



JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
OFFICE OF THE STATE BUDGET
LANSING

ROBERT L. EMERSON
DIRECTOR

December 28, 2007

The Honorable Jennifer M. Granholm, Governor
Members of the Legislature
People of the State of Michigan

As required by Article 9, Section 21, of the State Constitution and Section 494, Public Act 431 of 1984, as amended, we are pleased to submit the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)* for the fiscal year ended September 30, 2007.

INTRODUCTION TO THE REPORT

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

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

Report: The SOMCAFR is divided into four major sections: introductory, financial, statistical, and other information:

- The introductory section includes this letter, the State's organization chart, and the list of principal officials.
- The financial section includes: the independent auditor's report on the Basic Financial Statements; Management's Discussion and Analysis (MD&A) which provides an introduction, overview, and analysis to the Basic Financial Statements; the Basic Financial Statements, which present the government-wide financial statements and fund financial statements for governmental funds, proprietary funds, fiduciary funds, and component units, together with footnotes to the Basic Financial Statements; Required Supplementary Information other than MD&A, which presents budgetary comparison schedules and information about infrastructure assets; and the supplemental financial data which includes the combining financial statements and schedules.
- The statistical section includes such items as trend information, information on debt levels, and other selected economic and statistical data.
- The other information section includes General Fund and Special Revenue Funds revenue and expenditure schedules and General Fund source and disposition of spending authorization schedules.

Internal Control Structure: The Office of the State Budget is responsible for the overall operation of the State's central accounting system and for establishing and maintaining the State's internal control structure. The system of internal control has been designed to provide reasonable rather than absolute assurance that the financial statements are free from material misstatement.

All financial transactions of the State primary government are recorded in the central accounting system, except for the Michigan Unemployment Compensation Funds, Attorney Discipline System, the State Employees' Deferred Compensation Funds, the State Employees' Defined Contribution Retirement Fund, and the Michigan Education Savings Program. Many of the essential control features are decentralized, such as the preparation and entry of expenditure transactions into the central accounting system. Consequently, the Office of the State Budget relies upon the controls in place at the various State departments and agencies.

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

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

Internal Auditors: Pursuant to Executive Order 2007-31, the Office of the State Budget provides internal audit services to executive branch departments and agencies. Office of the State Budget internal audit staff perform periodic financial, performance, and compliance audits of department and agency programs and organizational units. In addition to periodic audits, Office of the State Budget internal audit staff also review department and agency management's processes for establishing, monitoring, and reporting on internal controls; advise department and agency management on internal control matters; and assist department and agency management with investigations of alleged fraud or other irregularities.

Independent Auditors: The Office of the Auditor General (OAG) is the principal auditor of the SOMCAFR. The OAG also relies on the opinions of outside public accounting firms, particularly for component unit financial statements (such as the Michigan State Housing Development Authority and 10 of the State's universities), the larger pension and other employee benefit trust funds, and the Unemployment Compensation funds. The purpose of the OAG's audit is to provide reasonable assurance that the Basic Financial Statements for the fiscal year ended September 30, 2007 are free of material misstatements. The OAG concluded that the Basic Financial Statements for the fiscal year ended September 30, 2007 are fairly presented in accordance with GAAP and issued unqualified opinions.

In addition to the annual audit of the SOMCAFR, the OAG also performs periodic financial statement and performance audits of the various State departments, agencies, and institutions of higher education. The Auditor General also has primary responsibility for conducting audits under the federal Single Audit Act Amendments of 1996. Pursuant to Michigan Public Act 251 of 1986, these audits are conducted biennially for applicable State departments, agencies and component unit authorities, and result in separately issued audit reports.

Management's Discussion and Analysis (MD&A): GAAP requires that management provide a narrative introduction, overview, and analysis to accompany the Basic Financial Statements in the form of MD&A. This letter of transmittal is intended to complement MD&A and should be read in conjunction with it. The MD&A can be found immediately following the Independent Auditor's Report.

PROFILE OF THE GOVERNMENT

Michigan was admitted to the Union as the 26th state in 1837. The State is governed under the Constitution of 1963, as amended.

Executive Branch: The Executive Branch consists of 18 principal departments. Fifteen principal departments are headed by commissions and/or directors appointed by the elected governor. Elected officials head two principal departments, Attorney General and State, and one, Education, is headed by an elected board.

Judicial Branch: The Judicial Branch consists of the Supreme Court, Court of Appeals, Court of Claims, and the State's circuit, district, probate, and municipal courts. In addition to its judicial duties, the Supreme Court is responsible for the general administrative supervision of all courts in the State. The Supreme Court also establishes rules for practice and procedure in all courts.

Legislative Branch: The Legislative Branch consists of the Senate, House of Representatives, and Office of the Auditor General. The Senate, which consists of 38 elected members, and House of Representatives, which consists of 110 elected members, enact the laws of Michigan. The Office of the Auditor General conducts post financial and performance audits of state government operations.

Reporting Entity: The financial reporting entity of the State includes all of the funds of the primary government as well as component units for which the State's elected officials are financially accountable. The transmittal letter, MD&A, and the financial statements focus on the primary government and its activities. Although information pertaining to the component units is provided, their separately issued financial statements should be read to obtain a complete overview of their financial position.

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

Compliance with the final updated budget for the annually budgeted operating funds of the State primary government is demonstrated in the budget and actual comparative schedules and notes in the SOMCAFR. In addition, subsequent to the

publication of the SOMCAFR, the State releases a Statewide Authorization Dispositions report that provides line item appropriation details, the legal level of budgetary control, for the General Fund and budgeted operating funds.

MAJOR INITIATIVES AND FUTURE PROJECTS

Working The Comprehensive Economic Plan: For Michigan to grow and compete, state government must invest in initiatives that will diversify the economy, promote job creation, and provide workers with the education and training they need. The Single Business Tax was replaced this year by the Michigan Business Tax which is more competitive, provides significant personal property tax relief, and creates incentives for companies to locate and create jobs here. The 21st Century Jobs Fund continues to foster high-tech, cutting edge businesses and made more than \$50 million in critical start-up funding available through the Capital Access Plan.

The No Worker Left Behind program and the MI Opportunity Partnership are helping workers connect with training and jobs. In just four months, No Worker Left Behind has enrolled 7,800 displaced workers in free training, while more than 48,500 citizens were placed in jobs in the second year of the MI Opportunity Partnership.

Local Jobs Today, a program that makes grants and loans available to cities, townships, and local transit agencies, enabling them to take advantage of available federal transportation funding, provided \$282 million this year for 267 local road and bridge projects creating more than 5,000 jobs.

Reforming Government: During fiscal year 2007, Governor Granholm and the legislature enacted a series of reforms, including closing a loophole that allowed some retired state employees to continue drawing a state pension after returning to active state employment, requiring school districts to shop for competitive health care coverage, and encouraging healthy behaviors for Medicaid recipients.

The State took additional steps to reduce costs and improve efficiency, including closing two prisons and two prison camps and eliminating the Department of Civil Service. Through Executive Order, the Governor consolidated the State's human resources, accounting, and internal audit functions. In addition, 37 additional boards and commissions were eliminated this year.

Agencies and departments throughout state government are also putting new technology to use to reduce costs and improve efficiency. The Department of Transportation developed a new computer system to manage and track construction projects, saving more than \$28 million this year. The Department of Agriculture is using a new web-based system to manage lab analysis data. The new program is expected to save approximately 3,000 staff hours for lab analyses while speeding turnaround times. The Department of Information Technology is working to consolidate hardware and application systems. In 2007, this effort allowed the state to close 21 separate facilities, saving the state more than \$9.5 million.

Education: The State is committed to providing every child with a quality education. As the foundation of our economic plan, over \$15.3 billion or 35.2% of the State's total fiscal year 2008 budget is devoted to educating Michigan's citizens through its public schools, community colleges, and universities.

The School Aid Budget, totaling \$13.0 billion, reflects the commitment to provide all students in the K-12 education system with the tools they need to succeed in a global economy. For fiscal year 2008, the minimum foundation allowance was increased to \$7,204 per pupil.

In 2007, five new revolutionary high schools also opened. Working in partnership with local hospitals and health care providers, these "early college high schools" will keep at-risk kids in school and prepare them for a career in health care. In just five years, students can graduate with a high school diploma and an associates degree or equivalent certification.

To make Michigan competitive, the fiscal year 2008 budget continues to invest in one of the state's largest economic catalysts – our universities. State colleges and universities will receive \$2.2 billion. In addition, more than 33,000 students enrolled in Michigan colleges and universities this year with the help of the \$4,000 Michigan Promise Scholarship. Another 86,000 students are eligible to receive the scholarship after completing two years.

Health and Human Services: For fiscal year 2008, the two departments primarily responsible for providing services to Michigan's most vulnerable citizens, the Department of Community Health and Department of Human Services, account for \$16.6 billion, or 38.2%, of the State budget.

The Michigan Medicaid program is a foundation of the social safety net for low-income families and vulnerable adults. By providing coverage to 1.6 million people, of which nearly 900,000 are children, the program ensures that low-income families, the elderly, and the disabled receive high-quality, cost-effective health care, while reducing the burden of uncompensated care costs on providers. The fiscal year 2008 budget includes \$7.5 billion for the medical and long-term care portions of the Medicaid program, which will provide health care services to one out of every seven state residents.

The fiscal year 2008 budget for the Department of Human Services provides funding for more than 300 additional workers to provide services to vulnerable families and help keep our children safe. Funding was also increased for foster parent recruitment and training to ensure that the state has enough safe, stable homes for children.

AWARDS AND ACKNOWLEDGEMENTS

Certificate of Achievement: The GFOA awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Michigan for its SOMCAFR for the year ended September 30, 2006. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report whose content satisfies both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The State has received a Certificate of Achievement for 20 consecutive years. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgments: The preparation of this report requires the collective efforts of the management and staff of the Accounting and Financial Reporting Division, Office of Financial Management; the chief financial officers, chief accountants, internal auditors and their staffs from all State agencies; and the management and staff of the Office of the Auditor General. We sincerely appreciate the dedicated efforts of all of these individuals that have allowed Michigan to maintain its position as a national leader in quality and efficiency for financial reporting.

Sincerely,



Robert L. Emerson
State Budget Director



Michael J. Moody, CPA
Director, Office of Financial Management