NOTE 1 Summary of Significant Accounting Policies

Reporting Entity

The accompanying financial statements report the financial position, changes in financial position, and cash flows of the Liquor Purchase Revolving Fund, a proprietary fund of the State of Michigan, as of and for the fiscal years ended September 30, 2012 and September 30, 2011. They are not intended to present the financial position, changes in financial position, and cash flows of the State of Michigan or its enterprise funds in conformity with accounting principles generally accepted in the United States of America. The Liquor Purchase Revolving Fund is reported as an enterprise fund in the *State of Michigan Comprehensive Annual Financial Report (SoMCAFR).*

The footnotes accompanying these financial statements relate directly to the Liquor Purchase Revolving Fund. The *SoMCAFR* provides more extensive disclosures regarding the State's significant accounting policies; budgeting, budgetary control, and legal compliance; common cash; and pension benefits and other postemployment benefits.

The Michigan Liquor Control Commission (MLCC), within the Department of Licensing and Regulatory Affairs, is primarily responsible for the Liquor Purchase Revolving Fund. MLCC is governed by Sections 436.1101 - 436.2303 of *the Michigan Compiled Laws* (Act 58, P.A. 1998, as amended, the Michigan Liquor Control Code of 1998). MLCC consists of five members, each appointed by the Governor with the advice and consent of the Senate. The responsibilities of MLCC include the oversight of alcoholic liquor distribution within the State; licensing of the manufacture, importation, and sale of liquor; levy and collection of excise and specific taxes on liquor, beer, and wine; and enforcement of the Michigan Liquor Control Code.

Section 436.1221 of the *Michigan Compiled Laws* authorized the MLCC, to maintain a revolving fund that is to be derived from the money deposited to the credit of the commission with the State Treasurer. Under State monopoly, liquor is sold at wholesale through a State controlled, privately operated distribution system. The Fund accounts for the sales of and the replenishing and transporting of the liquor stock. Administrative, warehousing, and delivery costs are paid for through the fund. At the end of each year, the “net income” of the fund is transferred to the General Fund in accordance with Section 18.1435 of the *Michigan Compiled Laws.*

Measurement Focus, Basis of Accounting, and Presentation

The financial statements contained in this report are prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. Operating revenues and expenses generally result from the purchasing and the reselling of liquor. Other revenues and expenses are reported as nonoperating.

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

Fund Cash Account

The Fund utilizes the State Treasurer's Common Cash pool as its primary cash account. For the purpose of the statement of cash flows, the Fund considers cash and equity in the State's Treasurer's Common Cash pool net of warrants outstanding to be cash equivalents.

NOTE 2 Equity in the State Treasurer's Common Cash

The investment authority for the MLCC is found in Public Act 58 of 1998, as amended authorizing the MLCC to maintain a revolving fund that is to be derived from the money deposited to the credit of the commission with the state treasurer. Equity in the State of Michigan Treasurer's (State Treasurer's) Common Cash pool represents the Fund's interest, at market, in an investment pool managed by the Treasurer of the State of Michigan (the State).

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

The Fund's pro-rata share of the State Treasurer's Common Cash pool was $68.5 million and $64.2 million at September 30, 2012 and September 30, 2011 respectively. For the total amount of deposits and investments in the State Treasurer's Common Cash pool and their specific risks, please refer to the *SOMCAFR*.

Common Cash Deposits

Custodial Credit Risk
The custodial credit risk for deposits is the risk that, in the event of failure of a depositor financial institution, the State's deposits may not be recovered.

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are:

a. Uncollateralized,

b. Collateralized with securities held by the pledging financial institution, or

c. Collateralized with securities held by the pledging financial institution’s trust department or agent but not in the depositor-government’s name.

The State Treasurer's Common Cash pool policy requires the following criteria to lessen the custodial credit risk: All financial institutions holding the State's money must pledge collateral equal to the amount of the account balance for all demand and time deposits, to secure the State's funds; a bank, savings and loan association, or credit union holding the State's funds must be organized under the law of Michigan or federal law and maintain a principal office or branch office in the State of Michigan; and no deposit in any financial organization may be in excess of 50% of the net worth of the organization.

Foreign Currency Risk
Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of deposits.

Public Act 35 of 1997 requires State deposits to be held in a financial institution that maintains a principal office or branch office located in the State of Michigan. The State had no Common Cash pool deposits subject to foreign currency risk at September 30, 2012 and at September 30, 2011.

Common Cash Investments

Types of Investments
State Treasurer's Common Cash pool investments include prime commercial paper, corporate notes, and emergency municipal notes.

Risk
In accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, investments also require certain disclosures regarding policies and practices with respect to the risk associated with them. The custodial credit risk, the credit risk, the interest rate risk, the concentration of credit risk, and the foreign currency risk are discussed in the following paragraphs.

Custodial Credit Risk
Custodial credit risk for investments is the risk that, in the event of a failure by a counterparty, the Fund will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government, and are held by either:

The counterparty, or

The counterparty's trust department or agent, but not in the government's name.

The State Treasurer's Common Cash pool does not have an investment policy for managing custodial credit risk. At September 30, 2012 and at September 30, 2011, Common Cash pooled investments were not exposed to custodial credit risk.

Credit Risk
Credit risk is the risk that an issuer or another counterparty to an investment will not fulfill its obligations.

The State Treasurer's Common Cash pool requires prime commercial paper investments be rated A-1 or P-1 at the time of purchase as rated by the two major rating services, Standard & Poor's (A-1) and Moody's Investor Service (P-1). Borrowers must also have at least $400 million in commercial paper outstanding, and the State Treasurer may not invest in more than 10% of a borrower's outstanding debt. The Common Cash pooled investments are further limited to $200 million in any borrower, unless the borrower has an A-1+ rating, in which case the investment is not to exceed $300 million.

The State Treasurer's investment of the Common Cash pool in sugar beet loans is evidenced by unrated zero-interest promissory notes. The State Treasurer's investment in emergency municipal loans is evidenced by unrated notes held by the State in the State's name. In addition, at September 30, 2012 and at September 30, 2011, prime commercial paper investment were rated at A-1, P-1, or above.

Interest Rate Risk
Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The State Treasurer's Common Cash pool policy states that cash equivalents are to be invested in short term fixed income securities with an average weighted maturity of less than one year to provide liquidity and safety of principal from capital market and default risk.

The State Treasurer does not have a policy for controlling interest rate risk regarding the Common Cash pool investments in special loan programs (Emergency Financial Assistance Loan Program, Michigan Marina Dredging Loan Program, Michigan Sugar Beet Loan Program). These loan programs are investments created through legislation. Although some interest rate risk exposures exist, interest rate risk is not a consideration when entering into the special loan programs.

Concentration of Credit Risk
Concentration of credit risk is the risk of loss attributable to the magnitude of a government's investment with a single issuer.

The Fund is invested in pooled investment in the State of Michigan Common Cash pool, which is excluded from concentration of credit risk disclosure requirements.

Foreign Currency Risk
Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of deposits.

The State Treasurer's Common Cash pool investment policy does not allow for investment in foreign investments or currency; therefore, the Fund is not exposed to foreign currency risk.

NOTE 3 Liquor Inventory

Inventory is stored and handled by private Authorized Distribution Agents on behalf of the MLCC. Inventory is purchased daily in amounts sufficient to fill orders received the prior day. Inventory is valued at current quoted cost, primarily using the first-in, first-out method. Expenses are recognized using the consumption method (i.e. when used or sold).

NOTE 4 Pensions Plans and Postemployment Benefits

Plan Descriptions - The defined benefit and defined contribution pension plans are part of the State Employees' Retirement System administered by the Department of Technology, Management and Budget, Office of Retirement Services. Participants in each plan are eligible for retirement, healthcare, disability, and death benefits upon meeting certain vesting requirements. The State Employees' Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the defined benefit plan. That report is available on the State's website at http://www.michigan.gov/ors. The financial report for the defined contribution plan may be obtained by writing to the Department of Technology, Management and Budget, Office of Retirement Services, 7150 Harris Drive, P.O. Box 30171, Lansing, MI 48909 or by calling (517) 322-5103.

New employees hired on or after March 31, 1997 participate in a defined contribution plan that is separate from the State Employee's Retirement System defined benefits plan. Employees hired before March 31, 1997 are covered by the defined benefits plan unless they chose to convert to the defined contribution plan during 1997.

Funding Policy - For the State Employee's Defined Benefit Retirement Plan, LPRF was billed and paid $1,585,505 and $1,278,697 for pension charges and retiree postemployment benefits in fiscal years 2011-12 and 2010-11, respectively. Effective April 1, 2012, defined benefit plan members are required to contribute 4% of their compensation for pension benefits. For the State Employee's Defined Contribution Retirement Plan, LPRF is required to make a contribution of 4% of the annual payroll and to match employee contributions up to 3% of annual covered payroll. LPRF contributions for the Plan were $114,469 and $86,081 for fiscal years 2011-12 and 2010-11, respectively.

Postemployment Benefits - The MLCC participates in the State of Michigan's postemployment benefits. The cost of retiree healthcare benefits is an allocation calculated by the State of Michigan and funded on a pay-as-you-go basis. The State contributes 90% of healthcare benefits for employees hired on or before March 30, 1997 who participate in either the defined benefit plan or the defined contribution plan and meet certain vesting and other requirements. For employees who were hired after March 30, 1997 through December 31, 2011 who participate in the defined contribution plan and meet certain vesting and other requirements, the State contributes up to 90% of healthcare benefits. Effective January 1, 2013, the State's contribution rate decreases to 80% for all employees hired prior to December 31, 2011.

Employees hired on or after January 1, 2012 receive a personal healthcare fund and receive up to a 2% matching contribution into a 401(k) account if the employee contributes 2% of his or her pay. Also, the employee will receive a credit into a health reimbursement account (HRA) at termination of employment if he or she has at least 10 years of service at termination.

NOTE 5 Risk Management

MLCC participates in the State of Michigan's (primary government) risk management program. The State is self-insured for most general liability and property losses; portions of its employee insurance benefit and bonding programs; and automobile liability, workers' compensation, and unemployment claims. The State Sponsored Group Insurance Fund and Risk Management Fund (internal service funds) have been established by the State to account for these self-insured risk management programs. As a participant, MLCC recognizes expenses for payments made to the State in a manner similar to purchasing commercial insurance. Charges to finance the self-insured programs are based on estimates of amounts needed to pay prior and current year claims as determined annually by the Department of Technology, Management, and Budget.

NOTE 6 Distribution Costs Paid to Suppliers

This is the amount paid directly to the liquor suppliers by the MLCC for the Authorized Distribution Agents' warehousing and delivery of spirits to retail licensees. The MLCC paid $6.97 per case during fiscal years 2011-12 and 2010-11. The liquor suppliers were required to add $1.35 per case to the State's payment and pay a minimum of $8.32 per case to the MLCC's Authorized Distribution Agents.

NOTE 7 Other Transfers

Includes transfers to the Civil Service Commission as authorized by Article XI, Section 5 of the State Constitution. These transfers represent not less than one percent of the aggregate payroll of the classified service for the preceding fiscal year.