# Index
## Notes to the Financial Statements

# NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the State conform in all material respects to generally accepted accounting principles (GAAP) as applicable to governments. The Governmental Accounting Standards Board (GASB) is the standard setting body for establishing governmental accounting and financial reporting principles, which are primarily set forth in the GASB's Codification of Governmental Accounting and Financial Reporting Standards (GASB Codification). Following is a summary of the significant policies:

## A. Reporting Entity

Michigan was admitted to the Union as the twenty-sixth state in 1837. The State of Michigan is governed under the Constitution of 1963, as amended. The legislative power is vested in a 38-member senate and a 110-member house of representatives; executive power is vested in a governor; and the judicial power is vested exclusively in one court of justice.

For financial reporting purposes, the State of Michigan's reporting entity includes the "primary government" and its "component units." The primary government includes all funds, departments and agencies, bureaus, boards, commissions, and those authorities that are considered an integral part of the primary government. Component units are legally separate governmental organizations for which the State's elected officials are financially accountable.

Financial accountability is defined in GASB Statement No. 14, The Financial Reporting Entity. The State is financially accountable for those entities in which the State appoints a voting majority of an organization's governing authority, and either is able to impose its will upon the entity or there exists a financial benefit or burden relationship with the State. For those entities in which the State does not appoint a voting majority of the governing authority, GASB Statement No. 14 requires inclusion in the reporting entity if they are fiscally dependent on the State or if it would be misleading to exclude the authority.

### Blended Component Units

The State Building Authority and the Michigan Underground Storage Tank Financial Assurance Finance Authority are legally separate organizations that have boards appointed by the primary government and provide services primarily to benefit the State. Therefore, they are reported as though they were part of the primary government, using the blending method.

### Discretely Presented Component Units

These types of component units are reported in separate columns or rows in the government-wide statements to emphasize that they are legally separate from the government.

The State is able to impose its will upon these discretely presented component units:

The Michigan Education Trust offers contracts, which for actuarially determined amounts, provide plan participants with future tuition at institutions of higher education.

The Michigan State Housing Development Authority finances loans for the construction of multi-family and single-family housing and home improvements.

The Michigan Municipal Bond Authority assists local units by pooling their borrowing activities. This authority is also responsible for assisting local units with their financing of water pollution control projects.

The Michigan Higher Education Facilities Authority accounts for the administration of no-commitment debt issued for the benefit of private institutions of higher education.

The Mackinac Bridge Authority accounts for the operation of the Mackinac Bridge.

The Michigan Strategic Fund provides business enterprises with additional sources of financing.

The Michigan State Hospital Finance Authority accounts for the administration of limited obligation debt issued for the benefit of hospitals.

The Michigan Higher Education Student Loan Authority is a financing authority that makes loans to students or their parents.

The Michigan Higher Education Assistance Authority is the State guaranty agency under the Stafford Loan Program, the Supplemental Loans to Students Program, and the Parent Loan for Undergraduate Students Program. This Authority also administers scholarships and grants that are financed with General Fund appropriations.

There is a financial burden/benefit relationship between these entities and the State:

The Mackinac Island State Park Commission operates the Mackinac Island and Michilimackinac State Parks.

The Michigan Economic Development Corporation manages programs to stimulate, coordinate, and advance economic development in the State.

The following entity's relationship with the State would be misleading if it were omitted from the State's reporting entity:

The State Bar of Michigan is a public body corporate whose membership consists of persons licensed to practice law.

Ten of the State's public universities are considered component units because they have boards appointed by the primary government. Their balances and operating results are included with the other discretely presented components units on the government-wide statements. The ten universities included in these statements are: 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. Michigan State University, the University of Michigan, and Wayne State University are not included in the State's reporting entity because they have separately elected governing boards and are legally separate. The State provides significant funding to support these institutions; however, under GASB Statement No. 14 criteria, they are considered fiscally independent, special-purpose governments.

### Availability of Financial Statements

The State's component units issue their own separately issued audited financial statements. These statements may be obtained by directly contacting the various component units. To obtain their phone numbers, you may contact the Office of the State Budget, Office of Financial Management, Financial Reporting Section at (517) 373-3029.

### Related Organizations

The State's Insurance Commissioner is responsible for appointing the members of the boards of the Michigan Catastrophic Claims Association and the Michigan Property and Casualty Guaranty Association, but the State's accountability for these organizations does not extend beyond making the appointments.

### Joint Ventures

As discussed in more detail in Note 7, the State participates in one joint venture. Its financial activities are not included in the State's financial statements, but the State's equity interest is recorded as an asset in the Statement of Net Assets.

### Jointly Governed Organizations

The State, the University of Michigan, Michigan State University, and Wayne State University appoint members of the board of the Michigan Public Health Institute (MPHI), a non-profit corporation. MPHI was established to plan, promote, and coordinate health services research with a public university or a consortium of public universities in the State. The State does not appoint a majority of the board, has no rights to the assets, and is not responsible for debts of MPHI. Therefore, the State's accountability for MPHI does not extend beyond making the appointments. During fiscal year 2000-2001, the State awarded contracts totaling $21.4 million to MPHI.

In fiscal year 1999-2000, the Governor and St. Mary's River Bridge Company of Ontario, Canada signed a 40-year agreement creating the Joint International Bridge Authority (JIBA), a non-profit organization. The State does not appoint a majority of the board, has no rights to the assets, and is not responsible for debts of JIBA. Therefore, the State's accountability for JIBA does not extend beyond making the appointments.

## B. Government-Wide and Fund Financial Statements

### Government-Wide Financial Statements

The Statement of Net Assets and Statement of Activities report information on all non-fiduciary activities of the primary government and its component units. Primary government activities are distinguished between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

The **Statement of Net Assets** presents the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

**Invested in capital assets, net of related debt** consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

**Restricted net assets** result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

**Unrestricted net assets** consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources which are imposed by management, but can be removed or modified.

The **Statement of Activities** demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are instead reported as general revenue.

### Fund Financial Statements

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide statements. Major individual governmental funds and major individual proprietary funds are reported as separate columns in the fund financial statements, with non-major funds being combined into a single column.

## C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

### Measurement Focus and Basis of Accounting

The government-wide statements are reported using the economic resources management focus and the accrual basis of accounting, as are the proprietary and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

As allowed by GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting, the State's proprietary funds follow all GASB pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

Governmental fund statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become *susceptible to accrual*, generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the State generally considers tax revenues and court settlements to be available if they are collected within 60 days of the end of the fiscal period. Revenues that the State earns by incurring obligations are recognized in the same period as when the obligations are recognized.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to debt service, compensated absences, and claims and judgments, are recorded only when payment is due and payable.

### Financial Statement Presentation

The State reports the following major governmental funds:

The General Fund is the State's primary operating fund. It accounts for all financial resources except those required to be accounted for in another fund.

The Counter-Cyclical Budget and Economic Stabilization Fund, commonly referred to as the "Rainy Day Fund," was created to assist in stabilizing revenue and employment during periods of economic recession and high unemployment.

The School Aid Fund's purpose is to aid in the support of the public schools and the intermediate school districts.

The State reports the following major enterprise funds:

The State Lottery Fund accounts for the operations of the State's lottery, bingo, and charitable game operations.

The Michigan Unemployment Compensation Funds receive contributions from employers and provide benefits to eligible unemployed workers.

Additionally, the State reports the following fund types:

### Governmental Fund Types:

**Special Revenue Funds** - include operating fund activities financed by specific revenue sources that are legally restricted for specified purposes. Examples include conservation, transportation, regulatory, and other activities.

**Debt Service Funds** - account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

**Capital Projects Funds** - account for the acquisition or construction of major State capital facilities financed by bond proceeds and commercial paper notes.

**Permanent Funds** - report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that benefit the government or its citizenry, such as veterans, child abuse and neglect prevention, state park preservation, and others.

### Proprietary Fund Types:

**Enterprise Funds** - report the activities for which fees are charged to external users for goods or services. This fund type is also used when the activity is financed with debt that is secured by a pledge of the net revenues from the fees. The State's liquor sales are reported in this type.

**Internal Service Funds** - provide goods or services primarily to other agencies or funds of the State, rather than to the general public. These goods and services include prisoner-built office furnishings; motor pool services; printing, reproduction and mailing services; information technology; risk management; and health-related fringe benefits. In the government-wide statements, internal service funds are included with governmental activities.

### Fiduciary Fund Types:

**Pension (and other employee benefits) trust funds** – report resources that are required to be held in trust for the members and beneficiaries of the State's defined benefit pension plans, defined contribution plans, and other postemployment benefit plans.

**Private Purpose Trust Funds** – report resources of all other trust arrangements in which principal and income benefit individuals, private organizations, or other governments. Examples include the State's Escheats Fund, gifts to the State, worker disability monies, and others.

**Agency Funds** – report assets and liabilities for deposits and investments entrusted to the State as an agent for others.

## D. Fiscal Year-Ends

All funds and discretely presented component units are reported using fiscal years which end on September 30, except for the Michigan State Housing Development Authority and the ten State universities, which utilize June 30 year-ends.

## E. Assets, Liabilities, and Net Assets/Fund Balance

### Cash and Cash Equivalents

On the Statement of Cash Flows, the amount reported as "Cash and cash equivalents" is equal to the total of the amounts on the Statement of Net Assets "Cash" and "Equity in Common Cash," less the amount of "Warrants outstanding."

### Cash

Cash reported on the Statement of Net Assets and the Balance Sheet consists of petty cash, undeposited receipts, deposits in transit to the Common Cash pool, and cash equivalents such as short-term investments with original maturities of less than three months used for cash management rather than investing activities.

### Equity in Common Cash

The State Treasurer maintains centralized management of most State cash resources (not including component units). From the perspective of the various State funds, the pool functions as both a cash management pool and a demand deposit account. The operations and investments of the Common Cash pool are described in Note 5.

### Taxes Receivable

Taxes receivable represent amounts due to the State at September 30, which will be collected sometime in the future. In the government-wide financial statements, a corresponding amount is recorded as revenue. In the governmental fund financial statements, the portion considered "available" (i.e., received by the State within approximately 60 days after year-end) is recorded as revenue; the remainder is recorded as deferred revenue. Application of the measurability and availability criteria regarding taxes is described in Note 6.

### Amounts Due From Federal Agencies

For most federally funded programs, revenue is accrued in the same period as related obligations are recorded. In certain programs financed entirely by the federal government, expenditures and related revenues are recognized only to the extent of billings received by fiscal year-end. This treatment, which is generally limited to certain programs within the Department of Education, understates both assets and liabilities, and expenditures and revenues; however, there is no impact on net assets or fund balance.

### Inventories

Inventories are valued at cost, primarily using the first-in, first-out flow method. Expenditures (governmental funds) and expenses (proprietary funds) are recognized using the consumption method (i.e., when used or sold).

### Investments
Generally, investments are reported at fair value, consistent with the provisions of GASB Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools. Short-term, highly liquid debt instruments including commercial paper, banker's acceptances, and U.S. Treasury obligations are reported at amortized cost. Additional disclosures describing investments are provided in Note 8.

### Security Lending Collateral
Securities on loan for cash collateral are reported in the Statement of Net Assets. Liabilities resulting from the security lending transactions are also reported. Additional disclosures describing security-lending transactions are provided in Note 8.

### Other Assets
Other assets include receivables, amounts held in escrow, and other types of assets not reported on other lines.

### Capital Assets
Capital assets and certain improvements of governmental fund types are recorded in the Statement of Net Assets at historical cost or, if donated, at the estimated fair market value at the date of acquisition. In some instances, capital asset historical costs were not available; therefore, the costs of these assets at the dates of acquisitions have been estimated.

Infrastructure, such as roads and bridges, is capitalized for the first time in fiscal year 2000-2001. Interest incurred during construction is only capitalized in proprietary funds. Most capital assets are depreciated over their useful lives, using the straight-line depreciation method. However, the State's significant infrastructure assets utilize an alternative accounting treatment in which costs to maintain and preserve these assets are expensed and no depreciation expense is recorded. This approach is discussed further in the Required Supplementary Information portion of this report.

Additional disclosures related to capital assets and assets acquired through capital leases are provided in Notes 10 and 13, respectively.

### Warrants Outstanding
Warrants outstanding represent drafts issued against the State Treasurer's Common Cash pool, which have not yet cleared. These are similar to outstanding checks; however, the issuing funds' balances in the pool are not reduced until warrants are redeemed.

### Income Tax Refunds Payable
The amount of collected or accrued personal income tax revenues that will be refunded is estimated and accrued as a General Fund liability. Note 16 more fully describes this liability.

### Deferred Revenue
In the government-wide statements and proprietary fund financial statements deferred revenue is recognized when cash, receivables, or other assets are received prior to their being earned. In the governmental fund statements deferred revenue is recognized when revenue is unearned or unavailable.

### Long-Term Liabilities
In the government-wide statements and proprietary fund financial statements, long-term debt and long-term liabilities are reported as liabilities. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of the debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds, are reported as debt service expenditures.

Long-term liabilities are more fully described in Notes 13, 14, 15, 17, and 18.

### Net Assets/Fund Balance
The difference between fund assets and liabilities is "Net Assets" on the government-wide, proprietary, and fiduciary fund statements, and "Fund Balance" on governmental fund statements.

### Reservations
Fund balances for governmental funds are classified as either reserved or unreserved in the fund financial statements. Reserved fund balances reflect either: 1) funds legally segregated for a specific use or 2) assets which, by their nature, are not available for expenditure. Unreserved fund balances reflect the balances available for appropriation for the general purposes of the fund. Note 24 provides a disaggregation of reserved fund balances.

## F. Revenues and Expenditures/Expenses

In the government-wide Statement of Activities, revenues and expenses are segregated by activity (governmental or business-type), then further by function (e.g. general government, education, transportation, etc). Additionally, revenues are classified between program and general revenues. Program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenues, rather than as program revenue. General revenues include all taxes. Certain indirect costs are included in the program expenses reported for individual functions.

In the governmental fund financial statements, revenues are reported by source. For budgetary control purposes, revenues are further classified as either "general purpose" or "restricted." General purpose revenues are available to fund any activity accounted for in the fund. Restricted revenues are, either by State law or by outside restriction (e.g., federal grants), available only for specified purposes. Unused restricted revenues at year-end are recorded as reservations of fund balance. When both general purpose and restricted funds are available for use, it is the State's policy to use restricted resources first.

In the governmental fund financial statements, expenditures are reported by character: "Current," "Capital outlay," "Intergovernmental-revenue sharing," or "Debt service." Current expenditures are subclassified by function and are for items such as salaries, grants, supplies, and services. Tax expenditures, which represent income tax credit programs that are in substance grants, are also reported as current expenditures. These are described in more detail in Note 16.

Capital outlay includes expenditures for real property or infrastructure (e.g., highways). Intergovernmental-revenue sharing accounts for the distribution of certain tax revenues that are shared with local units based upon constitutional and statutory requirements. Debt service includes both interest and principal outlays related to bonds and payments on capitalized leases.

Revenues and expenses of proprietary funds are classified as operating or nonoperating and are subclassified by object (e.g., salaries, depreciation, and purchases for resale). Operating revenues and expenses generally result from providing services and producing and delivering goods. All other revenues and expenses are reported as nonoperating.

### Other Financing Sources
These additions to governmental fund balances in the fund financial statements include resources and financing provided by bond proceeds, capital leases, and transfers from other funds.

### Reimbursements
Reimbursements result when a fund originally making a disbursement receives resources from another fund to which the expenditure/expense is more properly attributable. For example, the State uses this method when the administrative costs of proprietary funds, discretely presented component units, or pension (and other employee benefits) trust funds are appropriated in the General Fund.

### Interfund Services Provided and Used
When a sale or purchase of program-related goods and/or services between funds occurs, for a price approximating their external exchange value, the seller reports revenue and the purchaser expenditure or expense, depending upon the fund type.

Transactions between the primary government and a discretely presented component unit are generally classified as revenues and expenses, unless they represent repayments of loans or similar activities.

### Other Financing Uses
These reductions of governmental fund resources in fund financial statements normally result from transfers to other funds.

## G. Interfund Activity and Balances

### Interfund Activity
As a general rule, the effect of interfund activity has been eliminated from the government-wide statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities (examples include the transfers of profits from the Liquor Purchase Revolving Fund to General Fund and the Lottery Fund to the School Aid Fund) and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column (examples include activities between the Department of Treasury [general government line] and the Department of Education [education line]). Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

In the fund financial statements, transfers represent flows of assets (such as goods or cash) without equivalent flows of assets in return or a requirement for repayment. In addition, transfers are recorded when a fund receiving revenue provides it to the fund which expends the resources. An example is gas taxes collected by the Department of Transportation but expended by the Department of Natural Resources.

### Interfund Balances
Interfund receivables and payables have been eliminated from the Statement of Net Assets, except for the residual amounts due between governmental and business-type activities.

## NOTE 2 – FUNDS AND COMPONENT UNITS BY CLASSIFICATION

The following table lists all of the funds and component units whose balances are reflected in this financial report.

Operating funds which are subject to annual appropriation and for which budget and actual schedules are included in this report are identified by an "*". For each fund or component unit listed, the SOMCAFR page number of the first financial statement for that fund or component unit is shown in parenthesis.

### PRIMARY GOVERNMENT:

#### MAJOR FUNDS

**Governmental:**

General Fund* (p. 20)
Counter-Cyclical Budget and Economic Stabilization Fund* (p. 20)
School Aid Fund* (p. 20)

**Proprietary:**

State Lottery Fund (p. 26)
Michigan Unemployment Compensation Funds (p. 26)

#### NON-MAJOR FUNDS

**Governmental:**

**Special Revenue Funds:**

**Transportation Related:**

State Aeronautics Fund* (p. 106)
State Trunkline Fund* (p. 106)
Michigan Transportation Fund* (p. 106)
Comprehensive Transportation Fund* (p. 106)
Combined State Trunkline Bond Proceeds Fund (p. 107)
Combined Comprehensive Transportation Bond Proceeds Fund (p. 107)
Transportation Related Trust Funds (p. 107)

**Conservation, Environment, and Recreation Related:**

Game and Fish Protection Fund* (p. 116)
Michigan State Waterways Fund* (p. 116)
Marine Safety Fund* (p. 116)
Game and Fish Protection Trust Fund (p. 116)
State Park Improvement Fund* (p. 117)
Combined Recreation Bond Fund - Local Projects (p. 117)
Combined Environmental Protection Bond Fund (p. 117)
Michigan Nongame Fish and Wildlife Fund* (p. 117)
Forest Development Fund* (p. 117)
Michigan Underground Storage Tank Financial Assurance Fund (p. 117)
Bottle Deposits Fund (p. 118)
Michigan Underground Storage Tank Financial Assurance Finance Authority (p. 118)

**Regulatory and Administrative Related:**

Michigan Employment Security Act – Administration Fund* (p. 130)
Safety Education and Training Fund* (p. 130)
Uninsured Employers' Security Fund (p. 130)
State Construction Code Fund* (p. 130)
Homeowner Construction Lien Recovery Fund* (p. 130)
State Casino Gaming Fund* (p. 131)
Second Injury Fund (p. 131)
Silicosis, Dust Disease, and Logging Industry Compensation Fund (p. 131)
Self-Insurers' Security Fund (p. 131)
Utility Consumer Representation Fund (p. 131)

**Other State Funds:**

School Bond Loan Fund (p. 140)
Tobacco Settlement Trust Fund* (p. 140)
Michigan Merit Award Trust Fund* (p. 140)
Assigned Claims Facility and Plan Fund (p. 141)
Miscellaneous Special Revenue Funds (p. 141)

**Debt Service Funds:**

Combined State Trunkline Bond and Interest Redemption Fund (p. 148)
Combined Comprehensive Transportation Bond and Interest Redemption Fund (p. 148)
Recreation and Environmental Protection Bond Redemption Fund (p. 148)
School Loan Bond Redemption Fund (p. 149)
State Building Authority (p. 149)
Michigan Underground Storage Tank Financial Assurance Finance Authority (p. 149)

**Capital Projects Funds:**

Combined Recreation Bond Fund - State Projects (p. 154)
Advance Financing Funds (p. 154)
State Building Authority (p. 154)

**Permanent Funds:**

Michigan Natural Resources Trust Fund* (p. 158)
Michigan State Parks Endowment Fund* (p. 158)
Michigan Civilian Conservation Corps Endowment Fund* (p. 158)
Michigan Veterans' Trust Fund* (p. 159)
Children's Trust Fund* (p. 159)

**Proprietary:**

**Enterprise Funds:**

Liquor Purchase Revolving Fund (p. 26)

**Internal Service Funds:**

Correctional Industries Revolving Fund (p. 166)
Motor Transport Fund (p. 166)
Office Services Revolving Fund (p. 166)
Information Technology and Energy Fund (p. 167)
Risk Management Fund (p. 167)
State Sponsored Group Insurance Fund (p. 167)

**Fiduciary:**

**Pension (and other employee benefits) trust funds:**

State Employees' Deferred Compensation Funds (p. 174)
Legislative Retirement Fund (p. 174)
State Police Retirement Fund (p. 174)
State Employees' Retirement Fund (p. 175)
Public School Employees' Retirement Fund (p. 175)
Judges' Retirement Fund (p. 175)
State Employees' Defined Contribution Retirement Fund (p. 175)

**Private Purpose Trust Funds:**
Escheats Fund (p. 180)
Gifts, Bequests, and Deposits Investment Fund (p. 180)
Hospital Patients' Trust Fund (p. 180)
Federal Housing Administration Mortgages Escrow Fund (p. 181)
Michigan Education Savings Program (p. 181)
Workers' Disability Compensation Trust Funds (p. 181)

**Agency Funds:**
Financial Institutions Deposits Fund (p. 186)
Environmental Quality Deposits Fund (p. 185)
Insurance Carrier Deposits Fund (p. 185)
State Treasurer's Escrow and Paying Agent Fund (p. 185)
Child Support Collection Fund (p. 185)

**DISCRETELY PRESENTED COMPONENT UNITS:**

**Authorities:**

**Major Funds:**
Michigan Education Trust (p. 36)
Michigan State Housing Development Authority (p. 36)
Michigan Municipal Bond Authority (p. 36)

**Non-Major Funds:**
Michigan Higher Education Facilities Authority (p. 190)
Mackinac Bridge Authority (p. 190)
Michigan Strategic Fund (p. 190)
Michigan State Hospital Finance Authority (p. 190)
Michigan Higher Education Student Loan Authority (p. 191)
Michigan Higher Education Assistance Authority (p. 191)
Mackinac Island State Park Commission (p. 191)
State Bar of Michigan (p. 191)
Michigan Economic Development Corporation (p. 191)

**State Universities (1):**

**Major Funds:**
Central Michigan University (p. 37)
Western Michigan University (p. 37)

**Non-Major Funds:**
Eastern Michigan University (p. 194)
Ferris State University (p. 194)
Grand Valley State University (p. 194)
Lake Superior State University (p. 194)
Michigan Technological University (p. 195)
Northern Michigan University (p. 195)
Oakland University (p. 195)
Saginaw Valley State University (p. 195)

(1) Michigan State University, the University of Michigan, and Wayne State University are not included in the State's reporting entity because they have separately elected governing boards and are legally separate from the State. The State provides significant funding to support these institutions; however, under the GASB Statement No. 14 criteria, they are considered fiscally independent special-purpose governments.

# NOTE 3 – BUDGETING, BUDGETARY CONTROL, AND LEGAL COMPLIANCE

## A. Major Constitutional and Statutory Provisions

### Balanced Budget Requirements

Article 5 of the State Constitution mandates that the executive budget recommend spending limits for operating funds to the Legislature that are within available resources. Compliance with this is demonstrated in the executive budget and budget bills for each fiscal year.

Article 4 of the State Constitution mandates the Legislature to enact appropriations for each operating fund that does not exceed that fund's revenue estimates, including beginning unreserved fund balance.

Compliance with this requirement is demonstrated in schedules included in the annual appropriation acts, usually the "General Government" appropriation act. When it appears that revenue will fall below the estimates on which the appropriations are based, the Governor is required to recommend spending reductions as necessary to avoid a year-end deficit.

### Local Spending Requirements

Article 9, Section 30 of the State Constitution requires that State spending to, or on behalf of, local units of government shall not fall below a specified percentage of total State spending. The percentage, recalculated effective with fiscal year 1992-1993, is 48.97%.

Final calculations establishing the State's compliance with this constitutional provision for fiscal year 2000-2001 are not yet complete. For fiscal year 1999-2000, the most recent year for which final calculations are available, the proportion of total State spending paid to local units of government was determined to be 61.68%, reflecting payments that exceeded the minimum required by $3.0 billion. The State expects that payments to local units of government will exceed the minimum requirement for fiscal year 2000-2001.

### Revenue Limits

Article 9, Section 26, of the State Constitution restricts State revenues to a ceiling that is based upon revenues as a proportion of total personal income for the State. The base year ratio, determined in fiscal year 1978-1979, in relation to calendar year 1977 personal income, is 9.49%. Both the constitutional language and implementing statutes provide for other adjustments to the revenue and personal income calculations. If revenues exceed the limit by 1% or more, the amount in excess must be refunded to personal income tax payers and payers of the State's single business tax. If the limit is exceeded by an amount less than 1%, the excess may be deposited into the State's Budget Stabilization Fund. The calculations determining the State's compliance with this constitutional provision for fiscal year 2000-2001 are not final. For fiscal year 1999-2000, the most recent year for which final calculations are available, total State revenues subject to this limitation exceeded the constitutional limit by $159.7 million. The State expects that total State revenues subject to the limitation will not exceed the limit for fiscal year 2000-2001.

### Budget Stabilization Fund

The Counter-Cyclical Budget and Economic Stabilization Fund ("Budget Stabilization Fund") was created by P.A. 76 of 1977 to assist in stabilizing revenue and employment during periods of economic recession. In general, the law requires payments into the fund when real economic growth exceeds 2% and allows withdrawals from the fund when real economic growth is less than 0%. Funds can also be withdrawn when the State's unemployment rate exceeds 8% or upon appropriation to finance capital outlay or other projects, or for other purposes designated by the Legislature.

The following table summarizes the transactions for the fund for fiscal year 2000-2001 (in millions):

| | |
|---|---|
| Beginning unreserved fund balance | $ 1,264.4 |
| Interest income | 66.7 |
| Transfers to General Fund | (270.0) |
| Transfers to School Aid Fund | (32.0) |
| Transfers to State Trunkline Fund | (35.0) |
| Ending unreserved fund balance | $ 994.2 |

Transfers to the General Fund represent the transfer of $77.0 million pursuant to P.A. 112 of 2001, Section 353 (10), and the transfer of $193.0 million, pursuant to P.A. 161 of 2001, Section 353 (11). These transfers were made to ensure a balanced General Fund budget. The transfer to the School Aid Fund is for the purpose of making appropriations to school districts and intermediate school districts as required by P.A. 431 of 1984, as amended. The transfer to the State Trunkline Fund is for the purpose of funding a portion of the Build Michigan III program, pursuant to P.A. 189 of 2000, Section 358.

## B. Budgetary Overexpenditures

In the event that expenditures exceed authorization during a year, the department must request a supplemental appropriation for the amount overspent, if that amount exceeds their lapses or if they expect to make payments from prior year authorization in the next fiscal year. There were no net overexpenditures by General Fund departments. There were, however, the following line-item overexpenditures of State funds incurred during the year, which represent non-compliance with State budget laws (in millions):

| | |
|---|---|
| **General Fund:** | |
| Community Health | $ 31.3 |
| Career Development | .6 |
| General Fund Total | $ 31.9 |

## NOTE 4 – ACCOUNTING CHANGES AND RESTATEMENTS

During fiscal year 2000-2001, the State implemented several new accounting standards issued by GASB:

Statement No. 33, Accounting and Financial Reporting for Non-exchange Transactions,

No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments,

No. 35, Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities,

No. 36, Recipient Reporting for Certain Shared Non-exchange Revenues,

No. 37, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus, and

No. 38, Certain Financial Statement Note Disclosures.

Statement No. 33, as amended by Statement No. 36, establishes standards for recording non-exchange transactions on the modified accrual and accrual bases of accounting. The State derives a significant portion of its revenue from non-exchange transactions, such as taxes and federal aid. The effect on the tax related non-exchange transactions recorded as revenue in the governmental funds was insignificant. However, the State recorded taxes receivable of $2.5 billion in the governmental fund financial statements with a corresponding amount reported as deferred revenue. These amounts represent deferred revenues from non-exchange transactions during the fiscal year, which are not available to finance expenditures of the current period. On the government-wide financial statements reported on the accrual basis of accounting, taxes receivable are recorded as described in the preceding sentence; however, corresponding amounts are reported as revenue instead of deferred revenue.

Statement No. 34, as amended by Statement No. 37, establishes new financial reporting standards for state and local governments. This statement's requirements represent a significant change in the financial reporting model used by state governments, including statement formats and changes in fund types and account groups. In addition to fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus. As a result, fund reclassifications and adjustments to the fund equities reported in the prior financial statement balances were required.

Statement No. 35 establishes accounting and financial reporting standards for public colleges and universities within the financial reporting guidelines of Statement No. 34. The State universities, reported as discretely presented component units, adopted the requirements of Statement No. 35.

Statement No. 38 requires certain note disclosures when Statement No. 34 is implemented.

The provisions of these new standards have been incorporated into the financial statements and notes. The following tables summarize (in millions) changes to fund equities as previously reported on the Combined Balance Sheet. The changes resulted primarily from implementation of these GASB Statements, however, the State Building Authority, a capital projects fund, restated its fund equity by $348.1 million to properly reflect commercial paper as a long-term liability.

| | September 30, 2000 As Previously Reported | Fund Reclassifications | Prior Period Adjustments | September 30, 2000 As Restated |
|---|---|---|---|---|
| **GOVERNMENTAL FUNDS AND ACTIVITIES** | | | | |
| **Major Funds:** | | | | |
| General Fund | $ 2,101.3 | $ - | $ - | $ 2,101.3 |
| Previously reported as Special Revenue Funds: | | | | |
| Budget Stabilization Fund | - | 1,264.4 | - | 1,264.4 |
| School Aid Fund | - | 985.6 | - | 985.6 |
| **Non-major Funds:** | | | | |
| Special Revenue Funds: | | | | |
| Transportation Related: | | | | |
| Other Transportation related funds | 519.1 | - | - | 519.1 |
| Total Fund Balances | 519.1 | - | - | 519.1 |
| Conservation, Environment, and Recreation Related: | | | | |
| Michigan Natural Resources Trust Fund | 231.3 | (231.3) | - | - |
| Michigan State Parks Endowment Fund | 93.7 | (93.7) | - | - |
| Michigan Civilian Conservation Corps Endowment Fund | 22.0 | (22.0) | - | - |
| Other Conservation, Environment, and Recreation Related funds | 373.1 | - | - | 373.1 |
| Total Fund Balances | 720.1 | (347.0) | - | 373.1 |
| Regulatory and Administrative Related: | | | | |
| Second Injury Fund | - | 9.0 | - | 9.0 |
| Silicosis, Dust Disease, and Logging Industry Compensation Fund | - | 4.5 | - | 4.5 |
| Self-Insurers' Security Fund | - | 2.0 | - | 2.0 |
| Utility Consumer Representation Fund | - | 1.8 | - | 1.8 |
| Other Regulatory and Administrative Funds | 16.6 | - | - | 16.6 |
| Total Fund Balances | 16.6 | 17.2 | - | 33.8 |
| Other State Funds: | | | | |
| Budget Stabilization Fund | 1,264.4 | (1,264.4) | - | - |
| School Aid Fund | 985.6 | (985.6) | - | - |
| Michigan Veterans' Trust Fund | 48.8 | (48.8) | - | - |
| Children's Trust Fund | 20.6 | (20.6) | - | - |
| Miscellaneous Other State Funds | - | 3.9 | - | 3.9 |
| Other State Funds | 168.0 | - | - | 168.0 |
| Total Fund Balances | 2,487.5 | (2,315.6) | - | 171.9 |
| Total Special Revenue Funds: | 3,743.3 | (2,645.4) | - | 1,097.9 |
| Debt Service Funds | 291.8 | - | - | 291.8 |
| Capital Projects Fund: | | | | |
| State Building Authority | (457.8) | - | 348.1 | (109.8) |
| Other Capital Projects Funds | (44.5) | - | - | (44.5) |
| Total Capital Projects Funds | (502.3) | - | 348.1 | (154.2) |
| Permanent Funds: | | | | |
| Michigan Natural Resources Trust Fund | - | 231.3 | - | 231.3 |
| Michigan State Parks Endowment Fund | - | 93.7 | - | 93.7 |
| Michigan Civilian Conservation Corps Endowment Fund | - | 22.0 | - | 22.0 |
| Michigan Veterans' Trust Fund | - | 48.8 | - | 48.8 |
| Children's Trust fund | - | 20.6 | - | 20.6 |
| Total Permanent Funds | - | 416.4 | - | 416.4 |
| Total Non-major Funds: | 3,532.8 | (2,228.9) | 348.1 | 1,652.0 |
| Total Governmental Funds | $ 5,634.1 | $ 21.2 | $ 348.1 | $ 6,003.4 |

| | September 30, 2000 As Previously Reported | Fund Reclassifications | Prior Period Adjustments | September 30, 2000 As Restated |
|---|---|---|---|---|
| **Adoption of GASB Statement No. 33 and 34** | | | | |
| Revenue recognition | $ - | $ - | $ 2,219.3 | $ 2,219.3 |
| Capital assets, net of depreciation | - | 3,671.5 | 13,347.8 | 17,019.3 |
| Long-term bonds and notes payable | - | - | (4,239.7) | (4,239.7) |
| Other liabilities and long-term obligations | - | - | (1,921.3) | (1,921.3) |
| Interest in joint venture | - | - | 25.0 | 25.0 |
| Net pension assets | - | - | 94.9 | 94.9 |
| Net pension liabilities | - | - | (20.5) | (20.5) |
| Internal service fund conversion | - | 68.0 | - | 68.0 |
| Adoption of GASB Statement No. 33 and 34 | - | 3,739.5 | 9,505.5 | 13,245.0 |
| TOTAL GOVERNMENTAL FUNDS AND ACTIVITIES | $ 5,634.1 | $ 3,760.7 | $ 9,853.6 | $ 19,248.4 |
| **PROPRIETARY FUNDS AND BUSINESS-TYPE ACTIVITIES** | | | | |
| **Major Funds:** | | | | |
| Michigan Unemployment Compensation Funds | $ - | $ 3,262.0 | $ 18.1 | $ 3,280.1 |
| State Lottery Fund | 50.9 | - | - | 50.9 |
| Total net assets | 50.9 | 3,262.0 | 18.1 | 3,330.9 |
| **Non-major Funds:** | | | | |
| Liquor Purchase Revolving Fund | 6.7 | - | - | 6.7 |
| Internal Service Funds | 68.0 | (68.0) | - | - |
| TOTAL PROPRIETARY FUNDS AND BUSINESS-TYPE ACTIVITIES | $ 125.6 | $ 3,193.9 | $ 18.1 | $ 3,337.6 |
| **FIDUCIARY FUNDS** | | | | |
| Pension (and other employee benefits) Trust Funds: | | | | |
| State Employees' Deferred Compensation Funds | $ - | $ 3,554.9 | $ - | $ 3,554.9 |
| Other Pension Trust Funds | 53,758.2 | - | - | 53,758.2 |
| Total Pension (and other employee benefits) Trust Funds | 53,758.2 | 3,554.9 | - | 57,313.1 |
| Private Purpose Funds: | | | | |
| Escheats Fund | - | - | 21.7 | 21.7 |
| Gifts, Bequests, and Deposits Investment Fund | - | 35.6 | - | 35.6 |
| Hospital Patients' Trust Fund | - | .8 | - | .8 |
| Federal Housing Administration Mortgages Escrow Fund | - | 1.2 | - | 1.2 |
| Workers' Disability Compensation Funds | - | 1.8 | - | 1.8 |
| Total Private Purpose Trust Funds | - | 39.4 | 21.7 | 61.1 |
| Funds previously reported as Expendable Trust Funds: | | | | |
| Michigan Unemployment Compensation Fund | 3,178.7 | (3,178.7) | - | - |
| Michigan Employment Security Act Contingent Fund | 83.3 | (83.3) | - | - |
| Second Injury Fund | 9.0 | (9.0) | - | - |
| State Employees' Deferred Compensation Funds | 3,554.9 | (3,554.9) | - | - |
| Miscellaneous Trust Accounts Fund | 51.6 | (51.6) | - | - |
| Total Expendable Trust Funds | 6,877.4 | (6,877.4) | - | - |
| TOTAL FIDUCIARY FUNDS | $ 60,635.6 | $ (3,283.1) | $ 21.7 | $ 57,374.2 |
| **ACCOUNT GROUPS** | | | | |
| General Fixed Assets | $ 3,671.5 | $ (3,671.5) | $ - | $ - |
| General Long-term Obligations | - | - | - | - |
| TOTAL ACCOUNT GROUPS | $ 3,671.5 | $ (3,671.5) | $ - | $ - |
| TOTAL PRIMARY GOVERNMENT | $ 70,066.8 | $ - | $ 9,893.4 | $ 79,960.2 |

| | September 30, 2000 As Previously Reported | Fund Reclassifications | Prior Period Adjustments | September 30, 2000 As Restated |
|---|---|---|---|---|
| DISCRETELY PRESENTED COMPONENT UNITS | $ 4,021.7 | $ - | $ - | $ 4,021.7 |
| Adoption of GASB Statement No. 33, 34 and 35: | | | | |
| Revenue and expense recognition | - | - | (1.3) | (1.3) |
| Capital assets, net of depreciation | - | - | 91.4 | 91.4 |
| Fund reclassification | - | (57.0) | - | (57.0) |
| Other | - | - | 8.4 | 8.4 |
| Total Net Assets for Discretely Presented Component Units – restated | $ 4,021.7 | $ (57.0) | $ 98.5 | $ 4,063.2 |

# NOTE 5 – TREASURER'S COMMON CASH

## A. General Accounting Policies

The State Treasurer manages the State's Common Cash pool, which is used by most State funds. The pooling of cash allows the Treasurer to invest monies not needed to pay immediate obligations so that investment earnings on available cash are maximized. Investments of the pool are not segregated by fund; rather, each contributing fund's balance is treated as equity in the pool. Many funds, including pension (and other employee benefits) trust funds, use their equity in the pool as a short-term investment vehicle. The Treasurer separately publishes the "Annual Report of the State Treasurer" which includes audited schedules of Common Cash Assets and Equities, Investment Portfolios of Specific Funds, and Investment Earnings.

In this report, the Common Cash pool is not reported as a separate fund. Instead, each State fund's balance in the pool is presented as "Equity in Common Cash."

All negative balances in the pool are reclassified at year-end as interfund liabilities. If the negative balance is considered long-term, the reclassification is recorded as an advance.

Statute or administrative policy determines whether a particular fund receives or pays interest on its balances in the pool. If a fund does not receive or pay interest, the General Fund receives or absorbs such amounts. Earnings on positive balances and charges on negative balances are allocated quarterly based upon the average daily balances of the various funds and the average investment earnings rate for the quarter. Accrued earnings of the pool are recorded as assets, with the accrual allocated to the various funds' equity in the pool. Interest revenues on positive balances and interest charges on negative balances are reflected as revenues or expenditures/expenses of each of the participating funds.

## B. Investments and Deposits

The investment authority for the Common Cash pool is found in P.A. 105 of 1855, as amended. The State Treasurer may invest surplus funds belonging to the State in the bonds, notes, and other evidences of indebtedness of the United States Government, and its agencies; and in prime commercial paper. Certificates of deposit are permitted in financial institutions whose principal office is located in the State.

The Treasurer invests excess cash in short-term investments, mostly prime commercial paper. The law does not prohibit the Treasurer from entering into repurchase agreements; however, the Treasurer did not use these agreements in managing the pool in fiscal year 2000-2001.

Statutes provide for certain special State investment programs for which the General Fund is credited (charged) for earnings in excess of (under) those achieved by regular pool investments. There have been no principal losses because of these programs to date. The most significant program provides for emergency loans to local units of government. The Treasurer may loan not more than a combined total of $5 million in any one fiscal year to qualifying cities, villages, or townships in amounts as approved by the Emergency Financial Assistance Loan Board.

In fiscal year 1999-2000 the Emergency Financial Assistance Loan Board was authorized to approve the lending of up to $159.9 million to Wayne County to finance the payment of certain obligations to the State. The outstanding balance at September 30, 2001 was $41.8 million. Loan repayments by the County are supported by provisions of the loan agreement and legislation that pledge the County's share of a portion of the State collected taxes on cigarettes. There were no repayments on the loans in fiscal year 2000-2001.

Michigan Marina Dredging Loan Program: Public Act 280 of 2000 provides for a program under which financial institutions may make low-interest loans to eligible marinas for dredging costs necessitated by low water levels to accommodate the use of the marina by recreational watercraft.

Under this program, the Department of Treasury and a financial institution may enter into an investment agreement under which the Department of Treasury will invest the State's Common Cash with the financial institution at an agreed upon interest rate (generally 1.5 percent per annum). The financial institution will then use the principal to make a low-interest loan to an eligible marina.

The Act specifies that the maximum amount of a Michigan marina-dredging loan is $75 thousand per marina. The total amount of outstanding loans is statutorily limited to $20 million. The loans accrue at an interest rate of six percent, and the loans' term may not exceed seven years. Other details about the loans are available in the investment agreement. The total amount loaned in fiscal year 2000-2001 was $.6 million; repayments during the year were $71 thousand.

Assets and equities of the Common Cash pool as of September 30 were as follows (in millions):

| | |
|---|---|
| ASSETS | |
| Cash on hand | $ - |
| Demand deposits | 128.1 |
| Time deposits – regular | 54.0 |
| Time deposits – Marina Loan Programs | .6 |
| Prime commercial paper – at cost | 4,549.6 |
| Interest receivable | 13.8 |
| Emergency loans to local units – at cost | 42.1 |
| Total assets | $ 4,788.2 |
| EQUITIES | |
| Fund equities (net) in Common Cash (1): | |
| Governmental activities | $ 4,211.3 |
| Business-type activities | 147.4 |
| Fiduciary funds | 209.5 |
| Discretely presented component units | 219.9 |
| Net fund equities | $ 4,788.2 |

(1) Negative equity balances in the pool are reclassified at year-end as interfund receivables and liabilities. Current balances are included with "Amounts due from other funds" and "Amounts due to other funds" and long-term amounts are classified as interfund advances. Note 20 summarizes interfund receivables and liabilities.

The following paragraphs provide disclosures about deposits and investments of the Common Cash pool, as required by GASB Statement No. 3. Please see Note 8 for a description of the GASB custodial credit risk categories and for information about deposits and investments, which are not part of the Common Cash pool.

### Deposits

At September 30, 2001, the carrying amount of deposits, including time and demand deposits, was $182.6 million. The deposits were reflected in the accounts of the banks at $182.6 million. Of the bank balance, $7.1 million was covered by federal depository insurance (GASB credit risk category 1), $174.9 million was collateralized with securities held by the State's agent in the State's name (GASB credit risk category 1), and $.6 million of demand deposits which are uninsured and uncollateralized (GASB credit risk category 3). Compensating balances kept in demand deposit accounts to avoid service charges totaled $198.5 million at September 30, 2001.

### Investments

Using the GASB categories of custodial credit risk, all of the investments (including prime commercial paper and emergency municipal loans) are in category 1. The emergency municipal loans are evidenced by notes held by the State in the State's name, so they fall in custodial credit risk category 1. At September 30, 2001, the fair value of prime commercial paper was $4.6 billion.

## NOTE 6 – TAXES RECEIVABLE

Taxes receivable represent amounts due to the State at September 30, for revenues earned in fiscal year 2000-2001, which will be collected sometime in the future. Amounts expected to be collected in the next fiscal year are classified as "current" and amounts expected to be collected beyond the next fiscal year are classified as "noncurrent." The receivables have been recorded net of allowances for uncollectibles. Sales, use, single business, and income taxes are accrued to the extent that the related sales, wage, or activity being taxed occurred prior to October 1. Property taxes receivable are accrued when taxes are levied against the property owners.

In the government-wide financial statements, a corresponding amount is recorded as revenue using the accrual basis of accounting. In the governmental fund financial statements, revenue is recorded using the modified accrual basis of accounting for amounts due to the State at September 30 (as stated above) that are considered "available" (e.g. received by the State within approximately 60 days after that date). The remainder is recorded as deferred revenue. Annual tax payments (i.e., those paid with an annual return, such as individual personal income taxes filed in April) have not been accrued because they are neither reasonably estimable nor available. The State accrues single business taxes received prior to December 1 (i.e., quarterly filings due November 30).

Local units of government, as agents for the State, assess the State property tax. Taxes are due and payable at the same time as local unit taxes and are generally divided into a summer portion payable to the local units on the succeeding July 1 and a winter portion due December 31. The State accrues revenues received by the State or the local units, on its behalf, during October and November. Since the property taxes are levied and received by the local units, it is not feasible for the State to measure and record delinquent amounts receivable and, therefore, no delinquent amounts are recorded or reflected in the table below. The accrued telephone and telegraph taxes are due December 1 and were received at approximately that time. Delinquent taxes are recognized to the extent that they will be collected within 12 months.

Taxes receivable as of September 30, consisted of the following (in millions):

| Tax | General Fund | Special Revenue Funds | Total |
|---|---|---|---|
| Sales & use | $ 320.1 | $ 601.2 | $ 921.2 |
| Individual income | 1,783.5 | 295.7 | 2,079.2 |
| Single business | 1,805.1 | - | 1,805.1 |
| State education (property) tax | - | 557.8 | 577.8 |
| Telephone & telegraph | 67.4 | - | 67.4 |
| Motor fuel | .1 | 240.0 | 240.1 |
| Insurance - retaliatory | 56.4 | - | 56.4 |
| Estate & inheritance | 39.1 | - | 39.1 |
| Tobacco products | 23.9 | 43.7 | 67.6 |
| Other | 30.4 | 57.0 | 87.4 |
| Penalties and interest | 909.8 | .2 | 910.0 |
| Gross taxes receivable | 5,035.7 | 1,815.6 | 6,851.3 |
| Less allowance for uncollectibles | (1,661.5) | (396.0) | (2,057.5) |
| Total taxes receivable (net) | $ 3,374.2 | $ 1,419.6 | $ 4,793.8 |
| As reported on the financial statements | | | |
| Current taxes receivable | $ 2,680.7 | $ 1,283.1 | $ 3,963.8 |
| Noncurrent taxes receivable | 693.4 | 136.6 | 830.0 |
| Total taxes receivable (net) | $ 3,374.2 | $ 1,419.6 | $ 4,793.8 |

# NOTE 7 – JOINT VENTURES AND AFFILIATED FOUNDATIONS

## A. Joint Ventures - Primary Government

The State is a participant in the joint venture described below. Joint ventures are not reflected as component units within this report because they do not meet the GAAP criteria for inclusion. Their separately issued financial statements may be obtained by directly contacting the applicable organizations. To obtain their phone numbers, you may contact the Office of the State Budget, Office of Financial Management, Financial Reporting Section at (517) 373-3029.

### Great Lakes Protection Fund

(GLPF) is a not-for-profit corporation located in Chicago, Illinois. Its purpose is to finance and support research with respect to water quality of the Great Lakes. The eight states bordering the Great Lakes are eligible to become members if they make a required contribution to the endowment of GLPF.

Contribution requirements were established based upon water consumption and usage. Contributions to GLPF are permanently restricted and are not available for disbursement. Michigan is the largest contributor, having made a contribution of $25 million, constituting approximately 31% of the total. Michigan made its required contribution by issuing GLPF a general obligation bond authorized as part of the State's environmental protection bond program. No additional contributions from Michigan will be required.

Two members on GLPF's board of directors represent each of the participating seven member states. The states' respective governors select the board members. Directors control GLPF's financing and budgeting operations, within requirements established by the Articles of Incorporation. One-third of the net earnings on total contributions (after operating expenses) is granted to the respective states in proportion to their contributions to GLPF. Two-thirds of the net earnings are available to GLPF to make other grants. The State's equity interest in GLPF of $25 million is reflected as an asset in the government-wide statements.

## B. Affiliated Foundations - Discretely Presented Component Units

Several of the State university component units are affiliated with independent corporate foundations that exist for the sole purpose of soliciting, collecting, and investing donations for the benefit of the universities. The operations and net assets of these foundations are not included in the financial statements of the universities due to their independence. At June 30, 2001, net assets held by these foundations totaled $316.5 million.

# NOTE 8 – DEPOSITS AND INVESTMENTS

## A. General Information

This note provides information for all deposits and investments except those of the Common Cash pool, which are described in Note 5. GASB Statement No. 3 requires certain disclosures regarding policies and practices with respect to deposits, investments, and the custodial credit risk associated with them.

### Deposits

In accordance with GASB Statement No. 3, deposits are classified into three categories of custodial credit risk as follows:

***Category 1:*** Insured or collateralized with securities held by the entity or by its agent in the entity's name.

***Category 2:*** Collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name.

***Category 3:*** Uncollateralized (this includes any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent, but not in the entity's name).

### Investments

In accordance with GASB Statement No. 3, investments are also classified into three categories of custodial credit risk as follows:

***Category 1:*** Insured or registered, or securities held by the entity or its agent in the entity's name.

***Category 2:*** Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the entity's name.

***Category 3:*** Uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the entity's name. (This includes the portion of the carrying amount of any repurchase agreement that exceeds the fair value of the underlying securities.)

Certain types of investments are not categorized because they are not evidenced by securities that exist in physical or book entry form. Deposits classified as investments on the balance sheet are included in the investment tables following and are categorized using the deposit risk category definitions.

In accordance with GASB Statement No. 28, Accounting and Financial Reporting for Securities Lending Transactions, securities lent at year-end for cash collateral have not been categorized by custodial risk, while securities lent for securities collateral have been categorized.

## B. Deposits and Investments - Primary Government

### Deposits

In addition to equity in the Common Cash pool, some State funds maintain deposits with financial institutions. At year-end, the carrying amount of such deposits, excluding those classified as investments, was negative $11.1 million, which was caused primarily by a net book cash overdraft in an account maintained by the Michigan Unemployment Compensation Funds (MUCF). The deposits were reflected in the accounts of the banks at $12.6 million. Of the bank balances, $.2 million was covered by federal depository insurance or by collateral held by the State's agents in the State's name (GASB credit risk category #1), $11.3 million was covered by collateral held in the pledging banks' trust departments in the State's name (GASB credit risk category #2), and $1.2 million was uninsured and uncollateralized (GASB credit risk category #3).

### Investments

Investment authority for the State's pension (and other employee benefits) trust funds is found in P.A. 314 of 1965, as amended. This act allows the State Treasurer, as investment fiduciary, to make diverse investments in stocks, corporate and government bonds and notes, mortgages, real estate, venture capital, and other investments. The act has prudence standards and requires that the assets of a retirement system shall be invested solely in the interest of the participants and beneficiaries and be made for the exclusive purpose of providing benefits to the participants and the participants' beneficiaries, and of defraying reasonable expenses of investing the assets of the State system.

The State Treasurer is also authorized to invest a limited amount of pension (and other employee benefits) trust funds in futures contracts. At September 30, the pension (and other employee benefits) trust funds had a total of $205.0 million (market value) invested in such investments, which were made in Standard & Poors 500 and Standard & Poors Midcap Index futures contracts during the year. Derivatives are used for a small amount of the pension (and other employee benefits) trust fund portfolios to provide additional diversification. However, derivatives are not used for speculation and they are not used to leverage the investment portfolios. Less than 7% of the total pension (and other employee benefits) trust funds portfolio has been invested from time to time in futures contracts and swap agreements. The swap agreements provide that the retirement systems will pay quarterly, over the term of the swap agreements, interest indexed to the three month London Interbank Offered Rate (Libor), adjusted for an interest rate spread, on the notional amount stated in the agreements. United States domestic Libor-based floating rate notes were purchased in the open market to correspond with the notional amount of the swap agreements. The State Treasurer maintains custody and control of these notes. Swap agreements represent the largest category of derivatives used and total 6.4% of the total portfolio.

State statutes allow the pension (and other employee benefits) trust funds or other State funds to participate in securities lending transactions. The State Treasurer has authorized the agent bank to lend pension (and other employee benefits) trust fund or other State fund securities to broker-dealers and banks pursuant to a form of loan agreement.

The investment authority for other State funds is found in their enabling statutes and/or their bond resolutions where applicable. Except as noted below, the investments of the non-pension (and other employee benefits) trust funds are comprised mostly of United States government securities.

The State Building Authority makes diverse investments as allowed by State statute and/or bond resolutions.

Investments of MUCF represent their interest in a U.S. Treasury trust fund managed by the Secretary of the Treasury pursuant to Title IX of the Social Security Act, which includes deposits from the unemployment compensation funds of various states. MUCF is credited quarterly with trust fund investment earnings, as computed on a daily basis.

The deferred compensation plans are invested in mutual funds, U.S. Treasury strips, money market funds, and pooled investment funds. During fiscal year 2000-2001, the deferred compensation plans' investment activities were managed by a private investment firm, which invests as directed by members of the plan.

As a matter of administrative policy, the State Treasurer makes only limited use of investments in repurchase agreements. No such investments were outstanding at year-end.

The following table shows the carrying amounts and fair values of investments of the primary government by investment type and in total (in millions) at September 30:

| | GASB Category | | | | | |
|---|---|---|---|---|---|---|
| | #1 | #2 | #3 | Not Categorized | Total Carrying Value | Fair Value |
| Prime commercial paper | $ 3,082.4 | $ - | $ 40.5 | $ - | $ 3,122.9 | $ 3,117.5 |
| Short-term issues | 200.0 | - | - | 100.0 | 300.0 | 301.5 |
| Money market funds | - | - | - | 244.3 | 244.3 | 244.3 |
| Government securities | 4,348.2 | - | 165.8 | 104.0 | 4,618.1 | 4,618.1 |
| Investment agreements | 17.5 | - | - | - | 17.5 | 17.5 |
| Corporate bonds and notes | 4,524.6 | - | - | - | 4,524.6 | 4,524.6 |
| Equities | 18,470.8 | - | - | - | 18,470.8 | 18,470.8 |
| Mortgages | - | - | - | 44.6 | 44.6 | 44.6 |
| Real estate (1) | 93.1 | - | - | 4,148.1 | 4,241.2 | 4,241.2 |
| Venture capital and leveraged buyouts | 288.4 | - | - | 6,617.9 | 6,906.3 | 6,906.3 |
| International | 2,987.7 | - | - | - | 2,987.7 | 2,987.7 |
| U.S. Treasury (unemployment) trust fund | - | - | - | 2,834.5 | 2,834.5 | 2,834.5 |
| Mutual funds | - | - | - | 1,576.8 | 1,576.8 | 1,576.8 |
| Pooled investment funds | - | - | - | 1,714.0 | 1,714.0 | 1,714.0 |
| Security Lending Transactions: | | | | | | |
| Government securities | - | - | - | 1,629.1 | 1,629.1 | 1,629.1 |
| Corporate bonds and notes | - | - | - | 59.7 | 59.7 | 59.7 |
| Equities | - | - | - | 400.4 | 400.4 | 400.4 |
| Total Investments | $ 34,012.7 | $ - | $ 206.3 | $ 19,473.6 | $ 53,692.6 | $ 53,688.7 |

As Reported on the Statements of Net Assets and Statement of Fiduciary Net Assets

| | Current Investments | Non-Current Investments | Total |
|---|---|---|---|
| Governmental activities | $ 296.3 | $ 523.3 | $ 819.6 |
| Business-type activities | 2,943.3 | 709.3 | 3,652.7 |
| Fiduciary funds | 3,658.6 | 45,561.7 | 49,220.3 |
| | $ 6,898.3 | $ 46,794.4 | $ 53,692.6 |

(1) Category 1 real estate represents Real Estate Investment Trusts (REITs) which are evidenced by securities.

The cash collateral received on security lending transactions totaled $2.2 billion.

Pension (and other employee benefits) trust fund investments represent 91.3% of the total investments of the primary government. Other large holders of investments were the State Lottery Fund and MUCF.

The State Lottery Fund investments, $818.1 million, are all in the form of zero coupon U.S. Treasury bonds. As described more fully in Note 17, these investments are held to provide funding for deferred prize awards.

### Securities Lending Transactions

Under the authority of P.A. 314 of 1965, the State lends securities of the pension (and other employee benefits) trust funds and the State Lottery Fund to broker-dealers and other entities for collateral that will be returned for the same securities in the future. The custodian is not liable for any losses unless there is negligence or willful misconduct on its part. State statutes allow the Michigan Public School Employees, Michigan State Employees, Michigan State Police, and Michigan Judges Retirement Systems to participate in securities lending transactions, and the retirement systems have, via a Securities Lending Authorization Agreement, authorized the agent bank to lend its securities to broker-dealers and banks pursuant to a form of loan agreement. During the fiscal year, the agent bank lent, at the direction of the retirement systems, the retirement systems' securities and received: cash (United States and foreign currency), securities issued or guaranteed by the United States government, sovereign debt rated A or better, convertible bonds, and irrevocable bank letters of credit issued by a person other than the borrower or an affiliate of the borrower as collateral. The agent bank did not have the ability to pledge or sell collateral securities delivered absent a borrower default. Borrowers were required to deliver collateral for each loan equal to: 1) in the case of loaned securities denominated in United States dollars or whose primary trading market was located in the United States or sovereign debt issued by foreign governments, 102% of the market value of the loaned securities; and 2) in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States, 105% of the market value of the loaned securities.

The retirement systems did not impose any restrictions during the fiscal year on the amount of the loans that the agent bank made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or the agent bank.

During the fiscal year, the retirement systems and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool. As of September 30, 2001, the investment pool had an average duration of 75 days and an average weighted maturity of 551 days. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. On September 30, 2001, the retirement systems had no credit risk exposure to borrowers. The collateral held and the market value of securities on loan for the retirement systems as of September 30, 2001, were $2.1 billion and $2.0 billion respectively.

## C. Deposits and Investments - Discretely Presented Component Units

### Deposits

At year-end, the carrying amount of discretely presented component units deposits, excluding those classified as investments, was $224.9 million. The deposits were reflected in the accounts of the banks at $258.0 million. Of the bank balances, $14.8 million was covered by federal depository insurance or by collateral held by the component units' agents in the component units' names (GASB credit risk category #1), $8.9 million was covered by collateral held in the pledging banks' trust departments in the component units' names (GASB credit risk category #2), $182.1 million was uninsured and uncollateralized (GASB credit risk category #3), and $52.2 million was held in money market funds which are not categorized.

### Investments

The investment authority for most discretely presented component units is typically found in their enabling statutes and/or their bond resolutions where applicable. Those component units which are financing authorities generally may invest in government or government backed securities and deposits. The Michigan Education Trust's investments are subject to an investment agreement with the State Treasurer which allows the Treasurer, acting as agent, to make diverse investments including stocks, bonds, notes, and other investments. Investment policies for the State universities are typically set forth by their governing boards and include a broad range of investment types.

### Restricted Assets

Restricted assets on the government-wide Statement of Net Assets, totaling $1.2 billion, represent amounts that are pledged toward the payment of outstanding bonds and notes.

The following table shows the carrying amounts and fair values of investments of the discretely presented component units, including deposits classified as investments on the balance sheet, by investment type and in total (in millions):

| | GASB Category | | | | | |
|---|---|---|---|---|---|---|
| | #1 | #2 | #3 | Not Categorized | Total Carrying Value | Fair Value |
| Deposits(1): | | | | | | |
| Time deposits | $ 8.9 | $ - | $ 5.9 | $ 5.3 | $ 20.1 | $ 20.1 |
| Government money market accounts | - | - | 10.3 | 33.3 | 43.6 | 43.6 |
| Investments: | | | | | | |
| Commercial paper | 165.9 | 11.0 | 12.2 | - | 189.2 | 189.2 |
| Short-term notes | - | - | 52.4 | 12.8 | 65.2 | 65.2 |
| Repurchase agreements | 3.5 | - | 8.9 | - | 12.3 | 12.3 |
| Government securities | 758.4 | 43.3 | 58.0 | - | 859.7 | 859.7 |
| Insured mortgage backed securities | 124.3 | - | 13.7 | - | 138.0 | 138.0 |
| Government backed securities | 2.2 | - | 164.2 | - | 166.4 | 166.4 |
| Investment agreements | - | - | - | 317.7 | 317.7 | 317.7 |
| Corporate bonds and notes | 278.6 | - | 62.8 | - | 341.4 | 341.4 |
| Preferred stock | - | - | - | .9 | .9 | .9 |
| Equities | 8.4 | .2 | 25.9 | 16.8 | 51.3 | 51.3 |
| Real estate | .2 | .1 | - | .6 | .9 | .9 |
| Venture capital and leveraged buyouts | - | - | - | 12.7 | 12.7 | 12.7 |
| Government money market funds | - | - | - | 61.9 | 61.9 | 61.9 |
| Mutual funds | - | - | 12.5 | 160.2 | 172.6 | 172.6 |
| Guaranteed investment contracts | 50.2 | - | 9.8 | 1,092.6 | 1,152.6 | 1,152.6 |
| Pooled investment funds | - | - | - | 461.2 | 461.2 | 461.2 |
| Other investments | - | - | 6.1 | - | 6.1 | 6.1 |
| Total Investments | $ 1,400.6 | $ 54.6 | $ 442.6 | $ 2,176.0 | 4,073.8 | $ 4,073.8 |
| Less Investments Reported as "Cash" on the Statement of Net Assets | | | | | (633.5) | |
| Total Investments | | | | | $ 3,440.2 | |
| As Reported on the Statement of Net Assets | | | | | | |
| Current investments | | | | | $ 690.4 | |
| Noncurrent restricted investments | | | | | 665.5 | |
| Noncurrent investments | | | | | 2,084.4 | |
| Total Investments | | | | | $ 3,440.2 | |

(1) The deposits classified as investments were reflected in the accounts of the banks in amounts equal to their carrying value and are categorized using the deposit risk category definitions.

### Interest Rate Exchange Agreements

The Michigan Higher Education Student Loan Authority (MHESLA) has an outstanding interest rate exchange agreement with an outside party for a notional amount of $11.0 million. The agreement converts MHESLA's interest rate exposure on $11.0 million of its fixed rate bonds to a variable rate allowing improved matching yields on variable rate student loans. The agreement, which matures on September 1, 2002, exposes MHESLA to credit loss in the event of nonperformance by the other party.

On January 2, 2002, Michigan State Housing Development Authority entered into a forward interest rate swap with outside parties for a notional amount totaling $60.0 million to hedge variable rate bonds that will be sold in 2002.

## NOTE 9 – MORTGAGES AND LOANS RECEIVABLE - DISCRETELY PRESENTED COMPONENT UNITS

Mortgages and loans receivable reported by the discretely presented component units consist of the following (in millions):

| | Mortgages and Loans Receivable (Gross) | Unamortized Discount/ Premium and Deferred Loan Origin-ation Fees | Allowance for Possible Losses | Mortgages and Loans Receivable (Net) |
|---|---|---|---|---|
| Authorities: | | | | |
| Michigan Higher Education Student Loan Authority | $ 830.2 | $ 3.9 | $ (.9) | $ 833.1 |
| Michigan State Housing Development Authority | 1,946.5 | (11.7) | (32.0) | 1,902.8 |
| Michigan Economic Development Corporation | 49.1 | - | (23.1) | 26.0 |
| | $ 2,825.8 | $ (7.9) | $ (56.0) | $ 2,761.9 |

The Michigan State Housing Development Authority had loan commitments outstanding at June 30, 2001, of $98.5 million. The Michigan Economic Development Corporation had loan and grant commitments outstanding at September 30, 2001, of $180.5 million.

The loans made by the Michigan Municipal Bond Authority are to local units of government, so those loans of $2.5 billion are reported on the "Amounts due from local units" lines on Statement of Net Assets.

## NOTE 10 – CAPITAL ASSETS

### A. Primary Government

#### Summary of Significant Accounting Policies

**Methods used to value capital assets**
Capital assets, which include property, plant, equipment, and infrastructure items (e.g. roads, bridges, ramps, and similar items), are reported in the applicable governmental or business-type activity columns of the government-wide financial statements. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

**Capitalization policies**
All land and non-depreciable land improvements are capitalized, regardless of cost. Equipment is capitalized when the cost of individual items exceed $5 thousand, and all other capital assets are capitalized when the cost of individual items or projects exceed $100 thousand.

The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized.

**Items not capitalized and depreciated**
The State possesses certain capital assets that have not been capitalized and depreciated, because the assets cannot be reasonably valued and/or the assets have inexhaustible useful lives. These assets include works of art and historical treasures, such as statues; monuments; historical documents; paintings; forts and lighthouses; rare library books; miscellaneous capitol-related artifacts and furnishings; and the like.

**Depreciation and useful lives**
Applicable capital assets are depreciated using the straight-line method, with a half-year's depreciation charged in the year of acquisition and in the year of disposal. Agencies assigned useful lives that were most suitable for the particular assets. Estimated useful lives generally were assigned as follows:

| Asset | Years |
|---|---|
| Equipment | 2-25 |
| Buildings | 3-50 |
| Infrastructure | 15-40 |
| Land Improvements | 10-40 |

**Modified approach for infrastructure**
The State has elected to use the "modified approach" to account for certain infrastructure assets, as provided in GASB Statement No. 34. Under this process, the State does not record depreciation expense nor are amounts capitalized in connection with improvements to these assets, unless the improvements expand the capacity or efficiency of an asset. Utilization of this approach requires the State to: 1) commit to maintaining and preserving affected assets at or above a condition level established by the State, 2) maintain an inventory of the assets and perform periodic condition assessments to ensure that the condition level is being maintained, and 3) make annual estimates of the amounts that must be expended to maintain and preserve assets at the predetermined condition levels.

Roads and bridges maintained by the Department of Transportation are accounted for using the modified approach.

Capital asset activities for the fiscal year ended September 30, 2001 were as follows (in millions):

| Governmental Activities | Beginning Balance | Additions | Deletions | Adjustments and Reclas-sifications | Ending Balance |
|---|---|---|---|---|---|
| Capital assets, not being depreciated: | | | | | |
| Land | $ 3,015.8 | $ 82.1 | $ (10.8) | $ 6.2 | $ 3,093.3 |
| Land improvements | 7.9 | .5 | - | - | 8.4 |
| Construction in progress | 446.5 | 608.4 | (193.2) | .6 | 862.3 |
| Infrastructure | 11,545.2 | 264.1 | (214.4) | - | 11,594.9 |
| Mineral rights | 18.9 | - | - | - | 18.9 |
| Total capital assets, not being depreciated | 15,034.3 | 955.1 | (418.4) | 6.8 | 15,577.9 |
| Capital assets, being depreciated: | | | | | |
| Land improvements | 69.4 | 1.1 | (.7) | 2.6 | 72.3 |
| Equipment | 562.2 | 112.1 | (55.8) | (.7) | 617.9 |
| Buildings | 2,421.8 | 190.8 | (63.9) | 79.7 | 2,628.4 |
| Vehicles | 8.7 | - | (1.6) | - | 7.1 |
| Infrastructure | 490.8 | 4.5 | - | 3.0 | 498.3 |
| Total capital assets, being depreciated | 3,552.9 | 308.5 | (122.0) | 84.5 | 3,823.9 |
| Less accumulated depreciation for: | | | | | |
| Land improvements | (22.4) | (1.8) | .4 | (.7) | (24.5) |
| Equipment | (380.0) | (80.1) | 34.2 | 1.0 | (424.8) |
| Buildings | (792.6) | (61.4) | 31.1 | (91.0) | (913.9) |
| Vehicles | (6.4) | (.3) | 1.4 | - | (5.3) |
| Infrastructure | (264.1) | (18.6) | - | (.1) | (282.8) |
| Total accumulated depreciation | (1,465.5) | (162.1) | 67.1 | (90.8) | (1,651.3) |
| Total capital assets, being depreciated, net | 2,087.4 | 146.4 | (54.9) | (6.3) | 2,172.6 |
| Governmental activity capital assets, net | $ 17,121.7 | $ 1,101.5 | $ (473.2) | $ .5 | $ 17,750.5 |

| Business-type Activities | Beginning Balance | Additions | Deletions | Adjustments and Reclas-sifications | Ending Balance |
|---|---|---|---|---|---|
| Capital assets, being depreciated: | | | | | |
| Buildings | $ 1.5 | $ - | $ - | $ - | $ 1.5 |
| Equipment | 2.7 | .2 | (1.1) | - | 1.9 |
| Total capital assets, being depreciated | 4.3 | .2 | (1.1) | - | 3.4 |
| Less accumulated depreciation for: | | | | | |
| Buildings | (1.5) | - | - | - | (1.5) |
| Equipment | (2.3) | (.2) | 1.0 | - | (1.6) |
| Total accumulated depreciation | (3.8) | (.2) | 1.0 | - | (3.1) |
| Total capital assets, being depreciated, net | .5 | - | (.1) | - | .3 |
| Business-type activity capital assets, net | $ .5 | $ - | $ (.1) | $ - | $ .3 |

Depreciation expense was charged to functions of the primary government as follows:

| | | Amount |
|---|---|---|
| Governmental Activities: | | |
| General Government | $ | 18.4 |
| Education | | .7 |
| Family Independence Services | | 35.1 |
| Public Safety and Corrections | | 49.8 |
| Conservation, Recreation, and Agriculture | | 9.4 |
| Health Services | | 18.3 |
| Transportation | | 30.2 |
| Depreciation on capital assets held by the State's internal service funds is charged to the various functions based on their use of the assets. | | 37.6 |
| Total Depreciation Expense – Governmental Activities | $ | 199.5 |
| Business-type Activities: | | |
| Enterprise | | .2 |
| Total Depreciation Expense – Business-type Activities | $ | .2 |

## B. Discretely Presented Component Units

The following table summarizes net capital assets reported by the discretely presented component units (in millions):

| | | Amount |
|---|---|---|
| State Universities: | | |
| Land and other Non-depreciable Assets | $ | 79.5 |
| Buildings, Equipment, and other Depreciable Assets | | 3,084.9 |
| Infrastructure | | 55.0 |
| Construction in Progress | | 208.4 |
| Total | | 3,427.8 |
| Less Accumulated Depreciation | | (1,239.4) |
| Capital Assets, net – State Universities | | 2,188.4 |
| Capital Assets, net – Authorities | | 133.5 |
| Capital Assets, Total – Discretely Presented Component Units | $ | 2,321.9 |

# NOTE 11 – PENSION BENEFITS AND OTHER POSTEMPLOYMENT BENEFITS

## A. Defined Benefit Pension Plans

The State of Michigan administers the following defined benefit pension plans:

Legislative Retirement System (LRS) - single employer
State Police Retirement System (SPRS) - single employer
State Employees' Retirement System (SERS) - single employer
Public School Employees' Retirement System (PSERS) - cost sharing multi-employer
Judges' Retirement System (JRS) - cost sharing multi-employer
Military Retirement Plan (MRP) - single employer

Each plan provides retirement, disability, death benefits, and annual cost-of-living adjustments to plan members. Each plan, except MRP, is accounted for in a separate pension trust fund and also issues a publicly available financial report that includes financial statements and required supplementary information for that plan. Those reports, except LRS, may be obtained by writing to the Department of Management and Budget, Office of Retirement Services, 7150 Harris Drive, P.O. Box 30171, Lansing, MI 48909 or by calling (517) 322-6262. The LRS report may be obtained by writing to the Michigan Legislative Retirement System, House Office Building, Suite S0927, P.O. Box 30014, Lansing, MI 48909 or by calling (517) 373-0575.

As mandated by legislation, all new State of Michigan employees hired on or after March 31, 1997, are members of the defined contribution retirement plan as opposed to the LRS, SERS and JRS defined benefit plans. Employees hired before that date were given the option of remaining in the defined benefit plan or transferring to the defined contribution plan. The decision is irrevocable and transfers were completed by September 30, 1998. This was a one-time opportunity. With the passage of the legislation permitting the transfer, the LRS, SERS and JRS defined benefit plans became closed systems.

| Plan Membership Data | LRS | SPRS | SERS | PSERS | JRS | MRP |
|---|---|---|---|---|---|---|
| Current active: | | | | | | |
| Vested | 33 | 1,136 | 36,175 | 118,969 | 268 | 637 |
| Nonvested | 21 | 1,001 | 8,792 | 199,569 | 112 | 9,205 |
| Retirees & beneficiaries receiving benefits | 242 | 2,382 | 37,111 | 130,790 | 546 | 2,156 |
| Terminated members with vested deferred benefits | 80 | 24 | 4,865 | 14,313 | 15 | 965 |

### SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PLAN ASSETS MATTERS

**Basis of Accounting**
The financial statements are prepared using the accrual basis of accounting. Employee and employer contributions are recognized as revenues in the period in which employee services are performed. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

**Methods Used to Value Investments**
Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national exchange are valued at the last reported sales price. The fair value of real estate investments is based on independent appraisals. Investments that do not have an established market are reported at estimated fair value.

**Significant Investments**
No investment of any of the pension plans comprises 5% or more of the net assets available for benefits. There are no significant investments made in securities issued by the State, nor are there any loans made from the pension plans to the State. Additional disclosures concerning investments are provided in Note 8 and, concerning State Treasurer's Common Cash, in Note 5.

### FUNDING POLICY

The Legislature establishes the extent to which the employer and employees are required to make contributions and establishes the benefit provisions for each plan. Actual total contributions for pensions met or exceeded the contributions required by state law.

The Public School Employees' Retirement System (PSERS) is a cost-sharing, multiple-employer, State-wide defined benefit retirement system. Statute requires a reconciliation of required contributions and actual contributions in the PSERS. Public Act 158 of 1992 provides that any overage or shortage must be paid in installments over five years.

The contributions for judges in the Judges' Retirement System are non-employer contributions to cost-sharing multiple-employer defined benefit pension systems.

The contributions to all other systems are employer contributions to single-employer defined benefit systems. However, the State does not make actuarially computed contributions to the Military Retirement Plan (MRP). MRP benefits, which are funded on the pay-as-you-go basis, are paid from the General Fund.

Effective in fiscal year 2000-2001, SPRS, SERS, and PSERS use the valuation for the previous fiscal year for their respective reports. This approach is consistent with Governmental Accounting Standards Board (GASB) Statement No. 25. Consistent with this approach the most recent actuarial valuation was performed as of September 30, 2000.

## ANNUAL PENSION COST AND OTHER RELATED INFORMATION

*Current year contribution rates, annual pension cost, and related information for the current year for the State's single employer defined benefit plans are as follows:

| | LRS | SPRS | SERS | MRP |
|---|---|---|---|---|
| **Required contribution rates:** | | | | |
| State | - | 18.87% | 4.57% | -** |
| Plan Members | *** | - | - | - |
| (Amounts are in millions) | | | | |
| **Annual Pension Cost and Net Pension Obligation:** | | | | |
| Annual required contribution | $ - | $ 21.99 | $ 102.99 | $ 2.95 |
| Interest on net pension asset | (.16) | 1.18 | (7.40) | .46 |
| Adjustment to annual required contribution | .29 | (.75) | 7.60 | (.48) |
| Annual pension cost | .13 | 22.42 | 103.19 | 2.94 |
| Contributions made | - | 24.06 | 112.30 | 2.25 |
| Change in net pension asset/obligation | .13 | (1.64) | (9.11) | .69 |
| Net pension (asset) obligation at beginning of fiscal year | (2.34) | 14.70 | (92.55) | 5.79 |
| Net pension (asset) obligation at end of fiscal year | $ (2.21) | $ 13.06 | $ (101.66) | $ 6.48 |
| **Significant Actuarial Assumptions used include:** | | | | |
| Latest actuarial valuation date | 9/30/01 | 9/30/00 | 9/30/00 | 9/30/01 |
| Actuarial cost method | Entry Age | Entry Age | Entry Age | Entry Age |
| Amortization method | Level percent of payroll | Level percent closed | Level percent of payroll closed | Level dollar closed |
| Remaining amortization period | 12 years | 36 years | 36 years | 35 years |
| Asset valuation method | 5-year smoothed market | 5-year smoothed market | 5-year smoothed market | None, unfunded plan |
| Actuarial assumption: | | | | |
| Investment rate of return | 7% | 8% | 8% | 8% |
| Projected salary increases | 4% | 4.7 - 84% | 4 - 16% | 4% |
| Includes inflation at | 4% | 4% | 4% | 4% |
| Cost-of-living adjustments | 4% annual compounded for members hired before 1/1/95 | 2% annual non-compounded with maximum annual increase $500 | 3% annual non-compounded with maximum annual increase $300 | 4% for special duty retirants |

*For MRP, information provided is based on most recent biennial actuarial valuation.

**For MRP, there is no underlying payroll of participants. Except for five special duty members, retirants receive $600 in annual pension benefits. Accordingly, the annual required contribution from the State is determined as a dollar amount, not as a percentage of payroll.

***For participants prior to January 1, 1995, the required contribution rate is 9.0%. For participants after January 1, 1995, the required contribution rate is 7.0%. All contributions are made to the Health Insurance Fund, as described in Section C.

Contribution rates for the current year for the State's cost-sharing multiple-employer defined benefit plans are as follows:

| | PSERS | JRS |
|---|---|---|
| **Required contribution rates:** | | |
| State | 6.15% | ** |
| Plan Members | 3.9* | 5.95 |
| Number of participating employers | 716 | 172 |

*For those members who elect to participate in the "Member Investment Plan," the rate is 3.9%. Members hired after December 31, 1989, are required to participate in the "Member Investment Plan," and their contribution rate varies from 3.0 to 4.3% as salary increases.

**The State is required to contribute annually the greater of 3.5% of the aggregate annual compensation of State paid based salaries or required amount. However, the plan in the current year is fully funded; therefore, no contribution is required.

## THREE YEAR HISTORICAL TREND INFORMATION

The following table provides a schedule of funding progress for the State's defined benefit plans:

(Amounts in millions)

| | Actuarial Valuation Date | (a) Actuarial Value of Assets | (b) Actuarial Accrued Liability (AAL) | (b-a) Unfunded (Overfunded) AAL | (a/b) Funded Ratio | (c) Covered Payroll | ((b-a)/c) UAAL as a Percentage of Covered Payroll |
|---|---|---|---|---|---|---|---|
| **LRS** | | | | | | | |
| | 9/30/01 | $ 168.4 | $ 138.6 | $ (29.8) | 121.5% | $ 4.3 | (693.0)% |
| | 9/30/00 | 160.3 | 128.5 | (31.8) | 124.7 | 4.3 | (739.5) |
| | 9/30/99 | 146.1 | 127.1 | (19.0) | 115.0 | 4.2 | (452.4) |
| **SPRS**** | | | | | | | |
| | 9/30/00 | 1,113.1 | 1,040.7 | (72.4) | 107.0 | 116.6 | (62.1) |
| | 9/30/99 | 1,036.8 | 1,006.5 | (30.3) | 103.0 | 116.9 | (25.9) |
| | 9/30/98 | 974.4 | 962.5 | (11.9) | 101.2 | 108.2 | (11.0) |
| **SERS**** | | | | | | | |
| | 9/30/00 | 10,336.8 | 9,473.8 | (863.0) | 109.1 | 2,253.8 | (38.3) |
| | 9/30/99 | 9,648.3 | 9,028.6 | (619.7) | 106.8 | 2,213.8 | (28.0) |
| | 9/30/98 | 9,109.0 | 8,497.0 | (612.0) | 107.2 | 2,108.0 | (29.0) |
| **PSERS**** | | | | | | | |
| | 9/30/00 | 36,893.0 | 37,139.0 | 246.0 | 99.3 | 8,985.0 | 2.7 |
| | 9/30/99 | 34,095.0 | 34,348.0 | 253.0 | 99.3 | 8,644.0 | 2.9 |
| | 9/30/98 | 31,870.0 | 32,863.0 | 993.0 | 97.0 | 8,265.0 | 12.0 |
| **JRS** | | | | | | | |
| | 9/30/01 | 291.0 | 224.7 | (66.3) | 129.5 | 42.5 | (155.7) |
| | 9/30/00 | 274.8 | 204.2 | (70.6) | 134.6 | 37.0 | (190.7) |
| | 9/30/99 | 320.9 | 243.5 | (77.4) | 131.8 | 49.6 | (155.9) |
| **MRP*** | | | | | | | |
| | 9/30/01 | - | 34.4 | 34.4 | - | .5 | 7,284.7 |
| | 9/30/99 | - | 33.5 | 33.5 | - | .5 | 6,771.4 |
| | 9/30/97 | - | 30.3 | 30.3 | - | .4 | 7,575.0 |

*Actuarial valuation performed biennially.
**The most recent actuarial valuation was performed as of September 30, 2000.

The following table provides a schedule of annual pension cost and net pension obligation for the State's single employer defined benefit plans (amounts in millions):

| | Year | Annual Cost (APC) | Percentage Contributed | Net Pension Obligation (Asset) |
|---|---|---|---|---|
| **LRS** | | | | |
| | 1998-99 | .1 | - | (2.5) |
| | 1999-00 | .1 | - | (2.3) |
| | 2000-01 | .1 | - | (2.2) |
| **SPRS** | | | | |
| | 1998-99 | 23.0 | 93.7 | 12.2 |
| | 1999-00 | 24.6 | 89.8 | 14.7 |
| | 2000-01 | 22.4 | 107.3 | 13.1 |
| **SERS** | | | | |
| | 1998-99 | 111.5 | 108.6 | (91.8) |
| | 1999-00 | 121.1 | 100.6 | (92.6) |
| | 2000-01 | 103.2 | 108.8 | (101.7) |
| **MRP** | | | | |
| | 1998-99 | 2.5 | 84.4 | 5.0 |
| | 1999-00 | 3.0 | 74.8 | 5.8 |
| | 2000-01 | 3.0 | 76.5 | 6.5 |

The following table provides a schedule of annual required contributions for the State's cost-sharing multiple-employer defined benefit plans (amounts in millions):

| | Fiscal Year | Annual Required Contribution (ARC) | Percentage of ARC Contributed |
|---|---|---|---|
| **PSERS** | | | |
| | 1998-99 | 593.5 | 96.8 |
| | 1999-00 | 572.6 | 114.4 |
| | 2000-01 | 582.4 | 108.2 |
| **JRS** | | | |
| | 1998-99 | 1.3 | 4.6 |
| | 1999-00 | - | - |
| | 2000-01 | - | - |

## REQUIRED SUPPLEMENTARY INFORMATION

GASB Statement No. 25 requires the disclosure of certain six-year historical trend information. This information, except for MRP, is available from the separately issued financial reports of the retirement systems. For MRP, this information is presented below.

Trend information is intended to help users assess the funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other public employee retirement systems.

### Schedule of funding progress for MRP

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded AAL (b)-(a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a Percentage of Covered Payroll ((b-a)/c) |
|---|---|---|---|---|---|---|
| 9/30/97 | - | 30.3 | 30.3 | - | .4 | 7,575.0 |
| 9/30/99 | - | 33.5 | 33.5 | - | .5 | 6,771.4 |
| 9/30/01 | - | 34.4 | 34.4 | - | .5 | 7,284.7 |

Actuarial valuation performed biennially; plans with biennial valuations need not present duplicate information for the intervening years.

**Schedule of Employer Contributions for MRP:**

| Year ended September 30 | Annual required contribution | Percentage contributed |
|---|---|---|
| 2001 | 3.0 | 76.1 |
| 2000 | 3.0 | 74.6 |
| 1999 | 2.5 | 84.7 |
| 1998 | 2.5 | 82.3 |
| 1997 | 2.3 | 85.0 |
| 1996 | 2.3 | 94.3 |

Actuarial information for MRP is provided in the annual pension cost and other related information section.

## B. Defined Contribution Pension Plans

### State Employees' Defined Contribution Retirement Plan

The State Employees' Defined Contribution Retirement Plan (Plan) was established to provide benefits at retirement to employees of the State who were hired after March 31, 1997, and to those members of the State Employees' Retirement (defined benefit) System, Judges' Retirement System, and Legislative Retirement System who elected to transfer to this plan. The Plan is administered by the Department of Management and Budget. The State is required to contribute 4% of annual covered payroll. The State is also required to match employee contributions up to 3% of annual covered payroll. Plan provisions and contribution requirements are established and may be amended by the Legislature. Employer contributions to the plan for the year totaled $41.3 million. Participant contributions to the plan were $15.2 million. The reports may be obtained by writing to the Department of Management and Budget, Office of Retirement Services, 7150 Harris Drive, P.O. Box 30171, Lansing, MI 48909 or by calling (517) 322-6262.

The following investments represent 5% or more of net plan assets at September 30, 2001: SSGA Stable Value GIC Fund, $29.5 million; Yield Enhanced Short-Term Fund, $81.8 million; SSGA S&P 500 Index Fund, $21.6 million; Dodge & Cox Stock Fund, $19.7 million; Fidelity Magellan Fund, $29.6 million; Putnam Voyager, $21.5 million.

Effective September 30, 2000, the assets and coverage of members of the Michigan Judges' Retirement System were transferred to the State Employees' Defined Contribution Retirement Plan.

### Component Units

In addition to the Public School Employees' Retirement System (PSERS), the State university component units participate in the Teachers' Insurance and Annuity Association and College Retirement Equities Fund (TIAA-CREF). The TIAA-CREF is a defined contribution multiple-employer pension plan. The State university component units are required to contribute between 4% and 15% of annual covered payroll, as determined by each institution's employment agreements. The total contribution to the TIAA-CREF for all State university component units was $59.4 million for the year ending June 30, 2001.

Additional plan information may be found in the separately issued financial reports of the State university component units.

## C. Other Postemployment Benefits

In addition to the pension benefits previously described in this Note, State statutes require that the State provide certain postemployment benefits (OPEB) to many of its retired employees. Health, dental, and vision benefits as well as life insurance coverage are provided to retirees of all pension plans except MRP. These benefits are funded on a pay-as-you-go basis, except for LRS life insurance coverage, as explained below.

The LRS life insurance benefits are paid on an advance-funded basis. The actuarial cost method and actuarial assumptions are the same as for the pension plan, as discussed in Section A. At September 30, 2001, the actuarial accrued liability for life insurance premiums was $8.2 million with net assets available for benefits of $12.5 million. The expense for life insurance premiums was $.2 million in fiscal year 2000-2001.

The net assets available for benefits relate to residual balances from funding provided in prior fiscal years. There were no material changes in the OPEB provisions during fiscal year 2000-2001.

Following is a brief summary of the other postemployment benefits as of September 30, 2001:

| | LRS | SPRS | SERS | JRS | PSERS | TOTAL |
|---|---|---|---|---|---|---|
| Participants eligible for benefits | 330 | 2,382 | 37,111 | 546 | 130,790 | 171,159 |
| Contribution rates for current employees (% of payroll) | None | None | None | 1.5% | None | |
| Percentage of pre-Medicare premiums paid by participants | None | 5% | 5% | 5% | 10%* | |
| Expense for year (in millions) | $3.0 | $23.0 | $248.2 | $ .5 | $456.3 | $731.0 |
| Net assets available for benefits (in millions) | 5.7 | (2.5) | 23.0 | (.5) | 213.0 | 238.7 |

*The schools that employ the plan's members pay the employer share of health costs. PSERS retirees pay the same share of health care costs required from Social Security retirees for part B Medicare coverage until Medicare coverage begins at age 65. Dental, vision, and hearing benefits are also extended to all retirees and their beneficiaries, for which retirees pay 10% of the health premiums.

## NOTE 12 – COMPENSATED ABSENCES

### A. Primary Government

#### Plan Descriptions

Employees accumulate annual leave (vacation) balances to a maximum ranging from 256 to 316 hours. They receive a 100% termination payment upon separation based upon their final rate of pay. Employee sick leave balances accumulate without limit. Termination payments are made only upon separation from State service and only to employees hired prior to October 1, 1980. Payments at retirement or death are based on 50% of the employee's sick leave accumulation times their last rate of pay. When separating for any other reason, employees are paid a percentage of their unused sick leave which increases from 0 to 50% depending upon the balance of their sick leave hours.

#### Accounting Policy

In the government-wide and proprietary fund financial statements, the State accrues liabilities for compensated absences as required by GASB. Annual leave is valued at 100% of the balance plus the State's share of social security and retirement contributions. Sick leave is valued, as explained in the previous paragraph, at 0 to 50% plus the State's share of social security contributions. The pay rates in effect as of September 30, 2001, are used.

In the governmental fund financial statements, liabilities for compensated absences are accrued when they are considered "due and payable" and recorded in the fund only for separations or transfers that occur before year-end.

The following table summarizes liabilities for compensated absences as of September 30 (in millions):

| | Annual Leave | Sick Leave | Total |
|---|---|---|---|
| Governmental activities | $ 231.3 | $ 206.5 | $ 437.7 |
| Business-type activities | 1.5 | 1.6 | 3.1 |
| Total - primary government | $ 232.8 | $ 208.0 | $ 440.8 |

### B. Discretely Presented Component Units

Compensated absences liabilities of discretely presented component units totaled $48.5 million and are primarily related to State universities.

## NOTE 13 – LEASES

#### Accounting Policy

The State leases various assets under noncancelable leasing arrangements. Leases that constitute rental agreements are classified as operating leases; the resulting expenditures are recognized as incurred over the lease term. Leases that are comparable to purchases are classified as capital leases.

In the government-wide and proprietary fund statements, assets and liabilities resulting from capital leases are recorded at lease inception. The principal portion of lease payments reduces the liability, the interest portion is expensed.

For capital leases in governmental funds, other financing sources and expenditures are recorded at lease inception. Lease payments are recorded as debt service expenditures. (As explained in Note 3, for budgetary purposes, lease payments are only reported as expenditures when paid.)

Most leases have cancellation clauses with 1 to 6 month notice requirements in the event that funding is not available. For reporting purposes, such cancellation clauses are not considered in the determination of whether a lease is cancelable, because the likelihood that they will be exercised is considered remote. Some lease agreements include renewal or purchase options. The effect of such options is reflected in the minimum lease payments only if it is considered reasonably assured that an option will be exercised. Some lease agreements include escalation clauses or other contingent rentals.

The State has entered into a few installment purchase agreements. Because the amounts involved are immaterial, and the accounting treatment is similar, such agreements are reported together with capital leases.

Leases that exist between the State and the State Building Authority (SBA, a blended component unit) are not recorded as leases in this report. In their separately issued financial statements, SBA records a lease receivable from the State. Although payables and receivables technically exist between these parties, when combined for government-wide reporting, they are eliminated. A long-term liability exists on the government-wide statements for the bonds issued by SBA to construct the assets associated with the leases. Future payments to SBA are, therefore, not included in the schedules of lease commitments below. Note 14 provides information on the amount of the Authority's bonds outstanding and a schedule of debt service requirements.

## A. Primary Government – Governmental Activities

Rental expenditures incurred under operating leases totaled $84.4 million during the fiscal year. Payments for capital lease principal, interest, and executory costs totaled $33.7 million, $28.0 million, and $13.5 million, respectively.

A summary of the operating and noncancelable capital lease commitments to maturity follows (in millions):

| | | Capital Leases | | | |
|---|---|---|---|---|---|
| Year Ended September 30 | Operating Leases | Principal | Interest | Executory Costs | Total |
| 2002 | $ 44.7 | $ 30.4 | $ 26.9 | $ 12.4 | $ 69.6 |
| 2003 | 35.6 | 28.0 | 24.3 | 12.3 | 64.5 |
| 2004 | 30.0 | 26.8 | 21.7 | 12.0 | 60.5 |
| 2005 | 23.4 | 21.8 | 19.2 | 11.6 | 52.6 |
| 2006 | 15.5 | 19.5 | 16.8 | 10.5 | 46.9 |
| 2007-2011 | 22.3 | 66.5 | 55.6 | 35.3 | 157.5 |
| 2012-2016 | 1.8 | 37.5 | 26.4 | 17.5 | 81.3 |
| 2017-2021 | - | 22.5 | 6.9 | 7.6 | 37.0 |
| Thereafter | - | 2.0 | .4 | .7 | 3.1 |
| Total | $ 173.3 | $ 254.8 | $ 198.2 | $ 120.0 | $ 573.1 |

The above capital leases relate to governmental activities which include the General Fund, special revenue funds, and the internal service funds. A liability of $254.8 million has been recorded in the government-wide statements for the capital lease principal. The historical cost of assets acquired under capital leases and included in capital assets on the government-wide statements at September 30 follows (in millions):

| | |
|---|---|
| Buildings | $ 304.8 |
| Equipment | 92.4 |
| Total | 397.2 |
| Accumulated Depreciation | (178.2) |
| Net Buildings and Equipment | $ 219.1 |

## B. Primary Government – Business-Type Activities

Rental expense incurred under operating leases totaled $.2 million during the fiscal year. There were no capital lease obligations.

A summary of operating lease commitments to maturity follows (in millions):

| Year Ended September 30 | Operating Leases |
|---|---|
| 2002 | $ .2 |
| 2003 | .1 |
| 2004 | .1 |
| 2005 | .1 |
| | $ .5 |

## C. Discretely Presented Component Units

Operating lease commitments for universities and authorities totaled $15.0 million. Total capital lease obligations were $21.5 million, $14.7 million, and $0 for principal, interest, and executory costs, respectively.

# NOTE 14 – LONG-TERM LIABILITIES

## A. Bonded Debt

### General Obligation Bonded Debt

Article 9, Section 15, of the State Constitution authorizes general obligation long-term borrowing, subject to approval by the Legislature and a majority of voters at a general election. In addition, debt may be incurred without voter approval for the purpose of providing loans to school districts. General obligation notes to provide temporary financing for such loans are recorded as liabilities in the School Bond Loan Fund, a special revenue fund. No such borrowing occurred in fiscal year 2000-2001. General Fund appropriations are made to finance debt principal and interest requirements for all general obligation issues. General obligation bonds are backed by the full faith and credit of the State.

The State Constitution provides that the Legislature may also authorize the issuance of general obligation short-term notes, the principal amount of which may not exceed 15% of undedicated revenues received in the preceding year. The State Constitution also provides that such notes must be repaid within the fiscal year of the borrowing. No such borrowing occurred in fiscal year 2000-2001.

### Revenue Dedicated Bonded Debt

Long-term bonds have been issued periodically for specific purposes, with the stipulation that financing of debt requirements is to come strictly from designated revenue sources. The transportation related debt is payable solely out of funds restricted for transportation purposes by Article 9, Section 9, of the State Constitution. The State's general credit does not support such issues.

The Michigan Underground Storage Tank Financial Assurance Finance Authority issued revenue bonds to provide financing for the activities of the Michigan Underground Storage Tank Financial Assurance Fund (MUSTFA). The bonds and notes are a limited obligation of the Authority payable solely from dedicated revenues and do not represent a general obligation of the finance authority or the State.

Revenue bonds have been issued by the State Building Authority (SBA) to acquire and/or construct various facilities for use by the State or institutions of higher education. Revenue bonds have also been issued to finance equipment capital lease refinancings and acquisitions. The $307.4 million of commercial paper notes outstanding at year-end are not recorded as liabilities in the Authority's statements, but are included in the "long-term liability activity" schedule presented later in this Note.

Subsequent to September 30, 2001, SBA issued an additional $146.1 million in commercial paper. However, a significant portion of outstanding commercial paper has been paid by the issuance of the 2001 Revenue Bonds Series II in the amount of $170.1 million. Stated coupon rates for these bonds range from 3.0 to 5.5 percent, which mature on October 15, 2019. These bonds and notes are limited obligations of SBA and do not constitute general obligations of SBA or the State. The debt requirements of the bonds are financed through General Fund appropriations, excess bond proceeds, and investment earnings.

Grant anticipation notes have been issued by the Department of Transportation (MDOT) in the amount of $400.0 million. The notes have variable rates that may bear interest at a daily interest rate, a weekly rate, note interest term rate, long-term interest rate, or an ARS interest rate.

The notes are issued in accordance with the authorization provided in P.A. 51 of 1951, as amended. The proceeds of the sale of the notes together with investment earnings on the proceeds and other available monies will be used to pay a portion of the costs to complete the Build Michigan II highway program, to pay capitalized interest on the notes, and to pay note issuance costs.

The principal and interest on the notes are payable solely from and are secured by an irrevocable pledge of the State share of all federal grants received each year under the Federal-Aid Highway Program. Payment of the principal and interest on the notes from the State share shall be subject to an appropriation each year by the Legislature in an amount sufficient to make the payments. As of September 30, 2001, there were no principal payments made on the notes. The amount outstanding at September 30, 2001, is $400.0 million and is not disclosed in the table below. These notes mature in 2008.

Note 15 provides disclosures regarding the bonds and notes payable of the discretely presented component units.

### Bonds Issued and Outstanding

General obligation and revenue dedicated bonds issued and outstanding (excluding defeased bonds) at September 30 (in millions) are as follows:

| GENERAL OBLIGATION BONDED DEBT | AMOUNTS ISSUED | OUTSTANDING 9/30/2001 | MATURITIES FIRST YEAR | MATURITIES LAST YEAR | AVERAGE INTEREST RATE PERCENTAGE |
|---|---|---|---|---|---|
| General Obligation Refunding Debt: | | | | | |
| Series 2001 (Refunding) | $ 183.3 | $ 183.3 | 2002 | 2016 | 4.76 |
| Recreation and Environmental Protection: | | | | | |
| Series 1989 (1) | 75.0 | 28.2 | 1991 | 2011 | 6.92 |
| Series 1992 (1) | 246.3 | 120.4 | 1993 | 2012 | 6.15 |
| College Savings Bonds - Series 1992 Mini-bonds (1) | .5 | .8 | 2012 | 2012 | 6.50 |
| Series 1992 A (1)(2) | 13.9 | 9.4 | 1994 | 2012 | 6.17 |
| Series 1993 (1)(2) | 16.7 | 12.8 | 1995 | 2013 | 5.00 |
| Series 1995 (1) | 234.3 | 143.7 | 1996 | 2019 | 5.28 |
| Series 1998 (1) | 90.0 | 80.3 | 1998 | 2017 | 4.80 |
| Series 1999 A (3) | 81.8 | 81.8 | 2004 | 2020 | 5.57 |
| Series 1999 B (3) | 15.1 | 10.5 | 2001 | 2003 | 6.75 |
| Series 2000 (1) | 60.0 | 60.0 | 2002 | 2021 | 5.22 |

| | AMOUNTS ISSUED | OUTSTANDING 9/30/2001 | MATURITIES FIRST YEAR | MATURITIES LAST YEAR | AVERAGE INTEREST RATE PERCENTAGE |
|---|---|---|---|---|---|
| School Loan Bonds: | | | | | |
| Series 1995 | 180.0 | 65.3 | 1996 | 2015 | 5.47 |
| Series 1998 | 160.0 | 154.1 | 2000 | 2017 | 4.86 |
| Series 2001 A | 81.3 | 81.3 | 2005 | 2021 | 3.50 |
| TOTAL GENERAL OBLIGATION BONDED DEBT | 1,438.2 | 1,031.8 | | | |
| **REVENUE DEDICATED BONDED DEBT** | | | | | |
| MUSTFA Related: | | | | | |
| Tax Dedicated Bonds: | | | | | |
| 1996 - Revenue Bonds - Series I | 216.6 | 152.5 | 1997 | 2010 | 5.67 |
| TOTAL REVENUE DEDICATED BONDED DEBT - MUSTFA RELATED | 216.6 | 152.5 | | | |
| Transportation Related: | | | | | |
| Tax Dedicated Bonds: | | | | | |
| Michigan Comprehensive Transportation: | | | | | |
| Series 1992 (Series A and Series B Refunding) | 165.0 | 104.7 | 1996 | 2022 | 5.96 |
| Series 1996 (Series A Refunding) | 22.7 | 22.4 | 1998 | 2014 | 5.42 |
| Series 1998 (Series A Refunding) | 38.6 | 38.6 | 2004 | 2010 | 4.66 |
| Series 2001 (Series A Refunding) | 27.8 | 27.8 | 2008 | 2022 | 5.01 |
| State Trunkline Fund Bonds: | | | | | |
| Series 1989 (Series A) | 135.8 | 24.9 | 1994 | 2017 | 6.97 |
| Series 1992 (Series A and Series B Refunding) | 353.2 | 172.3 | 1999 | 2021 | 6.16 |
| Series 1994 (Series A and Series B Refunding) | 241.0 | 34.4 | 1994 | 2007 | 5.53 |
| Series 1996 (Series A) | 54.5 | 10.3 | 1997 | 2009 | 5.71 |
| Series 1998 (Series A) | 377.9 | 377.9 | 2005 | 2026 | 5.09 |
| Series 2001 (Series A) | 308.2 | 308.2 | 2003 | 2031 | 5.27 |
| TOTAL REVENUE DEDICATED BONDED DEBT - TRANSPORTATION RELATED | 1,724.6 | 1,121.5 | | | |
| State Building Authority: | | | | | |
| 1993 Revenue Bonds -- Refunding Series I | 491.5 | 288.4 | 1994 | 2016 | 4.58 |
| 1994 Series I Bonds | 39.8 | 25.8 | 1995 | 2012 | 5.07 |
| 1994 Series II Bonds | 29.1 | 20.9 | 1996 | 2011 | 4.62 |
| 1996 Series I Bonds | 109.9 | 76.8 | 1997 | 2010 | 5.04 |
| 1997 Series I Bonds | 144.8 | 111.0 | 1997 | 2010 | 5.18 |
| 1997 Series A Bonds | 34.3 | 23.0 | 1997 | 2006 | 4.76 |
| 1997 Series B Bonds | 42.9 | 1.3 | 1997 | 2001 | 4.51 |
| 1997 Series II Bonds | 371.9 | 325.0 | 1997 | 2014 | 5.53 |
| 1998 Series I Bonds | 109.5 | 98.5 | 1998 | 2014 | 4.84 |
| 1998 Series I Bonds Refunding | 330.4 | 315.3 | 1999 | 2021 | 4.75 |
| 1999 Series I | 85.7 | 80.1 | 1999 | 2016 | 4.54 |
| 2000 Revenue Bonds | 45.8 | 45.8 | 2002 | 2012 | 5.63 |
| 2000 Series I Bonds | 147.9 | 147.9 | 2002 | 2022 | 5.24 |
| 2001 Series I Bonds | 121.7 | 121.7 | 2002 | 2019 | 5.28 |
| 2001 Revenue Bonds | 58.2 | 58.2 | 2002 | 2014 | 5.13 |
| 2001 Series I Refunding Bonds | 419.7 | 419.7 | 2003 | 2026 | 5.31 |
| TOTAL STATE BUILDING AUTHORITY BONDED DEBT | 2,583.1 | 2,159.3 | | | |
| TOTAL REVENUE DEDICATED BONDED DEBT | 4,524.3 | 3,433.3 | | | |
| TOTAL GENERAL OBLIGATION AND REVENUE DEDICATED BONDED DEBT | $ 5,962.5 | $ 4,465.1 | | | |

(1) Public Act 327 of 1988 and P.A. 451 of 1994 authorized the issuance of bonds totaling $800 million. As of September 30, 2001, $676.6 million of such bonds had been issued, leaving remaining authorization of $123.4 million. Sum of amounts issued in table differs by amount of bonds refunded or redeemed.

(2) The $13.9 million Series 1992A and the $16.7 million Series 1993, Recreation and Environmental Protection General Obligation Bonds, were used to provide a contribution of capital to the Michigan Municipal Bond Authority (a discretely presented component unit). An outside trustee for the Authority is holding the bonds as an investment of the Authority; no immediate cash proceeds were provided. The trustee receives the debt service payments on the bonds, which are negotiable instruments held to subsidize water pollution control financing provided by the Authority.

(3) Public Act 284 of 1998 authorized the issuance of bonds totaling $675.0 million. As of September 30, 2001, $96.9 million of such bonds had been issued, leaving remaining authorization of $578.1 million.

**Capital Appreciation Bonds**

Capital appreciation and convertible capital appreciation bonds are recorded in the preceding table and section C at their accreted year-end book value. The tables which follow summarize capital appreciation bonds (in millions):

| | ACCRETED BOOK VALUE | ULTIMATE MATURITY VALUE | MATURITY DATES |
|---|---|---|---|
| **State Building Authority:** | | | |
| 1994 Series II | $ 19.6 | $ 24.2 | 2000-2012 |
| 1997 Series II | 29.3 | 42.5 | 2000-2012 |
| **General Obligation Bonds:** | | | |
| Series 1989 | 32.5 | 44.4 | 2011 |
| Series 1992 | 21.4 | 30.5 | 2012 |
| College Savings Bonds - Series 1992 Mini-bonds | .8 | 1.8 | 2012 |
| Series 1995 | 22.4 | 29.4 | 2001-2010 |
| **Revenue Dedicated – Transportation Related:** | | | |
| State Trunkline - Series 1989 A | 24.9 | 35.7 | 2004-2009 |
| State Trunkline - Series 1992 A and B | 61.1 | 97.7 | 2005-2012 |

## Advance Refundings and Defeasances

The State has defeased certain bonds by placing the proceeds of new bonds (i.e., the "refunding" bonds in the table of bonds issued and outstanding) in irrevocable trust to provide for all future debt service on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not recorded as assets or liabilities in these statements and are not included in the other debt tables in this note.

The following table summarizes the defeased bonds outstanding at September 30 (in millions):

| | AMOUNTS OUTSTANDING |
|---|---|
| Recreation and Environmental Protection: | |
| Series 1989 | $ 2.5 |
| Series 1992 | 69.1 |
| Series 1995 | 74.4 |
| Total | $ 145.9 |
| School Loan Bonds: | |
| Series 1995 | $ 84.5 |
| Michigan Comprehensive Transportation: | |
| Series 1992 A | $ 32.4 |
| State Trunkline Fund Bonds: | |
| Series 1992 A (partial) | $ 131.2 |
| Series 1992 B (partial) | 56.8 |
| Series 1994 A (partial) | 112.8 |
| Series 1996 A (partial) | 41.2 |
| Total | $ 342.0 |
| State Building Authority: | |
| 1982 Series III | $ 19.3 |
| 1988 Series I | 5.9 |
| 1988 Series II | 5.3 |
| 1989 Series I | 46.4 |
| 1990 Series II | 124.3 |
| 1991 Series I Refunding | 197.0 |
| 1991 Series II | 131.6 |
| 1992 Series I | 133.9 |
| 1992 Series II A | 30.3 |
| Total | $ 694.1 |

### Debt Service Requirements

The following table summarizes debt service requirements for outstanding bonds (in millions):

| FISCAL YEARS ENDING | GENERAL OBLIGATION PRINCIPAL | GENERAL OBLIGATION INTEREST | MUSTFA AND TRANSPORTATION RELATED PRINCIPAL | MUSTFA AND TRANSPORTATION RELATED INTEREST | STATE BUILDING AUTHORITY PRINCIPAL | STATE BUILDING AUTHORITY INTEREST | TOTAL PRINCIPAL AND INTEREST |
|---|---|---|---|---|---|---|---|
| 2002 | $ 49.0 | $ 39.9 | $ 45.9 | $ 58.7 | $ 106.5 | $ 103.0 | $ 402.9 |
| 2003 | 51.8 | 38.5 | 53.7 | 60.2 | 125.9 | 103.0 | 433.0 |
| 2004 | 54.4 | 43.3 | 56.6 | 57.4 | 132.2 | 96.3 | 440.1 |
| 2005 | 56.7 | 40.9 | 60.4 | 54.5 | 138.9 | 89.0 | 440.4 |
| 2006 | 57.9 | 38.1 | 63.8 | 51.6 | 118.3 | 82.4 | 412.1 |
| 2007-2011 | 318.8 | 153.7 | 318.1 | 216.1 | 624.3 | 332.9 | 1,963.9 |
| 2012-2016 | 316.7 | 75.3 | 214.0 | 160.0 | 497.9 | 178.9 | 1,442.9 |
| 2017-2021 | 148.7 | 15.6 | 257.1 | 99.0 | 288.2 | 66.7 | 875.4 |
| 2022-2026 | - | - | 158.6 | 40.3 | 127.2 | 11.8 | 338.0 |
| 2027-2032 | - | - | 93.3 | 12.4 | - | - | 105.7 |
| Total | $ 1,054.0 | $ 445.3 | $ 1,321.5 | $ 810.2 | $ 2,159.3 | $ 1,064.1 | $ 6,854.3 |

Interest to maturity for the State Building Authority will be significantly smaller than the amount shown in the above table because many of the bonds will be called prior to the final scheduled maturity date. The retirement of these bonds varies from project to project, as each bond issue is related to specific projects and any excess borrowing and accrued investment earnings are restricted to projects and debt service on the related bonds. State Building Authority debt service fund unreserved fund balances totaled $226.9 million at year-end. Most of this represents investments related to completed projects that will be used for debt service on the projects' bonds.

Some of the bonds of the State Building Authority carry variable interest rates and interest on these has been projected using an average interest rate.

## B. Other General Long-Term Obligations

### Capital Leases

This liability is described in more detail in Note 13.

### Compensated Absences

This liability is described in Note 12.

### Claims and Judgments

In general, expenditures and fund liabilities are not recorded in governmental funds for claims and judgments until they are considered "due and payable" at September 30 and the related losses are certain. Liabilities for material claims and judgment losses are recorded in the government-wide and proprietary fund financial statements when the loss is considered probable.

### Workers' Compensation

The gross amount of workers' compensation liability, $299.3 million at September 30, 2001, has been recorded at its discounted present value of $199.9 million, using a discount rate of 8%. The present value of the current portion of this liability is $45.1 million. The Accident Fund Company billed State agencies for actual workers' compensation claims paid plus administrative fees, totaling $51.1 million in fiscal year 2000-2001.

### Other Claims & Judgments

The governmental activity estimated liability for litigation losses, $632.5 million at September 30, 2001, includes amounts for litigation, such as damages in tort cases and refund claims in cases involving State taxes, transportation claims, natural resources and environmental quality claims, and other claims, in which it is considered probable that a loss will be incurred. Also included is an estimated liability totaling $5.4 million for arbitrage payable to the federal government for interest earned on bond proceeds. Where a range of potential loss exists, the amount recorded is based upon the expected minimum amount that will be lost if the State does, indeed, lose. The allowance also includes projections for highway related negligence cases based upon historical loss ratios. The State continues to vigorously contest all of these claims and the State may incur no liability in the individual cases involved. Therefore, the allowance for litigation losses may be overstated (to the extent that losses do not occur) or understated (if the State losses exceed the projected minimums which have been recorded). The maximum potential loss on the allowance for estimated litigation losses is not considered reasonably measurable.

The liability recorded for other claims and judgments within business-type activities represents overpayments by employers to the Michigan Unemployment Compensation Fund totaling $42.0 million.

### Durant Settlement

The reported estimated liability for litigation losses includes the Donald Durant, et al v State of Michigan, et al consolidated cases, which totaled $451.0 million at September 30, 2001. This amount will, over time, be paid to each "non-Durant" school district for its underfunded State mandated program costs if certain requirements are met. See Note 26 for additional disclosure regarding the Durant case and other contingencies.

Fund expenditures for workers' compensation and settled litigation with long-term repayment provisions are recognized on the "due and payable" basis. Other losses are recognized as fund liabilities in the year of settlement, except that cases settled shortly after year-end are recognized as fund liabilities using a sliding materiality scale that increases from recognizing all losses in early October to recording only settlements in excess of $1.5 million after November 30.

### Net Pension Obligation

This liability is described in Note 11.

## C. Changes in Long-Term Liabilities

Changes in long-term liabilities for the year ended September 30, 2001, are summarized as follows (in millions):

| Governmental Activities | Beginning Balance (Restated) | Additions | Reductions | Ending Balance | Amounts Due Within One Year | Amounts Due Thereafter |
|---|---|---|---|---|---|---|
| Bonds Payable: | | | | | | |
| General obligation debt | $ 930.3 | $ 328.8 | $ 227.3 | $ 1,031.8 | $ 49.0 | $ 982.8 |
| Revenue bonds | 1,003.6 | 341.3 | 70.8 | 1,274.0 | 45.9 | 1,228.1 |
| State Building Authority | 1,825.9 | 795.8 | 462.4 | 2,159.3 | 106.5 | 2,052.9 |
| Notes Payable: | | | | | | |
| Transportation related | - | 400.0 | - | 400.0 | - | 400.0 |
| State Building Authority | 131.9 | - | 131.9 | - | - | - |
| Deferred Loss on Refundings: | | | | | | |
| General obligation debt | - | (11.7) | .3 | (11.5) | - | (11.5) |
| Revenue dedicated debt | - | (.7) | - | (.7) | - | (.7) |
| State Building Authority | - | (8.2) | .1 | (8.2) | - | (8.2) |
| Unamortized Premiums: | | | | | | |
| General obligation debt | - | 14.4 | .3 | 14.0 | - | 14.0 |
| Revenue dedicated debt | - | 4.5 | - | 4.5 | - | 4.5 |
| State Building Authority | - | 26.0 | .6 | 25.5 | - | 25.5 |
| Other Debt: | | | | | | |
| State Building Authority Commercial paper | 348.1 | 653.8 | 694.5 | 307.4 | 137.3 | 170.1 |
| Total bonds and notes payable | 4,239.7 | 2,543.8 | 1,588.2 | 5,196.1 | 338.7 | 4,857.5 |
| Other Long-term Liabilities: | | | | | | |
| Capital lease obligations | 278.2 | 42.2 | 65.6 | 254.8 | 30.4 | 224.4 |
| Compensated absences | 468.3 | 227.0 | 257.6 | 437.7 | 20.6 | 417.1 |
| Workers' compensation | 195.0 | 48.9 | 44.0 | 199.9 | 45.1 | 154.8 |
| Net pension obligations | 20.5 | .7 | 1.6 | 19.5 | - | 19.5 |
| Other claims & judgments | 596.4 | 612.8 | 576.6 | 632.5 | 109.9 | 522.6 |
| Durant settlement | 509.6 | - | 58.7 | 451.0 | 60.0 | 391.0 |
| Total other liabilities | 2,068.1 | 931.6 | 1,004.2 | 1,995.4 | 265.9 | 1,729.5 |
| Total Long-term Liabilities | $ 6,307.8 | $ 3,475.4 | $ 2,592.4 | $ 7,191.5 | $ 604.6 | $ 6,587.0 |
| **Business-type Activities** | | | | | | |
| Other Long-term Liabilities: | | | | | | |
| Lottery prize awards* | $ 823.8 | $ - | $ 59.8 | $ 764.0 | $ 148.4 | $ 615.6 |
| Compensated absences | 4.6 | 1.0 | 2.5 | 3.1 | .5 | 2.6 |
| Other claims & judgments | - | 42.0 | - | 42.0 | - | 42.0 |
| Total Long-term Liabilities | $ 828.4 | $ 43.0 | $ 62.3 | $ 809.1 | $ 148.9 | $ 660.3 |

*The amounts due within one year are included with "Accounts payable and other liabilities" on the Statement of Net Assets.

The General Fund, special revenue, and internal service funds in which the leases are recorded will liquidate the capital lease obligations. The compensated absence and workers' compensation liabilities will be liquidated by the applicable governmental and internal service funds that account for the salaries and wages of the related employees. The net pension obligations will be liquidated by the State's governmental and internal service funds that contribute toward the pension funds, based on the statutorily required contribution rates. The School Aid Fund will liquidate the Durant settlement. Other claims and judgments attributable to the governmental activities will generally be liquidated by the General Fund and transportation related special revenue funds.

# NOTE 15 – BONDS AND NOTES PAYABLE - DISCRETELY PRESENTED COMPONENT UNITS

## A. Bonds and Notes Payable

### Bonds Payable

Bonds payable of the discretely presented component units are legal obligations of the component units and are not general obligations of the State.

The State universities and the Michigan State Housing Development Authority utilize June 30 fiscal year-ends. The remaining discretely presented component units have September 30 fiscal year-ends. The following table summarizes debt service requirements of the discretely presented component units as reported in their separately issued financial statements, utilizing their respective fiscal year-ends (in millions):

| Fiscal Years Ending In | Principal | Interest | Total |
|---|---|---|---|
| 2002 | $ 299.4 | $ 306.7 | $ 606.1 |
| 2003 | 252.1 | 296.7 | 548.8 |
| 2004 | 252.6 | 287.0 | 539.6 |
| 2005 | 246.8 | 276.3 | 523.2 |
| 2006 | 237.0 | 263.2 | 500.2 |
| | 1,288.0 | 1,429.9 | 2,717.9 |
| 2007-2011 | 1,333.2 | 1,072.8 | 2,406.0 |
| 2012-2016 | 1,165.3 | 740.8 | 1,906.1 |
| 2017-2021 | 1,038.1 | 438.3 | 1,476.4 |
| 2022-2026 | 543.1 | 205.4 | 748.4 |
| 2027-2031 | 403.4 | 88.2 | 491.6 |
| 2032-2036 | 193.4 | 19.7 | 213.1 |
| 2037-2042 | 5.8 | .3 | 6.1 |
| | 4,682.2 | 2,565.4 | 7,247.7 |
| | | $ 3,995.3 | $ 9,965.6 |
| Less: | | | |
| Unamortized discount | (.1) | | |
| Total principal | $ 5,970.2 | | |

Included in the table above is $409 million of demand bonds comprised of the Michigan Higher Education Student Loan Authority, $141.4 million, and the Michigan State Housing Development Authority, $267.6 million. Defeased bonds outstanding of the Mackinac Island State Park Commission, Michigan State Housing Development Authority, Michigan Municipal Bond Authority, and nine of the State universities are not reflected in the table above.

Subsequent to their respective year-ends, the following discretely presented component units issued bonds (in millions):

| | Amount |
|---|---|
| Michigan State Housing Development Authority | $ 24.4 |
| Michigan State Hospital Finance Authority | 91.3 |
| Eastern Michigan University | 41.4 |
| Grand Valley State University | 31.4 |
| Northern Michigan University | 30.0 |
| Oakland University | 48.0 |
| Saginaw Valley State University | 24.4 |
| | $ 290.9 |

Disclosures regarding these bonds and transactions are available in the separately issued reports of the various organizations.

Subsequent to June 30, 2001, the Michigan State Housing Development Authority entered into a forward interest rate swap in the amount of $60 million. The swap is in place to hedge variable rate bonds that will be sold in July 2002. The bonds are being issued to fund multi-family mortgage loans.

### Notes Payable

The Michigan Municipal Bond Authority has short-term notes outstanding of $614.1 million as of September 30, 2001.

## B. Unrecorded Limited Obligation Debt

Certain State financing authorities have issued limited obligation revenue bonds which are not recorded as liabilities in these statements because the borrowings are, in substance, debts of other entities. The State has no obligation for this debt. Typically, these borrowings are repayable only from the repayment of loans, unloaned proceeds and related interest earnings, and any collateral which may be provided.

The Michigan Higher Education Facilities Authority (MHEFA) issues limited obligation bonds to finance loans to private nonprofit institutions of higher education for capital improvements. As of September 30, 2001, MHEFA had bonds outstanding of $312.4 million. Of the above amount, $20.6 million of bonds have been defeased in substance, leaving a remaining undefeased balance of $291.8 million.

The Michigan Strategic Fund (MSF) issues industrial development revenue bonds ($5.8 billion for the period January 1, 1979 through September 30, 2001) which are not recorded as liabilities. Total taxable bonds issued by MSF for the period October 1, 1997 through September 30, 2001, was $8.3 million, which are not recorded as liabilities. These borrowings are, in substance, debts of other entities and financial transactions are handled by outside trustees.

The Michigan State Hospital Finance Authority (MSHFA) has issued $4.8 billion of no commitment bonds as of September 30, 2001. Of the above amount, $1.1 billion have been defeased in substance. Economic gains and accounting gains and losses, resulting from substance defeasance, inure to the benefit of the facility for which the bonds were issued, and accordingly are not reflected in the Authority's financial statements. Subsequent to September 30, 2001, the Authority issued similar limited obligation bonds totaling $91.3 million.

The Michigan State Housing Development Authority (MSHDA) has been authorized to issue up to $800 million of limited obligation bonds to finance multi-family housing projects. At June 30, 2001, limited obligation bonds had been issued totaling $426.7 million, of which eight issues totaling $70.2 million had been retired.

# NOTE 16 – INCOME TAX REFUNDS AND TAX EXPENDITURES

## A. Income Tax Credits

The Michigan Income Tax Act provides for several types of tax credits. Some credits are accounted for as revenue reductions for financial reporting purposes while others are reported as expenditures. Revenue reductions are reported for those income tax credits that are limited by the amount of an individual's tax liability before considering such credits. To the extent these nonrefundable credits will generate future year payments, they are accrued as income tax refund liabilities together with estimated overwithholdings.

Expenditures are reported for those credits which can be received even if they exceed the individual's tax liability. For these refundable credits, the substance of the transaction is that the State is making a grant payment using the income tax system as a filing and payment mechanism. The amount of credit received is not a part of the determination of tax liability. The State's property tax, home heating, and senior citizens' prescription drugs credits are the primary credits that fall into this category. Expenditures for these credits are recognized in the year the tax returns are filed and recipients claim the credits.

The following table summarizes the various credits, reported as an expense/expenditure on the "Tax credits" line in the government-wide and fund financial statements (in millions).

| | |
|---|---|
| Property tax credits: | |
| General homestead | $ 255.9 |
| Senior citizens | 220.4 |
| Farmland preservation | 18.9 |
| Other property tax credits | 21.0 |
| Subtotal – property tax credits | 516.2 |
| Home heating (excluding federal share) | 1.8 |
| Senior citizens' prescription drugs | 14.8 |
| Total tax expenditures | $ 532.8 |

## B. Income Tax Refunds Payable

The $618.0 million reported as a liability on the "Income tax refunds payable" line in the government-wide and fund financial statements includes: projected refund estimates for overwithholding and tax credits reported as revenue reductions, actual refunds made in October and November, and accruals for known income tax litigation losses.

# NOTE 17 – LOTTERY PRIZE AWARDS PAYABLE

The State Lottery Fund makes long-term prize awards for certain games, most notably the lotto games. Liabilities related to these deferred prize awards are recorded at their present value using discount rates ranging from 5.5% to 8.5%. The liquidation of these liabilities is provided for by investment in U.S. Treasury deep discount bonds and in the State's Common Cash pool.

Prize awards payable in future years are as follows (in millions):

| | |
|---|---|
| Fiscal year ending September 30: | |
| 2002 (net of unamortized discount) | $ 148.4 |
| 2003 | 109.8 |
| 2004 | 109.5 |
| 2005 | 103.0 |
| 2006 | 94.2 |
| 2007 through 2011 | 333.8 |
| 2012 through 2016 | 130.2 |
| Later years | 49.4 |
| Total | 1,078.2 |
| Less unamortized discount on long-term portion | (314.2) |
| Total at present value | $ 764.0 |

Public Act 239 of 1972 required that, as nearly as practicable, 45% of gross ticket revenue shall be allocated for prizes awards. Effective December 17, 1998, P.A. 393 of 1998 requires as nearly as practicable until January 1, 2003, that not less than 45% of gross ticket revenue shall be allocated for prize awards. On or after January 1, 2003, 45% of gross ticket revenues shall be allocated for prize awards.

Public Act 95 of 1996 allows the State Lottery to participate in joint enterprises (such as multi-state lotteries) with other sovereignties. Prize awards from joint enterprises shall be the percentage of total annual revenue accrued from that game as prescribed by the joint enterprise participation agreement. More detailed information on the State Lottery Fund is available in the fund's separately issued audited financial statements, which are prepared semiannually.

# NOTE 18 – OTHER LONG-TERM LIABILITIES

## Discretely Presented Component Units

### Michigan Education Trust (MET)

MET offers contracts which, for actuarially determined amounts, provide future tuition at State institutions of higher education. Contract provisions also allow the benefits to be used at private or out-of-state institutions, with the amount provided being based upon rates charged by the State's public institutions of higher education. The tuition payments are made by MET as a separate legal entity and these contracts are not considered obligations of the State. The Legislature is not obligated to provide appropriations should losses occur. The statutes and contracts provide for refunds to the participants if MET becomes actuarially unsound. Liabilities have been recorded on the statement of net assets for the actuarial present value of future tuition benefit obligations.

The 1988, 1989, and 1990 enrollments are known as Plans B and C. Enrollments after November 1995 are known as Plan D.

The actuarial report on the status of MET Plans B and C, as of September 30, 2001, shows the actuarial present value of future tuition obligations to be $635.6 million, as compared to the actuarially determined market value of assets available of $734.7 million. The actuarial assumptions used include: a projected tuition increase rate of 5.71% for the years through 2007 and 7.30% for subsequent years; and a discount rate of 6.20%.

The actuarial report on the status of MET Plan D, as of September 30, 2001, shows the actuarial present value of future tuition obligations to be $123.6 million, as compared to the actuarially determined market value of assets available of $127.3 million. The actuarial assumptions used include: a projected tuition increase rate of 5.71% for the years through 2007 and 7.30% for subsequent years; and a discount rate of 7.00%.

On November 8, 1994, the U.S. Court of Appeals for the Sixth Circuit ruled that MET is an integral part of the State of Michigan and, thus, the investment income realized by MET is not currently subject to federal income tax. On August 20, 1996, the Small Business Job Protection Act of 1996 (the "1996 Tax Act") was signed into law which included a provision adding a new section to the Internal Revenue Code of 1986 defining "qualified state tuition programs." A qualified state tuition program is generally exempt from income tax, but is subject to unrelated business income tax. MET has no unrelated business income. Distributions made in excess of contributions (whether to the refund designee, beneficiary, or to a college on behalf of the beneficiary) are taxable income to the beneficiary or the refund designee. The Internal Revenue Service (IRS) was expected to release regulations in 2000, which would have clarified the 1996 federal legislation for qualified state tuition programs. In May 1997, MET submitted a request for ruling to the IRS for verification that MET is in compliance with the 1996 Tax Act. On December 23, 1997, the IRS issued a favorable ruling which confirms that MET is in compliance with the Act.

# NOTE 19 – DEFERRED COMPENSATION PLANS

The State offers its employees (excluding university employees) two deferred compensation plans to allow a portion of their salary to be deferred until future years. Executive Order 1999-7 transferred administrative oversight of the plans, labeled 457 and 401k after sections of the Internal Revenue Code, to the Department of Management and Budget. Day-to-day operations of the plans have been contracted to a third-party; however, the State Treasurer oversees investment options. The 457 plan and the 401k plan are combined for reporting purposes under the heading of "State Employees' Deferred Compensation Funds."

The State makes no contribution to the 457 plan, but makes matching contributions to the 401k plan as part of certain employees' compensation packages. To expand investment options, three investment tiers were developed and made available to participants on July 1, 1997. Participants invest their contributions and accumulated earnings by selecting mutual funds in one or more of the investment tiers. Employees may, at any time, transfer accumulated balances and future contributions among mutual funds in the investment tiers. Investment earnings, net of administrative charges, are credited to the participants proportionally, based upon their balances in the plan.

The 401k plan includes loan provisions. Loans to participants are recorded as assets. The 457 plan does not include loan provisions.

Net assets available for plan benefits for the 457 plan and the 401k plan at September 30, 2001, were $2.0 and $1.1 billion, respectively.

# NOTE 20 – INTERFUND RECEIVABLES AND PAYABLES

## A. Primary Government

The balances of current interfund receivables and payables as of September 30 were (in millions):

| | Due To | | | | | | |
|---|---|---|---|---|---|---|---|
| Due From | General Fund | School Aid Fund | Non-major Governmental Funds | Unemployment Compensation Funds | Internal Service Funds | Fiduciary Funds | Total |
| General Fund | $ - | $ - | $ - | $ 1.6 | $ 12.5 | $ 13.6 | $ 27.6 |
| School Aid Fund | 117.3 | - | - | - | - | - | 117.3 |
| Non-major Governmental Funds | 181.1 | - | 192.2 | - | 1.3 | 1.3 | 375.9 |
| State Lottery Fund | - | 9.0 | - | - | - | - | 9.1 |
| Unemployment Compensation Funds | - | - | - | 2.8 | - | - | 2.8 |
| Non-major Enterprise Funds | - | - | - | - | - | - | .1 |
| Internal Service Funds | - | - | - | - | 26.3 | .1 | 26.4 |
| Fiduciary Funds | .2 | - | - | - | - | - | .2 |
| Total | $ 298.6 | $ 9.0 | $ 192.2 | $ 4.4 | $ 40.2 | $ 15.1 | $ 559.5 |

Interfund receivables and payables are recorded for 1) borrowings to eliminate negative balances in the Common Cash pool, as described in Note 5, 2) payroll liabilities for group insurance and retirement, and 3) tax accrual distributions for taxes collected in the following fiscal year.

Not included in the table above are the following interfund advances, which are not expected to be repaid within one year: $7.2 million due from the Correctional Industries Revolving Fund (an internal service fund) to the General Fund for amounts loaned for capital construction and $26.4 million due from the Blue Water Bridge Fund to the State Trunkline Fund (both reported as part of the State Trunkline Fund, a special revenue fund) for federal funds loaned for bridge construction.

## B. Discretely Presented Component Units

Receivables and related liabilities between the primary government and the discretely presented component units, do not agree because the Michigan State Housing Development Authority and the ten State universities have a June 30 fiscal year-end.

## NOTE 21 – INTERFUND COMMITMENTS

### A. Mackinac Bridge Authority

The Mackinac Bridge Authority, a discretely presented component unit, has over the years received $75.3 million of subsidies, including $12.3 million for operations and $63.0 million for debt service. These subsidies were provided by the State Trunkline and Michigan Transportation funds, respectively, both of which are special revenue funds.

State statutes require that the Authority continue charging bridge tolls and begin repaying the State funds for the subsidies provided. These repayments are to continue until such time as the subsidies have been completely returned. The Authority has not recorded a liability and the State funds have not recorded receivables for these subsidies because: the reimbursements are contingent upon future net revenues, there is no repayment schedule, and the repayment commitment is long-term and budgetary in nature. Repayments may be authorized by the Authority, after consideration of the Authority's annual needs for its operations and planned repairs and improvements.

As of September 30, 2001, the Authority has repaid a total of $9.5 million of the advance from the Michigan Transportation Fund, leaving a balance of $53.5 million. No repayments have been made on the advance from the State Trunkline Fund.

## NOTE 22 – INTERFUND TRANSFERS

Interfund transfers for the year ended September 30, 2001, consisted of the following (in millions):

| | Transferred To | | | | |
|---|---|---|---|---|---|
| Transferred From | General Fund | School Aid Fund | Non-major Governmental Funds | Fiduciary Funds | Total |
| General Fund | $ - | $ 385.2 | $ 351.0 | $ .7 | $ 737.0 |
| Budget Stabilization Fund | 270.0 | 32.0 | 35.0 | - | 337.0 |
| School Aid Fund | 2.9 | - | - | - | 2.9 |
| Non-major Governmental Funds | 176.6 | - | 1,157.7 | - | 1,334.3 |
| State Lottery Fund | 10.4 | 587.0 | - | - | 597.4 |
| Unemployment Compensation Funds | 2.6 | - | 10.3 | - | 12.9 |
| Non-major Enterprise Funds | 127.4 | - | - | - | 127.4 |
| Internal Service Funds | .2 | - | - | - | .2 |
| Fiduciary Funds | 37.0 | - | .6 | - | 37.6 |
| Total | $ 627.0 | $ 1,004.2 | $ 1,554.6 | $ .7 | $ 3,186.7 |

Transfers are used to 1) move revenues from the fund that statute requires to collect them to the fund that statute requires to expend them, 2) move receipts restricted to debt service from the funds collecting the receipts to the debt service fund as debt service payments become due, 3) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, 4) move profits from the Liquor Purchase Revolving Fund and the State Lottery Fund as required by law, and 5) transfer budgetary surpluses from the General Fund to the Counter-Cyclical Budget and Economic Stabilization Fund or transfer accumulated surpluses from the Counter-Cyclical Budget and Economic Stabilization Fund to other funds when necessary.

In the fiscal year ended September 30, 2001, the State recorded transfers for $270.0 million from the Counter-Cyclical Budget and Economic Stabilization Fund to the General Fund to subsidize lower than expected revenues. These transfers were made in accordance with statutory authority granted by the Legislature.

# NOTE 23 – FUND DEFICITS

## A. Primary Government

**Governmental Funds**
The Combined Recreation Bond Fund – Local Projects, a special revenue fund, had a fund balance deficit of $13.5 million. The deficit was caused by expenditures for projects for which bonds have not yet been issued.

The Combined Recreation Bond Fund – State Projects, a capital projects fund, had a fund balance deficit of $1.6 million. The deficit was caused by expenditures for projects for which bonds have not yet been issued.

The Advance Financing Funds, a capital projects fund, had a fund balance deficit of $175.5 million. The deficit was caused by expenditures for projects for which bonds have not yet been issued and for expenditures incurred to improve State-owned sites that have not been sold.

The State Building Authority, a capital projects fund, had a fund balance deficit of $95.4 million. The deficit was caused by amounts due to the Advance Financing Funds for reimbursable expenditures for which bond or commercial paper proceeds have not yet been received.

## B. Discretely Presented Component Units

All discretely presented component units have positive net asset balances as of September 30, 2001.

# NOTE 24 – FUND BALANCES

## A. Reservations - Primary Government

The line entitled "Reserved fund balance" on the Governmental Funds Balance Sheet at September 30 consists of the following (in millions):

| | General | School Aid | Other Special Revenue | Capital Projects | Permanent | Total |
|---|---|---|---|---|---|---|
| Budgetary carry-forwards: | | | | | | |
| Encumbrances | $ 137.6 | $ .3 | $ 112.3 | $ - | $ 16.9 | $ 267.1 |
| Restricted revenues | 1,006.6 | 7.7 | 358.2 | - | - | 1,372.5 |
| Multi-year projects (capital outlay and work projects) | 308.1 | - | 251.6 | - | 30.8 | 590.4 |
| Construction and debt service | - | - | 35.9 | 15.5 | - | 51.4 |
| Revolving loan programs | 5.0 | - | 43.6 | - | - | 48.6 |
| Funds held as permanent investments | - | - | 109.5 | - | 382.9 | 492.4 |
| Noncurrent assets | 423.1 | 1.3 | 27.1 | - | - | 451.5 |
| Total Reserved Fund Balances | $ 1,880.5 | $ 9.3 | $ 938.1 | $ 15.5 | $ 430.6 | $ 3,274.0 |

Budgetary carry-forwards represent unused spending authorization that continues to be available in the new year. Restricted revenue carry-forwards include revenues restricted by law for specified purposes. The largest restricted revenue carry-forwards in the General Fund are related to Medicaid Benefits Trust, $420.9 million, and local government revenue sharing, $207.4 million. Beginning in 1996, encumbrances in multi-year projects are recorded in the reserve for encumbrances. Similar amounts in previous years had not been specifically identified, and were thus included in the broader reserve for multi-year projects. The $308.1 million of multi-year projects in the General Fund includes $139.1 million of capital outlay and $169.0 million of work project authorizations. Such amounts are reserved because the funds are legally segregated for a specific purpose.

Construction and debt service reserves represent amounts which are restricted for State Trunkline Fund's debt service and State Building Authority projects that are in process.

Reserves for revolving loan programs represent fund balance which has been appropriated for the purpose of making loans that will encourage economic development in the State. Repayments on such loans are authorized to be used to make new loans.

Funds held as permanent investments represent amounts that have been legally restricted for the purpose of providing a long-term source of investment income. These investments can include either specific investments held for the fund or portions of the fund's share of the Common Cash pool.

Reserves are recorded for noncurrent assets if they do not represent current financial resources available for appropriation. No reservation is recorded for noncurrent assets if doing so would result in a duplicate reduction of unreserved fund balance. This occurs if the noncurrent assets have already been reserved for some other reason or if they are related to revenues that have been deferred because of not being "available."

Also, no reservations of fund balances are recorded in single purpose special revenue and debt service funds. From the overall State perspective, the unreserved fund balances of funds other than the General Fund are restricted by the nature of the fund type and they are not available for general State purposes.

## B. Net Asset Designations - Primary Government

The line "Unrestricted net assets" on the government-wide Statement of Net Assets contains designations as follows:

The State Sponsored Group Insurance Fund, an internal service fund, described in Note 27, designated $58.3 million for future catastrophic losses.

# NOTE 25 – DISAGGREGATION OF PAYABLES

The line "Current Liabilities: Accounts payable and other liabilities," as presented on the government-wide Statement of Net Assets and the applicable Balance Sheets and Statements of Net Assets in the fund financial statements, consists of the following (in millions):

| | General Fund | School Aid Fund | Non-major Govern-mental Funds | Other Funds | State Lottery Fund | Michigan Unemployment Compensation Funds | Liquor Purchase Revolving Fund | Total |
|---|---|---|---|---|---|---|---|---|
| Medicaid Programs | $ 451.5 | $ - | $ - | $ - | $ - | $ - | $ - | $ 451.5 |
| Non-Medicaid Health Programs | 180.1 | - | 3.5 | - | - | - | - | 183.6 |
| Family Independence Programs | 320.9 | - | .1 | - | - | - | - | 321.0 |
| Transportation Programs | - | - | 451.1 | - | - | - | - | 451.1 |
| School Aid Programs | - | 121.1 | - | - | - | - | - | 121.1 |
| Merit Award Scholarships | - | - | 101.4 | - | - | - | - | 101.4 |
| Payroll and Withholdings | 121.0 | - | 13.3 | - | .4 | - | .5 | 135.2 |
| Tax Refunds other than Income Tax | 155.0 | 4.1 | 7.2 | - | - | - | - | 166.4 |
| Unearned Receipts | 41.9 | - | 1.3 | - | - | - | - | 43.2 |
| Amounts Held for Others | 18.1 | - | 4.9 | - | .8 | - | - | 23.9 |
| Capital Project Related | - | - | 162.0 | - | - | - | - | 162.0 |
| Prize Awards | - | - | - | - | 148.4 | - | - | 148.4 |
| Liquor Purchase | - | - | - | - | - | - | 52.9 | 52.9 |
| Unemployment Payments | - | - | - | - | - | 17.3 | - | 17.3 |
| Internal Service Fund Liabilities | - | - | - | 35.1 | - | - | - | 35.1 |
| Due to Fiduciary Funds* | - | - | - | 15.1 | - | - | - | 15.1 |
| Miscellaneous | 313.5 | - | 102.8 | - | 5.2 | - | - | 421.5 |
| Total | $ 1,602.0 | $ 125.2 | $ 847.7 | $ 50.2 | $ 154.8 | $ 17.3 | $ 53.4 | $2,850.6 |

*This amount represents amounts due to fiduciary funds which were reclassified as external payables on the government-wide Statement of Net Assets.

# NOTE 26 – CONTINGENCIES AND COMMITMENTS

## A. Primary Government

### Litigation

In the government-wide and proprietary fund financial statements, the State accrues liabilities related to significant legal proceedings if a loss is probable and reasonably estimable. In the governmental fund financial statements, liabilities are accrued when cases are settled and the amount is due and payable.

The State is a party to various legal proceedings seeking damages, injunctive, or other relief. In addition to routine litigation, certain of these proceedings could, if unfavorably resolved from the point of view of the State, substantially affect State programs or finances. These lawsuits involve programs generally in the areas of corrections; tax collection; commerce and budgetary reductions to school districts and governmental units; and court funding. Relief sought generally includes damages in tort cases; improvement of prison medical and mental health care and refund claims under State taxes. The State is also a party to various legal proceedings that, if resolved in the State's favor, would result in contingency gains to the State, but without material effect upon fund balance/net assets. The ultimate dispositions and consequences of all of these proceedings are not presently determinable, but such ultimate dispositions and consequences of any single proceeding or all legal proceedings collectively should not themselves, except as listed below, in the opinion of the Attorney General of the State and the Office of the State Budget, have a material adverse effect on the State's financial position. Those lawsuits pending which may have a significant impact or substantial effect on State programs or finances, if resolved in a manner unfavorable to the State, include the following:

10th Judicial Circuit et al v State of Michigan et al: On August 22, 1994, the Ingham Circuit and Probate Courts, together with the 55th District Court, filed suits in the Court of Claims and Ingham County Circuit Court against the State of Michigan and Ingham County entitled, 30th Judicial Circuit et al v Governor et al for declaratory and injunctive relief, and for damages, due to the alleged failure of the State Court Administrative Office to properly calculate Ingham County's reimbursement under MCL 600.9947; MSA 27A.9947, the court funding statute. The 30th Judicial Circuit et al v Governor et al case has been dismissed by stipulation of the parties because the plaintiffs are raising the same claims as members of a class action captioned as 10th Judicial Circuit et al v State of Michigan et al (Saginaw Circuit Court No. 94-2936-AA-1/Court of Claims No. 94-15534-CM). Plaintiffs assert that the amount in controversy exceeds $5 million. The case is currently pending final class certification.

Durant et al v State of Michigan: On November 15, 2000, more than 365 Michigan school districts and individuals filed two suits in the Michigan Court of Appeals. The first suit, Durant et al v State et al, ("Durant III") asserts that the current State School Aid appropriation act, P.A. 297 of 2000, violates Michigan Constitution, Article 9, §§ 25-34 (the "Headlee Amendment"), because it allegedly transfers per pupil revenue guaranteed to school districts under the Constitution of 1963, Article 9, § 11, for unrestricted school operating purposes, in order to satisfy the State's independent funding obligation to those school districts under Article 9, § 29. The plaintiffs in Durant III are seeking a monetary remedy, including approximately $1.7 billion for the 1999-2000 through 2002-2003 school years for the State's alleged underfunding of special education programs and services, inclusive of special education transportation services. The Durant III plaintiffs are also requesting a declaratory judgment that the State, through P.A. 297 of 2000, is violating Article 9, § 11, and Article 9, § 29. The Durant III plaintiffs further seek orders declaring that the State has failed, through P.A. 297 of 2000, to meet its constitutional duty to fund services and activities provided by the plaintiff school districts during school years 1999-2000 through 2002-2003 in the same proportion by which they were funded when the Headlee Amendment became effective, and that the State has reduced the State-financed proportion of necessary costs incurred by the plaintiff school districts for special education services for the 1999-2000 through 2002-2003 school years below that provided by the State when the Headlee Amendment became effective. The Durant III plaintiffs also seek an injunction permanently enjoining the State from making any future reductions below the levels of funding provided when the Headlee Amendment became effective to pay for the cost of the activities and services required of them by State law. They also seek attorneys' fees and costs of litigation.

The second suit, Adair et al v State et al ("Adair"), asserts that the State has, by operation of law, increased the level of various specified activities and services beyond that which was required by State law as of December 23, 1978 and, subsequent to December 23, 1978, added various specified new activities or services by State law, including mandatory increases in student instruction time, without providing funding for these new activities and services, all in violation of the Headlee Amendment. In the original complaint, the Adair plaintiffs sought an unspecified money judgment equal to the reduction in the State financed proportion of necessary costs incurred by the plaintiff school districts for each school year from 1997-1998 through the date of any judgment and for attorneys' fees and litigation costs. The Adair plaintiffs also sought a declaratory judgment that the State has failed to meet its funding responsibility under the Headlee Amendment to provide the plaintiff school districts with revenues sufficient to pay for the necessary increased costs for activities and services first required by State law after December 23, 1978, and to pay for increases in the level of required activities and services beyond that which was required by State law as of December 23, 1978.

On January 2, 2001, plaintiffs filed a first amended complaint in both Durant III and Adair increasing the number of school district plaintiffs to 443. On February 22, 2001, plaintiffs filed a second amended complaint in Durant III increasing the number of school district plaintiffs to 457. On April 16, 2001, plaintiffs filed a second amended complaint in Adair increasing the number of school district plaintiffs to 463. The second amended complaint includes a request for declaratory relief, attorneys' fees and litigation costs but does not include a request for money judgment.

Jefferson Smurfit Corporation v State of Michigan: On November 24, 1999, the Michigan Court of Claims in Jefferson Smurfit Corporation v State of Michigan, File No. 98-17140-CM, ruled that the site-based capital acquisition deduction in Michigan's single business tax act is unconstitutional. According to the Michigan Department of Treasury, the potential financial impact of this decision is approximately $261 million. The State has appealed the decision. On November 13, 2001, the Michigan Court of Appeals issued its opinion reversing the decision of the lower court and holding that the capital acquisition deduction did not violate constitutional provisions. It is anticipated that the taxpayers will seek reconsideration or will file their application for leave to appeal with the Michigan Supreme Court.

**Federal Grants**
The State receives significant financial assistance from the federal government in the form of grants and entitlements. The receipt of federal grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal regulations. Substantially all federal grants are subject to either federal single audits or financial and compliance audits by grantor agencies. Questioned costs as a result of these audits may become disallowances after the appropriate review of federal agencies. Material disallowances are recognized as fund liabilities in the government-wide and proprietary fund financial statements when the loss becomes probable and reasonably estimable. As of September 30, 2001, the State estimates that additional disallowances of recognized revenue will not be material to the general purpose financial statements.

The Department of Community Health (DCH) administers the School Based Outreach Services Program to provide certain health services to school-aged children. A dispute arose between DCH and the U.S. Department of Health and Human Services (HHS) regarding costs which had been submitted to HHS for reimbursement. The dispute involved costs covering several years. In January 2002 the State and HHS negotiated an agreement to resolve the dispute. Although the U.S. Department of Justice must approve the settlement, the State views that action as a formality and has adjusted the accounting records at September 30, 2001, to reflect the impact of the settlement. In the event that the agreement is set aside, the State would again assert its claim for reimbursement for costs disallowed by HHS.

Federal sanctions that may result in a loss to the State include $47.5 million for the Food Stamp Program and $55.2 million for the Child Support Enforcement System.

**Gain Contingencies**
Certain contingent receivables related to the Family Independence Agency are not recorded as assets in these statements. Amounts recoverable from Family Independence Agency grant recipients for grant overpayments or from responsible third parties are recorded as receivables only if the amount is reasonably measurable, expected to be received within 12 months, and not contingent upon future grants or the completion of major collection efforts by the State. If recoveries are accrued and the program involves federal participation, a liability for the federal share of the recovery is also accrued. The unrecorded amount of potential recoveries, which are ultimately collectible, cannot be reasonably determined.

In November 1998, the Attorney General joined 45 other states and five territories in a settlement with the nation's largest tobacco manufacturers. The settlement includes base payments to states totaling $220.6 billion over the next 25 years, and continues in perpetuity. Michigan's share of the settlement is expected to be $8.5 billion over the next 25 years starting in 1998 and $348.3 million thereafter, adjusted for inflation and other factors. The State also received $2.2 million, representing costs incurred to litigate the case. While Michigan's share of the base payments will not change over time, the amount of the annual payment is subject to a number of modifications including adjustments for inflation and usage volumes. Some of the adjustments may result in increases in the payments (inflation, for example), while other adjustments will likely cause decreases in the payments (volume adjustments, for example). The net effect of these adjustments on future payments is unclear, therefore the financial statements only reflect amounts which can be reasonably estimated.

**Construction Projects**
As of September 30, 2001, several construction projects were in progress, with several others in the planning stages. A more detailed discussion of construction commitments is included in the construction in progress disclosures (Note 10).

The Department of Transportation has entered into construction contracts that will be paid with transportation related funds. As of September 30, 2001, the balances remaining in these contracts equaled $583.2 million.

**Contingent Liability for Local School District Bonds**
Public Act 108 of 1961, as amended, resulted in a contingent liability for the bonds of any school district which are "qualified" by the Superintendent of Public Instruction. Every qualified school district is required to borrow and the State is required to lend to it any amount necessary for the school district to avoid a default on its qualified bonds. In the event that funds are not available in the School Bond Loan Fund in adequate amounts to make such a loan, the State is required to make such loans from the General Fund. As of December 31, 2001, the principal amount of qualified bonds outstanding was $11.1 billion. Total debt service requirements on these bonds including interest will approximate $972.0 million in 2002. The amount of loans by the State (related to local school district bonds qualified under this program), outstanding to local school districts as of September 30, 2001, is $410.0 million. Interest due on these loans as of September 30, 2001, is $78.8 million.

## B. Discretely Presented Component Units

**Student Loan Guarantees**
The Michigan Higher Education Assistance Authority (MHEAA) is contingently liable for loans made to students by financial institutions that qualify for guaranty. The State, other than MHEAA, is not liable for these loans. MHEAA's default ratio is currently below 5% for the fiscal year ended September 30, 2001. As a result, the federal government's reinsurance rate for defaults for the fiscal year ended September 30, 2001, is 100% for loans made prior to October 1, 1993, and 98% for loans made on or after October 1, 1993 to September 30, 1998. In the event of future adverse default experience, MHEAA could be liable for up to 25% of defaulted loans. Management does not expect that all guaranteed loans could default in one year. At the beginning of each fiscal year, MHEAA's reinsurance rate returns to 98%. In the event of future adverse default experience, MHEAA could be liable for up to 25% of such defaulted loans. Accordingly, MHEAA's expected maximum contingent liability is less than 25% of outstanding guaranteed loans; however, the maximum contingent liability at September 30, 2001, is $639.8 million.

MHEAA entered into commitment agreements with all lenders that provide, among other things, that MHEAA will maintain cash and marketable securities. MHEAA was in compliance with this requirement as of September 30, 2001, at an amount sufficient to guarantee loans in accordance with the Higher Education Act of 1965, as amended.

**Multi-Family Mortgage Loans**
As of June 30, 2001, the Michigan State Housing Development Authority (MSHDA) has commitments to issue multi-family mortgage loans in the amount of $77.5 million and single-family mortgage loans in the amount of $21.0 million.

MSHDA has committed up to approximately $1.1 million per year for up to 30 years from the date of completion of the respective developments (subject to three years advance notice of termination) from its accumulated reserves and future income to subsidize operations or rents for certain tenants occupying units in certain developments funded under MSHDA's multi-family program.

# NOTE 27 – RISK MANAGEMENT

## A. Primary Government

### General

The State has elected not to purchase commercial insurance for many of the risks of losses to which it is exposed. The State is self-insured for most general liability and property losses, portions of its employee insurance benefit and employee bonding programs, automobile liability, and workers' compensation and unemployment compensation claims. Areas of risk where some level of insurance coverage is purchased include: aircraft liability, property and loss rental insurance that may be required by bond or lease agreements, portions of the State employee insurance benefits program, certain State artifacts, builder's risk coverage, boiler and machinery coverage, and employee bonding. Settled claims have not exceeded commercial coverage in any of the past nine fiscal years.

The State has established two internal service funds, which are described below, to account for certain aspects of the risk management program. Fund expenditures (expenses) are recognized in the paying funds in a manner similar to purchased commercial insurance. For other uninsured losses not covered by an internal service fund program, the State recognizes fund liabilities in the fund incurring the loss as follows: governmental funds record an expenditure when a loss is due and payable; proprietary funds record an expense when it is probable that a loss has occurred and the amount can be reasonably estimated. As explained more fully in Note 14, losses for workers' compensation and certain types of litigation losses have been recognized as liabilities in the government-wide financial statements.

For unemployment claims, the Unemployment Agency (UA) bills the State for the actual amount of claims paid to former State employees. The State accrues liabilities in the governmental fund financial statements for unemployment compensation, only to the extent paid by UA through September 30. During the 2000-2001 fiscal year, expenditures for payments to former State employees (not including university employees) totaled $5.4 million. The potential liability for future payments cannot be estimated.

The State's two internal service funds, which account for certain areas of risk management, follow accounting standards established by the GASB. This results in a reporting which is very similar to that used in the private insurance industry. The various component programs within the two funds may incur deficits during a given year, but each program's surplus and unrestricted net asset balance is considered in calculating future charges or benefit levels.

### Risk Management Fund

This fund was established during fiscal year 1989-1990 to account for insurance management activities implemented within the Department of Management and Budget. The automotive liability and administrative functions are accounted for as operating activities of this fund. Expenses and liabilities for claims, including incurred but not reported or not processed claims, have been recorded in the amount of $6.5 million. This includes a long-term portion, which is recorded at $4.3 million.

Changes in the Risk Management Fund's claims for automobile liability for the fiscal years ending September 30, 2001 and 2000 are as follows (in millions):

| | 2001 | 2000 |
|---|---|---|
| Balance - beginning | $ 8.0 | $ 6.9 |
| Current year claims and changes in estimates | 1.2 | 1.8 |
| Claim payments | (2.6) | (.8) |
| Balance - ending | $ 6.5 | $ 8.0 |

### State Sponsored Group Insurance Fund

The Department of Management and Budget uses this fund to account for employee and retiree insurance benefit programs, which are largely self-funded. Expenses and liabilities for claims, which include incurred but not reported or not processed benefit claims, based on preliminary estimates from the plan administrators, have been recorded as liabilities in the amount of $183.7 million. This includes a long-term portion which is recorded at a discounted present value of $84.0 million using a discount rate of 10.5% (first 10 years of disability), 9.0% (next 10 years), and 6.0% thereafter for claims incurred prior to January 1, 1992. Claims incurred in past years were discounted using rates as follows in the calculation of incurred but not reported claims: 1993 and 1994 used a rate of 6.0%, 1995 used a rate of 6.25%, 1996 and 1997 used a rate of 5.75%, and 1998 through 2001 used a rate of 5.25%.

Payments to the State Sponsored Group Insurance Fund are based on estimates of amounts needed to pay prior and current year claims. In addition, a portion of the fund's net assets has been designated for catastrophic losses. The risk management designation represents the level of reserves that should be maintained to ease large fluctuations in premium levels in years of unexpected excessive claims. That designation was $58.3 million at September 30, 2001. Unrestricted net assets totaled $60.0 million at September 30, 2001.

Changes in the State Sponsored Group Insurance Fund's claims liability for employee and retiree insurance benefit programs for the fiscal years ending September 30, 2001 and 2000 are as follows (in millions):

| | 2001 | 2000 |
|---|---|---|
| Balance - beginning | $ 184.0 | $ 173.7 |
| Current year claims and changes in estimates | 516.9 | 494.6 |
| Claim payments | (517.2) | (484.3) |
| Balance - ending | $ 183.7 | $ 184.0 |

## B. Discretely Presented Component Units

### State Universities

The State university component units participate with the other Michigan public universities in the Michigan Universities Self-Insurance Corporation (MUSIC), which provides indemnity to its members against comprehensive general liability, errors and omissions losses, and property damage commonly covered by insurance. Loss coverages for comprehensive general liability and property are structured on a three-layer basis with each member retaining a portion of its losses, MUSIC covering the second layer, and commercial carriers covering the third layer. For all policy years through June 30, 1993, errors and omissions coverage was structured on a two-layer basis with no excess insurance provided. Effective July 1, 1993, MUSIC obtained excess insurance coverage from commercial carriers covering the third layer. For automobile liability there is no member retention. Comprehensive general liability, property and automobile liability coverage is provided on an occurrence basis; errors and omissions coverage is provided on a claims made basis.

The universities made initial capital contributions and make premium payments to cover administrative costs, the cost of obtaining excess insurance coverage, and claims for risk retained by the facility. Premiums to facility participants are adjusted based on the difference between actual claims and the amount of claims originally estimated for a year. Liabilities for estimated losses retained by the universities under MUSIC have been established in the operating funds of the universities.

# NOTE 28 – SUBSEQUENT EVENTS

## A. Long-Term Borrowing

In October 2001, the State issued school loan bonds totaling $47.1 million to finance loans to school districts.

In October 2001, the State issued Clean Michigan Initiative bonds totaling $56.8 million. The bonds were part of the $675 million general obligation bond package authorized by the voters in 1998. The funds will be used primarily for environmental cleanup, water enhancement and protection, and infrastructure improvements at State parks.