

Office of the Auditor General
Performance Audit Report

Venture Michigan Fund

April 2018

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



Performance Audit

Venture Michigan Fund (VMF)

Report Number:
000-0435-16

Released:
April 2018

VMF is a charitable nonprofit 501(c)(3) corporation created under Public Act 296 of 2003, the Michigan Early Stage Venture Investment Act. VMF's goal is to promote Michigan's economic health by assisting in the creation of new jobs, new businesses, and new industries within Michigan by investing in certain businesses that focus on areas including, but not limited to, alternative energy technology, high-technology, and health care. To help attain that goal, VMF obtained private financing secured by State tax vouchers in the amount of \$450.0 million to invest in these early stage companies.

| Audit Objective | | Conclusion | |
|---|----------------------------------|----------------------|-----------------------------|
| Objective #1: To assess VMF's compliance with select legislative and contract requirements. | | Generally complied | |
| Findings Related to This Audit Objective | Material Condition | Reportable Condition | Agency Preliminary Response |
| None reported. | Not applicable. | | |
| Observations Related to This Audit Objective | Material Condition | Reportable Condition | Agency Preliminary Response |
| Envisioned success may not have been achieved. | Not applicable for observations. | | |

| Audit Objective | | Conclusion | |
|--|--------------------|----------------------|-----------------------------|
| Objective #2: To report other information related to VMF activities. | | Information provided | |
| Findings Related to This Audit Objective | Material Condition | Reportable Condition | Agency Preliminary Response |
| None reported. | Not applicable. | | |
| Exhibits Related to This Audit Objective | | | |
| <u>Exhibit #1</u> - VMF Legislation Summary <u>Exhibit #2</u> - Schedule of Venture Capital Funds and Primary Investment Strategies <u>Exhibit #3</u> - Schedule of Investment Value <u>Exhibit #4</u> - Principal Payment Requirements and Estimated Tax Voucher Usage <u>Exhibit #5</u> - Jobs by Industry Segment <u>Exhibit #6</u> - Schedule of Venture Capital Fund Investments | | | |

Exhibits Related to This Audit Objective
(Continued)

Exhibit #7 - List of Portfolio Companies and Descriptions

Exhibit #8 - VMF Board of Directors

Exhibit #9 - Flow Chart of VMF Investment Activities

Exhibit #10 - Statement of Net Assets/(Deficit)

Exhibit #11 - Cumulative Statement of Revenues, Expenses, and Changes in Net Assets/(Deficit)

Exhibit #12 - Cumulative Sources and Uses of Cash

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OAG

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Doug A. Ringler, CPA, CIA
Auditor General

April 25, 2018

Mr. Thomas C. Kinnear, Chair
Venture Michigan Fund Board of Directors
701 Tappan Street
Ann Arbor, Michigan

Dear Mr. Kinnear:

This is our performance audit report on the Venture Michigan Fund.

We organize our findings and observations by audit objective.

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

Sincerely,

Doug Ringler
Auditor General

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AUDIT OBJECTIVES, CONCLUSIONS, FINDINGS, AND OBSERVATIONS

COMPLIANCE WITH SELECT LEGISLATIVE AND CONTRACT REQUIREMENTS

BACKGROUND

Public Act 296 of 2003 (Sections 125.2231 - 125.2263 of the *Michigan Compiled Laws*) established the following criteria to guide the Venture Michigan Fund (VMF) in its investment decisions:

- Appointment criteria for the Board of Directors, including addressing potential conflicts of interest.
- A fund manager to administer VMF.
- Specific requirements for tax voucher usage.
- A Board-approved investment plan.
- Specific investment requirements, including:
 - An undertaking to invest in qualified businesses*.
 - No more than 15% of the total capital of VMF shall be invested in any single venture capital company.
 - The level of VMF's investment is limited to 25% of the venture capital company's total capital.
 - The venture capital company must have a significant presence in the State.
- Requirements for annual reporting from the fund manager and from VMF.

Material changes to the initial legislation include:

- Public Act 192 of 2015:
 - Reduced the maximum amount of tax vouchers that can be issued to \$450.0 million.
 - Prevented VMF from entering into any new agreements with investors.
- Public Act 193 of 2015 changed the expiration date of VMF from January 1, 2054 to January 1, 2030.

For additional detail regarding VMF legislation, see Exhibit #1.

* See glossary at end of report for definition.

AUDIT OBJECTIVE

To assess VMF's compliance with select legislative and contract requirements.

CONCLUSION

Generally complied.

**FACTORS
IMPACTING
CONCLUSION**

- We did not identify any significant noncompliance with legislative and contract requirements.

OBSERVATION #1

Envisioned success may not have been achieved.

We reviewed VMF activities specifically related to compliance with various sections of Public Act 296 of 2003, the Michigan Early Stage Venture Investment Act of 2003 (Early Stage Act). Although VMF was generally compliant with the legislative requirements, the actual financial results of its investment activities indicate that VMF may not have achieved the success envisioned when the legislation was enacted.

The Early Stage Act authorized the creation of a Michigan early stage venture investment corporation in January 2004. The Legislature determined that:

- Promoting the economic health of the State by assisting in the creation of new jobs, new businesses, and new industries was needed.
- Investing in early stage growth companies and promoting economic growth would assist the State in carrying out its essential governmental functions.
- Investing in certain businesses could promote the retention of businesses and jobs that would likely leave the State, would revitalize and diversify the economic base of the State, would generate and retain jobs and investment in the State, and would promote economic growth in the State.
- Entering into agreements with private corporations would help the State raise capital to invest in venture capital firms.

VMF, a charitable nonprofit 501(c)(3) corporation formed in 2006, is Michigan's only early stage venture investment corporation. VMF is composed of two investment funds: VMF I and VMF II. GCM Grosvenor (the fund manager under the Early Stage Act) serves as the general partner of, and contributed capital as a limited partner to, both VMF I and VMF II.

\$450.0 million borrowed to fund venture capital investments.

Because the newly created VMF did not have any assets or the ability to raise funds, the Early Stage Act provided \$450.0 million in tax vouchers approved by the Michigan Department of Treasury for use to offset any shortfall in debt servicing by fulfilling an equivalent amount of Michigan Single Business Tax, or any successor or replacement thereto, and/or Michigan withholding tax. VMF may issue tax voucher certificates in an amount equal to the maximum principal amount that VMF may borrow under the loan agreements. The maximum annual amount of vouchers that may be used in each tax year is \$112.5 million: \$50.0 million toward the VMF I loan and \$62.5 million toward the VMF II loan.

In August 2006, VMF borrowed \$200.0 million to fund venture capital investments for VMF I. Of the money borrowed, VMF I has committed or invested \$95.0 million in 11 different venture capital funds (see Exhibits #2 and #3). VMF was required to use the remaining funds to establish reserve accounts and to pay borrowing costs, including interest and principal payments. During July 2015, September 2015, and October 2015, VMF

presented tax vouchers to the lenders with an aggregate face amount of \$25.0 million, \$25.0 million, and \$50.0 million, respectively. The State of Michigan purchased all of the tax vouchers at face value. The proceeds from the sale of tax vouchers were utilized for the lenders' interest and principal payments. The remaining VMF I loans were fully repaid in January 2017 with the proceeds from the State's purchase of \$100.0 million in tax vouchers for \$71.7 million (see part c.).

\$235.0 million used for reserve accounts and debt service costs.

In December 2010, VMF borrowed another \$250.0 million to fund venture capital investments for VMF II. Of the money borrowed, VMF II has committed or invested \$120.0 million in 10 different venture capital funds (see Exhibits #2 and #3). Again, VMF was required to use the remaining funds to establish reserve accounts and to pay borrowing costs, including interest and principal payments. Principal payments are not due on the VMF II loans until January 2020 (see Exhibit #4).

Our review of the Early Stage Act related to job creation and investment disclosed:

- a. Section 2(2)(a) states that the Act's purpose was to foster job creation, retention, and expansion through the promotion of investment in certain businesses. VMF agreements with the venture capital funds state that job creation, retention, and expansion shall take precedence over maximizing profits when decisions regarding investments affect both jobs and profits.

Investments totaled nearly \$215.0 million

As of December 2015, the \$450.0 million borrowed and nearly \$215.0 million invested (see Exhibit #3) by VMF supported 1,426 jobs, of which 734 (51%) were newly created jobs (see Exhibit #5). Although our review consisted primarily of VMF activity through December 2015, the fund manager informed us that there has not been any significant change related to the financial activity and job creations of VMF through August 2017.

Investments supported 1,426 jobs, including 734 newly created jobs.

Also, we identified two companies that VMF invested in that were eventually sold and the buyers moved the operations out of Michigan one year after the sale in one case and five years after the sale in the other. This ultimately resulted in the loss of approximately 100 jobs. VMF's portion of the investment in these two companies was approximately \$1.1 million, with a total capital firm investment from all sources of \$7.8 million.

- b. Section 19(3)(e) requires the venture capital firms to "undertake to invest" in qualified businesses (i.e., Michigan start-ups) an amount equal to or greater than the amount provided by VMF. Section 3(m) defines a qualified business as a seed or early stage business that is domiciled in the State, that has its corporate headquarters in the State, or the majority of whose employees work a majority of their time at a site located in the State. The venture capital firms determine which investments they will finance based on partnership

agreements with VMF. The agreements mirror the requirements established in the legislation. We verified that the partnerships did invest in companies that were headquartered in the State or had a presence in the State.

We noted:

For 15 of the 21 venture capital funds that VMF invested in, sufficient proportionate investments were not made in Michigan start-ups.

- Of the 11 venture capital funds in which VMF I invested, 7 (64%) did not invest an amount in Michigan start-ups equal to or greater than the amount provided by VMF I (see Exhibit #6). In addition, 1 of the 7 funds, which received \$7.5 million from VMF I, did not have any ongoing investments in the State.
- Of the 10 venture capital funds in which VMF II invested, 8 (80%) did not invest an amount in Michigan start-ups equal to or greater than the amount provided by VMF II (see Exhibit #6).

These results may change depending on whether all committed funds are fully invested in Michigan start-ups in the future. As of December 2016, VMF I had \$6.1 million and VMF II had \$38.1 million of funds committed but not yet invested.

VMF I
Total venture capital available through the VMF I invested venture capital funds:
\$966.2 million

Total VMF I invested venture capital funds' investment in Michigan start-ups:
Goal - \$343.4 million.
Actual - \$123.5 million.

- c. Section 19(2)(b) states that VMF's fund manager shall "undertake to invest" VMF in such a way as to promote that at least \$2 will be invested in Michigan start-ups for every \$1 of principal for which tax vouchers may be claimed. To help ensure the success of its investment plans, VMF created criteria to evaluate each venture capital firm. Key criteria included the venture capital firm's success in generating above average returns through investing in Michigan start-ups, the firm's success in soliciting investments, and the firm's probability of success as it relates to the investment plan criteria.

VMF II
Total venture capital available through the VMF II invested venture capital funds:
\$1,144.9 million.

Total VMF II invested venture capital funds' investment in Michigan start-ups:
Goal - \$500.0 million.
Actual - \$101.9 million.

As of January 2017, the State had purchased the \$200.0 million in tax vouchers issued to VMF I for \$171.7 million. Accordingly, there should have been at least \$343.4 million in total investments in Michigan start-ups to meet the legislative goal. As of December 2015, total VMF I invested venture capital funds' investment in Michigan start-ups was \$123.5 million (see Exhibit #6).

With \$250.0 million in tax vouchers available for redemption of VMF II loans, the fund manager should target \$500.0 million in Michigan start-ups to meet the legislative goal. As of December 2015, total VMF II invested venture capital funds' investment in Michigan start-ups was \$101.9 million (see Exhibit #6).

VMF Board of Directors and fund manager disagree with the OAG's interpretation of "promote."

Conversely, the VMF Board of Directors and fund manager offered a differing interpretation of Section 19(2)(b):

Based upon the VMF Board of Directors' and fund manager's understanding of the purpose of the Early Stage Act, to "promote the economic health of the State by assisting in the creation of new jobs, new businesses, and new industries" means not just the investment activities of the Funds in isolation, but rather includes the additional investment activities of third parties enabled by the existence and available capital of the Funds [see Exhibit #9]. A more narrow interpretation that would demand an investment equal to twice the issued tax vouchers would not have been feasible given the money raised with the debt financing for both funds, but would also have defeated one of the purposes of the Early Stage Act, which was to leverage the tax voucher backed funds with investments in Michigan companies made not just by the venture capital funds in which VMF I and II directly invested but also by venture capital funds with which they co-invested in those Michigan companies. In determining compliance with the leveraging envisioned by Section 19(2)(b) of the Early Stage Act, the VMF Board of Directors and the fund manager concluded that the appropriate measure of investment activity in Michigan early stage business should include both the investments in those businesses sourced from the Fund and other investors investing at the same time and on the same terms. Accordingly, in making investment decisions, the fund manager evaluated each potential venture capital fund investment based upon, among other things, its ability to find and invest successfully in Michigan early stage businesses.

Based on this approach, the ability of the Funds to leverage their invested capital can reasonably be viewed as follows:

VMF I:

As of 12/31/16, approximately \$1.1 billion of equity had been invested into 32 portfolio Michigan-based companies in which the venture capital funds in which VMF I also invested, which represents:

- *A 7.9x leveraging multiple on the \$139.8 million that all of the venture capital funds in which VMF I invested in turn invested in Michigan companies;*

- *A 11.6x multiple on the \$95 million borrowed by VMF I that it committed to venture capital funds; and*
- *A 5.5x multiple on the \$200 million in vouchers issued to collateralize VMF's debt for VMF I; and*
- *A 6.4x multiple on the \$171.7 million of actual voucher usage.*

VMF II:

As of 12/31/16, \$541.1 million of equity had been invested into 26 portfolio Michigan-based companies in which the venture capital funds in which VMF II also invested, which represents:

- *A 4.3x leveraging multiple on the \$125.6 million that all of the venture capital funds in which VMF II invested in turn invested in Michigan companies;*
- *A 4.5x multiple on the \$120 million borrowed by VMF II that it committed to venture capital funds; and*
- *A 2.2x multiple on the \$250 million in vouchers issued to collateralize VMF's debt for VMF II.*

Reported leveraging could not be validated.

However, fund management does not verify the authenticity of the information reported. Also, because of the proprietary nature of the investment activities of the venture capital firms, the OAG could not validate the accuracy of the leveraging multiples reported by the VMF Board of Directors and the fund manager.

Program success was likely reduced by conflicting goals. Although VMF's primary goal focused on job creation and retention, the overall goal of venture capital firms sought higher returns on investment.

VMF's calendar year 2016 audited financial statements were released in November 2017. Utilizing these and prior audited financial statements, the OAG prepared VMF's statement of net assets/(deficit) as of December 31, 2016 (see Exhibit #10); cumulative statement of revenues, expenses, and changes in net assets/(deficit) (see Exhibit #11); and cumulative sources and uses of cash (see Exhibit #12).

Confidentiality provisions in the various agreements among VMF, GCM Grosvenor, and the various venture capital firms prohibit disclosure of certain financial information obtained from VMF's fund management. Therefore, certain financial information within the exhibits has been redacted to prevent disclosure of this

confidential information. As we have discussed in prior reports, statutory clarification is needed to define when public authorities should be allowed to enter into agreements that may limit transparency and consistency in the use of public funds.

OTHER INFORMATION RELATED TO VMF ACTIVITIES

BACKGROUND

Section 125.2251 of the *Michigan Compiled Laws* requires the fund manager to file an annual report with VMF that includes an annual financial audit conducted by an independent auditor and any other financial information and documentation required to ensure the proper administration and investment of VMF. Section 125.2257 of the *Michigan Compiled Laws* requires VMF to publish and make available on the Internet an annual report not more than three months after the close of the VMF's fiscal year (December). The information can be viewed at venturemichiganfund.com under "Fund Metrics."

AUDIT OBJECTIVE

To report other information related to VMF activities.

CONCLUSION

Information provided.

FACTORS IMPACTING CONCLUSION

- We reported information related to VMF activities generally as of December 31, 2016.

SUPPLEMENTAL INFORMATION

UNAUDITED
Exhibit #1

VENTURE MICHIGAN FUND (VMF) VMF Legislation Summary

Incorporation as a Nonprofit Corporation

- Public Act 296 of 2003 states that a Michigan early stage venture investment corporation shall be incorporated as a nonprofit corporation that has received, on or before September 1, 2004, a favorable determination from the Internal Revenue Service that the corporation is exempt from taxation under Section 501(c)(3) or 501(c)(4) of the Internal Revenue Code.
- Public Act 102 of 2005 extended this deadline to August 1, 2005.

Tax Credit vs. Tax Voucher

- Public Act 296 of 2003 states that for tax years that begin after December 31, 2008, investors that have certificates may claim a refundable tax credit under Section 37e of the Single Business Tax Act (Public Act 228 of 1975, Section 208.37e of the *Michigan Compiled Laws*) or Section 270 of the Income Tax Act (Public Act 281 of 1967, Section 206.270 of the *Michigan Compiled Laws*) equal to the difference between the amount actually repaid and the amount set as the repayment due in the agreement entered into by the taxpayer and the fund manager.
- Public Act 102 of 2005 changed from a refundable tax credit to a tax voucher that shall not exceed the tax liability of the taxpayer. The tax vouchers may be transferred in whole or in part and may be retained and used to pay a future tax liability of the investor.
- Public Act 173 of 2007 added the Michigan Business Tax as an allowable use for tax vouchers.

Investment Requirements

Public Act 296 of 2003 states:

- No more than 15% of the total capital and outstanding commitments of VMF shall be invested in any single venture capital company.
- The level of VMF's investment is limited to 25% of the venture capital company's total capital.
- The venture capital company must have a significant presence in the State.
- The venture capital company will undertake to invest in qualified businesses, determined at the point of initial investment, a percentage of invested capital equal to or greater than the percentage of invested capital that the venture capital company received from the fund.

This exhibit continued on next page.

Tax Voucher Purchase

- Public Act 86 of 2015 provides for tax vouchers with a face value of \$100.0 million to be tendered on or before September 30, 2016, with \$50.0 million each to be purchased during the fiscal years ended September 30, 2015 and September 30, 2016.

Dissolution of VMF

- Public Act 296 of 2003 states that property remaining after providing for debts and obligations shall be distributed to an organization that qualifies either as a governmental unit under Section 170(c) of the Internal Revenue Code or is exempt from tax under Section 501(c)(3) or 501(c)(4) of the Internal Revenue Code, as designated by the Board. If the Board fails to designate an organization as provided, the property remaining shall pass to the State.
- Public Act 192 of 2015 requires that the remaining property shall be distributed with the first \$140.0 million going to the General Fund of the State and any remaining going to the 21st Century Jobs Trust Fund established in Section 7 of the Michigan Trust Fund Act (Public Act 489 of 2000, Section 12.257 of the *Michigan Compiled Laws*).

Agreements With Investors

- Public Act 192 of 2015 prevented VMF from entering into any new agreements with investors.
- VMF shall not create a Michigan early stage venture investment fund and shall not make any new commitments to contribute capital to a venture capital company after the effective date of Public Act 192 of 2015.

Maximum Tax Credits

- Public Act 296 of 2003 states that the total of all certificates shall not exceed the maximum amount allowed under Section 37e(2) of the Single Business Tax Act, being \$150.0 million.
- Public Act 173 of 2007 raised the total amount of tax voucher certificates under the Single Business Tax Act and the Michigan Business Tax Act to not exceed \$600.0 million.
- Public Act 192 of 2015 reduced the total amount of tax vouchers to \$450.0 million.

VMF Expiration Date

- Public Act 296 of 2003 states that the expiration date of VMF is January 1, 2054.
- Public Act 193 of 2015 changed the expiration date to January 1, 2030.

Source: The OAG prepared this exhibit based on VMF legislation.

VENTURE MICHIGAN FUND (VMF)
Schedule of Venture Capital Funds and Primary Investment Strategies
As of December 31, 2016

VMF I

Arboretum Ventures II (medical devices, diagnostics, healthcare IT, and healthcare services)
Arboretum Ventures III (medical devices, diagnostics, healthcare IT, and healthcare services)
Arsenal Venture Partners II (defense, energy, healthcare, electronics, and IT)
Chrysalis Ventures III (healthcare and technology)
Early Stage Partners II (healthcare technology, IT, energy, electronics, and instruments)
Fletcher Spaght Ventures II (healthcare, IT, software, healthcare services, and medical devices)
North Coast Technology Investors III (software, communications, and medical devices)
Nth Power Fund IV (energy)
RPM Ventures II (mobile IT, e-commerce, and social media)
TGap Venture Capital Fund II (software, medical devices, plastics, healthcare, telecom)
Venture Investors Early Stage Fund IV (life sciences, engineering, and IT)

VMF II

Arboretum Ventures III (medical devices, diagnostics, healthcare IT, and healthcare services)
Baird Venture Partners IV (healthcare, industrial solutions, and business services)
Cultivian Sandbox Food & Agriculture Fund II (food and agriculture)
Draper Triangle Ventures III (IT, software, education, medical devices and electronic services)
Flagship Venture Fund IV (software)
Mercury Fund Ventures III (IT, energy, life and bio sciences, and advanced materials)
MK Capital II (IT, software, education tech, and digital media)
Plymouth Venture Partners II (life science, technology, service, manufacturing, and IT)
Plymouth Venture Partners III (life science, technology, service, manufacturing, and IT)
Venture Investors Early Stage Fund V (healthcare and wellness)

Source: The OAG identified the venture capital funds from data obtained from VMF and determined the primary investment strategies from fund and investment Web sites.

VENTURE MICHIGAN FUND (VMF)
Schedule of Investment Value
As of December 31, 2015
(In Millions)

VMF I

| Venture Capital Fund | Total Investment ¹ | Current Value of Investment ² | Total Distributions to VMF |
|----------------------|-------------------------------|--|----------------------------|
| Fund A | \$10.00 | \$ 7.77 | \$ – |
| Fund B | 10.00 | 9.05 | 2.95 |
| Fund C | 7.50 | 7.40 | – |
| Fund D | 5.00 | 1.85 | 0.82 |
| Fund E | 5.50 | 3.97 | – |
| Fund F | 6.98 | 4.35 | 1.73 |
| Fund G | 10.00 | 9.88 | 0.39 |
| Fund H | 10.00 | 3.04 | 0.16 |
| Fund I | 10.00 | 9.04 | 1.09 |
| Fund J | 10.00 | 6.21 | 6.71 |
| Fund K | 10.00 | 5.50 | 14.70 |
| VMF I Total | <u>\$94.98</u> | <u>\$68.06</u> | <u>\$28.55</u> |

VMF II

| Venture Capital Fund | Total Investment ¹ | Current Value of Investment ² | Total Distributions to VMF ³ |
|----------------------|-------------------------------|--|---|
| Fund L | \$ 15.00 | \$ 73.96 | \$2.58 |
| Fund M | 6.50 | 6.54 | 2.52 |
| Fund N | 15.00 | 4.67 | – |
| Fund O | 10.00 | 2.66 | – |
| Fund P | 15.00 | 4.88 | – |
| Fund Q | 10.00 | 3.72 | 0.25 |
| Fund R | 10.00 | 8.88 | 2.13 |
| Fund S | 13.50 | 4.68 | 0.01 |
| Fund T | 15.00 | 4.65 | 0.01 |
| Fund U | 10.00 | 9.04 | 1.09 |
| VMF II Total | <u>\$120.00</u> | <u>\$123.67</u> | <u>\$8.60</u> |

¹ The "Total Investment" amount represents all funds, including funds that have been committed but not yet invested.

² The funds' investments represent interests in nonredeemable, closed-end private investment funds that do not trade in an active market and represent illiquid long-term investments that generally require future capital contributions. Investments in underlying funds are carried at net asset value* (NAV). In addition, the general partner takes into consideration other information as well as any specific conditions and events affecting the funds and may adjust the NAV to reflect its estimate of fair value based on these factors. As of December 31, 2015, the general partner concluded that for substantially all funds, the NAV as reported by the general partner of the respective funds is a practical expedient of fair value.

³ An additional \$1.588 million was received for VMF II for in-kind distributions that were not included in our analysis.

Source: The OAG prepared this exhibit with data obtained from VMF.

* See glossary at end of report for definition.

VENTURE MICHIGAN FUND (VMF)
Principal Payment Requirements and Estimated Tax Voucher Usage
As of January 2017

VMF I

As of January 2017, the loan obtained by VMF I was fully repaid.

VMF II

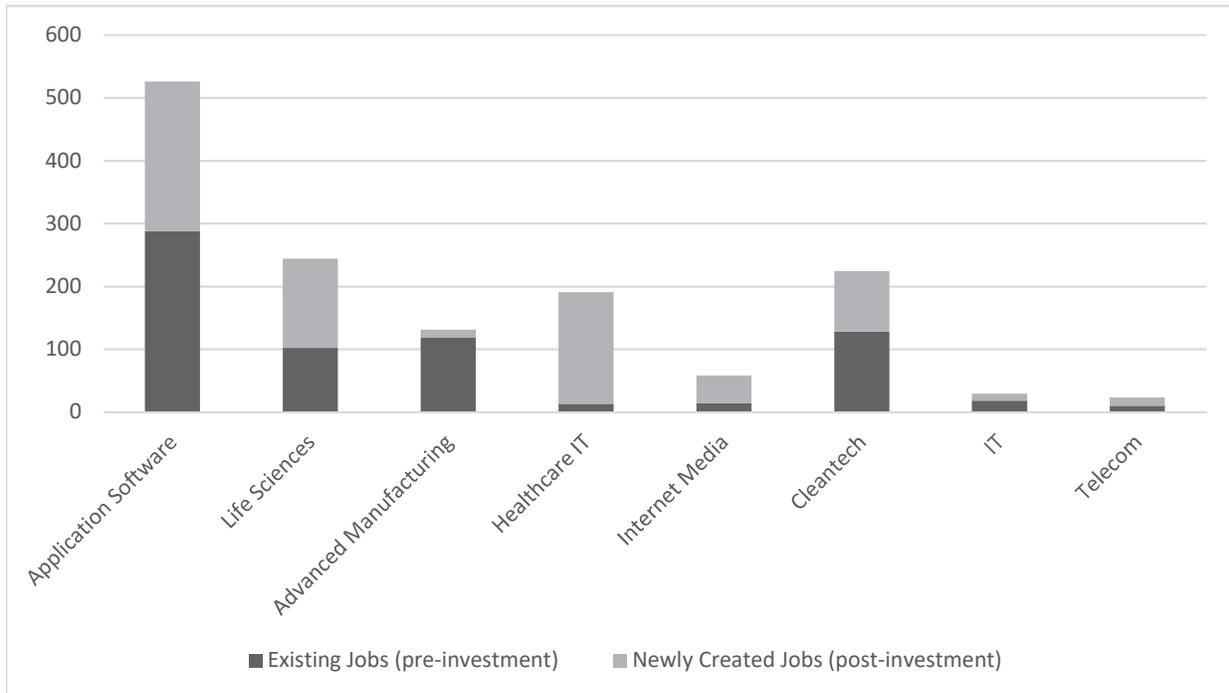
| <u>Fiscal Year</u> | <u>Principal Due</u> | <u>Estimated Return on Investment¹</u> | <u>Estimated Tax Voucher Usage²</u> |
|--------------------|----------------------|---|--|
| 2020 | \$45,000,000 | \$15,972,264 | \$32,253,040 |
| 2021 | \$60,000,000 | \$5,777,549 | \$60,247,168 |
| 2022 | \$60,000,000 | \$5,777,549 | \$60,247,168 |
| 2023 | \$60,000,000 | \$5,777,549 | \$60,247,168 |
| 2024 | \$25,000,000 | \$2,888,774 | \$24,568,029 |

Assumptions:

- ¹ "Estimated Return on Investment" assumes the average rate of return earned in fiscal years 2010 through 2016 will also be earned for fiscal years 2017 through 2024.
- ² "Estimated Tax Voucher Usage" equals the difference between principal due and estimated return with a 10% discount rate calculated in. VMF assumes tax vouchers will be sold at a 10% discount.

Source: The OAG prepared this exhibit with data obtained from VMF.

VENTURE MICHIGAN FUND (VMF)
Jobs by Industry Segment
As of March 31, 2016



| | |
|--------------------------------|--|
| Application Software: | End-user programs, including system and application software for phone apps. |
| Life Sciences: | Development of new processes or therapies and medical devices for the monitoring or treatment of diseases. |
| Advanced Manufacturing: | The use of innovative technology to improve products or processes. |
| Healthcare IT: | Design and development of information technology systems specific to the healthcare field. |
| Internet Media: | On-line media. |
| Cleantech: | Clean technology and greentech, including clean energy, environmental, and sustainable or green products and services. |
| IT: | Information technology. |
| Telecom: | Telecommunications. |

Note: See Exhibit #7 for examples of companies in each industry segment.

Source: The OAG prepared this exhibit with information obtained from VMF.

VENTURE MICHIGAN FUND (VMF)
Schedule of Venture Capital Fund Investments
As of December 31, 2015
(In Millions)

VMF I

| Venture Capital Fund | Total Fund | VMF I Investment | Total That Fund Invested in Michigan Start-Ups | Proportion of Investment in Michigan | Proportion of Investment in Non-Michigan Start-Ups |
|----------------------|-----------------|---------------------|--|--|---|
| Fund A | \$118.51 | \$10.00 | \$ 17.00 | \$ 1.43 | \$ 8.57 |
| Fund B | 55.56 | 10.00 | 9.00 | 1.62 | 8.36 |
| Fund C | 73.43 | 10.00 | 24.96 | 3.40 | 6.60 |
| Fund D | 64.39 | 10.00 | 2.15 | 0.33 | 9.67 |
| Fund E | 63.78 | 10.00 | 5.90 | 0.92 | 9.08 |
| Fund F | 138.15 | 10.00 | 42.01 | 3.04 | 6.96 |
| Fund G ¹ | 176.29 | 7.50 | - | - | 7.50 |
| Fund H | 169.09 | 10.00 | 5.84 | 0.35 | 9.65 |
| Fund I | 26.24 | 5.00 | 9.49 | 1.81 | 3.19 |
| Fund J | 54.50 | 6.98 | 5.42 | 0.69 | 6.28 |
| Fund K | 26.26 | 5.50 | 1.75 | 0.37 | 5.13 |
| Total | <u>\$966.20</u> | <u>\$94.98</u> | <u>\$123.52</u> | <u>\$13.96</u> | <u>\$80.99</u> |

¹ No current investments in Michigan.

VMF II

| Venture Capital Fund | Total Fund | VMF II Investment | Total That Fund Invested in Michigan Start-Ups | Proportion of Investment in Michigan | Proportion of Investment in Non-Michigan Start-Ups |
|----------------------|-------------------|----------------------|--|--|---|
| Fund L | \$ 82.50 | \$ 15.00 | \$ 5.64 | \$ 1.03 | \$ 13.97 |
| Fund M | 41.01 | 6.50 | 18.34 | 2.90 | 3.58 |
| Fund N | 100.00 | 15.00 | 3.57 | 0.54 | 14.46 |
| Fund O | 78.42 | 10.00 | 5.00 | 0.64 | 9.36 |
| Fund P | 138.15 | 10.00 | 42.42 | 3.07 | 6.93 |
| Fund Q | 114.18 | 10.00 | 4.95 | 0.43 | 9.57 |
| Fund R | 106.70 | 10.00 | 8.10 | 0.76 | 9.24 |
| Fund S | 184.51 | 13.50 | 4.75 | 0.35 | 13.15 |
| Fund T | 60.70 | 15.00 | 2.00 | 0.49 | 14.51 |
| Fund U | 238.75 | 15.00 | 7.12 | 0.45 | 14.55 |
| Total | <u>\$1,144.92</u> | <u>\$120.00</u> | <u>\$101.89</u> | <u>\$10.65</u> | <u>\$109.33</u> |

Source: The OAG prepared this exhibit with data obtained from VMF. The last two columns are presented as a proportionate share because VMF fund investments were not earmarked only to Michigan start-ups.

VENTURE MICHIGAN FUND (VMF)
List of Portfolio Companies and Descriptions
As of March 31, 2016

VMF I

| Company Name | Company Description | Category |
|--------------------------------|---|------------------------|
| Accord Biomaterials | Focuses on the development of Nogen™ nitric oxide materials for use in biomarker assays, diagnostic tools, and blood-contacting medical devices. | Life Sciences |
| Accuri Cytometers | Develops and manufactures personal flow cytometers for researchers. | Life Sciences |
| Amplifinity | Automated referral software that powers the referral programs of top enterprise brands yielding 4x higher conversions than traditional marketing. | Application Software |
| Arbor Photonics | Provides high-power fiber laser solutions that increase productivity and enable new capabilities for advanced laser materials processing and defense applications. Products feature beam quality and optical power based on large mode area single-mode optical fibers. | Advanced Manufacturing |
| ArborMetrix | Provides software, analytics, and consulting services for measuring and improving hospital quality and efficiency. | Healthcare IT |
| Concerto Healthcare | Managed-care organization focused on providing health care to patients who qualify for both Medicare and Medicaid benefits. | Healthcare IT |
| CytoPherx | Developing therapies to reduce mortality among patients with acute kidney failure due to a combination of acute kidney injury, sepsis, and/or multi-organ failure. | Life Sciences |
| DeepField | The leading provider of real-time, purpose-built, big data analytics SaaS for network performance management and security, supporting service providers, and large enterprises. | Application Software |
| Delphinus Medical Technologies | A medical imaging company that is commercializing an automated, whole-breast ultrasound imaging system for breast cancer detection, risk evaluation, and treatment monitoring. | Life Sciences |
| Energetx | Provides composite components for the wind energy, defense, aerospace, and transportation markets. Services include engineering, design, tooling, process development, technology, and manufacturing assembly. | Advanced Manufacturing |
| Esperion Therapeutics | Pharmaceutical company focused on developing and commercializing first-in-class, oral, low-density lipoprotein cholesterol (LDL-C) lowering therapies for the treatment of patients with elevated LDL-C. | Life Sciences |
| Gema Diagnostics | A molecular diagnostics company targeting assisted reproductive technology. | Life Sciences |
| HandyLab | Dedicated to the development, manufacture, and sale of novel molecular diagnostic products. | Life Sciences |
| Histosonics | Developing a non-invasive surgical technology for the treatment of Benign Prostatic Hyperplasia, a condition caused by enlargement of the prostate and results in difficult urination. | Life Sciences |
| Kabongo | Develops and publishes digital thinking products for children. It offers online educational games for preschoolers and kindergartners. | IT |
| Knew Deal (Social Proof) | Committed to building technology that makes online marketing effective for businesses of all sizes. | Application Software |
| Kontextual | Helps build transparent, metric-driven company cultures by facilitating the real-time sharing of key metrics and important information. | IT |
| Larky | Helps financial institutions, health insurers, and membership organizations engage in real-time with their audiences. They deliver relevant and compelling location-based discounts to their users through client-branded mobile and Web platforms. | Application Software |
| Life Magnetics | Commercialization of magnetic tags which can be used for both separation and detection, allowing more testing to be done on-site at clinics and pharmacies. | Life Sciences |
| Microposite | A revolutionary new siding product using a patented closed-cell technology. | Cleantech |
| Mobius Microsystems | Offers CMOS Harmonic Oscillator, a technology enabling system designers to create minute and mechanical robust products. | IT |
| Myine Electronics (Livio) | Develops aftermarket in-car connectivity devices. It offers Internet radio solution for home use. | Advanced Manufacturing |
| NanoBio | Safely harnessing nanotechnology to develop intranasal vaccines that prevent disease more effectively. | Life Sciences |
| NeoMoDx | Diagnostics company developing a next generation platform for automated molecular diagnostic processing. | Healthcare IT |
| Peachworks | Software development for back-office restaurant operations. | Application Software |
| Swift Biosciences | Specializes in sample preparation for next-generation sequencing (NGS). Focuses on creating better tools to empower NGS technologies and deliver superior science. | Life Sciences |
| Tangent Medical | Developing and commercializing catheter and related products for intravenous therapy. | Life Sciences |
| Tissue Regeneration Systems | A start-up medical device company commercializing a breakthrough skeletal reconstruction and bone regeneration technology platform licensed from the Universities of Michigan and Wisconsin. | Life Sciences |
| Unitask | Provides the most advanced and cost-effective output management software solution available in the world today. | Application Software |
| Varsity News Network | Technology automatically syncs schedules, game results, articles, photos, forms, and alerts. | IT |

VENTURE MICHIGAN FUND (VMF)
List of Portfolio Companies and Descriptions
As of March 31, 2016

VMF II

| Company Name | Company Description | Category |
|--------------------------------|--|------------------------|
| 365 Retail Markets | Supplier of hardware and software to vending operators who want to replace conventional vending banks with unmanned, small stores. | Application Software |
| Amplifinity | Automated referral software that powers the referral programs of top enterprise brands yielding 4x higher conversions than traditional marketing. | Application Software |
| ArborMetrix | Provides software, analytics, and consulting services for measuring and improving hospital quality and efficiency. | Healthcare IT |
| Carbon Media Group | Premier online video destination for premium outdoor-themed shows and engaging personalities. | Internet Media |
| Concerto Healthcare | Managed-care organization focused on providing health care to patients who qualify for both Medicare and Medicaid benefits. | Healthcare IT |
| Delphinus Medical Technologies | A medical imaging company that is commercializing an automated, whole-breast ultrasound imaging system for breast cancer detection, risk evaluation, and treatment monitoring. | Life Sciences |
| FutureNet Group | Contracting company that provides construction, environmental, and technology services. | Cleantech |
| IDV Solutions | A business intelligence software company committed to helping organizations gain more insight from data. | Application Software |
| Life Magnetics | Commercialization of magnetic tags which can be used for both separation and detection, allowing more testing to be done on-site at clinics and pharmacies. | Life Sciences |
| Llamasoft | Enables organizations around the world to model and optimize their supply chain operations for major improvements in cost, service, sustainability, and risk mitigation. | Application Software |
| Lynx Network Group | A telecom company that provides wholesale intrastate data services. | Telecom |
| NeoMoDx | Diagnostics company developing a next generation platform for automated molecular diagnostic processing. | Healthcare IT |
| Nutshell | Provider of a Customer Relationship Management (CRM) software platform that makes it easy for small- to medium-sized businesses to manage contacts, collaborate on tasks, and track sales leads. | Application Software |
| Pixel Velocity | Builds imagery and data analytic products to include image processing sensors, video analytics, and event management software and leak detection systems. | Advanced Manufacturing |
| Relume Technologies | Developer and manufacturer of LED lighting solutions. | Advanced Manufacturing |
| Resonant Therapeutics | High-throughput antibody discovery platform for breast and other cancers focused on identifying therapeutics targeted at novel antigens induced by the tumor microenvironment. | Life Sciences |
| Sight Machine | Developer of the world's leading manufacturing analytics platform. Provides real-time production, quality, and supply chain monitoring; retrospective analysis of product variation and failures; predictive analytics to support process improvement; and benchmarking on the contractor, factory, line, and tool levels. | Application Software |
| Skyspecs | Deploys autonomous drones as an aerial workforce to conduct safe, affordable, and automated inspections. | Advanced Manufacturing |
| Strata Oncology | Increase access to tumor sequencing and precision medicine trials and to accelerate approval and availability of cancer treatment medications. | Life Sciences |
| Tangent Medical | Developing and commercializing catheter and related products for intravenous therapy. | Life Sciences |
| UpTo | Designs and develops calendar applications for smartphones that allows a user to sync various calendars of interest to the user. | Application Software |
| Vesteron | A leader in the development and marketing of safe and effective bioinsecticides derived from naturally occurring peptides. | Advanced Manufacturing |
| XanEdu | Market leader in supplying digital course packs to colleges and universities. | Application Software |

Source: The OAG prepared this exhibit based on data obtained from VMF.

VENTURE MICHIGAN FUND (VMF)
VMF Board of Directors
As of September 2017

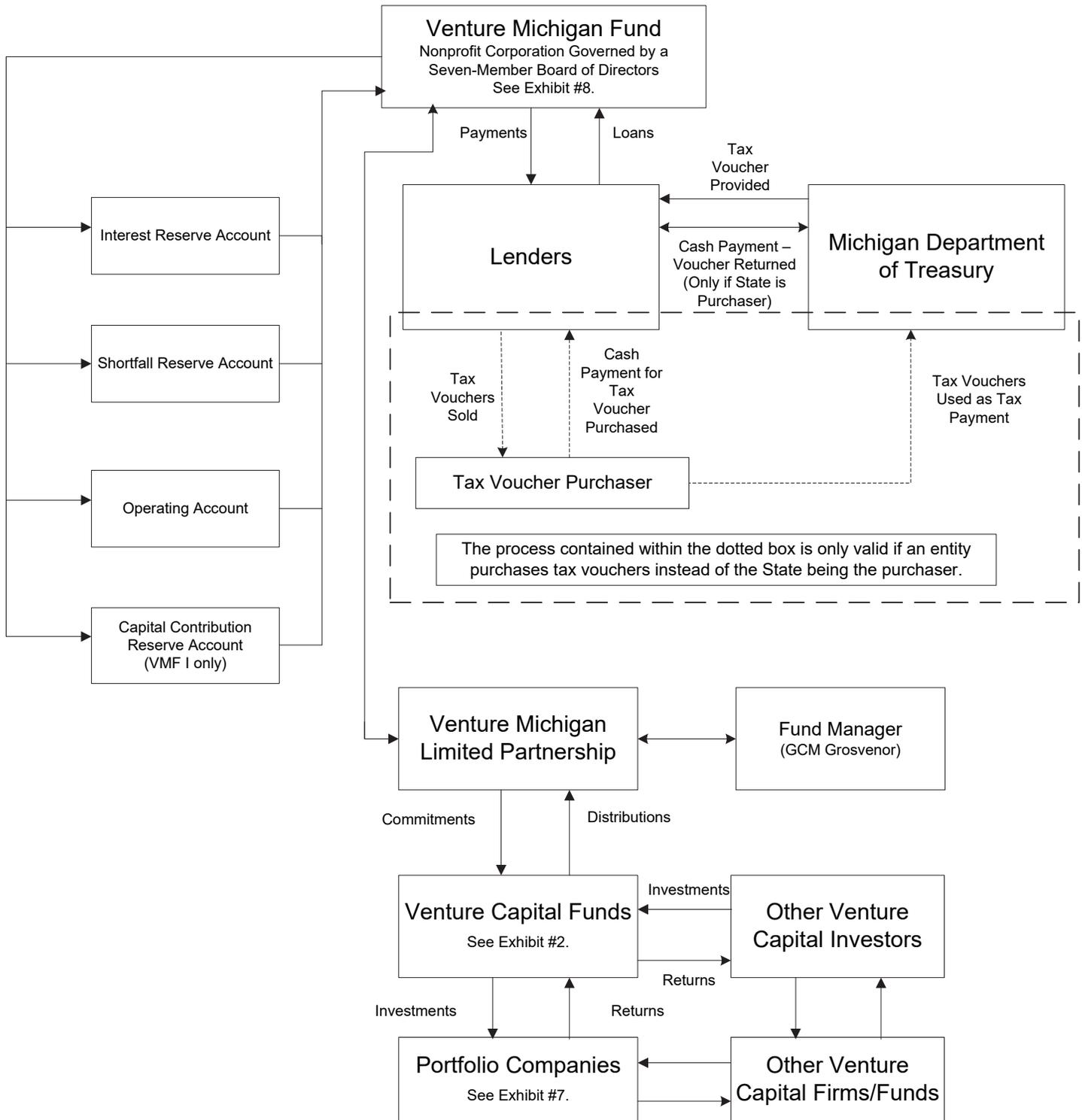
| <u>Director¹</u> | <u>Represents</u> | <u>Term Expires</u> |
|---------------------------------|---|------------------------|
| Thomas C. Kinnear, Chair | Michigan Venture Capital Association | June 2019 |
| Nick A. Khouri, or his designee | State Treasurer | Perpetual ² |
| Jeff Mason, or his designee | Michigan Economic Development Corporation | Perpetual ² |
| Robert Manilla | Senate | June 2018 |
| Scott Idle | House of Representatives | June 2020 |
| Peter T. Cracchiolo | General Public | June 2020 |
| Thomas Nastas | General Public | June 2018 |

¹ Requirements for the Board of Directors are established in Section 13(1) of Public Act 296 of 2003.

² The State Treasurer and the Michigan Economic Development Corporation chief executive officer, or their designees, are permanent members of the VMF Board of Directors.

Source: The OAG prepared this exhibit with information obtained from VMF.

Venture Michigan Fund (VMF)
Flow Chart of VMF Investment Activities
As of September 2016



Source: The OAG prepared this exhibit from information provided by VMF and the Senate Fiscal Agency.

VENTURE MICHIGAN FUND (VMF)
Statement of Net Assets/(Deficit)
As of December 31, 2016

ASSETS

Current Assets:

| | | |
|---------------------------------|----|------------|
| Cash and cash equivalents | \$ | 46,920,426 |
| Due from partnership investment | | 20,811 |
| Total Current Assets | \$ | 46,941,237 |

Noncurrent Assets:

| | | |
|--|----|-------------|
| Partnership investments at fair value | \$ | 214,822,490 |
| Certificates of deposit including accrued interest at fair value | | 16,452,362 |
| Restricted cash and cash equivalents | | 58,898,190 |
| Total Noncurrent Assets | \$ | 290,173,042 |
| Total Assets | \$ | 337,114,279 |

DEFERRED OUTFLOWS

| | | |
|-------------------------|----|------------|
| Interest rate swap | \$ | 27,786,046 |
| Total Deferred Outflows | \$ | 27,786,046 |

LIABILITIES

Current Liabilities:

| | | |
|---------------------------|----|------------|
| Notes payable | \$ | 88,348,562 |
| Accounts payable | | 155,714 |
| Accrued interest | | 4,949,188 |
| Total Current Liabilities | \$ | 93,453,464 |

Noncurrent Liabilities:

| | | |
|---|----|-------------|
| Notes payable - Long-term | \$ | 250,000,000 |
| Interest rate swap contract at fair value | | 27,786,046 |
| Minority interest in partnerships | | 440,620 |
| Total Noncurrent Liabilities | \$ | 278,226,666 |
| Total Liabilities | \$ | 371,680,130 |

NET ASSETS/(DEFICIT)

| | | |
|----------------------------|----|--------------|
| Restricted - Expendable | \$ | 58,898,190 |
| Unrestricted deficit | | (65,677,994) |
| Total Net Assets/(Deficit) | \$ | (6,779,804) |

Source: The OAG prepared this statement based on VMF audited financial statements.

VENTURE MICHIGAN FUND (VMF)
Cumulative Statement of Revenues, Expenses, and Changes in Net Assets/(Deficit)
From VMF Inception Through December 31, 2016

REVENUES/(LOSS)

| | |
|--|-----------------------|
| Dividend income | \$ 2,570,241 |
| Interest income | 277,228 |
| Accretion income (loss) from certificates of deposit | 11,348,658 |
| Accretion income (loss) from zero coupon bonds | 18,372,912 |
| Net change in unrealized depreciation from zero coupon bonds | (5,156,314) |
| Net change in unrealized appreciation (depreciation) from certificates of deposit | 123,918 |
| Net change in unrealized appreciation from zero coupon bonds and certificates of deposit | (231,032) |
| Net realized gain (loss) from investments | 3,632,891 |
| Net change in unrealized appreciation from investments | 81,564,252 |
| Net change in unrealized depreciation from investments | (1,035,051) |
| Net realized gain (loss) from sale of zero coupon bonds | 1,945,113 |
| Net realized gain (loss) from sale of certificates of deposit | 102,569 |
| Net Revenues/(Loss) | <u>\$ 113,515,385</u> |

EXPENSES

| | |
|--|-----------------------|
| Amortization of debt issuance costs | \$ 12,549,991 |
| Interest expense on long-term notes | 176,031,503 |
| Insurance expenses | 307,577 |
| Management fees | 20,219,532 |
| Commitment commission on long-term notes | 7,454,132 |
| Professional fees and other expenses | 3,551,442 |
| Total Expenses | <u>\$ 220,114,177</u> |

CAPITAL CONTRIBUTIONS

| | |
|------------------------------------|-----------------------|
| Proceeds from sale of tax vouchers | \$ 100,000,000 |
| Total Capital Contributions | <u>\$ 100,000,000</u> |

| | |
|---|-----------------------|
| Decrease in net assets/(deficit) before minority interest | \$ (6,598,792) |
| Minority interest | (165,169) |
| Decrease in net assets/(deficit) | <u>\$ (6,763,961)</u> |
| Net assets/(deficit), October 1, 2004 | <u>(15,843)</u> |
| Net Assets/(Deficit), December 31, 2016 | <u>\$ (6,779,804)</u> |

Source: The OAG prepared this statement based on VMF audited financial statements.

VENTURE MICHIGAN FUND (VMF)
Cumulative Sources and Uses of Cash
From VMF Inception Through December 31, 2016

| | |
|--|-----------------------------|
| Beginning Balance: Cash and Cash Equivalents | \$ 0 |
| SOURCES OF CASH | |
| Dividend income received | \$ 2,570,241 |
| Interest income received | 240,740 |
| Borrowings | 450,132,001 |
| Distribution from partnership investments | 41,250,018 |
| Distributions from minority interest in partnerships | 358,446 |
| Sale or redemption of certificate of deposits or zero coupon bonds | 81,807,165 |
| Sale of tax vouchers | 100,000,000 |
| Total Sources of Cash | <u>\$ 676,358,611</u> |
| USES OF CASH | |
| Operating expenses (including interest expense) | \$ (203,099,764) |
| Payment of debt issuance costs | (12,549,992) |
| Investments in certificates of deposit and zero coupon bonds | (71,753,703) |
| Investment in partnerships | (171,189,070) |
| Repayment of debt | (111,783,438) |
| Distributions to minority interest in partnerships | (82,996) |
| Total Uses of Cash | <u>\$ (570,458,963)</u> |
| Net increase (decrease) in cash | \$ 105,899,648 |
| Cash restricted for repayment of long-term debt and related interest | <u>58,979,221</u> |
| Net increase (decrease) in cash and cash equivalents | <u>\$ 46,920,427</u> |
| Ending Balance: Cash and Cash Equivalents | <u><u>\$ 46,920,427</u></u> |

Source: The OAG prepared this statement based on VMF audited financial statements.

DESCRIPTION

Section 125.2232 of the *Michigan Compiled Laws* establishes VMF's goal to promote Michigan's economic health by assisting in the creation of new jobs, new businesses, and new industries within Michigan by investing in certain businesses that focus on areas including, but not limited to, alternative energy technology, high-technology, and health care.

VMF is governed by a seven-member Board of Directors. The State Treasurer and the chief executive officer of the Michigan Economic Development Corporation, or their respective designees, have permanent seats on the Board. The other 5 members are appointed by the Governor, with the advice and consent of the Senate, as follows:

- 1 individual from a list of not fewer than three recommended by the Speaker of the House of Representatives.
- 1 individual from a list of not fewer than three recommended by the Majority Leader of the Senate.
- 1 individual recommended by the Michigan Venture Capital Association.
- 2 people representing the general public with the requisite knowledge and experience in finance and business investment.

The Early Stage Act allows VMF to contract with a fund manager to facilitate implementation of the Act. The Board of Directors contracted with one fund manager to manage both VMF I and VMF II.

As of December 31, 2016, VMF received \$41.3 million in cumulative investment returns.

AUDIT SCOPE, METHODOLOGY, AND OTHER INFORMATION

AUDIT SCOPE

To examine the activities and records related to VMF. We conducted this performance audit* in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

PERIOD

Our audit procedures, which included a preliminary survey, audit fieldwork, report preparation, and quality assurance, generally covered October 1, 2013 through June 30, 2017.

METHODOLOGY

We conducted a preliminary survey to gain an understanding of VMF's operations and activities in order to establish our audit objectives and scope. During our preliminary survey, we:

- Reviewed applicable State laws and loan agreements.
- Reviewed VMF's bylaws and Articles of Incorporation.
- Reviewed VMF Board of Directors' meeting minutes.
- Reviewed other states' venture capital programs.
- Reviewed VMF's annual report.
- Reviewed VMF's investment plan.

OBJECTIVE #1

To assess VMF's compliance with select legislative and contract requirements.

To accomplish this objective, we:

- Determined if the amounts invested in venture capital firms and portfolio companies were within the legislatively imposed investment limits.
- Determined if the venture capital firms met requirements for investment from VMF.
- Reviewed requirements for the fund manager.
- Determined if the portfolio companies had a Michigan presence.

* See glossary at end of report for definition.

- Verified that the Articles of Incorporation contained legislatively required elements.
- Reviewed VMF stakeholders for potential conflicts of interest.
- Reviewed VMF's required annual report for reasonableness.
- Reviewed Board activities to ensure that administrative requirements were being met.

OBJECTIVE #2

To report other information related to VMF activities.

To accomplish this objective, we:

- Reviewed VMF's annual report.
- Reviewed VMF Board of Directors' meeting minutes.
- Compiled information provided by the fund manager.

CONCLUSIONS

We base our conclusions on our audit efforts and any resulting material conditions* or reportable conditions*.

When selecting activities or programs for audit, we direct our efforts based on risk and opportunities to improve State government operations. Consequently, we prepare our performance audit reports on an exception basis.

AGENCY RESPONSES

Not applicable.

SUPPLEMENTAL INFORMATION

Our audit report includes supplemental information presented as Exhibits #1 through #12. Our audit was not directed toward expressing a conclusion on this information.

* See glossary at end of report for definition.

GLOSSARY OF ABBREVIATIONS AND TERMS

| | |
|------------------------------|---|
| IT | information technology. |
| material condition | A matter that, in the auditor's judgment, is more severe than a reportable condition and could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program. |
| net asset value (NAV) | An investment company's total assets minus its total liabilities. |
| OAG | Office of the Auditor General. |
| observation | A commentary that highlights certain details or events that may be of interest to users of the report. An observation may not include the attributes (condition, effect, criteria, cause, and recommendation) that are presented in an audit finding. |
| performance audit | An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision-making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability. |
| qualified business | A seed or early stage business that is domiciled in the State, that has its corporate headquarters in the State, or the majority of whose employees work a majority of their time at a site located in the State. |
| reportable condition | A matter that, in the auditor's judgment, is less severe than a material condition and falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the audit objectives; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred. |
| VMF | Venture Michigan Fund. |



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