



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



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

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

– Article IV, Section 53 of the Michigan Constitution

Audit report information can be accessed at:

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Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit

Report Number:
271-0401-08

Michigan Strategic Fund

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

October 1, 2005 through September 30, 2007

Released:
May 2008

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

Financial Statements:

Auditor's Report Issued

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

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Internal Control Over Financial Reporting

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

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Noncompliance and Other Matters

Material to the Financial Statements

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

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Background:

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.

Executive Order No. 1999-1, effective April 5, 1999, transferred MSF to the Department of Management and Budget as an autonomous agency. This Executive Order also 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 to help administer the programs transferred to MSF.

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.

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

May 1, 2008

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 of the Michigan Strategic Fund (MSF), a discretely presented component unit of the State of Michigan, as of and for the period October 1, 2005 through September 30, 2007. This financial audit was required by Act 270, P.A. 1984, as amended.

This report contains our report summary, our independent auditor's report on the financial statements, the MSF management's discussion and analysis, the MSF basic financial statements, and required supplementary information. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters and a glossary of acronyms and terms.

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

AUDITOR GENERAL

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INDEPENDENT AUDITOR'S REPORT



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

Independent Auditor's Report on the Financial Statements

Mr. 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 discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2007 and September 30, 2006, 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, 2007 and September 30, 2006 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, 2007 and September 30, 2006 and the changes in financial position for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 15, 2008 on our consideration of the Michigan Strategic Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 11 through 16 and the budgetary comparison schedule and budget-to-GAAP reconciliation and corresponding notes on pages 40 through 45 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it. The management's discussion and analysis for the comparison between fiscal year ended September 30, 2006 and September 30, 2005 was not presented because this information was presented with the Michigan Strategic Fund's prior year audited financial statements.

AUDITOR GENERAL

April 15, 2008

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, 2006 through September 30, 2007. 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 discretely presented 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

Effective March 2008, the State settled a tribal gaming lawsuit that resulted in MSF recognizing \$26.9 million in miscellaneous revenue.

In fiscal year 2005-06, Act 225, P.A. 2005, appropriated \$394.0 million (subsequently reduced to \$343.0 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. MSF requested \$96.3 million for disbursements, investments, and reserves.

Act 225, P.A. 2005, also required the Michigan Economic Development Corporation (MEDC) to transfer \$68.7 million in cash, loans, and investments related to its Life Sciences and Technology Tri-Corridor programs to MSF. The statute also reestablished the Capital Access Program within 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 \$87,791,407 at September 30, 2007 and by \$57,756,663 at September 30, 2006. Total net assets increased by \$30,034,744 during fiscal year 2006-07.

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

	<u>2007</u>	<u>2006</u>
Cash and equity in common cash	\$ 23,266,305	\$ 40,389,087
Amounts due from federal government	17,695,136	20,766,144
Other current assets	27,872,555	2,278,003
Total current assets	\$ 68,833,996	\$ 63,433,235
Noncurrent Assets	72,481,417	28,856,831
Total assets	\$ 141,315,413	\$ 92,290,066
Current liabilities	\$ 48,786,897	\$ 30,847,809
Long-term liabilities	4,737,109	3,685,594
Total liabilities	\$ 53,524,006	\$ 34,533,403
Net assets	\$ 87,791,407	\$ 57,756,663

Cash and equity in common cash primarily consists of the cash transferred per Public Act 225, P.A. 2005, as described in "Major Changes." The decrease in year 2006-07 is primarily related to \$13.1 million in disbursements for the Life Sciences and Technology Tri-Corridor loans, grants, and investments.

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 decreased by \$3.1 million during fiscal year 2006-07 because of a drop in subrecipient grant reimbursement requests at the end of the fiscal year, resulting in a decrease of MSF's request to the federal agency for reimbursement at fiscal year-end.

Other current assets primarily consist of short-term loans receivable and accounts receivable for the tribal gaming revenue settlement (see Note 10). The increase of \$25.6 million is primarily due to the recognition of the tribal gaming settlement in fiscal year 2006-07.

Noncurrent Assets primarily include loans and investments from the Life Sciences and Technology Tri-Corridor programs and the Jobs for Michigan Investment Fund. Total noncurrent assets increased by \$43.6 million primarily related to the increase of loans receivable and investments of \$13.1 million from Life Sciences and Technology Tri-Corridor programs and \$29.1 million from the Jobs for Michigan Investment Fund.

Current liabilities primarily consist of accounts payable and amounts due to component units. Total current liabilities increased by \$17.9 million during fiscal year 2006-07. This change was related to an increase of \$26.9 million in amounts due to component units for the tribal gaming settlement, which is payable to MEDC (see Note 10), and a decrease of \$8.9 million related primarily to a decrease in CDBG subrecipient grant reimbursement requests at year-end.

Long-term liabilities primarily consist of an amount equal to the reserves for the Capital Access Program. MSF Capital Access Program reserves are available to banks in the event of default on high-risk business loans.

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

	2007	2006
Expenses		
Community Development Block Grants (CDBG)	\$ 43,036,987	\$ 54,518,940
Jobs for Michigan Investment Fund	67,147,402	33,309,284
Payments to MEDC	57,893,473	34,821,598
Other	3,489,252	843,266
Total program expenses	\$ 171,567,114	\$ 123,493,088
Program revenues		
Charges for services	\$ 2,618,719	\$ 2,137,845
Operating grants and contributions	42,838,996	53,862,646
Total program revenues	\$ 45,457,715	\$ 56,000,491
Net program expenses	\$ 126,109,399	\$ 67,492,597
General revenues		
Payments from the State of Michigan	\$ 125,512,812	\$ 52,828,783
Other	30,631,331	72,271,618
Total general revenues	\$ 156,144,144	\$ 125,100,401
Increase in net assets	\$ 30,034,744	\$ 57,607,804
Net assets - Beginning	57,756,663	148,859
Net assets - Ending	\$ 87,791,407	\$ 57,756,663

CDBG expenses decreased by \$11.5 million in fiscal year 2006-07 because MSF awarded fewer grants for infrastructure projects, which have a shorter project life than other grant types.

Jobs for Michigan Investment Fund expenses primarily consist of grants for Life Sciences Technology; Advanced Automotive, Manufacturing, and Materials Technology; Alternative Energy Technology; and Homeland Security and Defense Technology and expenses for travel promotion, business marketing, administration, and pass-through

payments to the Department of Natural Resources, Department of History, Arts and Libraries, and Department of Agriculture. Jobs for Michigan Investment Fund expenses increased by \$33.8 million primarily because of an increase in the disbursements for grants during fiscal year 2006-07.

Payments to MEDC primarily consist of MSF State appropriations transferred to fund programs administered by MEDC and tribal gaming revenue. The payments to MEDC increased by \$23.1 million in fiscal year 2006-07 primarily because of \$26.9 million received from the tribal gaming settlement (see Note 10).

Charges for services primarily consist of industrial development revenue bond issuance fees and application and administrative fees for the Michigan Economic Growth Authority (MEGA) and Brownfield programs. During fiscal year 2006-07, there was an increase in MEGA administrative fee revenue because more companies filed for credit certifications and paid the required administrative fees.

Operating grants and contributions decreased by \$11.0 million during fiscal year 2006-07 primarily because of a decrease in CDBG federal pass-through grant expenditures to the subgrantees and corresponding decrease in reimbursed federal revenues to MSF.

Payments from the State of Michigan primarily consist of State General Fund and restrictively funded appropriations of \$29.2 million and reimbursements from the 21st Century Jobs Trust Fund of \$96.3 million. Payments from the State of Michigan had a net increase of \$72.7 million during fiscal year 2006-07 primarily related to the Jobs for Michigan Investment Fund revenues for grant, loan, and investment disbursements.

Other revenues for fiscal year 2005-06 primarily included the transfer of \$68.7 million assets from MEDC to MSF as required by Act 225, P.A. 2005, for the Life Sciences and Technology Tri-Corridor programs as explained under "Major Changes." Other revenues for fiscal year 2006-07 primarily consisted of \$26.9 million from the tribal gaming settlement (see Note 10).

Other Pertinent Information

From fiscal year 1996-97 through fiscal year 2006-07, MSF disbursed \$38.9 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, 2007, local entities received \$19.9 million in job credits and repaid \$9.6 million. In the event that no further jobs are created by these local entities, MSF may receive a return of \$10.9 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

	2007	2006
ASSETS		
Current assets:		
Cash (Note 2)	\$ 76,550	\$ 205,178
Equity in common cash (Note 2)	23,115,791	40,166,061
Capital Access Program - Cash (Note 2)	73,964	17,848
Amounts due from federal government	17,695,136	20,766,144
Loans receivable (Note 3)	918,215	1,015,783
Other current assets (Note 10)	26,954,340	1,262,220
Total current assets	\$ 68,833,996	\$ 63,433,235
Noncurrent assets:		
Capital Access Program (Note 2)	\$ 5,530,299	\$ 4,154,840
Loans receivable (Note 3)	54,300,700	16,044,573
Investments (Note 2)	12,650,418	8,657,418
Total noncurrent assets	\$ 72,481,417	\$ 28,856,831
Total assets	\$ 141,315,413	\$ 92,290,066
LIABILITIES		
Current liabilities:		
Accounts payable and other liabilities	\$ 20,613,062	\$ 29,716,701
Amounts due to component units (Note 10)	26,880,000	154,161
Capital Access Program (Note 4)	1,000,000	700,000
Compensated absences (Note 4)	198,461	210,565
Amounts due to primary government	6,713	20,464
Deferred revenue	88,661	45,918
Total current liabilities	\$ 48,786,897	\$ 30,847,809
Long-term liabilities:		
Capital Access Program (Note 4)	\$ 4,530,299	\$ 3,454,840
Compensated absences (Note 4)	206,810	230,755
Total long-term liabilities	\$ 4,737,109	\$ 3,685,594
Total liabilities	\$ 53,524,006	\$ 34,533,403
NET ASSETS		
Unrestricted net assets	\$ 87,791,407	\$ 57,756,663
Total net assets	\$ 87,791,407	\$ 57,756,663

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>2007</u>	<u>2006</u>
EXPENSES (Note 1)		
Administrative	\$ 662,050	\$ 744,678
Community Development Block Grants	43,036,987	54,518,940
Jobs for Michigan Investment Fund - Operations	21,940,880	19,688,532
Jobs for Michigan Investment Fund - Pass-through funds	5,311,426	76,444
Jobs for Michigan Investment Fund - Programs	39,895,096	13,544,308
Payments to MEDC (Note 10)	57,893,473	34,821,598
Payments to General Fund (indirect and refund)	277,537	98,588
Miscellaneous and receivable/payable write-off	2,549,665	
Total program expenses	<u>\$ 171,567,114</u>	<u>\$ 123,493,088</u>
PROGRAM REVENUES (Note 1)		
<u>Charges for services</u>		
IDRB issuance fees	\$ 657,683	\$ 258,845
Other fees	1,961,036	1,879,000
<u>Operating grants and contributions</u>		
Community Development Block Grants (federal)	40,776,397	52,381,808
Community Development Block Grants (local and others)	2,062,599	1,480,838
Total program revenues	<u>\$ 45,457,715</u>	<u>\$ 56,000,491</u>
Net program expense	<u>\$ 126,109,399</u>	<u>\$ 67,492,597</u>
GENERAL REVENUES (Note 1)		
<u>Payments from the State of Michigan</u>		
Payments from General Fund	\$ 29,249,923	\$ 32,971,544
Payments from 21st Century Trust Fund	96,262,889	19,857,239
<u>Other</u>		
Payments from MEDC - Other	183,359	3,945
Interest and investment earnings	791,293	2,762,116
Tribal gaming (Note 10)	26,880,000	
Transfer of programs from MEDC (Note 8)		68,672,599
Miscellaneous and receivable/payable write-off	2,776,679	832,959
Total general revenues	<u>\$ 156,144,144</u>	<u>\$ 125,100,401</u>
Increase in net assets	\$ 30,034,744	\$ 57,607,804
Net assets - Beginning	<u>57,756,663</u>	<u>148,859</u>
Net assets - Ending	<u>\$ 87,791,407</u>	<u>\$ 57,756,663</u>

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

MICHIGAN STRATEGIC FUND
Governmental Fund Balance Sheet
As of September 30

	2007			2006
	General Operations	Jobs for Michigan Investment Fund	Total	
ASSETS				
Current assets:				
Cash (Note 2)	\$ 76,550	\$	\$ 76,550	\$ 205,178
Equity in common cash (Note 2)		23,115,791	23,115,791	40,166,061
Capital Access Program - Cash (Note 2)	73,964		73,964	17,848
Amounts due from federal government	17,695,136		17,695,136	20,766,144
Amounts due from General Operations (Note 7)		2,504,633	2,504,633	
Loans receivable (Note 3)		918,215	918,215	1,015,783
Other current assets (Note 10)	26,885,896	68,444	26,954,340	1,262,220
Total current assets	<u>\$ 44,731,546</u>	<u>\$ 26,607,084</u>	<u>\$ 71,338,629</u>	<u>\$ 63,433,235</u>
Noncurrent assets:				
Capital Access Program (Note 2)	\$ 5,530,299	\$	\$ 5,530,299	\$ 4,154,840
Loans receivable (Note 3)		54,300,700	54,300,700	16,044,573
Investments (Note 2)		12,650,418	12,650,418	8,657,418
Total noncurrent assets	<u>\$ 5,530,299</u>	<u>\$ 66,951,118</u>	<u>\$ 72,481,417</u>	<u>\$ 28,856,831</u>
Total assets	<u>\$ 50,261,845</u>	<u>\$ 93,558,201</u>	<u>\$ 143,820,046</u>	<u>\$ 92,290,066</u>
LIABILITIES				
Current liabilities:				
Accounts payable and other liabilities	\$ 15,067,675	\$ 5,545,387	\$ 20,613,062	\$ 29,716,701
Amounts due to Jobs for Michigan Investment Fund (Note 7)	2,504,633		2,504,633	
Amounts due to component units			0	154,161
Capital Access Program (Note 4)	1,000,000		1,000,000	700,000
Amounts due to primary government	4,087	2,625	6,713	20,464
Deferred revenue (Note 10)	26,968,661		26,968,661	45,918
Total current liabilities	<u>\$ 45,545,057</u>	<u>\$ 5,548,012</u>	<u>\$ 51,093,069</u>	<u>\$ 30,637,244</u>
Long-term liabilities:				
Capital Access Program (Note 4)	\$ 4,530,299	\$	\$ 4,530,299	\$ 3,454,840
Total long-term liabilities	<u>\$ 4,530,299</u>	<u>\$ 0</u>	<u>\$ 4,530,299</u>	<u>\$ 3,454,840</u>
Total liabilities	<u>\$ 50,075,356</u>	<u>\$ 5,548,012</u>	<u>\$ 55,623,368</u>	<u>\$ 34,092,084</u>
FUND BALANCE				
Reserved fund balance (Note 9)	\$	\$ 79,124,574	\$ 79,124,574	\$ 50,601,681
Unreserved fund balance	186,489	8,885,616	9,072,105	7,596,301
Total fund balance	<u>\$ 186,489</u>	<u>\$ 88,010,189</u>	<u>\$ 88,196,678</u>	<u>\$ 58,197,983</u>
Total liabilities and fund balance	<u>\$ 50,261,845</u>	<u>\$ 93,558,201</u>	<u>\$ 143,820,046</u>	<u>\$ 92,290,066</u>

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

MICHIGAN STRATEGIC FUND

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

	<u>2007</u>	<u>2006</u>
Total fund balance	\$88,196,678	\$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>(405,271)</u>	<u>(441,320)</u>
Net assets of governmental activities	<u>\$87,791,407</u>	<u>\$57,756,663</u>

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

	2007			2006
	General Operations	Jobs for Michigan Investment Fund	Total	
REVENUES (Note 1)				
<u>Charges for services</u>				
IDRB issuance fees	\$ 657,683	\$	\$ 657,683	\$ 258,845
Other fees	1,961,036		1,961,036	1,879,000
<u>Operating grants and contributions</u>				
Community Development Block Grants (federal)	40,776,397		40,776,397	52,381,808
Community Development Block Grants (local and others)	2,062,599		2,062,599	1,480,838
<u>Payments from the State of Michigan</u>				
Payments from General Fund	29,249,923		29,249,923	32,971,544
Payments from 21st Century Jobs Trust Fund		96,262,889	96,262,889	19,857,239
<u>Other</u>				
Payments from MEDC - Other	183,359		183,359	3,945
Interest and investment earnings	56,116	735,178	791,293	2,762,116
Miscellaneous and receivable/payable write-off	2,615,089	161,590	2,776,679	832,959
Total revenues	<u>\$ 77,562,201</u>	<u>\$ 97,159,657</u>	<u>\$ 174,721,858</u>	<u>\$ 112,428,293</u>
EXPENDITURES (Note 1)				
Administrative	\$ 662,050	\$	\$ 662,050	\$ 744,678
Community Development Block Grants	43,073,036		43,073,036	54,077,620
Jobs for Michigan Investment Fund - Operations		21,940,880	21,940,880	19,688,532
Jobs for Michigan Investment Fund - Pass-through funds		5,311,426	5,311,426	76,444
Jobs for Michigan Investment Fund - Programs		39,895,096	39,895,096	13,544,308
Payments to MEDC	31,013,473		31,013,473	34,821,598
Payments to General Fund (indirect and refund)	277,537		277,537	98,588
Miscellaneous and receivable/payable write-off	2,549,665		2,549,665	
Total expenditures	<u>\$ 77,575,761</u>	<u>\$ 67,147,401</u>	<u>\$ 144,723,163</u>	<u>\$ 123,051,768</u>
Excess of revenues over/(under) expenditures	<u>\$ (13,560)</u>	<u>\$ 30,012,256</u>	<u>\$ 29,998,696</u>	<u>\$ (10,623,475)</u>
OTHER FINANCING SOURCES (USES) (Note 8)				
Transfer of programs from MEDC	\$	\$	\$ 0	\$ 68,672,599
Other financing sources (uses)	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 68,672,599</u>
Net change in fund balances	<u>\$ (13,560)</u>	<u>\$ 30,012,256</u>	<u>\$ 29,998,696</u>	<u>\$ 58,049,124</u>
Fund balance - Beginning	<u>200,049</u>	<u>57,997,934</u>	<u>58,197,983</u>	<u>148,859</u>
Fund balance - Ending	<u>\$ 186,489</u>	<u>\$ 88,010,189</u>	<u>\$ 88,196,678</u>	<u>\$ 58,197,983</u>

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

MICHIGAN STRATEGIC FUND

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

	<u>2007</u>	<u>2006</u>
Net change in fund balance	\$ 29,998,696	\$ 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>36,049</u>	<u>(441,320)</u>
Change in net assets of governmental activities	<u>\$ 30,034,744</u>	<u>\$ 57,607,804</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 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. 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 Labor and Economic Growth (DLEG).

Act 225, P.A. 2005, effective November 21, 2005, transferred MSF as an autonomous agency from DLEG to the Department of Treasury. The Act also appropriated \$394.0 million, subsequently reduced to \$343.0 million, to MSF that was financed by the 21st Century Jobs Trust Fund in the Department of Treasury. In addition, the Act 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 who are 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 Board of Directors to 9 members.

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

b. Financial Statement Presentation

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

MSF's governmental fund financial statements include 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 accounting principles generally accepted in the United States of America (GAAP).

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

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

d. Financial Data

MSF's General Operations primarily includes the following:

- (1) Revenues: Revenues primarily include Community Development Block Grants (CDBG) from the U.S. Department of Housing and Urban Development, State appropriations, tribal gaming, industrial development revenue bond (IDRB) issuance fees, Michigan Economic Growth Authority (MEGA) fees and Brownfield fees.
- (2) Expenditures (Expenses): CDBG expenditures primarily consist of pass-through grants to local units of government. Payments to MEDC include State appropriations for programs administered by MEDC, tribal gaming, and fees from IDRBs, MEGA, and Brownfield. Expenditures also include administrative and other miscellaneous costs.

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

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

Note 2 Deposits and Investments

a. Deposits

	As of September 30	
	2007	2006
State of Michigan's equity in common cash	\$ 23,115,791	\$ 40,166,061
Deposits	150,514	223,026
Capital Access Program	5,530,299	4,154,840
	<hr/>	<hr/>
Total deposits	<u>\$ 28,796,605</u>	<u>\$ 44,543,927</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 \$5,780,183 at September 30, 2007 and \$4,466,040 at September 30, 2006. The majority of this balance is from the various bank accounts within the

Capital Access Program. Of this amount, \$2,956,321 as of September 30, 2007 and \$2,284,386 at September 30, 2006 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, be organized under federal or State law, maintain an office in Michigan, and restricts deposits to a maximum of 50% of the financial institution's net worth. As of September 30, 2007 and September 30, 2006, 99.8% and 99.7%, respectively, of the State's common cash was covered by either 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 Note 5 of the *State of Michigan Comprehensive Financial Report (SOMCAFR)*.

b. Investments

To encourage economic developments, MEDC made venture capital investments in Life Sciences, Advanced Automotive, and Alternative Energy. These venture capital investments were required to be approved by the Life Sciences and Technology Tri-Corridor steering committees in MEDC and were transferred to MSF as required by Act 225, P.A. 2005.

Act 225, P.A. 2005, authorized MSF to invest in venture capital*, private equity*, and mezzanine* funds, with the MSF Board approval for each investment. The purpose of the investments is to strengthen and diversify Michigan's economy by investing in funds as a method to create jobs and provide financial assistance for the creation of new businesses or industries.

Venture capital investments, both transferred from MEDC and initially invested by MSF, were made either as a limited partner (\$6.4 million) or as a stockholder (\$6.2 million) and are reported using cost-based

* See glossary at end of report for definition.

measures, which MSF has determined approximate fair value. MSF had not invested in private equity or mezzanine funds as of September 30, 2007.

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: These investments are excluded from custodial credit risk because they are not an investment security.

Venture capital - stock investments: These investments are not exposed to custodial credit risk because they are held by LaSalle Bank's trust department in MSF's name.

- (2) Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. GAAP requires disclosure of the credit quality ratings of investments in debt securities. MSF does not have any investments in debt securities.
- (3) Interest Rate Risk: Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of those investments. MSF does not have interest bearing investments and is not subject to this risk.
- (4) Foreign Currency Risk: Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments or deposits. MSF does not have any investments in foreign securities.

- (5) Concentration of Credit Risk: Concentration of credit risk is the risk of loss attributable to the magnitude of MSF's investments with a single issuer. MSF does not have a policy limiting the dollar value of investments with a single issuer. At September 30, 2007, MSF had made investments in the following companies for more than 5% of MSF's total investments:

Name of Issuer	Amount	Percentage of Investment
Integrated Sensing Systems, Inc.	\$ 1,833,300	14.49%
Arboretum	\$ 1,578,352	12.48%
Nth Power	\$ 1,504,254	11.89%
Rubicon Genomics	\$ 1,448,060	11.45%
Venture Investors IV	\$ 1,365,559	10.79%
DNA Software	\$ 1,296,849	10.25%
Accumed Systems, Inc.	\$ 1,291,218	10.21%
Apjohn	\$ 944,566	7.47%
Seneca Partners	\$ 687,632	5.44%

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	Percentage 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 and Jobs for Michigan Investment Fund over the years. These investments in new start-up companies were made as an incentive for economic development.

Note 3 Loans Receivable

Loans receivable totaled \$55,218,915 at September 30, 2007 and \$17,060,356 at September 30, 2006 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. 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. These loans may be converted to investments at MSF's option with MSF Board and Strategic Economic Investment and Commercialization (SEIC) Board approval.

Loan Category	Fiscal Years	
	2006-07	2005-06
Technology Tri-Corridor	\$ 13,629,405	\$ 9,567,128
Life Sciences	7,412,828	7,493,228
Competitive Edge Technology:		
Advanced automotive, manufacturing, and materials technology	4,603,043	
Life sciences technology	19,543,294	
Homeland security and defense technology	4,010,850	
Alternative energy technology	6,019,495	
Total	<u>\$ 55,218,915</u>	<u>\$ 17,060,356</u>

Note 4 Long-Term Liabilities

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

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

The following table summarizes the Capital Access Program and compensated absences liabilities of MSF for the fiscal year ended September 30, 2006:

	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, 2007 and September 30, 2006, respectively.

Liabilities for the Capital Access Program consist of an obligation to reimburse financial institutions for future loan defaults on high-risk business loans. An asset for the same amount represents the available balance that can be used to reimburse the financial institutions. Additions to the Capital Access Program are fees charged to the financial institution, MSF, and the borrower to fund the program and defaulted loan recoveries. Reductions are payments to the financial institutions for defaulted loans. As of September 30, 2007 and September 30, 2006, there were 50 and 40 financial institutions, respectively, participating in the Capital Access Program.

Note 5 Pension Plans and Other Postemployment Benefits

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 401k 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 Defined Benefit Retirement Plan, MSF was billed and paid an average 21.0% (\$230,223) and 26.8% (\$258,002) of its payroll costs for pension charges and retiree postemployment benefits in fiscal years 2006-07 and 2005-06, respectively. For the State Employees' Defined Contribution Retirement Plan, MSF is required to make a contribution of 4% of the annual payroll and to match employee contributions up to 3% of annual covered payroll, totaling \$6,148 and \$7,452 for fiscal years 2006-07 and 2005-06, respectively. The Plans' detailed financial statements can be obtained from the Office of Retirement Services, Department of Management and Budget, 7150 Harris Drive, P.O. Box 30171, Lansing, MI 48909.

Nonclassified Employees:

MEDC offers a retirement plan (under Section 401(a) of the Internal Revenue Code) to nonclassified employees after one year of service. MEDC also offers a deferred compensation plan (under Section 457 of the Internal Revenue Code) to nonclassified employees upon employment. Both plans are administered by ING, a third party administrator, and the employees manage their own investments. MSF reimburses MEDC for MEDC employees working on MSF programs.

On August 5, 1999, the MEDC Executive Committee approved an employer contribution rate of 8% of an employee's gross wages to the 401(a) retirement plan for eligible employees. Employees cannot contribute to this plan. For the

fiscal years ended September 30, 2007 and September 30, 2006, MSF made contributions to the plan of \$29,037 and \$45,872, respectively.

MSF makes no contributions to the 457 deferred compensation plan. Only employees make contributions to the plan. For the fiscal years ended September 30, 2007 and September 30, 2006, employees contributed \$38,057 and \$51,770, respectively, to the plan.

Note 6 Limited Obligation Debt

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

The total amount of industrial development revenue bonds issued by MSF and its predecessor entity for the period January 1, 1979 through September 30, 2007 was \$7,442,811,576 (\$7,114,285,339 through September 30, 2006). The amount of tax-exempt bonds issued during fiscal year 2006-07 was \$328,526,237 (\$102,538,000 for fiscal year 2005-06). There were no bonds issued by MSF under the Taxable Bond Program for fiscal year 2006-07 (\$7,870,000 for fiscal year 2005-06).

Note 7 Interfund Receivable and Payable and Interfund Eliminations

An interfund payable for \$2,504,633 was recorded in MSF's General Operations and an interfund receivable for \$2,504,633 was recorded in the Jobs for Michigan Investment Fund for borrowing to eliminate a negative balance in MSF's share of the State of Michigan's equity in common cash. The interfund receivable and payable were eliminated in the Statement of Net Assets.

Note 8 Other Financing Sources

There were no "other financing sources" during fiscal year 2006-07.

The following table provides details of the transfer of programs from MEDC to MSF as required under Act 225, P.A. 2005, during fiscal year 2005-06:

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 9 Reserved Fund Balance

Reserved fund balance consists of \$67.0 million of noncurrent loans and investments and \$12.2 million of encumbrances at September 30, 2007 and \$24.7 million of noncurrent loans and investments and \$25.9 million of encumbrances at September 30, 2006 for the Jobs for Michigan Investment Fund which includes funds from Life Sciences and Technology Tri-Corridor programs.

Note 10 Subsequent Events

Tribal Gaming Revenue:

State of Michigan and Michigan Economic Development Corporation v. Little River Band of Ottawa Indians and Little Traverse Bay Band of Odawa Indians: 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 stopped making payments in fiscal year 2003-04. The tribes contend that the Club Keno game, introduced by the Bureau of State Lottery, violated the terms of the compact agreement.

The State of Michigan and MEDC filed a lawsuit challenging the defendants' withholding of payments and seeks an order compelling full payments of these funds. The U.S. District Court for the Western District of Michigan issued its opinion and order on April 27, 2007 and its final judgment on June 18, 2007 in favor of the State and MEDC that the tribes breached their obligation to make the payments required by their compacts with the State. The tribes appealed the judgment. However, the State of Michigan reached a settlement with the tribes that was effective March 2008. The general terms of the settlement were that lottery and similar activities by the State would not be considered commercial gaming, the tribes geographic gaming exclusivity would be reduced from Statewide to the tribes' competitive market area, and the State's percentage of tribal gaming revenue would be reduced to 6%. In addition, the tribal gaming revenue held in escrow during the dispute would be divided equally between the State and the tribes.

This settlement was reached after the end of the fiscal year. On the entity-wide financial statements, MSF recognized \$26.9 million of tribal gaming revenue and a current asset. In addition, MSF recognized a related expenditure and current liability to MEDC of \$26.9 million for the settlement. On the governmental fund financial statements, MSF recognized a current asset and deferred revenue of \$26.9 million for the settlement. In accordance with State policy, the Office of Financial Management, Department of Management and Budget, issued a waiver to MSF to present financial statements different from the *SOMCAFR* because the settlement occurred after the issuance of the *SOMCAFR*.

Limited Obligation Revenue Bonds:

Subsequent to September 30, 2007, MSF issued limited obligation revenue bonds Series 2008 A and 2008 B in the total amount of \$79,780,000 to acquire ownership in the Michigan House of Representatives Building known as the Cora Anderson Building, located on Capitol Avenue in Lansing, MI. The bonds are secured by and payable from rental to be paid by the House of Representatives of the State of Michigan under the lease and other revenues and funds pledged under the indenture. The lease is not a general obligation of the issuer or the State. Neither the full faith and credit nor the taxing power of the State are pledged to the rentals coming due under the lease.

The proceeds of the bonds will be 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 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. 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 3.3% - 5.11%. Series B bonds (\$1,130,000) will mature in 2011 with an interest rate yield of 4%.

REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY REPORTING

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

Statutory/Budgetary Basis	2007			Variance With Final Budget
	Original Budget	Final Budget	Actual	
Beginning budgetary fund balance	\$ 33,495,991	\$ 33,495,991	\$ 33,495,991	\$ 0
Resources (inflows):				
Revenues and other sources:				
Charges for services (Note 2)	\$ 78,600	\$ 78,600	\$ 2,618,719	\$ (2,540,119)
Operating grants and contributions	47,687,000	55,584,900	42,838,996	12,745,904
Payments from the State of Michigan:				
From General Fund	32,009,200	29,457,700	29,249,923	207,777
From 21st Century Jobs Trust Fund (Note 3)	373,142,761	323,142,761	96,262,889	226,879,872
Other miscellaneous	3,254,665	3,254,665	3,751,332	(496,667)
Other financing sources (Note 3)				0
Total revenues and other sources	<u>\$ 456,172,226</u>	<u>\$ 411,518,626</u>	<u>\$ 174,721,858</u>	<u>\$ 236,796,768</u>
Total resources available	<u>\$ 489,668,217</u>	<u>\$ 445,014,617</u>	<u>\$ 208,217,849</u>	<u>\$ 236,796,768</u>
Charges (outflows):				
Expenditures, transfers out, and encumbrances:				
Administrative (Note 2)	\$	\$	\$ 662,050	\$ (662,050)
Community Development Block Grants	47,750,093	55,724,693	43,073,036	12,651,657
Jobs for Michigan Investment Fund - Operations (Note 4):				
Administration	10,906,256	10,906,256	2,563,270	8,342,987
Business Development and Business Marketing	10,037,236	10,037,236	8,781,944	1,255,292
Michigan Promotion Program	10,555,980	10,555,980	9,900,950	655,031
Competitive Edge Technology Research	2,000,000			0
Defense Contractor Coordination Center	9,510,563	9,510,563	694,717	8,815,846
Jobs for Michigan Investment Fund - Pass-through (Note 4):				
Michigan Forest Finance Authority Grant	26,000,000	6,000,000	49,505	5,950,495
Good Manufacturing Facility	3,000,000	3,000,000	2,300,000	700,000
Automotive Technology Business Accelerator	6,000,000	6,000,000	2,000,000	4,000,000
Michigan Film Office	2,000,000	2,000,000	81,410	1,918,590
Agriculture Development Fund	4,923,556	4,923,556	880,510	4,043,046
Jobs for Michigan Investment Fund - Programs (Note 4):				
Capital Access Program	3,169,170	3,169,170	1,050,000	2,119,170
Competitive Edge Technology Grants	135,000,000	135,000,000	62,246,047	72,753,953
Investments and loans	150,040,000	122,040,000	5,714,536	116,325,464
Life Sciences and Technology Tri-Corridor				0
Payments to MEDC:				
Administration	2,451,000	2,362,200	2,353,456	8,744
Job creation services	14,745,907	13,826,107	12,824,505	1,001,603
Michigan Promotion Program	5,717,500	5,717,500	5,717,500	0
Economic Development Job Training Grants	9,798,000	8,178,400	8,084,047	94,353
Human resources optimization user charges	17,300	17,300	13,847	3,453
IDRB, MEGA, and casino revenue (Note 2)			2,020,119	(2,020,119)
Payments to General Fund			277,537	(277,537)
Miscellaneous and receivable/payable write-off	2,549,665	2,549,665	2,549,665	0
Total charges	<u>\$ 456,172,226</u>	<u>\$ 411,518,626</u>	<u>\$ 173,838,650</u>	<u>\$ 237,679,976</u>
Reconciling items:				
Encumbrances				\$ 0
Changes in noncurrent assets	\$	\$ (13,133,639)	\$ (13,133,639)	0
Net reconciling items	<u>\$</u>	<u>\$ (13,133,639)</u>	<u>\$ (13,133,639)</u>	<u>\$ 0</u>
Ending budgetary fund balance	<u>\$ 33,495,991</u>	<u>\$ 20,362,352</u>	<u>\$ 21,245,560</u>	<u>\$ (883,208)</u>

This schedule continued on next page.

2006

Original Budget	Final Budget	Actual	Variance With Final Budget
\$ 148,859	\$ 148,859	\$ 148,859	\$ 0
\$ 78,600	\$ 78,600	\$ 2,137,845	\$ (2,059,245)
48,021,800	56,021,800	53,862,646	2,159,154
31,290,900	32,990,900	32,971,544	19,356
394,000,000	393,000,000	19,857,239	373,142,761
705,000	705,000	3,599,019	(2,894,019)
68,672,599	68,672,599	68,672,599	0
<u>\$ 542,768,899</u>	<u>\$ 551,468,899</u>	<u>\$ 181,100,892</u>	<u>\$ 370,368,007</u>
\$ 542,917,758	\$ 551,617,758	\$ 181,249,751	\$ 370,368,007
\$ 47,617,416	\$ 55,617,416	\$ 744,678	\$ (744,678)
15,760,000	15,760,000	54,077,620	1,539,796
19,700,000	19,700,000	4,853,744	10,906,256
15,000,000	15,000,000	9,662,764	10,037,236
2,000,000	2,000,000	4,444,020	10,555,980
10,000,000	10,000,000	2,000,000	2,000,000
		489,437	9,510,563
26,000,000	26,000,000		26,000,000
3,000,000	3,000,000		3,000,000
6,000,000	6,000,000		6,000,000
2,000,000	2,000,000		2,000,000
5,000,000	5,000,000	76,444	4,923,556
3,500,000	3,500,000	330,830	3,169,170
135,000,000	135,000,000		135,000,000
151,040,000	150,040,000		150,040,000
40,926,195	40,926,195	39,351,736	1,574,459
2,346,700	2,346,700	2,341,185	5,515
14,616,684	14,616,684	13,540,563	1,076,121
5,717,500	5,817,500	6,235,923	(418,423)
9,798,000	11,398,000	11,395,830	2,170
			0
		1,308,097	(1,308,097)
		98,588	(98,588)
<u>\$ 515,022,495</u>	<u>\$ 523,722,495</u>	<u>\$ 148,951,458</u>	<u>\$ 374,771,037</u>
	\$ 25,899,690	\$ 25,899,690	\$ 0
	(24,701,992)	(24,701,992)	0
<u>\$ 0</u>	<u>\$ 1,197,698</u>	<u>\$ 1,197,698</u>	<u>\$ 0</u>
<u>\$ 27,895,263</u>	<u>\$ 29,092,961</u>	<u>\$ 33,495,991</u>	<u>\$ (4,403,030)</u>

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

Budget-to-GAAP Reconciliation	2007			Variance With Final Budget
	Original Budget	Final Budget	Actual	
Resources (inflows):				
Actual amount (budgetary basis) of "Total resources available"			\$ 208,217,849	
Differences - Budget to GAAP:				
Beginning budgetary fund balance is a budgetary resource but is not a current year revenue for financial reporting purposes			(33,495,991)	
Other financing sources are inflows of budgetary resources but are not revenues for financial reporting purposes				
Total revenues (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance			<u>\$ 174,721,858</u>	
Charges (outflows):				
Actual amount (budgetary basis) of "Total charges"			\$ 173,838,650	
Differences - Budget to GAAP:				
Encumbrances for loans, grants, and investments are not reported in the year the commitment is made for budgetary purposes but in the year the funding is disbursed for financial reporting purposes				
Loans and investments are outflows for budgetary reporting purposes but are not expenditures for financial reporting purposes			(29,115,487)	
Total expenditures (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance			<u>\$ 144,723,163</u>	

See accompanying notes to required supplementary information - budgetary reporting.

2006

<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance With Final Budget</u>
		\$ 181,249,751	
		(148,859)	
		(68,672,599)	
		<u>\$ 112,428,293</u>	
		\$ 148,951,458	
		(25,899,690)	
		<u>\$ 123,051,768</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 an appropriation for the Jobs for Michigan Investment Fund. MSF administers the CDBG Program and the Jobs for Michigan Investment Fund. The Michigan Economic Development Corporation (MEDC) administers the other State programs. MSF transfers the funding for the State programs to MEDC as required by an interlocal agreement between MSF and MEDC.

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

The budgetary comparison schedule presents both the original and final appropriated budgets for fiscal years 2006-07 and 2005-06, as well as the actual resource inflows, outflows, and fund balance stated on the budgetary basis.

The original budget and related estimated revenues represent the spending authority enacted into law as of October 1, 2005, November 21, 2005, and October 1, 2006 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 fiscal year 2005-06 for the Jobs for Michigan Investment Fund funded from the 21st Century Jobs Trust Fund. These appropriations are financed from the tobacco securitization settlement funds retained in the 21st Century Jobs Trust Fund at the Department of Treasury. The final budget was reduced to \$393.0 million because of a \$1.0 million reduction in a work project. During fiscal year 2006-07, the Legislature further reduced appropriations by \$50.0 million.

MSF received revenue of \$96.2 million and \$19.9 million from the 21st Century Jobs Trust Fund for fiscal years 2006-07 and 2005-06, respectively.

MEDC also transferred assets to MSF in fiscal year 2005-06 of \$68.7 million, including cash, loans, and investments, related to the Life Sciences and Technology Tri-Corridor programs (from appropriation years 2000 through 2005) 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. These charges for fiscal year 2006-07 include expenditures of \$67.1 million and disbursements for investments and loans of \$29.1 million for a total of \$96.2 million for budgetary reporting purposes. However, investments and loans are not expenditures for financial reporting purposes and are a reconciling item. Charges for fiscal years 2005-06 include expenditures of \$19.9 million. The charges for fiscal year 2005-06 also include expenditures and encumbrances of \$39.4 million related to Life Sciences and Technology Tri-Corridor programs transferred to the Jobs for Michigan Investment Fund.

MSF intends to spend this appropriation, which is designated as a work project with carry-forward authorization, over multiple years starting with fiscal year 2005-06. Variances with the final budget in fiscal year 2005-06 were carried over to fiscal year 2006-07 and adjusted for legislatively mandated reductions of \$50.0 million during the year.

INDEPENDENT AUDITOR'S REPORT ON
INTERNAL CONTROL AND COMPLIANCE



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

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

Mr. 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 discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2007 and September 30, 2006, as identified in the table of contents, and have issued our report thereon dated April 15, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined in the preceding paragraph.

Compliance and Other Matters

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

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

AUDITOR GENERAL

April 15, 2008

GLOSSARY

Glossary of Acronyms and Terms

CDBG	Community Development Block Grants.
control deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.
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 presented fairly in all material respects in conformity with the disclosed basis of accounting.
GAAP	accounting principles generally accepted in the United States of America.
GASB	Governmental Accounting Standards Board.
IDRB	industrial development revenue bond.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
material misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.

material noncompliance	Violations of laws, regulations, contracts, and grants that could have a direct and material effect on financial schedule and/or financial statement amounts.
material weakness in internal control over financial reporting	A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material misstatements of the financial schedules and/or financial statements will not be prevented or detected.
MEDC	Michigan Economic Development Corporation.
MEGA	Michigan Economic Growth Authority.
mezzanine fund	A type of investment fund that is primarily engaged in a hybrid of debt and equity financing that is typically used to finance the expansion of existing companies. It is generally used as an intermediate stage financing, preceding a company's initial public offering, and is considered less risky than start-up financing.
MSF	Michigan Strategic Fund.
private equity fund	A type of investment fund that buys majority interest in companies to restructure its capital, management, and organization. Usually, the companies are privately held for two to five years.
significant deficiency in internal control over financial reporting	A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial schedules and/or financial statements that is more than inconsequential will not be prevented or detected.

SOMCAFR

State of Michigan Comprehensive Annual Financial Report.

unqualified opinion

An auditor's opinion in which the auditor states that the financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting.

venture capital fund

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

