LAKE SUPERIOR STATE UNIVERSITY

ANNUAL FINANCIAL REPORT

FISCAL YEARS ENDED
JUNE 30, 2005 AND 2004

LAKE SUPERIOR STATE UNIVERSITY

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Management's Discussion and Analysis
Fiscal Year Ended June 30, 2005

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, 2005 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.* The accompanying 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		
	2005	**2004**	**2003**
Assets:			
Current assets	$10,099,022	$11,922,986	$ 8,843,430
Capital assets	76,531,442	77,380,346	73,757,574
Other noncurrent assets	9,745,363	8,538,675	7,202,652
Total Assets	**$96,375,827**	**$97,842,007**	**$89,803,656**
Liabilities:			
Current liabilities	$ 3,936,250	$ 4,886,497	$ 4,942,209
Noncurrent liabilities	31,883,735	31,757,658	32,850,290
Total Liabilities	35,819,985	36,644,155	37,792,499
Net Assets:			
Invested in capital assets, net of related debt	48,177,482	50,543,709	43,639,991
Restricted, nonexpendable	205,327	205,327	205,327
Restricted, expendable	11,091,742	9,856,894	8,660,903
Unrestricted, undesignated (deficit)	1,081,291	591,922	(495,064)
Total Net Assets	60,555,842	61,197,852	52,011,157
Total Liabilities and Net Assets	**$96,375,827**	**$97,842,007**	**$89,803,656**

Total current assets decreased by $1.8 million. This decrease is a result of a decrease in cash reserves of $1.1 million that have been held for the financing of several capital projects. During fiscal 2005, the University progressed with the implementation of a new administrative software system and upgrades to the University computer network infrastructure. Receivables from the State of Michigan decreased by $500,000 as reimbursements to the University for construction costs on the Fine Arts Building have declined significantly as this project approaches final completion. Inventories decreased by $100,000 as the University eliminated the final inventories of the campus bookstore. The management and operations of the bookstore were contracted to a third party effective July 1, 2004.

Capital assets decreased by $800,000 as a result of the annual depreciation charge of $4.4 million exceeding the value of new assets of $3.6 million.

Other noncurrent assets increased by $1.2 million. This is due to proceeds of $839,000 from an interest rate swap transaction being deposited in a diversified investment portfolio. The proceeds of this investment will be used to contribute to debt service payments in future years. Also an increase of $400,000 to the University endowment investment portfolio is a result of additional contributions and portfolio earnings.

Total liabilities decreased by $800,000 primarily as a result of a $900,000 decrease of accounts payable. Due to the implementation of the finance module of the University's new administrative software system, purchasing activity for fiscal year 2005 was virtually terminated in mid-May. This meant that purchasing normally done in June, and payable at June 30, was completed in May, thus eliminating much of the accounts payable at June 30, 2005. Although noncurrent liabilities increased by only $100,000, the long-term portion of bond debt was reduced by $700,000 and the University has recorded an interest rate swap liability of $800,000 (see the related footnote on page 31 of the financial statements).

Total net assets decreased by $600,000. The University's net investment in capital assets decreased by $2.4 million. Restricted, expendable scholarship net assets increased by $600,000, capital projects and debt service net assets increased by $500,000 and unrestricted reserves increased by $500,000. The June 30, 2005 unrestricted reserves of $1,081,000 consist of designated fund reserves of $451,000, auxiliary fund reserves of $183,000, insurance and benefit reserves of $1.56 million and a general fund deficit of $1.11 million.

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

	Year Ended June 30		
	2005	**2004**	**2003**
Total operating revenues	$26,067,559	$28,798,636	$26,132,049
Total operating expenses	39,560,111	41,938,597	43,499,008
Operating loss	(13,492,552)	(13,139,961)	(17,366,959)
Net nonoperating revenues	11,787,531	11,605,549	12,397,793
Loss before other revenues	(1,705,021)	(1,534,412)	(4,969,166)
Total other revenues	1,063,011	10,721,107	558,508
(Decrease) increase in net assets	**(642,010)**	**9,186,695**	**(4,410,658)**
Net assets, beginning of year	61,197,852	52,011,157	56,421,815
Net assets, end of year	**$60,555,842**	**$61,197,852**	**$52,011,157**

Operating revenues decreased by $2.7 million. The most significant change is a $1.9 million decrease in auxiliary revenues. This is due to the University no longer operating the campus bookstore. Operations of the bookstore were contracted to a third party effective July 1, 2004. A $700,000 decrease in tuition and fees is the result of lower enrollments for fiscal year 2005.

Operating expenses decreased overall by $2.4 million. Again this is a result of outsourcing of bookstore operations. This alone reduced operating expenses by $2.0 million. There were three new administrative positions added during fiscal year 2005 which are considered vital to the growth of the University. These positions were Dean of Enrollment Management, Webmaster and Director of Public Safety. Again in fiscal year 2005, operational spending was tightly controlled and departmental managers underspent their allotted supply budgets by $200,000.

Nonoperating and Other revenues decreased a total of $9.5 million. Capital appropriations decreased by $9.8 million due to the absence of major construction funded by the State of Michigan. After initial appropriations, executive order appropriations reductions, supplemental appropriations and restoration of executive order reductions, State appropriations for fiscal year 2005 did increase by $200,000.

Lake Superior State University
Condensed Statements of Cash Flows

	Year Ended June 30		
	2005	**2004**	**2003**
Cash provided by (used in):			
Operating activities	$(9,814,357)	$(7,972,715)	$(12,527,705)
Noncapital financing activities	12,779,744	12,723,262	13,882,838
Capital and related financing activities	(3,531,175)	(1,113,850)	(7,918,560)
Investing activities	(565,799)	(294,620)	8,343,862
Net change in cash and cash equivalents	(1,131,587)	3,342,077	1,780,435
Cash and cash equivalents, beginning of year	7,401,938	4,059,861	2,279,426
Cash and cash equivalents, end of year	**$ 6,270,351**	**$ 7,401,938**	**$ 4,059,861**

Cash and cash equivalents decreased by $1.1 million for the year ended June 30, 2005. Cash used in operations increased by $1.8 million. This is a result of cash received from operations (tuition, grants, and auxiliary activities) decreasing by $2.7 million and cash used for operations (payments to employees and vendors) decreasing by $700,000. Fluctuations of cash flows in financing and investing activities are the result of capital project costs on the administrative software and the network infrastructure projects which are not funded with capital appropriations.

A Year in Review…A Look Ahead

During fiscal year 2004-2005, the University saw a continued need to focus on spending controls while maintaining high quality academic programs. Management continued to review all University operations for potential cost reductions and cost avoidance opportunities. As a result, the combined fund balances of the University's general fund, designated funds, auxiliary funds and plant reserve funds increased by $950,000. Management continues to make progress toward the elimination of deficit fund balances in all funds.

Enrollment declined in Fall 2004. Headcount enrollment declined 11.3% or 367 students. Full-time equivalent enrollment decreased by 8.0% or 218 students. Elimination of the off-campus Skilled Trades Program and three on-campus degree programs played a role in the declining enrollment. The University had fewer students, but on-campus students were enrolled in more credit hours. This increased institutional operating efficiencies.

The Higher Education Appropriations Bill for fiscal year 2004-2005 mandated that Michigan universities limit tuition increases to 2.8%. Unfortunately, the specifics of the Bill were not known until after the Board of Trustees of Lake Superior State University approved a tuition rate increase of 2.4%. In exchange for the cap on tuition increases, the State promised not to make further reductions to university appropriations during the fiscal year 2004-2005. However, in February 2005, the governor issued an executive order that once again cut higher education appropriations. The 2005 executive order cut came with the promise to restore this reduction should the State revenues surpass the February 2005 projections. As of August 2005, 55% of this executive order reduction had been restored. Additional restoration may occur in Fall 2005.

Reduced tuition revenues and stagnate State appropriations have placed a great burden on the University. Increases in health care costs, utility costs, and the expenses associated with the MPSERS retirement program have made it necessary to further reduce other operating costs. These reductions have come primarily from a salary freeze and continued deferred maintenance. The University is engaged in negotiations with its two employee unions and is attempting to negotiate a sharing of escalating health care costs.

On April 5, 2005, the University entered into a basis rate swap transaction with Piper Jaffray Financial Products (PJFP). However, the swap does not become effective until May 2008. The elements of this transaction state that, LSSU will pay PJFP at the Bond Market Association (BMA) interest rate and PJFP will pay to LSSU sixty-eight percent of the London Inter Bank Offer Rate (LIBOR). The payments, to be made monthly, will be calculated on the notional amount of University bonds outstanding at the end of each month. The initial notional amount of this transaction in May 2008 will be $20,115,000. The BMA rate and 68% of LIBOR rate have a thirty-five year history that shows the BMA to LIBOR relationship, and it is expected that over the life of this basis rate swap (which terminates in May 2031) the monthly differences between these rates swaps will be minimal. Because the University entered into this agreement in 2005, with a future effective date of May 2008, the University received a lump sum cash distribution from PJFP in the amount of $839,000. Under direction from the Board of Trustees of the University, this cash was placed into a diversified investment portfolio. The fair market value of the portfolio will be liquidated over the life of the swap agreement (2008-2031) and the liquidated proceeds will be used to pay for debt service payments. If this swap agreement were to be terminated by the University prior to May 2008, the University would be liable for a termination payment which could be greater than the proceeds already received (see the related footnote on page 31 of the financial statements).

Looking forward into fiscal year 2005-2006, the University will officially open the new Fine and Performing Arts Center. The Arts Center will be used for faculty offices and academic classrooms. In its inaugural season, the Arts Center will host several concerts, lectures, and other presentations and performances. South, East, and Brown Halls have been vacated.

State appropriations for higher education are expected to remain near the fiscal year 2004-2005 level. There has been much discussion in the Michigan legislature about formula funding based on student enrollment, number of degrees offered, and research activities. At this time, management does not have final information concerning 2005-06 State appropriations. Tuition rates at Lake Superior State University, as well as all other Michigan universities, are likely to rise at levels higher than in past years to compensate for little or no growth in State funding.

The University will also continue to review academic programs. The University will add programs that will benefit current and future students, provided that they are cost effective. Likewise, management will continue to evaluate low-enrollment programs to measure viability and/or ways to increase enrollment.

In an effort to increase enrollment, the University reorganized the offices of Admissions, Registrar and Financial Aid into a combined Enrollment Management unit. Under the guidance of a Dean of Enrollment Management, policies, procedures and practices are continually studied, reviewed and revised. Specifically, the University will continue to enhance its presence in the State of Michigan through increased staff visits to high schools, advanced use of technology in recruiting, and advertising in markets with high concentrations of high school students. There is also a strong commitment to recruit transfer students from regional community colleges.

In summary, Lake Superior State University continues to be a viable alternative in higher education. LSSU is the only university in Michigan that provides public education in a learning environment that is similar to private institutions. Through the dedication and determination of its dedicated faculty and staff, the University will continue to provide a high quality educational experience for its students.

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INDEPENDENT AUDITORS' REPORT

September 9, 2005

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, 2005 and 2004 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, 2005 and 2004 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 2005 the University adopted the provisions of the Governmental Accounting Standards Board ("GASB") Statement No. 40, *Deposit and Investment Risk Disclosures*. This pronouncement requires the disclosure of credit risk, custodial credit risk, interest rate risk, concentration of credit risk, the University's investment policy and various additional information.

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.

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In accordance with *Government Auditing Standards*, we have also issued under separate cover our report dated September 9, 2005, on our consideration of Lake Superior State University's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. 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 considered in assessing the results of our audits.

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	**2005**	**2004**
Current assets		
Cash and cash equivalents	$ 6,270,351	$ 7,401,938
Accounts receivable, net	1,015,436	1,016,149
State appropriations receivable	2,501,861	3,020,065
Inventories	269,309	398,239
Other	42,065	86,595
Total current assets	**10,099,022**	**11,922,986**
Noncurrent assets		
Student loans receivable, net	2,638,767	2,720,507
Investments	847,761	-
Endowment investments	6,258,835	5,818,168
Land and construction in progress	19,297,898	16,778,249
Depreciable capital assets, net	57,233,544	60,602,097
Total noncurrent assets	**86,276,805**	**85,919,021**
Total assets	**$ 96,375,827**	**$ 97,842,007**
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	$ 1,746,077	$ 2,613,221
Deferred revenue	818,094	853,317
Deposits	105,229	133,955
Current portion of long-term debt	961,035	902,255
Current portion of employee benefit programs	305,815	383,749
Total current liabilities	**3,936,250**	**4,886,497**
Interest rate swap liability	839,000	-
Long-term debt, net of current portion	29,615,954	30,285,294
Employee benefit programs, net of current portion	1,428,781	1,472,364
Total liabilities	**35,819,985**	**36,644,155**
Net assets		
Invested in capital assets, net of related debt	48,177,482	50,543,709
Restricted		
Nonexpendable		
Scholarships and research	205,327	205,327
Expendable		
Scholarships and research	6,643,002	5,995,686
Loans	3,132,576	3,010,530
Capital projects and debt service	1,316,164	850,678
Unrestricted	1,081,291	591,922
Total net assets	**60,555,842**	**61,197,852**
Total liabilities and net assets	**$ 96,375,827**	**$ 97,842,007**

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	
	2005	**2004**
Operating revenues		
Tuition and fees (net of scholarship allowances of $4,220,065 and $4,275,159 in 2005 and 2004, respectively)	$ 11,255,142	$ 11,921,362
Federal grants and contracts	4,277,045	4,220,458
State grants and contracts	221,368	227,644
Nongovernmental grants and contracts	1,813,355	2,064,045
Auxiliary activities	7,715,825	9,630,194
Other	784,824	734,933
Total operating revenues	**26,067,559**	**28,798,636**
Operating expenses		
Instruction	12,118,631	12,464,749
Research	450,589	354,357
Public service	742,806	753,535
Academic support	2,378,092	2,346,677
Student services	1,879,369	1,742,467
Student aid	1,620,258	1,533,085
Institutional support	4,331,140	4,663,413
Operation and maintenance of plant	3,907,421	3,540,722
Auxiliary activities	7,305,808	9,265,597
Depreciation	4,486,318	4,877,101
Other	339,679	396,894
Total operating expenses	**39,560,111**	**41,938,597**
Operating loss	**(13,492,552)**	**(13,139,961)**
Nonoperating revenues (expenses)		
State appropriations	12,631,309	12,429,555
Interest on capital debt and leases	(1,571,912)	(1,596,223)
Investment income, net of investment expenses	722,629	819,186
Gain (loss) on assets sold or retired	5,505	(46,969)
Net nonoperating revenues	**11,787,531**	**11,605,549**
Loss before other revenues	**(1,705,021)**	**(1,534,412)**
Other revenues		
Capital grants and gifts	469,270	432,273
Additions to expendable endowments	180,153	16,425
Capital appropriations	413,588	10,272,409
Total other revenues	**1,063,011**	**10,721,107**
(Decrease) Increase in net assets	**(642,010)**	**9,186,695**
Net assets, beginning of year	61,197,852	52,011,157
Net assets, end of year	**$ 60,555,842**	**$ 61,197,852**

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

LAKE SUPERIOR STATE UNIVERSITY

STATEMENTS OF CASH FLOWS

	Year Ended June 30	
	2005	**2004**
Cash flows from operating activities		
Tuition and fees	$ 11,229,376	$ 11,767,768
Grants and contracts	6,260,168	6,651,767
Payments to employees	(23,469,866)	(24,583,576)
Payments to vendors	(10,794,520)	(10,359,601)
Payments for financial aid	(1,620,258)	(1,533,085)
Loans issued to students	(686,239)	(762,868)
Collections of interest and principal on loans to students	767,979	540,651
Auxiliary activities	7,755,086	9,585,854
Other receipts	743,917	720,375
Net cash used in operating activities	**(9,814,357)**	**(7,972,715)**
Cash flows from noncapital financing activities		
State appropriations	12,599,591	12,706,837
Gifts for endowments	180,153	16,425
Federal Direct Lending receipts	8,834,062	8,617,636
Federal Direct Lending disbursements	(8,834,062)	(8,617,636)
Net cash provided by noncapital financing activities	**12,779,744**	**12,723,262**
Cash flows from capital and related financing activities		
Capital appropriations	963,510	9,426,688
Capital grants and gifts received	407,746	367,327
Purchases and construction of capital assets	(3,302,797)	(8,449,509)
Proceeds from interest rate swap transaction	839,000	-
Proceeds from disposal of capital assets	76,708	-
Principal paid on capital debt and leases	(939,080)	(858,059)
Interest paid on capital debt and leases	(1,576,262)	(1,600,296)
Net cash used in capital and related financing activities	**(3,531,175)**	**(1,113,850)**
Cash flows from investing activities		
Proceeds from sales and maturities of investments	453,269	4,933,094
Purchases of investments	(1,335,016)	(5,348,347)
Interest on investments	315,948	120,633
Net cash used in investing activities	**(565,799)**	**(294,620)**
Net (decrease) increase in cash and cash equivalents	(1,131,587)	3,342,077
Cash and cash equivalents, beginning of year	7,401,938	4,059,861
Cash and cash equivalents, end of year	**$ 6,270,351**	**$ 7,401,938**

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

LAKE SUPERIOR STATE UNIVERSITY

STATEMENTS OF CASH FLOWS
(Concluded)

	Year Ended June 30	
Reconciliation of net operating loss to net cash used in operating activities	**2005**	**2004**
Operating loss	$ (13,492,552)	$ (13,139,961)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation	4,486,318	4,877,101
Change in assets and liabilities:		
Accounts receivable, net	(15,063)	(70,784)
Student loans receivable, net	81,740	(222,217)
Inventories	128,930	620,392
Other	44,530	308,755
Accounts payable and accrued liabilities	(862,794)	(60,346)
Deferred revenue	(35,223)	28,777
Deposits	(28,726)	(30,865)
Employee benefit programs	(121,517)	(283,567)
Net cash used in operating activities	**$ (9,814,357)**	**$ (7,972,715)**
Supplemental disclosures of non-cash financing and investing activities		
Gifts in-kind received and recorded as capital assets	$ 77,300	$ 37,543
Acquisition of capital equipment financed by capital lease	$ 328,520	$ 59,789

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

LAKE SUPERIOR STATE UNIVERSITY FOUNDATION

STATEMENTS OF NET ASSETS

	June 30	
	2005	2004
Assets		
Cash and cash equivalents	$ 1,245,765	$ 849,684
Investments	3,411,343	3,049,988
Deferred charges	37	-
Unconditional promises to give, net	240,904	324,182
Beneficial interest in charitable remainder trust	229,623	193,468
Total assets	**$ 5,127,672**	**$ 4,417,322**
Liabilities		
Accounts payable and accrued expenses	$ 19,791	$ 13,962
Employee benefit programs	22,342	18,231
Annuity obligations	70,093	111,703
Total liabilities	112,226	143,896
Net assets		
Unrestricted	53,856	29,992
Temporarily restricted	1,220,916	943,512
Permanently restricted	3,740,674	3,299,922
Total net assets	**5,015,446**	**4,273,426**
Total liabilities and net assets	**$ 5,127,672**	**$ 4,417,322**

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

LAKE SUPERIOR STATE UNIVERSITY FOUNDATION

STATEMENTS OF ACTIVITIES

	Year Ended June 30	
	2005	2004
Revenue and support		
Contributions	$ 1,242,639	$ 1,512,656
Investment income	148,031	198,964
Net unrealized gains on investments	132,441	73,904
Change in value of split interest agreements	77,765	49,728
Total revenue and support	**1,600,876**	**1,835,252**
LSSU distributions and expenses		
Distributions to Lake Superior State University	496,006	601,753
Operating expenses	362,850	407,876
Total LSSU distributions and expenses	**858,856**	**1,009,629**
Change in net assets	**742,020**	**825,623**
Net assets, beginning of year	4,273,426	3,447,803
Net assets, end of year	**$ 5,015,446**	**$ 4,273,426**

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 position and 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.

Contributions to the University by the Foundation (reported primarily as Other revenues-capital gifts and grants) have been made in the amount of $496,006 for fiscal 2005 and $601,753 for fiscal 2004. Support from the University provided to the Foundation amounted to $274,546 and $273,695 during fiscal 2005 and 2004, respectively.

Governmental Accounting Standards Board Statement No. 40

Effective for the fiscal year ended June 30, 2005, the University adopted the provisions of the GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures*. This statement is an amendment of the GASB Statement No. 3, which classified deposits and investments into three categories of custodial credit risk.

This Statement addresses the common deposit and investment risks related to credit risk, concentration of credit risk, interest risk, and foreign currency risk. As an element of interest rate risk, this Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates.

This Statement is designed to inform financial statement users about deposit and investment risks that could affect the University's ability to provide services and meet its obligations as they become due. The Board of Trustees believes that there are risks inherent in all deposits and investments, and it believes that the disclosures required by this Statement provide users of the University's financial statements with information to assess common risks inherent in deposit and investment transactions.

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 / Investments

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

Foundation Investments

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

Inventories

Inventories, consisting primarily of 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 and the balance of remaining inventories in fiscal year 2005. 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 2005 and 2004 the University received $14,914,236 and $13,136,854 (net of a 3% administrative fee retained by the University), respectively, of State appropriations which were forwarded to seven charter schools. The University also received $100,000 in State appropriations for Bay Mills Community College during fiscal 2005 which were forwarded to Bay Mills Community College immediately upon receipt. Appropriations received and related disbursements passed on to the charter schools and Bay Mills Community College 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 either fiscal year 2005 or 2004.

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 accompanying 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 - UNIVERSITY

Cash and short-term investments - 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.

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.

Reports are submitted to the Board of Trustees on an annual basis to ensure compliance with the prescribed policy.

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.

Cash and Cash Equivalents

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

	2005	2004
Disbursement accounts (deposits)	$ 4,325,591	$ 5,517,955
Money market funds	1,930,733	1,874,299
Equities	14,027	9,684
Total cash and cash equivalents	**$ 6,270,351**	**$ 7,401,938**

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

	2005	2004
University endowment investments		
Mutual funds		
Equity funds	$ 4,699,755	$ 4,368,261
Bond/fixed income funds	1,559,080	1,449,907
Total University endowment investments	6,258,835	5,818,168
University investments		
Mutual funds		
Money market funds	126,414	--
Equity funds	508,891	--
Bond/fixed income funds	212,456	--
Total University investments	847,761	--
Total investments	**$ 7,106,596**	**$ 5,818,168**

Interest Rate Risk – The University's investment policy does not limit investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The maturity dates for each investment is identified below for investments held at year end.

As of June 30, 2005, the University had the following debt investments and maturities:

		Maturities (in Years)		
	Fair Market Value	Less Than 1	1-5	6-10
Government money market funds	$ 126,414	$ 126,414	$ -	$ -
Mutual bond funds	1,771,536	-	-	1,771,536
Total investments	**$ 1,897,950**	**$ 126,414**	**$ -**	**$1,771,536**

Credit Risk - State law limits investments to specific government securities, certificates of deposits and bank accounts with qualified financial institutions, commercial paper with specific maximum maturities and ratings when purchased and qualified mutual funds. The University's investment policy does not have specific limits in excess of state law on investment credit risk.

Custodial Credit Risk – Deposits - Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned. State law does not require a policy for deposit custodial credit risk. 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. As of year-end, $1,038,215 of the University's bank balance of $1,138,215 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Custodial Credit Risk – Investments - For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. State law does not require and the University does not have a policy for investment custodial credit risk. Custodial credit risk for the University's mutual fund investments cannot be determined as these investments are not evidenced by specifically identifiable securities.

Concentration of Credit Risk - State law limits allowable investments but does not limit concentration of credit risk. The University's investment policy does not have specific limits in excess of state law on concentration of credit risk. None of the investments held by the University exceeds 5 percent of the University's investments.

Foreign Currency Risk – The University's exposure to foreign currency risk is derived from its positions in international investments consisting solely of foreign currency denominated mutual fund equity investments. The University's investment policy permits it to invest in these asset types. At June 30, 2005 the University held 28,066 units of the EuroPacific Growth Fund Class F (Security identifier: AEGFX) with a fair value of $1,004,491. The University holds no other assets which may be subject to the risks of foreign currency.

There is no foreign currency risk with any holdings under the caption "cash and cash equivalents" in the accompanying statements of net assets and all international investments are equity investments held through mutual funds.

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 $736,000 and $497,000 at June 30, 2005 and 2004, 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:

	2005	**2004**
Interest and dividends	1.7 %	1.0%
Net realized and unrealized gains	6.7	13.2
Total return	**8.4%**	**14.2%**

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. INVESTMENTS - FOUNDATION

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

	2005	2004
Mutual funds		
Money market funds	$ 100,067	$ --
Equity funds	2,487,239	2,282,702
Bond/fixed income funds	813,812	757,083
Sub-total	3,401,118	3,039,785
Marketable securities	10,225	10,203
Total Foundation investments	**$ 3,411,343**	**$ 3,049,988**

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 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 $361,186 and $308,113 at June 30, 2005 and 2004, respectively.

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

	2005	2004
Tuition and fees	$ 257,246	$ 240,311
Auxiliary activities	129,899	204,622
Governmental grants and contracts	544,932	479,130
Private grants and contracts	3,674	8,806
Other	79,685	83,280
Accounts receivable, net	**$ 1,015,436**	**$ 1,016,149**

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:

	2005	2004
State appropriations - operations	$ 2,206,062	$ 2,174,344
State appropriations - other	295,799	845,721
Total State appropriations receivable	**$ 2,501,861**	**$ 3,020,065**

In addition, the University has student loans receivable, in the amount of $2,638,767 and $2,720,507, net of an allowance for uncollectible loans of $265,534 and $263,231 as of June 30, 2005 and 2004, respectively. Approximately 80% of student loans receivable are expected to be collected in periods beyond one year.

5. PROMISES RECEIVABLE

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

	2005	2004
Total promises receivable	$ 389,889	$ 486,707
Less discounts to net present value at 8%	132,277	150,354
Present value of promises receivable	257,612	336,353
Less allowance for uncollectible amounts	16,708	12,171
Net promises receivable	**$ 240,904**	**$ 324,182**

6. 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, 2005 and 2004 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 $229,623 and $193,468, respectively.

7. CAPITAL ASSETS

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

	2005			
	Balance July 1, 2004	**Additions**	**Reductions**	**Balance June 30, 2005**
Capital assets not being depreciated				
Land - restricted	$ 838,684	$ --	$ --	$ 838,684
Land	1,186,744	--	(22,100)	1,164,644
Construction-in-progress	14,752,821	2,541,749	--	17,294,570
Total capital assets not being depreciated	16,778,249	2,541,749	22,100	19,297,898
Capital assets being depreciated				
Land improvements	5,424,733	--	--	5,424,733
Infrastructure	1,343,648	21,240	--	1,364,888
Building and building improvements	97,841,105	94,987	(15,000)	97,921,092
Equipment and other	17,683,375	1,050,641	(504,494)	18,229,522
Total capital assets being depreciated	122,292,861	1,166,868	(519,494)	122,940,235
Less accumulated depreciation	(61,690,764)	(4,486,318)	470,391	(65,706,691)
Total capital assets being depreciated, net	60,602,097	(3,319,450)	(49,103)	57,233,544
Total capital assets, net	**$ 77,380,346**	**$ (777,701)**	**$ (71,203)**	**$ 76,531,442**

	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**

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.

During the fiscal year ended June 30, 2005, some minor reallocations were made among the approved projects and, in addition, subsequent earnings on project funds were also allocated. Capital funds in the amount of $163,100 from the State of Michigan are expected in the 2005-2006 fiscal year and are planned for the electrical loop project.

The three capital projects consist of:

Project	Amount	Anticipated Completion
Banner Software Implementation	$ 2,540,000	June, 2007
Network Fiber Upgrade and Extension	1,260,000	September, 2005
Electrical Loop Upgrade	652,000	July, 2006
	$ 4,452,000	

At June 30, 2005, construction-in-progress consists of work completed on the design and construction of the Fine and Performing Arts Center along with the three projects described above. The Fine and Performing Arts Center is substantially complete and the University expects to place the building into service in Fall of 2005.

Construction-in-progress

Estimated cost of construction	$ 20,092,183
Costs incurred through June 30, 2005	17,294,570
Estimated cost to complete	**$ 2,797,613**
Expected sources of financing:	
State funds	$ 952,103
University funds and other sources	1,845,510
Total	**$ 2,797,613**

8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

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

	2005	2004
Accounts payable to vendors	$ 595,798	$ 1,247,189
Payroll and payroll taxes	813,222	785,698
Interest	192,057	196,407
Workers' compensation claims	145,000	383,927
Total accounts payable and accrued expenses	**$ 1,746,077**	**$ 2,613,221**

Worker's Compensation

The University is self-insured for workers' compensation claims up to $500,000 per claim. The accrued workers' compensation obligation represents claims made prior to June 30, 2005 and 2004, 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:

	2005	2004
Claims liability at beginning of year	$ 383,927	$ 180,000
Claims and damages incurred	132,403	470,104
Claims payments	(371,330)	(266,177)
Claims liability at end of year	**$ 145,000**	**$ 383,927**

9. LONG TERM DEBT

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

			2005				
			Outstanding Principal				
	Interest Rate	Maturity	July 1 2004	Additions	Reductions	June 30 2005	Current Portion
Bonds payable							
General Revenue Bonds, Series 2001							
Series bonds	4.00%-5.00%	2006-2016	$ 4,795,000	$ --	$ 285,000	$ 4,510,000	$ 295,000
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%	2006-2008	2,890,000	--	520,000	2,370,000	575,000
Term bonds	5.18%-5.35%	2012-2019	6,805,000	--	--	6,805,000	--
Total –bonds payable			**31,015,000**	**--**	**805,000**	**30,210,000**	**870,000**
Capital leases			172,549	328,520	134,080	366,989	91,035
Total – long term debt			**$ 31,187,549**	**$ 328,520**	**$ 939,080**	**$ 30,576,989**	**$961,035**
Less current portion						961,035	
Long term debt, net of current portion						**$ 29,615,954**	

	Interest Rate	Maturity	July 1 2003	Additions	Reductions	June 30 2004	Current Portion
			2004				
			Outstanding Principal				
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**	

Bonded Debt

General Revenue Bonds, Series 2001

Bonds payable in the amount of $21,035,000 are payable from general revenues and consist of $4,510,000 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 $9,175,000 are payable from general revenues and consist of $2,370,000 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 ending June 30	Principal	Interest	Total
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	1,005,000	1,345,118	2,350,118
2011-2015	5,795,000	5,920,057	11,715,057
2016-2020	5,285,000	4,484,344	9,769,344
2021-2025	5,000,000	3,153,951	8,153,951
2026-2030	6,440,000	1,680,654	8,120,654
2031	3,065,000	162,882	3,227,882
Total – bonds payable	**$30,210,000**	**$22,562,888**	**$52,772,888**

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 $6,735,000 and $7,115,000 as of June 30, 2005 and 2004, 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 at June 30, 2004, which were called during fiscal 2005. The principal amount of the defeased bonds at June 30, 2004 was returned and the call premium was $79,700. The escrow agent refunded the remaining cash balance in the defeasement account to the University and closed the account as of December 15, 2004.

Interest Rate Swap

On April 12, 2005, the University entered into a twenty-six year forward-looking basis interest rate swap agreement for a notional amount of $20,115,000. The intention of the swap was to effectively change the fixed interest rate on the University's bonds to a variable rate. The effective date of the swap agreement is May 15, 2008. The stated maturity date of the swap is November 15, 2031.

Under the terms of the swap agreement, the University will pay interest based on the Bond Market Association ("BMA") rate. In return, the University will receive interest calculated at the outstanding notional amount times 68% of the one-month London Interbank Offered Rate ("LIBOR"). Only the net difference in interest payments will be actually exchanged each month. The University will continue to pay interest to the bondholders at the fixed rate on the outstanding bonds. However, during the term of the swap agreement, the University effectively pays a variable rate on the debt based on the economics of the swap agreement. The swap exposes the University to basis risk should the relationship between LIBOR, BMA and the fixed interest rate on the outstanding bonds diverge changing the effective fixed rate of the bonds. As of June 30, 2005, 68% of the one-month LIBOR was 2.27% whereas the BMA rate was 2.28%.

When the swap transaction was initiated, the University received a payment from the issuer in the amount of $839,000, which is included in the accompanying statement of net assets at June 30, 2005 under the caption "Investments". Since the University can terminate the swap agreement at its option prior to the effective date, under which circumstance a termination payment would be required, this amount is also included as a liability under the caption "Interest rate swap liability" in the accompanying statement of net assets at June 30, 2005. As of June 30, 2005, the fair value of the required termination payment is $1,429,520 which represents the amount that the University would be required to pay as of June 30, 2005 if the swap was terminated. The University does not intend to terminate the swap agreement.

Obligations Under Capital Leases

The University leases certain equipment with a net book value of $783,779 at June 30, 2005 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, 2005:

Year ending June 30	**Amount**
2006	$ 107,603
2007	70,098
2008	69,827
2009	55,643
2010	55,643
2011-2012	60,280
Total minimum payments due	419,094
Less amounts representing interest, imputed at annual rates ranging from 3.7% to 5.8%	52,105
Present value of net minimum lease payments	**$ 366,989**

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, 2005 and 2004 are insignificant.

10. 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 $1,228,000 and $1,221,000 for the years ended June 30, 2005 and 2004, 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 $1,094,000, $974,000 and $1,075,000, for the years ended June 30, 2005, 2004 and 2003, respectively, all of which was contributed during the applicable year.

Beginning October 1, 2005 the University is required to contribute 6.30% of MPSERS covered payroll for normal pension costs and 3.65% for unfunded pension liability. In addition, separately computed supplemental contributions will be required for retiree health care benefits. 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, 2005 and 2004, the requirements of several deferred compensation agreements had been satisfied. The liability, which is all classified as current, is $14,091 and $9,749 at June 30, 2005 and 2004, 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. 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, 2005 and 2004, respectively, amounted to $188,292 and $199,387 to reduce the liability and $11,786 and $31,039 which was recorded as additional salary expense.

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

	2005				
	July 1 2004	Additions	Payments	June 30 2005	Current Portion
Compensated absences	$ 633,608	$ 39,913	$ 56,011	$ 617,510	$ 60,000
Accumulated sick leave benefits	604,079	142,000	75,255	670,824	80,000
Deferred compensation	9,749	4,342	--	14,091	14,091
Early retirement severance program	608,677	11,786	188,292	432,171	151,724
Total-employee benefit programs	**$ 1,856,113**	**$ 198,041**	**$ 319,558**	**$ 1,734,596**	**$ 305,815**

	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	31,039	262,879	608,677	194,000
Total-employee benefit programs	**$ 2,139,680**	**$ 224,913**	**$ 508,480**	**$ 1,856,113**	**$ 383,749**

11. SELF INSURANCE

Liability and Property

The University participates with 10 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 $1,556,817 and $1,135,132 at June 30, 2005 and 2004, respectively. The workers' compensation claims liability of $145,000 and $383,927 at June 30, 2005 and 2004, 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.

12. 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 support personnel expired on August 31, 2003. In November 2004, the members of the support personnel group elected to discontinue the representation provided by the Michigan Educational Association and chose to be represented by the United Steelworkers. An agreement for the support personnel is being negotiated, but has not been finalized. The collective bargaining agreement covering the Faculty Association expired on August 31, 2004. An agreement for the Faculty Association 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
Support Personnel	United Steelworkers	Expired
Faculty	Michigan Education Association/ National Education Association	Expired
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, 2005 and 2004 the unfunded portion of the related pension benefits is significant. The University's portion of this obligation is not determinable at June 30, 2005 or 2004. 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.

13. NATURAL CLASSIFICATION OF EXPENSES

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

2005

	Salaries, Wages, Benefits	Supplies and Equipment	Utilities	Scholarship Expenses	Depreciation	Other	Total
Instruction	$ 10,779,266	$ 1,339,365	$ --	$ --	$ --	$ --	$ 12,118,631
Research	294,239	156,350	--	--	--	--	450,589
Public service	473,204	269,602	--	--	--	--	742,806
Academic support	1,903,273	474,819	--	--	--	--	2,378,092
Student service	1,415,079	464,290	--	--	--	--	1,879,369
Student aid	--	--	--	1,620,258	--	--	1,620,258
Institutional support	2,922,351	1,408,789	--	--	--	--	4,331,140
Plant operations	2,108,492	461,377	1,337,552	--	--	--	3,907,421
Auxiliary activities	3,478,806	2,823,761	1,003,241	--	--	--	7,305,808
Depreciation	--	--	--	--	4,486,318	--	4,486,318
Other	--	--	--	--	--	339,679	339,679
Total operating expenses	**$ 23,374,710**	**$ 7,398,353**	**$ 2,340,793**	**$ 1,620,258**	**$ 4,486,318**	**$ 339,679**	**$ 39,560,111**

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
Institutional 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**

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