STATE OF MICHIGAN

JOHN ENGLER, Governor

STATE BUDGET OFFICE

P.O. BOX 30026, LANSING, MICHIGAN 48909
MARY A. LANNOYE, State Budget Director

February 15, 2000

The Honorable John Engler, Governor
Members of the Legislature
People of the State of Michigan

As required by Article 9, Section 21, of the State Constitution and Section 494, Public Act 431 of 1984, as amended, we are pleased to submit the *State of Michigan Comprehensive Annual Financial Report* (SOMCAFR) for the fiscal year ended September 30, 1999.

INTRODUCTION TO THE REPORT

Responsibility: The Department of Management and Budget, Office of Financial Management, prepares the SOMCAFR and is responsible for both the accuracy of the data and the completeness and fairness of the presentation, including disclosures. To the best of our knowledge and belief, the information contained in the SOMCAFR is accurate in all material respects and reported in a manner which fairly presents the financial position and results of operations of the State primary government and component units for which it is financially accountable. All disclosures necessary to enable the reader to gain a reasonable understanding of the State's financial affairs have been included.

Adherence to Generally Accepted Accounting Principles: As required by State statute, the financial statements contained in the SOMCAFR have been prepared in accordance with generally accepted accounting principles (GAAP) applicable to state and local governments, as promulgated by the Governmental Accounting Standards Board (GASB). The State also voluntarily follows the recommendations of the Government Finance Officers Association of the United States and Canada (GFOA) for the contents of government financial reports, and participates in the GFOA's review program for the Certificate of Achievement for Excellence in Financial Reporting.

Method of Presentation: The term "Comprehensive Annual Financial Report" (CAFR) collectively refers to all of the financial information and data presented in this report. The SOMCAFR is divided into three major sections: introductory, financial, and statistical. The introductory section includes this letter, the State's organization chart, and the list of principal officials. The financial section includes: the "General Purpose Financial Statements," which present combined financial information in eight principal financial statements for the State primary government and its blended and discretely presented component units, together with footnotes to the General Purpose Financial Statements; the independent auditor's report on the General Purpose Financial Statements; and the supplemental financial data section, which includes the combining financial statements and schedules. The statistical section includes such items as trend information, information on debt levels, and other selected economic and statistical data.

Reporting Entity: The State of Michigan reporting entity reflected in the SOMCAFR, which is described more fully in Note 1 to the financial statements, conforms with the requirements of GASB Statement No. 14, The Financial Reporting Entity. The accounting and reporting principles contained in Statement No. 14 are based primarily on the fundamental concept that publicly elected officials are accountable to their constituents. Further, Statement No. 14 provides that the financial statements should emphasize the *primary government* and permit financial statement users to distinguish between the primary government and its *component units.*

The SOMCAFR includes all the funds and account groups of the State primary government, which includes the Executive Branch departments and agencies, the Legislature, and the State portion of the court system. Also included are "blended" component units, which are, in substance, part of the primary government; the State primary government includes two such blended component units, the State Building Authority and the Michigan Underground Storage Tank Financial Assurance Finance Authority. The SOMCAFR also includes financial information for certain legally separate governmental organizations for which the State is *financially accountable*. Financial accountability may exist if the primary government has the legal authority to appoint a voting majority of the separate organization's governing board. These types of component units are presented "discretely" (i.e., separate and distinct from the primary government) in the SOMCAFR and include: the Mackinac Bridge Authority, Michigan Higher Education Facilities Authority, Michigan State Hospital Finance Authority, Michigan Education Trust, Michigan Higher Education Student Loan Authority, Michigan Higher Education Assistance Authority, Mackinac Island State Park Commission, Michigan Strategic Fund, Michigan Economic Development Corporation, Michigan State Housing Development Authority, Michigan Municipal

Bond Authority, and the State Bar of Michigan. This group of discretely presented component units is further subdivided between *governmental* and *proprietary* types, depending on the primary characteristics of their operations. In addition, pursuant to GASB Statement No. 14, the SOMCAFR includes financial statements for the State's ten public universities, which have governing boards that are appointed by the Governor. They include: Central Michigan University, Eastern Michigan University, Ferris State University, Grand Valley State University, Lake Superior State University, Michigan Technological University, Northern Michigan University, Oakland University, Saginaw Valley State University, and Western Michigan University.

Organizations which receive substantial financing from the State, but which do not meet the GAAP criteria for inclusion in the State's reporting entity, include: public universities which have governing boards that are elected at statewide public elections (Michigan State University, the University of Michigan, and Wayne State University); community colleges, which in Michigan are considered to be a part of general or special purpose local units of government; and the portions of the court system which are considered to be local units of government.

ECONOMIC CONDITION AND OUTLOOK

If the current recovery continues through February 2000, it will mark the longest economic expansion in U.S. history. The U.S. economy continued to grow above long-term historic rates marking the fourth consecutive year in which real gross domestic product grew faster than 3.5%. In 2000, the U.S. economy and consumer confidence remain strong. The gross domestic product is expected to increase at the rate of 3.5% in 2000 and 3.2% in 2001. Car and light truck sales rose to a projected record of 16.7 million units in 1999, eclipsing the prior record set in 1986.

Michigan's December 1999 unemployment rate helped ensure that 1999 was the year with the lowest annual jobless rate since 1970. The unemployment rate was 3.7%, which represents a .2% decrease from 1998. It was the eighth straight year that the jobless rate has been cut, and marked the eighth straight month that the jobless rate was below 4%. This was also the 54th straight month that Michigan's unemployment rate was below the national average. The Michigan economy will continue to benefit from anticipated moderate growth in employment of 65,000 jobs in 2000 and an additional 53,000 jobs in 2001. The inflation rate, as measured by the Detroit Consumer Price Index, is projected to be 3.0% in calendar year 2000 and 3.2% in calendar year 2001.

As a result of continued growth in the State's economy, the Administration projects that Michigan personal income will grow 4.8% in 2000 and 4.6% in 2001.

MAJOR INITIATIVES AND FUTURE PROJECTS

Education Remains a Top Priority: The Administration continues its strong support for financing K-12 education and reducing the equity gap in per pupil funding. In fiscal year 2000, for the third consecutive year, the state will spend more on K-12 education than is spent for all other expenditures financed from the General Fund general purpose revenues. Total state and local funding for schools is projected to exceed $12.5 billion in fiscal year 2000 and climb to $13.2 billion in fiscal year 2001.

One of the most important features of the school finance reform passed by the voters in March 1994 was the commitment to reduce inequities in per pupil spending. Prior to passage of this referendum, only 52 of Michigan's 555 school districts were spending more than $6,500 per pupil. By fiscal year 2003, no district will receive foundation allowances of less than $6,500 in per pupil funding. The Administration continues to place great emphasis on academic achievement by setting high expectations and rewarding excellence. The Golden Apple Award is a new academic competition that rewards local elementary school personnel for student achievement on the Michigan Education Assessment Program.

Census 2000: The Administration has committed resources to ensure the 2000 Census results in a complete count of Michigan's citizens, because the census serves as the information cornerstone for the next decade. The census is important because it impacts federal funding; allocations to schools and local units of governments; and decisions regarding health care, job training, transportation, and businesses. A poor census count could cost Michigan a seat in Congress for the next decade.

Transportation Infrastructure Investments: The *Build Michigan II* investment plan is delivering on the commitment to make the transportation infrastructure second to none. The Michigan Department of Transportation (MDOT) has developed strategies for more effectively targeting road and bridge repairs to system needs. These strategies include: a five-year plan of road and bridge construction projects; employing a mix that provides for a balanced program of reconstruction, resurfacing, and capital preventive maintenance; instituting a corridor approach that minimizes motorist inconvenience by coordinating construction activity on large-scale projects to the same construction season; and creating a more competitive bid process by having 90% of the State's construction program out for bid in the first six months of the fiscal year. MDOT's fiscal year 2000 road and bridge program will invest nearly $1.37 billion to repair 1,400 miles of road and rehabilitate 230 bridges. Maintenance program support has increased by 20%, with nearly $300 million invested annually to extend the pavement life and structural integrity of existing roads and bridges.

Welfare Reform: Michigan continues its aggressive actions to reform welfare and make families independent from public assistance. From September 1992 to October 1999, the Family Independence Program (FIP, formerly AFDC) caseload has declined by 63%, compared to a national average decrease of nearly 40%. In December 1999, only 76,113 Michigan families collected FIP benefits.

One of Michigan's welfare reform initiatives, Project Zero, is aimed at encouraging and supporting employment. The goal is to reduce to zero the number of FIP families without earned income. In September 1999, 63% of target cases in Project Zero sites had earnings, compared to 54% statewide. Community participation and support are key elements in the Project Zero formula. Community organizations provide childcare, transportation, family support and counseling services to Project Zero customers.

Economic Redevelopment: For the fifth year, the Environment Cleanup and Redevelopment Program continues. With passage of the Clean Michigan Bond Initiative, $335 million has been targeted to prepare sites for economic redevelopment. Re-use of "brownfield" sites, properties where perceived or actual environmental contamination is a barrier to redevelopment, allows sites to be used for new development. A survey of 33 Michigan communities shows that cleanup activities have increased financial investment and created jobs.

Financial Management System Improvements: As 2000 begins, the Department of Management and Budget (DMB) is continuing its joint efforts with all state departments to upgrade and improve its financial management systems.

The State is moving aggressively into the world of E-Commerce. Three projects are underway to further improve the State's processes for conducting business. The State currently pays its vendors with about 11 million paper checks each year. The Electronic Funds Transfer (EFT) Project will expand the use of EFTs as the preferred method of vendor payment, significantly reducing the number of paper checks issued when implemented. Second, e-Invoice is a pilot project involving Consumers Energy and the Department of State Police to automate the receipt of invoices from vendors. When this pilot is completed in May 2000, the State plans to expand the project to include other vendors and departments. Third, e-Michigan is a comprehensive, long-term project to develop a seamless interface for the global marketplace to access all applications of Michigan state government. This project, now in the planning phases, will involve all agencies of government working together to ensure the public can use the internet to more easily conduct business with and to get information about Michigan and its government.

The Department of Civil Service, the Department of Management and Budget, and the Office of the State Employer are leading an effort, involving all State agencies, to replace the State's existing human resources systems with a fully integrated system for all three branches of government. The mission of the Human Resources Management Network (HRMN) Project is to implement a comprehensive, state-of-the-art human resources system that meets evolving user needs in an efficient, timely, and cost effective manner. Implementation is expected by August 2000.

The State succeeded in its Year 2000 efforts. Through the efforts of countless individuals, State government and the citizens of Michigan experienced a very smooth and uneventful transition to the new century. Clearly, the Year 2000 Project has exceeded all expectations. Not only was the Year 2000 problem solved, but also the project's efforts and expenditures have been leveraged to gain long-term benefits in preparing Michigan's technology infrastructure for the future. Inefficient systems and equipment have been replaced; new skills in managing a large, complex project have been learned; and new levels of cooperation among key stakeholders have opened the doors to future joint endeavors.

DMB also continues to lead a statewide effort to reduce the time and cost of the annual bookclosing process that produces the SOMCAFR. As recently as three years ago, Michigan was 33rd in the nation in the time required to publish the SOMCAFR. As of September 30, 1998, Michigan ranked 13th and expects to rank in the top 10 with the close of the 1998-99 fiscal year. DMB attributes this improvement to further enhancements to the Michigan Administrative Information Network (MAIN); outstanding support from MAIN's management and staff, department accounting, budget, and finance offices; and streamlining of the audit conducted by the Office of the Auditor General.

During fiscal year 1999-2000, DMB will continue its progression toward issuing the financial statements in accordance with GASB Statement No. 34. This GASB statement is considered the most significant change ever in governmental reporting. It requires the State to produce statements which show all activity in one statement, explain budget activity more clearly, show infrastructure and debt, and move closer to private sector reporting.

In addition, DMB recently implemented a new computer audit environment that will allow users across State government to remotely connect and perform audit and analysis procedures. The purpose of the Audit and Analysis Computer Environment (AACE) is to provide the Office of Financial Management and internal auditors with a means to enhance their auditing, monitoring, and other reporting processes. This software support will improve internal controls over the financial and programmatic activities of State government.

FINANCIAL INFORMATION

Internal Control Structure: The Department of Management and Budget is responsible for the overall operation of the State's central accounting system, and for establishing and maintaining the State's internal control structure. All financial transactions of the State primary government are recorded in the central accounting system, except for the Michigan Unemployment Compensation Fund, the State Employees' Deferred Compensation Funds, and the State Employees' Defined Contribution Retirement Fund. Many of the essential control features are decentralized, such as the preparation and entry of expenditure transactions into the central accounting system. Consequently, the Department of Management and Budget relies upon the controls in place at the various State departments and agencies. The Management and Budget Act (Section 18.1483 – 18.1489 of the *Michigan Compiled Laws*) requires that the head of each principal department shall establish and maintain an internal accounting and administrative control system. The Act also requires that the heads of each principal department shall report biennially on any material inadequacy or weakness discovered in connection with the evaluation of their system. DMB's Office of Financial Management recently issued *"Evaluation of Internal Controls – A General Framework and System of Reporting"*. It is a comprehensive revision to the guidance that was last issued in 1990. This document, developed in consultation with the Office of the Auditor General, provides the required guidance associated with the evaluation of internal controls in Michigan State government.

The Management and Budget Act requires each principal department to appoint an internal auditor and maintain adequate internal control systems. Each department is also required to periodically report to the Governor on the adequacy of its internal accounting and administrative control systems and, if any material weaknesses exist, to provide corrective action plans and time schedules for addressing such weaknesses. This reporting is required on or before March 1 of each odd numbered year, effective as of the preceding October 1.

The "discretely" presented component units generally operate outside the State's central accounting system and are responsible for establishing and maintaining their own separate internal control structures.

Budgetary Reporting and Control: For the State primary government operating funds (i.e., the General Fund and annually appropriated special revenue funds), Public Act 431 of 1984, as amended, requires the State to adhere to GAAP in budgeting projected revenues and expenditures and calculating fund balance for budgetary purposes. The Act also prohibits the State from budgeting for an ending fund balance deficit in an operating fund. If an actual deficit is incurred, the Constitution and Act 431 require that it be addressed in the subsequent year's budget. If accounting principles change, Act 431 requires the State to also implement such changes in its budgetary process.

The budgetary "basis of accounting" used by the State primary government departs from GAAP only in ways that do not affect unreserved fund balance, and that do not impact most revenue and expenditure line items. Appropriations for nearly all line items, therefore, are made on a basis consistent with GAAP, which makes it possible for the State to use the central accounting system for both budgetary control and financial reporting purposes. The two variances between GAAP and the budgetary basis of accounting are: (1) the use of encumbrances for budgetary control purposes (which GAAP does not require), and (2) the timing of recording expenditures and liabilities for capital lease commitments on a "pay as you go" basis for budgetary purposes, rather than at lease inception as required by GAAP. Compliance with the final updated budget for the annually budgeted operating funds of the State primary government is demonstrated in the budget to actual comparative statements, notes, and related supplementary schedules in the SOMCAFR.

Revenue and Spending Limitation Requirements: Under the State Constitution, total State revenues are limited to a percentage of total Michigan personal income. If the limit is exceeded by an amount less than 1%, the excess may be transferred to the Budget Stabilization Fund. If revenues exceed the limit by 1% or more, the amount in excess must be refunded to payers of personal income and single business taxes. The calculations necessary to determine the State's compliance with this requirement for fiscal year 1998-99 are not considered final. The State estimates that total State revenues subject to the limitation will exceed the limit of $23.2 billion by $21.7 million for fiscal year 1998-99. This excess was included in the final transfer to the State's Budget Stabilization Fund.

The State Constitution also requires that spending to local units of government be maintained at not less than a specified level of total State spending, originally determined to be 41.61% for the base fiscal year 1978-79. The originally determined percentage was recalculated effective with fiscal year 1992-93 reflecting the terms of a legal settlement agreement. The recalculated base year percentage is 48.97%. The calculations necessary to determine the State's compliance with this requirement for fiscal year 1998-99 are not yet final; however, based upon preliminary calculations, the State has substantially exceeded the minimum required spending to local units of government for fiscal year 1998-99.

The State's status, with regard to these Constitutional provisions, is discussed more fully in Note 3 to the financial statements.

FINANCIAL HIGHLIGHTS - PRIMARY GOVERNMENT

General Governmental Functions: For the purposes of the following two tables and related discussions in this letter, the "General Governmental Functions" are considered to be the activities of the General Fund and the special revenue funds of the State primary government. These are the State funds that are used to account for the activities most traditionally thought of as being a normal part of State government operations.

The two tables report only direct revenues and expenditures and, therefore, do not include "other financing sources and uses."

Revenues (in millions):

Revenue Source	1998-99 Amount	Percent of Total	Change From 1997-98	Percentage Change
Personal Income Tax	$ 7,394.0	23.1%	$ 600.9	8.8%
Sales Tax	5,901.7	18.4	284.4	5.1
Single Business Tax	2,360.5	7.4	11.4	0.5
State Education (Property) Tax	1,273.5	4.0	16.6	1.3
Other Taxes	5,029.2	15.7	419.6	9.1
Federal Revenues	7,902.7	24.7	223.2	2.9
Special Medicaid Reimbursements	690.8	2.2	105.6	18.0
Other Revenues	1,450.2	4.5	99.7	7.4
Total	$ 32,002.6	100.0%	$ 1,761.5	5.8%

The table above does not include other financing sources, the most significant of which are: State Lottery Fund profits of $621.1 million and Budget Stabilization Fund appropriations of $73.7 million transferred to the School Aid Fund; and Liquor Purchase

Revolving Fund profits of $105.3 million transferred to the General Fund. In addition, transfers of $244.4 million were made from the General Fund to the Budget Stabilization Fund. This amount represents unreserved fund balance of $55.2 million remaining after the close of fiscal year 1997-98 and the transfer of fiscal year 1998-99 unreserved fund balance of $189.2 million.

The State's personal income tax will experience a gradually reduced rate in the coming years, and the single business tax will experience a slow-paced phase-out. Beginning January 1,1999, the single business tax rate will be reduced by .1% each January 1 if the Budget Stabilization Fund has a fund balance greater than $250 million. Beginning January 1, 2000, the personal income tax will also be reduced by .1% per year until the rate reaches 3.9%. There were no significant structural changes in the State's sales taxes during fiscal year 1998-99. The increases in tax revenues over the prior year primarily reflect growth in the underlying activity from the State's continuing strong economy.

Other taxes include use taxes, $1.3 billion; motor vehicle and fuel taxes, $1.8 billion; liquor and tobacco taxes, $740 million; and miscellaneous sources, $1.2 billion.

Federal revenues include financial assistance received from the U.S. Department of Health and Human Services, which provides a significant portion of the financing for health and welfare programs; such financial assistance amounted to approximately $5.2 billion and approximately 65% of total federal revenues for fiscal year 1998-99.

Revenue from special Medicaid reimbursements represents funding received by the State from other units of government and other public entities to help finance the Medicaid program.

Other revenues include local, $183.8 million; services, $113.4 million; licenses and permits, $383.8 million; investment income, $135.5 million; child support recoveries, $54.3 million; and other miscellaneous sources, $579.4 million. The increase in other revenues is a result of $107.5 million collected from the tobacco settlement.

Expenditures (in millions):

Current, Capital Outlay, and Intergovernmental Expenditures by Function	1998-99 Amount	Percent of Total	Change From 1997-98	Percentage Change
Current:				
General government	$ 1,072.7	3.5%	$69.6	6.9%
Education	11,827.2	38.0	365.1	3.2
Family independence services	3,229.4	10.4	(33.2)	(1.0)
Public safety & corrections	1,908.9	6.1	188.8	11.0
Conservation, environment, recreation, & agriculture	482.9	1.6	36.5	8.2
Labor, commerce & regulatory	720.1	2.3	(43.4)	(5.7)
Health services	7,100.8	22.8	319.2	4.7
Transportation	1,645.1	5.3	89.0	5.7
Tax expenditures	486.1	1.6	9.1	1.9
Capital outlay (including highways)	1,144.6	3.7	246.1	27.4
Intergovernmental – revenue sharing	1,410.4	4.5	29.4	2.1
Debt service - capital lease payments	59.3	0.2	0.4	0.7
Total Current, Capital Outlay, and Intergovernmental Expenditures	$ 31,087.5	100.0%	$1,276.6	4.3%

Under Executive Order No. 1999-1, effective April 5, 1999, a principal department, Michigan Jobs Commission, was abolished. The authority, duties, and responsibilities of the Michigan Jobs Commission was split between a newly created principal department, Career Development, and the Michigan Strategic Fund (MSF), an autonomous type I agency within the Department of Management and Budget. As a result, the portion transferred to MSF is now reported as component unit activity, rather than as part of the General Fund.

The table above does not include $569.0 million in distributions to the 10 State universities, which are considered discretely presented component units of the State. These transactions are reported as operating transfers in the SOMCAFR.

General government expenditures include operations of the Legislature, the Judiciary, and Executive Branch functions within the Departments of Management and Budget, Attorney General, Civil Rights, Civil Service, State, and Treasury. The change in general government expenditures resulted primarily from the decrease in interfund borrowing costs of $22.9 million and an increase in out-of-period tax refunds of $117.3 million.

Education expenditures continue to increase as support for public education continues. Total funding for education increased $247 million from the prior year, including foundation allowance increases of $68.7 million and Durant–related settlement payments of $73.0 million.

Family independence service expenditures, and associated federal revenues, decreased primarily from a reduction in the food stamp caseload.

The increase in corrections spending resulted from the construction of a new prison in Ionia and increased expenditures for the Youth Correctional Facility in Baldwin. Growth in Michigan's prison population has slowed. In contrast to the 1980's, with population growth of 125%, population growth in the 1990's was less than 50%. Serious crime is down by 1%, declining for the seventh consecutive year.

Health service expenditures increased as a result of increases in long-term health care cost and mental health services.

Tax expenditures represent refundable income tax credit programs including the homestead property tax credit and the senior citizen property tax credit, which accounted for $440.9 million of the total tax expenditures of $486.1 million.

The largest component of capital outlay expenditures is related to State Trunkline highway expenditures, which amounted to $1.02 billion, an increase of approximately $201.1 million compared to the prior year. This increase resulted from a significant program to improve Michigan's roads and bridges.

General Fund Highlights: A major objective of the Administration has been to improve financial management by eliminating the chronic overspending and overestimation of revenues that had occurred in the 1980s. This year's results reflect the success of this approach; no department had net budgetary overexpenditures for fiscal year 1998-99.

General Fund revenues and other financing sources (including restricted sources, operating transfers in, and capital lease acquisitions) totaled approximately $20.3 billion for the fiscal year. Expenditures and other financing uses totaled approximately $20.1 billion. Fund balance reserves for budgetary carry-forwards, noncurrent assets and revolving loans (discussed more fully in Note 24) increased approximately $365.7 million from $1.2 billion to $1.6 billion. The unreserved fund balance of the General Fund was zero at fiscal year-end, after reflecting a legally required transfer of any ending balance at year-end to the Budget Stabilization Fund.

Proprietary Fund Operations: The State accounts for the wholesale distribution of alcoholic beverages through the Liquor Purchase Revolving Fund. Statutory net income, $105.3 million, and funding for administrative costs, $7.6 million, were transferred to the General Fund during fiscal year 1998-99.

State Lottery Fund operating revenues increased $73.8 million to $1.8 billion. Net income from lottery operations (after prizes and other costs) transferred to the School Aid Fund increased $5.0 million to $621.1 million.

The State Sponsored Group Insurance Fund accounts for the State's risk retention for employee benefit programs. The fund had a net loss of $33.1 million during the year and ended the year with total assets of $191.8 million, liabilities of $183.2 million, and retained earnings of $8.6 million. The State, under a management plan to reduce the retained earnings of this fund, anticipated this loss.

Pension Plans: The State Constitution requires the State to provide current funding of plan benefits for the State's defined benefit pension plans. Statutes provide for the amortization of unfunded prior service costs. In two of the four plans for which the State is responsible for providing funding, the enabling statutes for the plans contain provisions under which a shortfall in the legally required contributions will be corrected in succeeding fiscal years.

The State Employees' Retirement System (SERS) is the largest of the defined benefit plans for which the State is responsible for providing funding. Total assets of SERS at September 30, 1999 were $10.6 billion, with net assets held in trust for pension and postemployment health-care benefits totaling $10.3 billion. Additional disclosures relating to the State's pension funds are provided in Note 11 to the financial statements.

Debt Management: There were no new general obligation bonds issues in fiscal year 1998-99. In 1999, the State's general obligations are rated Aa1 by Moody's, and AA+ by both Fitch IBCA and Standard & Poors.

Revenue dedicated bonded debt, including that of the State Building Authority, decreased by $100 million to $3.0 billion during 1998-99.

Additional disclosures about the State's general long-term obligations are provided in Note 14 to the financial statements.

Cash Management: As discussed more fully in Note 5 to the financial statements, the State Treasurer maintains the State's common cash pool, which is used by most State funds for short-term investment and to provide centralized control over disbursements. The total amount of pooled cash, which is primarily invested in prime commercial paper, amounted to $4.2 billion at September 30, 1999, an increase of approximately $974 million from $3.2 billion at September 30, 1998.

The State Constitution provides that the Legislature may authorize the issuance of short-term general obligation notes to assist in managing cash flows. Such borrowings are limited by the Constitution to 15% of undedicated State revenue. The Constitution also requires that such borrowings be repaid before year-end. No such borrowings occurred during the fiscal year.

HIGHLIGHTS - COMPONENT UNIT OPERATIONS

Except for the State Building Authority and the Michigan Underground Storage Tank Financial Assurance Finance Authority, which are "blended" directly with the fund types of the State primary government (refer also to the section describing the State reporting entity), all of the component units are presented discretely in the SOMCAFR. Condensed financial statements for all of the discretely presented component units, with total assets amounting to $10.9 billion, are presented in Note 26.

Selected highlights for certain State proprietary type component units follow:

The largest such component unit is the Michigan State Housing Development Authority, which provides financing for various types of housing programs. The authority had total assets of $2.8 billion and bonds payable of $2.0 billion outstanding as of June 30, 1999.

The Michigan Education Trust (MET) was established to provide a means for parents and other individuals to finance future tuition costs at State public colleges and universities. As of September 30, 1999, MET had total assets, valued at market, of $777.5 million. Additional information about MET's financial operations, including the actuarial assumptions used in valuing the obligation for future tuition costs, is included in Note 18.

The Michigan Municipal Bond Authority (MMBA) was created to permit local units of government the opportunity to pool their bond sales used to finance local projects. In addition, MMBA operates the State Water Pollution Control Fund which is used to account for a program created to provide local governments financing for local water pollution control projects. MMBA had total assets of $3.2 billion and bonds and notes payable of $2.3 billion outstanding as of September 30, 1999.

OTHER INFORMATION

Risk Management: Risk management was established within the Department of Management and Budget in 1987 to improve the State's risk control policies and procedures. The unit's activities include analysis of and control over insurance coverage and risk exposure, and planning and implementing a statewide safety and health policy and program. The State is self-insured for many types of general liability and property losses. Additional disclosures on the State's risk management activities are provided in Note 27.

Audits: The principal auditor of the State's reporting entity is the legislative Office of the Auditor General (OAG). The OAG's audit of the SOMCAFR was conducted in accordance with generally accepted auditing standards (GAAS), and their independent auditor's report precedes the General Purpose Financial Statements. In addition to the annual audit of the State's SOMCAFR, the Office of the Auditor General also performs periodic financial and performance audits of the various State departments, agencies, and institutions of higher education. The OAG engages outside public accounting firms periodically, particularly for the audits of separately issued component unit financial statements (such as the Michigan State Housing Development Authority), the larger pension funds, and the Michigan Unemployment Compensation Fund. The Auditor General also has primary responsibility for conducting audits under the federal Single Audit Act of 1984. Pursuant to Michigan Public Act 251 of 1986, these audits are conducted biennially for applicable State departments, agencies, and component unit authorities, and result in separately issued audit reports.

Certificate of Achievement: The GFOA awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Michigan for its SOMCAFR for the year ended September 30, 1998. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of state and local government financial reports.

To be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The State has received a Certificate of Achievement for the last twelve consecutive years. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA for review.

Acknowledgments: In any year, the preparation of this report requires the collective efforts of literally hundreds of finance personnel throughout the State, both individually and in teams from virtually all State agencies. We sincerely appreciate the dedicated efforts of all of these individuals. This year, we are particularly pleased to have continued to reduce the amount of time and resources required to complete the SOMCAFR. Achieving this outcome is the result of the dedicated management and staff of the Financial Control Division, Office of Financial Management; the chief financial officers, chief accountants, and their staffs; and the management and staff of the Office of the Auditor General; who continue to strive for improvements that will result in Michigan being a national leader in quality and efficiency for financial reporting.

Sincerely,

Mary A. Lannoye

Mary A. Lannoye
State Budget Director

Leon E Hank

Leon E. Hank, CPA
Director, Office of Financial Management