

MICHIGAN STATE
UNIVERSITY

FINANCIAL REPORT
2010-2011

TABLE OF CONTENTS

Michigan State University

	Page
Letter from Vice President for Finance and Operations and Treasurer	3
Management's Discussion and Analysis	4
Independent Auditor's Report	13
Basic Financial Statements:	
Statements of Net Assets - Michigan State University	14
Statements of Financial Position - Michigan State University Foundation	15
Statements of Revenues, Expenses, and Changes in Net Assets - Michigan State University	16
Statements of Activities and Changes in Net Assets - Michigan State University Foundation	17
Statements of Cash Flows - Michigan State University	18
Notes to the Financial Statements	20
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	39

MICHIGAN STATE UNIVERSITY
BOARD OF TRUSTEES

Joel I. Ferguson
Chairman
Lansing

Brian Breslin
East Lansing

Mitch Lyons
Grand Rapids

George Perles
East Lansing

Melanle Foster
Vice Chairperson
East Lansing

Dianne Byrum
East Lansing

Faylene Owen
East Lansing

Diann Woodard
Detroit

EXECUTIVE OFFICERS

Lou Anna K. Simon
President

Bill Beekman
Secretary of the Board of
Trustees and Executive
Assistant to the President

Robert W. Groves
Vice President for
University Advancement

Paulette Granberry Russell
Senior Advisor to the President
for Diversity and Director of the
Office for Inclusion and
Intercultural Initiatives

Kim A. Wilcox
Provost and Vice President
for Academic Affairs

Mark Burnham
Vice President for
Governmental Affairs

Denise Maybank
Interim Vice President for
Student Affairs and Services

Heather Swain
Interim Vice President for
University Relations

Fred L. Poston
Vice President for Finance
and Operations and Treasurer

J. Ian Gray
Vice President for Research
and Graduate Studies

Robert A. Noto
Vice President for Legal
Affairs and General Counsel

Scott Westerman
Associate Vice President and
Executive Director of the
MSU Alumni Association

VICE PRESIDENT FOR FINANCE AND OPERATIONS AND TREASURER ADMINISTRATIVE STAFF

Fred L. Poston
Vice President for Finance
and Operations and Treasurer

David B. Brower
Assistant Vice President,
Chief Financial Officer and
Controller

David A. Gift
Vice Provost for Libraries,
Computing, and Technology

William J. Latta
Assistant Vice President for
Administration

Elizabeth A. Alexander
University Physician

David S. Byelich
Assistant Vice President
and Director of Planning
and Budgets

Vennie Gore
Assistant Vice President for
Residential and Hospitality
Services

Kathryn E. Lindahl
Assistant Vice President for
Finance and Operations

Jennifer Battle
Assistant Director of
Campus Sustainability

James H. Dunlap
Police Chief and Director
of MSU Police

Mark P. Haas
Assistant Vice President for
Business and Chief Financial
Officer (Designee)

Charles J. Reid
Director of Land
Management

Brent Bowditch
Assistant Vice President
for Human Resources

Ronald T. Filinn
Assistant Vice President
for Physical Plant

Jeff R. Kacos
Director of Campus
Planning and Administration

BUSINESS OPERATIONS ADMINISTRATIVE STAFF

David B. Brower
Assistant Vice President,
Chief Financial Officer and
Controller

Ruth Daoust
Manager of Surplus Store
and Recycling Center

Glen J. Klein
Director of Investments
and Financial Management

Matthew G. McCabe
Director of Risk
Management and Insurance

Mark P. Haas
Assistant Vice President for
Business and Chief Financial
Officer (Designee)

Gregory J. Deppong
Chief Accountant and
Manager of Financial
Reporting

Kimberly Kokenakes
Acting Director of
University Services

Vincent Schimzizi
Assistant Controller
EBS Finance Systems

Daniel T. Evon
Director of Contract and
Grant Administration

Terry Livermore
Manager of University
Licensing

Susan J. Waltersdorf
Associate Controller
Student Financial Services

MICHIGAN STATE UNIVERSITY

This report presents the financial position and results of operations of Michigan State University for the fiscal years ended June 30, 2011, and June 30, 2010. The financial report has been adopted by the Board of Trustees and is provided as part of the commitment by Michigan State University to report annually on its fiscal affairs. These financial statements have been audited by Plante & Moran PLLC, Certified Public Accountants. Their audit report appears on page 13.

Michigan State University has been working to advance the common good in uncommon ways for more than 150 years. One of the top research universities in the world, MSU focuses its vast resources on creating solutions to some of the world's most pressing challenges, while providing life-changing opportunities to a diverse and inclusive academic community through more than 200 programs of study in 17 degree-granting colleges.

Throughout the year ended June 30, 2011, the University continued focusing its priorities to maximize its resources in an increasingly challenging economic environment. Through a long-term strategic planning initiative, the University is "Shaping the Future" by changing the way we work, while maintaining the quality of work we do for students and communities close to home and around the world. Through thoughtful past planning, hard work, decision making, and collaboration, the University is positioned to pursue greater efficiency and effectiveness in ways that do not compromise its values or vision. By adhering to its basic financial principles, including funding recurring operations with recurring revenues, the University has made necessary fiscal adjustments with the objective of maintaining quality.

Significant areas of accomplishments under the University's "Shaping the Future" initiatives include strategic expansion of academic programs including expansion of the College of Human Medicine and College of Osteopathic Medicine to other areas of Michigan, and the expansion of the College of Nursing through the Bott Building for Nursing Education and Research – now under construction. These will further establish Michigan State University as a leader in medical education and research. In addition, expansion of the University's research initiatives continues through the development of the Facility for Rare Isotope Beams (FRIB). On track for completion by 2020, FRIB will enable scientists to make discoveries about the properties of rare isotopes in order to better understand the physics of nuclei, nuclear astrophysics, fundamental interactions, and applications for society.

As we move forward in a challenging economic environment, the University is adapting. We are increasing efficiencies, creating synergies, reshaping programs and services, and constantly investigating how resources can be shared and conserved, while continuing to invest in and nurture the intellectual capital critical to the nation's future. However, challenging, these times play to the strength of the University and the can-do spirit hallmark to MSU. As we adapt, we will remain resilient, maintaining our momentum and our excellence, while putting every dollar possible into opportunities for students and developing critical programs and initiatives.



OFFICE OF THE VICE PRESIDENT FOR FINANCE AND OPERATIONS

Fred L. Poston
Vice President and
Treasurer

Michigan State University
412 Administration Building
East Lansing, Michigan
48824-1046

Phone 517.355.5014
Fax 517.353.6772
www.vpfo.msu.edu

A handwritten signature in black ink, appearing to read "Fred L. Poston".

Fred L. Poston
Vice President for Finance and Operations and Treasurer
October 24, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

Michigan State University

Introduction

The following discussion provides an overview of the financial position of Michigan State University (the "University") for the years ended June 30, 2011 and 2010 and includes an analysis of the University's Statement of Net Assets, which presents the assets, liabilities, and net assets of the institution as of the end of the fiscal year, and Statement of Revenues, Expenses, and Changes in Net Assets, which reflects revenues and expenses recognized during the fiscal year. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) pronouncements.

The Michigan State University Foundation (the "Foundation") is a legally separate entity which meets the criteria set forth for component units under GASB regulations. The Foundation provides financial support for the objectives, purposes, and programs of the University. Although the University does not control the timing, purpose, or amount of its receipts from the Foundation, the resources (and income thereon) which the Foundation holds and invests are dedicated to benefit the University. Because these resources held by the Foundation can only be used by, or for the benefit of, the University, the Foundation is considered a component unit of the University and is discretely presented in the University's financial statements. The Foundation is a private organization that reports under Financial Accounting Standards Board (FASB) standards. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the Foundation financial information included in the University's financial report to account for these differences.

The University's financial statements, related footnote disclosures, and discussion and analysis (which excludes the Foundation), have been prepared by management. The discussion and analysis should be read in conjunction with the financial statements and footnotes.

Statement of Net Assets

The Statement of Net Assets includes all assets and liabilities. It is prepared under the accrual basis of accounting, whereby revenues and assets are recognized when services are provided and expenses and liabilities are recognized when others provide the services, regardless of when cash is exchanged. Assets and liabilities are generally measured using current values. One exception is capital assets, which are stated at historical cost less an allowance for depreciation.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Michigan State University

A summarized comparison of the University's assets, liabilities and net assets at June 30, 2011, 2010, and 2009 follows:

	<u>2011</u>	<u>2010</u> <i>(in millions)</i>	<u>2009</u>
Current assets	\$ 428	\$ 420	\$ 395
Noncurrent assets:			
Restricted cash and cash equivalents and restricted investments	111	203	-
Endowment and other investments	1,773	1,465	1,372
Capital assets, net	1,703	1,622	1,508
Other	120	134	153
Total assets	<u>4,135</u>	<u>3,844</u>	<u>3,428</u>
Current liabilities	408	387	483
Noncurrent liabilities	1,003	989	654
Total liabilities	<u>1,411</u>	<u>1,376</u>	<u>1,137</u>
Total net assets	<u>\$ 2,724</u>	<u>\$ 2,468</u>	<u>\$ 2,291</u>

Current assets:

Current assets consist of cash and cash equivalents, collateral from securities lending, investments, net accounts and interest receivable, and other assets. The net increase in current assets in 2011 is due in part to a net \$15 million increase in federal, state, and local sponsored program accounts receivable. Sponsored program accounts receivable balances vary from year to year due in part to timing differences between amounts expended in accordance with grant or contract guidelines and actual cash draws from the grantor. This increase is partially offset with a \$10 million decrease in collateral from the securities lending program. The decrease in securities lending collateral is due primarily to a change in the makeup of the underlying investment holdings under the securities lending program as of June 30, 2011 and their related propensity for lending. The net decrease in 2010 is due in part to a net \$61 million increase in cash and cash equivalents and investments (primarily a function of the University's operating, financing, and investing activities as reported in the Statement of Cash Flows), and a net \$13 million increase in the amount of pledges receivable expected to be collected in the next fiscal year. These increases were partially offset by a \$46 million decrease in collateral from the securities lending program.

Noncurrent assets:

Restricted cash and cash equivalents and restricted investments

All balances represent unspent bond proceeds which are externally restricted for the construction or purchase of capital assets. The decrease in 2011 represents the spending of Series 2010A bond proceeds consistent with their restricted purpose. The increase in 2010 was due to the Series 2010A issuance in April 2010.

Endowment and other investments

At June 30, 2011 and June 30, 2010, the University's endowment investments totaled \$1,395 million (an increase of \$259 million) and \$1,136 million (an increase of \$90 million), respectively. Market value (realized

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Michigan State University

and unrealized) increases within the investment portfolio accounted for \$182 million and \$103 million in 2011 and 2010, respectively. In addition, endowment gifts totaled \$19 million in 2011 and \$28 million in 2010, while the draw on the endowment's accumulated net capital gains totaled \$11 million in 2011 and \$41 million in 2010. During 2011, \$60 million of investments were reallocated to designated endowment investments, consistent with the University's Board approved cash management and investment plan. No allocation was made in 2010.

Other investments consist primarily of the Liquidity Reserve Pool component of the University's Operating Cash Pool, which totaled \$244 million and \$233 million at June 30, 2011 and 2010, respectively. Funded retirement and postemployment benefit reserves (\$86 million in 2011 and \$72 million in 2010) substantially account for the remainder of other investments.

For the years ended June 30, 2011, 2010, and 2009, the total returns on investments were as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating Cash Pool:			
Liquidity Pool	1.4%	3.9%	3.6%
Liquidity Reserve Pool	5.0%	12.2%	(2.1)%
Common Investment Fund	20.6%	11.4%	(18.0)%
Other Separately Invested Investments	35.9%	(38.2)%	23.4%

Capital assets

The University continues to implement its long-range plan to modernize and renew its teaching, research and residential life facilities in support of its missions. At June 30, 2011, 2010, and 2009, the University's investment in capital assets was as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
		<i>(in millions)</i>	
Land	\$ 32	\$ 32	\$ 26
Buildings and site improvements	2,156	2,125	1,929
Construction in progress	205	163	204
Software and other intangibles	87	-	-
Equipment and other	626	597	562
Museum collections	9	9	8
Less: accumulated depreciation	<u>(1,412)</u>	<u>(1,304)</u>	<u>(1,221)</u>
	<u>\$ 1,703</u>	<u>\$ 1,622</u>	<u>\$ 1,508</u>

Major additions to buildings and site improvements during 2011 include \$9 million for the Secchia Center, \$6 million for the Facility for Rare Isotope Beams Utility Relocation, and \$4 million for Hubbard Hall First Floor Commons Renovation. Major additions to buildings and site improvements during 2010 include \$71 million for the Secchia Center, \$23 million for the Farm Lane Underpass, \$16 million for Wharton Center for the Performing Arts alterations and expansion, \$17 million for the Cyclotron Low Energy Experimental Research and Office additions, and \$13 million for MSU's Surplus Store & Recycling Center.

The addition to software and other intangibles during 2011 was the implementation of MSU's Enterprise Business Systems Project, which went live January 1, 2011. This was a multi-year system development project that updated and integrated the financial and human resource/payroll systems across the University.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Michigan State University

Construction in progress reflects multi-year projects which, once completed and placed into service, are generally categorized as buildings and site improvements. The 2011 balance includes \$45 million for the Brody Hall renovation, \$26 million for Plant Science Building expansion, \$24 million for the Eli and Edythe Broad Art Museum, and \$17 million for Wells Hall addition and Old Horticulture Building renovation. The 2010 balance includes \$69 million for MSU's Enterprise Business Systems Project, \$34 million for the Brody Hall renovation, and \$8 million for the Eli and Edythe Broad Art Museum.

As of June 30, 2011, the University had initiated plans and incurred certain contractual commitments related to the construction and renovation of various facilities. The costs to complete the projects are estimated to be \$168 million and are to be funded from debt proceeds, other University funds, and private gifts.

Current liabilities:

Current liabilities consist primarily of trade accounts and interest payable, accrued compensation and other personnel costs, obligations under securities lending, deferred revenues, and other liabilities payable within one year or less. The net increase in 2011 is due in part to \$22 million increase in trade accounts payable. Trade accounts payable balances vary from year to year due in part to timing of University initiatives and payments of related programmatic costs. In addition, debt interest payable increased \$7 million and the current portion of long-term debt and other obligations increased \$23 million. The net increase in the current portion of long-term debt and other obligations is due in part to the issuance of \$14 million of General Revenue Commercial Paper (short term financing), Series B, which was used to finance or reimburse all or part of the costs of capital projects (\$9 million) and refund outstanding General Revenue Bonds, Series 2002B (\$5 million). In addition, a net issuance of \$43 million of General Revenue Commercial Paper, Series C proceeds were used to refund outstanding General Revenue Commercial Paper, Series A (\$35 million) and finance or reimburse all or part of the costs of eligible capital projects (\$8 million). Partially offsetting these increases, is a decrease of \$24 million in accrued compensation and other personnel costs primarily due to realigning the timing of academic employee compensation payments to correspond with the nine month academic duty period (September – May annually), resulting in no accrual at June 30, 2011. In addition, obligations under securities lending decreased \$11 million due primarily to a change in the make-up of the underlying investment holdings under the securities lending program as of June 30, 2011 and their related propensity for lending. The net decrease in current liabilities in 2010 is due in part to a \$47 million decrease in obligations under securities lending and a \$39 million net decrease in the current portion of long-term debt and other obligations, due primarily to converting \$116 million of General Revenue Commercial Paper to long-term debt, offset by a net issuance of \$84 million of new General Revenue Commercial Paper.

Noncurrent liabilities, primarily debt:

At June 30, 2011, the University had noncurrent debt and other obligations outstanding of \$758 million compared with \$779 million at June 30, 2010. This balance is comprised primarily of outstanding General Revenue Bonds of \$713 million and \$734 million in 2011 and 2010, respectively. The decrease in noncurrent debt and other obligations is due primarily to scheduled principal debt payments of \$14 million on outstanding General Revenue Bonds and the current refunding of General Revenue Bonds, Series 2002B (\$5 million) with General Revenue Commercial Paper, Series B. The University periodically reviews its debt capacity and related capital asset needs to optimize the use of long-term resources. The University's outstanding General Revenue debt carry an investment grade credit rating from Moody's and Standard & Poor's of Aa1 and AA, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Michigan State University

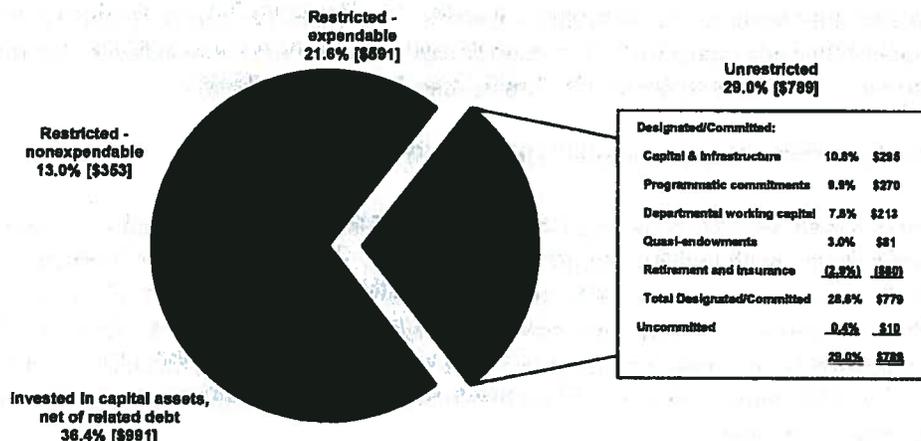
The University faces the continuing challenge of funding its increasing health care and dental benefits costs. This includes the cost of providing postemployment health and dental benefits to eligible employees (other postemployment benefits, or OPEB). For the year ended June 30, 2011, the University has estimated the cost (annual expense) of providing OPEB through an actuarial valuation as of January 1, 2010 and adjusted for 2010-11 health care cost experience. The actuarial valuation computes an annual required contribution, which represents a level of funding that, if paid on an ongoing basis, is projected to cover current year costs and amortize any unfunded actuarial liabilities over a period of thirty years. The University's total unfunded OPEB obligation in 2011 and 2010 is estimated at \$792 million and \$783 million, respectively. The University has recorded a noncurrent liability of \$170 million and \$128 million for 2011 and 2010, respectively, representing the net OPEB obligation (the annual required contribution less actual retiree health and dental payments made during the respective fiscal years). This increase is due to the continued amortization (over thirty years) of the total unfunded OPEB obligation. The University discontinued providing retiree health and dental care benefits to new employees beginning July 1, 2010.

Net assets:

Net assets represent residual University assets after liabilities are deducted. The University's net assets at June 30, 2011, 2010, and 2009 are summarized as follows:

	<u>2011</u>	<u>2010</u> <i>(in millions)</i>	<u>2009</u>
Invested in capital assets, net of related debt	\$ 991	\$ 987	\$ 974
Restricted:			
Nonexpendable	353	447	393
Expendable	591	396	360
Total restricted	<u>944</u>	<u>843</u>	<u>753</u>
Unrestricted	789	638	564
Total net assets	<u>\$ 2,724</u>	<u>\$ 2,468</u>	<u>\$ 2,291</u>

The following is a breakdown of net assets at June 30, 2011. See footnote 15 for further information (amounts are presented in millions of dollars):



TOTAL NET ASSETS \$2.7 BILLION

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Michigan State University

Net assets invested in capital assets, net of related debt, represent the University's land, buildings, software and equipment net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

Restricted nonexpendable net assets are subject to externally imposed stipulations that they be maintained permanently. Such net assets include the corpus portion (historical value) of gifts to the University's permanent endowment funds and certain investment earnings stipulated by the donor to be reinvested permanently.

Restricted expendable net assets are subject to externally imposed restrictions governing their use. Such net assets include the net appreciation of the University's permanent endowment funds that have not been stipulated by the donor to be reinvested permanently, restricted quasi-endowments, restricted gifts, and federal and state sponsored programs.

Although unrestricted net assets are not subject to externally imposed restrictions, virtually all of the University's unrestricted net assets are subject to internal designation to meet various specific commitments, including funding the completion of the 2011 summer semester and the first quarter of fiscal year 2012, maintaining reserves for capital projects, the continued recognition of the OPEB obligation, working capital for self-supporting departmental activities, and unrestricted quasi and term endowments.

Over time, increases or decreases in net assets are an indicator of the improvement or erosion of the University's financial health when considered with non-financial facts such as enrollment levels, strength of faculty, and condition of facilities. In addition, net assets are directly affected by the performance of the University's investments. Net assets increased during 2011 and 2010 by focusing on cost controls, pursuing a long-term investment strategy to maximize risk-adjusted total returns, and appropriately utilizing debt and other resources to meet programmatic needs, including the maintenance and replacement of the University's infrastructure.

The University's ongoing review of its infrastructure indicates a need to expend approximately \$850 million over the next 10 years to modernize and renovate aging teaching, research, housing and other support facilities, utility systems, and roads, consistent with its just-in-time maintenance strategy, and to upgrade administrative and other campus-wide technology systems. The University intends to address these maintenance and technology needs through the use of capital and infrastructure reserves, appropriate use of additional borrowing, and efforts to obtain gifts, grants, and capital appropriations.

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the University, as well as the nonoperating revenues and expenses. Operating revenues primarily include net student tuition and fees, grants and contracts, and auxiliary activities. Given a public university's dependency on revenues such as state appropriations, gifts, and investment income, which are prescribed by GASB as nonoperating revenues, operating expenses will exceed operating revenues, resulting in an operating loss. Net nonoperating revenues or expenses are an integral component in determining the increase or decrease in net assets.

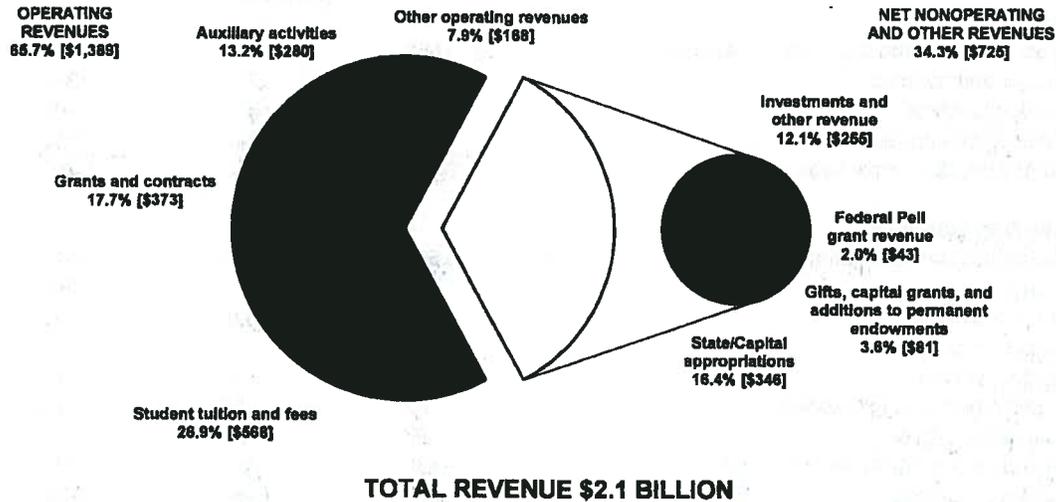
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**Michigan State University**

A summarized comparison of the University's revenues, expenses, and changes in net assets for the years ended June 30, 2011, 2010, and 2009 follows:

	<u>2011</u>	<u>2010</u> <i>(in millions)</i>	<u>2009</u>
Operating revenues:			
Student tuition and fees, net of allowances	\$ 568	\$ 542	\$ 510
Grants and contracts	373	373	340
Auxiliary activities	280	276	275
Other operating revenues	168	148	138
Total operating revenues	<u>1,389</u>	<u>1,339</u>	<u>1,263</u>
Operating expenses:			
Instruction and departmental research	561	556	551
Research	294	277	262
Public services	220	228	212
Academic support	78	75	77
Student services	32	32	31
Scholarships and fellowships	53	50	41
Institutional support	94	91	90
Operation and maintenance of plant	138	143	158
Auxiliary enterprises	269	256	256
Depreciation	116	98	91
Other operating expenses, net	3	4	6
Total operating expenses	<u>1,858</u>	<u>1,810</u>	<u>1,775</u>
Operating loss	(469)	(471)	(512)
Nonoperating revenues (expenses):			
State operating appropriation	284	284	293
State agricultural experiment station appropriation	33	18	34
State cooperative extension service appropriation	29	18	30
State appropriated federal fiscal stabilization funds	-	36	-
Federal Pell grant revenue	43	39	24
Gifts	46	53	55
Net investment income (loss)	289	164	(243)
Interest expense on capital asset related debt	(39)	(20)	(23)
Other nonoperating revenues, net	5	2	22
Net nonoperating revenues	<u>690</u>	<u>594</u>	<u>192</u>
Income (loss) before other revenues	221	123	(320)
State capital appropriations	-	1	2
Capital grants and gifts	18	28	12
Additions to permanent endowments	17	25	16
Increase (decrease) in net assets	<u>256</u>	<u>177</u>	<u>(290)</u>
Net assets, beginning of year	2,468	2,291	2,581
Net assets, end of year	<u>\$ 2,724</u>	<u>\$ 2,468</u>	<u>\$ 2,291</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Michigan State University

The following is a graphic illustration of total net revenue by source for the year ended June 30, 2011 (amounts are presented in millions of dollars):



The University is supported by a diverse stream of revenue which supplements its student tuition and fees, including state appropriations, federal and state sponsored programs, private gifts and grants, and investment income. The University continues to seek funding from all possible sources consistent with its mission and to manage the financial resources realized from these efforts to fund its operations.

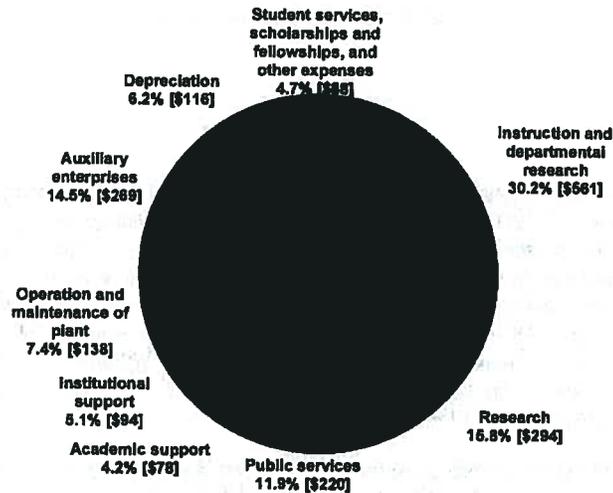
Operating revenues: The most significant source of operating revenue for the University is tuition and fees (net of scholarship allowances), totaling \$568 million and \$542 million in 2011 and 2010, respectively. Gross tuition and fees revenue increased 4.7% in 2011, which includes a 4.0% effective rate increase in tuition and fees and a 0.7% revenue increase from additional student credit hours taken and changes in the student blend. The 8.3% increase in 2010 reflected a 7.5% effective rate increase in tuition and fees and a 0.8% revenue increase from additional student credit hours taken and changes in the student blend. Other major revenue sources in 2011 include auxiliary activities of \$280 million (an increase of \$4 million) and federal grants and contracts of \$297 million (an increase of \$16 million), including \$286 million for sponsored programs.

Net nonoperating and other revenues: The primary source of this net revenue is State appropriations, which totaled \$346 million in 2011, a decrease of \$10 million (2.8%). Base appropriations funded directly by the State increased \$26 million, offset with the elimination of \$36 million in one-time American Recovery and Reinvestment Act of 2009 (ARRA) funds received in 2010 (none in 2011). In 2011, the University received \$284 million in funding for general operations, consistent with amount funded directly by the State in 2010, offset with the elimination of \$8 million in one-time ARRA funding received in 2010. In 2011, Michigan State University Extension and MSU AgBioResearch appropriations totaled \$62 million, a 72.2% increase over 2010 appropriations (\$36 million), offset with the elimination of \$28 million in one-time ARRA funding received in 2010. Other significant components of net nonoperating revenues in 2011 include gift revenue (decreased \$7 million), and net investment income (increased \$125 million). In 2010, gift revenue decreased \$2 million, and net investment income increased \$407 million due to recovery of market conditions from 2009.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Michigan State University

The following is a graphic illustration of operating expenses by source for the year ended June 30, 2011 (amounts are presented in millions of dollars):



TOTAL OPERATING EXPENSES \$1.9 BILLION

During 2011, \$1,075 million was expended for the core missions of the University - instruction and departmental research, research, and public services, an increase of \$14 million (1.3%) over 2010. Instruction and departmental research expenses increased \$5 million (0.8%), due primarily to salary increases (0.5%). Research and public service expenses increased \$9 million due in part to growth in sponsored programs (\$4 million). Auxiliary enterprises (activities which provide services to students, faculty, staff, and the public) increased \$13 million (5.3%), while expenses for the operation and maintenance of plant decreased \$5 million (3.9%).

Economic Outlook

The University's revenue mix is closely associated with the level of State support. Due to continued economic pressures affecting the State of Michigan, the 2011-12 fiscal year state appropriations have been reduced 15.0% (\$52 million). Static or declining State appropriations generally result in increased tuition and fees. Consequently, the Board of Trustees approved a 6.9% increase for fall 2011 in-state undergraduate tuition. In addition, the University has undertaken a number of reductions, including workforce reductions, trimmed benefit programs, forgone salary increases, and operating funding cuts for all units. Continued economic pressures affecting the State may continue to result in declining adjustments in State appropriations for higher education. Despite constrained resources, the University continues to focus on providing internationally competitive undergraduate and graduate education, research, and outreach for the benefit of Michigan, the country, and the world.

Independent Auditor's Report

To the Board of Trustees
Michigan State University

We have audited the accompanying statements of net assets of Michigan State University (the "University") as of June 30, 2011 and 2010 and the related statements of revenue, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the financial statements of the Michigan State University Foundation (the "Foundation"), which present all the assets and revenue of the discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us and our opinion, insofar as it relates to the amounts included for the Foundation, is based on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence 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 that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Michigan State University and its component unit as of June 30, 2011 and 2010 and the results of their operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 6, 2011 on our consideration of Michigan State University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters for the year ended June 30, 2011. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide opinions on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis presented on pages 4 through 12 is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and express no opinion on it.

Plante & Moran, PLLC

Kalamazoo, Michigan
October 6, 2011

STATEMENTS OF NET ASSETS
Michigan State University

	June 30,	
	2011	2010
ASSETS		
Current assets:		
	(In thousands)	
Cash and cash equivalents	\$ 18,954	\$ 19,811
Investments	174,752	173,653
Collateral from securities lending	12,880	22,801
Accounts and interest receivable, net	170,114	150,386
Student loans receivable, net	8,566	9,224
Pledges receivable, net	24,109	29,719
Inventories and other assets	18,305	14,184
Total current assets	427,680	419,778
Noncurrent assets:		
Restricted cash and cash equivalents	23,219	44,110
Restricted investments	87,360	159,122
Endowment investments	1,395,282	1,136,440
Other investments	378,127	328,417
Student loans receivable, net	36,312	36,998
Pledges receivable, net	36,893	43,106
Investments in joint ventures	6,676	6,329
Deferred outflows from hedging derivative instruments	35,770	42,885
Unamortized bond origination costs	4,708	4,860
Capital assets, net	1,703,365	1,621,531
Total noncurrent assets	3,707,710	3,423,798
TOTAL ASSETS	\$ 4,135,390	\$ 3,843,576
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts and interest payable	\$ 87,913	\$ 58,855
Accrued personnel costs	49,256	73,223
Obligations under securities lending	20,317	30,853
Accrued self-insurance liabilities	15,073	13,770
Payroll taxes and other payroll deductions	22,188	26,841
Deposits held for others	31,754	29,653
Deferred revenues	86,155	81,505
Current portion of long term debt and other obligations	95,702	72,623
Total current liabilities	408,358	387,323
Noncurrent liabilities:		
Accrued personnel costs	31,937	30,841
Accrued self-insurance liabilities	6,881	7,932
Hedging derivative instruments	35,770	42,885
Net other postemployment benefit obligation	169,608	128,234
Long term debt and other obligations	758,304	778,583
Total noncurrent liabilities	1,002,500	988,475
Total liabilities	1,410,858	1,375,798
Net assets:		
Invested in capital assets, net of related debt	991,459	986,891
Restricted:		
Nonexpendable	352,696	447,289
Expendable	590,891	395,368
Unrestricted	789,486	638,230
Total net assets	2,724,632	2,467,778
TOTAL LIABILITIES AND NET ASSETS	\$ 4,135,390	\$ 3,843,576

See accompanying notes

STATEMENTS OF FINANCIAL POSITION
Michigan State University Foundation

	June 30,	
	2011	2010
	(In thousands)	
ASSETS		
Cash equivalents	\$ 1,926	\$ 3,252
Interest and dividends receivable	212	159
Grants and contracts receivable, net	400	778
Other receivables, net	1,665	1,781
Investments:		
Marketable securities	209,297	177,828
Investments in limited partnerships	100,683	97,245
Venture capital	43,560	33,257
Cash value of life insurance	2,142	1,484
Land held for investment	3,944	3,830
Other investments	1,180	1,400
Investment in Spartan Ventures LLC	-	460
Investment in Research Park	5,920	5,932
Prepaid expenses	119	111
Property and equipment, net	10,055	10,445
Intangible assets, net	846	850
Other assets	4	1
	<u>4</u>	<u>1</u>
TOTAL ASSETS	\$ 381,963	\$ 338,813
	<u><u>381,963</u></u>	<u><u>338,813</u></u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accrued expenses and other payables	\$ 3,809	\$ 3,181
Deferred compensation	177	177
Note payable - deferred compensation	196	196
Note payable	4,228	4,327
Trusts and annuities payable	9,501	9,163
Deferred gifts	433	433
Deposit held for Michigan State University	8,596	3,804
Obligations under life estate agreements	9	13
Total liabilities	<u>27,949</u>	<u>21,294</u>
Net assets:		
Unrestricted	309,392	278,427
Temporarily restricted	30,313	26,344
Permanently restricted	14,299	12,748
Total net assets	<u>354,004</u>	<u>317,519</u>
TOTAL LIABILITIES AND NET ASSETS	\$ 381,963	\$ 338,813
	<u><u>381,963</u></u>	<u><u>338,813</u></u>

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
Michigan State University

	Year ended June 30,	
	2011	2010
OPERATING REVENUES		
	(In thousands)	
Student tuition and fees	\$ 661,110	\$ 631,665
Less: scholarship allowances	92,665	89,276
Net student tuition and fees	<u>568,445</u>	<u>542,389</u>
State of Michigan grants and contracts	10,358	19,152
Federal grants and contracts	296,874	280,744
Local and private sponsored programs	65,816	73,190
Interest and fees on student loans	940	837
Departmental activities (net of scholarship allowances of \$4,476 in 2011 and \$4,644 in 2010)	166,897	146,752
Auxiliary activities (net of room and board allowances of \$16,460 in 2011 and \$16,237 in 2010)	280,227	276,215
TOTAL OPERATING REVENUES	<u>1,389,556</u>	<u>1,339,279</u>
OPERATING EXPENSES		
Instruction and departmental research	560,794	556,404
Research	293,705	276,580
Public services	220,549	228,084
Academic support	78,197	74,924
Student services	31,840	31,802
Scholarships and fellowships	53,357	49,943
Institutional support	93,646	90,979
Operation and maintenance of plant	137,919	143,467
Auxiliary enterprises	269,466	255,933
Depreciation	116,183	98,429
Other operating expenses, net	2,520	3,527
TOTAL OPERATING EXPENSES	<u>1,868,176</u>	<u>1,810,072</u>
Operating loss	(468,621)	(470,793)
NONOPERATING REVENUES (EXPENSES)		
State operating appropriation	283,685	283,909
State agricultural experiment station appropriation	33,243	18,116
State cooperative extension service appropriation	28,873	17,825
State appropriated federal fiscal stabilization funds	-	35,888
Federal Pell grant revenue	43,424	39,313
Gifts	46,196	52,839
Net investment income	288,510	164,110
Interest expense on capital asset related debt	(38,878)	(19,467)
Other nonoperating revenues, net	5,552	2,100
Net nonoperating revenues	<u>690,405</u>	<u>594,433</u>
INCOME BEFORE OTHER REVENUES	221,784	123,640
State capital appropriations	-	500
Capital grants and gifts	17,743	28,095
Additions to permanent endowments	17,227	24,578
Increase in net assets	<u>256,754</u>	<u>176,813</u>
Net assets, beginning of year	2,467,778	2,290,965
NET ASSETS, END OF YEAR	<u>\$ 2,724,532</u>	<u>\$ 2,467,778</u>

See accompanying notes

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
Michigan State University Foundation

	Year ended June 30, 2011			
	Unrestricted	Temporarily	Permanently	Total
	Funds	Restricted	Restricted	
(in thousands)				
REVENUE, GAINS AND OTHER SUPPORT:				
Contributions	\$ 67	\$ 4,871	\$ 152	\$ 5,090
Equity earnings - subsidiaries	(143)			(143)
Income from investments	8,026	455	634	9,115
Royalty income	1,133			1,133
Rental income	1,076			1,076
Rental expenses	(3,234)			(3,234)
Realized and unrealized gain on securities	37,483	2,689	1,124	41,296
Grants and contracts	2,523			2,523
Other income	62			62
Net assets released from restrictions:				
Satisfaction of program restrictions	22	(10)	(12)	-
Current year transfers	4,383	(4,036)	(347)	-
TOTAL REVENUE, GAINS AND OTHER SUPPORT	51,398	3,969	1,551	56,918
EXPENSES AND LOSSES:				
Contributions to the University	11,418			11,418
Patent expense	908			908
Investment management fees	2,382			2,382
Investment consulting fees	460			460
Adjustments to value of annuities payable	(119)			(119)
Management and general	3,837			3,837
Postretirement benefits				
Net periodic benefit cost	67			67
Changes other than net periodic benefit cost	(929)			(929)
MBI program expenses	2,409			2,409
TOTAL EXPENSES AND LOSSES	20,433	-	-	20,433
Change in net assets	30,965	3,969	1,551	36,485
Net assets, beginning of year	278,427	26,344	12,748	317,519
NET ASSETS, END OF YEAR	\$ 309,392	\$ 30,313	\$ 14,299	\$ 354,004

	Year ended June 30, 2010			
	Unrestricted	Temporarily	Permanently	Total
	Funds	Restricted	Restricted	
(in thousands)				
REVENUE, GAINS AND OTHER SUPPORT:				
Contributions	\$ 39	\$ 5,916	\$ 108	\$ 6,063
Equity earnings - subsidiaries	59			59
Income from investments	2,674	25	386	3,085
Royalty income	1,416			1,416
Rental income	1,161			1,161
Rental expenses	(3,112)			(3,112)
Realized and unrealized gain on securities	22,504	1,858	825	25,187
Grants and contracts	2,706			2,706
Other income	222			222
Net assets released from restrictions:				
Satisfaction of program restrictions	(1,672)	1,677	(5)	-
Current year transfers	5,859	(5,315)	(544)	-
TOTAL REVENUE, GAINS AND OTHER SUPPORT	31,856	4,161	770	36,787
EXPENSES AND LOSSES:				
Contributions to the University	19,504			19,504
Patent expense	914			914
Investment management fees	2,665			2,665
Investment consulting fees	373			373
Adjustments to value of annuities payable	(1,821)			(1,821)
Management and general	3,560			3,560
Postretirement benefits				
Net periodic benefit cost	119			119
Operational expenses - Spartan Ventures	37			37
MBI program expenses	2,238			2,238
TOTAL EXPENSES AND LOSSES	27,589	-	-	27,589
Change in net assets	4,267	4,161	770	9,198
Net assets, beginning of year	274,160	22,183	11,978	308,321
NET ASSETS, END OF YEAR	\$ 278,427	\$ 26,344	\$ 12,748	\$ 317,519

See accompanying notes

STATEMENTS OF CASH FLOWS
Michigan State University

	Year ended June 30,	
	2011	2010
Cash flows from operating activities	(In thousands)	
Tuition and fees	\$ 571,968	\$ 547,036
Research grants and contracts	358,089	367,459
Auxiliary activities	285,989	273,625
Departmental activities	181,977	152,038
Interest and fees on student loans	940	837
Loans issued to students	(8,550)	(9,728)
Collection of loans from students	9,894	9,308
Scholarships and fellowships	(73,520)	(59,507)
Payments to suppliers	(447,204)	(437,890)
Payments to employees	(1,192,321)	(1,181,752)
Other payments	(18,574)	(14,917)
Net cash used by operating activities	(331,332)	(333,491)
Cash flows from noncapital financing activities		
State appropriations	340,919	362,291
Federal Pell grant revenue	43,424	39,313
Gifts	46,472	53,118
Endowment gifts	17,268	24,545
William D. Ford Direct Lending receipts	348,242	332,470
William D. Ford Direct Lending disbursements	(348,764)	(332,521)
Net cash provided by noncapital financing activities	447,561	479,214
Cash flows from capital and related financing activities		
Capital appropriations	-	500
Capital gifts and grants	29,250	15,290
Proceeds from issuance of debt and other long term obligations	65,809	611,090
Purchase of capital assets	(194,351)	(214,950)
Proceeds from sale of capital assets	367	841
Principal paid on capital debt	(63,559)	(320,702)
Interest paid	(34,384)	(21,485)
Other receipts (payments)	8,822	(17,114)
Net cash provided (used) by capital and related financing activities	(190,046)	53,270
Cash flows from investing activities		
Investment income, net	107,717	69,653
Proceeds from sales and maturities of investments	1,741,967	4,206,842
Purchase of investments	(1,797,815)	(4,426,496)
Net cash provided (used) by investing activities	52,069	(150,201)
Net increase (decrease) in cash	(21,748)	48,792
Cash and cash equivalents, beginning of year	63,921	15,129
Cash and cash equivalents, end of year	\$ 42,173	\$ 63,921

See accompanying notes

STATEMENTS OF CASH FLOWS (Continued)
Michigan State University

	Year ended June 30,	
	2011	2010
Reconciliation of net operating loss to cash flows from operating activities:	(In thousands)	
Operating loss	\$ (488,821)	\$ (470,793)
<i>Adjustments to reconcile net loss to net cash used by operating activities:</i>		
Depreciation expense	116,183	98,429
<i>Change in assets and liabilities:</i>		
Accounts receivable	(14,838)	(4,647)
Student loans receivable	1,344	(421)
Inventories and other assets	(4,121)	(859)
Investments in joint ventures	(347)	(347)
Unamortized bond origination costs	154	(1,612)
Accounts payable	18,061	1,595
Accrued personnel costs	(22,871)	9,051
Payroll taxes and other payroll deductions	(4,653)	(11,781)
Deposits held for others	2,101	6,959
Deferred revenues	4,650	3,337
Accrued self-insurance liabilities	252	(2,551)
Net other postemployment benefit obligation	41,374	40,129
Net cash used by operating activities	\$ (331,332)	\$ (333,491)

NOTES TO THE FINANCIAL STATEMENTS (All dollar figures stated in these Notes are in thousands)
Michigan State University

1. Organization, basis of presentation, reporting entity, and summary of significant accounting policies

Organization:

Michigan State University (the "University") was founded in 1855 as the Agricultural College of the State of Michigan. It was the first institution of higher learning in the nation to teach scientific agriculture and in 1863 became a pioneer land grant college under the Morrill Act. The University has grown into a comprehensive research university providing undergraduate, graduate, and professional degree programs. The University is not a component unit of the State of Michigan as defined by the Governmental Accounting Standards Board (GASB).

Basis of presentation:

The University follows all applicable GASB pronouncements. In addition, the University applies all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. The University has elected not to apply FASB pronouncements issued after November 30, 1989.

The accompanying financial statements have been prepared using the economic resource measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America for publicly owned colleges and universities and is presented in accordance with the reporting model as prescribed in Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and GASB Statement No. 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities*, as amended by GASB Statements No. 37 and No. 38. The University follows the "business-type" activities requirements of GASB Statement No. 34. This approach requires the following components of the University's financial statements:

- Management's Discussion and Analysis.
- Basic Financial Statements: Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; Statement of Cash Flows; and Notes to the Financial Statements.

GASB Statement No. 34 establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following four net asset categories:

- Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.
- Restricted:
 - Nonexpendable – Net assets subject to externally imposed constraints that they be maintained permanently by the University. Nonexpendable net assets include the corpus portion (historical value) of gifts to the University's permanent endowment funds and certain investment earnings stipulated by the donor to be reinvested permanently.
 - Expendable – Net assets whose use by the University is subject to externally imposed constraints that can be fulfilled by actions of the University pursuant to those constraints or that expire by the passage of time. Expendable net assets include net appreciation of the University's permanent endowment funds that have not been stipulated by the donor to be reinvested permanently.
- Unrestricted: Net assets that are not subject to externally imposed constraints. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees (the "Board") or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for academic, research, and outreach programs and initiatives, postemployment benefits, and capital asset renewals and replacements.

Reporting entity:

The Michigan State University Foundation (the "Foundation") is a legally separate, tax-exempt entity which meets the criteria set forth for component units under GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*. The Foundation provides financial support for the objectives, purposes, and programs of the University. Although the University does not control the timing, purpose, or amount of its receipts from the Foundation, the resources (and income thereon) which the Foundation holds and invests are dedicated to benefit the University. Because the resources held by the Foundation can only be used by, or for the benefit of, the University, the Foundation is considered a component unit of the University and its Statements of Financial Position and Statements of Activities and Changes in Net Assets are discretely presented in the University's financial statements. In addition, the Foundation's significant notes are summarized in Footnote 4.

The Foundation is a private organization that reports under FASB standards. As such, certain revenue recognition criteria and presentation features are different from those under GASB. No modifications have been made to the Foundation financial information included in the University's financial report to account for these differences.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

Complete financial statements for the Foundation can be obtained by a written request to: Michigan State University Foundation, 2727 Alliance Drive, Suite C, Lansing, Michigan 48910-3338.

Summary of significant accounting policies:

Cash and cash equivalents – For purposes of the Statement of Cash Flows, the University defines cash and cash equivalents as highly liquid, short-term (90 days or less) investments that bear little or no market risk. Cash equivalents held in the Liquidity Reserve Pool (LRP), Common Investment Fund (CIF), and other investment funds are included in investments because the intent of these funds is long-term appreciation. Any cash balances held in these funds at the date of the financial statements are due to timing of reinvesting the proceeds within the fund.

Restricted cash and cash equivalents and restricted investments – Restricted cash and cash equivalents and restricted investments represent unspent bond proceeds that are externally restricted for the construction or purchase of capital assets.

Pledges – Financial support in the form of pledges is received from business enterprises, foundations and individuals. Revenue from gift pledges is recorded only when there is an unconditional promise to pay and all eligibility requirements, including time requirements, have been met. Contributions to permanent and term endowments are not recognized as assets until actually received.

Inventories – Inventories are recorded using various methods, including last in first out (LIFO) and first in first out (FIFO).

Investments – All investments are stated at fair value. Investments in publicly traded securities are stated at fair value as established by major securities markets. Non-publicly traded investments are valued based on independent appraisals and estimates considering market prices of similar investments.

Capital assets – Capital assets are stated at cost or, when donated, at fair market value at date of gift. Depreciation is computed using the straight-line method, with a full-year expense in the year of acquisition and none in the year of disposal. Assets are depreciated over the estimated useful lives ranging from four to forty years for the respective assets. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts. The University does not capitalize certain works of art or historical treasures (except for certain museum collections) that are held for exhibition, education, research, or public service. These collections are neither disposed of for financial gain nor encumbered in any way. Accordingly, such collections are not recognized or capitalized for financial statement purposes.

Compensated absences – University employees earn vacation and sick leave benefits based, in part, on length of service. Vacation pay is fully vested when earned. Upon separation from service, employees are paid accumulated vacation and sick pay based upon the nature of separation (death, retirement, or termination). Certain limitations have been placed on the hours of vacation and sick leave that employees may accumulate and carry over for payment at death, retirement, or termination. Unused hours exceeding these limitations are forfeited.

Deferred revenue – Deferred revenue consists primarily of advance ticket sales for athletic events, summer school tuition not earned during the current year, and contract and sponsored program advances.

Derivative instruments – Derivative instruments consist of interest rate swap agreements and are stated at fair value based on the zero coupon valuation method.

Bond issuance costs – Bond issuance costs are capitalized and amortized over the life of the bond issue.

Operating and Nonoperating Revenues – Operating activities as reported on the Statements of Revenues, Expenses, and Changes in Net Assets are those activities that generally result from exchange transactions, such as payments received for providing services and payments made for services or goods received. Nearly all of the University's expenses are from exchange transactions. Certain significant revenue streams relied upon for operations are recorded as nonoperating revenues, as defined by GASB Statement No. 34, including state appropriations, federal Pell grant revenue, gifts, and investment income. Restricted and unrestricted resources are spent and tracked at the discretion of the recipient University department within the guidelines of donor restrictions, if any.

Student tuition and fees – Student tuition and fee revenues are reported net of scholarship allowances in the Statements of Revenues, Expenses, and Changes in Net Assets. Scholarship allowances represent the difference between the stated charge for goods and services provided by the University and the amount that is paid by the students or third parties on behalf of the students, where the University has discretion over such expenses.

Auxiliary activities – Auxiliary activities primarily represent revenues generated from University Residential and Hospitality Services, Intercollegiate Athletics, and various other departmental activities that provide services to the student body, faculty, staff, and general public.

Donor restricted endowments – Under Michigan law set forth in the Uniform Prudent Management of Institutional Funds Act, as adopted in Michigan in 2009 ("UPMIFA"), the Board acts in a fiduciary capacity as trustee of its endowment funds. UPMIFA

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

requires that the Board exercise its fiduciary duties prudently and consider both the charitable purposes and needs of the University and the purposes of the specific endowment regarding current expenditures and preservation of the purchasing power of the funds. Under the spending policy established by the Board, 5.00% of the average market value of endowment investments for the twenty quarters of the five calendar years prior to the beginning of the fiscal year has been authorized for expenditure.

Eliminations – In preparing the financial statements, the University eliminates inter-fund assets and liabilities that would otherwise be reflected twice in the Statements of Net Assets. Similarly, revenues and expenses related to internal service activities are also eliminated from the Statement of Revenues, Expenses, and Changes in Net Assets. Student tuition and residence fees are presented net of scholarships and fellowships applied to student accounts where the University has discretion over such expenses, while stipends and other payments made directly to students are presented as scholarship and fellowship expenses.

Use of estimates – The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

Income taxes – The University is a part of the State of Michigan for purposes of Internal Revenue Code Section 115, and is an organization as described in Internal Revenue Code Section 501(c)(3). The University's income generally is exempt from federal income taxes, although income from certain activities may be subject to taxation as unrelated business income.

Reclassifications – Certain amounts from the prior year have been reclassified to conform to the current year's presentation.

2. Cash and cash equivalents

The University's cash and cash equivalents as of June 30, 2011 and 2010 were as follows:

	2011	2010
Cash and cash equivalents, current	\$ 18,954	\$ 19,811
Restricted cash and cash equivalents, noncurrent	23,219	44,110
Total cash and cash equivalents	<u>\$ 42,173</u>	<u>\$ 63,921</u>

Of the bank balances for cash, \$250 of the total \$27,154 in 2011 and \$11,186 in 2010 were covered by federal depository insurance. The remaining amounts were uninsured and uncollateralized, as banks holding deposits of the University are legally prohibited from collateralizing these deposits.

NOTES TO THE FINANCIAL STATEMENTS (continued)
Michigan State University

3. Investments

The University manages investments in accordance with the policy approved by the Board. The investment policy distinguishes guidelines for the Liquidity Pool (LP), Liquidity Reserve Pool (LRP), and Common Investment Fund (CIF). In addition, the University has other investments that are restricted by external agreements or by special donor limitations (Other).

Securities Lending Transactions: The University participates in a Board-authorized securities lending program whereby University securities are contractually loaned to approved borrowers in exchange for the receipt of collateral which is invested. The University had loaned securities with a market value of approximately \$19,848 and \$30,083 at June 30, 2011 and 2010, respectively. One of the University's custodians is an agent in lending the University's domestic securities for cash collateral of 102% and international securities for cash collateral of 105%. At June 30, 2011 and 2010, the University had no credit risk exposure to borrowers because the amounts the University owed the borrowers exceed the amounts the borrowers owed the University. The contract with the lending agent requires it to indemnify the University if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent). All securities loans can be terminated on demand by either the University or the borrower. As a means of managing the University's interest rate risk, the securities lending agreement limits the difference between the average weighted maturity of securities loans and the average weighted maturity of the cash collateral investment portfolio to a maximum of 90 days. At June 30, 2011 and 2010, the difference was less than 90 days.

As of June 30, 2011 and 2010, the University had the following investments:

Investment type	June 30, 2011					
	LP	LRP	CIF	Securities Lending	Other	Total
Investment pools	\$ 10,390	\$ 244,425	\$ 1,194,613	\$ 4,118	\$ 29,237	\$ 1,482,783
U.S. Treasury bonds	36,508	-	9,583	-	3,885	49,976
U.S. Government agencies	61,206	-	40,326	-	-	101,532
Municipal bonds	-	-	1,037	-	-	1,037
Corporate bonds	115,321	-	19,144	2,562	-	137,027
Asset-backed securities	35,891	-	14,884	6,200	-	56,975
U.S. Equities	-	-	195,881	-	-	195,881
International equities	-	-	10,526	-	-	10,526
International governmental bonds	2,796	-	816	-	-	3,612
Investment derivatives	-	-	-	-	9,052	9,052
Total	\$ 262,112	\$ 244,425	\$ 1,486,810	\$ 12,880	\$ 42,174	\$ 2,048,401

Investment type	June 30, 2010					
	LP	LRP	CIF	Securities Lending	Other	Total
Investment pools	\$ 10,052	\$ 232,706	\$ 982,785	\$ 9,653	\$ 13,445	\$ 1,248,641
U.S. Treasury bonds	37,662	-	22,767	-	1,203	61,632
U.S. Government agencies	124,796	-	25,482	-	2,123	152,401
Municipal bonds	-	-	388	-	-	388
Corporate bonds	106,854	-	18,662	1,950	-	127,466
Asset-backed securities	50,776	-	16,447	11,198	-	78,421
U.S. Equities	-	-	147,008	-	-	147,008
International equities	-	-	2,388	-	-	2,388
International governmental bonds	2,635	-	796	-	-	3,431
Investment derivatives	-	-	-	-	(1,343)	(1,343)
Total	\$ 332,775	\$ 232,706	\$ 1,216,723	\$ 22,801	\$ 15,428	\$ 1,820,433

Interest Rate Risk: As a means of managing its exposure to fair value losses arising from increasing interest rates, University investment policy limits the average duration of the LP portfolio to three years and the LRP and CIF portfolios to six years. At June 30, 2011 and 2010, the University was in compliance with its investment policy with regard to average duration. University policy does not address average duration of investments by investment type.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

The maturities of fixed income investments as of June 30, 2011 and 2010 are as follows:

June 30, 2011					
Fixed Income Investment Maturities					
Investment type	Less than 1	1-5 years	6-10 years	More than 10	Total
	year			years	
Investment pools	\$ 31,602	\$ 126,612	\$ 170,103	\$ 30,874	\$ 359,191
U.S. Treasury bonds	3,802	42,717	464	2,993	49,976
U.S. Government agencies	36,632	14,933	4,735	45,232	101,532
Municipal bonds	-	-	248	789	1,037
Corporate bonds	20,961	103,995	9,061	3,010	137,027
International governmental bonds	1,013	2,029	438	132	3,612
Asset-backed securities	10,809	13,546	17,004	15,616	56,975
Total	<u>\$ 104,819</u>	<u>\$ 303,832</u>	<u>\$ 202,053</u>	<u>\$ 98,646</u>	<u>\$ 709,350</u>

June 30, 2010					
Fixed Income Investment Maturities					
Investment type	Less than 1	1-5 years	6-10 years	More than 10	Total
	year			years	
Investment pools	\$ 13,694	\$ 123,096	\$ 169,099	\$ 34,680	\$ 340,569
U.S. Treasury bonds	-	55,050	2,878	3,704	61,632
U.S. Government agencies	84,239	28,633	8,321	31,208	152,401
Municipal bonds	-	-	-	388	388
Corporate bonds	56,821	60,806	6,897	2,942	127,466
International governmental bonds	-	3,028	122	281	3,431
Asset-backed securities	21,244	37,534	3,330	16,313	78,421
Total	<u>\$ 175,998</u>	<u>\$ 308,147</u>	<u>\$ 190,647</u>	<u>\$ 89,516</u>	<u>\$ 764,308</u>

The University invests in asset-backed securities such as mortgage pass-through securities issued by U.S. Government agencies. These securities are based on cash flows from interest payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

At June 30, 2011 and 2010, the University is invested in six separate investment derivative instruments five of which are pay-variable, receive-variable interest rate swaps and one of which is a pay-fixed, receive-variable rate swap.

2011 Notional Amount	Rate Paid	Rate Received	Effective Date	Termination Date	Counterparty/ Counterparty Credit Rating	2011 Fair Value	2010 Fair Value
\$ 277,560	67% USD-LIBOR-BBA one month	67% USD-ISDA Sw ap Rate ten year less .407%	8/15/2009	2/15/2034	Deutsche Bank * AG/Aa3	\$ 16,481	\$ 14,204
14,975	USD-LIBOR-BBA one month	USD-ISDA Sw ap Rate ten year less .575%	5/26/2006	2/15/2033	Deutsche Bank * AG/Aa3	1,359	1,192
74,290	SIFMA Municipal Sw ap Index	67% USD-LIBOR-BBA one month plus .44%	5/17/2010	8/15/2032	Bank of New York Mellon/Aaa	(71)	(826)
49,525	SIFMA Municipal Sw ap Index	67% USD-LIBOR-BBA one month plus .44%	5/17/2010	8/15/2032	Deutsche Bank AG/Aa3	(47)	(551)
71,685	4.226%	67% USD-LIBOR-BBA three month plus .63%	5/17/2007	2/15/2037	JP Morgan Chase Bank/Aa1	(11,751)	(14,815)
118,655	SIFMA Municipal Sw ap Index	67% USD-ISDA Sw ap Rate ten year plus .0063%	6/8/2007	2/15/2037	JP Morgan Chase Bank/Aa1	3,081	(547)
<u>\$ 606,690</u>						<u>\$ 9,052</u>	<u>\$ (1,343)</u>

* Novated from UBS AG to Deutsche Bank AG

During the year ended June 30, 2011, three of the University's pay-variable, receive-variable interest rate swaps were amended per the terms listed in the table below and became effective subsequent to June 30, 2011. After the amendment period, these interest rate swaps revert back to the original terms as outlined in the table above.

2011 Notional Amount	Rate Paid	Rate Received	Amendment Effective Date	Amendment Termination Date	Counterparty/ Counterparty Credit Rating
\$ 277,560	0%	1.407%	8/15/2011	8/14/2014	Deutsche Bank AG/Aa3
14,975	0%	2.1725%	8/15/2011	8/14/2014	Deutsche Bank AG/Aa3
118,655	SIFMA Municipal Sw ap Index	67% USD-LIBOR-BBA one month plus 1.8653%	8/1/2011	7/31/2014	JP Morgan Chase Bank/Aa1

Credit Risk: The University is exposed to credit risk on investment derivative instruments that are in asset positions. To minimize its exposure to loss related to credit risk, it is the University's policy to require counterparty collateral posting provisions; refer to Footnote 14 for thresholds and minimum transfers. The University has never failed to access collateral when required. The aggregate fair value of investment derivative instruments in asset positions at June 30, 2011 was \$20,921. This represents the maximum loss that would be recognized at the reporting date if the counterparty failed to perform as contracted. This maximum exposure is reduced by \$30,112 of negative hedging and investment derivative fair values included in netting arrangements with the counterparties and \$750 of collateral posted with the University, resulting in no significant net exposure to credit risk with any individual counterparty.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

As a means of managing credit risk on its fixed income investments, University Investment policy limits investments at time of purchase to the following ratings issued by nationally recognized statistical rating organizations: LP portfolio – short-term A1/P1, long-term BBB; LRP portfolio – short-term A2/P2, long-term B; CIF portfolio – short-term A2/P2, long-term BB. Thereafter, the minimum quality for separately managed funds in all three portfolios is limited to AA. At June 30, 2011 and 2010, the University was in compliance with its credit risk policy for each portfolio. University policy does not address credit risk by investment type.

The Standard & Poor's credit ratings for fixed income investments at June 30, 2011 and 2010 are as follows

As of June 30, 2011								
Rating	Investment pools	U.S. Treasury bonds	U.S. Government agencies	Municipal bonds	Corporate bonds	International governmental bonds	Asset-backed securities	Total
AAA	\$ 4,117	\$ -	\$ 17,774	\$ -	\$ 14,568	\$ 1,013	\$ 34,036	\$ 71,508
AA	-	-	-	363	27,320	2,029	1,965	31,677
A	-	-	-	674	60,787	176	1,870	63,507
BBB	-	-	-	-	27,838	394	26	28,258
BB	-	-	-	-	2,042	-	40	2,082
Below BB	-	-	-	-	-	-	4,045	4,045
Not rated	355,074	49,976	83,758	-	4,472	-	14,993	508,273
Total	\$ 359,191	\$ 49,976	\$ 101,532	\$ 1,037	\$ 137,027	\$ 3,612	\$ 56,975	\$ 709,350

As of June 30, 2010								
Rating	Investment pools	U.S. Treasury bonds	U.S. Government agencies	Municipal bonds	Corporate bonds	International governmental bonds	Asset-backed securities	Total
AAA	\$ 9,653	\$ -	\$ 42,920	\$ -	\$ 5,329	\$ 806	\$ 57,300	\$ 116,008
AA	-	-	-	266	20,783	1,293	1,547	23,889
A	-	-	-	122	62,960	1,060	6,293	70,435
BBB	-	-	-	-	34,522	272	47	34,841
BB	-	-	-	-	342	-	54	396
Below BB	-	-	-	-	-	-	4,846	4,846
Not rated	330,916	61,632	109,481	-	3,530	-	8,334	513,893
Total	\$ 340,569	\$ 61,632	\$ 152,401	\$ 388	\$ 127,466	\$ 3,431	\$ 78,421	\$ 764,308

Concentration of Credit Risk: As a means of managing the concentration of credit risk, University investment policy limits the concentration of investments as follows: LP portfolio – No more than 15% of the portfolio's market value may be invested in dollar denominated foreign securities of developed countries (i.e., no emerging markets). No more than 10% of the portfolio's market value will be invested in (1) Rule 144A securities or (2) securities of any single issuer, except those which are obligations of, or fully guaranteed as to both principal and interest by, the U.S. Government or its agencies. LRP portfolio – No more than 10% of the portfolio's market value may be invested in securities below BBB. No more than 30% of the portfolio's market value may be invested in securities denominated in foreign currencies. No more than 10% of the portfolio's market value may be invested in securities of any single issuer, except those which are obligations of, or fully guaranteed as to both principal and interest by, the U.S. Government or its agencies. CIF portfolio – Investments are managed in accordance with asset allocation guidelines and manager guidelines established at time of manager appointment and consist of U.S. equities, inflation hedge funds, limited partnerships, absolute return funds, and fixed income assets.

As of June 30, 2011 and 2010, not more than 5% of the University's total investments were invested in any one issuer.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. University investment policy does not limit the value of investments that may be held by an outside party. Of the University's investments \$42,812 of the U.S. Treasury bonds, \$101,532 of the U.S. Government agencies, \$1,037 of the Municipal bonds, \$133,039 of the Corporate bonds, \$3,612 of the International governmental bonds, \$50,776 of the Asset-backed securities, \$181,034 of the U.S. Equities, \$10,229 of the International equities, and \$26,873 of the external investment pools are held by the University's counterparty, not in the name of the University. Consistent with the University's securities lending agreement, \$12,880 was held by the counterparty that was acting as the University's agent in securities lending transactions.

Foreign Currency Risk: University investment policy limits foreign currency risk on its LRP portfolio to 30% of the portfolio's market value.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

4. Foundation Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the Statements of Financial Position.

The Foundation has entered into various limited partnerships and managed accounts with investment managers. These investments are secured by the underlying value of the securities composing the portfolios.

Foundation investments at June 30, 2011 and 2010 are summarized as follows:

	2011		2010	
	Cost	Market	Cost	Market
Short-term investments	\$ 2,663	\$ 2,663	\$ 2,826	\$ 2,826
Domestic equities	44,275	49,628	35,493	28,939
Foreign equities	14,415	21,961	22,100	25,573
Other equities	18,040	17,890	20,285	20,785
Fixed income	78,131	81,497	66,657	69,649
Mutual funds – Equities	14,878	17,666	16,741	15,292
Mutual funds – Fixed	18,733	19,559	16,372	17,351
Limited partnerships	84,529	100,682	84,940	97,245
Venture capital	36,918	43,560	34,667	33,257
	<u>\$ 312,582</u>	<u>\$ 355,106</u>	<u>\$ 300,081</u>	<u>\$ 310,917</u>

Certain 2010 amounts have been restated to conform with 2011 presentation.

The cost and market values listed above include \$1,566 and \$2,587 for 2011 and 2010, respectively, of short-term investments classified as cash equivalents on the Foundation's Consolidating Statements of Financial Position.

Marketable securities: The fair values for marketable debt and equity securities are based on quoted market prices. Securities traded on national securities exchanges are valued at the reported sales price on the last business day of the year. Investments traded over the counter on the over-the-counter market and listed securities for which no sale was reported on that date are valued at the average of the last reported bid and asked prices.

Limited partnership investments: The carrying amount reported in the Statements of Financial Position is stated at market value or estimated market value.

Venture capital investments: The carrying amount reported in the Statement of Financial Position is stated at market value or estimated market value. Management, external consultants, and the Board of Directors evaluate these investments for impairments on a quarterly basis. As of June 30, 2011, the Foundation has an outstanding commitment to fund limited partnership and venture capital investments in the amount of \$28,602.

In determining the fair value of investments, the Foundation utilizes a fair value hierarchy that ranks the quality and reliability of the information used to determine fair values and is based on certain assumptions that market participants would use in pricing the asset, including assumptions about risk and/or the risks inherent in the inputs to the valuation techniques. The Foundation's total investment fair value measurement is categorized by the following valuation techniques: (1) Valuations from quoted prices in active markets that are traded by dealers and brokers (\$158,342); (2) Valuations obtained from third party pricing services for identical or similar assets (\$50,955); (3) Valuations from other techniques including option pricing models, discounted cash flow models, and other similar techniques, and not based on market exchange transactions (\$144,243).

Research park investment (not included in the above summary): The Foundation is also invested in a research park development, which consists of land transferred at historical cost from the University plus costs incurred to develop the infrastructure of the research park.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

5. Accounts and interest receivable

The composition of accounts and interest receivable at June 30, 2011 and 2010 is summarized as follows:

	2011	2010
State appropriations	\$ 62,837	\$ 58,155
Research and sponsored programs	83,231	64,074
Departmental activities	21,181	21,553
Interest receivable	1,454	2,108
Other	19,528	14,885
	<u>188,231</u>	<u>160,775</u>
Less: allowance for doubtful accounts	18,117	10,389
Net accounts and interest receivable	<u>\$ 170,114</u>	<u>\$ 150,386</u>

6. Student loans receivable

Student loans receivable at June 30, 2011 and 2010 are summarized as follows:

Description	2010	Distributed	Collected	2011	Current Portion
Federal Family Education Loan Program	\$ 2,870	\$ -	\$ 373	\$ 2,497	\$ 183
Perkins Federal Loan Program	37,580	4,316	4,806	37,090	4,544
Other	10,444	4,234	4,498	10,180	4,022
	<u>50,894</u>	<u>\$ 8,550</u>	<u>\$ 9,677</u>	<u>49,767</u>	<u>8,749</u>
Allowance for uncollectible loans	(4,672)			(4,889)	(183)
Net student loan receivable	<u>\$ 46,222</u>			<u>\$ 44,878</u>	<u>\$ 8,566</u>

Description	2009	Distributed	Collected	2010	Current Portion
Federal Family Education Loan Program	\$ 3,065	\$ -	\$ 195	\$ 2,870	\$ 207
Perkins Federal Loan Program	36,821	5,071	4,312	37,580	4,365
Other	10,348	4,857	4,561	10,444	4,833
	<u>50,234</u>	<u>\$ 9,728</u>	<u>\$ 9,068</u>	<u>50,894</u>	<u>9,405</u>
Allowance for uncollectible loans	(4,433)			(4,672)	(181)
Net student loan receivable	<u>\$ 45,801</u>			<u>\$ 46,222</u>	<u>\$ 9,224</u>

Principal repayment and interest rate terms of federal and University loans vary considerably. Campus-based federal loan programs are funded principally with federal and institutional contributions to the University under the Perkins and various health professions loan programs.

The University holds and services student loans related to the discontinued U.S. Department of Education Federal Family Education Loan Program. As of June 30, 2011, the University held a non-revolving line of credit, used to facilitate the servicing of the loans (see Footnote 13).

For the year ended June 30, 2011 and 2010, the University distributed \$347,760 and \$322,087, respectively, for student loans through the U.S. Department of Education William D. Ford Direct Loan Program. These distributions and related funding sources are not included as expenses and revenues in the accompanying financial statements.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

7. Pledges receivable

Payments on pledges receivable at June 30, 2011, expected to be received in the following fiscal years ended June 30, are summarized below. The allowance for uncollectible pledges receivable is made based on prior collection experience and management judgment. Gift pledges expected to be collected in the future years are reported at the net present value of the related cash flows discounted at 5%.

2012	\$	26,884
2013		24,562
2014		5,241
2015		3,542
2016		2,181
2017 and beyond		5,537
Total discounted pledges receivable		<u>67,947</u>
Less: allowance for uncollectible pledges		<u>6,945</u>
Net pledges receivable, June 30, 2011		61,002
Less: current portion		24,109
Noncurrent portion	\$	<u><u>36,893</u></u>

8. Investments in joint ventures

The University is a member of several incorporated nonprofit joint ventures, most of which are accounted for under the equity method. The University and Sparrow Health System are members of Mid-Michigan MRI, Inc., which provides high technology cross-sectional diagnostic imaging services. University Rehabilitation Alliance, Inc. has the University and Peckham Vocational Industries of Lansing as members and is an enterprise for the treatment of persons with brain injury. Alliance Corporation is an enterprise formed with Spectrum Health System to support and direct the collaboration of physicians and researchers to enhance patient treatments and increase the investigation of leading-edge medical research. The University is a 50% member in each of the foregoing nonprofit corporations. Additionally, the University is a one-third member in Radiation Oncology Alliance, a nonprofit corporation formed with Ingham Regional Medical Center and the University of Michigan to provide radiation oncology services. Copies of financial statements for these entities can be obtained by a written request to: Office of the Controller, Michigan State University, Room 305 John A. Hannah Administration Building, East Lansing, Michigan 48824-1046.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

9. Capital assets and collections

Capital asset and collection activity for the years ended June 30, 2011 and 2010 follows:

	2010	Additions (Deductions)	Disposals	2011
Non-depreciated capital assets:				
Land	\$ 32,143	\$ -	\$ -	\$ 32,143
Construction in progress	162,670	42,358	-	205,028
Museum collections	8,805	66	-	8,871
Total non-depreciated capital assets	203,618	42,424	-	246,042
Depreciated capital assets:				
Buildings and site improvements	2,125,025	31,799	(869)	2,155,955
Software and other intangibles	-	87,264	-	87,264
Equipment and other	597,401	37,959	(9,524)	625,836
Less: accumulated depreciation				
Buildings and site improvements	(849,582)	(60,996)	866	(909,712)
Software and other intangibles	-	(17,453)	-	(17,453)
Equipment and other	(454,931)	(37,734)	8,098	(484,567)
Total depreciated capital assets	1,417,913	40,839	(1,429)	1,457,323
Total capital assets	\$ 1,621,531	\$ 83,263	\$ (1,429)	\$ 1,703,365

	2009	Additions (Deductions)	Disposals	2010
Non-depreciated capital assets:				
Land	\$ 26,281	\$ 5,862	\$ -	\$ 32,143
Construction in progress	204,032	(41,362)	-	162,670
Museum Collections	8,341	464	-	8,805
Total non-depreciated capital assets	238,654	(35,036)	-	203,618
Depreciated capital assets:				
Buildings and site improvements	1,928,593	200,536	(4,104)	2,125,025
Equipment and other	561,812	47,573	(11,984)	597,401
Less: accumulated depreciation				
Buildings and site improvements	(792,930)	(60,756)	4,104	(849,582)
Equipment and other	(428,013)	(37,673)	10,755	(454,931)
Total depreciated capital assets	1,269,462	149,680	(1,229)	1,417,913
Total capital assets	\$ 1,508,116	\$ 114,644	\$ (1,229)	\$ 1,621,531

10. Contingencies and risk management

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. To manage these risks, the University uses commercial insurance with various self-insured retentions. Self-insured amounts are computed based on historical claim experience.

The University's liability for various medical professional liability claims is funded based on actuarial valuations. The University carries excess commercial medical professional liability insurance to manage the liability. The liability is reported at its present value of \$4,273 as of June 30, 2011. The discount rate used was 4%.

The University is also self-insured for various employee benefits which include health care and dental insurance, workers compensation, and unemployment compensation. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Those losses include an estimate of claims that have been incurred but not reported. The workers compensation liability, which will be settled by fixed payments over an extended period of time, is reported at its present value of \$3,729 as of June 30, 2011. The discount rate used was 6%.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

Changes in the total reported general, professional, and self-insured employee benefit liabilities during 2011, 2010, and 2009 were as follows:

	2011	2010	2009
Balance, beginning of year	\$ 21,702	\$ 24,253	\$ 23,448
Claims incurred and changes in estimates	100,822	103,170	103,027
Claim payments	(100,570)	(105,721)	(102,222)
Balance, end of year	21,954	21,702	24,253
Less: current portion	15,073	13,770	15,196
Noncurrent portion	<u>\$ 6,881</u>	<u>\$ 7,932</u>	<u>\$ 9,057</u>

For those risks that the University has purchased commercial insurance, settled claims have not exceeded the commercial coverage in any of the past three years.

In the normal course of its activities, the University has been a party in various legal actions. Historically, the University has not experienced significant losses from such actions. After taking into consideration legal counsel's evaluation of pending actions, the University is of the opinion that the outcome thereof will not have a material effect on the financial statements.

11. Retirement benefits

The University has a defined contribution base retirement program administered through TIAA-CREF, Fidelity Investments, and The Vanguard Group for all qualified employees. All regular employees are eligible to participate based on the service requirements specific to their employee group. Participants maintain individual contracts with the base retirement vendors and are fully vested.

Participating employees contribute 5% of their base salary or wages and the University contributes 10% of the employee's base salary or wages subject to applicable Internal Revenue Service limits. Participants may elect to contribute additional amounts to a supplemental program and/or a deferred compensation plan, within specified limits, which are not matched by University contributions. Plan provisions and contribution requirements of plan members and the University are established and may be amended in accordance with University policies, union contracts, or plan provisions. Contributions under the base program, excluding the participants' supplemental contributions, for the years ended June 30, 2011 and 2010 were as follows:

	2011	2010
University contributions	\$ 68,254	\$ 65,396
Employee contributions	34,127	32,698

In addition, the University has a single-employer, defined benefit plan covering 644 employees hired prior to January 1, 1973. The plan is closed to new entrants and monies have been internally reserved by the University to fully fund program costs. The benefits are based on the employee's compensation during the last three years of employment and/or years of service. There were no required annual contributions and no pension costs for each of the three preceding years ended June 30, 2011.

12. Other postemployment benefits (OPEB)

Plan Description: The University provides retiree health and dental care benefits, including prescription drug coverage, to eligible retired employees and qualified spouses/beneficiaries. This is a closed single employer defined benefit plan administered by the University. Benefits are provided to eligible faculty, academic staff and support staff who meet normal retirement requirements while still working for the University. Currently, the plan has approximately 17,300 members. The plan does not issue a separate stand-alone financial statement. Effective for new employees hired on or after July 1, 2010, the University discontinued providing retiree health and dental care benefits.

Funding Policy: The University's medical plans are self-funded and each plan's premiums are updated annually based on actual claims. The University contributes to the lowest cost health plan's single rate cost for which retirees are eligible. No payment is required by retirees who select the lowest cost health plan for coverage. In the event a retiree selects an alternative health plan, the retiree is responsible for payment of the difference in premium costs. Retirees are responsible for various co-payments. The University funds OPEB on a pay-as-you-go basis, and there is no obligation to make contributions in advance of when the insurance premiums or claims are due for payment.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

Funding Progress: For the year ended June 30, 2011, the University has estimated the cost (annual expense) of providing retiree health and dental care benefits through an actuarial valuation as of January 1, 2010 and adjusted for 2010-11 health care cost experience. In accordance with GASB Statement No. 45, the valuation computes an annual required contribution, which represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years. This valuation's computed contribution and actual funding are summarized as follows:

	2011	2010	2009
Annual required contribution	\$ 66,616	\$ 66,970	\$ 72,157
Interest on the prior year's net OPEB obligation	8,976	6,167	3,031
Less adjustment to the annual required contribution	<u>(6,939)</u>	<u>(4,654)</u>	<u>(2,236)</u>
Annual OPEB cost	68,653	68,483	72,952
Amounts contributed:			
Payments of current premiums and claims	(27,279)	(28,354)	(28,142)
Advance funding	<u>-</u>	<u>-</u>	<u>-</u>
Increase in net OPEB obligation	41,374	40,129	44,810
OPEB obligation - beginning of year	<u>128,234</u>	<u>88,105</u>	<u>43,295</u>
OPEB obligation - end of year	<u>\$ 169,608</u>	<u>\$ 128,234</u>	<u>\$ 88,105</u>

The annual OPEB cost, the percentage contributed to the plan, and the net OPEB obligation for the current and two preceding years are as follows:

	Fiscal Year Ended June 30,		
	2011	2010	2009
Annual OPEB cost	\$ 68,653	\$ 68,483	\$ 72,952
Percentage contributed	39.7%	41.4%	38.6%
Net OPEB obligation	\$ 169,608	\$ 128,234	\$ 88,105

The funding progress of the plan as of the most recent and two preceding valuation dates are as follows:

	Valuation as of January 1,		
	2011	2010	2009
Actuarial value of assets	\$ -	\$ -	\$ -
Actuarial accrued liability (AAL)	791,921	782,796	852,360
Unfunded AAL (UAAL)	<u>\$ 791,921</u>	<u>\$ 782,796</u>	<u>\$ 852,360</u>
Funded ratio	0.0%	0.0%	0.0%
Annual covered payroll (annual payroll of active employees covered by the plan)	\$ 783,187	\$ 753,757	\$ 732,254
UAAL as a percentage of covered payroll	101.1%	103.9%	116.4%

Actuarial methods and assumptions: Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the health care cost trend. Amounts are determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the January 1, 2010 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions include a 7.0% investment rate of return (net of administrative expenses), which is a blended rate of the expected long-term and short-term investment returns on the University's own assets to be used for funding the current liability, and an annual health care cost trend rate of 5.0% which includes a 4.0% inflation assumption. The UAAL is being amortized over 30 years as a level percentage of projected payroll on a closed basis, with 26 years remaining.

NOTES TO THE FINANCIAL STATEMENTS (continued)
Michigan State University

13. Long term debt and other obligations

Long term debt and other obligations for the years ended June 30, 2011 and 2010 are summarized as follows:

	2010	Borrowed	Retired	2011	Current Portion
General Revenue Bonds:					
Series 2010A	\$ 205,000	\$ -	\$ -	\$ 205,000	\$ -
Series 2010C	289,230	-	5,075	284,155	11,530
Series 2007A	27,955	-	2,985	24,970	3,090
Series 2007B	25,000	-	-	25,000	-
Series 2005	54,140	-	-	54,140	-
Series 2003A	48,205	-	-	48,205	-
Series 2003C	9,850	-	230	9,620	245
Series 2002A	1,490	-	1,490	-	-
Series 2002B	5,710	-	5,710	-	-
Series 2000A	78,700	-	1,560	77,140	-
Series 1998A-2	2,815	-	2,815	-	-
	<u>748,095</u>	<u>-</u>	<u>19,865</u>	<u>728,230</u>	<u>14,865</u>
General Revenue Commercial Paper:					
Series A tax-exempt	34,929	-	34,929	-	-
Series B taxable	20,000	13,880	-	33,880	33,880
Series C tax-exempt	4,071	51,929	8,525	47,475	47,475
	<u>59,000</u>	<u>65,809</u>	<u>43,454</u>	<u>81,355</u>	<u>81,355</u>
Federal student loan deposits	36,838	460	-	37,298	-
Line of credit	3,410	-	982	2,428	-
Lease obligations and other	3,863	-	(832)	4,695	(518)
	<u>\$ 851,206</u>	<u>\$ 66,269</u>	<u>\$ 63,469</u>	<u>\$ 854,008</u>	<u>\$ 95,702</u>
	2009	Borrowed	Retired	2010	Current Portion
General Revenue Bonds:					
Series 2010A	\$ -	\$ 205,000	\$ -	\$ 205,000	\$ -
Series 2010C	-	289,230	-	289,230	5,075
Series 2007A	30,820	-	2,865	27,955	2,985
Series 2007B	25,000	-	-	25,000	-
Series 2005	80,845	-	26,705	54,140	-
Series 2003A	73,465	-	25,260	48,205	-
Series 2003B	20,835	-	20,835	-	-
Series 2003C	10,070	-	220	9,850	230
Series 2002A	43,955	-	42,465	1,490	1,490
Series 2002B	6,945	-	1,235	5,710	355
Series 2000A	100,050	-	21,350	78,700	1,505
Series 1998A-2	51,935	-	49,120	2,815	2,815
	<u>443,920</u>	<u>494,230</u>	<u>190,055</u>	<u>748,095</u>	<u>14,455</u>
General Revenue Commercial Paper:					
Series A tax-exempt	60,000	91,000	116,071	34,929	34,929
Series B taxable	31,500	-	11,500	20,000	20,000
Series C tax-exempt	-	4,071	-	4,071	4,071
	<u>91,500</u>	<u>95,071</u>	<u>127,571</u>	<u>59,000</u>	<u>59,000</u>
Federal student loan deposits	36,457	381	-	36,838	-
Line of credit	3,842	-	432	3,410	-
Lease obligations and other	4,178	2,621	2,936	3,863	(832)
	<u>\$ 579,897</u>	<u>\$ 592,303</u>	<u>\$ 320,994</u>	<u>\$ 851,206</u>	<u>\$ 72,623</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

All bonds are secured by General Revenues and certain variable rate issues bear interest based on weekly or quarterly rates determined by the trustee or remarketing agent and are amortized through mandatory redemptions as follows:

- Series 2007B: from fiscal 2020 through 2037
- Series 2005: from 2021 through 2034
- Series 2003A: from 2021 through 2033
- Series 2003C: through 2033
- Series 2000A: from 2022 through 2031

With the exception of the Series 2007B bonds, the foregoing bonds may be converted to a permanent fixed rate provided certain conditions are met.

The Series 2010A bonds bear interest at 6.17% and are subject to mandatory redemption from fiscal 2044 through 2050. In accordance with the Build America Bonds program, the University will receive semi-annual federal credit payments equal to 35.00% of actual interest expense incurred on the outstanding principal balance of the bonds.

The Series 2010C bonds bear interest at fixed rates from 3.00% to 5.13% and mature either serially through fiscal 2029 or are subject to mandatory redemption from 2030 through 2044.

The Series 2007A bonds bear interest at rates of 4.00% and 5.00% and mature serially through fiscal 2019.

The University utilizes variable-rate commercial paper to provide interim financing. The Board has authorized the issuance of up to \$200,000 in commercial paper secured by General Revenues and allows for tax-exempt and taxable issuances. Outstanding commercial paper debt is converted to long-term financing, as appropriate, within the normal course of business. Outstanding tax-exempt balances bear interest at rates from 0.14% to 0.31% and taxable balances bear interest at rates from 0.23% to 0.28%, with principal and accrued interest payments due within a maximum of 270 days from the date of issuance.

During the year ended June 30, 2011, the University used \$5,355 par value of Commercial Paper Series B to refund \$5,355 par value of Series 2002B bonds.

Hedging derivative instrument payments and hedged debt: Using rates as of June 30, 2011, scheduled fiscal year maturities of bonds payable and related interest expense are as follows. These amounts assume that current interest rates on variable-rate bonds and the current reference rates of hedging derivative instruments will remain the same for their term. As these rates vary, interest payments on variable-rate bonds and net receipts/payments on the hedging derivative instruments will vary. See Footnote 14 for information on derivative instruments.

Fiscal Year Ending June 30,	Fixed-Rate Bonds		Variable-Rate Bonds		Hedging	Total
	Principal	Interest	Principal	Interest	Derivatives, Net	
2012	\$ 14,620	\$ 27,255	\$ 245	\$ 317	\$ 7,882	\$ 50,319
2013	15,015	26,670	255	317	7,853	50,110
2014	15,595	25,914	270	316	7,823	49,918
2015	16,235	25,116	285	315	7,792	49,743
2016	16,915	24,285	300	315	7,760	49,575
2017-2021	76,255	108,902	11,715	1,538	36,046	236,456
2022-2026	24,975	96,820	75,705	1,096	29,129	227,725
2027-2031	7,105	94,072	92,065	476	12,155	205,873
2032-2036	23,760	91,193	32,265	150	1,342	148,710
2037-2041	47,330	82,796	1,000	5	-	131,131
2042-2046	122,020	62,847	-	-	-	184,867
2047-2051	134,300	18,085	-	-	-	152,385
Total	\$ 514,125	\$ 683,955	\$ 214,105	\$ 4,845	\$ 119,782	\$ 1,536,812

Interest expense was \$38,878 (net of \$2,291 capitalized interest) and \$19,467 (net of \$3,226 capitalized interest) for 2011 and 2010, respectively.

Federal student loan deposits represent funds from the federal government related to various federal student loan programs.

At June 30, 2011, the University owed \$2,428 on a \$4,100 non-revolving line of credit related to the University's servicing of unsold graduate and professional degree student loans under the Federal Family Education Loan Program (see Footnote 6). Subsequent to year end, the University amended the non-revolving line of credit agreement to bear interest equal to the British Bankers Association (BBA) London Interbank Offering Rate (LIBOR) Daily Floating Rate plus 1.00%. Payments of accrued interest are due monthly, with all unpaid accrued interest and principal due October 2013.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

Lease obligations and other includes lease obligations of \$2,066 (\$249 current) and deferred bond premium of \$20,523 (\$366 current), net of deferred debt refunding costs of \$17,894 (\$1,134 current). Deferred amounts will be amortized over the applicable bond issue life.

Accrued personnel costs include vacation and sick leave days earned but unused, including the University's share of payroll taxes, valued at the current rate of pay. Changes in the balances of accrued personnel costs during 2011 and 2010 were as follows:

	2011	2010
Balance, beginning of year	\$ 104,064	\$ 95,013
Additions	4,465	10,556
Reductions	(27,336)	(1,505)
Balance, end of year	81,193	104,064
Less: current portion	49,256	73,223
Noncurrent portion	\$ 31,937	\$ 30,841

14. Derivative Instruments

The fair value and notional amounts of derivative instruments outstanding at June 30, 2011 and 2010, classified by type, and the changes in fair value of such derivative instruments are as follows:

	June 30, 2011				
	Changes in Fair Value		Fair Value		Notional Amount
	Classification	Amount	Classification	Amount	
Hedging derivatives:					
Cash flow hedges:					
Pay-fixed interest rate sw aps	Deferred charges	\$ 7,115	Debt	\$ (35,770)	\$ 210,855
Investment derivatives:					
Pay-variable interest rate sw aps	Net investment income (loss)	\$ 7,331	Investment	\$ 20,803	\$ 535,005
Pay-fixed interest rate sw aps	Net investment income (loss)	3,064	Investment	(11,751)	71,685
Total investment derivatives		<u>\$ 10,395</u>		<u>\$ 9,052</u>	<u>\$ 606,690</u>

	June 30, 2010				
	Changes in Fair Value		Fair Value		Notional Amount
	Classification	Amount	Classification	Amount	
Hedging derivatives:					
Cash flow hedges:					
Pay-fixed interest rate sw aps	Deferred charges	\$ 17,049	Debt	\$ (42,885)	\$ 212,945
Investment derivatives:					
Pay-variable interest rate sw aps	Net investment income (loss)	\$ 4,523	Investment	\$ 13,472	\$ 549,460
Pay-fixed interest rate sw aps	Net investment income (loss)	(14,815)	Investment	(14,815)	71,685
Total investment derivatives		<u>\$ (10,292)</u>		<u>\$ (1,343)</u>	<u>\$ 621,145</u>

Fair Value: The fair values of the interest rate swaps were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swaps, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. The payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the dates of each future net settlement on the swaps.

Objective: The University is party to eight separate derivative instruments which are pay-fixed, receive-variable interest rate swaps that hedge the changes in cash flows on various variable-rate debt series. In order to protect against the potential of rising interest rates, the University entered into these derivative instruments at a cost less than what the University would have paid to issue fixed-rate debt. In order to benefit from both expected changes in the relationship of short and long-term interest rates and the relationships between the SIFMA Municipal Swap Index and both the ten-year USD-ISDA Index and the one-month USD-LIBOR-BBA Index, the University also entered into five separate derivative instruments which are pay-variable, receive-variable interest rate swaps which relate to various debt series. See Footnote 3 for more information on investment derivative instruments.

Terms, Fair Values, and Credit Risk: The following table displays the terms and fair values of the University's hedging derivative instruments outstanding at June 30, 2011 and 2010, along with the notional amounts and credit rating of the associated

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

counterparty as of June 30, 2011. As disclosed in Footnote 13, the University retired \$5,355 of its Series 2002B debt with proceeds from its Commercial Paper (CP) Series B. The related hedging derivative instruments were assigned to the portion of the University's CP Series B that was used to retire the 2002B debt.

Type	Cash Flow Hedge for Debt Series	2011 Notional Amount	Effective Date	Termination Date	Rate Paid	Rate Received	Counterparty/ Counterparty Credit Rating	2011 Fair Value	2010 Fair Value
Pay-fixed interest rate sw ap	2000A	71,535	11/3/2008	8/15/2029	4.074%	67% USD-LIBOR-BBA one month	Deutsche Bank AG/Aa3	(14,465)	(16,994)
Pay-fixed interest rate sw ap	CP Series B	3,315	10/17/2002	8/15/2018	4.330%	USD-LIBOR-BBA one month	Deutsche Bank AG/Aa3	(339)	(360)
Pay-fixed interest rate sw ap	CP Series B	2,040	10/17/2002	8/15/2022	5.280%	USD-LIBOR-BBA one month	Deutsche Bank AG/Aa3	(404)	(461)
Pay-fixed interest rate sw ap	2003A	48,205	11/3/2008	2/15/2033	3.618%	67% USD-LIBOR-BBA one month	Barclays Bank FLC/Aa3	(7,225)	(8,881)
Pay-fixed interest rate sw ap	2003C	9,620	11/3/2008	2/15/2033	5.330%	USD-LIBOR-BBA one month	Barclays Bank FLC/Aa3	(1,913)	(2,326)
Pay-fixed interest rate sw ap	2005	54,140	11/3/2008	2/15/2034	3.647%	67% USD-LIBOR-BBA one month	Barclays Bank FLC/Aa3	(8,318)	(10,192)
Pay-fixed interest rate sw ap	2007B & CP Series C	22,000	5/17/2007	2/15/2028	4.139%	67% USD-LIBOR-BBA three month plus .58%	JP Morgan Chase Bank/Aa1	(3,106)	(3,641)
<u>\$ 210,855</u>								<u>\$ (35,770)</u>	<u>\$ (42,865)</u>

Credit Risk: The University is exposed to credit risk on hedging derivative instruments that are in asset positions. The aggregate fair value of hedging derivative instruments in asset positions at June 30, 2011 was zero and the University was not exposed to credit risk related to these swaps. Refer to Footnote 3 for information on credit risk of investment derivative instruments.

To mitigate credit risk, the University executes interest rate swaps with various counterparties and it is the University's policy to require collateralization. The following table demonstrates the thresholds and minimum transfers for collateralization:

Credit Rating	Deutsche Bank AG		JP Morgan Chase Bank N.A.		Bank of New York Mellon		Barclays Bank PLC	
	Threshold	Minimum Transfer	Threshold	Minimum Transfer	Threshold	Minimum Transfer	Threshold	Minimum Transfer
Aaa/AAA	\$ 40,000	\$ 1,000	\$ 40,000	\$ 1,000	\$ 40,000	\$ 1,000	\$ 40,000	\$ 1,000
Aa3/AA- to Aa1/AA+	6,000*	1,000	20,000	1,000	6,000*	1,000	6,000	1,000
A3/A- to A1/A+	1,500	500	5,000	500	1,500	500	1,500	500
Baa1/BBB+	500	250	500	250	500	250	500	250
Baa2/BBB	-	250	-	250	-	-	-	-
Below Baa2/BBB	-	250	-	250	-	-	-	-

*Threshold for the University is \$20,000

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

Interest rate risk: The University is not exposed to interest rate risk on its derivative instruments.

Basis Risk: The University is exposed to basis risk on its pay-fixed, receive-variable interest rate swap hedging derivative instruments because the variable-rate payments received by the University on these hedging derivative instruments are based on a rate or index other than interest rates the University pays on its variable-rate debt, which bear interest based on weekly or quarterly rates determined by the trustee or remarketing agent. These pay-fixed, receive-variable swaps expose the University to basis risk should the rates resulting from the 67% of USD-LIBOR-BBA swaps not equal the rate the University pays on the 2000A, 2003A, 2005, 2007B, and CP Series C debt, and should the rates resulting from the USD-LIBOR-BBA swaps not equal the rate the University pays on the 2003C and CP Series B debt.

Termination Risk: The University or any of the involved counterparties may terminate a derivative instrument if the other party fails to perform under the terms of the contract. If at the time of termination, a hedging derivative instrument is in a liability position, the University would be liable to the appropriate counterparty for a payment equal to the liability, subject to any netting arrangement.

Rollover Risk: The University is not exposed to rollover risk on its derivative instruments.

Contingencies: All of the University's derivative instruments include provisions that require the University to post collateral at certain thresholds depending on the University's credit rating. See the table under "Credit Risk" for thresholds and minimum transfers for collateralization. As of June 30, 2011, the University's credit ratings were Aa1 as assigned by Moody's and AA as assigned by Standard & Poor's. The aggregate fair value of all derivative instruments with these collateral posting provisions at June 30, 2011 was \$26,718. The University had \$12,323 in collateral posted to its counterparties and held \$750 in collateral posted by its counterparties.

15. Net assets

Restricted and unrestricted net assets for the years ended June 30, 2011 and 2010 are as follows:

	2011	2010
Restricted - nonexpendable:		
Permanent endowments	\$ 352,696	\$ 447,289
Restricted - expendable:		
Gifts, endowment income and sponsored programs	\$ 351,085	\$ 185,981
Quasi and term endowments	166,101	136,069
Capital projects	65,539	65,190
Student loans	8,166	8,128
Total Restricted - expendable	<u>\$ 590,891</u>	<u>\$ 395,368</u>
Total Restricted Net Assets	<u>\$ 943,587</u>	<u>\$ 842,657</u>
Unrestricted:		
Designated/Committed	\$ 779,390	\$ 618,085
Uncommitted	10,096	20,145
Total Unrestricted Net Assets	<u>\$ 789,486</u>	<u>\$ 638,230</u>

Restricted – Net assets are restricted when they are subject to externally imposed constraints.

Unrestricted – Unrestricted net assets are not subject to externally imposed constraints. However, these net assets are subject to internal designations. Unrestricted net assets include amounts designated for specific purposes by action of the Board or management or may otherwise be subject to pending contractual commitments with external parties. Substantially all unrestricted net assets are internally designated for programmatic initiatives or capital asset renewals.

16. Grants and contracts

The University receives grants and contracts from certain federal, state, and local agencies to fund research and other activities. Revenues from government grants and contracts are recognized when all eligibility requirements have been met. The University records indirect costs related to such grants and contracts at predetermined rates that are negotiated with the University's federal cognizant agency. Both direct and indirect costs charged to the grants or contracts are subject to audit and approval by the granting agencies. University management believes adjustments of costs, if any, resulting from such examination by the granting agency would not be material.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

17. Commitments

At June 30, 2011, the University had initiated plans and incurred certain contractual commitments related to the construction or capital improvement of various facilities. The costs to complete the projects are estimated to be \$167,847 and are to be funded from debt proceeds, other University funds, and private gifts. Certain University facilities have been, or are scheduled to be, financed in whole or in part by SBA bond issues secured by a pledge of rentals to be received from the State of Michigan pursuant to lease agreements between the SBA, the State of Michigan, and the University. During the lease terms, the SBA will hold title to the respective buildings, the State of Michigan will make all lease payments to the SBA, and the University will pay certain operating and maintenance costs. The SBA will be obligated to sell each building to the University for one dollar, after full payment of all rentals due under the related lease.

At June 30, 2011, the University had entered into various limited partnerships with investment managers of oil and gas, real estate, venture capital, private equity, and restructuring funds. As of June 30, 2011, \$159,724 of the initial \$419,230 investment commitment remains outstanding.

18. New accounting pronouncements

The University will be required to implement the provisions of GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements (SCAs)*, effective with the fiscal year ending June 30, 2013. The University will be required to address financial reporting related to service concession agreements which are a type of public-private or public-public partnership. The University has not yet determined the full impact of this standard on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 61, *The Financial Reporting Entity Omnibus*, effective with the fiscal year ending June 30, 2013. The University will be required to address modifications to certain requirements for inclusion of component units in the financial reporting entity. The University has not yet determined the full impact of this standard on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, effective with the fiscal year ending June 30, 2013. The University will be required to address certain FASB Statements and Interpretations, APB Opinions, and Accounting Research Bulletins of the AICPA Committee on Accounting Procedure that this standard incorporates into GASB literature. The University has not yet determined the full impact of this standard on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective with the fiscal year ending June 30, 2013. This Statement defines deferred outflows and inflows of resources as elements of consuming or acquiring net assets by the University that is applicable to a future reporting period. The standard also incorporates deferred outflows or inflows of resources into the definition of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The University has not yet determined the full impact of this standard on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53*, effective with the fiscal year ending June 30, 2012. The requirements of this Statement enhance comparability and improve financial reporting by clarifying the circumstances in which hedge accounting should continue when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The University has not yet determined the full impact of this standard on its financial statements.

Financial report prepared under the direction of Fred L. Poston, Vice President for Finance and Operations and Treasurer; David B. Brower, Assistant Vice President, Chief Financial Officer and Controller; Mark P. Haas, Assistant Vice President for Business and Chief Financial Officer; Glen J. Klein, Director of Investments and Financial Management; Gregory J. Deppong, Chief Accountant; and John L. Thelen, Manager of Financial and Cost Analysis.

Michigan State University is an affirmative-action, equal-opportunity employer.
The Michigan State University IDEA is institutional Diversity: Excellence in Action

**Report on Internal Control Over Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in Accordance
with *Government Auditing Standards***

**To the Board of Trustees
Michigan State University**

We have audited the basic financial statements of Michigan State University as of and for the years ended June 30, 2011 and 2010 and have issued our report thereon dated October 6, 2011. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered Michigan State University's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Michigan State University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Michigan State University's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the University's financial statements will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Michigan State University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

To the Board of Trustees
Michigan State University

This report is intended solely for the information and use of the finance and audit committee, the board of trustees, and management and is not intended to be and should not be used by anyone other than these specified parties.

Plante & Moran, PLLC

Kalamazoo, Michigan
October 6, 2011

MICHIGAN STATE
UNIVERSITY