

STATE OF MICHIGAN
NOTES TO FINANCIAL STATEMENTS
FISCAL YEAR ENDED SEPTEMBER 30, 2000

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). The following is a summary of the significant policies:

A. Reporting Entity

For financial reporting purposes, the State of Michigan's reporting entity includes the "primary government" and "component units." The primary government includes all funds, account groups, departments and agencies, bureaus, boards, commissions, and those authorities which are considered an integral part of the primary government. The 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 criteria for determining financial accountability include the following considerations: 1) appointment of a voting majority of an organization's governing authority and the ability of the primary government to either impose its will on that organization or the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary government, or 2) an organization is fiscally dependent on the primary government.

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 State's primary government using the blending method.

Discretely Presented Component Units

Most component units are reported in the combined financial statements in separate discrete columns, that are labeled as "Component Units." This separate reporting to the right of the "TOTALS PRIMARY GOVERNMENT (MEMORANDUM ONLY)" column emphasizes that these organizations are legally separate from the State's primary government. The primary government appoints the governing body of these entities. All of the component units are reported in a single column on the Combined Balance Sheet; the component units' operations are reported on the appropriate combined statement(s), depending on the primary activities of the component unit and the related measurement focus and basis of accounting (i.e., governmental, proprietary, or university component units).

The following component units, which the State is able to impose its will upon, use the modified accrual basis, and their operating results are presented with the governmental fund types on the Combined Statement of Revenues, Expenditures, and Changes in Fund Balances:

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

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

The Michigan Higher Education Assistance Authority accounts for funds held on behalf of the U.S. Department of Education. A portion of this authority is accounted for using the accrual basis.

The following component units use accrual accounting and their operating results are presented with the proprietary fund types on the Combined Statement of Revenues, Expenses, and Changes in Retained Earnings and Fund Balances; and the Combined Statement of Cash Flows.

The State is able to impose its will upon these entities:

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

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

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. A portion of this authority is accounted for using the modified accrual basis.

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.

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.

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Ten of the State's public universities are considered component units because they have boards appointed by the primary government. These universities all follow the American Institute of Certified Public Accountants Industry Audit Guide, Audits of Colleges and Universities (the AICPA Model). The universities' operating results are reflected in the Combined Statement of Changes in Fund Balances, and the Combined Statement of Current Funds Revenues, Expenditures, Transfers, and Changes in Fund Balances. These statements are unique to the AICPA model and only a "Component Units" column appears on these statements because the State has no institutions of higher education which are part of the primary government. 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

All of 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 Department of Management and 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 General Fixed Assets Account Group.

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 1999-2000, the State awarded contracts totaling \$15.8 million to MPHI.

The International Bridge Authority of Michigan, previously reported as a joint venture, was abolished by P.A. 243 of 2000 because the bonds issued to finance the construction of the bridge were retired. During 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. Basis of Presentation

The financial statements for most primary government funds are based upon financial transactions as they are recorded in individual funds in the State's central accounting system. The amounts presented for the Michigan Unemployment Compensation Fund, the State Building Authority, the State Employees' Deferred Compensation Funds, the State Employees' Defined Contribution Retirement Fund, and the discretely presented component units are based upon audited financial statements and schedules issued by those agencies. The various primary government funds, including the blended State Building Authority, are combined into the various fund types described below. Note #2 provides details showing which funds are reported in each fund type.

GOVERNMENTAL FUND TYPES

General Fund: The General Fund is the State's primary operating fund. It is used to account for general purpose financial resources and those restricted revenues which are not required to be accounted for in separate funds.

Special Revenue Funds: This fund group includes operating fund activities financed by specific revenue sources that are legally restricted for specified purposes.

Debt Service Funds: This group accounts for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Capital Projects Funds: Funds which account for the acquisition or construction of major State capital facilities financed by bond proceeds and commercial paper notes are reported in this fund group.

PROPRIETARY FUND TYPES

Enterprise Funds: This fund group includes funds whose operations and finances are accounted for in a manner similar to private business enterprises. For this group, it is the intent of the State that: (a) the costs (i.e., expenses, including depreciation) of providing goods or services to the general public be financed primarily by user charges; or (b) "net income" be periodically determined and used as appropriate for capital maintenance, management control, or determination of amounts to be transferred to other operating funds as required by statute.

Internal Service Funds: This group is similar to enterprise funds, except that the goods or services are provided primarily to other agencies or funds of the State, rather than to the general public.

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FIDUCIARY FUND TYPES

Trust and Agency Funds: This group includes assets held by the State on behalf of outside parties, including other governments, or on behalf of other State funds. The group is subdivided into three subtypes: (a) pension trust funds, which are accounted for in a manner similar to proprietary funds; (b) expendable trust funds, which are accounted for in a manner similar to governmental funds; and (c) agency funds, where the State's responsibility is purely custodial in nature and for which asset and liability balances, but not operating results, are included in the general purpose financial statements.

ACCOUNT GROUPS

General Fixed Assets Group: This account group is used to account for fixed assets (i.e., land, buildings, and equipment) owned by the State, except for assets of proprietary fund types which are recorded directly in those funds. Equity interests in joint ventures are also recorded in this account group.

General Long-Term Obligations Group: This account group accounts for all of the long-term obligations of the State, except for those accounted for directly in a fund.

TOTALS PRIMARY GOVERNMENT (MEMORANDUM ONLY)

Amounts in the "TOTALS PRIMARY GOVERNMENT (MEMORANDUM ONLY)" columns represent summations of the primary government fund types and account groups and are presented only for analytical purposes. The summations include fund types and account groups that use different bases of accounting, interfund transactions that have not been eliminated, and the caption "amounts to be provided," which is not an asset in the usual sense. Consequently, amounts shown in the "TOTALS PRIMARY GOVERNMENT (MEMORANDUM ONLY)" columns are not comparable to a consolidation.

DISCRETELY PRESENTED COMPONENT UNITS

As detailed in part A of this note, component units other than the State Building Authority and the Michigan Underground Storage Tank Financial Assurance Finance Authority are discretely presented in the combined financial statements that correspond to the accounting model they use. Those that use the governmental and proprietary models follow the same practices of the fund types that are described above.

The universities, which follow the AICPA model, use different fund types and groupings. Current funds include the universities' general, designated, auxiliary activities, and expendable restricted funds. Current funds' operating results are reflected in the "Combined Statement of Current Funds Revenues, Expenditures, Transfers, and Changes in Fund Balances." Other university fund types include student loan, endowment, plant fund, and agency funds. All university fund activities are reflected in the Combined Statement of Changes in Fund Balances. In the State's financial report, only component unit totals are reported. Readers interested in fund detail for a component unit should obtain the separately issued financial statements for that agency.

C. Basis of Accounting

Modified Accrual

The governmental fund types, expendable trust funds, and agency funds are accounted for on the modified accrual basis of accounting. There are some departures from the modified accrual basis for statutory/budgetary purposes that have no effect on the funds' balance sheets. The nature of these departures is such that they only affect how operating results are reported. This is further explained in Note #3.

The modified accrual basis emphasizes the measurement of current financial resources and obligations (i.e., "financial flow" focus). Therefore, fund revenues and other financing sources are recorded when financial resources become "measurable and available" to finance expenditures of the current period; expenditures are recorded when fund liabilities are incurred, except for principal and interest on general long-term obligations.

Accrual

The proprietary fund types and the pension trust funds use the accrual basis of accounting. The accrual basis emphasizes the measurement of "net income," (i.e., "capital maintenance" focus). Using this basis, revenues are recognized when "earned" and expenses are recognized when "incurred." All financial resources and obligations of a fund, whether current or noncurrent, are recorded in the fund.

The primary effects of the differences in these bases are:

- (1) For governmental fund types, most long-term liabilities are reported in the General Long-Term Obligations Account Group rather than as fund liabilities. The proceeds of long-term borrowings result in increases to fund balance because "other financing sources" are credited to the fund. Fund liabilities for both principal and interest related to general long-term obligations are recognized when they become "due and payable" (i.e., when normally liquidated with expendable available financial resources). For additional explanation of the accounting basis for long-term obligations, including claims and judgments, see Note #14.
- (2) Fixed asset acquisitions are recorded as expenditures of governmental fund types in the year acquired. Such assets are capitalized in proprietary fund types, with depreciation expense recognized over the life of the asset.
- (3) For governmental fund types, revenue which is not "available" is recorded as deferred revenue. Other noncurrent assets result in reservations of fund balance. Such deferrals and reserves are usually not reflected in proprietary type funds.

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.

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AICPA Model

As a general rule, the AICPA model followed by the discretely presented State university component units uses the accrual basis of accounting; however, the basis of presentation and fund groupings are unique. For "current funds" the measurement focus is the flow of financial resources related to the delivery of services. Plant funds are used to account for fixed assets and related depreciation and financing, and student loan, endowment and agency funds are used to report other noncurrent fund activities.

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 are reported using June 30 year-ends.

E. Assets, Liabilities, and Fund Equity

Cash and Cash Equivalents

On the Combined Statement of Cash Flows, the amount reported as "Cash and cash equivalents" is equal to the total of the amounts on the Combined Balance Sheet lines "Cash" and "Equity in common cash," less the amount of "Warrants outstanding."

Cash

Cash reported on 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

Tax revenue is accrued to the extent that it is both measurable and available. 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 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 balance sheet. 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.

Property, Plant, and Equipment

General fixed assets and capitalizable improvements of governmental fund types are recorded in the General Fixed Assets Account Group at historical cost or, if donated, at the estimated fair market value at the date of acquisition. In assembling the General Fixed Assets Account Group for the first time in 1985, certain fixed asset costs were not available; historical costs of these assets at the dates of acquisitions have been estimated.

Infrastructure ("public domain") fixed assets such as undeveloped State owned land, roads, and bridges are not capitalized. Interest incurred during construction is not capitalized and depreciation is not recognized on general fixed assets.

Assets of proprietary funds are capitalized at cost upon acquisition. Interest incurred during construction is capitalized. Depreciation expense on buildings and equipment is recorded over the expected useful lives of the assets. Depreciation is calculated using the straight-line method, except for automotive equipment in the Motor Transport Fund (an internal service fund), which is depreciated using the 150% declining balance method.

Additional disclosures related to fixed 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

Deferred revenue is recognized when cash, receivables, or other assets are received or recognized prior to their being earned or available.

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Long-Term Liabilities

General long-term obligations which are not reported as fund liabilities are reported in the General Long-Term Obligations Account Group. The group, which is more fully described in Note #14, includes obligations related to the funds accounted for on the modified accrual basis for: general obligation and revenue dedicated bonds, capital leases, compensated absences, claims and judgments, workers' compensation, net pension obligations, claims against the Michigan Underground Storage Tank Financial Assurance Fund (MUSTFA), and revenue bonds issued by the State Building Authority. Fund expenditures are recognized for these obligations in the period when they are "normally liquidated with available financial resources." For obligations other than claims and judgments, claims against MUSTFA, and capital leases, the expenditures are recognized as they become "due and payable." Note #14 explains the accounting for claims and judgments and claims against MUSTFA. Note #13 explains the accounting for capital leases.

Long-term liabilities of proprietary funds, agency funds, and discretely presented component units are recognized in the funds, except the portions of the State's workers' compensation liability for which fund distribution is not reasonably estimable. These long-term liabilities are more fully explained in Notes #13, #15, #17, and #18.

Fund Equity

Fund equity represents the difference between fund assets and fund liabilities. The governmental and fiduciary funds' fund equity is called "fund balance." For proprietary funds, equity attributable to accumulated earnings is referred to as "retained earnings."

Equity provided by other funds or governmental units for property, plant, and equipment or for original start-up costs for new funds is classified as "contributed capital." Note #22 explains the basis for the amounts which are reported as contributed capital.

Reservations

Fund balances for all governmental funds are classified as either reserved or unreserved. 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. Details related to the make-up of reserved fund balances are reported in Note #24.

Fund balance reservations in the discretely presented component units column reflect the restricted funds of State universities. Retained earnings reservations in the discretely presented component units column primarily reflect amounts required to be set aside by bond agreements. These are described in Note #23.

F. Revenues, Expenditures, Encumbrances, Expenses, and Other Financing Sources and Uses

Revenues

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.

Revenues of governmental funds that accrue to the State, independent of when expenditures are incurred by the State (such as taxes, licenses, and permits), are considered "available" if the payer incurs the obligation to the State before year-end and payment is received within 60 days of year-end, except for revenue related to delinquent taxes receivable which is recognized in the amount expected to be received within 12 months (see Note #6).

Revenues which the State earns by incurring obligations (such as matching federal grants) are generally recognized in the same period that the related obligations are recognized. Such accrued revenue is considered available even if it is not received within 60 days of year-end. This method provides improved reporting and control at the program level because it appropriately matches funding sources and uses.

Expenditures

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 is used to account for the distribution of certain tax revenues which are shared with local units based upon statutory requirements. Debt service includes both interest and principal outlays related to bonds accounted for in the General Long-Term Obligations Account Group and payments on capitalized leases.

Encumbrances

Encumbrances are commitments related to unperformed (executory) contracts for goods or services. During the fiscal year, agencies may enter all types of encumbrances in the accounting system for spending control purposes. For year-end financial reporting purposes, encumbrances are recorded only to the extent that spending authority is allowed to be carried forward to the next year. The method of reflecting encumbrances in the statements is more fully described in Note #3.

Unless a statutory exception has been made, there are limits on the types of encumbrances that can be recorded as spending authority carry-forwards at year-end. Encumbrances are recorded only if the encumbrance is for an obligation that was entered into prior to September 16. Encumbrances for services are recorded only if the contract is for a nonrecurring item.

Encumbrance contracts for goods that specify delivery after September 30 are not recorded and encumbered amounts in excess of available line-item spending authority are not recognized.

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Expenses

Expenses are classified as operating or nonoperating and are subclassified by object (e.g., salaries, depreciation, and purchases for resale).

Other Financing Sources

These additions to governmental fund balances include resources and financing provided by bond proceeds, capital leases, and operating transfers from other funds.

Other Financing Uses

These are reductions of governmental fund resources, normally resulting from operating transfers to other funds.

G. Interfund Transactions

Operating Transfers

Except as described below, transactions between primary government funds (including blended component units) are classified as operating transfers. These include most of the routine transfers of resources between funds, such as a transfer from a fund receiving revenue to the fund through which resources are to be expended. Transactions between the primary government and a discretely presented component unit are classified as operating transfers if they are in the nature of a subsidy or grant for general operations. The State's general operating appropriations and State Building Authority projects for the ten discretely presented university component units are reported in this manner.

Equity Transfers

Residual equity transfers, which are detailed in Note #22, are used to record capital contributions and other nonrecurring or nonroutine transfers of equity between funds and discretely presented component units.

Reimbursements

The reimbursement method reclassifies an expenditure/expense from the fund originally making a disbursement to 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 trust funds are appropriated in the General Fund.

Quasi - External Transactions

Certain interfund transactions are recorded as if they were occurring with an outside entity. This method is most commonly used to report revenues of the internal service funds, pension funds, and certain expendable trust funds. The paying funds report expenditures or expenses, depending upon fund type.

H. Future Changes in Accounting Standards

The Governmental Accounting Standards Board has issued Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions; Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments; and Statement No. 35, Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities. These new accounting and reporting standards will impact the State's revenue and expenditure recognition; and assets, liabilities and fund equity reporting. The new standards will also require reformatting of the financial statements and the restating of beginning balances. The State intends to early implement these statements for fiscal year 2000-01, and due to the significance of the changes required, it is not possible to present pro-forma data prior to their implementation.