275,609)

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. (575,603)

Other interest expense for bonds payable that is not due and payable in the current period is not recorded in the governmental fund statement. (450,203)

Debt service principal redemption was due and payable in the current period and was reported as an expenditure in the governmental fund statement. 2,325,000

Miscellaneous and payable write-off were not recorded in the governmental fund statement for payables recorded in the statement of activities. (395,603)

Miscellaneous and receivable write-off were not recorded in the governmental fund statement for receivables recorded in the statement of activities. 395,603

Compensated absences are not reported in the governmental fund statement because payments are not due and do not use current financial resources. 44,543

Change in net assets of governmental activities \$ 81,962,919

Notes to the Financial Statements

Note 1 Significant Accounting Policies

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

a. Reporting Entity

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

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

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

MSF is governed by an 11-member Board of Directors that consists of MEDC's chief executive officer, the State Treasurer, the director of 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. Change in Reporting Entity

Executive Order No. 2011-4, 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 were transferred effective October 1, 2011, except for Michigan State Housing Development Authority, which is responsible for its own accounting and reporting responsibilities.

In accordance with governmental accounting and financial reporting standards, the Land Bank Fast Track Authority and the Michigan State Housing Development Authority are not considered component units of MSF and continue to be reported as discretely presented component units of the State of Michigan in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. Financial transactions and balances of the workforce programs are reported in MSF's Workforce Development Agency Fund and financial transactions and balances of the energy programs are reported in MSF's General Operations Fund. Governmental accounting and financial reporting standards require MSF to report this change in reporting entity retrospectively to show financial information for the new reporting entity for all prior periods presented. Detailed information regarding the impact of this change is included in Note 10.

c. 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, Workforce Development Agency Fund (a special revenue fund), Jobs for Michigan Investment Fund (a special revenue fund), and Debt Service Fund. MSF's four 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 Workforce Development Agency Fund, the Jobs for Michigan Investment Fund, and the Debt Service Fund. The Workforce Development Agency Fund accounts for revenues and expenditures related to the workforce programs, including the State's workforce initiatives, adult education, the Veteran's Services Division, and programs related to migrant and seasonal workers. 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, the changes in financial position, or, where applicable, cash flows of the State of Michigan or its component units in conformity with GAAP.

d. 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.

e. Financial Data

(1) MSF's General Operations Fund includes the following:

- (a) Revenues: Revenues include federal revenues for Community Development Block Grants (CDBGs) from the U.S. Department of Housing and Urban Development; State Small Business Credit Initiative (SSBCI) from the U.S. Department of Treasury; federal grants from the U.S. Department of Energy; State appropriations from the General Fund; tribal gaming; interest and investment earnings; fees from private activity bond* (PAB) issuances; and fees from Michigan Economic Growth Authority (MEGA) and Brownfield program applications.
- (b) Expenditures: CDBG expenditures primarily consist of pass-through grants to local governmental units. Michigan Energy Office expenditures primarily consist of pass-through grants to local governmental units and private entities. 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 include amounts transferred from the Jobs for Michigan Investment Fund to the General Operations Fund to fund the Michigan Film Office.

* See glossary at end of report for definition.

- (2) MSF's Workforce Development Agency Fund primarily includes the following:
 - (a) Revenues: Revenues include federal grants from the U.S. Department of Agriculture, U.S. Department of Education, U.S. Department of Health and Human Services, and U.S. Department of Labor and State General Fund appropriations.
 - (b) Expenditures: Expenditures primarily consist of pass-through grants to local governmental units, private entities, and universities.
- (3) 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) Expenditures: Expenditures primarily consist of grants to private entities, universities, and colleges and expenditures for travel promotion, business marketing, business incentive programs, and administration.
- (4) 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.

f. 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, fund balance for funds created through enabling legislation, collateral deposits and participation loans of the Michigan Business Growth Fund (MBGF) programs, the unspent amount of the cash advance from the SSBCI program, the unspent cash reserve for cost of the bond issuance for the Cadillac Place, and the limited obligation revenue bond cash remaining in the Debt Service Fund at year-end (Note 9).

- (2) Committed fund balance includes amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the State Legislature through legislation passed into law. MSF's committed fund balance consists of the fund balance for grant application fees authorized to be collected through MSF's annual appropriations act.
- (3) Assigned fund balance includes amounts that are constrained by MSF's intent to be used for specific purposes, but are neither restricted nor committed. MSF's assigned fund balance consists of encumbrances funded by MSF appropriations that were not previously restricted or committed.
- (4) 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.
- (5) MSF's policy is that restricted amounts are spent first when an expenditure is incurred for purposes for which both restricted or unrestricted (committed, assigned, and unassigned) resources are available.

Note 2 Deposits and Investments

- a. Deposits held by MSF at September 30, 2012 were as follows:

Equity in common cash	\$115,703,430
Deposits	32,476,307
Capital Access Program (noncurrent)	5,998,320
MSDF - Collateral Deposit	15,687,851
MBGF - Collateral Deposit	17,153,354
	<hr/>
Total deposits	\$187,019,262
	<hr/>

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 \$71,494,076 at September 30, 2012. 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, \$63,472,370 as of September 30, 2012 was 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, 2012, 100% 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 *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 fair values were estimated by the partnerships, using the most recent reports and financial statements of the partnership investments:

<u>Type of Investment</u>	<u>Fair Value (in millions) as of September 30, 2012</u>
Venture capital - Limited partner	\$40.1
Venture capital - Stockholder	30.4
Mezzanine funds	12.1
Private equity	9.9
	<hr/>
Total investments	\$92.5
	<hr/>

* See glossary at end of report for definition.

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, 2012:

Name of Issuer	Amount (in millions)	Percentage of Investments
ProNAi Therapeutics, Inc.	\$5.0	5.4%
Integrated Sensing Systems, Inc.	\$4.9	5.3%

Note 3 Loans and Interest Receivable

Loans receivable totaled \$44,929,787 at September 30, 2012 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 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 \$2,075,862, consisting of \$1,889,990 in current interest receivable (reported as other current assets) and \$185,872 in noncurrent interest receivable, 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 receivables totaled \$13,723,372 at September 30, 2012 for the General Operations Fund. These are loans issued by the Michigan Energy Office to public or private entities with limited resources to gain access to capital to purchase and install energy conservation measures, manufacturing equipment, and retooling. The direct loans are for Energy Efficiency and Renewable Energy projects and are limited to those activities specifically listed as eligible activities in the federal State Energy Program regulation.

Loans receivable held by MSF as of September 30, 2012 consisted of the following:

Loan Category	Loans Receivable
Technology Tri-Corridor	\$ 8,564,833
Life Sciences	2,872,632
Choose Michigan Fund	9,146,877
Competitive Edge Technology:	
Advanced Automotive, Manufacturing, and Materials Technology	12,003,020
Life Sciences Technology	31,935,610
Homeland Security and Defense Technology	9,640,038
Alternative Energy Technology	2,661,715
Capital Conduit Program	724,730
Michigan Energy Office loans	13,723,372
Total	<u>\$ 91,272,826</u>
Less: Allowance for uncollectible loans	<u>(32,619,666)</u>
Total loans receivable (net)	<u><u>\$ 58,653,159</u></u>

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, 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 interest and retire 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, 2012
Total lease payments to be received	\$297,526,889
Less: Unearned interest income	96,614,064
	\$200,912,825
Statement of net assets classification:	
Current portion of lease receivable	\$ 3,697,544
Long-term portion of lease receivable	197,215,281
	\$200,912,825

Lease payments to be received from the House of Representatives and DTMB as of September 30, 2012:

Fiscal Year Ended September 30	Lease Receivable
2013	\$ 13,129,813
2014	17,054,063
2015	17,569,313
2016	18,100,813
2017	18,645,563
2018 - 27	170,032,638
2028 - 31	42,994,688
	\$297,526,889

Note 5 Long-Term Liabilities

The following table summarizes the long-term liabilities of MSF for the fiscal year ended September 30, 2012:

	Beginning Balance - Restated	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$ 5,790,488	\$1,114,353	\$ 906,521	\$ 5,998,320	\$ 800,000
Compensated absences	\$ 2,108,203	\$1,159,944	\$1,107,409	\$ 2,160,737	\$1,159,339
Bonds payable	\$198,845,000	\$ 0	\$2,325,000	\$196,520,000	\$2,780,000
Unamortized premium	\$ 6,488,809	\$ 0	\$ 403,562	\$ 6,085,246	\$ 403,562

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. Increases in the Capital Access Program liabilities represent 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, 2012, 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, 2012. The beginning balance was restated to include Workforce Development Agency and Michigan Energy Office employees who were transferred to MSF by Executive Order No. 2011-4.

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 paid an average of 50.85% of its payroll costs for pension charges in fiscal year 2011-12. As of April 1, 2012, defined benefit plan members were required to contribute 4% of their payroll toward their pension benefit. 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. In addition, MSF contributed 9.30% towards other postemployment benefits for most State employees in fiscal year 2011-12. 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 Alerus Retirement Solutions, 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.

MSF makes no contributions to the 457 deferred compensation plan. Only employees make contributions to the plan.

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% to 5.19%. The Series B bonds (\$1,130,000) matured 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
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	5,590,000	3,058,763	8,648,763
2018 - 22	36,965,000	10,201,056	47,166,056
2023 - 24	19,375,000	1,012,463	20,387,463
Total	<u>\$77,405,000</u>	<u>\$28,813,206</u>	<u>\$106,218,207</u>
Unamortized premium	2,195,533		2,195,533
Total	<u><u>\$79,600,533</u></u>	<u><u>\$28,813,206</u></u>	<u><u>\$108,413,739</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

* See glossary at end of report for definition.

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
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	3,550,000	5,780,050	9,330,050
2018 - 27	61,675,000	43,492,425	105,167,425
2028 - 32	47,880,000	5,896,538	53,776,538
Total	\$119,115,000	\$79,554,463	\$198,669,463
Unamortized premium	3,889,713		3,889,713
Total	\$123,004,713	\$79,554,463	\$202,559,176

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, 2012 was \$9,284,710,304. The amount of tax-exempt bonds issued during fiscal year 2011-12 was \$46,420,000. There were no taxable bonds issued by MSF under the Taxable Bond Program for fiscal year 2011-12.

Note 9 Fund Balance

Restricted fund balance (in millions) as of September 30, 2012 consists of:

Restricted by enabling legislation:	
Jobs for Michigan Investment Fund	\$225.2
Michigan Film Promotion Fund	25.7
Energy Efficiency and Renewable Energy Revolving Loan Fund	23.7
Other restricted fund balance:	
MBGF - Collateral Deposit	17.2
MBGF - Participation Loan	13.5
SSBCI checking account	21.6
Cadillac Place - Cost of Issuance Account	.1
Debt Service Fund	7.8
	<hr/>
Total restricted fund balance	<u>\$334.8</u>

Committed fund balance of \$23,587 represents grant application fees authorized to be collected through MSF's annual appropriations act. Assigned fund balance of \$17,977 consists of encumbrances funded with the State's General Fund. Remaining fund balance is considered unassigned.

Note 10 Accounting Changes and Restatements

During fiscal year 2011-12, MSF restated its beginning fund balance and/or beginning net assets for the following:

- a. Increased beginning fund balance in its General Operations Fund and increased beginning net assets on its statement of activities by \$17,285,862 to reflect the fund balance for the Energy Efficiency and Renewable Energy Revolving Loan Fund, which was transferred to MSF by Executive Order No. 2011-4.
- b. Decreased beginning net assets on its statement of activities by \$351,981 to reflect the supplemental pension liability for Workforce Development Agency and Michigan Energy Office employees who were transferred to MSF by Executive Order No. 2011-4.
- c. Decreased beginning net assets on its statement of activities by \$1,803,004 to reflect the compensated absences liability for Workforce Development Agency and Michigan Energy Office employees who were transferred to MSF by Executive Order No. 2011-4.
- d. Increased fund balance by \$22,641,818 in its Jobs for Michigan Investment Fund and decreased fund balance by \$22,641,818 in its General Operations Fund to account for MSDF program funding that was previously reported as transfers and revenue adjustments between the two funds rather than being reported as amounts due to other funds and amounts due from other funds. In addition to restating beginning fund balance, MSF began reporting the MSDF program assets in the Jobs for Michigan Investment Fund in fiscal year 2011-12.

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REQUIRED SUPPLEMENTARY INFORMATION

MICHIGAN STRATEGIC FUND
 Budgetary Comparison Schedule and Budget-to-GAAP Reconciliation
 For the Fiscal Year Ended September 30, 2012

Budgetary Comparison Schedule (Statutory/Budgetary Basis)	Original Budget	Final Budget	Actual	Variance With Final Budget
Beginning budgetary fund balance	\$ 65,698,913	\$ 65,698,913	\$ 65,698,913	\$ 0
Resources (inflows):				
Revenues and other sources:				
Charges for services (Note 2)	\$ 43,100	\$ 43,100	\$ 4,211,930	\$ (4,168,830)
Operating grants and contributions	642,497,461	645,883,661	414,798,907	231,084,754
Payments from the State of Michigan:				
From General Fund	61,980,191	63,101,891	62,655,492	446,399
From 21st Century Jobs Trust Fund (Note 3)	210,811,087	210,811,087	92,252,825	118,558,262
Other miscellaneous (Note 4)	12,247,206	12,266,506	82,326,086	(70,059,580)
Other financing sources			68,535	(68,535)
Total revenues and other sources	<u>\$ 927,579,045</u>	<u>\$ 932,106,245</u>	<u>\$ 656,313,776</u>	<u>\$ 275,792,469</u>
 Total resources available	 <u>\$ 993,277,958</u>	 <u>\$ 997,805,158</u>	 <u>\$ 722,012,689</u>	 <u>\$ 275,792,469</u>
Charges (outflows):				
Expenditures, transfers out, and encumbrances:				
Administrative (Note 2)	\$	\$	\$ 816,019	\$ (816,019)
Community Development Block Grants	51,846,243	52,477,843	34,054,171	18,423,671
Other interest			9,055,387	(9,055,387)
Debt service principal redemption			2,325,000	(2,325,000)
Jobs for Michigan Investment Fund - Appropriation Year 2006	63,976,499	63,976,499	18,962,365	45,014,134
Jobs for Michigan Investment Fund - Appropriation Year 2008	3,528,982	3,528,982	435,001	3,093,981
Jobs for Michigan Investment Fund - Appropriation Year 2009	15,813,249	15,813,249	11,145,781	4,667,468
Jobs for Michigan Investment Fund - Appropriation Year 2010	7,206,318	7,206,318	3,003,941	4,202,377
Jobs for Michigan Investment Fund - Appropriation Year 2011	45,286,038	45,286,038	27,133,804	18,152,235
Jobs for Michigan Investment Fund - Appropriation Year 2012	75,000,000	75,000,000	31,571,933	43,428,067
Jobs for Michigan Investment Fund - Permanent Fund	5,944,300	5,944,300	5,944,300	0
Payments to MEDC:				
Administration	2,786,200	2,918,500	2,918,500	0
Job creation services	12,985,168	13,250,768	13,250,768	0
Precollege Prog-Science and Engineering		680,100	680,100	0
PAB, MEGA, and tribal gaming revenue (Notes 2 and 4)			42,765,147	(42,765,147)
Michigan Energy Office	77,083,785	77,136,885	34,041,072	43,095,813
Workforce Development Agency	531,355,933	534,252,932	333,955,227	200,297,705
Michigan Film Office and other programs	766,900	793,200	2,963,808	(2,170,608)
Arts and Cultural Grants	2,567,400	2,567,400	2,257,293	310,107
Payments to General Fund			1,103,211	(1,103,211)
Miscellaneous and receivable write-off	5,389,807	5,389,807	8,305,734	(2,915,927)
Total charges	<u>\$ 901,536,822</u>	<u>\$ 906,222,821</u>	<u>\$ 586,688,562</u>	<u>\$ 319,534,259</u>
Reconciling items:				
Changes in noncurrent assets	\$ 0	\$ 4,698,407	\$ 4,698,407	\$ 0
Net reconciling items	<u>\$ 0</u>	<u>\$ 4,698,407</u>	<u>\$ 4,698,407</u>	<u>\$ 0</u>
Ending budgetary fund balance	<u>\$ 91,741,136</u>	<u>\$ 96,280,743</u>	<u>\$ 140,022,533</u>	<u>\$ (43,741,790)</u>

This schedule continued on next page.

MICHIGAN STRATEGIC FUND
 Budgetary Comparison Schedule and Budget-to-GAAP Reconciliation
 For the Fiscal Year Ended September 30, 2012
Continued

<u>Budget-to-GAAP Reconciliation</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance With Final Budget</u>
Resources (inflows):				
Actual amount (budgetary basis) of "Total resources available"			\$ 722,012,689	
Differences - Budget to GAAP:				
Beginning budgetary fund balance is a budgetary resource but is not a current year revenue for financial reporting purposes			(65,698,913)	
Other financing sources are inflows of budgetary resources but are not revenues for financial reporting purposes			<u>(68,535)</u>	
Total revenues (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance			<u>\$ 656,245,241</u>	
Charges (outflows):				
Actual amount (budgetary basis) of "Total charges"			\$ 586,688,562	
Differences - Budget to GAAP:				
Other financing uses are outflows of budgetary resources but are not expenditures for financial reporting purposes			(68,535)	
Loans and investments are outflows for budgetary reporting purposes but are not expenditures for financial reporting purposes			<u>(12,747,630)</u>	
Total expenditures (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance			<u>\$ 573,872,397</u>	

See accompanying notes to required supplementary information.

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 Grant (CDBG) Program, the Jobs for Michigan Investment Fund, Workforce Development Agency programs, Michigan Energy Office programs, the Michigan Film Office, Arts and Cultural Grants, and other State programs. 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 year 2011-12, as well as the actual resource inflows, outflows, and fund balance stated on the budgetary basis.

The original budget and related estimated revenues represent the spending authority enacted into annual appropriations acts, as amended, for the years 2005 through 2012 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 paid to MEDC pursuant to the interlocal agreement.

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; Act 191, P.A. 2010, appropriated \$75.0 million for fiscal year 2010-11; and Act 63, P.A. 2011, appropriated \$75.0 million for fiscal year 2011-12 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 \$92.3 million from the 21st Century Jobs Trust Fund for fiscal year 2011-12.

Note 4 Tribal Gaming

The other miscellaneous revenues in the actual column include tribal gaming revenue of \$52.2 million. The payments to MEDC expenditures include a portion of 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, 2011, and 2012

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 2011 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 2011-12 were \$92.3 million, of which \$12.7 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.

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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 year ended September 30, 2012, 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 February 21, 2013. 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.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined in the preceding paragraph. However, we identified certain deficiencies in internal control over financial reporting, as described in Findings 1 and 2, that we consider to be significant deficiencies in internal control over financial reporting. A significant deficiency is 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.

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 responses to the findings identified in our audit are included in the body of our report. We did not audit the Michigan Strategic Fund's preliminary responses and, accordingly, we express no opinion on them.

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
February 21, 2013

FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

FINDING

1. Controls Over Loans Receivable Data

The Michigan Strategic Fund's (MSF's) internal control* over loans receivable data did not ensure that loss provisions were properly excluded from loans receivable balances before recording transactions in its financial accounting systems. As a result, MSF could not ensure the prevention or detection of misstatements in loans receivable reported in its financial statements.

MSF used a subsidiary ledger system to track its loans receivable balances. MSF also used a separate spreadsheet to document loss provisions for its loans at the end of the fiscal year. MSF compiled the loan data from both sources into one spreadsheet and used this information to record transactions in its separate financial accounting systems. MSF uses the financial accounting systems to report its balances for loans receivable in its prepared financial statements.

Our review of MSF's internal control over loans receivable data disclosed that MSF did not have a sufficient process to ensure that all loss provisions were properly excluded from loans receivable balances. As a result, its loans receivable balance reported on its spreadsheet was overstated by \$2.6 million. Although this error was related to the loss provision for one loan, MSF's manual process of documenting loss provisions for loans once per year was not sufficient to properly account for its total loan loss provisions. Upon our notification, MSF made the necessary adjustments to its loans receivable data prior to providing us with draft financial statements.

RECOMMENDATION

We recommend that MSF improve its internal control over loans receivable data to ensure that loss provisions are properly excluded from loans receivable balances before recording transactions in its financial accounting systems.

AGENCY PRELIMINARY RESPONSE

MSF agrees and, as stated in the finding, made the necessary adjustments to reflect the correct loans receivable amount. MSF informed us that it has made a change in its subsidiary ledger system to flag loans with loss provisions. MSF also informed us that this will help it reconcile loss provisions maintained on its

* See glossary at end of report for definition.

spreadsheet with the list generated from the system prior to recording loss provisions. MSF stated that the process will include comparing the current year loan loss provisions spreadsheet with the prior year and following up with portfolio managers on any changes.

FINDING

2. Management of Awards to Recipients System (MARS) Controls

MSF had not established effective access controls over MARS. Also, MSF, in conjunction with the Department of Technology, Management, and Budget (DTMB), did not obtain assurances regarding internal control over MARS from its service provider. As a result, MSF could not ensure that it could prevent or detect errors or irregularities that may be caused by users performing unauthorized activities. Also, MSF could not ensure the confidentiality, integrity, and availability of the MARS applications and data.

Part VII, Chapter 1, Section 900 of the State of Michigan Financial Management Guide states that effective access controls are necessary to ensure that users are able to access only information technology applications which they are authorized to view and use. Also, Part VII, Chapter 1, Section 1000 of the State of Michigan Financial Management Guide requires State agencies to ensure that third party service organizations have an adequate internal control system when service organizations develop, provide, or maintain information technology systems and applications.

MSF uses MARS in the administration of grant activities and disbursements for various federal workforce programs. Responsibility for the administration of MARS was transferred to MSF from the Department of Energy, Labor & Economic Growth (DELEG) when Executive Order No. 2011-4 transferred various workforce programs from DELEG to MSF effective October 1, 2011. MSF distributed \$263.7 million to local agencies using MARS during the fiscal year ended September 30, 2012. MSF contracts with a service provider to provide and maintain MARS and its data.

Our review of MSF's controls over MARS disclosed:

- a. MSF did not monitor user activity in MARS, including the activity of those with privileged access rights, to ensure that users are performing only authorized activities relevant to their respective jobs and positions.
- b. MSF did not periodically monitor user access rights to MARS to ensure that only authorized users have access to the applications and data.
- c. MSF did not ensure the protection of passwords from unauthorized use by requiring users to periodically change their passwords in MARS.
- d. MSF, in conjunction with DTMB, did not obtain assurance regarding the MARS service provider's internal control by obtaining its established policies and procedures, an independent audit, or certification of the service provider's hosting facility to verify that policies are in place to protect confidential and sensitive data.

We reported similar conditions regarding controls over MARS in our prior audit report on the financial audit, including the provisions of the Single Audit Act, of the Department of Energy, Labor & Economic Growth (641-0100-11) for the period October 1, 2008 through September 30, 2010 (Findings 6411103 and 6411105).

RECOMMENDATIONS

We recommend that MSF establish effective access controls over MARS.

We also recommend that MSF, in conjunction with DTMB, obtain assurances regarding internal control over MARS from its service provider.

AGENCY PRELIMINARY RESPONSE

MSF agrees. MSF informed us that DTMB developed MARS on behalf of DELEG using third party software and that MSF inherited this system as a result of an executive order implementation which transferred the Workforce Development

Agency from DELEG. MSF stated that it has started to work with DTMB and the vendor in resolving these legacy issues as follows:

- a. A procedure is being developed so that all activity of MARS "superusers" will be reviewed monthly and a report verifying this review will be provided to MSF management. This process is expected to be implemented in April 2013.
- b. A procedure is being developed to require authorized officials of recipients and State departments using MARS to validate their lists of employees with access to MARS. This validation process will be designed so that all users are reviewed within a cycle of 12 months. This process is expected to begin implementation in April 2013.
- c. A programming request was presented to the MARS software developer in February 2013 to address the issue identified in this finding. MSF is awaiting the developer's response.
- d. DTMB has been aware of the requirement and has begun a process, in conjunction with its DIT-0170 "Information Technology Project Security Plan & Assessment" review, to obtain the required certifications. MSF will contact DTMB and will continue to work with DTMB to acquire appropriate documentation.

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. Effective April 24, 2011, DELEG became the Department of Licensing and Regulatory Affairs.
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 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.

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.
MARS	Management of Awards to Recipients System.
material misstatement	A misstatement in the financial statements that causes the 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 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.
private activity bond (PAB)	A category of municipal bonds distinguished from public purpose bonds in the Tax Reform Act of 1986.
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.
<i>SOMCAFR</i>	<i>State of Michigan Comprehensive Annual Financial Report.</i>
SSBCI	State Small Business Credit Initiative.
unqualified opinion	An auditor's opinion in which the auditor states that the 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.

