LAKE SUPERIOR STATE UNIVERSITY

ANNUAL FINANCIAL REPORT

FISCAL YEAR ENDED
JUNE 30, 2004

LAKE SUPERIOR STATE UNIVERSITY

TABLE OF CONTENTS

Lake Superior State University

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President

Dr. William E. Becker
Vice President, Business and Finance

Dr. Bruce T. Harger
Vice President, Academic Affairs and Provost

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Lake Superior State University
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2004

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, 2004 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 on behalf of certain University employees, and reimbursements for capital outlay projects.

The basic financial statements include not only the University itself, but also a legally separate entity, the Lake Superior State University Foundation, for which the University is financially accountable. Financial statement information for this *component unit* is reported separately from the financial information presented for the University.

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 grants will result in operating deficits because the financial reporting model classifies State appropriations and grants 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

	June 30	
	2004	**2003**
Assets:		
Current assets	$ 11,922,986	$ 8,843,430
Capital assets	77,380,346	73,757,574
Non-current assets	8,538,675	7,202,652
Total Assets	**$ 97,842,007**	**$ 89,803,656**
Liabilities:		
Current liabilities	$ 4,886,497	$ 4,942,209
Noncurrent liabilities	31,757,658	32,850,290
Total Liabilities	36,644,155	37,792,499
Net Assets:		
Invested in capital assets, net of related debt	50,543,709	43,639,991
Restricted, nonexpendable	205,327	205,327
Restricted, expendable	9,856,894	8,660,903
Unrestricted, undesignated (deficit)	591,922	(495,064)
Total Net Assets	61,197,852	52,011,157
Total Liabilities and Net Assets	**$ 97,842,007**	**$ 89,803,656**

Total current assets increased by $3.1 million. This increase is a result of an increase in cash reserves of $3.4 million that are being held for the financing of several capital improvement projects. During fiscal 2004, the State of Michigan approved the increase of its portion of the financing of the Fine and Performing Arts building. This increase in funding, in effect, refunded to Lake Superior State University $3.5 million that the University had issued bonds for in 2001. Because the proceeds of the University bonds issued in 2001 are restricted to capital improvement projects, the Board approved three capital projects that will use these funds. Receivables from the State of Michigan increased by $600,000 which is primarily reimbursement to the University for construction costs on the Fine Arts Building. Inventories decreased by $600,000 as the University discontinued its management of the campus bookstore. The management and operations of the bookstore have been contracted to a third party effective July 1, 2004.

Capital assets increased by $3.6 million as a result of further construction of the Fine and Performing Arts Center and other minor asset additions totaling $8.5 million less annual depreciation charges of $4.9 million.

Total liabilities decreased by $1.1 million. Current liabilities remained consistent with the prior year while total bond indebtedness was reduced by $800,000 and the liability for employee benefit programs decreased by $300,000 as the University continued to pay off the liability for an early retirement program offered in fiscal 2000.

Total net assets increased by $9.2 million. The most significant increase is that of the University's investment in capital assets, which increased by $6.9 million. Restricted, expendable scholarship net assets increased by $700,000, capital projects and debt service net assets increased by $300,000 and unrestricted reserves increased by $1.1 million. The June 30, 2004 unrestricted reserves of $592,000 consist of designated fund reserves of $400,000, auxiliary fund reserves of $300,000, insurance and benefit reserves of $1.1 million and a general fund deficit of $1.2 million.

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

	Year Ended June 30	
	2004	**2003**
Operating revenues		
Tuition and fees	$ 11,921,362	$ 10,024,816
Grants and contracts	6,512,147	6,316,014
Auxiliary activities	9,630,194	9,156,371
Other operating revenues	734,933	634,848
Total operating revenues	28,798,636	26,132,049
Operating expenses		
Instruction	12,464,749	12,595,988
Academic support	2,346,677	2,746,967
Student services	1,742,467	1,891,756
Student aid	1,533,085	1,579,858
Institutional support	4,663,413	4,834,093
Operation and maintenance of plant	3,540,722	3,851,777
Research	354,357	334,478
Public service	753,535	698,184
Auxiliary activities	9,265,597	8,946,024
Depreciation	4,877,101	4,975,664
Other operating expenses	396,894	1,044,219
Total operating expenses	41,938,597	43,499,008
Operating loss	(13,139,961)	(17,366,959)
Net non-operating revenues	11,605,549	12,397,793
Loss before other revenues	(1,534,412)	(4,969,166)
Capital appropriations and gifts	10,721,107	558,508
Total increase (decrease) in net assets	9,186,695	(4,410,658)
Net assets, beginning of year	52,011,157	56,421,815
Net assets, end of year	**$ 61,197,852**	**$ 52,011,157**

Operating revenues increased by $2.6 million. The most significant change is a $1.9 million increase in tuition and fees. This is an 18.9% increase over the prior year and is predominately a replacement of $1.3 million in state appropriations reductions. There was also an increase in auxiliary revenues (room and board) of $500,000.

Operating expenses decreased overall by $1.5 million. Operational costs have been reduced across campus as a result of more than 50 positions being eliminated or not replaced when a vacancy occurred. Also, departmental managers in all areas were asked to restrict spending to emergency and essential purchases, without impairing service to our students. As a result of this directive, managers underspent their allotted supply budgets by nearly $1.0 million.

Non-operating and Other revenues increased a total of $9.7 million. This is due to $10.2 million being received from the State of Michigan in support of the construction of the Fine and Performing Arts Center.

Lake Superior State University
Condensed Statements of Cash Flows

	Year Ended June 30	
	2004	**2003**
Cash provided by (used in):		
Operating activities	$ (7,972,715)	$ (12,527,705)
Noncapital financing activities	12,723,262	13,882,838
Capital and related financing activities	(1,113,850)	(7,918,560)
Investing activities	(294,620)	8,343,862
Net change in cash and cash equivalents	3,342,077	1,780,435
Cash and cash equivalents, beginning of year	4,059,861	2,279,426
Cash and cash equivalents, end of year	**$ 7,401,938**	**$ 4,059,861**

Cash and cash equivalents increased by $3.3 million for the year ended June 30, 2004. Cash used in operations improved by $4.5 million. This is a result of cash received from operations (tuition, grants, and auxiliary activities) increasing by $2.8 million and cash used for operations (payments to employees and vendors) decreasing by $1.7 million. Fluctuations of cash flows in financing and investing activities are the result of construction costs on the Fine Arts Center and reimbursement of a portion of those costs by the State of Michigan.

A Year in Review…A Look Ahead

The past fiscal year was one of revising institutional spending plans and adjusting expectations to live within lower revenue levels. University policies have been revised; operational procedures have been adjusted; and, directions have been given to budget managers with the specific intent of conserving resources and increasing efficiency. The result has been a substantial (32%) reduction in the University's general fund deficit. At the same time, designated fund reserves have increased from a deficit of $60,000 to a reserve of $418,000.

Midway through the past fiscal year, the University received its fourth reduction in funding from the State of Michigan. Coming at mid-year, reducing the budget to accommodate the $642,100 revenue loss would have resulted in catastrophic departmental budget decreases. Consequently, the University Board of Trustees approved a five percent increase in tuition and the University administration imposed further budget reductions in order to continue making progress in reducing the general fund deficit while providing for instruction and essential University services. Even with the mid-year tuition increase, LSSU tuition rates remained competitive with other Michigan public universities.

Lake Superior State University's General Fund budget for FY 2004-2005 is balanced. It is based on the assumption that the State of Michigan will follow through with the promised restoration of $770,000 of the cuts taken over the past 8 months (this $770,000 is a restoration of part of the January 2004 Executive Order reduction and the decrease in base appropriations in the FY 2004-2005 Higher Education Appropriations Bill). To receive this restoration, the University responded to Governor Granholm's requirement that the tuition increase for the new academic year be no more than 2.4%. With the many fiscal demands facing the University, there is pressure to increase tuition by more than that amount (the nation-wide 2004-2005 tuition increase for public universities is approximately 14%, as reported in the *Chronicle of Higher Education*). However, the University is pursuing internal cost control measures, delaying some actions to a later date (e.g., the newly constructed Fine Arts Building will open no earlier than Fall, 2005), imposing cost sharing for health benefits and freezing wages for non-union employees and bargaining for shared health costs and wage freezes with union employees.

In looking toward the future, the University has initiated several actions to revitalize the institution, even in the face of austere fiscal realities. The University has retained an experienced professional to serve as Dean of Enrollment Services. The goal is to turn around the decline in enrollment over the next two years and institute a program that will sustain a minimum annual enrollment growth of at least two percent and greatly enhance student retention. The University has also begun the process of replacing the existing administrative software system with BANNER, a standard in higher education administrative software. Similarly, the University is replacing greatly outdated electrical and information technology infrastructure. Each of these upgrades is expected to provide much more effective and reliable service to the campus.

The University continues to plan for higher operating expenses, mainly due to the continuing increases in energy, health care, and MPSERS retirement program liability. The delays in replacing equipment, upgrading facilities and the elimination of support positions will all mean a period of "catch up" as additional funding is acquired in the future. It is anticipated this added funding will result primarily from tuition revenues gained through enrollment growth.

Fortunately, Lake Superior State University's academic program array is already broad, offering students a variety of technical, professional and liberal arts options from which to choose. Consequently, academic program additions are not necessary to enable the University to continue to attract students.

The University has also begun to develop a more realistic and achievable capital improvement plan. This plan will continue to identify the academic needs of the campus. But, it will be expanded to bring much needed attention to the residence halls and infrastructure requirements of the University, as well.

In summary, LSSU is adapting to the demands of constrained resources. And, in so doing, the University is putting in place the information, practices and policies needed to address future needs, regardless of the fiscal response of the State of Michigan in the future.

REHMANN ROBSON
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INDEPENDENT AUDITORS' REPORT

September 3, 2004

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

We have audited the accompanying financial statements of the business-type activities and the discretely presented component unit of ***Lake Superior State University ("the University"),*** a component unit of the State of Michigan, as of June 30, 2004 and 2003 and for the years then ended, which collectively comprise the University's basic financial statements as listed in the table of contents. 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 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 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the discretely presented component unit of ***Lake Superior State University*** as of June 30, 2004 and 2003 and the respective changes in financial position and cash flows of the University for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, during fiscal 2004 the University adopted the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 39, *Determining Whether Certain Organizations are Component Units*, which amends GASB Statement No. 14, *The Financial Reporting Entity*. Adoption of this pronouncement results in the University including in its financial statements, the financial statements of the Lake Superior State University Foundation as a discretely presented component unit. The University's 2003 financial statements have been restated to reflect this change in accounting principle.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 3, 2004 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.

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The Management's Discussion and Analysis (MD&A) presented on pages 2 to 7 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 inquires of management regarding the methods of measurement and presentation of this required supplementary information. However, we did not audit the information and express no opinion on it.

Rehmann Robson

LAKE SUPERIOR STATE UNIVERSITY

STATEMENTS OF NET ASSETS

	June 30	
Assets	**2004**	**2003**
Current assets		
Cash and cash equivalents	$ 7,401,938	$ 4,059,861
Accounts receivable, net	1,016,149	917,962
State appropriations receivable	3,020,065	2,451,626
Inventories	398,239	1,018,631
Other	86,595	395,350
Total current assets	**11,922,986**	**8,843,430**
Noncurrent assets		
Student loans receivable, net	2,720,507	2,498,290
Endowment investments	5,818,168	4,704,362
Land and construction in progress	16,778,249	8,984,516
Depreciable capital assets, net	60,602,097	64,773,058
Total noncurrent assets	**85,919,021**	**80,960,226**
Total assets	**$ 97,842,007**	**$ 89,803,656**
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	$ 2,613,221	$ 2,677,640
Deferred revenue	853,317	824,540
Deposits	133,955	164,820
Current portion of long-term debt	902,255	846,897
Current portion of employee benefit programs	383,749	428,312
Total current liabilities	**4,886,497**	**4,942,209**
Long-term debt, net of current portion	30,285,294	31,138,922
Employee benefit programs, net of current portion	1,472,364	1,711,368
Total liabilities	**36,644,155**	**37,792,499**
Net assets		
Invested in capital assets, net of related debt	50,543,709	43,639,991
Restricted		
Nonexpendable		
Scholarships and research	205,327	205,327
Expendable		
Scholarships and research	5,995,686	5,295,319
Loans	3,010,530	2,813,726
Capital projects and debt service	850,678	551,858
Unrestricted (deficit)	591,922	(495,064)
Total net assets	**61,197,852**	**52,011,157**
Total liabilities and net assets	**$ 97,842,007**	**$ 89,803,656**

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	
	2004	**2003**
Operating revenues		
Tuition and fees (net of scholarship allowances of $4,275,159 and $4,058,122 in 2004 and 2003, respectively)	$ 11,921,362	$ 10,024,816
Federal grants and contracts	4,220,458	4,337,442
State grants and contracts	227,644	274,331
Nongovernmental grants and contracts	2,064,045	1,704,241
Auxiliary activities	9,630,194	9,156,371
Other	734,933	634,848
Total operating revenues	**28,798,636**	**26,132,049**
Operating expenses		
Instruction	12,464,749	12,595,988
Research	354,357	334,478
Public service	753,535	698,184
Academic support	2,346,677	2,746,967
Student services	1,742,467	1,891,756
Student aid	1,533,085	1,579,858
Institutional support	4,663,413	4,834,093
Operation and maintenance of plant	3,540,722	3,851,777
Auxiliary activities	9,265,597	8,946,024
Depreciation	4,877,101	4,975,664
Other	396,894	1,044,219
Total operating expenses	**41,938,597**	**43,499,008**
Operating loss	**(13,139,961)**	**(17,366,959)**
Nonoperating revenues (expenses)		
State appropriations	12,429,555	13,707,126
Interest on capital debt and leases	(1,596,223)	(1,630,705)
Investment income net of investment expenses	819,186	362,093
Loss on assets sold or retired	(46,969)	(40,721)
Net nonoperating revenues	**11,605,549**	**12,397,793**
Loss before other revenues	**(1,534,412)**	**(4,969,166)**
Other revenues		
Capital grants and gifts	432,273	525,478
Additions to expendable endowments	16,425	33,030
Capital appropriations	10,272,409	-
Total other revenues	**10,721,107**	**558,508**
Increase (decrease) in net assets	**9,186,695**	**(4,410,658)**
Net assets, beginning of year	52,011,157	56,421,815
Net assets, end of year	**$ 61,197,852**	**$ 52,011,157**

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

LAKE SUPERIOR STATE UNIVERSITY

STATEMENTS OF CASH FLOWS

	Year Ended June 30	
	2004	**2003**
Cash flows from operating activities		
Tuition and fees	$ 11,767,768	$ 10,081,257
Grants and contracts	6,651,767	6,027,755
Payments to employees	(24,583,576)	(25,468,062)
Payments to vendors	(10,359,601)	(11,161,806)
Payments for financial aid	(1,533,085)	(1,579,858)
Loans issued to students	(762,868)	(533,046)
Collections of interest and principal on loans to students	540,651	345,620
Auxiliary activities	9,585,854	9,136,226
Other receipts	720,375	624,209
Net cash used in operating activities	**(7,972,715)**	**(12,527,705)**
Cash flows from noncapital financing activities		
State appropriations	12,706,837	13,849,808
Gifts for endowments	16,425	33,030
Federal Direct Lending receipts	8,617,636	7,709,994
Federal Direct Lending disbursements	(8,617,636)	(7,709,994)
Net cash provided by noncapital financing activities	**12,723,262**	**13,882,838**
Cash flows from capital and related financing activities		
Capital appropriations	9,426,688	118,650
Capital grants and gifts received	367,327	468,349
Purchases and construction of capital assets	(8,449,509)	(6,421,762)
Proceeds from disposal of capital assets	-	387,859
Principal paid on capital debt and leases	(858,059)	(837,099)
Interest paid on capital debt and leases	(1,600,296)	(1,634,558)
Net cash used in capital and related financing activities	**(1,113,850)**	**(7,918,560)**
Cash flows from investing activities		
Proceeds from sales and maturities of investments	4,933,094	8,296,761
Purchases of investments	(5,348,347)	(266,299)
Interest on investments	120,633	313,400
Net cash (used in) provided by investing activities	**(294,620)**	**8,343,862**
Net increase in cash and cash equivalents	3,342,077	1,780,435
Cash and cash equivalents, beginning of year	4,059,861	2,279,426
Cash and cash equivalents, end of year	**$ 7,401,938**	**$ 4,059,861**

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

LAKE SUPERIOR STATE UNIVERSITY

STATEMENTS OF CASH FLOWS
(Continued)

	Year Ended June 30	
Reconciliation of operating loss to net cash used in operating activities	**2004**	**2003**
Operating loss	$ (13,139,961)	$ (17,366,959)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation	4,877,101	4,975,664
Change in assets and liabilities:		
Accounts receivables, net	(70,784)	(294,237)
Student loans receivable, net	(222,217)	(187,426)
Inventories	620,392	(89,481)
Other	308,755	(159,574)
Accounts payable and accrued liabilities	(60,346)	853,109
Deferred revenue	28,777	24,369
Deposits	(30,865)	7,266
Employee benefit programs	(283,567)	(290,436)
Net cash used in operating activities	**$ (7,972,715)**	**$ (12,527,705)**
Supplemental disclosures of non-cash financing and investing activities		
Gifts in-kind received and recorded as capital assets	$ 37,543	$ 95,731
Amortized bond issue cost recognized in investment income	$ -	$ 38,602
Acquisition of capital equipment financed by capital lease	$ 59,789	$ -

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

LAKE SUPERIOR STATE UNIVERSITY FOUNDATION

STATEMENTS OF NET ASSETS

	June 30	
	2004	2003
Assets		
Cash and cash equivalents	$ 849,684	$ 921,384
Investments	3,049,988	1,787,188
Due from Lake Superior State University	-	336,959
Unconditional promises to give, net of allowance for uncollectible accounts and unamortized discounts of $162,525 in 2004 and $179,493 in 2003	324,182	389,722
Beneficial interest in charitable remainder trust	193,468	175,541
Total assets	**$ 4,417,322**	**$ 3,610,794**
Liabilities		
Accounts payable and accrued expenses	$ 13,962	$ 16,543
Employee benefit programs	18,231	18,357
Annuity obligations	111,703	128,091
Total liabilities	143,896	162,991
Net assets		
Unrestricted	29,992	8,709
Temporarily restricted	943,512	1,219,183
Permanently restricted	3,299,922	2,219,911
Total net assets	**4,273,426**	**3,447,803**
Total liabilities and net assets	**$ 4,417,322**	**$ 3,610,794**

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

LAKE SUPERIOR STATE UNIVERSITY FOUNDATION

STATEMENTS OF ACTIVITIES

	Year Ended June 30	
	2004	**2003**
Revenue and support		
Contributions	$ 1,512,656	$ 1,146,871
Investment income	198,964	71,366
Net unrealized gains on investments	73,904	50,025
Change in value of split interest agreements	49,728	10,731
Total revenue and support	**1,835,252**	**1,278,993**
LSSU distributions and expenses		
Distributions to Lake Superior State University	601,753	533,065
Operating expenses	407,876	449,451
Total LSSU distributions and expenses	**1,009,629**	**982,516**
Change in net assets	**825,623**	**296,477**
Net assets, beginning of year	3,447,803	3,151,326
Net assets, end of year	**$ 4,273,426**	**$ 3,447,803**

The accompanying notes are an integral part of these 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 on behalf of certain University employees.

As required by Governmental Accounting Standards Board Statement No. 39 (see discussion of adoption of this accounting standard below) the University's basic financial statements include the financial statements of both the University and its component unit, the Lake Superior State University Foundation (the "Foundation") which is a legally separate tax-exempt component unit of the University. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation's Board of Directors includes members of the University's Board of Trustees, certain officers of the University and other community representatives elected by the Foundation Board. Although the University does not necessarily control the timing or amount of receipts from the Foundation, the majority of its resources or income earned thereon are restricted by the donors to the activities of the University. Because these restricted resources held by the Foundation can be used only by, or for the benefit of, the University, the Foundation is considered a component unit of the University. The Foundation financial statements are reported on separate pages to emphasize that a) it is legally separate from the University and b) its assets are not necessarily available to satisfy all liabilities of the University. However, the Foundation's financial activities are summarized with those of the University in the notes to the financial statements.

Basis of Presentation

The accompanying University 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, *Accounting and Financial Reporting for Proprietary Funds and other Governmental Entities that Use Proprietary Fund Accounting*, 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 statements that focus on accountability of individual funds.

Governmental Accounting Standards Board Statement No. 39

Effective for the fiscal year ended June 30, 2004, the University adopted the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units,* which resulted in inclusion of the financial statements of the Lake Superior State University Foundation as a discretely presented component unit in the financial statements of the University.

The Foundation's financial statements are prepared in accordance with the accounting standards established by the Financial Accounting Standards Board and, accordingly, a reporting model different from that of the University is used.

Certain assets and liabilities of the Foundation were previously recorded in the University's financial statements. Adoption of Statement No. 39 resulted in the restatement of the 2003 financial statements to eliminate these Foundation amounts as follows:

Cash and cash equivalents	$ 921,384
Accounts receivable	336,923
Other assets	36
Other long-term investments	1,787,188
Accounts payable and accrued expenses	16,542
Employee benefits	18,357
Deposits	3,010,632

This restatement had no effect on the change in net assets or cash flows for 2003.

Contributions to the University by the Foundation (reported primarily as Other revenues-capital gifts and grants) have been made in the amount of $601,753 for fiscal 2004 and $533,065 for fiscal 2003. Support from the University provided to the Foundation amounted to $273,695 and $336,923 during fiscal 2004 and 2003, respectively.

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.

University Endowment Investments

University endowment investments consist primarily of long-term mutual funds and are stated at fair value.

Foundation Investments

Foundation investments consist primarily of intermediate and long-term mutual funds.

Inventories

Inventories, consisting primarily of bookstore materials (in fiscal 2003) and supplies and petroleum products, are valued at cost (using the specific identification method) not in excess of market.

During fiscal 2004, the University contracted with a third party to manage the operations of the campus bookstore. In contemplation of this outsourcing arrangement, the University sold most of the bookstore inventories by the end of fiscal 2004. The third party officially began managing the bookstore on July 1, 2004.

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 residence halls and certain other facilities.

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

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

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 2004 and 2003 the University received $13,136,854 and $11,676,308 (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 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 2004 and 2003, respectively.

The Foundation is also exempt from federal income taxes under Section 501(c) (3) and qualifies as a nonprofit foundation under Section 509 (a) (1) of the Internal Revenue Code. Accordingly, no provision for income taxes has been recorded in the financial statements.

Split-Interest Agreements

The Foundation's split-interest agreements with donors consist of irrevocable charitable remainder trusts for which the Foundation is a beneficiary. Contribution revenue was recognized at the date the trust was established based on the expected present value of the Foundation's interest in the trust assets. Changes in the value of the assets and other changes in the estimates of future receipts are recognized in the statement of activities of the Foundation.

Annuity Obligations Payable

The Foundation's annuity and life income agreements require payments during the life of the annuitant at various rates up to 7% of the principal amounts. The obligation for annuity obligations payable is reported at the present value of the future payments based on the life expectancy tables and an implied rate of discount of 5.8%. Changes in the value of annuity obligations payable are reported in the statement of activities of the Foundation.

2. CASH AND CASH EQUIVALENTS AND INVESTMENTS

Cash and Cash Equivalents

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

	2004	2003
Disbursement accounts (deposits)	$ 5,517,955	$ 2,197,125
Mutual funds	1,874,299	1,857,490
Equities	9,684	5,246
Total cash and cash equivalents	**$ 7,401,938**	**$ 4,059,861**

Foundation cash and cash equivalents of $849,684 and $921,384 at June 30, 2004 and 2003, respectively, consisted entirely of amounts in disbursement accounts (deposits).

All cash and cash equivalents, including those of the Foundation, are held in the University's name. The banks reported balances in the disbursement accounts of $584,730 and $521,157 at June 30, 2004 and 2003, respectively. Of these balances $100,000 was covered by federal depository insurance and $484,730 and $421,157, 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.

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 undo 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.

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 and Foundation utilize the "pooled" method of accounting for substantially all investments, which consisted of the following amounts at June 30:

University endowment investments	2004	2003
Mutual funds		
Equity funds	$ 1,449,907	$ 3,300,968
Bond/fixed income funds	4,368,261	1,232,273
Short-term funds	--	171,121
Total University endowment investments	**$ 5,818,168**	**$ 4,704,362**

Foundation investments	2004	2003
Mutual funds		
Equity funds	$ 757,083	$ 876,367
Bond/fixed income funds	2,282,702	678,247
Intermediate funds	--	226,581
Sub-total	3,039,785	1,781,195
Marketable securities	10,203	5,993
Total Foundation investments	**$ 3,049,988**	**$ 1,787,188**

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 marketable securities 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.

Investments, which include mutual funds classified as cash and cash equivalents for financial statement presentation, 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 for risk classification purposes as follows at June 30:

	Fair Value	
	2004	2003
University Investments		
Risk Category 3		
Equities	$ 9,684	$ 5,246
Unclassified as to risk		
Mutual funds	7,692,467	6,561,852

	Fair Value 2004	Fair Value 2003
Foundation Investments		
Risk Category 3		
Marketable securities	$ 10,203	$ 5,993
Unclassified as to risk		
Mutual funds	3,039,785	1,781,195

Policies regarding marketable securities in the University 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 University 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 $497,000 and $903,000 at June 30, 2004 and 2003, respectively. The net appreciation is a component of restricted, expendable net assets. The yields of the University endowment investments were as follows for the year ended June 30:

	2004	2003
Interest and dividends	1.0%	2.2%
Net realized and unrealized gains	13.2	0.3
Total return	**14.2%**	**2.5%**

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.

3. 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 $308,113 and $203,872 at June 30, 2004 and 2003, respectively.

University accounts receivable consist of the following net amounts at June 30:

	2004	2003
Tuition and fees	$ 240,311	$ 136,264
Auxiliary activities	204,622	143,228
Governmental grants and contracts	479,130	530,784
Private grants and contracts	8,806	35,502
Other	83,280	72,184
Accounts receivable, net	**$ 1,016,149**	**$ 917,962**

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:

	2004	2003
State appropriations - operations	$ 2,174,344	$ 2,451,626
State appropriations - other	845,721	--
Total state appropriations receivable	**$ 3,020,065**	**$ 2,451,626**

In addition, the University has student loans receivable, in the amount of $2,720,507 and $2,498,290, net of an allowance for uncollectible loans of $263,231 and $285,718 as of June 30, 2004 and 2003, respectively. Approximately 80% of student loans receivable are expected to be collected in periods beyond one year.

4. PROMISES RECEIVABLE

The following is a summary of promises receivable for the Foundation as of June 30:

	2004	2003
Total promises receivable	$ 486,707	$ 569,215
Less discounts to net present value at 8%	150,354	164,981
Present value of promises receivable	336,353	404,234
Less allowance for uncollectible amounts	12,171	14,512
Net promises receivable	**$ 324,182**	**$ 389,722**

5. CHARITABLE REMAINDER TRUST

A donor having a charitable remainder unitrust managed by a third party named the Foundation as the remainder beneficiary. Under the terms of the split-interest agreement, the third party trustee must pay to the donor in each taxable year of the trust during the donor's life the lesser of the trust income for the taxable year or five percent (5%) of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust. At the time of the donor's death, the trust is to terminate, and the remaining trust assets are to be distributed to the Foundation.

At June 30, 2004 and 2003 based on the donor's life expectancy and an assumed 5.8% discount rate, the present value of the future benefits expected to be received by the Foundation was estimated to be $193,468 and $175,541, respectively.

6. CAPITAL ASSETS

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

	2004			
	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004
Capital assets not being depreciated				
Land - restricted	$ 838,684	$ --	$ --	$ 838,684
Land	1,186,744	--	--	1,186,744
Construction-in-progress	6,959,088	7,793,733	--	14,752,821
Total capital assets not being depreciated	8,984,516	7,793,733	--	16,778,249
Capital assets being depreciated				
Land improvements	5,424,733	--	--	5,424,733
Infrastructure	1,339,981	3,667	--	1,343,648
Building and building improvements	97,735,772	105,333	--	97,841,105
Equipment and other	17,691,579	644,110	(652,314)	17,683,375
Total capital assets being depreciated	122,192,065	753,110	(652,314)	122,292,861
Less accumulated depreciation	(57,419,007)	(4,877,101)	605,344	(61,690,764)
Total capital assets being depreciated, net	64,773,058	(4,123,991)	(46,970)	60,602,097
Total capital assets, net	**$ 73,757,574**	**$ 3,669,742**	**$ (46,970)**	**$ 77,380,346**

	2003			
	Balance July 1, 2002	Additions	Reductions	Balance June 30, 2003
Capital assets not being depreciated				
Land - restricted	$ 838,684	$ --	$ --	$ 838,684
Land	1,186,744	--	--	1,186,744
Construction-in-progress	1,272,278	5,686,810	--	6,959,088
Total assets not being depreciated	3,297,706	5,686,810	--	8,984,516
Capital assets being depreciated				
Land improvements	5,429,233	--	(4,500)	5,424,733
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
Total capital assets being depreciated	122,546,761	830,683	(1,185,379)	122,192,065
Less accumulated depreciation	(53,200,142)	(4,975,664)	756,799	(57,419,007)
Total capital assets being depreciated, net	64,346,619	(4,144,981)	(428,580)	64,773,058
Total capital assets, net	**$ 72,644,325**	**$ 1,541,829**	**$ (428,580)**	**$ 73,757,574**

On November 10, 2003, the State of Michigan passed Enrolled House Bill No. 4386 in which the State's share of the capital outlay for the Fine and Performing Arts Center was increased from 50% to 75%. This action changed the amount the State would pay for the facility from $8,000,000 to $11,470,000, an increase of $3,470,000 and caused an equal amount of the bond proceeds from the General Revenue Bonds of 2001 to become available for other capital projects. On April 5, 2004, the Board of Trustees approved the use of the $3,470,000 of General Revenue Bond proceeds plus $730,000 of accumulated income on bond proceeds to fund three capital projects totaling $4,200,000. The Bond Trustee, U.S. Bank National Association, was notified of the change in project scope on June 16, 2004. The three projects are Banner Software Implementation, $2,400,000; Network Fiber Upgrade and Expansion, $1,400,000; and Electrical Loop Upgrade, $400,000.

At June 30, 2004, construction-in-progress consists primarily of work completed on the design and construction of the Fine and Performing Arts Center. Although the construction of the Fine and Performing Arts Center is substantially complete, no furnishings have been purchased and the University does not expect to place the building into service until fall of 2005. Therefore, the project is included in construction-in-progress at June 30, 2004. In addition to the main projects funded through the General Revenue Bonds of 2001, the three capital projects described above were begun in the summer of 2004.

Construction-in-progress

Estimated cost of construction	$ 20,424,648
Costs incurred through June 30, 2004	14,752,821
Estimated cost to complete	**$ 5,671,827**
Expected sources of financing:	
State funds	$ 1,202,591
University funds and other sources	4,469,236
Total	**$ 5,671,827**

7. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

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

	2004	2003
Accounts payable to vendors	$ 1,247,189	$ 1,597,490
Payroll and payroll taxes	785,698	699,670
Interest	196,407	200,480
Workers' compensation claims	383,927	180,000
Total accounts payable and accrued expenses	**$ 2,613,221**	**$ 2,677,640**

Worker's Compensation

The University is self-insured for workers' compensation claims up to $500,000 per claim for the years ended June 30, 2003 and thereafter. The accrued workers' compensation obligation represents claims made prior to June 30, 2004 and 2003, 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:

	2004	2003
Claims liability at beginning of year	$ 180,000	$ 165,000
Claims and damages incurred	470,104	193,717
Claims payments	(266,177)	(178,717)
Claims liability at end of year	**$ 383,927**	**$ 180,000**

8. LONG TERM DEBT

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

2004

			Outstanding Principal				
	Interest Rate	Maturity	July 1 2003	Additions	Reductions	June 30 2004	Current Portion
Bonds payable							
General Revenue Bonds, Series 2001							
Series bonds	4.00%-5.00%	2005-2016	$ 5,065,000	$ --	$ 270,000	$ 4,795,000	$ 285,000
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%	2005-2008	3,385,000	--	495,000	2,890,000	520,000
Term bonds	5.18%-5.35%	2012-2019	6,805,000	--	--	6,805,000	--
Total –bonds payable			**31,780,000**	**--**	**765,000**	**31,015,000**	**805,000**
Capital leases			205,819	59,789	93,059	172,549	97,255
Total – long term debt			**$ 31,985,819**	**$ 59,789**	**$ 858,059**	**$ 31,187,549**	**$ 902,255**
Less current portion						902,255	
Long term debt, net of current portion						**$ 30,285,294**	

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	4.30%-5.00%	2004-2008	3,860,000	--	475,000	3,385,000	495,000
Term bonds	5.18%-5.35%	2012-2019	6,805,000	--	--	6,805,000	--
Total –bonds payable			**32,515,000**	**--**	**735,000**	**31,780,000**	**765,000**
Capital leases			307,918	--	102,099	205,819	81,897
Total – long term debt			**$ 32,822,918**	**$ --**	**$ 837,099**	**$ 31,985,819**	**$ 846,897**
Less current portion						846,897	
Long term debt, net of current portion						**$ 31,138,922**	

Bonded Debt

General Revenue Bonds, Series 2001

Bonds payable in the amount of $21,320,000 are payable from general revenues and consist of $4,795,000 in serial bonds maturing in varying amounts through November 2016, with interest charged at annual rates ranging from 4% to 5%. In addition four term bonds are 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. 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 $9,695,000 are payable from general revenues and consist of $2,890,000 in serial bonds maturing in varying amounts through November 2008, with interest charged at annual rates ranging from 4.4% to 5%. In addition two term bonds are 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. 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:

Year ended June 30	Principal	Interest	Total
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	955,000	1,390,628	2,345,628
2010-2014	5,525,000	6,200,682	11,725,682
2015-2019	5,320,000	4,756,250	10,076,250
2020-2024	5,135,000	3,422,192	8,557,192
2025-2029	6,125,000	2,006,813	8,131,813
2030-2031	4,485,000	361,070	4,846,070
Total – bonds payable	**$31,015,000**	**$24,116,732**	**$55,131,732**

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 outstanding balance for these defeased bonds was $7,115,000 and $7,480,000 as of June 30, 2004 and 2003, 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 $4,235,000 and $4,470,000 at June 30, 2004 and 2003, respectively.

Obligations Under Capital Leases

The University leases certain equipment with a net book value of $521,326 at June 30, 2004 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, 2004:

Year ended June 30	**Amount**
2005	$ 105,495
2006	52,231
2007	14,184
2008	14,184
Total minimum payments due	186,094
Less amounts representing interest, imputed at annual rates ranging from 3.7% to 5.8%	13,545
Present value of net minimum lease payments	**$ 172,549**

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, 2004 and 2003 are insignificant.

Interest expense on all borrowed debt was $1,596,223 and $1,630,705 for the years ended June 30, 2004 and 2003, respectively.

9. 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 (MPSERS). MPSERS 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 MPSERS plan will continue to remain in that plan. The University will contribute to MPSERS the percentage mandated by state statute of their eligible wages.

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. The University contributed approximately $1,221,000 and $1,323,000 for the years ended June 30, 2004 and 2003, respectively. Plan participants maintain individual annuity contracts with TIAA-CREF, the plan administrator, which are fully vested. 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 $974,000, $1,075,000 and $971,000, for the years ended June 30, 2004, 2003 and 2002, respectively, all of which was contributed during the applicable year.

Beginning October 1, 2004 the University is required to contribute 6.52 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 $729,585. 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.

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, 2004 and 2003, the requirements of several deferred compensation agreements had been satisfied. The liability, which is all classified as current, is $9,749 and $13,312 at June 30, 2004 and 2003, respectively.

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, 2004, one employee opted out of the program, which reduced the previously recorded liability by $63,492. 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, 2004 and 2003, respectively, amounted to $199,387 and $225,284 to reduce the liability and $31,039 and $56,087 which was recorded as additional salary expense.

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

	2004				
	July 1 2003	**Additions**	**Payments**	**June 30 2004**	**Current Portion**
Compensated absences	$ 673,411	$ 47,048	$ 86,851	$ 633,608	$ 80,000
Accumulated sick leave benefits	612,440	142,000	150,361	604,079	100,000
Deferred compensation	13,312	4,826	8,389	9,749	9,749
Early retirement severance program	840,517	--	231,840	608,677	194,000
Total-employee benefit programs	**$ 2,139,680**	**$ 193,874**	**$ 477,441**	**$ 1,856,113**	**$ 383,749**

	2003				
	July 1 2002	Additions	Payments	June 30 2003	Current Portion
Compensated absences	$ 707,492	$ 53,284	$ 87,365	$ 673,411	$ 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	974,142	91,659	225,284	840,517	235,000
Total-employee benefit programs	**$ 2,429,784**	**$ 296,008**	**$ 586,112**	**$ 2,139,680**	**$ 428,312**

10. 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 $1,135,132 and $1,084,399 at June 30, 2004 and 2003, respectively. The workers' compensation claims liability of $383,927 and $180,000 at June 30, 2004 and 2003, 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.

11. CONTINGENCIES AND COMMITMENTS

Union Contracts

The University has three groups of employees, two of which are covered under union collective bargaining agreements. The collective bargaining agreement covering the Educational Support Personnel expired on August 31, 2003. A successor agreement is being negotiated, but has not been finalized. The employee groups covered and the expiration of the contracts are as follows:

Employee Group	Union Name	Contract Expires
Educational Support Personnel	Michigan Education Association/ National Education Association	Expired
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.

MPSERS Unfunded Liability

Certain employees of the University are covered under the MPSERS retirement plan. As of June 30, 2004 and 2003 the unfunded portion of the related pension benefits is significant. The University's portion of this obligation is not determinable at June 30, 2004 or 2003. 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 for the University are summarized as follows for the year ended June 30:

2004

	Salaries, Wages, Benefits	Supplies and Equipment	Utilities	Scholarship Expenses	Depreciation	Other	Total
Instruction	$ 11,461,974	$1,002,775	$ --	$ --	$ --	$ --	$ 12,464,749
Research	228,933	125,424	--	--	--	--	354,357
Public service	417,186	336,349	--	--	--	--	753,535
Academic support	1,930,207	416,470	--	--	--	--	2,346,677
Student service	1,408,589	333,878	--	--	--	--	1,742,467
Student aid	--	--	--	1,533,085	--	--	1,533,085
Institution support	3,124,397	1,539,016	--	--	--	--	4,663,413
Plant operations	2,046,681	317,184	1,176,857	--	--	--	3,540,722
Auxiliary activities	3,768,071	4,548,200	949,326	--	--	--	9,265,597
Depreciation	--	--	--	--	4,877,101	--	4,877,101
Other	--	--	--	--	--	396,894	396,894
Total operating expenses	**$ 24,386,038**	**$8,619,296**	**$2,126,183**	**$1,533,085**	**$4,877,101**	**$396,894**	**$ 41,938,597**

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**

13. SUBSEQUENT EVENTS

In August 2004, the University received and installed a new telephone switch to control and administer telephone traffic across the campus. This phone switch will be financed through a capital lease that calls for monthly principal and interest payments of $4,637 through August 2011.

In July 2004, the University entered into a service agreement with SCT Corporation. This agreement secures training, consulting and implementation assistance for the conversion of the University's administrative software system from the current SCT IA+ system to the SCT Banner system. The service agreement requires payments totaling $1,453,162 through December 2006.

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