



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
Including the Provisions of the Single Audit Act
Michigan Strategic Fund
(A Component Unit of the State of Michigan)
October 1, 2004 through September 30, 2006

Report Number:
271-0400-07

Released:
April 2007

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

Financial Statements:

Auditor's Report Issued

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

~ ~ ~ ~ ~

Internal Control Over Financial Reporting

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

~ ~ ~ ~ ~

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

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

~ ~ ~ ~ ~

Federal Awards:

Auditor's Reports Issued on Compliance

We audited one program as a major program and issued an unqualified opinion. The federal program audited as a major program is identified on the back of this summary.

~ ~ ~ ~ ~

Internal Control Over Major Programs

We did not report any findings related to internal control over major programs.

~ ~ ~ ~ ~

Required Reporting of Noncompliance

We did not identify any instances of noncompliance that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133.

~ ~ ~ ~ ~

We audited the following program as a major program:

<u><i>CFDA Number</i></u>	<u><i>Program Title</i></u>	<u><i>Compliance Opinion</i></u>
14.228	Community Development Block Grants/State's Program	Unqualified

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



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

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

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



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

April 27, 2007

Mr. James C. Epolito, President
Michigan Strategic Fund
300 North Washington Square
Lansing, Michigan

Dear Mr. Epolito:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Michigan Strategic Fund (MSF), a component unit of the State of Michigan, for the period October 1, 2004 through September 30, 2006.

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

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

AUDITOR GENERAL

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	10
MANAGEMENT'S DISCUSSION AND ANALYSIS	
Management's Discussion and Analysis	13
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
Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balance	23
Reconciliation of the Governmental Fund Balance Sheet to the Statement of Net Assets	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 Reporting	
Budgetary Comparison Schedule and Budget-to-GAAP Reconciliation	36
Notes to Required Supplementary Information - Budgetary Reporting	40

SUPPLEMENTAL FINANCIAL SCHEDULE

Schedule of Expenditures of Federal Awards	44
--	----

INDEPENDENT AUDITOR'S REPORTS ON INTERNAL CONTROL AND COMPLIANCE

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters	48
Independent Auditor's Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133	50

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I: Summary of Auditor's Results	53
Section II: Findings Related to the Financial Statements	54
Section III: Findings and Questioned Costs Related to Federal Awards	54

OTHER SCHEDULES

Summary Schedule of Prior Audit Findings	56
Corrective Action Plan	57

GLOSSARY

Glossary of Acronyms and Terms	59
--------------------------------	----

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. James C. Epolito, President
Michigan Strategic Fund
300 North Washington Square
Lansing, Michigan

Dear Mr. Epolito:

We have audited the accompanying financial statements of the Michigan Strategic Fund, a component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2006 and September 30, 2005, as identified in the table of contents. These financial statements are the responsibility of the Michigan Strategic Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As described in Note 1, the financial statements present only the Michigan Strategic Fund and do not purport to, and do not, present fairly the financial position of the State of Michigan or its component units as of September 30, 2006 and September 30, 2005 and the changes in financial position thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Michigan Strategic Fund as of September 30, 2006 and September 30, 2005 and the changes in financial position for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 15, 2007 on our consideration of the Michigan Strategic Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 13 through 17 and the budgetary comparison schedule and budget-to-GAAP reconciliation and corresponding notes on pages 38 through 43 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it. The management's discussion and analysis for the fiscal year ended September 30, 2005 was not presented because this information was presented in the Michigan Strategic Fund's prior year audited financial statements.

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

AUDITOR GENERAL

February 15, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

This is a discussion and analysis of the financial performance of the Michigan Strategic Fund (MSF) for the fiscal year ended September 30, 2006. 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 Labor and Economic Growth (DLEG). Effective November 21, 2005, Act 225, P.A. 2005, transferred MSF as an autonomous agency from DLEG to the Department of Treasury. MSF is a component unit of the financial reporting entity of the State of Michigan. MSF's management is responsible for the financial statements, notes to the financial statements, and this discussion.

Using the Financial Report

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

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

This financial report includes the reports of independent auditors, management's discussion and analysis, the basic financial statements, the notes to the financial statements, and other required supplementary information.

Major Changes

The significant changes in fiscal year 2005-06 were:

1. Effective November 21, 2005, Act 225, P.A. 2005, appropriated \$394.0 million to MSF to be spent in multiple fiscal years starting with fiscal year 2005-06. These appropriations are financed from the tobacco securitization settlement funds retained in the 21st Century Jobs Trust Fund at the Department of Treasury. Act 225, P.A. 2005, requires the MSF Board of Directors to oversee the programs and allows MSF to request funds for disbursements, investments, and reserves.
2. Act 225, P.A. 2005, also required a transfer of assets (\$68.7 million), including cash, loans, and investments, related to the Life Sciences and Technology

Tri-Corridor programs to MSF from the Michigan Economic Development Corporation (MEDC). The statute also reestablished the Capital Access Program within the MSF. Assets and liabilities (\$4.1 million each) related to the Capital Access Program were transferred to MSF from MEDC.

Analysis of Financial Activities

The assets of MSF exceeded its liabilities by \$57,756,663 at September 30, 2006 and by \$148,859 at September 30, 2005. Total net assets increased by \$57,607,804 during fiscal year 2005-06. This increase is primarily related to the transfer of assets related to the Life Sciences and Technical Tri-Corridor programs from MEDC to the MSF.

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

	2006	2005
Cash and equity in common cash	\$ 40,389,087	\$ 582,604
Amounts due from federal government	20,766,144	16,201,084
Other current assets	2,278,003	96,359
Total current assets	<u>\$ 63,433,235</u>	<u>\$ 16,880,047</u>
Noncurrent Assets	<u>28,856,831</u>	
Total assets	<u>\$ 92,290,066</u>	<u>\$ 16,880,047</u>
Current liabilities	\$ 30,847,809	\$ 16,731,188
Long-term liabilities	3,685,594	
Total liabilities	<u>\$ 34,533,403</u>	<u>\$ 16,731,188</u>
Net assets	<u>\$ 57,756,663</u>	<u>\$ 148,859</u>

Amounts due from federal government primarily consist of receivables for federal pass-through funds for the Community Development Block Grants (CDBG) Program. This line item increased during fiscal year 2005-06 because a significant increase in subrecipient grant reimbursement requests at the end of the fiscal year resulted in an increase in MSF's request for reimbursement at fiscal year-end.

Increases in **cash and equity in common cash, other current assets, noncurrent assets, current liabilities, and long-term liabilities** during fiscal year 2005-06 are primarily the result of transferring the Life Sciences, Technology Tri-Corridor, and Capital Access programs from MEDC to MSF as explained under the "Major Changes" discussion.

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

	2006	2005
Expenses		
Community Development Block Grants (CDBG)	\$ 54,077,620	\$ 50,589,912
Jobs for Michigan Investment Fund	33,309,284	
Payments to MEDC	34,821,598	65,164,122
Other	1,284,586	1,110,830
Total program expenses	\$ 123,493,088	\$ 116,864,863
Program revenues		
Charges for services	\$ 2,137,845	\$ 1,730,021
Operating grants and contributions	53,862,646	50,826,410
Total program revenues	\$ 56,000,491	\$ 52,556,431
Net program expenses	\$ 67,492,597	\$ 64,308,432
General revenues		
Payments from the State of Michigan	\$ 52,828,783	\$ 63,697,535
Other	72,271,618	694,236
Total general revenues	\$ 125,100,401	\$ 64,391,771
Increase in net assets	\$ 57,607,804	\$ 83,339
Net assets - Beginning	148,859	65,520
Net assets - Ending	\$ 57,756,663	\$ 148,859

CDBG expenses increased because subrecipients are completing current and prior years' grant projects and requesting reimbursement on a more timely basis. In addition, MSF awarded more grants for infrastructure projects, which have a shorter project life

than other grant types. Subrecipients are completing these infrastructure grants faster than other types of grants.

Jobs for Michigan Investment Fund expenses primarily consist of grants to Life Sciences and Technology Tri-Corridor companies and expenses for travel promotion, business marketing, and administration.

Payments to MEDC primarily consist of MSF State appropriations transferred to fund programs administered by MEDC. Payments to MEDC decreased because of the elimination of the State appropriation for Technology Tri-Corridor Initiative. This initiative was replaced with a new appropriation to the Jobs for Michigan Investment Fund, which is administered by MSF.

Charges for services primarily consist of industrial development revenue bond (IDRB) issuance fees and application and administrative fees for the Michigan Economic Growth Authority (MEGA) and Brownfield programs. Using a portion of the federal allocation of tax-free bond issuance authority given to the State, MSF can assist manufacturing businesses and nonprofit organizations raise funds for projects under \$10 million by issuing IDRBs. MSF receives fees for assisting with IDRB issuance. During fiscal year 2005-06, there was an increase in MEGA administrative fee revenue as more companies filed for credit certifications and paid the required administrative fees.

Operating grants and contributions increased during fiscal year 2005-06 primarily because of an increase in CDBG federal pass-through grant expenditures and corresponding federal revenues by the subgrantees. CDBG funds are disbursed to communities on a reimbursement basis for economic development activities and infrastructure developments. Subgrantees expended grant funds and completed projects in shorter time frames than in prior years.

Payments from the State of Michigan primarily consist of appropriations from the State's General Fund and the 21st Century Jobs Trust Fund and other restrictively funded appropriations to MSF. Payments from the State of Michigan decreased by \$10.9 million during fiscal year 2005-06. The decrease was because the State appropriation for the Technology Tri-Corridor Initiative (\$30.0 million in fiscal year 2004-05) ended in fiscal year 2004-05. This initiative was replaced by appropriations from the 21st Century Jobs Trust Fund (\$19.9 million) for the Jobs for Michigan Investment Fund initiative.

Other revenues increased \$68.7 million in fiscal year 2005-06 because of the transfer of assets from MEDC to MSF for the Life Sciences and Technology Tri-Corridor programs. In addition, MSF recognized \$2.7 million of interest and investment earnings from Life Sciences and Technology Tri-Corridor investments.

Casino Revenues

MSF had been receiving an 8% share of the net revenues collected from two Indian tribes (Little River Band of Ottawa Indians and Little Traverse Bay Band of Odawa Indians), which was paid in accordance with the terms of the tribes' 1998 compact agreement with the State. The tribes have placed the payments for fiscal years 2005-06, 2004-05, and 2003-04 into a separate account rather than submitting them to MSF. The tribes contend that the Club Keno game, introduced by the Bureau of State Lottery, violated the terms of the compact agreement. Based on information provided by the tribes, MSF estimated that the tribes placed a total of \$36.8 million into a separate account for fiscal years 2005-06, 2004-05, and 2003-04.

Other Pertinent Information

From fiscal year 1996-97 through fiscal year 2005-06, MSF disbursed \$37.5 million of CDBG federal funds for Industrial Park Loans/Grants to various local government entities. According to the agreement, local entities either could receive credits for creating a specific number of jobs or would need to return the funds to MSF. As of September 30, 2006, local entities received \$18.7 million in job credits and repaid \$8.5 million. In the event that no further jobs are created by these local entities, MSF may receive a return of \$13.3 million of federal funds from local government agencies in future years. Returned funds are treated as program income except for projects that have failed to meet a national objective. The returned funds for projects failing to meet a national objective are treated as recaptured funds and, in accordance with federal regulation, are returned to the federal grantee 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

	2006	2005
ASSETS		
Current assets:		
Cash (Note 2)	\$ 205,178	\$ 50,000
Equity in common cash (Note 2)	40,166,061	532,604
Capital Access Program - Cash	17,848	
Amounts due from federal government	20,766,144	16,201,084
Loans receivable (Note 4)	1,015,783	
Other current assets	1,262,220	96,359
Total current assets	\$ 63,433,235	\$ 16,880,047
Noncurrent assets:		
Capital Access Program (Note 2)	\$ 4,154,840	\$
Loans receivable (Note 4)	16,044,573	
Investments (Note 2)	8,657,418	
Total noncurrent assets	\$ 28,856,831	\$ 0
Total assets	\$ 92,290,066	\$ 16,880,047
LIABILITIES		
Current liabilities:		
Accounts payable and other liabilities	\$ 29,716,701	\$ 16,503,196
Amounts due to component units	154,161	
Capital Access Program (Note 5)	700,000	
Compensated absences (Note 5)	210,565	
Amounts due to primary government	20,464	11,463
Deferred revenue	45,918	216,530
Total current liabilities	\$ 30,847,809	\$ 16,731,188
Long-term liabilities:		
Capital Access Program (Note 5)	\$ 3,454,840	\$
Compensated absences (Note 5)	230,755	
Total long-term liabilities	\$ 3,685,594	\$ 0
Total liabilities	\$ 34,533,403	\$ 16,731,188
NET ASSETS		
Unrestricted net assets	\$ 57,756,663	\$ 148,859
Total net assets	\$ 57,756,663	\$ 148,859

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

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

	<u>2006</u>	<u>2005</u>
EXPENSES		
Administrative	\$ 744,678	\$ 842,348
Community Development Block Grants (Note 1)	54,077,620	50,589,912
Compensated absences	441,320	
Jobs for Michigan Investment Fund - Operations (Note 1)	19,688,532	
Jobs for Michigan Investment Fund - Pass through funds	76,444	
Jobs for Michigan Investment Fund - Programs (Note 1)	13,544,308	
Payments to MEDC (Note 1)	34,821,598	65,164,122
Payments to General Fund (indirect and refund)	98,588	268,482
Total program expenses	<u>\$123,493,088</u>	<u>\$116,864,863</u>
PROGRAM REVENUES		
<u>Charges for services</u>		
IDRB issuance fees	\$ 258,845	\$ 324,173
Other fees	1,879,000	1,405,848
<u>Operating grants and contributions</u>		
Community Development Block Grants (federal)	52,381,808	47,318,758
Community Development Block Grants (local and others)	1,480,838	3,066,676
Employment Service (federal)		440,976
Total program revenues	<u>\$ 56,000,491</u>	<u>\$ 52,556,431</u>
Net program expenses	<u>\$ 67,492,597</u>	<u>\$ 64,308,432</u>
GENERAL REVENUES		
<u>Payments from the State of Michigan</u>		
Payments from General Fund	\$ 32,971,544	\$ 53,697,535
Payments from Tobacco Settlement Trust Fund		10,000,000
Payments from 21st Century Trust Fund	19,857,239	
<u>Other</u>		
Tribal gaming (Note 9)		148,559
Payment from MEDC - Other	3,945	52,637
Interest and investment earnings	2,762,116	
Transfer of programs from MEDC (Note 7)	68,672,599	
Miscellaneous	832,959	493,039
Total general revenues	<u>\$125,100,401</u>	<u>\$ 64,391,771</u>
Increase in net assets	\$ 57,607,804	\$ 83,339
Net assets - Beginning	<u>148,859</u>	<u>65,520</u>
Net assets - Ending	<u>\$ 57,756,663</u>	<u>\$ 148,859</u>

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

MICHIGAN STRATEGIC FUND
Governmental Fund Balance Sheet
As of September 30

	2006			2005
	General Operations	Jobs for Michigan Investment Fund	Total	
ASSETS				
Current assets:				
Cash (Note 2)	\$ 205,178	\$	\$ 205,178	\$ 50,000
Equity in common cash (Note 2)	649,280	39,516,780	40,166,061	532,604
Capital Access Program - Cash (Note 2)	17,848		17,848	
Amounts due from federal government	20,766,144		20,766,144	16,201,084
Loans receivable (Note 4)		1,015,783	1,015,783	
Other current assets	44,676	1,217,544	1,262,220	96,359
Total current assets	<u>\$ 21,683,127</u>	<u>\$ 41,750,108</u>	<u>\$ 63,433,235</u>	<u>\$ 16,880,047</u>
Noncurrent assets:				
Capital Access Program (Note 2)	\$ 4,154,840	\$	\$ 4,154,840	\$
Loans receivable (Note 4)		16,044,573	16,044,573	
Investments (Note 2)		8,657,418	8,657,418	
Total noncurrent assets	<u>\$ 4,154,840</u>	<u>\$ 24,701,992</u>	<u>\$ 28,856,831</u>	<u>\$ 0</u>
Total assets	<u>\$ 25,837,967</u>	<u>\$ 66,452,100</u>	<u>\$ 92,290,066</u>	<u>\$ 16,880,047</u>
LIABILITIES				
Current liabilities:				
Accounts payable and other liabilities	\$ 21,426,683	\$ 8,290,018	\$ 29,716,701	\$ 16,503,196
Amounts due to component unit		154,161	154,161	
Capital Access Program (Note 5)	700,000		700,000	
Amounts due to primary government	10,477	9,986	20,464	11,463
Deferred revenue	45,918		45,918	216,530
Total current liabilities	<u>\$ 22,183,078</u>	<u>\$ 8,454,166</u>	<u>\$ 30,637,244</u>	<u>\$ 16,731,188</u>
Long-term liabilities:				
Capital Access Program (Note 5)	\$ 3,454,840	\$	\$ 3,454,840	\$
Total long-term liabilities	<u>\$ 3,454,840</u>	<u>\$ 0</u>	<u>\$ 3,454,840</u>	<u>\$ 0</u>
Total liabilities	<u>\$ 25,637,918</u>	<u>\$ 8,454,166</u>	<u>\$ 34,092,084</u>	<u>\$ 16,731,188</u>
FUND BALANCE				
Reserved fund balance (Note 8)	\$	\$ 50,601,681	\$ 50,601,681	\$
Unreserved fund balance	200,049	7,396,252	7,596,301	148,859
Total fund balance	<u>\$ 200,049</u>	<u>\$ 57,997,934</u>	<u>\$ 58,197,983</u>	<u>\$ 148,859</u>
Total liabilities and fund balance	<u>\$ 25,837,967</u>	<u>\$ 66,452,100</u>	<u>\$ 92,290,066</u>	<u>\$ 16,880,047</u>

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

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

	2006			2005
	General Operations	Jobs for Michigan Investment Fund	Total	
REVENUES (Note 1d)				
<u>Charges for services</u>				
IDRB issuance fees	\$ 258,845	\$	\$ 258,845	\$ 324,173
Other fees	1,879,000		1,879,000	1,405,848
<u>Operating grants and contributions</u>				
Community Development Block Grants (federal)	52,381,808		52,381,808	47,318,758
Community Development Block Grants (local and others)	1,480,838		1,480,838	3,066,676
Employment Service (federal)				440,976
<u>Payments from the State of Michigan</u>				
Payments from General Fund	32,971,544		32,971,544	53,697,535
Payments from Tobacco Settlement Trust Fund				10,000,000
Payments from 21st Century Jobs Trust Fund		19,857,239	19,857,239	
<u>Other</u>				
Tribal gaming (Note 9)				148,559
Payment from MEDC - Other	3,945		3,945	52,637
Interest and investment earnings	17,848	2,744,268	2,762,116	
Miscellaneous	799,845	33,113	832,959	493,039
Total revenues	<u>\$ 89,793,674</u>	<u>\$ 22,634,620</u>	<u>\$ 112,428,293</u>	<u>\$ 116,948,202</u>
EXPENDITURES (Note 1d)				
Administrative	\$ 744,678	\$	\$ 744,678	\$ 842,348
Community Development Block Grants	54,077,620		54,077,620	50,589,912
Jobs for Michigan Investment Fund - Operations		19,688,532	19,688,532	
Jobs for Michigan Investment Fund - Pass-through funds		76,444	76,444	
Jobs for Michigan Investment Fund - Programs		13,544,308	13,544,308	
Payments to MEDC	34,821,598		34,821,598	65,164,122
Payments to General Fund (indirect and refund)	98,588		98,588	268,482
Total Expenditures	<u>\$ 89,742,484</u>	<u>\$ 33,309,284</u>	<u>\$ 123,051,768</u>	<u>\$ 116,864,863</u>
Excess of revenues over/(under) expenditures	<u>\$ 51,190</u>	<u>\$ (10,674,665)</u>	<u>\$ (10,623,475)</u>	<u>\$ 83,339</u>
OTHER FINANCING SOURCES (USES)				
Transfer of programs from MEDC (Note 7)	\$	\$ 68,672,599	\$ 68,672,599	\$
Other financing sources (uses)	<u>\$ 0</u>	<u>\$ 68,672,599</u>	<u>\$ 68,672,599</u>	<u>\$ 0</u>
Excess of revenues and other sources over/(under) expenditures and other uses	<u>\$ 51,190</u>	<u>\$ 57,997,934</u>	<u>\$ 58,049,124</u>	<u>\$ 83,339</u>
Fund balance - Beginning	<u>148,859</u>		<u>148,859</u>	<u>65,520</u>
Fund balance - Ending	<u>\$ 200,049</u>	<u>\$ 57,997,934</u>	<u>\$ 58,197,983</u>	<u>\$ 148,859</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, 2006

Total fund balance	\$58,197,983
Amounts reported for governmental activities in the statement of net assets are different because:	
Compensated absences liabilities are not due and payable in the current period and, therefore, are not reported in the governmental fund statement	<u>(441,320)</u>
Net assets of governmental activities	<u><u>\$57,756,663</u></u>

MICHIGAN STRATEGIC FUND

Reconciliation of the Governmental Fund Statement of Revenues, Expenditures,
and Changes in Fund Balance to the Statement of Activities
For the Fiscal Year Ended September 30, 2006

Net change in fund balance	\$58,049,124
Amounts reported for governmental activities in the statement of activities are different because:	
Expenses for compensated absences are not reported in the governmental fund statement because payments are not due and do not use current financial resources	<u>(441,320)</u>
Change in net assets of governmental activities	<u><u>\$57,607,804</u></u>

Notes to the Financial Statements

Note 1 Significant Accounting Policies

The accounting policies of the Michigan Strategic Fund (MSF) conform to accounting principles generally accepted in the United States of America 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 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 created the Michigan Economic Development Corporation (MEDC) as a new public entity in 1999 to help administer the programs transferred to MSF. Any economic development programs transferred to MSF could be transferred, along with the relevant personnel and funding, to the new MEDC. MSF entered into an interlocal agreement with the Economic Development Corporation of the Charter County of Wayne, and MEDC was formed.

Under Executive Order No. 2003-18, effective December 7, 2003, MSF was transferred from the Department of Management and Budget to the Department of Labor and Economic Growth (DLEG). MSF remains an autonomous agency. The Executive Order also transferred the MSF Board of Directors' position designated for the director of the Department of Management and Budget to the director of DLEG.

Effective November 21, 2005, Act 225, P.A. 2005, transferred MSF as an autonomous agency from DLEG to the Department of Treasury. The Act also appropriated \$394.0 million, financed by the 21st Century Jobs Trust

Fund in the Department of Treasury to MSF for various programs and requires the MSF Board of Directors to oversee the programs.

MSF is governed by an 11-member Board of Directors that consists of MEDC's chief executive officer, the State Treasurer, the director of DLEG, and 8 members appointed by the Governor with the advice and consent of the Senate. After December 31, 2007, the number of members appointed by the Governor will fall to 6, reducing the MSF governing board to 9 members.

MSF is a component unit of the financial reporting entity of the State of Michigan. The decision to include a potential component unit in the reporting entity is made by applying the criteria set forth in Governmental Accounting Standards Board Statement No. 14, *The Financial Reporting Entity*. The basic criteria include the appointment of a voting majority of the governing board of MSF; the legal separation of the State and MSF; the fiscal independence of MSF; whether exclusion of the unit would make the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)* misleading; and whether there is a potential for MSF to provide specific financial benefits to, or impose specific financial burdens on, the State.

b. Financial Statement Presentation

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

MSF's governmental fund financial statements include the general operating fund of MSF and the Jobs for Michigan Investment Fund. MSF's two funds are accounted for in a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues, and expenditures. The general operating fund accounts for all of the activities of MSF except those accounted for in the Jobs for Michigan Investment Fund. The Jobs for Michigan Investment Fund accounts for the investment, loan, and grant activity provided for in Act 225, P.A. 2005.

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

c. Measurement Focus and Basis of Accounting

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

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

Generally accepted accounting principles require a reconciliation between the entity-wide and governmental fund financial statements.

d. Financial Data

MSF's General Operations column primarily includes the following:

- (1) Revenues: Operating grants and contributions are amounts received from Community Development Block Grants (CDBG) from the U.S. Department of Housing and Urban Development, the Employment Service grant from the U.S. Department of Labor, and other restricted revenues. Revenues also include amounts received from State appropriations and tribal gaming revenue.

- (2) Expenditures: CDBG expenditures primarily consist of pass-through grants. Also included in expenditures are administrative costs and payments to MEDC for the tribal gaming revenue, industrial development revenue bond (IDRB) issuance fees, Michigan Economic Growth Authority (MEGA) and Brownfield fees, Employment Service grant, and State appropriations for programs administered by MEDC.

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

- (1) Revenues: Operating grants and contributions include funding from the Tobacco Settlement Trust Fund and the 21st Century Jobs Trust Fund for investments and expenses. Revenues also include interest and investment earnings from Life Sciences and Technology Tri-Corridor loans and investments transferred from MEDC.
- (2) Expenditures: Jobs for Michigan Investment Fund expenditures primarily consist of grants to Life Sciences and Technology Tri-Corridor companies and expenditures for travel promotion, business marketing, and administration.

Note 2 Deposits and Investments

a. Deposits

	As of September 30	
	2006	2005
State of Michigan's equity in common cash	\$ 40,166,061	\$ 532,604
Deposits	223,026	50,000
Capital Access Program	4,154,840	
Total deposits	<u>\$ 44,543,927</u>	<u>\$ 582,604</u>

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

securities held by the pledging financial institution's trust department or agent but not in MSF's name.

Deposits included in MSF's bank accounts (without recognition of outstanding checks or deposits in transit) were \$4,466,040 at September 30, 2006 (\$50,000 at September 30, 2005). Of this amount, \$2,284,386 (none at September 30, 2005) was uninsured and uncollateralized at September 30, 2006. There were no deposits collateralized with securities held by the pledging financial institution or by the pledging financial institution's trust department or agent but not in MSF's name. 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. Custodial credit risk disclosures and policies for controlling the risks regarding these deposits are described in Note 5 of the *SOMCAFR* for the fiscal year ended September 30, 2006.

b. Investments

To encourage economic developments MEDC made investments in Life Sciences, Advance Automobile, and Alternative Energy companies. These venture capital investments are required to be approved by the Life Sciences and Technology Tri-Corridor steering committees in MEDC and transferred to MSF as required by Act 225, P.A. 2005. These investments were made either as a limited partner (\$2.8 million) or as a stockholder (\$5.9 million) and are reported using cost-based measures, which MSF has determined approximate fair value.

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

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

Venture capital - Limited partner investments are excluded from custodial credit risk because they are not an investment security. Venture capital - Stock investments are held by LaSalle Bank in MSF's name and, hence, there is no custodial credit risk.

- (2) Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Generally accepted accounting principles require disclosure of the credit quality ratings of investments in debt securities. MSF does not have any investments in debt securities.
- (3) Interest Rate Risk: Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of those investments. MSF does not have interest bearing investments and is not subject to this risk.
- (4) Foreign Currency Risk: Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments or deposits. MSF does not have any investments in foreign securities.
- (5) Concentration of Credit Risk: Concentration of credit risk is the risk of loss attributable to the magnitude of MSF's investments with a single issuer. MSF does not have a policy limiting the dollar value of investments with a single issuer. At September 30, 2006, MSF had made investments in the following companies for more than 5% of MSF's total investments:

Name of Issuer	Amount	Percent of Investment
Integrated Sensing Systems, Inc.	\$ 1,833,296	21.18%
Rubicon Genomics	\$ 1,448,059	16.73%
DNA Software	\$ 1,296,844	14.98%
Accumed Systems, Inc.	\$ 1,291,214	14.91%
Arboretum	\$ 930,000	10.74%
Apjohn	\$ 715,149	8.26%
Seneca Partners	\$ 555,000	6.41%

These investments were made from the Life Sciences and Technology Tri-corridor programs over the years. These investments in new start-up companies were made as an incentive for economic development.

Note 3 Bond Programs

MSF and a predecessor entity (the Michigan Job Development Authority) issued IDRBs. 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 IDRBs issued by MSF and its predecessor entity for the period January 1, 1979 through September 30, 2006 was \$7,114,285,339 (\$7,011,747,339 through September 30, 2005). The amount of tax-exempt bonds issued during fiscal year 2005-06 was \$102,538,000 (\$244,379,000 for fiscal year 2004-05). The total amount of bonds issued by MSF under the Taxable Bond Program for fiscal year 2005-06 was \$7,870,000 (\$9,700,000 for fiscal year 2004-05).

Note 4 Loans Receivable

Loans receivable consist of \$17,060,356 at September 30, 2006 for the Life Sciences and Technology Tri-Corridor programs transferred from MEDC to the Jobs for Michigan Investment Fund.

Note 5 Long-Term Liabilities

The following table summarizes the Capital Access Program and compensated absences liabilities of MSF for the fiscal year ended September 30, 2006 (the fiscal year 2004-05 liabilities were recorded in MEDC):

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$5,847,147	\$1,692,307	\$4,154,840	\$ 700,000	
Compensated absences		\$ 441,320		\$ 441,320	\$ 210,565

Liabilities for compensated absences for the employees of the Jobs for Michigan Investment Fund and the CDBG Program were included in the statement of net assets, which is on the accrual basis, and not on the fund balance sheet, which is on the modified accrual basis. These liabilities represent unused sick, banked, and annual leave accrued, which will be paid when the employees terminate employment. The liability is calculated using 100% of the employees' annual and banked leave and a portion of the sick leave, based on the pay rates in effect as of September 30, 2006.

Note 6 Pension Plans

State classified employees who work on MSF programs are covered by the plans offered by the State of Michigan. Detailed information regarding the plan 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 *SOMCAFR* and the plans' detailed financial reports, issued by the Office of Retirement Services, Department of Management and Budget.

Nonclassified employees who work on MSF programs (Jobs for Michigan Investment Fund and CDBG) are offered a defined contribution plan (under Internal Revenue Code Section 401(a)). MSF contributes 8% of the gross wages to the pension plan for the eligible employees. As of September 30, 2006, 6 employees were eligible to receive contributions. The employer contributions to the plan were current. The employers also offer a 457 deferred compensation plan to these employees. As of September 30, 2006, 7 employees participated in this plan. The employer does not make any contributions to the 457 plan. Both plans are administered by a third party administrator and the employees manage their own investments.

Note 7 Other Financing Sources

The following table provides details of the transfer of programs from MEDC to MSF as required under Act 225, P.A. 2005:

Transfer of Life Sciences and Technology Tri-Corridor assets from MEDC:	
Cash	\$ 45,326,463
Loans	15,097,006
Investments	8,249,130
Total	<u>\$ 68,672,599</u>
Transfer of Capital Access Program assets	4,060,788
Transfer of Capital Access Program liabilities	<u>(4,060,788)</u>
Other financing sources (uses)	<u><u>\$ 68,672,599</u></u>

Note 8 Reserved Fund Balance

Reserved fund balance consists of the balance of noncurrent loans and investments (\$24.7 million) and encumbrances (\$25.9 million) for the Life Sciences and Technology Tri-Corridor programs in prior years in MEDC and transferred to MSF in fiscal year 2005-06 in accordance with Act 225, P.A. 2005.

Note 9 Contingencies

MSF had been receiving an 8% share of the net revenues collected from two Indian tribes (Little River Band of Ottawa Indians and Little Traverse Bay Band of Odawa Indians), which was paid in accordance with the terms of the tribes' 1998 compact agreement with the State. The tribes have placed the payments for fiscal years 2005-06, 2004-05, and 2003-04 into a separate tribal account rather than submitting them to MSF. The tribes contend that the Club Keno game, introduced by the Bureau of State Lottery, violated the terms of the compact agreement. Based on information provided by the tribes, MSF estimated that the tribes placed a total of \$36.8 million into a separate account for fiscal years 2005-06, 2004-05, and 2003-04.

The State of Michigan and MEDC filed a lawsuit challenging the defendants' (Little River Band of Ottawa Indians and Little Traverse Bay Band of Odawa Indians) withholding of payments and seeks an order compelling full payments of these funds. The matter is in discovery and the likelihood of a successful outcome cannot be assessed.

REQUIRED SUPPLEMENTARY INFORMATION

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

Statutory/Budgetary Basis	2006			Variance With Final Budget
	Original Budget	Final Budget	Actual	
Beginning budgetary fund balance	\$ 148,859	\$ 148,859	\$ 148,859	\$ 0
Resources (inflows):				
Revenues and other sources:				
Charges for services (Note 2)	\$ 78,600	\$ 78,600	\$ 2,137,845	\$ (2,059,245)
Operating grants and contributions from federal agencies	48,021,800	56,021,800	53,862,646	2,159,154
Payments from the State of Michigan:				
From General Fund	31,290,900	32,990,900	32,971,544	19,356
From Tobacco Settlement Trust Fund				
From 21st Century Jobs Trust Fund (Note 3)	394,000,000	393,000,000	19,857,239	373,142,761
Other miscellaneous	705,000	705,000	3,599,019	(2,894,019)
Other financing sources (Note 3)	68,672,599	68,672,599	68,672,599	0
Total revenues and other sources	<u>\$ 542,768,899</u>	<u>\$ 551,468,899</u>	<u>\$ 181,100,892</u>	<u>\$ 370,368,007</u>
Total resources available	<u>\$ 542,917,758</u>	<u>\$ 551,617,758</u>	<u>\$ 181,249,751</u>	<u>\$ 370,368,007</u>
Charges (outflows):				
Expenditures, transfers out, and encumbrances:				
Administrative (Note 2)	\$	\$	\$ 744,678	\$ (744,678)
Community Development Block Grants	47,617,416	55,617,416	54,077,620	1,539,796
Jobs for Michigan Investment Fund - Operations (Note 4):				
Administration	15,760,000	15,760,000	4,853,744	10,906,256
Business Development and Business Marketing	19,700,000	19,700,000	9,662,764	10,037,236
Michigan Promotion Program	15,000,000	15,000,000	4,444,020	10,555,980
Competitive Edge Technology Research	2,000,000	2,000,000		2,000,000
Defense Contractor Coordination Center	10,000,000	10,000,000	489,437	9,510,563
Jobs for Michigan Investment Fund - Pass-through (Note 4):				
Michigan Forest Finance Authority Grant	26,000,000	26,000,000		26,000,000
Good Manufacturing Facility	3,000,000	3,000,000		3,000,000
Automotive Technology Business Accelerator	6,000,000	6,000,000		6,000,000
Michigan Film Office	2,000,000	2,000,000		2,000,000
Agriculture Development Fund	5,000,000	5,000,000	76,444	4,923,556
Jobs for Michigan Investment Fund - Programs (Note 4):				
Capital Access Program	3,500,000	3,500,000	330,830	3,169,170
Competitive Edge Technology Grants	135,000,000	135,000,000		135,000,000
Investments and loans	151,040,000	150,040,000		150,040,000
Life Sciences and Technology Tri-Corridor	40,926,195	40,926,195	39,351,736	1,574,459
Payments to MEDC:				
Administration	2,346,700	2,346,700	2,341,185	5,515
Job creation services	14,616,684	14,616,684	13,540,563	1,076,121
Michigan Promotion Program	5,717,500	5,817,500	6,235,923	(418,423)
Economic Development Job Training Grants	9,798,000	11,398,000	11,395,830	2,170
Technology Tri-Corridor for Life Sciences Initiative				
Human resources optimization user charges				
IDRB, MEGA, and casino revenue (Note 2)			1,308,097	(1,308,097)
Payments to General Fund			98,588	(98,588)
Total charges	<u>\$ 515,022,495</u>	<u>\$ 523,722,495</u>	<u>\$ 148,951,458</u>	<u>\$ 374,771,037</u>
Reconciling items:				
Encumbrances		\$ 25,899,690	\$ 25,899,690	\$ 0
Changes in noncurrent assets		(24,701,992)	(24,701,992)	
Net reconciling items	<u>\$ 0</u>	<u>\$ 1,197,698</u>	<u>\$ 1,197,698</u>	<u>\$ 0</u>
Ending budgetary fund balance	<u>\$ 27,895,263</u>	<u>\$ 29,092,961</u>	<u>\$ 33,495,991</u>	<u>\$ (4,403,030)</u>

This schedule continued on next page.

2005

Original Budget	Final Budget	Actual	Variance With Final Budget
\$ 65,520	\$ 65,520	\$ 65,520	\$ 0
\$ 104,100	\$ 104,100	\$ 1,730,021	\$ (1,625,921)
53,014,300	53,014,300	50,826,410	2,187,890
54,106,600	53,716,600	53,697,535	19,065
10,000,000	10,000,000	10,000,000	0
903,100	903,100	694,236	208,864
<u>\$ 118,128,100</u>	<u>\$ 117,738,100</u>	<u>\$ 116,948,202</u>	<u>\$ 789,898</u>
<u>\$ 118,193,620</u>	<u>\$ 117,803,620</u>	<u>\$ 117,013,722</u>	<u>\$ 789,898</u>
\$ 52,558,501	\$ 52,558,501	\$ 842,348	\$ (842,348)
		50,589,912	1,968,590
2,732,400	2,732,400	2,731,780	620
17,042,199	16,902,199	16,020,236	881,963
5,717,500	5,717,500	5,709,646	7,854
10,048,000	9,798,000	9,794,623	3,377
30,000,000	30,000,000	30,000,000	0
29,500	29,500	25,175	4,325
		882,662	(882,662)
		268,482	(268,482)
<u>\$ 118,128,100</u>	<u>\$ 117,738,100</u>	<u>\$ 116,864,863</u>	<u>\$ 873,237</u>
\$	\$	\$	\$ 0
<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
<u>\$ 65,520</u>	<u>\$ 65,520</u>	<u>\$ 148,859</u>	<u>\$ (83,339)</u>

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

<u>Budget-to-GAAP Reconciliation</u>	2006			Variance With Final Budget
	Original Budget	Final Budget	Actual	
Resources (inflows):				
Actual amount (budgetary basis) of "Total resources available"			\$ 181,249,751	
Differences - Budget to GAAP:				
Beginning budgetary fund balance			(148,859)	
Other financing sources are inflows but are not revenues			(68,672,599)	
Total revenues (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance			\$ 112,428,293	
Charges (outflows):				
Actual amount (budgetary basis) of "Total charges"			\$ 148,951,458	
Differences - Budget to GAAP			(25,899,690)	
Encumbrances are outflows but are not expenditures				
Total expenditures (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance			\$ 123,051,768	

See accompanying notes to required supplementary information - budgetary reporting.

2005

<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance With Final Budget</u>
		\$ 117,013,722	
		(65,520)	
		<u>\$ 116,948,202</u>	
		\$ 116,864,863	
		<u>\$ 116,864,863</u>	

Notes to Required Supplementary Information - Budgetary Reporting

Note 1 Statutory Budgetary Presentation

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

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

The budgetary comparison schedule presents both the original and final appropriated budgets for fiscal years 2005-06 and 2004-05, as well as the actual resource inflows, outflows, and fund balance stated on the budgetary basis.

The original budget and related estimated revenues represent the spending authority enacted into law as of October 1, 2004, October 1, 2005, and November 21, 2005 and include encumbrances and multi-year projects' budgetary carryforwards 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 amounts in the actual column include charges for services collected by MSF for the Brownfield, industrial development revenue bond (IDRB), and Michigan Economic Growth Authority (MEGA) programs and the corresponding cost of administering those programs. All excess fees collected are transferred to MEDC pursuant to the interlocal agreement.

Note 3 Payments from the 21st Century Jobs Trust Fund/Other Financing Sources

Act 225, P.A. 2005, appropriated \$394.0 million to MSF for the Jobs for Michigan Investment Fund funded from the 21st Century Jobs Trust Fund. The Office of the State Budget reduced the final budget to \$393.0 million because the original appropriation of \$394.0 million combined with a \$7.0 million appropriation to the Department of Treasury exceeded the \$400.0 million available for appropriation in the 21st Century Jobs Trust Fund. The 21st Century Jobs Trust Fund transferred \$19.9 million in fiscal year 2005-06 to MSF. MEDC also transferred to MSF assets (\$68.7 million), including cash, loans, and investments, related to the Life Sciences and Technology Tri-Corridor programs in accordance with Act 225, P.A. 2005.

Note 4 Jobs for Michigan Investment Fund - Operations, Pass-through, and Programs

These charges are financed by the funds appropriated in Act 225, P.A. 2005, as described in Note 3. MSF intends to spend this work project appropriation over multiple years starting with fiscal year 2005-06. Variances with the final budget in fiscal year 2005-06 will be included in the subsequent year's original budget amounts.

SUPPLEMENTAL
FINANCIAL SCHEDULE

MICHIGAN STRATEGIC FUND
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2004 Through September 30, 2006

Federal Agency/Program	CFDA (2) Program Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2005		
			Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
<u>U.S. Department of Housing and Urban Development</u>					
Direct Programs:					
Community Development Block Grants/State's Program (3) (4)	14.228		\$ 1,297,810	\$ 48,983,218	\$ 50,281,028
Community Development Block Grants/Brownsfields Economic Development Initiative	14.246				
Total U.S. Department of Housing and Urban Development			\$ 1,297,810	\$ 48,983,218	\$ 50,281,028
<u>U.S. Department of Labor</u>					
Pass-Through Program:					
Michigan Department of Labor and Economic Growth Employment Service/Wagner-Peyser Funded Activities	17.207	205-Y04	\$ 440,976	\$	\$ 440,976
Total U.S. Department of Labor			\$ 440,976	\$ 0	\$ 440,976
Total Expenditures of Federal Awards			\$ 1,738,786	\$ 48,983,218	\$ 50,722,004

- (1) Basis of Presentation: This schedule presents the federal grant activity of the Michigan Strategic Fund on the modified accrual basis of accounting and in accordance with the requirements of U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts may differ from amounts presented in, or used in the preparation of, the financial statements.
- (2) CFDA is defined as *Catalog of Federal Domestic Assistance*.
- (3) Program income increases the federal award; federal regulations allow for the entity to retain and spend program income according to the federal guidelines.
- (4) CFDA 14.228 has open grants from program years 1999 through 2006.

For the Fiscal Year Ended September 30, 2006			
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	Total Expended and Distributed for the Two-Year Period
\$ 960,474	\$ 52,074,615	\$ 53,035,089	\$ 103,316,117
	228,061	228,061	228,061
\$ 960,474	\$ 52,302,676	\$ 53,263,150	\$ 103,544,178
\$	\$	\$ 0	\$ 440,976
\$ 0	\$ 0	\$ 0	\$ 440,976
\$ 960,474	\$ 52,302,676	\$ 53,263,150	\$ 103,985,154

INDEPENDENT AUDITOR'S REPORTS 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. James C. Epolito, President
Michigan Strategic Fund
300 North Washington Square
Lansing, Michigan

Dear Mr. Epolito:

We have audited the financial statements of the Michigan Strategic Fund, a component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2006 and September 30, 2005, as identified in the table of contents, and have issued our report thereon dated February 15, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Michigan Strategic Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

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

AUDITOR GENERAL

February 15, 2007



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

Mr. James C. Epolito, President
Michigan Strategic Fund
300 North Washington
Lansing, Michigan

Dear Mr. Epolito:

Compliance

We have audited the compliance of the Michigan Strategic Fund with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each major federal program for the two-year period ended September 30, 2006. The Michigan Strategic Fund's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Michigan Strategic Fund's management. Our responsibility is to express an opinion on the Michigan Strategic Fund's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the previous paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Michigan Strategic Fund's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a

reasonable basis for our opinion. Our audit does not provide a legal determination of the Michigan Strategic Fund's compliance with those requirements.

In our opinion, the Michigan Strategic Fund complied, in all material respects, with the requirements referred to in the first paragraph that are applicable to each major federal program for the two-year period ended September 30, 2006.

Internal Control Over Compliance

The management of the Michigan Strategic Fund is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Michigan Strategic Fund's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

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

AUDITOR GENERAL

February 15, 2007

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I: Summary of Auditor's Results

Financial Statements

Type of auditor's report issued:	Unqualified*
Internal control* over financial reporting:	
Material weakness(es)* identified?	No
Reportable condition(s)* identified that are not considered to be material weakness(es)?	None reported
Noncompliance or other matters material to financial statements?	No

Federal Awards

Internal control over major programs:	
Material weakness(es) identified?	No
Reportable condition(s) identified that are not considered to be material weakness(es)?	None reported
Type of auditor's report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, Section 510(a)?	No

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
14.228	Community Development Block Grants/State's Program

Dollar threshold used to distinguish between type A and type B programs:	\$3,119,555
Auditee qualified as a low-risk auditee*?	No

* See glossary at end of report for definition.

Section II: Findings Related to the Financial Statements

We did not report any findings related to the financial statements.

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

We did not report any findings related to federal awards.

The status of the findings related to federal awards that were reported in prior Single Audits* is disclosed in the summary schedule of prior audit findings.

** See glossary at end of report for definition.*

OTHER SCHEDULES

MICHIGAN STRATEGIC FUND
Summary Schedule of Prior Audit Findings
As of February 15, 2007

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL STATEMENTS

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

PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

Audit Findings That Have Been Fully Corrected:

Audit Period: October 1, 2002 through September 30, 2004

Finding Number: 64S0501

Finding Title: Subrecipient* Monitoring

Finding: The Michigan Strategic Fund's (MSF's) internal control over the Community Development Block Grants (CDBG) Program did not ensure compliance with federal laws and regulations relating to subrecipient monitoring.

Comments: This particular finding was in relation to the grants awarded to the Michigan State Housing Development Authority (MSHDA) and monitoring them as a subrecipient in compliance with federal requirements.

MSF (specifically, CDBG Program administrative staff) has implemented a plan, with the assistance of MSHDA staff, to ensure compliance related to the federal subrecipient monitoring requirements.

* See glossary at end of report for definition.

MICHIGAN STRATEGIC FUND

Corrective Action Plan

As of April 11, 2007

FINDINGS RELATED TO THE FINANCIAL STATEMENTS

There were no findings related to the financial statements for fiscal years 2005-06 and 2004-05.

FINDINGS RELATED TO FEDERAL AWARDS

There were no findings related to federal awards for the two-year period ended September 30, 2006.

GLOSSARY

Glossary of Acronyms and Terms

CDBG	Community Development Block Grants.
<i>CFDA</i>	<i>Catalog of Federal Domestic Assistance.</i>
DLEG	Department of Labor and Economic Growth.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
IDRB	industrial development revenue bond.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
low-risk auditee	As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee.
material misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.
material noncompliance	Violations of laws and regulations that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts.

material weakness	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that either misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and/or financial statements or noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
MEDC	Michigan Economic Development Corporation.
MEGA	Michigan Economic Growth Authority.
MSF	Michigan Strategic Fund.
MSHDA	Michigan State Housing Development Authority.
OMB	U.S. Office of Management and Budget.
questioned cost	A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.
reportable condition	A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the entity's ability to (1) initiate, record, process, and report financial data consistent with the assertions of management

in the financial schedules and/or financial statements or (2) administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Violations of State laws, regulations, contracts, and grant agreements that should be communicated to management but are not material to the financial schedules and/or financial statements may also be reported.

Single Audit

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

SOMCAFR

State of Michigan Comprehensive Annual Financial Report.

subrecipient

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

unqualified opinion

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

- a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or

- b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules and/or financial statements to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules and/or financial statements taken by themselves; or

- c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.

