

## NOTE 28 – CONTINGENCIES AND COMMITMENTS

### A. Primary Government

#### Litigation

The State accrues liabilities related to significant legal proceedings if a loss is probable and reasonably estimable. In the event that a significant, probable, and reasonably estimable loss is not settled prior to the preparation of these statements, the obligation is recorded as a general long-term liability or fund liability, depending on the fund type (see Note #14).

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

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

Durant v State of Michigan (Durant II): In a decision rendered October 19, 1999, the Court of Appeals held that the State School Aid Act complied with the State's obligations under Article 9, § 29 of the Michigan Constitution to fund the state-mandated portions of the special education, special education transportation, and school lunch programs at the levels required by the Headlee Amendment.

The Court of Appeals further held that certain sections of the State School Aid Act violated Article 9, § 11 of the Michigan

Constitution. Article 9, § 11 of the Michigan Constitution provides, in part, that beginning in the 1995-96 state fiscal year, and each fiscal year thereafter, the State shall guarantee that the total state and local per pupil revenue for school operating purposes for each local school district shall not be less than the 1994-95 total state and local per pupil revenues for school operating purposes. The Court held that under Article 9, § 11, the Legislature must appropriate the state portion of the per pupil revenue for school operating purposes to local school districts as unrestricted school aid. Thus, the Court held that to

the extent the Legislature appropriated restricted funds to pay for special education and special education transportation from funds that were guaranteed to local school districts as unrestricted aid, the amendments to the State School Aid Act violated Article 9, § 11.

The Court of Appeals denied plaintiffs' request for mandamus, injunctive relief, and monetary damages and, as described above, granted declaratory relief only. The Court also held that plaintiffs may petition for costs and reasonable attorney fees as allowed by Article 9, § 32 of the Michigan Constitution. Under the court rules, the parties had until November 9, 1999 to appeal the decision to the Supreme Court or to move for rehearing in the Court of Appeals. Neither party appealed the decision nor moved for rehearing. Plaintiffs' petition for costs and attorney fees was granted by the Court of Appeals on January 14, 2000 in the amount of \$.4 million. On February 4, 2000 the State filed an application for leave to appeal and motion for peremptory reversal of the January 14, 2000 Court of Appeals order in the Supreme Court. On February 9, 2000, pursuant to the State's request, the Court of Appeals stayed the effect of the January 14, 2000 order, pending resolution of the appeal to the Supreme Court or further order of the Court of Appeals.

#### Federal Grants

The State receives significant financial assistance from the federal government in the form of grants and entitlements. The receipt of federal grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal regulations. Substantially all federal grants are subject to either federal single audits or financial and compliance audits by grantor agencies. Questioned costs as a result of these audits may become disallowances after the appropriate review of federal agencies. Material disallowances are recognized as either fund liabilities or liabilities of the General Long-Term Obligations Account Group when the loss becomes probable and reasonably estimable. As of September 30, 1999, the State estimates that additional disallowances of recognized revenue will not be material to the general purpose financial statements.

For fiscal year 1998-99, estimated mispayments (both State and federal shares) totalled approximately \$28.9 million in the Family Independence program (formerly the Aid to Families with Dependent Children (AFDC) program), \$62.8 million in the Food Stamp program, and \$45.3 million in the Medicaid program.

#### Gain Contingencies

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

Certain mispayments related to Department of Education grant programs are not recorded as assets in these statements. The mispayments generally occur because of the inclusion of ineligible student members in census counts at local school districts and are identified through department audits of

STATE OF MICHIGAN  
**NOTES TO FINANCIAL STATEMENTS (Continued)**  
FISCAL YEAR ENDED SEPTEMBER 30, 1999

membership counts. Receivables resulting from such audits are recognized as the audits are completed.

In November 1998, the Attorney General joined 45 other states and five territories in a settlement agreement against the nation's largest tobacco manufacturers, to seek restitution for monies spent by the states under Medicaid and other health care programs for treatment of smoking-related diseases and conditions. The Master Settlement Agreement includes base payments to states totaling \$220.6 billion over the next 25 years, and continues in perpetuity. Michigan's share of the settlement is expected to be \$8.5 billion over the next 25 years, and \$348.3 million thereafter, adjusted for inflation and other factors. The State also received \$2.2 million, representing costs incurred to litigate the case. While Michigan's share of the base payments will not change over time, the amount of the annual payment is subject to a number of modifications including adjustments for inflation and usage volumes. Some of the adjustments may result in increases in the payments (inflation, for example), while other adjustments will likely cause decreases in the payments (volume adjustments, for example). The net effect of these adjustments on future payments is unclear, therefore only receivables and deferred revenues which can be reasonably estimated have been recorded for the future payments.

#### **Construction Projects**

As of September 30, 1999, several construction projects were in progress, with several others in the planning stages. A more detailed discussion of construction commitments is included in the construction in progress disclosures (Note #10).

The Department of Transportation has entered into construction contracts for transportation related funds. As of September 30, 1999, the balances remaining in these contracts equaled \$544.4 million.

#### **Contingent Liability for Local School District Bonds**

Public Act 108 of 1961, as amended, resulted in a contingent liability for the bonds of any school district which are "qualified" by the Superintendent of Public Instruction. Every qualified school district is required to borrow and the State is required to lend to it any amount necessary for the school district to avoid a default on its qualified bonds. In the event that funds are not available in the School Bond Loan Fund in adequate amounts to make such a loan, the State is required to make such loans from the General Fund. As of December 31, 1999, the principal amount of qualified bonds outstanding was \$8.2 billion. Total debt service requirements on these bonds including interest will approximate \$765.2 million in 2000. The amount of loans by the State (related to local school district

bonds qualified under this program), outstanding to local school districts as of September 30, 1999, is \$284.3 million. Interest due on these loans as of September 30, 1999, is \$42.6 million.

#### **Michigan Underground Storage Tank Financial Assurance Fund (MUSTFA) Projects**

The MUSTFA Fund, a special revenue fund, receives revenues dedicated to reimbursing owners/operators of underground storage tanks (UST) for costs incurred related to conducting corrective actions at sites where a release has occurred from an UST. The MUSTFA reimbursement fund was declared insolvent and received no additional claims after June 29, 1995. The revenue is still collected to pay off two main obligations of the MUSTFA Fund: the long-term liability for incurred claims recorded in the General Long-Term Obligations Account Group, which is discussed in Note 14, and the debt and debt service charges associated with the financial borrowing mechanisms utilized to expedite reimbursement to eligible owners/operators.

### **B. Discretely Presented Component Units**

#### **Student Loan Guarantees**

The Michigan Higher Education Assistance Authority (MHEAA) is contingently liable for loans made to students by financial institutions that qualify for guaranty. The State of Michigan, other than MHEAA, is not liable for these loans. The MHEAA's default ratio is currently below 5% for the fiscal year ended September 30, 1999. As a result, the federal government's reinsurance rate for defaults for the fiscal year ended September 30, 1999, is 100% for loans made prior to October 1, 1993, and 98% for loans made on or after October 1, 1993 to September 30, 1998. In the event of future adverse default experience, the MHEAA could be liable for up to 22% of defaulted loans. Management does not expect that all guaranteed loans could default in one year. For loans made on or after October 1, 1998, the reinsurance rate will be 95%. In the event of future adverse default experience, MHEAA could be liable for up to 25% of such defaulted loans. Accordingly, the MHEAA's expected maximum contingent liability is less than 22% of outstanding guaranteed loans; however, the maximum contingent liability at September 30, 1999, is \$559.4 million.

The MHEAA entered into commitment agreements with all lenders that provide, among other things, that the MHEAA will maintain cash and marketable securities. The MHEAA was in compliance with this requirement as of September 30, 1999, at an amount sufficient to guarantee loans in accordance with the Higher Education Act of 1965, as amended.