

LAKE SUPERIOR STATE UNIVERSITY

ANNUAL FINANCIAL REPORT

**FISCAL YEAR ENDED
JUNE 30, 2003**

LAKE SUPERIOR STATE UNIVERSITY

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Lake Superior State University

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**Lake Superior State University
Management's Discussion and Analysis
Fiscal Year Ending June 30, 2003**

This section of the Lake Superior State University ("University") annual financial report presents management's discussion and analysis of the financial condition of the University as of June 30, 2003 and its financial performance during the fiscal year then ended. This discussion should be read in conjunction with the accompanying financial statements and footnotes. The financial statements, footnotes and this discussion are the responsibility of University management.

Reporting Entity

Lake Superior State University is an institution of higher education and is considered to be a component unit of the State of Michigan. The Governor of the State of Michigan appoints the University's Board of Trustees. The University is included in the State's financial statements as a discrete component unit. Transactions with the State of Michigan primarily relate to appropriations for operations, appropriations for Charter Schools, receipt of grants, payments to State retirement programs for University employees, and reimbursements for capital outlay projects.

Using the Annual Financial Report

This annual report includes financial statements prepared in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities*. These financial statements, which focus on the financial condition, results of operations and cash flows of the University as a whole, present financial information in a form similar to that used by commercial enterprises. The financial statements are prepared using the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged.

The Statement of Net Assets includes all assets and liabilities. Over time, increases or decreases in net assets (the difference between assets and liabilities) is one indicator of the improvement or erosion of the University's financial health when considered with operating measures such as enrollment levels and the physical condition of facilities.

The Statement of Revenues, Expenses and Changes in Net Assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. A public University's dependency on State aid and gifts will result in operating deficits because the financial reporting model classifies State appropriations and gifts as nonoperating revenues. The utilization of capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

The Statement of Cash Flows presents information related to cash inflows and outflows summarized by operating, noncapital financing, capital and related financing and investing activities, and helps measure the University's ability to meet its financial obligations as they mature.

Summary of Selected Financial Data

Lake Superior State University Condensed Statements of Net Assets

	<u>June 30</u>	
	<u>2003</u>	<u>2002</u>
ASSETS:		
Current assets	\$ 10,101,773	\$ 7,770,597
Capital assets	73,757,574	72,644,325
Non-current assets	<u>8,989,840</u>	<u>16,772,228</u>
Total Assets	<u>\$ 92,849,187</u>	<u>\$ 97,187,150</u>
LIABILITIES:		
Current liabilities	\$ 7,969,383	\$ 6,874,770
Noncurrent liabilities	<u>32,868,647</u>	<u>33,890,565</u>
Total Liabilities	<u>40,838,030</u>	<u>40,765,335</u>
NET ASSETS:		
Invested in capital assets, net of related debt	\$ 43,639,991	\$ 47,394,982
Restricted, nonexpendable	205,327	205,327
Restricted, expendable	8,660,903	8,806,639
Unrestricted, undesignated (deficit)	<u>(495,064)</u>	<u>14,867</u>
Total Net Assets	<u>52,011,157</u>	<u>56,421,815</u>
Total Liabilities and Net Assets	<u>\$ 92,849,187</u>	<u>\$ 97,187,150</u>

Total current assets increased by \$2.3 million primarily as a result of moving cash from non-current bond proceeds to short term cash reserves as construction on the Fine and Performing Arts Center began. Also, accounts receivable increased by \$600,000 due to delays in receipt of various Federal and State grant funds, (\$260,000), and an increase in LSSU Foundation receivables, due from the University, of (\$340,000). Capital assets increased by \$1.1 million as a result of the Fine and Performing Arts Center construction and other minor asset additions totaling \$6.5 million less annual depreciation charges of \$5.0 million.

Total liabilities remain consistent with the prior year. Current liabilities increased by \$800,000 as a result of amounts payable to construction contractors and long-term liabilities decreased by \$800,000 as a result of annual bond principal payments.

Total Net Assets declined by \$4.4 million. Investment in capital assets, net of related debt, decreased by \$3.8 million primarily from annual depreciation charges. Unrestricted reserves fell to a deficit of \$495,000 due to mid-year reductions in state appropriations of \$497,000.

Lake Superior State University
Condensed Statements of Revenues, Expenses and Changes in Net Assets

	Year Ended June 30	
	2003	2002
Operating revenues		
Tuition and fees	\$ 10,024,816	\$ 9,027,848
Federal grants and contracts	4,337,442	3,620,952
State grants and contracts	274,331	233,685
Nongovernmental grants and contracts	1,704,241	1,773,218
Auxiliary activities	9,156,371	9,016,331
Other operating revenues	634,848	645,535
Total operating revenues	26,132,049	24,317,569
Operating expenses		
Instruction	12,595,988	11,934,397
Academic support	2,746,967	3,121,791
Student services	1,891,756	1,837,153
Student aid	1,579,858	1,459,784
Institutional support	4,834,093	4,582,374
Operation and maintenance of plant	3,851,777	3,532,007
Research	334,478	260,345
Public service	698,184	650,359
Auxiliary activities	8,946,024	8,808,725
Depreciation	4,975,664	4,337,107
Other operating expenses	1,044,219	1,000,576
Total operating expenses	43,499,008	41,524,618
Operating loss	(17,366,959)	(17,207,049)
Net non-operating revenues	12,397,793	11,859,589
Loss before other revenues	(4,969,166)	(5,347,460)
Capital appropriations and gifts	558,508	2,264,776
Total decrease in net assets	(4,410,658)	(3,082,684)
Net assets, beginning of year	56,421,815	59,504,499
Net assets, end of year	\$ 52,011,157	\$ 56,421,815

Operating revenues increased by \$1.8 million. The most significant change is a \$1.0 million increase in tuition and fees. This is an 11% increase over the prior year and is a result of a 9.8% increase in tuition rate, offset by an increase in institutional aid of \$700,000; 3.0% is attributable to an increase in enrollment. There was also an increase in Federal grant and contract receipts of \$700,000.

Operating expenses increased overall by \$2.0 million. Instructional costs increased by \$600,000, primarily as a result of salary and benefit increases. Operation of plant increased by \$300,000 due to higher utility costs. Annual depreciation increased by \$600,000 due to the June 2002 capitalization of the completed Crawford Hall renovation.

Non-operating and Other revenues decreased a total of \$1.2 million. The most significant change is a decrease in gifts from outside donors of \$1.4 million.

**Lake Superior State University
Condensed Statements of Cash Flows**

	Year Ended June 30	
	2003	2002
Cash provided (used) by:		
Operating activities	\$ (12,524,188)	\$ (13,443,299)
Noncapital financing activities	13,882,838	14,498,024
Capital and related financing activities	(7,918,560)	(5,699,471)
Investing activities	8,293,304	2,864,751
Net change in cash and cash equivalents	1,733,394	(1,779,995)
Cash and cash equivalents, beginning of year	3,247,851	5,027,846
Cash and cash equivalents, end of year	\$ 4,981,245	\$ 3,247,851

Cash and cash equivalents increased for the year ended June 30, 2003 by \$1.7 million, primarily a net result of proceeds from construction financing. When bonds were sold in 2001, the University invested these proceeds in non-current investment accounts because the construction of the Fine and Performing Arts Center was delayed due to design and construction schedule revisions. In 2003, as construction on the Arts Center progressed, the University liquidated these non-current investments to provide the cash required for construction progress payments.

A Year in Review...A Look Ahead

Fiscal year 2002-2003 was an extremely difficult year for Lake Superior State University. The University President assessed the financial condition of the University and placed new personnel in the both the Provost and Vice President for Business and Finance positions. Each of these individuals has many years of experience in their respective roles and will bring new direction and resolve to the financial management of the institution.

The University faced a structural deficit of nearly \$1 million dollars at the beginning of the year. Immediate and successful action was taken to reduce University costs in order to eliminate this deficit. Subsequent Executive Orders from the Governor reduced the University's State appropriations by approximately \$500,000. Consequently, General Fund operations resulted in a deficit of \$450,000 for the fiscal year ended June 30, 2003.

Looking forward to the 2003-2004 fiscal year, the General Fund budget is balanced as a result of reducing an additional \$2 million from the overall University budgets. The existing deficits in the General Fund and other specific accounts will be addressed with a multi-year fiscal strategy, which will focus on balancing expenditures to revenues, and securing amounts within each budget year to address a portion of the deficit.

It is assumed that the State appropriation to the University will grow minimally over the next few years. Consequently, the University's expenditures must be further reduced. Concomitantly, tuition and fee increases will be made in a manner that is responsive to inflation while keeping the University in a competitive cost position with other Michigan public universities. An enrollment management plan now being completed is expected to begin having a positive impact in Fall 2005 with a projected increase of 2% to 4 % in overall enrollment.

The University's fiscal strategy and cost control initiatives are also taking into consideration the continuing increase in energy and health benefit costs, the University's obligation to Michigan Public Employee Retirement System (MPERS) for unfunded liabilities for retirees, and the operating costs for the Fine and Performing Arts Building, which is currently under construction and is expected to be completed and operational by Spring 2004.

The University's fiscal responsibility mandates continuing efforts to conserve resources and seek efficiencies. The University must also continue to enhance the quality of the learning experience of its students. While this is difficult in a constrained resource environment, it is required. The central task of the University is the provision of high quality instruction and student support. Through the careful and continuing review of instructional programs, support activities and operational procedures, the University's management and staff are committed to carrying out the institutional mission with available resources.



REHMANN ROBSON

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INDEPENDENT AUDITORS' REPORT

September 3, 2003

Board of Trustees
Lake Superior State University
Sault Ste. Marie, Michigan

We have audited the accompanying basic financial statements of *Lake Superior State University ("the University")*, a component unit of the State of Michigan, as of June 30, 2003 and 2002 and for the years then ended as listed in the table of contents. These basic financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

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. 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 basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of *Lake Superior State University* as of June 30, 2003 and 2002 and the results of its operations and its 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 our report dated September 3, 2003 on our consideration of the University's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report, which is included in the University's single audit report, is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

The Management's Discussion and Analysis (MD&A) presented on pages 2 to 6 is not a required part of the basic financial statements but is supplementary 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 this supplementary information. However, we did not audit the information and express no opinion on it.

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LAKE SUPERIOR STATE UNIVERSITY

STATEMENTS OF NET ASSETS

Assets	June 30	
	2003	2002
Current assets		
Cash and cash equivalents	\$ 4,981,245	\$ 3,247,851
Accounts receivable, net	1,254,885	644,825
State appropriations receivable	2,451,626	2,712,958
Inventories	1,018,631	929,150
Other	395,386	235,813
Total current assets	10,101,773	7,770,597
Noncurrent assets		
Student loans receivable, net	2,498,290	2,310,864
Endowment investments	4,704,319	4,703,005
Other long-term investments	1,787,231	9,758,359
Capital assets, net	73,757,574	72,644,325
Total noncurrent assets	82,747,414	89,416,553
Total assets	\$ 92,849,187	\$ 97,187,150
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	\$ 2,694,182	\$ 1,882,359
Deferred revenue	824,540	800,171
Deposits	3,175,452	2,822,605
Current portion of long-term debt	846,897	837,099
Current portion of employee benefit programs	428,312	532,536
Total current liabilities	7,969,383	6,874,770
Net Long-term debt, net of current portion	31,138,922	31,985,819
Employee benefit programs, net of current portion	1,729,725	1,904,746
Total liabilities	40,838,030	40,765,335
Net assets		
Invested in capital assets, net of related debt	43,639,991	47,394,982
Restricted		
Nonexpendable		
Scholarships and research	205,327	205,327
Expendable		
Scholarships and research	5,295,319	5,295,347
Loans	2,813,726	2,683,145
Capital projects and debt service	551,858	828,147
Unrestricted (deficit)	(495,064)	14,867
Total net assets	52,011,157	56,421,815
Total liabilities and net assets	\$ 92,849,187	\$ 97,187,150

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

LAKE SUPERIOR STATE UNIVERSITY

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Year Ended June 30	
	2003	2002
Operating revenues		
Tuition and fees (net of scholarship allowances of \$4,058,122 and \$3,389,528 in 2003 and 2002, respectively)	\$ 10,024,816	\$ 9,027,848
Federal grants and contracts	4,337,442	3,620,952
State grants and contracts	274,331	233,685
Nongovernmental grants and contracts	1,704,241	1,773,218
Auxiliary activities	9,156,371	9,016,331
Other	634,848	645,535
Total operating revenues	26,132,049	24,317,569
Instruction	12,595,988	11,934,397
Research	334,478	260,345
Public service	698,184	650,359
Net cash used in operating activities	2,746,967	3,121,791
Student services	1,891,756	1,837,153
Student aid	1,579,858	1,459,784
Institutional support	4,834,093	4,582,374
Operation and maintenance of plant	3,851,777	3,532,007
Auxiliary activities	8,946,024	8,808,725
Depreciation	4,975,664	4,337,107
Other	1,044,219	1,000,576
Total operating expenses	43,499,008	41,524,618
Operating loss	(17,366,959)	(17,207,049)
Nonoperating revenues (expenses)		
State appropriations	13,707,126	14,229,527
Interest on capital debt and leases	(1,630,705)	(1,665,751)
Investment income (net of investment expenses)	362,093	146,135
Loss on assets sold or retired	(40,721)	(850,322)
Net nonoperating revenues	12,397,793	11,859,589
Loss before other revenues	(4,969,166)	(5,347,460)
Other revenues		
Capital grants and gifts	525,478	1,627,785
Additions to expendable endowments	33,030	306,097
Capital appropriations	-	330,894
Total other revenues	558,508	2,264,776
Decrease in net assets	(4,410,658)	(3,082,684)
Net assets, beginning of year	56,421,815	59,504,499
Net assets, end of year	\$ 52,011,157	\$ 56,421,815

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

LAKE SUPERIOR STATE UNIVERSITY

STATEMENTS OF CASH FLOWS

	Year Ended June 30	
	2003	2002
Cash flows from operating activities		
Tuition and fees	\$ 10,081,257	\$ 9,064,929
Grants and contracts	6,027,755	5,839,600
Payments to employees	(25,456,871)	(24,432,232)
Payments to vendors	(11,199,238)	(11,433,121)
Payments for financial aid	(1,579,858)	(1,459,784)
Loans issued to students	(533,046)	(535,858)
Collections of interest and principal on loans to students	345,620	492,322
Auxiliary activities	9,136,226	8,978,700
Other receipts	653,967	42,145
Net cash used in operating activities	(12,524,188)	(13,443,299)
Cash flows from noncapital financing activities		
State appropriations	13,849,808	14,191,927
Net cash used in operating activities	33,030	306,097
Federal Direct Lending receipts	7,709,994	7,307,237
Federal Direct Lending disbursements	(7,709,994)	(7,307,237)
Net cash provided by noncapital financing activities	13,882,838	14,498,024
Cash flows from capital and related financing activities		
Capital appropriations	118,650	421,024
Capital grants and gifts received	468,349	1,184,620
Purchases and construction of capital assets	(6,421,762)	(5,397,526)
Proceeds from disposal of capital assets	387,859	428,153
Principal paid on capital debt and leases	(837,099)	(667,602)
Interest paid on capital debt and leases	(1,634,558)	(1,668,140)
Net cash used in capital and related financing activities	(7,918,560)	(5,699,471)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	8,296,761	4,019,429
Purchases of investments	(316,857)	(1,787,877)
Interest on investments	313,400	633,199
Net cash provided by investing activities	8,293,304	2,864,751
Net increase (decrease) in cash and cash equivalents	1,733,394	(1,779,995)
Cash and cash equivalents, beginning of year	3,247,851	5,027,846
Cash and cash equivalents, end of year	\$ 4,981,245	\$ 3,247,851

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

LAKE SUPERIOR STATE UNIVERSITY

STATEMENTS OF CASH FLOWS

(Continued)

	Year Ended June 30	
	2003	2002
Reconciliation of net operating loss to net cash used in operating activities		
Operating loss	\$ (17,366,959)	\$ (17,207,049)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation	4,975,664	4,337,107
Change in assets and liabilities:		
Accounts receivables, net	(610,060)	190,098
Student loans receivable, net	(187,426)	(43,537)
Inventories	(89,481)	(80,435)
Other	(159,573)	52,673
Accounts payable and accrued liabilities	815,676	185,224
Deferred revenue	24,369	(76,153)
Deposits	352,847	(546,140)
Employee benefit programs	(279,245)	(255,087)
Net cash used in operating activities	\$ (12,524,188)	\$ (13,443,299)
Supplemental disclosures of non-cash financing and investing activities		
Gifts in-kind received and recorded as capital assets	\$ 95,731	\$ 443,165
Amortized bond issue cost recognized in investment income	\$ 38,602	\$ -

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

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Lake Superior State University (“the University”) is an institution of higher education and is considered a discrete component unit of the State of Michigan because its Board of Trustees is appointed by the Governor. Accordingly, the University's financial statements are included in those of the State. Transactions with the State of Michigan relate primarily to appropriations for operations, appropriations for charter schools, grants from various State agencies, State Building Authority (SBA) revenues and payments to the State retirement program for certain University employees.

Basis of Presentation

The accompanying financial statements have been prepared using the economic resource measurement focus and the accrual basis of accounting with the exception that certain investment income and interest earned on the Federal Perkins student loan program are recorded only when received.

In accordance with Governmental Accounting Standards Board (“GASB”) Statement No. 20, 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.

In applying these accounting pronouncements, the University follows the guidance for special purpose governments engaged only in “business type” activities rather than issuing financial statement that focus on accountability of individual funds.

Recently Issued Accounting Standards

In May, 2002 the GASB issued Statement No. 39, *Determining Whether Certain Organizations are Component Units*, which amends Statement No. 14, *The Financial Reporting Entity*, to provide additional guidance whether entities associated with a primary government, although for which a primary government is not financially accountable, should be reported as component units, and discretely presented in the primary government’s financial statements based on the nature and significance of the relationship. Generally, Statement No. 39 requires inclusion of an organization that raises and holds economic resources for the direct benefit of the primary governmental unit. As a result, it is contemplated that in implementing Statement No. 39, the University will begin including in its financial statements the Lake Superior State University Foundation (*see Note 10*) for the fiscal year ending June 30, 2004.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid investments, excluding noncurrent investments, with an original maturity when purchased of three months or less.

Endowment Investments

Endowment investments consist primarily of long term mutual funds and are stated at fair value.

Other Long-Term Investments

Other long-term investments consist primarily of intermediate and long-term mutual funds and a guaranteed investment contract which are stated at fair value.

Inventories

Inventories, consisting primarily of bookstore materials, supplies and petroleum products, are valued at cost (specific identification) not in excess of market.

Capital Assets

Capital assets, consisting of institutional physical properties used in University operations, are stated at cost when purchased and at estimated fair value at date of receipt for other acquisitions. Building additions and improvements with a cost in excess of \$10,000 are capitalized if the life of the building is extended. Equipment with a cost in excess of \$2,500 with a useful life of 3 or more years is capitalized. Certain maintenance and replacement reserves have been established to provide for significant repair and maintenance costs to residences and certain other facilities.

Depreciation is provided on a straight line basis over the estimated useful life of the related capital assets as follows:

<u>Classification</u>	<u>Life</u>
Buildings	40 years
Land improvements	20 years
Infrastructure	20 years
Equipment	7 years
Personal computers	3 years
Library books	7 years
Vehicles	7 years

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Revenue Recognition

Revenues are recognized when earned and expenses are recognized when the service is provided or when materials are received. Restricted grant revenue is recognized only to the extent expended. Operating revenues of the University consist of tuition and fees, grants and contracts, sales and services of educational activities and auxiliary enterprise revenues. Transactions related to capital and financing activities, noncapital financing activities, investing activities and State appropriations are components of nonoperating revenue. Restricted and unrestricted resources are allocated to the appropriate departments within the University which are responsible for adhering to any donor restrictions.

State appropriation revenue is recognized in the period for which it is appropriated.

During fiscal 2003 and 2002 the University received \$9,782,613 and \$9,757,273 (net of a 3% administrative fee retained by the University), respectively, of State appropriations which were forwarded to seven charter schools. Appropriations received and related disbursements passed on to the charter schools are considered agency transactions and, accordingly, are not reported in the accompanying basic financial statements.

Income Taxes

The University is classified as a State instrumentality under Internal Revenue Code Section 115, and is also classified as a charitable organization under Internal Revenue Code section 501 (c) (1), and is therefore exempt from federal income taxes. Certain activities of the University may be subject to taxation as unrelated business income under Internal Revenue Code Sections 511 to 514. No such taxes were incurred for fiscal years 2003 and 2002, respectively.

Reclassifications

Certain amounts as previously reported in the 2002 financial statements have been reclassified to conform with the 2003 financial statement presentation.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

2. CASH AND CASH EQUIVALENTS AND INVESTMENTS

Cash and Cash Equivalents

Cash and cash equivalents consist of the following amounts at June 30:

	<u>2003</u>	<u>2002</u>
Disbursement accounts (deposits)	\$ 3,118,509	\$ 840,642
Mutual funds	1,857,490	2,315,790
Equities	5,246	983
Cash surrender value of life insurance	<u>--</u>	<u>90,436</u>
Total cash and cash equivalents	<u>\$ 4,981,245</u>	<u>\$ 3,247,851</u>

All cash and cash equivalents are held in the University's name. The University uses a zero balance account in operating its cash management system. Accordingly, any outstanding checks are reflected as negative operating cash in its disbursement accounts. The banks reported balances in the disbursement accounts of \$521,157 and \$967,326 at June 30, 2003 and 2002, respectively. Of these balances \$100,000 was covered by federal depository insurance and \$421,157 and \$867,326, respectively, was uninsured and uncollateralized.

The University utilizes the "pooled cash" method of accounting for substantially all of its cash and short-term investments. Investment policies for cash and short-term investments, as set forth by the Board of Trustees, authorize the University to invest, with limitations, in commercial paper of companies with a rating within the two highest classifications of prime as established by at least one of the standard rating services. Investments may also be made in securities of the U.S. Treasury and federal agencies and in time savings accounts. Short-term investments are stated at fair value.

The University believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits. As a result, management evaluates each financial institution it deposits University funds with and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Investments

The Board of Trustees has authorized certain University administrators to invest in short, intermediate and long-term pools of investments, depending on the nature and need of funds. An established Board policy is followed for the investment of University funds. The primary investment objective for the investment pools is as follows:

- *Short-term investment pool* - to provide for the preservation of capital. Funds needed for expenditures in less than one year will be considered short-term.
- *Intermediate investment pool* - to provide for preservation of capital and maximization of income without undue exposure to risk. Funds needed for expenditures within one to five years will be considered intermediate term.
- *Long-term investment pool* - to provide for long-term growth of principal and income without undue exposure to risk. Funds not needed for expenditures within five years will be considered long-term. The University's general policy toward the long-term investment pool shall be to diversify investments within both equity and fixed income securities so as to provide a balance that will enhance total return. The University invests with selected money managers as part of an institutional mutual fund or in segregated accounts at the investment management company.

Performance objectives for each pool of investments have been established to measure the total return of a manager against a comparable index, as well as the amount of risk the manager is taking. The University uses the service of outside investment counsel in providing performance measurements and asset allocation recommendations.

Investment income and realized gains or losses are distributed using an average cash method on accounts designated to receive investment earnings. Unrealized gains or losses are distributed based on cash balances on June 30.

The University's investments are presented in the financial statements under the following categories at June 30:

	<u>2003</u>	<u>2002</u>
Endowment investments	\$ 4,704,319	\$ 4,703,005
Other long-term investments	<u>1,787,231</u>	<u>9,758,359</u>
Total investments	<u>\$ 6,491,550</u>	<u>\$ 14,461,364</u>

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

The University utilizes the "pooled" method of accounting for substantially all of its investments, which consisted of the following amounts at June 30:

	2003	2002
Mutual funds		
Equity funds	\$ 4,177,335	\$ 4,197,964
Bond funds	1,910,520	1,847,424
Intermediate funds	226,581	213,879
Short term funds	171,121	173,909
Sub-total	6,485,557	6,433,176
Marketable securities	5,993	7,148
Guaranteed investment contract held with an insurance company	--	8,021,040
Total investments	\$ 6,491,550	\$ 14,461,364

Investments are primarily held either in the name of a custodian or a broker. The University's ownership is reflected in the internal records of the custodian or broker. The mutual fund investments, including the mutual funds reported as cash and cash equivalents, are not categorized because they are not evidenced by securities that exist in physical or book entry form. The remaining investments, including the equities and cash surrender value of life insurance reported as cash and cash equivalents, are classified as a Risk Category 3, which includes investments that are neither insured nor registered and are held by either the counterparty or the counterparty's trust department (or agent) but are not in the University's name.

3. ENDOWMENT INVESTMENTS

Marketable securities are substantially all unregistered securities, which are held by the University's master custodian, or by its agent or by a central depository, not in the University's name and are summarized as follows at June 30:

	Fair Value		Cost	
	2003	2002	2003	2002
Endowment investments, held in trust	\$ 2,144,896	\$ 2,171,803	\$ 2,366,726	\$ 2,352,117
Mutual funds	2,559,423	2,531,202	1,434,762	1,441,453
Total endowment investments	\$ 4,704,319	\$ 4,703,005	\$ 3,801,488	\$ 3,793,570

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Policies regarding marketable securities in the endowment investments, as set forth by the Board of Trustees, authorize the investment manager to invest in high-grade equities, bonds or other marketable securities. The endowment income spending policy is 100% of the cash earnings of each endowment. The annual spending income allocation cannot reduce the original gift principal. The spending policy is reviewed periodically by the finance committee, which recommends changes to the Board of Trustees. The net appreciation on investments of donor-restricted endowments approximated \$903,000 and \$909,000 at June 30, 2003 and 2002, respectively. The net appreciation is a component of restricted, expendable net assets. The yields of the endowment investments were as follows for the year ended June 30:

	<u>2003</u>	<u>2002</u>
Interest and dividends	2.2%	1.8%
Net realized and unrealized gains (losses)	0.3	(9.8)
Total return (loss)	<u>2.5%</u>	<u>(8.0)%</u>

According to the law of the State of Michigan, the Board of Trustees may appropriate for expenditure for the uses and purposes for which an endowment is established an allocation of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment over the historic dollar value as is prudent under the facts and circumstances prevailing at the time of the action or decision.

4. ACCOUNTS, STATE APPROPRIATIONS AND STUDENT LOAN RECEIVABLES

Accounts receivable result primarily from student tuition and fee billings and auxiliary enterprise sales, such as food service, bookstore and student residence. In addition, receivables arise from grant awards, financial aid and State Building Authority ("SBA") revenues. These receivables are reported net of an allowance for collection losses in the amount of \$203,872 and \$164,054 at June 30, 2003 and 2002, respectively.

Accounts receivable consist of the following net amounts at June 30:

	<u>2003</u>	<u>2002</u>
Tuition and fees	\$ 136,264	\$ 119,973
Auxiliary activities	143,228	154,442
Governmental grants and contracts	530,784	276,408
Private grants and contracts	35,502	18,068
Other	<u>409,107</u>	<u>75,934</u>
Accounts receivable, net	<u>\$ 1,254,885</u>	<u>\$ 644,825</u>

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Based on Senate Bill 905, PA 273 of 1998, State appropriations are recorded on the accrual basis, when earned. As a result, the University recorded State appropriations receivable in the following amounts at June 30:

	2003	2002
State appropriations - operations	\$ 2,451,626	\$ 2,594,308
State appropriations - other	--	118,650
Total state appropriations receivable	\$ 2,451,626	\$ 2,712,958

In addition, the University has student loans receivable, in the amount of \$2,498,290 and \$2,310,864 for uncollectible loans of \$285,718 and \$264,128 as of June 30, 2003 and 2002, respectively. Approximately 80% of student loans receivable are expected to be collected in periods beyond one year.

5. CAPITAL ASSETS

Changes in the components of capital assets are as follows for the year ended June 30:

	2003			
	Balance July 1, 2002	Additions	Reductions	Balance June 30, 2003
Land - restricted	\$ 838,684	\$ --	\$ --	\$ 838,684
Land and land improvements	6,615,977	--	4,500	6,611,477
Infrastructure	1,312,681	27,300	--	1,339,981
Building and building improvements	97,927,938	207,618	399,784	97,735,772
Equipment and other	17,876,909	595,765	781,095	17,691,579
Construction-in-progress	1,272,278	5,686,810	--	6,959,088
Total capital assets	125,844,467	6,517,493	1,185,379	131,176,581
Less accumulated depreciation	53,200,142	4,975,664	756,799	57,419,007
Capital assets, net	\$ 72,644,325	\$ 1,541,829	\$ 428,580	\$ 73,757,574

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

	2002			
	<u>Balance July 1, 2001</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2002</u>
Land - restricted	\$ 838,684	\$ --	\$ --	\$ 838,684
Land and land improvements	7,274,530	254,500	913,053	6,615,977
Infrastructure	1,204,953	107,728	--	1,312,681
Building and building improvements	91,011,249	7,255,370	338,681	97,927,938
Equipment and other	17,899,575	1,040,615	1,063,281	17,876,909
Construction-in-progress	<u>4,317,601</u>	<u>2,793,838</u>	<u>5,839,161</u>	<u>1,272,278</u>
Total capital assets	122,546,592	11,452,051	8,154,176	125,844,467
Less accumulated depreciation	<u>49,899,575</u>	<u>4,337,107</u>	<u>1,036,540</u>	<u>53,200,142</u>
Capital assets, net	<u>\$ 72,647,017</u>	<u>\$ 7,114,944</u>	<u>\$ 7,117,636</u>	<u>\$ 72,644,325</u>

Construction-in-progress consists entirely of work completed on the design and construction phase for the Fine and Performing Arts Center ("Center").

The estimated cost of construction and expected sources of financing for the Center, which is expected to be completed in the Spring of 2004, are shown below:

Estimated cost of construction	\$ 15,875,014
Costs incurred through June 30, 2003	<u>6,959,088</u>
Estimated cost to complete	<u>\$ 8,915,926</u>
Expected sources of financing:	
State funds	\$ 8,000,000
University funds and other sources	<u>915,926</u>
Total	<u>\$ 8,915,926</u>

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

6. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following liabilities at June 30:

	<u>2003</u>	<u>2002</u>
Accounts payable to vendors	\$ 1,613,414	\$ 828,439
Payroll and payroll taxes	700,288	684,587
Interest	200,480	204,333
Workers' compensation claims	<u>180,000</u>	<u>165,000</u>
Total accounts payable and accrued expenses	<u>\$ 2,694,182</u>	<u>\$ 1,882,359</u>

Worker's Compensation

The University is self-insured for workers' compensation claims up to \$500,000 and \$300,000 per claim for the years ended June 30, 2003 and 2002, respectively. The accrued workers' compensation obligation represents claims made prior to June 30, 2003 and 2002, which remain unpaid at those dates. The University's third party administrator bases these amounts upon an analysis of workers' compensation claims, which includes historical incident rates and other related factors.

Changes in the workers' compensation claims liability are summarized as follows for the year ended June 30:

	<u>2003</u>	<u>2002</u>
Claims liability at beginning of year	\$ 165,000	\$ 148,612
Claims and damages incurred	193,717	150,819
Claims payments	<u>(178,717)</u>	<u>(134,431)</u>
Claims liability at end of year	<u>\$ 180,000</u>	<u>\$ 165,000</u>

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

7. LONG TERM DEBT

Changes in the components of long term debt are as follows for the year ended June 30:

		2003					
		Outstanding Principal					
	Interest Rate	Maturity	July 1 2002	Additions	Reductions	June 30 2003	Current Portion
Bonds payable							
General Revenue							
Bonds, Series 2001							
Series bonds	4.00%-5.00%	2004-2016	\$ 5,325,000	\$ --	\$ 260,000	\$ 5,065,000	\$ 270,000
Term bonds	5.125%-5.5%	2018-2031	16,525,000	--	--	16,525,000	--
General Revenue							
Bonds, Series 1997							
Series bonds	4.40%-5.00%	2004-2008	3,860,000	--	475,000	3,385,000	495,000
Term bonds	5.18%-5.35%	2012-2019	<u>6,805,000</u>	--	--	<u>6,805,000</u>	--
Total –bonds payable			32,515,000	--	735,000	31,780,000	765,000
Capital leases			<u>307,918</u>	--	<u>102,099</u>	<u>205,819</u>	<u>81,897</u>
Total – long term debt			<u>\$ 32,822,918</u>	<u>\$ --</u>	<u>\$ 837,099</u>	<u>\$ 31,985,819</u>	<u>\$ 846,897</u>
Less current portion						<u>846,897</u>	
Long term debt, net of current portion						<u>\$ 31,138,922</u>	

		2002					
		Outstanding Principal					
	Interest Rate	Maturity	July 1 2001	Additions	Reductions	June 30 2002	Current Portion
Bonds payable							
General Revenue							
Bonds, Series 2001							
Series bonds	4.00%-5.00%	2003-2016	\$ 5,325,000	\$ --	\$ --	\$ 5,325,000	\$ 260,000
Term bonds	5.125%-5.5%	2018-2031	16,525,000	--	--	16,525,000	--
General Revenue							
Bonds, Series 1997							
Series bonds	4.30%-5.00%	2003-2008	4,315,000	--	455,000	3,860,000	475,000
Term bonds	5.18%-5.35%	2012-2019	<u>6,805,000</u>	--	--	<u>6,805,000</u>	--
Total –bonds payable			32,970,000	--	455,000	32,515,000	735,000
Capital leases			<u>520,520</u>	--	<u>212,602</u>	<u>307,918</u>	<u>102,099</u>
Total – long term debt			<u>\$ 33,490,520</u>	<u>\$ --</u>	<u>\$ 667,602</u>	<u>\$ 32,822,918</u>	<u>\$ 837,099</u>
Less current portion						<u>837,099</u>	
Long term debt, net of current portion						<u>\$ 31,985,819</u>	

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Bonded Debt

General Revenue Bonds, Series 2001

Bonds payable in the amount of \$21,590,000 are payable from general revenues and are comprised of \$5,065,000 in serial bonds maturing in varying amounts through November 2016, with interest charged at annual rates ranging from 4% to 5%. In addition there are four term bonds outstanding in the amounts of \$1,170,000, \$2,700,000, \$5,535,000 and \$7,120,000, respectively. The term bonds mature in November 2018, 2021, 2026 and 2031 and accrue interest at 5.125%, 5.5%, 5.125% and 5.25%, respectively. All of the bonds are callable after November 15, 2012 and the term bonds are subject to minimum funding reserves. The serial and term bonds were issued under the same official statement dated May 15, 2001.

General Revenue Bonds, Series 1997

Bonds payable in the amount of \$10,190,000 are payable from general revenues and are comprised of \$3,385,000 in serial bonds maturing in varying amounts through November 2008, with interest charged at annual rates ranging from 4.4% to 5.125%. In addition there are two term bonds outstanding in the amounts of \$2,835,000 and \$3,970,000, respectively. The term bonds mature in November 2012 and 2019 and accrue interest at 5.18% and 5.35%, respectively. All the bonds are callable after November 15, 2008 and the term bonds are subject to minimum funding reserves. The serial and term bonds were issued under the same official statement dated November 1, 1997.

Debt Service Requirements

Principal and interest on the bonds are payable only from certain general revenues. The following table summarizes debt service requirements by years of scheduled maturity:

<u>Year ended</u> <u>June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 765,000	\$ 1,587,533	\$ 2,352,533
2005	805,000	1,553,843	2,358,843
2006	870,000	1,516,168	2,386,168
2007	880,000	1,475,418	2,355,418
2008	915,000	1,433,668	2,348,668
2009-2013	5,265,000	6,463,542	11,728,542
2014-2018	5,570,000	5,033,333	10,603,333
2019-2023	5,050,000	3,693,308	8,743,308
2024-2028	5,825,000	2,315,482	8,140,482
2029-2031	<u>5,835,000</u>	<u>631,970</u>	<u>6,466,970</u>
Total – bonds payable	<u>\$31,780,000</u>	<u>\$25,704,265</u>	<u>\$57,484,265</u>

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Defeased Bonds

In May 2001, the University issued \$21,850,000 of General Revenue Bonds, Series 2001 with yields ranging from 3.1% to 5.43%. A portion of the proceeds were used to refund and defease a portion of the Board's General Revenue Bonds, Series 1997 maturing at varying amounts each November 15 through 2019 in the amount of \$8,160,000. The University purchased U.S. Treasury securities, which were deposited in an irrevocable escrow fund with an escrow agent to provide for all future debt service payments on the refunded bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not recorded as assets or liabilities in the basic financial statements of the University. The portion of the bonds used to defease the debt reduced the University's related annual debt service payments while increasing its total debt service payments by \$7,318,423. The defeasance resulted in an economic loss (difference between the present values of the debt service payments on the old and new debt) of \$208,297. The remaining proceeds were used to finance various capital projects. The outstanding balance for these defeased bonds was \$7,480,000 and \$7,830,000 as of June 30, 2003 and 2002, respectively.

In November 1997, the University issued \$20,940,000 of General Revenue Bonds, Series 1997 with yields ranging from 3.9% to 5.35%. The proceeds of this bond issue were used to finance various capital projects and to refund and defease various other bonds issued by the Board of Trustees. The outstanding balance for these defeased bonds was \$4,470,000 and \$4,695,000 at June 30, 2003 and 2002, respectively.

During the fiscal year ended June 30, 2002, the Board of Trustee bonds of 1992 which had been defeased were called. The principal returned was \$3,610,000 and the call premium was \$65,000. The escrow agent refunded the remaining cash balance in the defeasement account to the University and closed the account as of May 21, 2002.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Obligations Under Capital Leases

The University leases printing and computer equipment valued at \$484,937 at June 30, 2003 under lease agreements which meet the capitalization criteria specified by generally accepted accounting principles.

The following is a schedule of annual future minimum lease payments required under capitalized leases obligations as of June 30, 2003:

Year ended June 30	Amount
2004	\$ 91,638
2005	91,310
2006	<u>38,047</u>
Total minimum payments due	220,995
Less amounts representing interest, imputed at annual rates ranging from 3.7% to 5.8%	<u>15,176</u>
Present value of net minimum lease payments	<u>\$ 205,819</u>

Commitments and related rental expenses under operating leases with initial or remaining non-cancelable lease terms in excess of one year as of and for the years ended June 30, 2003 and 2002 are insignificant.

Interest expense on all borrowed debt was \$1,630,705 and \$1,665,751 for the years ended June 30, 2003 and 2002, respectively.

8. EMPLOYEE RETIREMENT PLANS AND OTHER POSTEMPLOYMENT BENEFITS

Pension plan

The University provides noncontributory retirement plans for all qualified employees. In December 1995, the State enacted Public Act 272 of 1995 that precludes University employees hired after January 1, 1996 from participating in the Michigan Public School Employees Retirement System (MPERS). MPERS and the Teachers Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF) were the two retirement plans offered by the University to its eligible employees. Employees currently covered under the MPERS plan will continue to remain in that plan. The University will contribute to MPERS the percentage mandated by state statute of their eligible wages.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

ESP (Educational Support Personnel) employees hired after January 1, 1996, faculty and administrative employees are eligible for the TIAA-CREF plan. TIAA-CREF is a defined contribution plan where the University contributes an amount equal to 12.0 percent of administrative and faculty group employees' pay, and 10.0 percent of ESP employees' pay. Plan participants maintain individual annuity contracts with TIAA-CREF, the plan administrator, which are fully vested. The University contributed approximately \$1,323,000 and \$1,284,000 for the years ended June 30, 2003 and 2002, respectively. All eligible employees hired after January 1, 1996 elected TIAA-CREF.

Plan provisions and contribution requirements of the TIAA-CREF plan are established and may be amended by the University's Board of Trustees.

MPSERS is a noncontributory cost-sharing multiple-employer defined benefit plan administered by the Michigan State Employees' Retirement System. The cost of the MPSERS plan allocated to the University was approximately \$1,075,000, \$971,000 and \$1,027,000, for the years ended June 30, 2003, 2002 and 2001, respectively, all of which was contributed during the applicable year.

Beginning October 1, 2002 the University is required to contribute 6.47 percent of MPSERS covered payroll for normal pension costs. In addition, separately computed supplemental contributions were required for retiree health care benefits in the amount of \$719,031. Future contribution requirements, which depend on the level of MPSERS covered payroll, cannot be determined. Additional pension data for MPSERS is contained in MPSERS's comprehensive Annual Financial Report, which may be obtained by writing to the Office of Retirement Systems, 7150 Harris Dr., P. O. Box 30026, Lansing, MI 48901.

Benefit provisions and contribution requirements of MPSERS are established and may be amended by state statute.

Compensated Absences

The University has a policy to pay eligible employees for their unused accumulated vacation, up to a maximum of 288 hours, upon termination of employment with the University.

Accumulated Sick Leave Benefits

The University has a policy to pay eligible employees for their unused accumulated sick leave, up to a maximum of 800 hours, at retirement from the University, if the employee has met certain vesting and age requirements at that date. Employees in the Faculty and Administrative and Professional groups hired after June 30, 1987 and employees in the Educational Support Personnel group hired after December 31, 1989 are not eligible for participation in the program.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Deferred Compensation

The University has deferred compensation agreements for certain employees which call for the University to fund a specified amount each year into an investment vehicle selected by the participant. Upon fulfillment of the deferred compensation agreement, the balances accumulated in these accounts will be disbursed to the employee. Each agreement has an investment equal to the liability, which is grouped with cash and cash equivalents. As of June 30, 2003 and 2002, the requirements of several deferred compensation agreements had been satisfied. Therefore, the deferred liability, in the amount of \$13,312 and \$146,994 at June 30, 2003 and 2002, respectively, has been reclassified from long-term to a current liability.

Early Retirement Severance Program

During the year ended June 30, 2000, twenty two faculty members elected to participate in a early retirement severance incentive program (the "program") offered by the University. During the year ended June 30, 2003, one additional employee was allowed to retire and participate in the program, which increased the liability by \$91,659. The University is required to make payments to each participant as directed by the contract entered into under the program. The University does not fund the program under a formal plan. However, beginning in January 2000, the University began funding the program with current operating cash or investments. Amounts paid under the terms of the program during the year ended June 30, 2003 and 2002, respectively, amounted to \$225,284 and \$308,637 to reduce the liability and \$56,087 and \$58,619 which was recorded as additional salary expense.

Activity in accrued employee benefit programs is summarized below for the year ended June 30:

	2003				
	July 1 2002	Additions	Payments	June 30 2003	Current Portion
Compensated absences	\$ 714,990	\$ 64,143	\$ 87,365	\$ 691,768	\$ 80,000
Accumulated sick leave benefits	583,925	142,000	113,485	612,440	100,000
Deferred compensation	164,225	9,065	159,978	13,312	13,312
Early retirement severance program	<u>974,142</u>	<u>91,659</u>	<u>225,284</u>	<u>840,517</u>	<u>235,000</u>
Total-employee benefit programs	<u>\$ 2,437,282</u>	<u>\$ 306,867</u>	<u>\$ 586,112</u>	<u>\$ 2,158,037</u>	<u>\$ 428,312</u>
	2002				
	July 1 2001	Additions	Payments	June 30 2002	Current Portion
Compensated absences	\$ 702,054	\$ 105,625	\$ 92,689	\$ 714,990	\$ 90,000
Accumulated sick leave benefits	559,316	96,000	71,391	583,925	60,000
Deferred compensation	148,220	46,000	29,995	164,225	146,994
Early retirement severance program	<u>1,282,779</u>	<u>--</u>	<u>308,637</u>	<u>974,142</u>	<u>235,542</u>
Total-employee benefit programs	<u>\$ 2,692,369</u>	<u>\$ 247,625</u>	<u>\$ 502,712</u>	<u>\$ 2,437,282</u>	<u>\$ 532,536</u>

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

9. SELF INSURANCE

Liability and Property

The University participates with 11 other Michigan universities in the Michigan Universities Self-Insurance Corporation ("MUSIC"). MUSIC's purpose is to provide indemnity to members against auto, comprehensive general liability, errors and omissions and property losses commonly covered by insurance. MUSIC also provides risk management and loss control services and programs.

Loss coverages are structured on a three-layer basis with each member retaining a portion of its losses, MUSIC covering the second layer of losses and commercial carriers covering the third layer. Comprehensive general liability coverage is provided on an occurrence basis; errors and omissions coverage is provided on a claims-made basis.

Premiums are assessed annually for (1) insurance risks retained by MUSIC, (2) costs related to excess coverage and (3) general and administrative expenses. The amount assessed reflects the claims experience of each University.

Insurance Reserves

The University provides coverage for up to a maximum of \$500,000 for each workers' compensation claim and \$75,000 for each health insurance claim. The University purchases commercial insurance for workers' compensation and health insurance claims in excess of coverage provided by the self insurance reserves. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years.

The University reserves an amount within unrestricted net assets for health and maintenance reserves and records a liability for workers' compensation insurance. These liabilities are recorded based on estimates of the amounts needed to pay prior-year and current-year claims plus a reserve for losses relating to catastrophes. These reserves are determined by MUSIC. These reserves amounted to \$1,086,422 and \$1,112,024 at June 30, 2003 and 2002, respectively. The workers' compensation claims liability of \$180,000 and \$165,000 at June 30, 2003 and 2002, respectively, which is included in accounts payable and accrued expenses, is based on the requirements of GASB Statement No. 10, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

10. LAKE SUPERIOR STATE UNIVERSITY FOUNDATION

The Lake Superior State University Foundation (the Foundation) is an independent corporation formed for the purpose of receiving funds for the sole benefit of the University. The Foundation's Board of Directors includes members of the Lake Superior State University Board of Trustees, certain officers of the University and other community representatives elected by the Foundation Board. Total net assets of the Foundation amounted to approximately \$3,448,000 and \$3,151,000 as of June 30, 2003 and 2002. Most assets of the Foundation have been restricted by donors, for specific purposes, are held by the Foundation, and are recorded in the accompanying financial statements as investments and deposits. The Foundation annually transfers resources from individual endowments and designated funds to recipient University accounts to be expended for the specified purpose of each gift. During the years ended June 30, 2003 and 2002, the Foundation transferred \$533,065 and \$2,016,967, respectively, to the University. Support from the University given to the Foundation amounted to \$336,923 and \$302,000 during the years ended June 30, 2003 and 2002, respectively.

11. CONTINGENCIES AND COMMITMENTS

Union Contracts

The University has three groups of employees, two of which are covered under union collective bargaining agreements. The employee groups covered and the expiration of the contracts are as follows:

<u>Employee Group</u>	<u>Union Name</u>	<u>Contract Expires</u>
Educational Support Personnel	Michigan Education Association/ National Education Association	August 31, 2003
Faculty	Michigan Education Association/ National Education Association	August 31, 2004
Administrative and Professional	N/A	N/A

Legal Matters

In the normal course of its activities, the University is a party to various legal and administrative actions. Although some actions have been brought for large amounts, the University has not experienced significant losses or costs. After taking into consideration legal counsel's evaluation of pending actions and information relative to potential future claims based on past events, University management is of the opinion that the outcome thereof will not have a material effect on the financial statements.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

MPSERS Unfunded Liability

Certain employees of the University are covered under the MPSERS retirement plan. As of June 30, 2003 and 2002 the unfunded portion of the related pension benefits is significant. The University's portion of this obligation is not determinable at June 30, 2003 or 2002. While the University has continued to pay the required monthly payments as determined by MPSERS, it is management's position that the University is not responsible for any shortfall in the fund as a result of changes in benefits made by MPSERS.

12. NATURAL CLASSIFICATION OF EXPENSES

Operating expenses by natural classification are summarized as follows for the year ended June 30:

2003							
	Salaries, Wages, Benefits	Supplies and Equipment	Utilities	Scholarship Expenses	Depreciation	Other	Total
Instruction	\$ 11,343,988	\$1,252,000	\$ --	\$ --	\$ --	\$ --	\$ 12,595,988
Research	239,482	94,996	--	--	--	--	334,478
Public service	395,527	302,657	--	--	--	--	698,184
Academic support	2,372,722	374,245	--	--	--	--	2,746,967
Student service	1,466,115	425,641	--	--	--	--	1,891,756
Student aid	--	--	--	1,579,858	--	--	1,579,858
Institution support	3,271,743	1,562,350	--	--	--	--	4,834,093
Plant operations	2,152,806	533,315	1,165,656	--	--	--	3,851,777
Auxiliary activities	3,950,944	4,053,505	941,575	--	--	--	8,946,024
Depreciation	--	--	--	--	4,975,664	--	4,975,664
Other	--	--	--	--	--	1,044,219	1,044,219
Total operating expenses	\$ 25,193,327	\$8,598,709	\$2,107,231	\$1,579,858	\$4,975,664	\$1,044,219	\$ 43,499,008
2002							
	Salaries, Wages, Benefits	Supplies and Equipment	Utilities	Scholarship Expenses	Depreciation	Other	Total
Instruction	\$ 10,586,716	\$1,347,681	\$ --	\$ --	\$ --	\$ --	\$ 11,934,397
Research	202,359	57,986	--	--	--	--	260,345
Public service	368,179	282,180	--	--	--	--	650,359
Academic support	2,353,720	768,071	--	--	--	--	3,121,791
Student service	1,467,002	370,151	--	--	--	--	1,837,153
Student aid	--	--	--	1,459,784	--	--	1,459,784
Institution support	3,252,834	1,329,540	--	--	--	--	4,582,374
Plant operations	2,053,792	521,352	956,863	--	--	--	3,532,007
Auxiliary activities	3,896,482	4,052,523	859,720	--	--	--	8,808,725
Depreciation	--	--	--	--	4,337,107	--	4,337,107
Other	--	--	--	--	--	1,000,576	1,000,576
Total operating expenses	\$ 24,181,084	\$8,729,484	\$1,816,583	\$1,459,784	\$4,337,107	\$1,000,576	\$ 41,524,618

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