



State of Michigan
Comprehensive Annual Financial Report

Fiscal Year Ended September 30, 2006

JENNIFER M. GRANHOLM
Governor

ROBERT L. EMERSON
State Budget Director
Office of the State Budget

MICHAEL J. MOODY, CPA
Director
Office of Financial Management

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JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
OFFICE OF THE STATE BUDGET
LANSING

ROBERT L. EMERSON
DIRECTOR

March 30, 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, 2006.

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 three major sections: introductory, financial, and statistical:

- The introductory section includes this letter, the State's organization chart, and the list of principal officials.
- The financial section includes: the independent auditor's report on the Basic Financial Statements; Management's Discussion and Analysis (MD&A) which provide 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.

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 appoint an internal auditor and 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.

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, 2006 are free of material misstatements. The OAG concluded that the Basic Financial Statements for the fiscal year ended September 30, 2006 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 of 1984. Pursuant to Michigan Public Act 251 of 1986, these audits are conducted biennially for applicable State departments, agencies and component unit authorities, and result in separately issued audit reports.

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 19 principal departments. Sixteen 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 budgets projected revenues and expenditures and calculates fund balance 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.

ECONOMIC CONDITIONS AND OUTLOOK

U.S. Economy: The current U.S. economic expansion is now five years old, having begun in November 2001. The U.S. economy, as measured by inflation-adjusted gross domestic product, is estimated to have grown 3.3% in 2006 and is predicted to slow substantially to 2.2% in 2007 before rebounding to 2.7% growth in 2008.

Light vehicle sales fell 450,000 units to 16.5 million units, the lowest level since 1998. The Big Three vehicle market share continued to shrink. As a result, Big Three vehicle sales fell from 9.7 million units to 8.9 million units, the lowest level since 1992. Light vehicle sales are forecast to be 16.3 million units in 2007 and 16.5 million units in 2008.

U.S. employment has increased each month since mid-2003. Employment gains in 2006 averaged approximately 190,000 jobs a month. Monthly U.S. employment now exceeds its pre-recession peak by 4.6 million jobs. For calendar year 2006, U.S. employment rose 1.8%. The U.S. unemployment rate is projected to remain relatively stable with a 4.6% and 4.7% unemployment rate in 2007 and 2008, respectively.

Michigan Economy: Michigan's economy relies heavily on the performance of the manufacturing sector in general and the auto industry specifically. Given extremely weak manufacturing employment performance, declining vehicle production, continued declines in Big 3 market share along with continued supply rationalization among vehicle suppliers, Michigan employment performance has been below the national average. Substantial productivity gains in the vehicle industry have also contributed to Michigan's sub-par employment performance.

Michigan personal income is forecast to increase 2.8% in 2007 and 3.0% in 2008. In fiscal year 2007, wages and salaries are expected to grow by 1.5% and then slow to 1.2% growth in fiscal year 2008. The inflation rate is expected to remain moderate at 1.3% in fiscal year 2007 and 2.5% in fiscal year 2008.

MAJOR INITIATIVES AND FUTURE PROJECTS

Jobs and Economy: Strong business and entrepreneurial investment, a skilled and dedicated workforce, and effective infrastructure and transportation systems fuel Michigan's economic engine. During fiscal year 2006, the State created the 21st Century Jobs Fund and provided \$400 million to invest in areas such as life science technology, advanced automotive, manufacturing and materials technology and alternative energy technology. Over the next decade, the State will invest \$2 billion in public and private resources to diversify the economy and create jobs.

State government is also committed to investing in its workforce. The Michigan Opportunity Partnership, created to fast-track jobs in high demand areas such as health care and the building trades, is aimed at matching and placing qualified resources in new jobs. In addition, beginning in 2006 and continuing in 2007, the departments of Human Services and Labor and Economic Growth are collaborating on a new Jobs, Employment and Training (JET) pilot to provide intensive services to long-term cash recipients in order to reduce poverty and welfare dependency, which is expected to save \$11 million in 2007.

The effective and efficient movement of people and goods is critical to growing Michigan's economy. Continued investment in road infrastructure projects is necessary to keep pace with the accelerated demands of modern commerce. Over \$3.4 billion, or 8.1%, of the State's total fiscal year 2007 budget is dedicated to transportation programs such as new construction and maintenance for local road and bridge projects, airport infrastructure improvements, and public transportation programs.

Education: The State is committed to providing a quality education to all age levels. Over \$15.3 billion, or 36.1%, of the State's total fiscal year 2007 budget is devoted to educating Michigan citizens through its public schools, community colleges and universities.

The School Aid Budget, totaling \$13.1 billion, reflects the commitment to provide all students in the K-12 educational system with the tools they need to succeed in a global economy. During fiscal year 2007, the minimum foundation allowance was increased to \$7,100 per pupil, the highest amount in the state's history. In addition, a new after school program for middle school pupils was created to focus on math, science and computer technology and help students meet local, state and federal standards and better prepare students for more rigorous high school curriculum expectations.

In order to compete in a global economy, Michigan must significantly increase the number of citizens who attend and complete post-secondary education programs. To support this goal, state colleges and universities will receive \$2.1 billion during fiscal year 2007.

Health and Human Services: For fiscal year 2007, the two departments primarily responsible for health and human services, the Department of Community Health and Department of Human Services, account for \$15.7 billion, or 36.9%, of the overall State budget.

While the State administers a variety of health and human services programs, Medicaid is the most extensive, accounting for \$8.6 billion of the fiscal year 2007 budget. This program provides a social safety net for low-income families and vulnerable adults, by providing coverage to over 1.5 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.

During 2006, the State announced the Michigan First Healthcare Plan, with the overall goal of making quality health care accessible to all Michigan residents. By partnering with insurers, the business community, and health care providers, the plan will create a competitive market-based health insurance exchange to expand access to more than 500,000 low-income parents and adults. The state anticipates receiving federal approval for this program this spring.

Hometown Security: Protection of Michigan's residents is a top priority and a core function of state government, accounting for \$2.9 billion, or 6.8%, of the overall State budget in fiscal year 2007. Hometown security requires a balanced spectrum of state activities from street-level public safety programs, to military preparedness of the Michigan National Guard, to the incarceration of dangerous felons. The departments of Corrections, Judiciary, Military and Veterans Affairs, and State Police are charged with providing protection services to our citizens.

Environment: State government is committed to the conservation, protection, management, use, and enjoyment of the State's natural resources for current and future generations. Michigan has 11,000 inland lakes, 36,000 miles of rivers and streams, and 3,000 miles of freshwater shoreline. Numerous park and recreation areas enable Michigan's citizens and visitors to enjoy outdoor recreation in a fun and safe environment on public lands and waters while benefiting the economy. Michigan lands also yield several agricultural products which rank number one nationally in the State's second largest industry – agricultural production.

Efforts to enhance the quality of Michigan's natural environment are primarily the responsibilities of the departments of Agriculture, Environmental Quality and Natural Resources who will spend approximately \$845.7 million in fiscal year 2007.

Better Government: Making government more cost effective and efficient is a primary focus of state government. Better government in Michigan means keeping the budget balanced, providing fast and friendly service to all citizens, cutting red tape, and frugally managing the workplaces, tools, and equipment of state government. It also means improving collaboration in order to increase efficiencies, improving services through the use of technology, making Michigan more equitable for all residents, and making state government a great place to work.

The State is continuing with a number of technology initiatives in fiscal year 2007 that will result in streamlining and consolidating computer operations and equipment. For example, the Human Resources Call Center, created in the Department of Civil Service, streamlines human resource operations and is estimated to save \$25 million by 2009. In addition, the Department of Human Services continues to develop an integrated human services delivery system to improve services to citizens in need.

State government agencies, local units of governments and school districts are exploring efforts to consolidate and share resources to keep spending in check. Consolidating business services, administrative personnel and other like services will help cut waste and create efficiencies across state government.

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, 2005. 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.

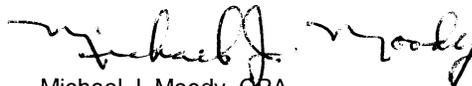
A Certificate of Achievement is valid for a period of one year only. The State has received a Certificate of Achievement for 19 consecutive years. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA to determine 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

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of Michigan

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
September 30, 2005

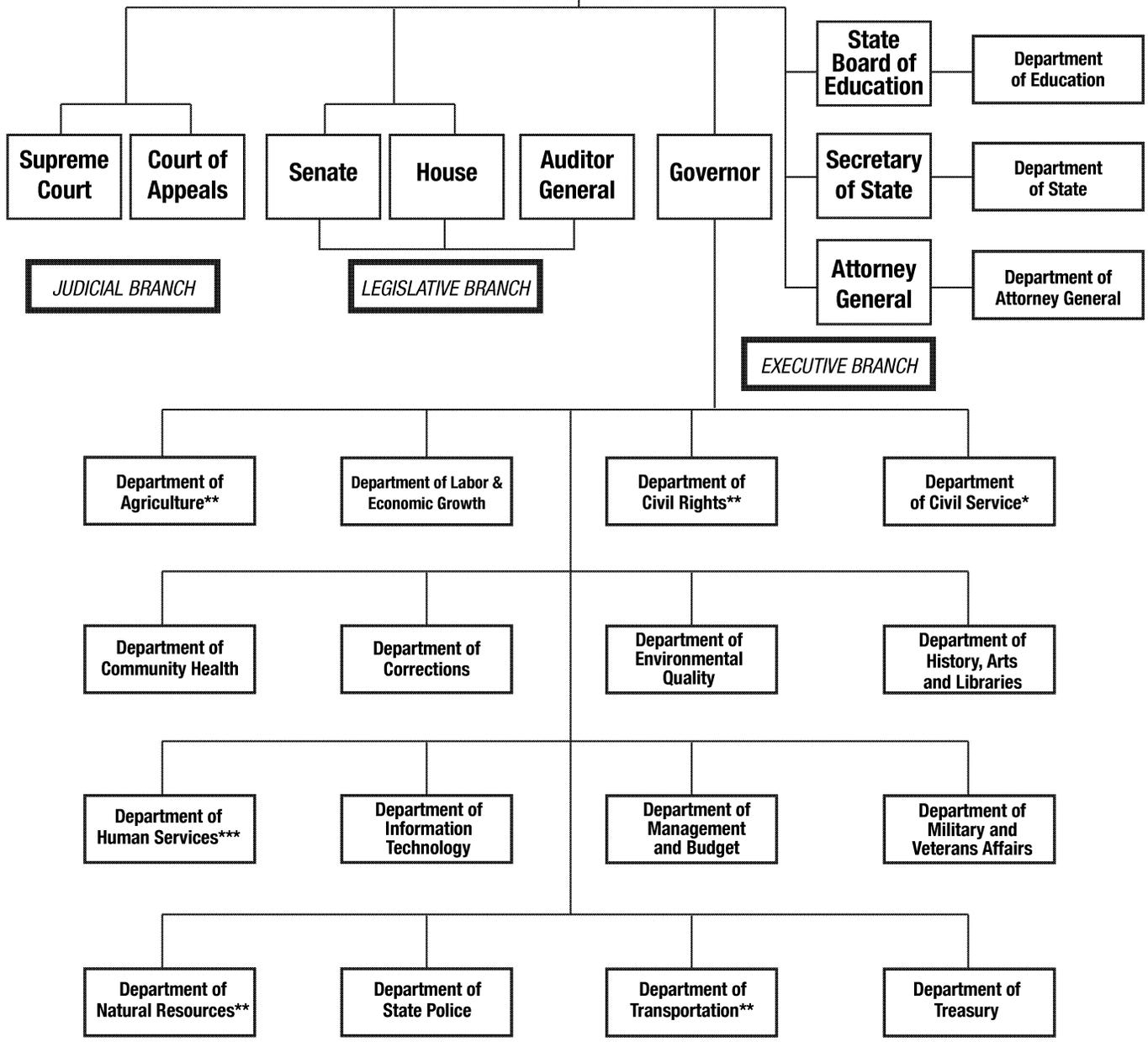
A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

STATE OF MICHIGAN ORGANIZATIONAL STRUCTURE



* Has Commission appointed by Governor
 ** Has Commission appointed by Governor, confirmed by Senate
 *** Formerly the Family Independence Agency

STATE OF MICHIGAN
PRINCIPAL STATE OFFICIALS

JUDICIAL BRANCH

Supreme Court Justices
Honorable Clifford W. Taylor, Chief Justice
Honorable Michael F. Cavanagh, Justice
Honorable Maura D. Corrigan, Justice
Honorable Marilyn Kelly, Justice
Honorable Stephen J. Markman, Justice
Honorable Elizabeth A. Weaver, Justice
Honorable Robert P. Young, Jr., Justice

LEGISLATIVE BRANCH

Honorable Michael Bishop
Majority Leader of the Senate

Honorable Andy Dillon
Speaker of the House of Representatives

Thomas H. McTavish
Legislative Auditor General

EXECUTIVE BRANCH

Honorable Jennifer M. Granholm, Governor

Honorable John D. Cherry, Jr., Lt. Governor

Honorable Mike Cox, Attorney General

Honorable Terri Lynn Land, Secretary of State

State Board of Education
Kathleen N. Straus, President
John C. Austin
Elizabeth W. Bauer
Carolyn L. Curtin
Nancy Danhof
Marianne Yared McGuire
Reginald M. Turner
Casandra E. Ulbrich
Honorable Jennifer M. Granholm (Ex Officio)
Michael P. Flanagan
Superintendent of Public Instruction

Michigan Commission of Agriculture
James E. Byrum, Chair
Donald M. Coe
Ann Jousma-Miller
Dale N. Norton
Vacant
Mitch Irwin, Director, Department of Agriculture

Civil Rights Commission
Mohammed Abdrabboh, Chair
Mark Bernstein
Kelvin W. Scott
Tarun K. Sharma
Karen Henry Stokes
Matthew Wesaw
J. Michael Zelle
Vacant
Linda V. Parker, Director, Department of Civil Rights

Civil Service Commission
Susan Grimes Munsell, Chair
F. Thomas Lewand
Sherry L. McMillan
Vacant
James D. Farrell, Director, Department of Civil Service

Janet Olszewski, Director
Department of Community Health

Patricia L. Caruso, Director
Department of Corrections

Steven E. Chester, Director
Department of Environment Quality

William Anderson, Director
Department of History, Arts and Libraries

Marianne Udow, Director
Department of Human Services

Teresa M. Takai, Director
Department of Information Technology

Keith W. Cooley, Director
Department of Labor and Economic Growth

Lisa Webb Sharpe, Director
Department of Management and Budget

Robert L. Emerson, State Budget Director
Office of the State Budget

Major General Thomas G. Cutler, Director
Department of Military and Veterans Affairs

Natural Resources Commission
Keith J. Charters, Chair
Mary C. Brown
Hurley J. Coleman, Jr.
Darnell Earley
Bob Garner
John M. Madigan
Franklin C. Wheatlake
Rebecca A. Humphries, Director
Department of Natural Resources

Lt. Col. Peter C. Munoz, Director
Department of State Police

Transportation Commission
Ted B. Wahby, Chair
Linda Miller Atkinson
Vincent J. Brennan
Maureen Miller Brosnan
James R. Rosendall
James S. Scalici
Kirk T. Steudle, Director
Department of Transportation

Robert J. Kleine, State Treasurer



II. FINANCIAL SECTION

**INDEPENDENT AUDITOR'S REPORT
MANAGEMENT'S DISCUSSION AND ANALYSIS
BASIC FINANCIAL STATEMENTS
REQUIRED SUPPLEMENTARY INFORMATION**



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THOMAS H. McTAVISH, C.P.A.
 AUDITOR GENERAL

Independent Auditor's Report

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

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Michigan, principally as of and for the year ended September 30, 2006, which collectively comprise the State's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the State Lottery Fund, Michigan Unemployment Compensation Funds, Michigan Employment Security Act - Administration Fund, State Building Authority - Debt Service Fund, State Building Authority - Capital Projects Fund, Attorney Discipline System, State Sponsored Group Insurance Fund, State Employees' Deferred Compensation Funds, State Police Retirement Fund, State Employees' Retirement Fund, Public School Employees' Retirement Fund, Judges' Retirement Fund, State Employees' Defined Contribution Retirement Fund, Michigan Education Savings Program, Michigan State Housing Development Authority, Michigan Municipal Bond Authority, Mackinac Bridge Authority, Mackinac Island State Park Commission, Michigan Higher Education Assistance Authority, Michigan Higher Education Facilities Authority, Michigan Higher Education Student Loan Authority, Michigan State Hospital Finance Authority, State Bar of Michigan, Farm Produce Insurance Authority, Central Michigan University, Western Michigan University, Eastern Michigan University, Ferris State University, Grand Valley State University, Lake Superior State University, Michigan Technological University, Northern Michigan University, Oakland University, and Saginaw Valley State University. Those financial statements reflect total assets and revenues or additions of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information as follows:

<u>Opinion Unit</u>	<u>Percent of Total Assets</u>	<u>Percent of Total Revenues/Additions</u>
Governmental Activities	1.6%	1.5%
Business-Type Activities	96.8%	84.5%
Aggregate Discretely Presented Component Units	92.7%	92.0%
State Lottery Fund	100.0%	100.0%
Michigan Unemployment Compensation Funds	100.0%	100.0%
Aggregate Remaining Fund Information	93.5%	67.6%

Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for these component units and funds, are based solely upon the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

The Honorable Jennifer M. Granholm, Governor
Members of the Legislature
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supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Michigan, as of September 30, 2006, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 5 through 14, budgetary comparison schedules and corresponding notes on pages 100 through 103, and information about infrastructure assets reported using the modified approach on pages 104 and 105 are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of Michigan's basic financial statements. The combining and individual fund statements and schedules - non-major funds listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. These statements and schedules have been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of other auditors, are fairly stated, in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections listed in the table of contents have not been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Sincerely,

A handwritten signature in black ink that reads "Thomas H. McTavish".

Thomas H. McTavish, C.P.A.
Auditor General
March 28, 2007



MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a discussion and analysis of the State of Michigan's (the State's) financial performance, providing an overview of the activities for the fiscal year ended September 30, 2006. Please read it in conjunction with the transmittal letter at the front of this report and with the State's financial statements, which follow this section.

HIGHLIGHTS

Government-wide:

- At September 30, 2006, the State's assets exceeded its liabilities by \$16.8 billion.
- The State's unrestricted net assets were (\$1.7) billion as of the close of the year. A positive balance in unrestricted net assets represents excess assets available to meet ongoing obligations. A negative balance means that it would be necessary to convert restricted assets to unrestricted assets if all ongoing obligations were immediately due and payable.
- The State's total net assets decreased by \$692.2 million (4.0 percent) during fiscal year 2006 as a result of long-term debt issuance and continued unemployment.

Fund Level:

- As of the close of the fiscal year, the State's governmental funds reported combined ending fund balances of \$3.7 billion. Of this amount, \$1.0 billion is *unreserved fund balance* in the General Fund, special revenue funds, debt service funds, capital projects funds, and permanent funds and, therefore, available to fund general-purpose expenditures of those funds in future years. The remaining \$2.7 billion is reserved for specific purposes, such as education and transportation.
- The State's three major governmental funds, the General Fund, Counter-Cyclical Budget and Economic Stabilization Fund, and the School Aid Fund, all closed the fiscal year with positive fund balances, totaling a combined \$1.1 billion, with \$1.1 billion reserved for specific purposes such as education and multi-year projects. The General Fund and the Counter-Cyclical Budget and Economic Stabilization Fund ended the year with unreserved fund balances of \$2.5 million and \$2.0 million, respectively. In the School Aid Fund, the entire fund balance of \$7.4 million is reserved for specific purposes.
- The State's proprietary funds reported net assets at year-end of \$630.2 million. This represents a decrease of \$271.8 million (30.1 percent) compared to the prior year-end, mostly resulting from the increase in unemployment benefits paid from the Michigan Unemployment Compensation Funds.

Long-term Debt:

- The State's total long-term debt (bonds and notes payable) as of September 30, 2006 was \$7.6 billion. This is an increase of \$1.7 billion since the last fiscal year-end. The increase represents the net difference between new issuances, payments, and refundings of outstanding debt, mostly related to the Michigan Tobacco Settlement Finance Authority (\$490.5 million) and the State Building Authority (\$834.8 million).

More detailed information regarding the government-wide, fund level, and long-term debt activities can be found beginning on page 8.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is an introduction to the State's basic financial statements, which comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements.

Government-wide Statements (Reporting the State as a Whole)

The Statement of Net Assets and the Statement of Activities are two financial statements that report information about the State, as a whole, and about its activities that should help answer this question: How has the State's financial position, as a whole, changed as a result of this year's activities? These statements include all non-fiduciary assets and liabilities using the accrual basis of accounting. The current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Net Assets (pages 16 and 17) presents all of the State's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases and decreases in net assets measure whether the State's financial position is improving or not.

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The Statement of Activities (pages 18 and 19) presents information showing how the State's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will result in cash flows in future fiscal periods (e.g. uncollected taxes and earned but unused vacation leave).

Both statements report three activities:

- *Governmental Activities* – Most of the State's basic services are reported under this category. Taxes and intergovernmental revenues generally fund these services. The Legislature, the Judiciary, and the general operations of the Executive departments fall within the governmental activities.
- *Business-type Activities* – The State charges fees to customers to help it cover all or most of the cost of certain services it provides. Lottery tickets, liquor purchases, and the State's unemployment compensation services are examples of business-type activities.
- *Discretely Presented Component Units* – Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. The State has 18 authorities and 10 universities that are reported as discretely presented component units of the State.

This report includes two schedules (pages 23 and 25) that reconcile the amounts reported on the governmental fund financial statements, which are prepared using the modified accrual basis of accounting, with the governmental activities in the government-wide statements, which are prepared using the accrual basis of accounting. The following table summarizes the differences between modified accrual and full accrual accounting:

Description	Reported in Governmental Fund Financial Statements (modified accrual basis)	Reported in Government- Wide Financial Statements (accrual basis)
Capital assets of the general government (e.g., land, buildings, and infrastructure)	No	Yes
Liability for earned but deferred revenue	Yes	No
Assets and liabilities of internal service funds that primarily serve governmental funds	No	Yes
Net pension assets in excess of the annual required contribution	No	Yes
Deferred charges for debt issuance costs	No	Yes
Unmatured long-term debt (e.g., bonds, notes, capital lease obligations) net of unamortized premiums, discounts, and similar items	No	Yes
Certain accrued obligations not normally expected to be liquidated with expendable available financial resources unless they are due for payment in the current period (i.e., claims and judgments, compensated absences, and net pension obligations)	No	Yes
Accrued interest on long-term debt	No	Yes
Liability for unearned deferred revenue	Yes	Yes

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Description	Reported in Governmental Fund Financial Statements (modified accrual basis)	Reported in Government- Wide Financial Statements (accrual basis)
Capital outlay spending	Yes	No
Debt service principal payments and refunding payments	Yes	No
Other financial sources, uses, and expenditures resulting from debt issuance	Yes	No
Sales of capital assets	Yes, in the amount of the proceeds of the sale	Yes, gain or loss on the sale
Revenues earned during the period but not yet available	No	Yes
Expenses incurred during the period, but not normally expected to be liquidated with expendable available financial resources unless they are due for payment in the current period	No	Yes
Depreciation	No	Yes
Revenues and expenditures related to prior periods	Yes	No
Amortization of issuance costs, premiums, discounts, and similar items	No	Yes
Activities of internal service funds properly included within governmental activities	No	Yes

The Notes to the Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found beginning on page 43 of this report.

Fund Financial Statements (Reporting the State's Major Funds)

The fund financial statements begin on page 22 and provide detailed information about the major individual funds. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the State uses to keep track of specific sources of funding and spending for a particular purpose. In addition to the major funds, page 108 begins the individual fund data for the non-major funds. The State's funds are divided into three categories – governmental, proprietary, and fiduciary – and use different accounting approaches.

- *Governmental funds* -- Most of the State's basic services are reported in the governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for future spending. The governmental fund financial statements provide a detailed short-term view of the State's general government operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the State's programs. These funds are reported using *modified accrual* accounting, which measures cash and all other financial assets that can readily be converted to cash. Governmental funds include the General Fund and special revenue, capital project, debt service, and permanent funds.
- *Proprietary funds* -- When the State charges customers for the services it provides, whether to outside customers or to other agencies within the State, these services are generally reported in proprietary funds. Proprietary (enterprise and internal service) funds utilize accrual accounting, the same method used by private sector businesses. Enterprise funds report activities that provide supplies and services to the general public. An example is the State Lottery Fund. Internal service funds report activities that provide supplies and services for the State's other programs and activities - such as the State's Vehicle and Travel Services. Internal service funds are reported as governmental activities on the government-wide statements.

- *Fiduciary funds* -- The State acts as a trustee or fiduciary for its employee pension plans. It is also responsible for other assets that, because of a trust arrangement, can be used only for the trust beneficiaries. The State's fiduciary activities are reported in separate Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets beginning on page 34. These funds, which include pension (and other employee benefit), private-purpose, and agency funds, are reported using accrual accounting. The government-wide statements exclude fiduciary fund activities and balances because these assets are restricted in purpose and do not represent discretionary assets of the State to finance its operations.

Additional Required Supplementary Information

Following the basic financial statements is additional Required Supplementary Information that further explains and supports the information in the financial statements. The Required Supplementary Information includes budgetary comparison schedules reconciling the statutory and generally accepted accounting principles (GAAP) fund balances at fiscal year-end, and condition and maintenance data regarding certain portions of the State's infrastructure.

Other Supplementary Information

Other supplementary information includes combining financial statements for non-major governmental, proprietary, and fiduciary funds, and non-major discretely presented component units. These funds are added together, by fund type, and presented in single columns in the basic financial statements, but are not reported individually, as with major funds, on the governmental fund financial statements.

FINANCIAL ANALYSIS OF THE GOVERNMENT AS A WHOLE

The State's combined net assets decreased \$692.2 million (4.0 percent) over the course of this fiscal year's operations. The net assets of the governmental activities decreased \$420.4 million (2.5 percent) and business-type activities had a decrease of \$271.8 million (30.1 percent).

Statement of Net Assets
For Fiscal Year Ending September 30
(In Millions)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2006	2005 *	2006	2005 *	2006	2005 *
Current and other non-current assets	\$10,118.9	\$ 9,558.5	\$ 1,618.4	\$ 1,956.5	\$11,737.4	\$11,515.0
Capital assets	19,227.7	19,144.1	.4	.6	19,228.2	19,144.6
Total assets	<u>29,346.7</u>	<u>28,702.6</u>	<u>1,618.8</u>	<u>1,957.1</u>	<u>30,965.5</u>	<u>30,659.7</u>
Current liabilities	4,253.1	4,084.2	624.2	637.0	4,877.4	4,721.2
Long-term liabilities	8,925.8	8,030.2	364.4	418.1	9,290.2	8,448.3
Total liabilities	<u>13,178.9</u>	<u>12,114.4</u>	<u>988.6</u>	<u>1,055.1</u>	<u>14,167.6</u>	<u>13,169.5</u>
Net assets:						
Invested in capital assets, net of related debt	15,827.6	15,433.6	.4	.6	15,828.0	15,434.2
Restricted	2,065.0	2,086.8	622.0	894.5	2,686.9	2,981.3
Unrestricted	(1,724.8)	(932.2)	7.8	6.9	(1,717.0)	(925.3)
Total net assets	<u>\$16,167.8</u>	<u>\$16,588.2</u>	<u>\$ 630.2</u>	<u>\$ 902.0</u>	<u>\$16,798.0</u>	<u>\$17,490.2</u>

* The prior year columns have been restated. More detailed information regarding the restatements can be found on page 53.

The largest component of the State's net assets (\$15.8 billion) reflects its investment in capital assets (e.g. land, buildings, equipment, infrastructure, and others), less any related debt outstanding that was needed to acquire or construct the assets. Restricted net assets are the next largest component, comprising \$2.7 billion. These represent resources that are subject to external restrictions, constitutional provisions, or enabling legislation on how they can be used. The State's unrestricted net assets were (\$1.7) billion as of the close of the year. A positive balance in unrestricted net assets represents excess assets available to meet ongoing obligations. A negative balance means that it would be necessary to convert restricted assets to unrestricted assets if all ongoing obligations were immediately due and payable.

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The following condensed financial information was derived from the government-wide Statement of Activities and reflects how the State's net assets changed during the fiscal year:

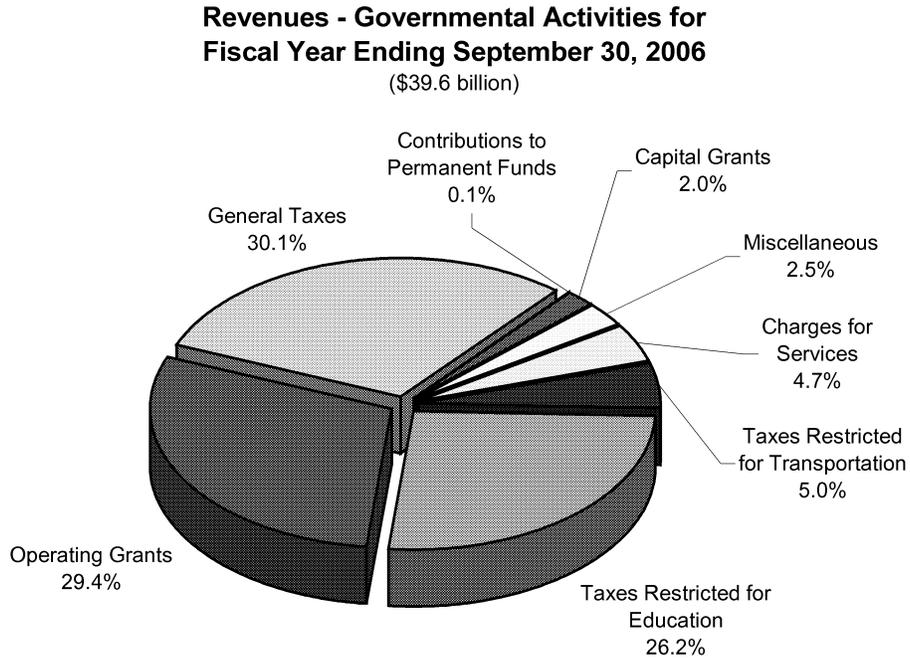
Changes in Net Assets For Fiscal Year Ending September 30 (In Millions)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2006	2005 *	2006	2005	2006	2005 *
Revenues						
Program revenues						
Charges for services	\$1,862.1	\$1,871.0	\$4,682.7	\$4,422.1	\$6,544.8	\$6,293.1
Operating grants	11,624.8	11,792.1	53.9	54.1	11,678.7	11,846.3
Capital grants	779.3	805.6	-	-	779.3	805.6
General revenues						
General taxes	11,905.8	11,842.6	12.7	12.2	11,918.5	11,854.8
Taxes restricted for educational purposes	10,389.8	10,294.1	-	-	10,389.8	10,294.1
Taxes restricted for transportation purposes	1,994.8	1,995.6	-	-	1,994.8	1,995.6
Unrestricted investment and interest earnings	10.0	14.1	4.9	2.8	14.9	16.9
Miscellaneous	1,004.0	788.8	-	.1	1,004.0	788.9
Total revenues	<u>39,570.5</u>	<u>39,403.9</u>	<u>4,754.1</u>	<u>4,491.2</u>	<u>44,324.6</u>	<u>43,895.2</u>
Expenses						
General government	2,288.5	1,877.4	-	-	2,288.5	1,877.4
Education	14,695.2	14,531.4	-	-	14,695.2	14,531.4
Human Services	4,384.3	4,154.8	-	-	4,384.3	4,154.8
Public safety and corrections	2,541.6	2,320.4	-	-	2,541.6	2,320.4
Conservation, environment, etc.	688.4	652.3	-	-	688.4	652.3
Labor, commerce, and regulatory	951.5	936.5	-	-	951.5	936.5
Health services	9,963.4	10,179.7	-	-	9,963.4	10,179.7
Transportation	3,133.1	3,107.0	-	-	3,133.1	3,107.0
Tax expenditures	834.0	815.3	-	-	834.0	815.3
Intergovernmental - revenue sharing	1,103.6	1,112.9	-	-	1,103.6	1,112.9
Interest on long-term debt	306.8	287.5	-	-	306.8	287.5
Liquor Purchase Revolving Fund	-	-	583.0	557.4	583.0	557.4
State Lottery Fund	-	-	1,584.2	1,447.3	1,584.2	1,447.3
Attorney Discipline System	-	-	4.1	3.9	4.1	3.9
Michigan Unemployment Compensation Funds	-	-	1,990.2	1,892.5	1,990.2	1,892.5
Total expenses	<u>40,890.5</u>	<u>39,975.3</u>	<u>4,161.5</u>	<u>3,901.0</u>	<u>45,052.0</u>	<u>43,876.3</u>
Excess (deficiency) Before Contributions and Transfers	(1,320.0)	(571.3)	592.6	590.2	(727.3)	18.9
Contributions to permanent fund principal	35.2	41.0	-	-	35.2	41.0
Transfers	864.4	859.3	(864.4)	(859.3)	-	-
Increase (decrease) in net assets	(420.4)	329.0	(271.8)	(269.0)	(692.2)	59.9
Net assets – beginning restated	16,588.2	16,259.2	902.0	1,171.0	17,490.2	17,430.2
Net assets – ending	<u>\$16,167.8</u>	<u>\$16,588.2</u>	<u>\$630.2</u>	<u>\$902.0</u>	<u>\$16,798.0</u>	<u>\$17,490.2</u>

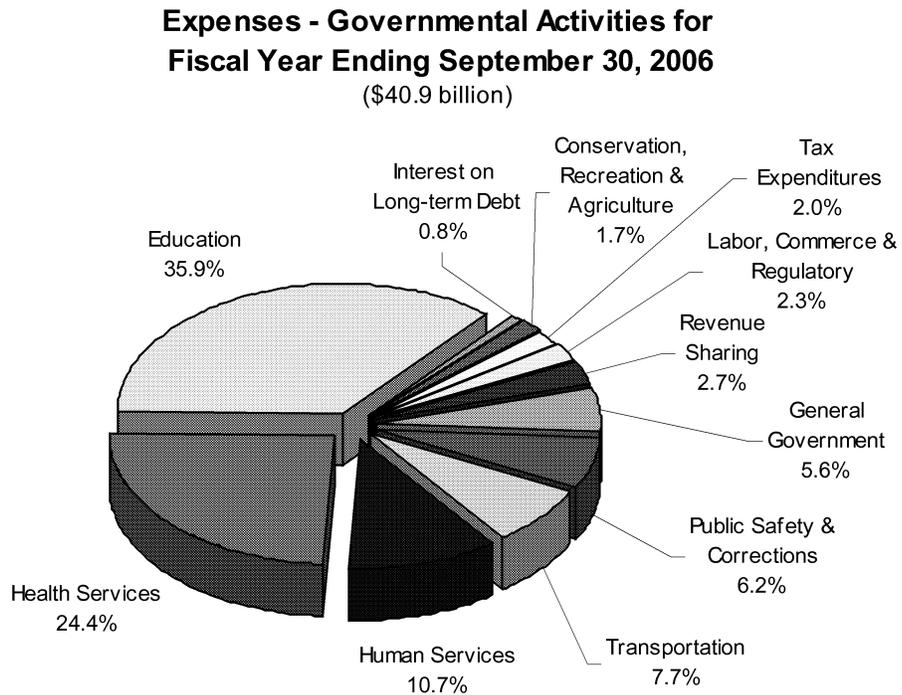
* The prior year columns have been restated. More detailed information regarding the restatements can be found on page 53.

Governmental Activities:

The following chart depicts revenues of the governmental activities for the fiscal year:



The following chart depicts expenses of the governmental activities for the fiscal year:



Business-type Activities

The business-type activities' net assets decreased by \$271.8 million (30.1 percent) during the fiscal year. Factors contributing to these results included:

- The increase in unemployment in the State resulted in the Michigan Unemployment Compensation Funds finishing the fiscal year with a decrease in net assets of \$256.2 million (30.4 percent).
- The State Lottery Fund's net assets decreased by \$16.4 million (31.2 percent), which resulted from a decrease in the market value of investments that Lottery holds to fund future payments due for lottery prizes.

FINANCIAL ANALYSIS OF THE STATE'S FUNDS

As the State completed the year, its governmental funds reported fund balances of \$3.7 billion. Of this total amount, \$1.0 billion constitutes unreserved fund balance, which is available for appropriation for the general purposes of the General Fund, special revenue funds, debt service funds, capital projects funds, and permanent funds. The transportation-related funds (\$230.1 million) and the other state funds (\$483.6 million) comprise a significant portion of the unreserved fund balance. Although reported as unreserved fund balances, these amounts are dedicated to those specific funds and can only be used for specific activities. The remainder of fund balance is reserved and is not available for new spending because it has already been dedicated for various commitments, such as capital outlay projects.

General Fund

The General Fund is the chief operating fund of the State. At the end of fiscal year 2006, the General Fund unreserved fund balance was \$2.5 million and the reserved fund balance was \$1.1 billion. Total fund balance decreased during the fiscal year by \$384.2 million (26.4 percent), primarily because prior year fund balances were needed to support spending.

General Fund Budgetary Highlights:

During fiscal year 2006, the State was again faced with difficult budget challenges that resulted in amendments to the original budget by various supplemental appropriations and appropriation reductions. The following summarizes the differences between the original and final budget amounts:

- General-purpose tax revenues of \$8.4 billion were \$251.7 million more than the original estimate of \$8.1 billion.
- Restricted revenue inflows of \$14.2 billion were \$169.2 million less than the estimated \$14.4 billion.
- The General Fund received transfers of \$256.0 million from other appropriated funds. The largest transfer was from the Liquor Purchase Revolving Fund, totaling \$152.4 million.

Differences between the final budget and actual spending result from spending authority lapses of \$88.2 million and restricted revenue authorized, but not spent, of \$8.4 million.

The Michigan State Police finished the year with net over-expenditures of \$2.9 million. All other agencies finished the year with lapses.

School Aid Fund

Fund balance at September 30, 2006, totaled \$7.4 million, a decrease of \$90.6 million (92.5 percent) from the prior year. Revenues and transfers to the fund totaled \$12.6 billion, up \$132.1 million from the prior year. Expenditures totaled \$12.6 billion, an increase of \$243.2 million over the previous year. The School Aid Stabilization Fund began the year with a \$93.7 million reserve. This balance was used to support an increase of \$175 per-pupil in the foundation allowance.

Counter-Cyclical Budget and Economic Stabilization Fund

During the year, the BSF received \$65,000 in interest earnings. As a result, fund balance increased to \$2.0 million.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets: At the end of the fiscal year 2006, the State had invested \$19.2 billion, net of accumulated depreciation, in a broad range of capital assets (see the table below). Depreciation charges for this fiscal year totaled \$183.6 million.

Capital Assets as of September 30
(Net of Depreciation, In Millions)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2006	2005 *	2006	2005	2006	2005 *
Land	\$ 3,207.2	\$3,187.6	\$ -	\$ -	\$ 3,207.2	\$ 3,187.6
Land improvement	83.5	83.6	-	-	83.5	83.6
Buildings and improvements	2,123.6	2,195.4	-	-	2,123.6	2,195.4
Equipment	196.0	191.4	.4	.6	196.4	192.0
Infrastructure	12,629.2	12,578.5	-	-	12,629.2	12,578.5
Other	19.8	19.8	-	-	19.8	19.8
Subtotal	18,259.3	18,256.4	.4	.6	18,259.7	18,257.0
Construction in progress	968.5	887.6	-	-	968.5	887.6
Total	<u>\$19,227.7</u>	<u>\$19,144.1</u>	<u>\$.4</u>	<u>\$.6</u>	<u>\$19,228.2</u>	<u>\$19,144.6</u>

The most significant impact on capital assets during the year resulted from the road and bridge construction and repair projects.

* The prior year columns have been restated. More detailed information regarding the restatements can be found on page 53.

As allowed by GASB Statement No. 34, the State has adopted an alternative process for recording depreciation expense on selected infrastructure assets. Under this alternative method, referred to as the modified approach, the State expenses certain maintenance and preservation costs and does not report depreciation expense. Assets accounted for under the modified approach include the State's network of public transportation roads and bridges, including ancillary assets, such as guard rails, signs, lighting, culverts, fencing, and the like. The State is responsible for maintaining approximately 27,521 lane miles of roads and 4,729 bridges (spans in excess of 20 feet).

The State has consistently improved the assessed condition of roads over the past five years. The State's goal is to have no more than 30% of roads in poor or very poor condition. The most recent condition assessment, completed for calendar year 2005, indicated that 18.6% of roads were considered poor or very poor.

The State's bridges have assessed conditions that are better than the established benchmarks. The most recent assessment (2005) indicated that the condition of the bridges had improved from the condition reported for 2004. For calendar year 2005, 15.2% of the bridges were assessed as structurally deficient.

The State's fiscal year 2007 capital outlay appropriations projects spending \$180.5 million for new construction and special maintenance projects. In addition, \$432.8 million of unspent capital outlay authorizations that existed at September 30, 2006 are available to spend in fiscal year 2007. More detailed information about the State's capital assets is presented in Note 9 to the financial statements.

Long-term Debt: The State, along with the State Building Authority (SBA) and the Michigan Tobacco Settlement Finance Authority (MTSFA), blended component units of the State, are empowered by law to authorize, issue, and sell debt obligations. General obligation bonds, issued by the State, are backed by the full faith and credit of the State. The State also issues revenue dedicated bonded debt, whose payment for principal and interest comes solely out of funds that receive legally restricted revenues. The State is not legally obligated for the debt issued by SBA or MTSFA. SBA's bonds generate revenue to finance the construction of facilities used by the State and universities. Revenues derived from leases on the facilities fund the debt service requirements. MTSFA's bonds provided funding to the 21st Century Jobs Fund and will be used for economic development initiatives. More detailed information regarding the State's long-term obligations is presented in Notes 12 and 14 to the financial statements.

Michigan

Outstanding Bonded Debt as of September 30 (In Millions)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2006	2005	2006	2005	2006	2005
General obligation bonds (backed by the State)	\$1,793.5	\$1,645.1	\$ -	\$ -	\$1,793.5	\$1,645.1
Revenue bonds and notes (backed by specific tax and fee revenues)	5,842.6	4,280.8	-	-	5,842.6	4,280.8
Total	<u>\$7,636.1</u>	<u>\$5,925.9</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$7,636.1</u>	<u>\$5,925.9</u>

During the year, the State issued general obligation refunding bonds to retire older bonds as well as issued revenue-dedicated bonds to retire grant anticipation notes and to secure more favorable interest rates and reduce certain debt service payments. In addition, the Michigan Tobacco Settlement Finance Authority issued taxable tobacco settlement asset backed bonds of \$490.5 million to fund economic development initiatives.

Bond Ratings

The State's general obligations are rated AA negative outlook by Standard & Poors and Aa2 negative outlook by Moody's.

Limitations on Debt

The State Constitution authorizes general obligation long-term borrowing, with approval of the Legislature and a majority of the voters, and general obligation short-term notes, of which the principal may not exceed 15% of undedicated revenues received in the preceding year. In fiscal year 2006 the State issued and repaid short-term borrowing totaling \$1.3 billion.

ECONOMIC CONDITION AND OUTLOOK

Michigan's economy relies heavily on the performance of the manufacturing sector, in general, and the auto industry, specifically. Given weak manufacturing employment performance, declining vehicle production, continued declines in Big 3 market share, and continued supply rationalization among vehicle suppliers, Michigan's employment performance has been below the national average. Substantial productivity gains in the manufacturing sector and vehicle industry have also contributed to Michigan's sub-par employment performance.

For 2006, Michigan employment is estimated to have declined by 39,000 jobs (0.9 percent) – the sixth straight year that Michigan employment has declined. From Michigan's employment peak in June 2000, Michigan has lost approximately 325,000 jobs. In contrast, Michigan employment had increased approximately 375,000 jobs above its pre-recession peak by this time after the 1990-1991 recession.

Personal income was up an estimated 4.0 percent and wages and salaries income rose an estimated 2.0 percent in 2006. Personal income growth outpaced the increase in consumer prices as measured by the Detroit consumer price index (3.2 percent) but wages and salaries income did not.

With continued but slower U.S. economic growth, Michigan employment is expected to decline in 2007 at a slower pace than in 2006 with 2007 employment falling by 0.2 percent. Michigan personal income and wages and salaries income are projected to rise 4.2 percent and 3.1 percent, respectively, in 2007. Consumer prices are projected to increase 2.3 percent.

CONTACTING THE STATE'S OFFICE OF FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. Additional copies of this report and other financial information can be obtained by visiting the Office of Financial Management website at www.michigan.gov/ofm. You can also contact the office by phone at (517) 373-3029.

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





II. FINANCIAL SECTION

BASIC FINANCIAL STATEMENTS

Michigan

STATEMENT OF NET ASSETS

SEPTEMBER 30, 2006

(In Thousands)

	PRIMARY GOVERNMENT			COMPONENT UNITS
	GOVERNMENTAL ACTIVITIES	BUSINESS-TYPE ACTIVITIES	TOTALS	
ASSETS				
Current Assets:				
Cash	\$ 7,307	\$ 7,709	\$ 15,016	\$ 769,684
Equity in common cash (Note 5)	1,078,067	82,477	1,160,544	156,799
Taxes, interest, and penalties receivable (Note 6)	5,075,376	-	5,075,376	-
Internal balances	19,147	(19,147)	-	-
Amounts due from component units	4,653	359	5,012	334
Amounts due from primary government	-	-	-	188,407
Amounts due from federal government	974,007	1,425	975,432	41,124
Amounts due from local units	190,495	36,635	227,130	750,988
Inventories	48,679	7,128	55,808	19,301
Investments (Note 8)	227,686	454,054	681,740	1,760,878
Securities lending collateral (Note 8)	196,338	391,855	588,193	-
Other current assets	657,126	286,959	944,086	491,433
Total Current Assets	<u>8,478,882</u>	<u>1,249,454</u>	<u>9,728,336</u>	<u>4,178,949</u>
Restricted Assets:				
Cash and cash equivalents	-	-	-	50,797
Investments	-	-	-	395,272
Mortgages and loans receivable	-	-	-	47,553
Taxes, interest, and penalties receivable (Note 6)	304,350	-	304,350	-
Amounts due from federal government	9,365	-	9,365	-
Amounts due from local units	583,963	-	583,963	2,790,007
Mortgages and loans receivable	-	-	-	3,595,857
Investments (Note 8)	656,075	350,780	1,006,856	2,612,202
Capital Assets (Note 9):				
Land and other non-depreciable assets	3,244,164	-	3,244,164	112,624
Buildings, equipment, and other depreciable assets	4,831,068	4,741	4,835,809	4,334,695
Less accumulated depreciation	(2,195,897)	(4,329)	(2,200,226)	(1,644,887)
Infrastructure	12,379,939	-	12,379,939	102,722
Construction in progress	968,476	-	968,476	161,272
Total capital assets	<u>19,227,750</u>	<u>412</u>	<u>19,228,162</u>	<u>3,066,425</u>
Interest in joint ventures (Note 7)	32,644	-	32,644	-
Other noncurrent assets	53,662	18,200	71,862	315,407
Total Assets	<u>\$ 29,346,692</u>	<u>\$ 1,618,846</u>	<u>\$ 30,965,538</u>	<u>\$ 17,052,468</u>
LIABILITIES				
Current Liabilities:				
Warrants outstanding	\$ 100,164	\$ 8,092	\$ 108,256	\$ 5,009
Obligations under security lending	196,338	391,855	588,193	-
Accounts payable and other liabilities	2,506,371	223,433	2,729,804	325,980
Income tax refunds payable (Note 15)	672,394	-	672,394	-
Amounts due to component units	2,319	-	2,319	154
Amounts due to primary government	-	-	-	5,897
Bonds and notes payable (Notes 12 and 13)	260,755	-	260,755	895,972
Interest payable	126,763	-	126,763	106,764
Deferred revenue	105,448	524	105,972	69,806
Current portion of other long-term obligations (Note 14)	282,597	319	282,916	119,651
Total Current Liabilities	<u>4,253,149</u>	<u>624,224</u>	<u>4,877,372</u>	<u>1,529,234</u>
Prize awards payable (Note 14)	-	316,304	316,304	-
Deferred revenue	18,570	-	18,570	3,048
Bonds and notes payable (Notes 12 and 13)	7,206,112	-	7,206,112	7,939,623
Noncurrent portion of other long-term obligations (Note 14)	1,701,094	48,099	1,749,192	1,502,326
Total Liabilities	<u>\$ 13,178,925</u>	<u>\$ 988,626</u>	<u>\$ 14,167,551</u>	<u>\$ 10,974,230</u>

The accompanying notes are an integral part of the financial statements.

	PRIMARY GOVERNMENT			COMPONENT UNITS
	GOVERNMENTAL ACTIVITIES	BUSINESS-TYPE ACTIVITIES	TOTALS	
NET ASSETS				
Invested in capital assets, net of related debt	\$ 15,827,600	\$ 412	\$ 15,828,012	\$ 1,956,023
Restricted For:				
Education	-	-	-	229,041
Construction and debt service	-	-	-	321,036
Public safety and corrections	4,947	-	4,947	-
Conservation, environment, recreation, and agriculture	451,310	-	451,310	-
Health and human services	47,716	-	47,716	-
Transportation	791,443	-	791,443	-
Unemployment compensation	-	585,903	585,903	-
Labor and economic growth	63,269	-	63,269	-
Other purposes	98,595	36,079	134,674	1,947,682
Funds Held as Permanent Investments:				
Expendable	100,276	-	100,276	36,257
Nonexpendable	507,409	-	507,409	221,221
Unrestricted	(1,724,799)	7,827	(1,716,972)	1,366,978
Total Net Assets	<u>\$ 16,167,767</u>	<u>\$ 630,220</u>	<u>\$ 16,797,987</u>	<u>\$ 6,078,238</u>

STATEMENT OF ACTIVITIES

FISCAL YEAR ENDED SEPTEMBER 30, 2006

(In Thousands)

Functions/Programs	EXPENSES	PROGRAM REVENUES		
		CHARGES FOR SERVICES	OPERATING GRANTS AND CONTRIBUTIONS	CAPITAL GRANTS AND CONTRIBUTIONS
Primary Government:				
Governmental Activities:				
General government	\$ 2,288,504	\$ 965,130	\$ 67,794	\$ 30,177
Education	14,695,186	9,306	1,415,093	-
Human services	4,384,311	56,367	3,066,192	-
Public safety and corrections	2,541,630	160,829	187,764	-
Conservation, environment, recreation, and agriculture	688,407	251,591	154,239	389
Labor, commerce, and regulatory	951,519	262,021	600,361	-
Health services	9,963,373	72,564	5,688,295	-
Transportation	3,133,137	84,280	445,048	748,703
Tax expenditures (Note 15)	834,000	-	-	-
Intergovernmental-revenue sharing	1,103,625	-	-	-
Interest on long-term debt	306,788	-	-	-
Total governmental activities	<u>40,890,480</u>	<u>1,862,089</u>	<u>11,624,786</u>	<u>779,269</u>
Business-type Activities:				
Liquor Purchase Revolving Fund	582,982	718,085	-	-
State Lottery Fund	1,584,186	2,232,204	35,105	-
Attorney Discipline System	4,122	4,631	-	-
Michigan Unemployment Compensation Funds	1,990,197	1,727,761	18,827	-
Total business-type activities	<u>4,161,487</u>	<u>4,682,681</u>	<u>53,932</u>	<u>-</u>
Total primary government	<u>\$ 45,051,967</u>	<u>\$ 6,544,770</u>	<u>\$ 11,678,718</u>	<u>\$ 779,269</u>
Component Units:				
Authorities:				
Michigan Education Trust	\$ 55,314	\$ 158	\$ 49,442	\$ -
Michigan State Housing Development Authority	548,483	163,911	395,952	-
Michigan Municipal Bond Authority	171,620	124,449	375,752	-
Non-Major	561,179	174,839	243,280	5,450
State Universities:				
Central Michigan University	315,284	214,379	28,128	4,153
Western Michigan University	435,371	269,317	59,680	2,758
Non-Major	1,367,907	830,635	176,071	9,034
Total component units	<u>\$ 3,455,158</u>	<u>\$ 1,777,688</u>	<u>\$ 1,328,306</u>	<u>\$ 21,395</u>
General Revenues:				
Taxes:				
General:				
Sales and use				
Personal income				
Single business				
Other				
Restricted For Educational Purposes:				
Sales and use				
Personal income				
Education, property, and real estate transfers				
Other				
Restricted For Transportation Purposes:				
Sales and use				
Gasoline and diesel fuel				
Motor vehicle weight				
Other				
Unrestricted investment and interest earnings				
Miscellaneous				
Contributions to permanent fund principal				
Payments from State of Michigan				
Transfers				
Total general and other revenue, payments, and transfers				
Change in net assets				
Net assets-beginning-restated				
Net assets-ending				

The accompanying notes are an integral part of the financial statements.

NET (EXPENSE) REVENUES AND
CHANGES IN NET ASSETS

PRIMARY GOVERNMENT			
GOVERNMENTAL ACTIVITIES	BUSINESS-TYPE ACTIVITIES	TOTALS	COMPONENT UNITS
\$ (1,225,403)	\$ -	\$ (1,225,403)	\$ -
(13,270,787)	-	(13,270,787)	-
(1,261,753)	-	(1,261,753)	-
(2,193,036)	-	(2,193,036)	-
(282,188)	-	(282,188)	-
(89,137)	-	(89,137)	-
(4,202,514)	-	(4,202,514)	-
(1,855,106)	-	(1,855,106)	-
(834,000)	-	(834,000)	-
(1,103,625)	-	(1,103,625)	-
(306,788)	-	(306,788)	-
<u>(26,624,336)</u>	<u>-</u>	<u>(26,624,336)</u>	<u>-</u>
-	135,103	135,103	-
-	683,124	683,124	-
-	509	509	-
<u>-</u>	<u>(243,609)</u>	<u>(243,609)</u>	<u>-</u>
<u>-</u>	<u>575,127</u>	<u>575,127</u>	<u>-</u>
<u>(26,624,336)</u>	<u>575,127</u>	<u>(26,049,209)</u>	<u>-</u>
-	-	-	(5,714)
-	-	-	11,380
-	-	-	328,582
-	-	-	(137,610)
-	-	-	(68,623)
-	-	-	(103,616)
-	-	-	(352,167)
-	-	-	(327,768)
2,665,614	-	2,665,614	-
5,123,885	-	5,123,885	-
1,926,884	-	1,926,884	-
2,189,417	12,654	2,202,070	-
5,240,334	-	5,240,334	-
2,069,435	-	2,069,435	-
2,320,578	-	2,320,578	-
759,440	-	759,440	-
66,405	-	66,405	-
1,054,766	-	1,054,766	-
867,663	-	867,663	-
5,974	-	5,974	-
9,991	4,861	14,851	96,448
1,003,976	-	1,003,976	120,522
35,153	-	35,153	-
-	-	-	624,047
864,406	(864,406)	-	-
<u>26,203,921</u>	<u>(846,892)</u>	<u>25,357,029</u>	<u>841,017</u>
<u>(420,415)</u>	<u>(271,766)</u>	<u>(692,181)</u>	<u>513,248</u>
<u>16,588,182</u>	<u>901,986</u>	<u>17,490,168</u>	<u>5,564,990</u>
<u>\$ 16,167,767</u>	<u>\$ 630,220</u>	<u>\$ 16,797,987</u>	<u>\$ 6,078,238</u>



GOVERNMENTAL FUND FINANCIAL STATEMENTS



Major Funds

GENERAL FUND

This fund is the State's operating fund. It accounts for the financial resources and transactions not accounted for in other funds.

COUNTER - CYCLICAL BUDGET AND ECONOMIC STABILIZATION FUND

This fund, commonly referred to as the "Budget Stabilization Fund" or "Rainy Day Fund," was created by MCL Section 18.1351 to assist in stabilizing revenue during periods of economic recession. In general, transfers are made into this fund from the General Fund during improving economic times and funds flow from this fund to the General Fund in times of declining economy. Additional information regarding the fund is provided in Note 3.

SCHOOL AID FUND

An amendment to the 1908 State Constitution created this fund in 1955. The 1963 State Constitution provided for the fund's continued existence. Its purpose is to aid in the support of the public schools and the intermediate school districts of the State. School aid payments to school districts are based on a statutory formula. Michigan Compiled Laws Section 388.1611a, effective October 1, 2003, created the school aid stabilization fund as a separate account within the School Aid Fund. Pursuant to this act, any remaining unreserved fund balance in the School Aid Fund at year-end is transferred to this account.

The fund receives State revenues restricted to local school programs, including: the constitutionally dedicated sixty percent of the collections of sales tax imposed at a rate of 4% and all of the collections of sales tax imposed at the additional rate of 2%; State Lottery Fund earnings; a percentage of the adjusted gross receipts from casino gaming; the real estate transfer tax; and portions of the personal income, cigarette, liquor, and industrial and commercial facilities taxes. A constitutional amendment approved by voters in 1994 made structural changes in the method of financing local school districts. The amendment authorized the levy of a statewide property tax, which is deposited in the School Aid Fund. Appropriated transfers are also made from the General Fund.

Non-Major Funds

Non-major governmental funds are presented, by fund type, beginning on page 108.

Michigan

BALANCE SHEET
GOVERNMENTAL FUNDS
 SEPTEMBER 30, 2006
 (In Thousands)

	GENERAL FUND	COUNTER - CYCLICAL BUDGET AND ECONOMIC STABILIZATION FUND	SCHOOL AID FUND	NON-MAJOR FUNDS	TOTALS
ASSETS					
Current Assets:					
Cash	\$ 6,945	\$ -	\$ -	\$ 349	\$ 7,295
Equity in common cash (Note 5)	-	2,017	-	836,847	838,864
Taxes, interest, and penalties receivable (Note 6)	2,876,556	-	2,092,181	106,639	5,075,376
Amounts due from other funds (Note 17)	533,307	-	18,017	1,412,499	1,963,824
Amounts due from component units	518	-	-	4,043	4,561
Amounts due from federal agencies	743,230	-	51,085	159,692	954,007
Amounts due from local units	51,905	-	43,574	95,017	190,495
Inventories	24,832	-	-	7,256	32,088
Investments (Note 8)	-	-	-	227,686	227,686
Securities lending collateral	-	-	-	196,338	196,338
Other current assets	369,469	-	-	250,961	620,430
Total Current Assets	<u>4,606,762</u>	<u>2,017</u>	<u>2,204,857</u>	<u>3,297,327</u>	<u>10,110,963</u>
Taxes, interest, and penalties receivable (Note 6)	254,109	-	48,318	1,923	304,350
Advances to other funds (Note 17)	7,295	-	-	-	7,295
Amounts due from federal agencies	9,365	-	-	-	9,365
Amounts due from local units	530,380	-	5,845	47,738	583,963
Investments (Note 8)	-	-	-	656,075	656,075
Other noncurrent assets	7,637	-	-	5,308	12,945
Total Assets	<u>\$ 5,415,548</u>	<u>\$ 2,017</u>	<u>\$ 2,259,020</u>	<u>\$ 4,008,371</u>	<u>\$ 11,684,956</u>
LIABILITIES AND FUND BALANCES					
Current Liabilities:					
Warrants outstanding	\$ 89,320	\$ -	\$ 650	\$ 8,026	\$ 97,995
Obligations under security lending	-	-	-	196,338	196,338
Accounts payable and other liabilities (Note 22)	1,607,319	-	139,365	631,361	2,378,045
Income tax refunds payable (Note 15)	672,394	-	-	-	672,394
Amounts due to other funds (Note 17)	48,905	-	1,737,986	208,720	1,995,610
Amounts due to component units	2,319	-	-	-	2,319
Bonds and notes payable	-	-	-	57,000	57,000
Interest payable	-	-	-	326	326
Deferred revenue	1,563,810	-	325,351	238,536	2,127,697
Total Current Liabilities	<u>3,984,066</u>	<u>-</u>	<u>2,203,352</u>	<u>1,340,306</u>	<u>7,527,724</u>
Long-Term Liabilities:					
Deferred revenue	362,243	-	48,318	6,321	416,881
Total Liabilities	<u>4,346,308</u>	<u>-</u>	<u>2,251,669</u>	<u>1,346,628</u>	<u>7,944,605</u>
Fund Balances:					
Reserved fund balance (Note 21)	1,066,757	-	7,350	1,649,898	2,724,006
Unreserved fund balance reported in:					
General Fund	2,482	-	-	-	2,482
Special revenue funds	-	2,017	-	866,121	868,138
Debt service funds	-	-	-	189,851	189,851
Capital projects funds	-	-	-	(87,918)	(87,918)
Permanent funds	-	-	-	43,791	43,791
Total Fund Balances	<u>1,069,240</u>	<u>2,017</u>	<u>7,350</u>	<u>2,661,743</u>	<u>3,740,351</u>
Total Liabilities and Fund Balances	<u>\$ 5,415,548</u>	<u>\$ 2,017</u>	<u>\$ 2,259,020</u>	<u>\$ 4,008,371</u>	<u>\$ 11,684,956</u>

The accompanying notes are an integral part of the financial statements.

**RECONCILIATION OF THE BALANCE SHEET - GOVERNMENTAL FUNDS
TO THE STATEMENT OF NET ASSETS**

SEPTEMBER 30, 2006

(In Thousands)

Total fund balances for governmental funds		\$ 3,740,351
Amounts reported for governmental activities in the Statement of Net Assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. (Note 9)		
Land and other non-depreciable assets	3,234,994	
Buildings, equipment, and other depreciable assets	4,226,356	
Infrastructure	12,379,939	
Construction in progress	968,476	
Interest in joint ventures	32,644	
Accumulated depreciation	<u>(1,805,488)</u>	19,036,922
Certain tax revenues are earned but not available and therefore are not reported in the funds.		
		2,138,768
Other long-term assets are not available to pay for current period expenditures and therefore are deferred in the funds.		
		298,913
Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the Statement of Net Assets.		
		218,398
Certain pension trust funds have been funded in excess of the annual required contributions, creating a year-end asset. This asset is not a current available resource and is not reported in the funds. (Note 10)		
		1,451
Deferred issue costs are reported as current expenditures in the funds. However, deferred issue costs are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Assets.		
		39,266
Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds. (Note 14)		
Capital lease obligations	(234,903)	
Compensated absences	(490,673)	
Workers' compensation	(111,826)	
Litigation	(469,260)	
Net pension obligations	(457,667)	
Other long-term liabilities	<u>(5,669)</u>	(1,769,997)
Long-term bonded debt is not due and payable in the current period and therefore is not reported in the funds. Unamortized premiums, loss on refundings, and interest payable are not reported in the funds. However, these amounts are included in the Statement of Net Assets. This is the net effect of these balances on the statement. (Note 12)		
Bonds and notes payable	(7,720,102)	
Unamortized premiums	(284,563)	
Less unamortized discounts	496,444	
Less deferred loss amount on refundings	98,354	
Accrued interest payable	<u>(126,437)</u>	<u>(7,536,305)</u>
Net assets of governmental activities		<u>\$ 16,167,767</u>

The accompanying notes are an integral part of the financial statements.

Michigan

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS**

FISCAL YEAR ENDED SEPTEMBER 30, 2006

(In Thousands)

	GENERAL FUND	COUNTER - CYCLICAL BUDGET AND ECONOMIC STABILIZATION FUND	SCHOOL AID FUND	NON-MAJOR FUNDS	TOTALS
REVENUES					
Taxes	\$ 11,809,223	\$ -	\$ 10,393,976	\$ 1,995,725	\$ 24,198,924
From federal agencies	9,538,417	-	1,360,742	1,260,863	12,160,022
From local agencies	105,566	-	-	18,536	124,101
From services	266,147	-	-	3,447	269,593
From licenses and permits	275,063	-	-	162,497	437,560
Special Medicaid reimbursements	93,621	-	-	-	93,621
Miscellaneous	747,142	65	84,914	717,737	1,549,857
Total Revenues	22,835,178	65	11,839,632	4,158,803	38,833,678
EXPENDITURES					
Current:					
General government	1,397,949	-	-	237,429	1,635,378
Education	1,925,200	-	12,636,481	197,311	14,758,992
Human services	4,337,871	-	-	3,903	4,341,774
Public safety and corrections	2,453,084	-	-	2,061	2,455,145
Conservation, environment, recreation, and agriculture	343,850	-	-	298,966	642,815
Labor, commerce, and regulatory	759,205	-	-	193,716	952,921
Health services	9,861,386	-	-	96,718	9,958,104
Transportation	-	-	-	2,082,846	2,082,846
Tax expenditures (Note 15)	834,000	-	-	-	834,000
Capital outlay	48,527	-	-	1,413,878	1,462,405
Intergovernmental-revenue sharing	1,103,625	-	-	-	1,103,625
Debt service:					
Bond principal retirement	-	-	-	773,826	773,826
Bond interest and fiscal charges	-	-	-	294,093	294,093
Capital lease payments	48,567	-	-	616	49,183
Total Expenditures	23,113,264	-	12,636,481	5,595,363	41,345,108
Excess of Revenues over (under) Expenditures	(278,086)	65	(796,849)	(1,436,559)	(2,511,430)
OTHER FINANCING SOURCES (USES)					
Bonds and notes issued	-	-	-	1,453,606	1,453,606
Premium on bond issuance	-	-	-	46,234	46,234
Discount on bond issuance	-	-	-	(496,466)	(496,466)
Refunding bonds issued	-	-	-	1,494,050	1,494,050
Payment to refunded bond escrow agent	-	-	-	(563,776)	(563,776)
Capital lease acquisitions	30,086	-	-	3,973	34,059
Proceeds from sale of capital assets	1,339	-	-	12,635	13,974
Transfers from other funds (Note 19)	256,044	-	750,731	2,130,996	3,137,772
Transfers to other funds (Note 19)	(393,535)	-	(44,500)	(1,833,921)	(2,271,956)
Total Other Financing Sources (Uses)	(106,067)	-	706,231	2,247,332	2,847,496
Net changes in fund balances	(384,153)	65	(90,617)	810,772	336,067
Fund Balances - Beginning of fiscal year	1,453,393	1,953	97,968	1,850,971	3,404,284
Fund Balances - End of fiscal year	<u>\$ 1,069,240</u>	<u>\$ 2,017</u>	<u>\$ 7,350</u>	<u>\$ 2,661,743</u>	<u>\$ 3,740,351</u>

The accompanying notes are an integral part of the financial statements.

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES**

FISCAL YEAR ENDED SEPTEMBER 30, 2006

(In Thousands)

Net change in fund balance - total governmental funds		\$	336,067
<p>Governmental funds report capital outlay as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period. (Note 9)</p>			
Land and other non-depreciable assets	19,572		
Buildings, equipment, and other depreciable assets	191,523		
Infrastructure additions	61,412		
Construction in progress	80,832		
Gain on disposal of capital assets	9,105		
Accumulated depreciation	<u>(131,755)</u>		230,689
Certain revenues that were reported as resources in the funds but were earned in prior fiscal years are not reported in the Statement of Activities.			(3,414)
Increase in equity interest in joint ventures (Note 7)			735
Tax revenues that were reported as resources in the funds but were earned in prior fiscal years are not reported in the Statement of Activities.			101,233
Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities.			9,953
<p>Bond proceeds provide current financial resources to governmental funds by issuing debt which increases long-term bonded debt in the Statement of Net Assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term bonded debt in the Statement of Net Assets. This is the amount proceeds exceed repayments. (Note 12)</p>			
Bond proceeds and premiums received	(2,993,890)		
Repayment of bond principal	773,826		
Payment to refunded bond escrow agent	563,776		
Discount on bond issuances	496,444		
Accrued interest and amortization	(12,286)		
Deferred issue costs	<u>16,268</u>		(1,155,862)
<p>Certain expenditures are reported in the funds. However, they either increase or decrease long-term liabilities reported on the Statement of Net Assets and have been eliminated from the Statement of Activities. (Note 14)</p>			
Net pension obligation	(108,767)		
Capital lease payments	18,114		
Compensated absences payments	28,845		
Litigation settlements and payments	131,676		
Workers' compensation	(5,180)		
Other	<u>(4,505)</u>		60,184
Change in net assets of governmental activities		\$	<u>(420,415)</u>

The accompanying notes are an integral part of the financial statements.

