



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

Report Number:
271-0401-11

Michigan Strategic Fund

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

October 1, 2008 through September 30, 2010

Released:
February 2011

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

Financial Statements:

Auditor's Report Issued

We issued unqualified opinions on MSF's basic financial statements.

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Internal Control Over Financial Reporting

We did not 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:

Act 270, P.A. 1984, created MSF. Executive Order No. 1999-1, effective April 5, 1999, transferred MSF to the Department of Management and Budget as an autonomous agency, governed by a Board of Directors. Executive Order No. 2003-18, effective December 7, 2003, transferred MSF as an autonomous agency to the Department of Energy, Labor & Economic Growth (DELEG). Effective November 21, 2005, Act 225, P.A. 2005, transferred MSF as an autonomous agency from DELEG to the Department of Treasury. MSF is a discretely presented component unit of the financial reporting entity of the State of Michigan.

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



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

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

Scott M. Strong, C.P.A., C.I.A.
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

February 24, 2011

Mr. Michael Finney, President and Chief Executive Officer
Michigan Strategic Fund
300 North Washington Square
Lansing, Michigan

Dear Mr. Finney:

This is our report on the financial audit of the Michigan Strategic Fund (MSF), a discretely presented component unit of the State of Michigan, for the period October 1, 2008 through September 30, 2010.

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. Michael Finney, President and Chief Executive Officer
Michigan Strategic Fund
300 North Washington Square
Lansing, Michigan

Dear Mr. Finney:

We have audited the accompanying financial statements of the governmental activities and each major fund of the Michigan Strategic Fund, a discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2010 and September 30, 2009, which collectively comprise the Michigan Strategic Fund's basic financial statements as identified in the table of contents. These financial statements are the responsibility of the Michigan Strategic Fund's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

As described in Note 1, the financial statements present only the Michigan Strategic Fund and do not purport to, and do not, present fairly the financial position of the State of Michigan or its component units as of September 30, 2010 and September 30, 2009 and the changes in financial position thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Michigan Strategic Fund as of September 30, 2010 and September 30, 2009 and the respective changes in financial position for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 8, 2011 on our consideration of the Michigan Strategic Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 11 through 15 and the budgetary comparison schedule and budget-to-GAAP reconciliation and corresponding notes on pages 44 through 49 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it. The management's discussion and analysis for the comparison between the fiscal years ended September 30, 2009 and September 30, 2008 was not presented because this information was presented with the Michigan Strategic Fund's prior year audited financial statements.

AUDITOR GENERAL

February 8, 2011

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, 2009 through September 30, 2010. Act 270, P.A. 1984, created MSF. Executive Order No. 1999-1, effective April 5, 1999, transferred MSF to the Department of Management and Budget as an autonomous agency, governed by a Board of Directors. Executive Order No. 2003-18, effective December 7, 2003, transferred MSF as an autonomous agency to the Department of Energy, Labor & Economic Growth (DELEG). Effective November 21, 2005, Act 225, P.A. 2005, transferred MSF as an autonomous agency from DELEG to the Department of Treasury. MSF is a discretely presented component unit of the financial reporting entity of the State of Michigan. MSF's management is responsible for the basic financial statements, required supplementary information, and this discussion.

Using the Financial Report

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

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

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

Major Change

During fiscal year 2008-09, the State of Michigan renegotiated a tribal gaming compact with Nottawaseppi Huron Band of Potawatomi Indian Tribe operating FireKeepers Casino in Battle Creek. The State has agreed to extend the tribe's right to operate casinos through October 2030. This is the first year that MSF has received and recognized full year revenue from this casino. Revenues collected from this tribe will be deposited into the Jobs for Michigan Investment Fund established as a permanent fund within MSF. Under the amended compact, this tribe will contribute in the 4% to 8% range of its net win from electronic gaming. The new terms also allow tribes to adjust future payments up or down based on three-year averages, as well as the opening of new casinos in their regions.

Analysis of Financial Activities

The assets of MSF exceeded its liabilities by \$156.7 million at September 30, 2010 and by \$134.2 million at September 30, 2009. Total net assets increased by \$22.5 million during fiscal year 2009-10.

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

	<u>2010</u>	<u>2009</u>
Cash and equity in common cash	\$ 33,231,033	\$ 24,600,522
Amounts due from federal government	32,510,366	18,574,600
Other current assets	29,268,917	18,417,619
Total current assets	<u>\$ 95,010,316</u>	<u>\$ 61,592,741</u>
Noncurrent assets	206,979,457	204,434,603
Total assets	<u>\$ 301,989,773</u>	<u>\$ 266,027,344</u>
Current liabilities	\$ 57,500,382	\$ 45,215,461
Long-term liabilities	87,815,639	86,592,718
Total liabilities	<u>\$ 145,316,021</u>	<u>\$ 131,808,179</u>
Net assets	<u>\$ 156,673,752</u>	<u>\$ 134,219,165</u>

Amounts due from federal government primarily consist of receivables for federal pass-through funds for the Community Development Block Grants (CDBG) Program to subrecipients. This line item increased by \$13.9 million during fiscal year 2009-10. These receivables vary from year to year as they are dependent on the project activity of the subrecipients.

Other current assets primarily consist of short-term loans receivable, capital lease receivable (see Note 4), and the tribal gaming revenue receivables. There is an overall increase of \$10.9 million in other current assets primarily related to \$6.2 million of casino revenue, of which \$5.5 million of this is attributable to an additional full year of revenues from the FireKeepers Casino, described in the major change section, \$2.4 million for capital lease receivable, and \$1.2 million short-term loans receivable.

Noncurrent assets include the Capital Access Program, capital lease receivable, loans receivable, interest receivable, investments, and Michigan Supplier Diversification Fund. The total increase in noncurrent assets was \$2.5 million. Loan receivables decreased

by \$17.2 million and investments increased by \$14.5. The Michigan Supplier Diversification Fund was created in 2009 and has two programs within the fund. The Michigan Collateral Support Program (MCSP) is designed to assist lender and borrowers in acquiring the financing necessary due to a collateral shortfall. Collateral funding totaled \$9,102,100 as of September 30, 2010. The Michigan Loan Participation Program (LPP) is designed to assist lenders and borrowers in acquiring the necessary financing that might otherwise be unavailable due to cash flow shortages.

During fiscal year 2009-10, loans worth \$7.7 million were converted into investments. Also, loan loss provision for doubtful loans was increased by \$15.7 million, and \$3.0 million was written off for uncollectible loans. The total amount of loans and investments (net of loss provisions of \$24.7 million) included in current and noncurrent assets category is \$115.7 million.

Current liabilities primarily consist of accounts payable, amounts due to component units, and interest payable related to the limited obligation revenue bonds. Total current liabilities increased by \$12.3 million during fiscal year 2009-10 primarily related to amounts due to CDBG Program subrecipients.

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

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

	2010	2009
Expenses		
Community Development Block Grants (CDBG)	\$ 47,735,535	\$ 35,500,991
Jobs for Michigan Investment Fund	59,275,936	92,749,536
Payments to the Michigan Economic Development Corporation (MEDC)	59,428,277	56,150,015
Arts and Cultural Grants	2,277,999	
Other	8,992,349	7,165,288
Total program expenses	<u>\$ 177,710,096</u>	<u>\$ 191,565,830</u>
Program revenues		
Charges for services	\$ 2,359,944	\$ 2,870,737
Operating grants and contributions	48,412,294	35,292,346
Total program revenues	<u>\$ 50,772,238</u>	<u>\$ 38,163,083</u>
Net program expenses	<u>\$ 126,937,858</u>	<u>\$ 153,402,747</u>
General revenues		
Payments from the State of Michigan	\$ 96,433,293	\$ 145,752,853
Other	52,959,152	31,351,608
Total general revenues	<u>\$ 149,392,445</u>	<u>\$ 177,104,461</u>
Increase in net assets	<u>\$ 22,454,588</u>	<u>\$ 23,701,714</u>
Net assets - Beginning	<u>134,219,165</u>	<u>110,517,451</u>
Net assets - Ending	<u><u>\$ 156,673,752</u></u>	<u><u>\$ 134,219,165</u></u>

CDBG expenses increased by \$12.2 million in fiscal year 2009-10 because of accelerated project activities and reimbursement requests submitted by subrecipients. CDBG is a federal pass-through grant program.

Jobs for Michigan Investment Fund expenses decreased by \$33.5 million in fiscal year 2009-10 primarily because of reduced State appropriations for the Jobs for Michigan Investment Fund in 2010. The Jobs for Michigan Investment Fund expenses 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 and Environment and the Department of Agriculture.

Payments to MEDC primarily consist of MSF State appropriations transferred to fund programs administered by MEDC and tribal gaming revenue. The net increase in payments to MEDC was \$3.3 million in fiscal year 2009-10. This net increase included \$9.5 million for a tourism promotion program reduced by a drop in casino gaming revenue compared to the previous year.

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

Payments from the State of Michigan primarily consist of appropriations from the State General Fund of \$27.1 million and reimbursements from the 21st Century Jobs Trust Fund of \$69.4 million. The revenue from the 21st Century Jobs Trust Fund for grants, loans, investments, and promotion programs decreased by \$48.7 million as a result of reduced appropriations for program expenditures.

Other revenues increased by \$21.6 million during fiscal year 2009-2010 as a result of \$9.5 million special appropriations for a tourism marketing program, recording of a full year of revenue from a new casino, and the net increase in fair market value of investments.

Other Pertinent Information

From fiscal year 1996-97 through fiscal year 2009-10, MSF disbursed \$41.1 million of CDBG federal funds for Industrial Park Loans/Grants to various local governmental entities. According to the agreement, local governmental entities would need to return the funds to MSF if they did not create a specific number of jobs. As of September 30, 2010, local governmental entities had earned \$21.2 million and repaid \$14.1 million. In the event that no further jobs are created by these local governmental entities, MSF may receive a return of \$5.8 million of federal funds from local governmental entities in future years. Returned funds are treated as program income and allowed to be redistributed by MSF for allowable CDBG projects. Any returned funds for projects that failed to meet a CDBG program objective are treated as recaptured funds and, in accordance with federal regulation, are returned to the federal grantor to be placed in the State's letter of credit to be used for future grants.

BASIC FINANCIAL STATEMENTS

MICHIGAN STRATEGIC FUND

Statement of Net Assets

As of September 30

	2010	2009
ASSETS		
Current assets:		
Cash (Note 2)	\$ 2,751,059	\$ 2,157,985
Equity in common cash (Note 2)	30,263,488	21,826,185
Capital Access Program - Cash (Note 2)	177,233	167,352
Michigan Supplier Diversification Fund - Collateral Support Program (Note 2)	39,253	449,000
Michigan Supplier Diversification Fund - Loan Participation	499,000	
Amounts due from federal government	32,510,366	18,574,600
Loans receivable (net) (Note 3)	7,052,793	5,834,735
Capital lease receivable (Note 4)	2,678,181	323,770
Other current assets	19,038,943	12,259,114
Total current assets	\$ 95,010,316	\$ 61,592,741
Noncurrent assets:		
Capital Access Program (Notes 2 and 5)	\$ 5,718,483	\$ 5,366,875
Michigan Supplier Diversification Fund - Collateral Support Program (Note 2)	9,102,100	
Capital lease receivable (Note 4)	80,978,999	83,657,180
Loans receivable (net) (Note 3)	53,480,701	70,718,324
Interest receivable (Note 3)	2,502,764	4,009,910
Investments (Note 2)	55,196,411	40,682,314
Total noncurrent assets	\$ 206,979,457	\$ 204,434,603
Total assets	\$ 301,989,773	\$ 266,027,344
LIABILITIES		
Current liabilities:		
Accounts payable and other liabilities	\$ 43,158,830	\$ 30,759,199
Amounts due to component units	11,647,659	10,656,636
Capital Access Program (Note 5)	500,000	1,300,000
Compensated absences (Note 5)	209,628	268,440
Amounts due to primary government	16,515	39,118
Interest payable	1,861,642	1,861,642
Bonds payable (Note 7)	35,000	233,841
Deferred revenue	71,108	96,585
Total current liabilities	\$ 57,500,382	\$ 45,215,461
Long-term liabilities:		
Bonds payable (Note 7)	\$ 82,323,214	\$ 82,333,214
Capital Access Program (Note 5)	5,218,483	4,066,875
Compensated absences (Note 5)	273,942	192,629
Total long-term liabilities	\$ 87,815,639	\$ 86,592,718
Total liabilities	\$ 145,316,021	\$ 131,808,179
NET ASSETS		
Unrestricted net assets	\$ 156,673,752	\$ 134,219,165
Total net assets	\$ 156,673,752	\$ 134,219,165

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>2010</u>	<u>2009</u>
EXPENSES (Note 1)		
Administrative	\$ 1,324,651	\$ 771,236
Community Development Block Grants	47,735,535	35,500,991
Arts and Cultural Grants	2,277,999	
Michigan Film Office	895,734	646,414
Jobs for Michigan Investment Fund - Operations	12,222,009	43,553,028
Jobs for Michigan Investment Fund - Pass-through funds	392,671	2,245,349
Jobs for Michigan Investment Fund - Programs	46,661,256	46,951,159
Payments to MEDC	59,428,277	56,150,015
Payments to General Fund (indirect and refund)	329,707	152,588
Other interest	3,861,733	3,862,798
Miscellaneous and receivable write-off	2,580,524	1,732,252
Total program expenses	<u>\$ 177,710,096</u>	<u>\$ 191,565,830</u>
PROGRAM REVENUES (Note 1)		
<u>Charges for services</u>		
PAB issuance fees	\$ 255,376	\$ 230,756
Other fees	2,104,568	2,639,981
<u>Operating grants and contributions</u>		
Community Development Block Grants (federal)	46,002,702	33,836,748
Community Development Block Grants (local and others)	1,570,437	1,455,598
Arts and Cultural Grants (federal)	839,155	
Total program revenues	<u>\$ 50,772,238</u>	<u>\$ 38,163,083</u>
Net program expenses	<u>\$ 126,937,858</u>	<u>\$ 153,402,747</u>
GENERAL REVENUES (Note 1)		
<u>Payments from the State of Michigan</u>		
Payments from General Fund	\$ 27,067,964	\$ 27,704,072
Payments from 21st Century Jobs Trust Fund	69,365,329	118,048,781
<u>Other</u>		
Use taxes (4%)	9,499,596	
Payments from MEDC - Other	171,375	49,159
Interest and investment earnings	1,772,451	1,858,592
Net increase (decrease) in fair value of investments	1,064,566	(4,209,434)
Tribal gaming	33,106,769	28,363,103
Lease revenue	3,787,992	3,751,790
Miscellaneous and payable write-off	3,556,402	1,538,398
Total general revenues	<u>\$ 149,392,445</u>	<u>\$ 177,104,461</u>
Increase in net assets	\$ 22,454,588	\$ 23,701,714
Net assets - Beginning	<u>134,219,165</u>	<u>110,517,451</u>
Net assets - Ending	<u>\$ 156,673,752</u>	<u>\$ 134,219,165</u>

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

MICHIGAN STRATEGIC FUND
Governmental Fund Balance Sheet
As of September 30

	2010			Total
	General Operations	Jobs for Michigan Investment Fund	Debt Service Fund	
ASSETS				
Current assets:				
Cash (Note 2)	\$ 668,295		\$ 2,082,764	\$ 2,751,059
Equity in common cash (Note 2)		30,263,488		30,263,488
Capital Access Program - Cash (Note 2)	177,233			177,233
Michigan Supplier Diversification Fund - Collateral Support Program (Note 2)	39,253			39,253
Michigan Supplier Diversification Fund - Loan Participation	499,000			499,000
Amounts due from federal government	32,510,366			32,510,366
Amounts due from general operations (Note 9)		401,214		401,214
Loans receivable (net) (Note 3)		7,052,793		7,052,793
Other current assets	10,887,156	8,151,787		19,038,943
Total current assets	<u>\$ 44,781,303</u>	<u>\$ 45,869,282</u>	<u>\$ 2,082,764</u>	<u>\$ 92,733,349</u>
Noncurrent assets:				
Capital Access Program (Notes 2 and 5)	\$ 5,718,483			\$ 5,718,483
Michigan Supplier Diversification Fund - Collateral Support Program (Note 2)	9,102,100			9,102,100
Loans receivable (net) (Note 3)		53,480,701		53,480,701
Interest receivable (Note 3)		2,502,764		2,502,764
Investments (Note 2)		55,196,411		55,196,411
Total noncurrent assets	<u>\$ 14,820,583</u>	<u>\$ 111,179,875</u>	<u>\$ 0</u>	<u>\$ 126,000,458</u>
Total assets	<u>\$ 59,601,886</u>	<u>\$ 157,049,157</u>	<u>\$ 2,082,764</u>	<u>\$ 218,733,807</u>
LIABILITIES				
Current liabilities:				
Accounts payable and other liabilities	\$ 32,078,234	\$ 11,080,596		\$ 43,158,830
Amounts due to Jobs for Michigan Investment Fund (Note 9)	401,214			401,214
Amounts due to component units	6,373,268	832,391		7,205,659
Capital Access Program (Note 5)	500,000			500,000
Amounts due to primary government	6,055	10,459		16,515
Deferred revenue	4,513,108	7,250,000		11,763,108
Total current liabilities	<u>\$ 43,871,879</u>	<u>\$ 19,173,447</u>	<u>\$ 0</u>	<u>\$ 63,045,326</u>
Long-term liabilities:				
Deferred revenue (Note 3)	\$	\$ 2,502,764		\$ 2,502,764
Capital Access Program (Note 5)	5,218,483			5,218,483
Total long-term liabilities	<u>\$ 5,218,483</u>	<u>\$ 2,502,764</u>	<u>\$ 0</u>	<u>\$ 7,721,246</u>
Total liabilities	<u>\$ 49,090,361</u>	<u>\$ 21,676,211</u>	<u>\$ 0</u>	<u>\$ 70,766,572</u>
FUND BALANCE				
Reserved fund balance (Note 10)	\$ 9,102,100	\$ 109,493,871	\$ 2,082,764	\$ 120,678,735
Unreserved fund balance	1,409,425	25,879,075		27,288,500
Total fund balance	<u>\$ 10,511,525</u>	<u>\$ 135,372,947</u>	<u>\$ 2,082,764</u>	<u>\$ 147,967,235</u>
Total liabilities and fund balance	<u>\$ 59,601,886</u>	<u>\$ 157,049,157</u>	<u>\$ 2,082,764</u>	<u>\$ 218,733,807</u>

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

2009

General Operations	Jobs for Michigan Investment Fund	Debt Service Fund	Total
\$ 116,410	\$	\$ 2,041,575	\$ 2,157,985
488,991	21,337,194		21,826,185
167,352			167,352
449,000			449,000
			0
18,574,600			18,574,600
			0
	5,834,735		5,834,735
10,174,233	2,084,881		12,259,114
<u>\$ 29,970,586</u>	<u>\$ 29,256,810</u>	<u>\$ 2,041,575</u>	<u>\$ 61,268,971</u>
\$ 5,366,875	\$	\$	\$ 5,366,875
	70,718,324		70,718,324
	4,009,910		4,009,910
	40,682,314		40,682,314
<u>\$ 5,366,875</u>	<u>\$ 115,410,548</u>	<u>\$ 0</u>	<u>\$ 120,777,423</u>
<u>\$ 35,337,461</u>	<u>\$ 144,667,358</u>	<u>\$ 2,041,575</u>	<u>\$ 182,046,394</u>
\$ 18,256,439	\$ 12,502,760	\$	\$ 30,759,199
			0
4,550,227	81,409		4,631,636
1,300,000			1,300,000
14,624	24,495		39,119
6,121,585	1,730,000		7,851,585
<u>\$ 30,242,875</u>	<u>\$ 14,338,664</u>	<u>\$ 0</u>	<u>\$ 44,581,539</u>
\$	\$ 4,009,910	\$	\$ 4,009,910
4,066,875			4,066,875
<u>\$ 4,066,875</u>	<u>\$ 4,009,910</u>	<u>\$ 0</u>	<u>\$ 8,076,785</u>
\$ 34,309,750	\$ 18,348,574	\$ 0	\$ 52,658,324
\$	\$ 114,187,535	\$ 2,041,575	\$ 116,229,110
1,027,711	12,131,249		13,158,960
<u>\$ 1,027,711</u>	<u>\$ 126,318,784</u>	<u>\$ 2,041,575</u>	<u>\$ 129,388,070</u>
<u>\$ 35,337,461</u>	<u>\$ 144,667,358</u>	<u>\$ 2,041,575</u>	<u>\$ 182,046,394</u>

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

	2010	2009
Total fund balance	\$ 147,967,235	\$ 129,388,070
<p>Amounts reported for governmental activities in the statement of net assets are different because:</p>		
<p>Capital lease receivable is not available to pay for current period expenditures and therefore is not reported in the governmental fund statement.</p>	83,657,180	83,980,950
<p>Compensated absences are not due and payable in the current period and therefore are not reported in the governmental fund statement.</p>	(483,570)	(461,069)
<p>Bonds payable and interest payable are not due and payable in the current period and therefore are not reported in the governmental fund statement.</p>		
Bonds payable	(82,358,214)	(82,567,055)
Interest payable	(1,861,642)	(1,861,642)
<p>Amounts due to component units are not due and payable in the current period and therefore are not reported in the governmental fund statement.</p>	(4,442,000)	(6,025,000)
<p>Deferred revenue is not available for the current period and therefore is not recognized as revenue in the governmental fund statement.</p>	14,194,764	11,764,910
Net assets of governmental activities	\$ 156,673,752	\$ 134,219,165

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

	2010			Total
	General Operations	Jobs for Michigan Investment Fund	Debt Service Fund	
REVENUES (Note 1)				
<u>Charges for services</u>				
PAB issuance fees	\$ 255,376	\$	\$	\$ 255,376
Other fees	2,104,568			2,104,568
<u>Operating grants and contributions</u>				
Community Development Block Grants (federal)	46,002,702			46,002,702
Community Development Block Grants (local and others)	1,570,437			1,570,437
Arts and Cultural Grants (federal)	839,155			839,155
<u>Payments from the State of Michigan</u>				
Payments from General Fund	27,067,964			27,067,964
Payments from 21st Century Jobs Trust Fund		69,365,329		69,365,329
<u>Other</u>				
Use taxes (4%)	9,499,596			9,499,596
Tribal gaming	23,600,520	3,867,367		27,467,887
Payments from MEDC - Other	171,375			171,375
Interest and investment earnings	49,562	3,230,035		3,279,597
Net increase (decrease) in fair value of investments		1,064,566		1,064,566
Lease revenue			4,111,763	4,111,763
Miscellaneous and receivable/payable write-off	891,131	563,390	400,000	1,854,520
Total revenues	<u>\$ 112,052,386</u>	<u>\$ 78,090,687</u>	<u>\$ 4,511,762</u>	<u>\$ 194,654,836</u>
EXPENDITURES (Note 1)				
Administrative	\$ 1,302,150	\$	\$	\$ 1,302,150
Other interest			4,060,574	4,060,574
Debt service principal redemption			10,000	10,000
Community Development Block Grants	47,735,535			47,735,535
Arts and Cultural Grants	2,277,999			2,277,999
Michigan Film Office	895,734			895,734
Jobs for Michigan Investment Fund - Operations		12,222,009		12,222,009
Jobs for Michigan Investment Fund - Pass-through funds		392,671		392,671
Jobs for Michigan Investment Fund - Programs		46,661,256		46,661,256
Payments to MEDC	59,309,395			59,309,395
Payments to General Fund (indirect and refund)	329,707			329,707
Miscellaneous and receivable write-off	478,642		400,000	878,642
Total expenditures	<u>\$ 112,329,161</u>	<u>\$ 59,275,936</u>	<u>\$ 4,470,574</u>	<u>\$ 176,075,671</u>
Excess of revenues over (under) expenditures	<u>\$ (276,775)</u>	<u>\$ 18,814,751</u>	<u>\$ 41,189</u>	<u>\$ 18,579,165</u>
OTHER FINANCING SOURCES (USES)				
Transfer from Jobs for Michigan Investment Fund	\$ 9,760,589	\$	\$	\$ 9,760,589
Transfer to General Operations Fund		(9,760,589)		(9,760,589)
Other financing sources (uses)	<u>\$ 9,760,589</u>	<u>\$ (9,760,589)</u>	<u>\$ 0</u>	<u>\$ 0</u>
Net change in fund balances	\$ 9,483,814	\$ 9,054,162	\$ 41,189	\$ 18,579,165
Fund balance - Beginning	1,027,711	126,318,784	2,041,575	129,388,070
Fund balance - Ending	<u>\$ 10,511,525</u>	<u>\$ 135,372,947</u>	<u>\$ 2,082,764</u>	<u>\$ 147,967,235</u>

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

2009

General Operations	Jobs for Michigan Investment Fund	Debt Service Fund	Total
\$ 230,756	\$	\$	\$ 230,756
2,639,981			2,639,981
33,836,748			33,836,748
1,455,598			1,455,598
27,704,072	118,048,781		27,704,072
			118,048,781
26,811,476			26,811,476
49,159			49,159
14,284	1,840,708	3,600	1,858,592
	(4,209,434)		(4,209,434)
		4,061,763	4,061,763
1,160,402	377,996		1,538,398
<u>\$ 93,902,476</u>	<u>\$ 116,058,051</u>	<u>\$ 4,065,363</u>	<u>\$ 214,025,890</u>
\$ 588,067	\$	\$	\$ 588,067
		4,422,683	4,422,683
		5,000	5,000
35,500,991			35,500,991
646,414			646,414
	43,553,028		43,553,028
	2,245,349		2,245,349
(449,000)	47,400,159		46,951,159
56,328,388			56,328,388
152,588			152,588
819,860			819,860
<u>\$ 93,587,308</u>	<u>\$ 93,198,536</u>	<u>\$ 4,427,683</u>	<u>\$ 191,213,527</u>
\$ 315,168	\$ 22,859,515	\$ (362,320)	\$ 22,812,363
\$ 468,747	\$	\$	\$ 468,747
	(468,747)		(468,747)
<u>\$ 468,747</u>	<u>\$ (468,747)</u>	<u>\$ 0</u>	<u>\$ 0</u>
\$ 783,915	\$ 22,390,768	\$ (362,320)	\$ 22,812,363
243,796	103,928,016	2,403,895	106,575,707
<u>\$ 1,027,711</u>	<u>\$ 126,318,784</u>	<u>\$ 2,041,575</u>	<u>\$ 129,388,070</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

	2010	2009
Net change in fund balance	\$ 18,579,165	\$ 22,812,363
Amounts reported for governmental activities in the statement of activities are different because:		
Net gaming revenues are recognized in different fiscal years because they were unavailable and deferred at the governmental fund level but are recognized in the statement of activities.	5,638,882	1,551,627
Certain interest and investment earnings are delayed and not available and have been deferred at the governmental fund level but are recognized in the statement of activities.	(1,507,146)	0
Lease revenue is recorded as a resource in the governmental fund statement; however, a portion of the lease revenue is applied to the lease receivable in the statement of activities.	(323,770)	(309,973)
Payments to MEDC that were reported as expenditures in the governmental fund statement but were due and payable in the prior fiscal year are not reported in the statement of activities.	(118,882)	178,373
Other interest expense for bonds payable is not recorded in the governmental fund statement.	198,841	559,885
Debt service principal redemption is reported as an expenditure in the governmental fund statement.	10,000	5,000
Miscellaneous and receivable/payable write-offs were not recorded in the governmental fund statement for receivables recorded in the statement of activities.	(1,701,882)	(912,392)
Miscellaneous and receivable/payable write-offs were not recorded in the governmental fund statement for payables recorded in the statement of activities.	1,701,882	0
Compensated absences is not reported in the governmental fund statement because payments are not due and do not use current financial resources.	(22,501)	(183,169)
Change in net assets of governmental activities	\$ 22,454,588	\$ 23,701,714

Notes to the Financial Statements

Note 1 Significant Accounting Policies

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

a. Reporting Entity

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

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

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

MSF is governed by an 11-member Board of Directors that consists of MEDC's chief executive officer, the State Treasurer, the director of DELEG, and 8 members who are appointed by the Governor with the advice and consent of the Senate.

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

b. Financial Statement Presentation

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

MSF's governmental fund financial statements include MSF's general operating fund, Jobs for Michigan Investment Fund, and debt service fund. MSF's three funds are accounted for in a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues, and expenditures. The general operating fund accounts for all of the activities of MSF except those accounted for in the Jobs for Michigan Investment Fund and the debt service fund. The Jobs for Michigan Investment Fund accounts for the investment, loan, and grant activity provided for in Act 225, P.A. 2005. The debt service fund accounts for the accumulation of resources for, and the payment of, principal and interest for limited obligation revenue bonds issued to acquire ownership in the Michigan House of Representatives facilities.

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

c. Measurement Focus and Basis of Accounting

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

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

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

d. Financial Data

MSF's General Operations column includes the following:

- (1) Revenues: Revenues primarily include Community Development Block Grants (CDBG) from the U.S. Department of Housing and Urban Development, State appropriations, tribal gaming, interest and investment earnings, PAB issuance fees (private activity bonds [PABs] were formerly known as industrial development revenue bonds [IDRBs]), and other fees (including Michigan Economic Growth Authority [MEGA] fees and Brownfield fees).

Revenues in fiscal year 2009-10 also include a one time, \$9.5 million use tax collected by the Michigan Department of Treasury and transferred to the Michigan Promotion Fund. The Michigan Promotion Fund, as authorized by Act 37, P.A. 2010, was created in MSF for the promotion of tourism.

- (2) Expenses/Expenditures: CDBG expenditures primarily consist of pass-through grants to local governmental units. Payments to MEDC include tribal gaming; fees from PAB, MEGA, and Brownfield; and State appropriations for programs administered by MEDC. Expenditures also include administrative and other miscellaneous costs.

- (3) Other Financing Sources: Other financing sources primarily include amounts transferred from the Jobs for Michigan Investment Fund to fund the Michigan Supplier Diversification Fund (MSDF) - Collateral Support Program and Loan Participation Program.

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

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

MSF's Debt Service Fund column includes revenues. Revenues include lease revenues and interest earned on the lease payments deposited in the bank for the accumulation of resources for, and the payment of, principal and interest for limited obligation revenue bonds.

Note 2 Deposits and Investments

a. Deposits

	As of September 30	
	2010	2009
State of Michigan's equity in common cash	\$ 30,263,488	\$ 21,826,185
Deposits	2,928,292	2,325,337
Capital Access Program	5,718,483	5,366,875
MSDF - Collateral Support Program	9,141,353	449,000
Total deposits	<u>\$ 48,051,616</u>	<u>\$ 29,967,397</u>

Custodial Credit Risk: Custodial credit risk for deposits is the risk that, in the event of a bank failure, MSF deposits may not be returned to it.

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent but not in MSF's name.

Without recognition of outstanding checks or deposits in transit, MSF's bank statement shows a balance of \$18,352,936 at September 30, 2010 and \$8,670,680 at September 30, 2009. The majority of these balances are from the various bank accounts within the Capital Access Program and MSDF. Of these amounts, \$11,932,285 as of September 30, 2010 and \$3,913,919 as of September 30, 2009 were uninsured and uncollateralized and, therefore, exposed to custodial credit risk. MSF has no policy for controlling custodial credit risk.

MSF's deposits included in the State of Michigan's equity in common cash are managed by the State Treasurer. The State Treasurer's policy requires financial institutions to secure State funds with collateral, to be organized under federal or State law, and to maintain an office in Michigan. The policy also restricts deposits to a maximum of 50% of each financial institution's net worth. As of September 30, 2010 and September 30, 2009, 100% and 99.9%, respectively, of the State's common cash was either covered by federal depository insurance or collateralized with securities held in the State's name by the State's agent. Additional details on this policy are described in the *State of Michigan Comprehensive Financial Report (SOMCAFR)*.

b. Investments

MSF invests directly, or through investment funds, to strengthen and diversify Michigan's economy by providing financial assistance to businesses to create jobs or new businesses and industries. Act 225, P.A. 2005, authorized MSF to invest in venture capital*, mezzanine*, and private equity* funds. The MSF Board of Directors approves new investments.

* See glossary at end of report for definition.

In 2006, MSF entered into a contract with DLJ MB Advisors, Inc. (DLJ), an affiliate of the Credit Suisse Group, to facilitate these investments in new businesses and industries or new products and processes, which may have a higher risk than investments in established businesses or industries. The Michigan 21st Century Investment Fund, a limited partnership, was established for these investments. DLJ is the general partner, and MSF is a limited partner.

In addition, MSF has venture capital investments in Life Sciences, Advanced Automotive, and Alternative Energy (transferred from MEDC by Act 225, P.A. 2005). These venture capital investments were previously approved by the Life Sciences and Technology Tri-Corridor steering committees in MEDC.

MSF reported investments at fair value if it was readily determinable or used cost-based measures if fair value was not readily determinable. The fair values were estimated by the partnerships, using the most recent reports and financial statements of the partnership investments:

Type of Investment	Fair Value (in millions) as of September 30	
	2010	2009
Venture capital - Limited partner	\$17.8	\$14.1
Venture capital - Stockholder	23.4	15.9
Mezzanine funds	7.7	6.4
Private equity	6.3	4.3
Total investments	<u>\$55.2</u>	<u>\$40.7</u>

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

- (1) Custodial Credit Risk: Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, MSF will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are

uninsured, are not registered in the name of MSF, and are held by either the counterparty or the counterparty's trust department or agent but not in MSF's name.

MSF's investments in venture capital limited partnerships, mezzanine funds, and private equity are excluded from custodial credit risk because they are not an investment security. MSF's investments in venture capital stocks are not exposed to custodial credit risk because they are held by US Trust - Bank of America in MSF's name.

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

following companies for more than 5% of MSF's total investments at September 30, 2010 and September 30, 2009:

Name of Issuer	September 30, 2010		September 30, 2009	
	Amount (in millions)	Percentage of Investments	Amount (in millions)	Percentage of Investments
Midwest Mezzanine	\$5.6	10.0%	\$4.8	11.9%
Pronai	\$5.0	9.0%	\$5.8	14.3%
Integrated Sensing Systems, Inc.	\$4.9	8.8%	\$4.9	12.0%
Quad Partners	\$4.8	8.7%	\$2.6	6.3%
Venture Investors IV	\$4.0	7.3%	\$3.7	9.2%
Nth Power	\$3.4	6.2%	\$2.8	6.8%
Arboretum	\$3.4	6.1%	\$3.3	8.1%

Note 3 Loans and Interest Receivable

Loans receivable totaled \$60,533,494 at September 30, 2010 and \$76,553,059 at September 30, 2009 for the Jobs for Michigan Investment Fund. These are high-risk loans issued for the purpose of diversifying Michigan's economy and helping to create jobs in competitive edge technologies. The loans were issued to organizations that research or commercialize (transition from research to market) products, processes, or services in the competitive edge technologies. These loans may be converted to investments at MSF's option with MSF Board of Directors and Strategic Economic Investment and Commercialization (SEIC) Board* approval.

The loans are for varying lengths and interest rates. Interest and loan repayments may be initially delayed for several years to provide the borrower an opportunity to substantially complete the project. Delayed interest receivable of \$2.5 million (\$4.0 million at September 30, 2009) was reported as revenue on the entity-wide financial statements, but as deferred revenue on the governmental fund balance sheet because the revenue was not available.

* See glossary at end of report for definition.

Loan Category	Loans Receivable as of September 30	
	2010	2009
Technology Tri-Corridor	\$ 4,608,712	\$ 10,315,036
Life Sciences	121,856	2,767,349
Choose Michigan Fund	2,000,000	0
Competitive Edge Technology:		
Advanced Automotive, Manufacturing, and Materials Technology	11,724,323	10,234,194
Life Sciences Technology	24,633,425	38,418,580
Homeland Security and Defense Technology	8,643,413	7,550,786
Alternative Energy Technology	8,801,765	7,267,114
Total	\$ 60,533,494	\$ 76,553,059

Note 4 Capital Lease Receivable

As described in Note 7, MSF issued limited obligation revenue bonds to acquire ownership in the Michigan House of Representatives facilities. MSF entered into a capital lease agreement with the House of Representatives to lease the facilities until October 15, 2023. At the end of the lease, the House of Representatives may purchase the facilities for a nominal amount. The lease payments are paid to a trustee and will be used to pay the bonds issued to purchase the facilities. The lease payments are contingent upon annual appropriation by the State of Michigan, and neither the full faith and credit nor the taxing power of the State are pledged to the rentals coming due under the lease.

	Capital Lease Receivable as of September 30	
	2010	2009
Total lease payments to be received	\$115,019,100	\$119,080,862
Less: Unearned interest income	31,361,920	35,099,912
Net lease receivable	\$ 83,657,180	\$ 83,980,950
Statement of net assets classification:		
Current portion of lease receivable	\$ 2,678,181	\$ 323,770
Long-term portion of lease receivable	80,978,999	83,657,180
Total	\$ 83,657,180	\$ 83,980,950

Lease payments to be received from the House of Representatives as of September 30, 2010:

Fiscal Year Ending September 30	Lease Receivable
2011	\$ 6,401,763
2012	6,675,262
2013	6,960,513
2014	8,054,763
2015	8,361,513
2016 - 20	46,621,063
2021 - 23	31,944,225
Total	<u>\$115,019,100</u>

Note 5 Long-Term Liabilities

The following tables summarize the long-term liabilities of MSF for the fiscal years ended September 30, 2010 and September 30, 2009:

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

Fiscal Year 2008-09	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$ 5,588,589	\$ 1,322,034	\$1,543,747	\$ 5,366,875	\$1,300,000
Compensated absences	\$ 277,899	\$ 291,213	\$ 108,044	\$ 461,069	\$ 268,440
Bonds payable	\$79,780,000		\$ 5,000	\$79,775,000	\$ 35,000
Unamortized premium	\$ 2,990,896		\$ 198,841	\$ 2,792,055	\$ 198,841

Liabilities for compensated absences were included in the statement of net assets, which is on the accrual basis, and not in the governmental fund balance sheet, which is on the modified accrual basis. These liabilities represent unused sick, banked, and annual leave accrued, which will be paid

when the employees terminate employment. The liability is calculated using 100% of the employees' annual and banked leave plus the State's share of social security and retirement contributions and a portion of the sick leave, based on the pay rates in effect as of September 30, 2010 and September 30, 2009, respectively.

Liabilities for the Capital Access Program consist of an obligation to reimburse financial institutions for possible future loan defaults on high-risk business loans. An asset for the same amount represents the available cash balance that can be used to reimburse the financial institutions for future loan defaults. Additions to the Capital Access Program liabilities are fees paid by the financial institution, MSF, and the borrower to fund the program and recoveries of defaulted loans. Reductions are payments to the financial institutions for defaulted loans. As of September 30, 2010, there were 44 financial institutions participating in the Capital Access Program.

Detailed information on bonds payable and unamortized premium is provided in Note 7.

Note 6 Pension Plans and Other Postemployment Benefits

a. Classified Employees

State classified employees who work on MSF programs are covered by two single employer pension plans offered by the State of Michigan: the State Employees' Defined Benefit Retirement Plan and the State Employees' Defined Contribution Retirement Plan (Plans). Detailed information regarding the Plans' descriptions, accounting policies, vesting and eligibility requirements, actuarial cost methods and assumptions, funding status and requirements, and 10-year historical trend information are provided in the Plans' detailed financial reports.

In addition to the Plans, State classified employees have the option to invest a portion of their salaries into 401(k) and 457 deferred compensation plans. Generally, MSF does not make any contributions to the deferred compensation plans.

State statutes provide retired employees with other postemployment benefits, such as health, dental, vision, and life insurance coverage based

on vesting and other requirements. The cost of retiree health care and other benefits is allocated by the Office of Retirement Services and funded on a pay-as-you-go basis.

For the State Employees' Defined Benefit Retirement Plan, MSF was billed and paid an average of 33.26% (\$422,536) and 30.6% (\$392,284) of its payroll costs for pension charges and retiree postemployment benefits in fiscal years 2009-10 and 2008-09, respectively. For the State Employees' Defined Contribution Retirement Plan, MSF is required to make a contribution of 4% of the annual payroll and to match employee contributions up to 3% of annual covered payroll, totaling \$14,473 and \$14,589 for fiscal years 2009-10 and 2008-09, respectively. The Plans' detailed financial statements can be obtained from the Office of Retirement Services, Department of Technology, Management & Budget, 7150 Harris Drive, P.O. Box 30171, Lansing, Michigan 48909.

b. Nonclassified Employees

MSF reimburses MEDC for MEDC nonclassified employees working on MSF programs. MEDC offers these nonclassified employees a retirement plan (under Section 401(a) of the Internal Revenue Code) after one year of service. MEDC also offers a deferred compensation plan (under Section 457 of the Internal Revenue Code) to these nonclassified employees upon employment. Both plans are administered by Pension Trend, a third party administrator, and the employees manage their own investments. Other than making contributions to the 401(a) retirement plan, neither MEDC nor MSF has any other pension benefit obligation liability. Nonclassified employees do not have any other postemployment benefits.

MSF reimburses MEDC for an employer contribution rate of 8% of an employee's gross wages to the 401(a) retirement plan for eligible employees. The MEDC Executive Committee approved the contribution and rate on August 5, 1999. Employees cannot contribute to this plan. For the fiscal years ended September 30, 2010 and September 30, 2009, MSF reimbursed MEDC for contributions to the plan of \$126,481 and \$67,983, 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, 2010 and September 30, 2009, employees contributed \$92,996 and \$78,553, respectively.

Note 7 Limited Obligation Revenue Bonds - Michigan House of Representatives Facilities

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

The proceeds of the bonds were used, together with other available funds, to (a) acquire an office building containing offices for the members of the House of Representatives and their staff through (i) the defeasance of the prior owner's outstanding Certificates of Participation* and (ii) the discharge of a prior loan, (b) finance the acquisition and construction of improvements to the facilities, and (c) pay costs of issuing and insuring the bonds.

The scheduled payments of principal and interest on the bonds when due are guaranteed under the financial guarantee insurance policy issued concurrently with the delivery of the bonds by Assured Guaranty Corp. The Series A bonds (\$78,650,000) have a maturity schedule starting in 2011 and ending in 2023 with an interest rate yield in the range of 3.33% to 5.19%. The Series B bonds

* See glossary at end of report for definition.

(\$1,130,000) will mature in 2011 with an interest rate yield of 4.00%. The following table summarizes debt service requirements for outstanding bonds:

Fiscal Year	Principal	Interest	Total
2011	\$ 35,000	\$ 4,058,138	\$ 4,093,138
2012	2,410,000	4,014,763	6,424,763
2013	2,780,000	3,902,763	6,682,763
2014	3,205,000	3,753,138	6,958,138
2015	4,475,000	3,561,138	8,036,138
2016 - 20	30,915,000	13,666,938	44,581,938
2021 - 24	35,945,000	3,929,231	39,874,231
Total	\$79,765,000	\$36,886,106	\$116,651,106
Unamortized premium	2,593,214		2,593,214
Total	\$82,358,214	\$36,886,106	\$119,244,320

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

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

The total amount of PABs issued by MSF and its predecessor entity for the period January 1, 1979 through September 30, 2010 was \$8,827,798,525 (\$8,652,893,525 through September 30, 2009). The amount of tax-exempt bonds issued during fiscal year 2009-10 was \$143,860,000 (\$324,535,000 for fiscal year 2008-09). There were no taxable bonds issued by MSF under the Taxable Bond Program for fiscal year 2009-10 (\$42,375,000 for fiscal year 2008-09).

Note 9 Interfund Receivable and Payable and Interfund Eliminations

As of September 30, 2010, an interfund payable for \$401,214 (none as of September 30, 2009) was recorded in general operations and an interfund receivable for \$401,214 (none as of September 30, 2009) was recorded in the Jobs for Michigan Investment Fund for borrowing to eliminate a negative balance in equity in common cash in general operations. The interfund receivable and payable were eliminated in the statement of net assets for fiscal year 2009-10.

Note 10 Reserved Fund Balance

Reserved fund balance (in millions) consists of:

	As of September 30	
	2010	2009
Noncurrent loans	\$ 53.5	\$ 70.7
Noncurrent investments	55.2	40.7
Encumbrances	.8	2.8
MSDF	9.1	0.0
Debt service	2.1	2.0
Total reserved fund balance	<u>\$ 120.7</u>	<u>\$ 116.2</u>

REQUIRED SUPPLEMENTARY INFORMATION

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

Budgetary Comparison Schedule (Statutory/Budgetary Basis)	2010			
	Original Budget	Final Budget	Actual	Variance With Final Budget
Beginning budgetary fund balance	\$ 17,069,686	\$ 17,069,686	\$ 17,069,686	\$ 0
Resources (inflows):				
Revenues and other sources:				
Charges for services (Note 2)	\$ 86,500	\$ 86,500	\$ 2,359,944	\$ (2,273,444)
Operating grants and contributions	65,616,500	65,599,400	48,412,294	17,187,106
Payments from the State of Michigan:				
From General Fund	27,135,700	27,008,400	27,067,964	(59,564)
From 21st Century Jobs Trust Fund (Note 3)	220,119,428	220,119,428	69,365,329	150,754,098
Other miscellaneous (Note 4)	13,096,342	13,096,342	47,449,304	(34,352,962)
Total revenues and other sources	<u>\$ 326,054,470</u>	<u>\$ 325,910,070</u>	<u>\$ 194,654,836</u>	<u>\$ 131,255,234</u>
Total resources available	<u>\$ 343,124,155</u>	<u>\$ 342,979,755</u>	<u>\$ 211,724,521</u>	<u>\$ 131,255,234</u>
Charges (outflows):				
Expenditures, transfers out, and encumbrances:				
Administrative (Note 2)	\$ 64,746,797	\$ 64,729,697	\$ 1,302,150	\$ (1,302,150)
Community Development Block Grants	64,746,797	64,729,697	47,735,535	16,994,162
Other interest			4,060,574	(4,060,574)
Debt service principal redemption			10,000	(10,000)
Jobs for Michigan Investment Fund - Appropriation Year 2006	115,690,752	115,690,752	28,068,959	87,621,793
Jobs for Michigan Investment Fund - Appropriation Year 2008	35,723,531	35,723,531	22,063,292	13,660,239
Jobs for Michigan Investment Fund - Appropriation Year 2009	40,205,145	40,205,145	9,836,347	30,368,798
Jobs for Michigan Investment Fund - Appropriation Year 2010	28,500,000	28,500,000	9,396,732	19,103,269
Jobs for Michigan Investment Fund - Permanent Fund	1,765,000	1,765,000	514,079	1,250,921
Payments to MEDC:				
Administration	2,413,100	2,389,600	2,388,622	978
Job creation services	13,529,205	13,427,005	12,638,070	788,935
Michigan Promotion Program	5,402,800	5,402,800	5,402,800	0
Economic Development Job Training Grants	4,705,800	4,705,800	4,705,800	0
Michigan Promotion Fund		9,500,000	9,497,524	2,476
IDRB, MEGA, and tribal gaming revenue (Notes 2 and 4)			24,676,580	(24,676,580)
Michigan Film Office	721,400	719,800	895,734	(175,934)
Arts and Cultural Grants	2,267,400	2,346,400	2,277,999	68,401
Payments to General Fund			329,707	(329,707)
Miscellaneous and receivable write-off	478,642	478,642	878,642	(400,000)
Total charges	<u>\$ 316,149,571</u>	<u>\$ 325,584,171</u>	<u>\$ 186,679,143</u>	<u>\$ 138,905,028</u>
Reconciling items:				
Changes in noncurrent assets	\$ 0	\$ (3,566,410)	\$ (3,566,410)	\$ 0
Net reconciling items	<u>\$ 0</u>	<u>\$ (3,566,410)</u>	<u>\$ (3,566,410)</u>	<u>\$ 0</u>
Ending budgetary fund balance	<u>\$ 26,974,584</u>	<u>\$ 13,829,174</u>	<u>\$ 21,478,968</u>	<u>\$ (7,649,794)</u>

This schedule continued on next page.

2009

Original Budget	Final Budget	Actual	Variance With Final Budget
\$ 15,121,687	\$ 15,121,687	\$ 15,121,687	\$ 0
\$ 85,500	\$ 85,500	\$ 2,870,737	\$ (2,785,237)
55,438,800	64,738,800	35,292,346	29,446,454
29,603,800	27,741,100	27,704,072	37,028
323,668,209	309,668,209	118,048,781	191,619,428
3,042,304	3,042,304	30,109,954	(27,067,650)
<u>\$ 411,838,613</u>	<u>\$ 405,275,913</u>	<u>\$ 214,025,890</u>	<u>\$ 191,250,023</u>
\$ 426,960,300	\$ 420,397,600	\$ 229,147,577	\$ 191,250,023
\$ 55,744,054	\$ 65,044,054	\$ 588,067	\$ (588,067)
		35,500,991	29,543,063
		4,422,683	(4,422,683)
		5,000	(5,000)
155,926,187	150,976,187	35,285,435	115,690,752
105,742,022	105,742,022	70,018,491	35,723,531
62,000,000	52,950,000	12,744,855	40,205,145
1,250,000	1,250,000	435,000	815,000
2,555,100	2,518,600	2,518,382	218
14,324,946	14,118,946	13,363,392	755,555
5,717,500	5,717,500	5,717,500	0
7,320,500	5,704,600	5,704,600	0
		29,024,514	(29,024,514)
731,600	727,300	646,414	80,886
		152,588	(152,588)
526,704	526,704	819,860	(293,156)
<u>\$ 411,838,613</u>	<u>\$ 405,275,913</u>	<u>\$ 216,947,772</u>	<u>\$ 188,328,142</u>
\$	\$ 4,869,880	\$ 4,869,880	\$ 0
\$ 0	\$ 4,869,880	\$ 4,869,880	\$ 0
<u>\$ 15,121,687</u>	<u>\$ 19,991,567</u>	<u>\$ 17,069,685</u>	<u>\$ 2,921,881</u>

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

Budget-to-GAAP Reconciliation	2010			Variance With Final Budget
	Original Budget	Final Budget	Actual	
Resources (inflows):				
Actual amount (budgetary basis) of "Total resources available"			\$ 211,724,521	
Differences - Budget to GAAP:				
Beginning budgetary fund balance is a budgetary resource but is not a current year revenue for financial reporting purposes			(17,069,686)	
Total revenues (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance			<u>\$ 194,654,836</u>	
Charges (outflows):				
Actual amount (budgetary basis) of "Total charges"			\$ 186,679,143	
Differences - Budget to GAAP:				
Other financing uses are outflows of budgetary resources but are not expenditures for financial reporting purposes			(608,789)	
Loans and investments are outflows for budgetary reporting purposes but are not expenditures for financial reporting purposes			(9,994,684)	
Total expenditures (GAAP basis) on the statement of revenues, expenditures, and changes in fund balance			<u>\$ 176,075,671</u>	

See accompanying notes to required supplementary information

2009

<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance With Final Budget</u>
		\$ 229,147,577	
		<u>(15,121,687)</u>	
		<u>\$ 214,025,890</u>	
		\$ 216,947,771	
		(468,747)	
		<u>(25,265,498)</u>	
		<u>\$ 191,213,527</u>	

Notes to Required Supplementary Information

Note 1 Statutory Budgetary Presentation

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

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

The budgetary comparison schedule presents both the original and final appropriated budgets for fiscal years 2009-10 and 2008-09, as well as the actual resource inflows, outflows, and fund balance stated on the budgetary basis.

The original budget and related estimated revenues represent the spending authority enacted from annual appropriations bills, as amended, for the years 2005 through 2010 and include encumbrances and multi-year projects' budgetary carry-forwards from the prior year.

The budgetary fund balance represents the total fund balance, net of reserves for noncurrent assets. Reserves for noncurrent assets do not represent current financial resources available for appropriations and are not included for budgetary purposes.

Note 2 Charges for Services

The revenue amounts in the actual column include charges for services collected by MSF for the Brownfield, private activity bonds (formerly known as industrial development revenue bonds [IDRBs]), and Michigan Economic Growth Authority (MEGA) programs. The corresponding cost of administering those programs is recorded as administrative expenditures. All excess fees

collected are transferred to MEDC pursuant to the interlocal agreement as a payment to MEDC expenditure.

Note 3 Payments From the 21st Century Jobs Trust Fund

Act 225, P.A. 2005, appropriated \$394.0 million (subsequently reduced to \$338.0 million) in fiscal year 2005-06; Act 127, P.A. 2007, and Act 98, P.A. 2008, appropriated \$125.0 million in fiscal year 2007-08; Act 261, P.A. 2008, appropriated \$62.0 million (subsequently reduced to \$53.0 million) in fiscal year 2008-09; and Act 128, P.A. 2009, appropriated \$28.5 million in fiscal year 2009-10 to MSF. These appropriations are financed from the tobacco securitization settlement funds retained in the 21st Century Jobs Trust Fund at the Department of Treasury.

MSF received revenue of \$69.4 million and \$118.0 million from the 21st Century Jobs Trust Fund for fiscal years 2009-10 and 2008-09, respectively.

Note 4 Tribal Gaming

The other miscellaneous revenues in the actual column include tribal gaming revenue of \$27.5 million. The payments to MEDC include the tribal gaming revenue transferred to MEDC per the interlocal government agreement.

Note 5 Jobs for Michigan Investment Fund Charges for Appropriation Years 2006, 2008, 2009, and 2010

MSF has received a work project authorization for all Jobs for Michigan Investment Fund related appropriations and is thus permitted to spend unspent appropriations over multiple years. The original budget amount for appropriation year 2006 and appropriation year 2009 reflects the carryforward of unspent appropriation from these years.

Charges are financed by the funds appropriated by enabling acts stated in Note 3. Total charges for fiscal year 2009-10 were \$69.4 million, of which \$10 million was disbursed for investments and loans. Total charges for fiscal year 2008-09 were \$118.0 million, of which \$25.3 million was disbursed for investments and loans. Investments and loans are not expenditures for financial reporting purposes and are thus listed as a budget-to-GAAP reconciling item.

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. Michael Finney, President and Chief Executive Officer
Michigan Strategic Fund
300 North Washington Square
Lansing, Michigan

Dear Mr. Finney:

We have audited the financial statements of the governmental activities and each major fund of the Michigan Strategic Fund, a discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2010 and September 30, 2009, which collectively comprise the Michigan Strategic Fund's basic financial statements as identified in the table of contents, and have issued our report thereon dated February 8, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

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

Compliance and Other Matters

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

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

AUDITOR GENERAL

February 8, 2011

GLOSSARY

Glossary of Acronyms and Terms

CDBG	Community Development Block Grants.
Certificate of Participation	Financing in which an individual buys a share of the lease revenues of an agreement made by a municipal or governmental entity, rather than the bond being secured by those revenues.
deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.
DELEG	Department of Energy, Labor & Economic Growth.
DLJ	DLJ MB Advisors, Inc.
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 weakness in internal control over financial reporting A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the financial schedules and/or financial statements will not be prevented, or detected and corrected, on a timely basis.

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.

MSDF Michigan Supplier Diversification Fund.

MSF Michigan Strategic Fund.

PAB private activity bond.

private equity fund A type of investment fund that buys majority interest in companies to restructure their capital, management, and organization. Usually, the companies are privately held for two to five years.

significant deficiency
in internal control over
financial reporting

A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Strategic Economic
Investment and
Commercialization
(SEIC) Board

A board that awards grants, loans, and investments from the 21st Century Jobs Trust Fund for basic research, applied research, university technology transfer, and commercialization of products, processes, and services to encourage the development of competitive edge technologies to create jobs in Michigan.

unqualified opinion

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

venture capital fund

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

