FINANCIAL REPORT
2006-2007

MICHIGAN STATE
UNIVERSITY

Advancing Knowledge.
Transforming Lives.

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Michigan State University

MICHIGAN STATE UNIVERSITY

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MICHIGAN STATE
UNIVERSITY

This report presents the financial position and results of operations of Michigan State University for the fiscal years ended June 30, 2007, and June 30, 2006. The financial report has been adopted by the Board of Trustees and is provided as part of the commitment by Michigan State University to report annually on its fiscal affairs. These financial statements have been audited by Plante & Moran PLLC, Certified Public Accountants. Their audit report appears on page 17.

For more than 150 years, MSU has been advancing knowledge and transforming lives through teaching, research, and outreach. More than 45,000 students from every county in the state, every state in the nation, and nearly 130 countries worldwide enroll at Michigan State each year in more than 200 programs of undergraduate and graduate study. The university's commitment to research, dedication to maximizing the student learning experience, and strong international agenda are what make MSU one of the world's top research universities, a leader in study abroad, and a globally and responsibly engaged institution.

Despite continued difficult financial times, MSU made the necessary fiscal adjustments through a series of strategies with the objective of maintaining quality and balancing the budget. This was achieved by focusing on cost controls, pursuing a long-term investment strategy to maximize risk-adjusted total returns, and appropriately utilizing debt and other resources to meet programmatic needs, including the maintenance and replacement of the university's infrastructure.

Recently, the University successfully completed *The Campaign for MSU*, a comprehensive fund-raising initiative commenced in 1999 with a goal to generate $1.2 billion. In total, $1.44 billion was raised, including $476 million in endowments and $347 million in pledged planned gifts. The enormous generosity of MSU alumni, friends, faculty, staff, and retirees will help secure the future for the next generation of Spartans and position MSU to meet the global challenges of the 21st century.

Michigan State University believes that all of those who invest in us deserve a solid return on their investment. As we move forward, we continue to put every dollar possible into opportunities for students and developing critical programs and initiatives. We also continue to place a great emphasis on controlling costs so that dollars saved, not just new dollars, can be directed toward our strategic priorities and emerging opportunities.

Fred L. Poston
Vice President for Finance and Operations and Treasurer
October 30, 2007

OFFICE OF THE
VICE PRESIDENT FOR FINANCE AND OPERATIONS AND TREASURER

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Michigan State University is defining what it means to be a land-grant university in the twenty-first century.

From its roots as the nation's pioneer land-grant institution, the university has a long tradition of using the research and knowledge developed at MSU to create practical solutions that make a difference for individuals and communities across Michigan and around the world.

Today, Michigan State is one of the top 100 universities in the world. As a major public university with global reach and extraordinary impact, MSU continues its proud tradition of advancing knowledge and transforming lives. What follows is a small sample of activities that demonstrates how the people of MSU increase research opportunities, improve daily life on a global scale, and provide first-rate learning opportunities for tomorrow's leaders.

Building *stronger communities*

The research and scholarly activities conducted by faculty and students at Michigan State benefit communities in Michigan and beyond, making daily life safer, healthier, and more enriched. Here are some examples of how the work done by MSU faculty improves lives:

This year, faculty at MSU completed a comprehensive background check system for employees in Michigan's long-term care facilities. Because of its success, the system is now being used as a model for the rest of the country in legislation introduced in the U.S. Senate.

The National Institutes of Health selected Michigan State as one of 51 sites around the country that will take part in a major clinical study to test the effectiveness of a drug that could slow the progression of Parkinson's disease. This is one of several Parkinson's-related projects at MSU.

In one of MSU's many projects focused on child development, a team of early childhood experts from MSU found that a child's social skills at age 3 could predict future social and academic performance. The group currently is working with Early Head Start providers in six Michigan counties to evaluate a curriculum, targeting early social and emotional development.

In addition to offering world-class entertainment, MSU's Wharton Center for Performing Arts provides outreach programs for Michigan young people. More than 30,000 children and their families participate in educational programs at Wharton Center each season, including Jazz Kats: Jazz for Kids, which uses jazz to teach subjects like math, social studies, science, and music.

MSU Extension, present in all 83 counties in the state, created Senior Project FRESH to give low-income seniors access to healthy food. Nearly 72,000 Senior Project FRESH coupons were redeemed for fresh produce sold at farm markets in 2006, which totaled more than $142,000 in sales for local farmers and improved nutrition for seniors.

Making *global impact*

The scope of Michigan State's impact extends far beyond the boundaries of Michigan. It is an ongoing mission of the university to expand research opportunities, international experiences for students, and collaboration with institutions around the globe. As a model land-grant university, Michigan State is committed to spreading the knowledge generated at the university to the people of the state, the nation, and the world. Here are just a few of the ways in which MSU is making a difference around the globe:

In October 2006, Michigan State opened an office in Beijing. Similar to the extension offices located throughout Michigan, the China office serves as a hub for activities like education and research programs in collaboration with Chinese institutions, recruitment efforts, and technology transfer. The office also is working with the Michigan Economic Development Corporation office in Shanghai to promote Michigan's business interests in China and attract Chinese investment in Michigan.

Efforts by Michigan State faculty secured a donation from General Electric Corp. of an MRI machine to a hospital in Malawi. Researchers from the university who do work in the African nation will use it to conduct research and treat patients who come through the hospital. The goal is to help attract and retain more doctors in Malawi.

In Mexico's Yucatán peninsula, MSU faculty and graduate students have partnered with a local nonprofit organization to perform clinical work for children with hearing and speech impairments and give presentations in Spanish to teachers, parents, and community members, educating them on special needs issues. Since the program began in 2000, about 3,000 families have been helped by the MSU team.

Already a top producer of Peace Corps recruits, MSU now offers a master's degree program that combines course work on campus with Peace Corps volunteer work abroad. Based on an existing program in the College of Agriculture and Natural Resources, students spend a year on campus before going abroad to work on issues like degradation, hunger, infectious disease, and poverty.

Driving *economic development*

Michigan State University plays a pivotal role in driving economic development in Michigan. As traditional manufacturing jobs continue to leave the state, MSU is maximizing resources that draw new high-tech companies and jobs to Michigan and speed up technology transfer to boost the state's competitiveness.

Michigan State, the University of Michigan, and Wayne State University—the three schools that form the University Research Corridor (URC)—joined together to help create a more vibrant Michigan economy by leveraging intellectual capital that attracts knowledge–economy businesses to the state and provides research activity that promotes new enterprise. An independent analysis shows the URC universities helped create 68,803 Michigan jobs and produced $12.8 billion of net economic benefit in 2006.

In the life sciences arena, MSU is investing in Michigan with the expansion of the College of Human Medicine into west Michigan and the College of Osteopathic Medicine into southeast Michigan. Medical schools and enterprises that are spawned around them contribute to local economic development by training highly skilled employees and attracting funding for biotechnical research. When both of the college expansions are operating fully, they together will graduate about 200 new doctors every year. The College of Osteopathic Medicine, which consistently ranks in the top 5 percent of all medical schools for its primary care education, also has a long-standing tradition of retaining its alumni to practice in Michigan. More than two-thirds of the college's graduates remain to practice in Michigan.

Truly groundbreaking biobased research is being done at MSU—from manufacturing eco-friendly packing materials, finding ways to increase fuel efficiency in engines, and producing crops for biodiesel production on industrial waste sites to developing a chemical compound that makes drug synthesis more efficient and less costly. Recently, Michigan State was selected by the U.S. Department of Energy to conduct research for one of three new U.S. Department of Energy Bioenergy Research centers, which is expected to create some 100 jobs in Michigan.

In order to more efficiently translate MSU knowledge into products and businesses, the university established the MSU Technologies office. MSU researchers routinely make important discoveries and develop new technologies that have commercial potential. The new office will market the most promising to potential commercial partners around the world and also help MSU innovators start new businesses to develop the commercial potential of their discoveries.

One of MSU's spinoff companies, AquaBioChip LLC, a new high-tech firm located in Lansing, is developing a handheld pathogen detector that would make testing for deadly microbial agents simpler and cheaper. During 2006, seven MSU faculty members started their own high-tech companies in Michigan, bringing the total to at least 28 over the past four years.

Educating *tomorrow's innovators*

Students at MSU get more than a classroom education. They play active roles in faculty research projects, embark on semester-long internships abroad, and have countless opportunities to learn from prominent leaders in their fields.

In the *U.S. News & World Report* rankings of America's Best Colleges 2008, three MSU programs, including service-learning and residential colleges, were listed as "stellar examples" of "Programs to Look For." During the 2006–07 academic year, more than 13,800 students took part in service-learning activities, working with 375 community service agencies and organizations. MSU offered 300 courses that included a service-learning component.

MSU's three residential colleges—James Madison, Lyman Briggs, and the new

Residential College in the Arts and Humanities—integrate learning and living in a dynamic way in which conversations spill outside classrooms and faculty and students work closely together. In a James Madison College research seminar, students study the state's economic climate and emerging industries to determine how the state will compete in the global economy. A recent class came up with policy recommendations that could help Michigan's economy recover and presented findings to legislative staff and the public at the Capitol; the event was featured on several television and radio stations in Michigan.

Michigan State is the top public university in the nation for study abroad, also recognized as a "Program to Look For" in *U.S. News & World Report* rankings. Students can choose from more than 200 programs in more than 60 countries, including semester-long international academic internships that let them experience a field of interest in the context of another culture. Students gain valuable experience interning at places like the World Health Organization in Switzerland, a multinational corporation in Spain, a nongovernmental organization in Bangladesh, and environmental agencies in Japan.

The university recognizes the value of students doing hands-on research and has increased significantly its investment in learning opportunities for undergraduates. A new Web site is being tested this fall that gives undergrads a searchable online database of research opportunities, linking them with faculty research projects.

Investing *in people*

Michigan State adds value to people's lives. Graduates leave MSU with degrees and practical knowledge and skills that take them far. Faculty and staff devote time and expertise to provide the highest quality learning experiences while making significant contributions through research and outreach. An institution-wide culture of collaboration permeates the work done by faculty, students, and staff—making it possible to positively affect more lives in a more meaningful way.

> "The research and scholarly activities conducted by faculty and students at Michigan State benefit communities in Michigan and beyond, making daily life safer, healthier, and more enriched."

Introduction

The following discussion provides an overview of the financial position of Michigan State University (the “University”) for the years ended June 30, 2007 and 2006 and includes an analysis of the University’s Statement of Net Assets, which presents the assets, liabilities, and net assets of the institution as of the end of the fiscal year, and Statement of Revenues, Expenses, and Changes in Net Assets, which reflects revenues and expenses recognized during the fiscal year. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) pronouncements.

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

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

Statement of Net Assets

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

A summarized comparison of the University’s assets, liabilities and net assets at June 30, 2007, 2006, and 2005 follows:

	2007	2006	2005
		(in millions)	
Current assets	$ 445	$ 450	$ 550
Noncurrent assets:			
Restricted cash and cash equivalents and restricted investments	83	28	83
Endowment and other investments	1,561	1,363	1,211
Capital assets, net	1,293	1,205	1,080
Other	76	54	56
Total assets	3,458	3,100	2,980
Current liabilities	350	357	424
Noncurrent liabilities	590	476	486
Total liabilities	940	833	910
Total net assets	$ 2,518	$ 2,267	$ 2,070

Over time, increases or decreases in net assets are an indicator of the improvement or erosion of the University’s financial health when considered with non-financial facts such as enrollment levels, strength of faculty, and condition of facilities. The University increased total net assets approximately 10% in each of the last two years by focusing on cost controls, pursuing a long-term investment strategy to maximize risk-adjusted total returns, and appropriately utilizing debt and other resources to meet programmatic needs, including the maintenance and replacement of the University’s infrastructure.

Current assets:

Current assets consist of cash and cash equivalents, collateral from securities lending, investments, net accounts and interest receivable, and other assets. The net decrease in current assets in 2007 is due in part to a net decrease in accounts receivable due primarily to the State of Michigan’s deferral of the University’s August 2007 operating appropriations payment ($26 million) and operating budget rescission ($5 million). This decrease in operating appropriations receivable is partially offset by a $12 million increase in State capital appropriations receivable. The net decrease in current assets in 2007 also includes a $37 million increase in cash and cash equivalents (this increase is a function of the University’s operating, financing, and investing activities as reported in the Statement of Cash Flows), and a $28 million decrease in collateral from the securities lending program. The decrease in securities lending collateral is due to a change in the makeup of the underlying investment holdings available for loan under the securities lending program as of June 30, 2007 and their related propensity for lending. The net decrease in current assets in 2006 was due primarily to a decrease in collateral from the securities lending program.

Noncurrent assets:

Restricted cash and cash equivalents and restricted investments

All balances represent unspent bond proceeds which are externally restricted for the construction or purchase of capital assets. The increase in 2007 is due to the Series 2007 issuance in May 2007. The decrease in 2006 represents the spending of Series 2005 bond proceeds consistent with their restricted purpose.

Endowment and other investments

At June 30, 2007 and June 30, 2006, the University's endowment investments totaled $1,247 million (an increase of $186 million) and $1,061 million (an increase of $154 million), respectively. During 2007 and 2006, $30 million and $60 million, respectively, in investments were reallocated to designated endowment investments, consistent with the University's Board approved cash management and investment plan. Market value (realized and unrealized) increases within the investment portfolio accounted for $117 million and $66 million of the increases in 2007 and 2006, respectively, while gifts to permanent endowments totaled $26 million in 2007 and $19 million in 2006.

Other investments consist primarily of the Intermediate Term Fixed Income Fund component of the University's Operating Cash Pool, which totaled $201 million and $191 million at June 30, 2007 and 2006, respectively. Funded retirement and post-employment benefit reserves ($90 million in 2007 and $81 million in 2006) substantially account for the remainder of other investments.

For the years ended June 30, 2007, 2006, and 2005, the total returns on investments were as follows:

	2007	2006	2005
Operating Cash Pool:			
Liquidity Pool	5.1%	2.3%	2.3%
Intermediate Term Fixed Income Pool	5.8%	(0.7)%	7.4%
Common Investment Fund	19.0%	13.9%	15.3%
Other Separately Invested Investments	13.2%	3.2%	5.1%

Capital assets

The University continues to implement its long-range plan to modernize and renew its teaching, research and residential life facilities in support of its missions. At June 30, 2007, 2006, and 2005, the University's investment in capital assets was as follows:

	2007	2006 (in millions)	2005
Land	$ 24	$ 20	$ 20
Buildings and site improvements	1,726	1,650	1,432
Construction in progress	108	78	138
Equipment and other	497	456	435
Museum collections	7	6	5
Less: accumulated depreciation	(1,069)	(1,005)	(950)
	$ 1,293	$ 1,205	$ 1,080

Major additions to buildings and site improvements during 2007 included $19 million for the Grand River Parking Ramp, $8 million for the Shaw Lane to Munn Arena steam tunnel and road replacement, $8 million for the Energy and Automotive Research Laboratories, and $7 million each for building chiller projects (Erickson Hall, Fee Hall, and International Center) and for renovations to University apartments. Major additions to buildings and site improvements during 2006 included $62 million for the Spartan Stadium Addition, $55 million for the Diagnostic Center for Population and Animal Health, $39 million for an expansion of the T.B. Simon Power Plant, $12 million for the Veterinary Medical Center Oncology expansion, and $7 million for renovations to Kellogg Center guest rooms.

Construction in progress reflects multi-year projects which, once completed and placed into service, are categorized as buildings and site improvements. The 2007 balance includes $40 million for Snyder-Phillips Hall renovations, $16 million for reconstruction at University Village, and $14 million for Chemistry Building renovations. The 2006 balance includes $15 million for the Grand River Parking Ramp, $8 million for Snyder-Phillips Hall renovations, and $6 million each for improvements to steam tunnel vaults and for construction of the Energy and Automotive Research Laboratories.

As of June 30, 2007, the University had initiated plans and incurred certain contractual commitments related to the construction and renovation of various facilities. The costs to complete the projects are estimated to be $71 million and are to be funded from debt proceeds, other University funds, State of Michigan and State Building Authority (SBA) capital appropriations, and private gifts.

Current liabilities:

Current liabilities consist primarily of trade accounts payable, accrued compensation and other personnel costs, obligations under securities lending, deferred revenues, and other liabilities payable within one year or less. The net decrease in current liabilities in 2007 is due primarily to a $28 million reduction in obligations under securities lending due to a change in the make-up of the underlying investment holdings available for loan under the securities lending program as of June 30, 2007 and their related propensity for lending. Offsetting the net decrease in current liabilities is an $11 million increase in deferred revenues, due in part to the receipt of grant funds ($6 million) prior to the completion of the contracted work. The net decrease in current liabilities in 2006 is due primarily to an $83 million reduction in obligations under securities lending. Offsetting the net decrease in current liabilities is a $6 million increase in accounts and interest payable, due primarily to completed improvements to steam tunnel vaults ($3 million) and Snyder-Phillips Hall renovations ($2 million), and a $6 million increase in deferred revenues, due in part to sales of athletic tickets (increased $2 million, as a result of one more home football game in 2006 over 2005).

Noncurrent liabilities, primarily debt:

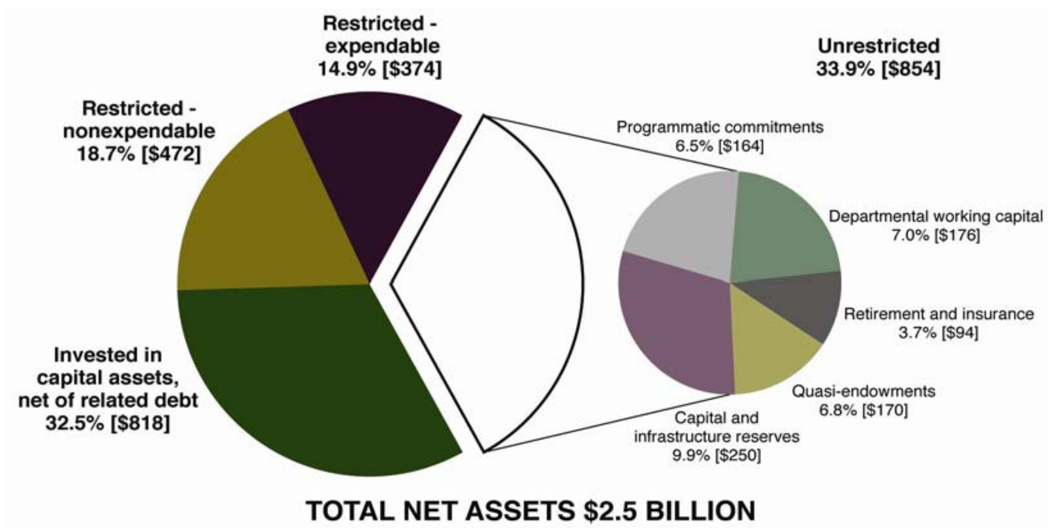
At June 30, 2007, the University had noncurrent debt and other obligations outstanding of $563 million compared with $451 million at June 30, 2006. This balance is comprised primarily of outstanding General Revenue Bonds of $525 million and $413 million in 2007 and 2006, respectively, an increase mainly due to Series 2007 bonds issued in May 2007 ($125 million). The University periodically reviews its debt capacity and related capital asset needs to optimize the use of long-term resources. The University's outstanding bonds carry an investment grade bond rating from Moody's and Standard & Poor's of Aa2 and AA, respectively.

Net assets:

Net assets represent residual University assets after liabilities are deducted. The University's net assets at June 30, 2007, 2006, and 2005 are summarized as follows:

	2007	2006	2005
		(in millions)	
Invested in capital assets, net of related debt	$ 818	$ 792	$ 711
Restricted:			
Nonexpendable	472	384	333
Expendable	374	323	319
Total restricted	846	707	652
Unrestricted	854	768	707
Total net assets	$ 2,518	$ 2,267	$ 2,070

The following is a breakdown of net assets at June 30, 2007. See footnote 16 for further information (amounts are presented in millions of dollars):



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

Restricted nonexpendable net assets are made up of the University's permanent endowment funds.

Restricted expendable net assets, which are subject to externally imposed restrictions governing their use, include restricted quasi-endowments, restricted gifts, and federal and state sponsored programs.

Although unrestricted net assets are not subject to externally imposed restrictions, virtually all of the University's unrestricted net assets are designated for purposes to fulfill its various fiduciary responsibilities, including maintaining reserves for capital projects, future postemployment benefits, working capital for self-supporting departmental activities, and unrestricted quasi and term endowments.

The University's ongoing review of its infrastructure indicates a need to expend approximately $700 million over the next 10 years to modernize and renovate aging teaching, research, housing and other support facilities, utility systems, and roads, consistent with its just-in-time maintenance strategy, and to upgrade administrative and other campus-wide technology systems. The University intends to address these maintenance and technology needs through the use of capital and infrastructure reserves, appropriate use of additional borrowing, and efforts to obtain gifts, grants, and capital appropriations.

In addition, the University faces the challenge of funding its increasing health care and dental benefits costs. This includes the cost of providing postemployment health and dental benefits to eligible employees. The University will be required to implement the provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, effective with the fiscal year ending June 30, 2008. In accordance with this Statement, the University will address the accounting and financial reporting for the unfunded accumulated benefit obligations related to postemployment healthcare and other non-pension benefits. Based upon the latest actuarial calculation (completed July 2006), these obligations are estimated at $830 million.

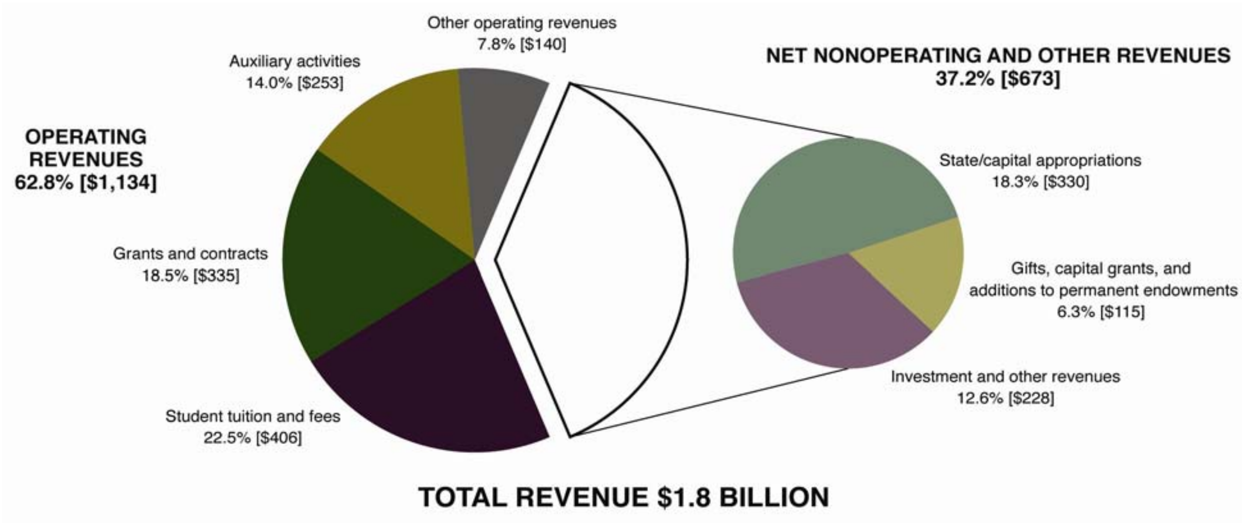
Statement of Revenues, Expenses, and Changes in Net Assets

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

A summarized comparison of the University's revenues, expenses, and changes in net assets for the years ended June 30, 2007, 2006, and 2005 follows:

	2007	2006	2005
		(in millions)	
Operating revenues:			
Student tuition and fees, net of allowances	$ 406	$ 373	$ 329
Grants and contracts	335	323	320
Auxiliary activities	253	246	235
Other operating revenues	140	132	129
Total operating revenues	1,134	1,074	1,013
Operating expenses:			
Instruction and departmental research	476	437	420
Research	244	247	236
Public services	186	172	172
Academic support	72	68	66
Student services	28	29	25
Scholarships and fellowships	32	32	29
Institutional support	68	64	61
Operation and maintenance of plant	136	116	102
Auxiliary enterprises	230	229	208
Depreciation	77	73	65
Other operating expenses, net	7	14	4
Total operating expenses	1,556	1,481	1,388
Operating loss	(422)	(407)	(375)
Nonoperating revenues (expenses):			
State appropriations	318	348	356
Gifts	55	43	37
Net investment income	244	154	148
Interest expense on capital asset related debt	(16)	(16)	(13)
Other nonoperating expenses, net	-	(2)	(1)
Net nonoperating revenues	601	527	527
Income before other revenues	179	120	152
State capital appropriations	12	55	-
Capital grants and gifts	34	3	6
Additions to permanent endowments	26	19	19
Increase in net assets	251	197	177
Net assets, beginning of year	2,267	2,070	1,893
Net assets, end of year	$ 2,518	$ 2,267	$ 2,070

The following is a graphic illustration of total net revenue by source for the year ended June 30, 2007 (amounts are presented in millions of dollars):



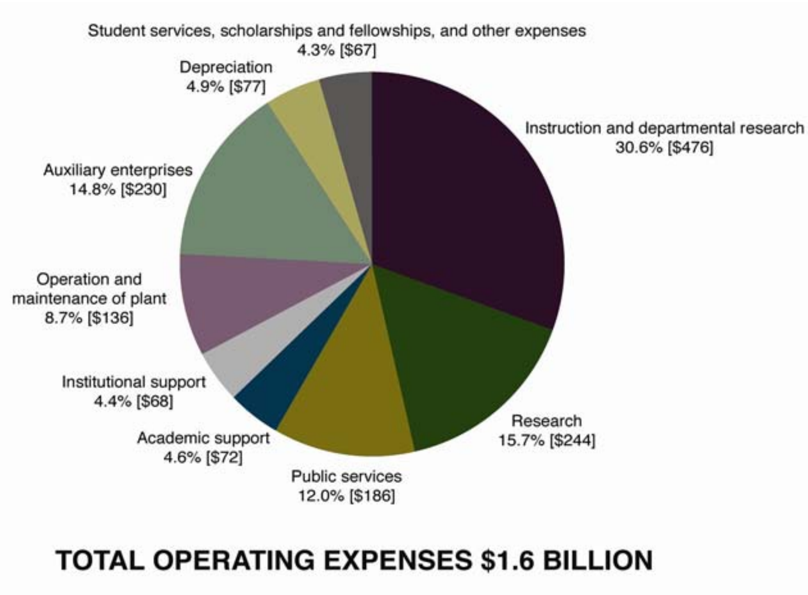
The University is supported by a diverse stream of revenue which supplements its student tuition and fees, including state appropriations, federal and state sponsored programs, private gifts and grants, and investment income. The University continues to seek funding from all possible sources consistent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

Recently, the University successfully completed *The Campaign for MSU*, a comprehensive fund-raising initiative commenced in 1999 with a goal to generate $1.2 billion. As of June 30, 2007, $1.4 billion had been raised in cash, in-kind gifts, pledges, irrevocable life income agreements, and bequests.

Operating revenues: The most significant source of operating revenue for the University is tuition and fees (net of scholarship allowances), totaling $406 million and $373 million in 2007 and 2006, respectively. Gross tuition and fees revenue increased 9.1% in 2007 which includes an 8.4% effective rate increase in tuition and fees and a .7% revenue increase from additional student credit hours taken and changes in the student blend. The 13.6% increase in 2006 reflects a 11.6% effective rate increase in tuition and fees and a 2.0% revenue increase from additional student credit hours taken and changes in the student blend. Other major revenue sources in 2007 include federal grants and contracts of $259 million (an increase of $12 million), including $172 million for sponsored research programs, and auxiliary services of $253 million (an increase of $7 million).

Net nonoperating and other revenues: The primary source of this net revenue is State appropriations, which totaled $318 million in 2007, a decrease of $30 million (8.6%). For 2007, $292 million in funding for general operations was initially appropriated, but subsequently reduced $5 million via an operating budget reduction by the State. Also, the State of Michigan has deferred $26 million in 2007 operating appropriation payments until fiscal year 2008. For 2006, $284 million in funding for general operations was appropriated, and the State also restored $2 million of 2005 Executive Order budget cuts. Michigan State University Extension and Michigan Agricultural Experiment Station appropriations increased $1.2 million to $63 million in 2007. However, $6 million in payments were deferred by the State until fiscal year 2008. In 2007, other significant components of net nonoperating revenues include gift revenue (increased $12 million) and net investment income (increased $90 million). In 2006, both gift revenue and net investment income increased $6 million.

The following is a graphic illustration of operating expenses by source for the year ended June 30, 2007 (amounts are presented in millions of dollars):



During 2007, $906 million was expended for the core missions of the University, instruction and departmental research, research, and public services, an increase of $50 million (5.8%) over 2006. Total instruction and departmental research expenses increased $39 million (8.9%), primarily due to an increase in faculty and staff salary increases (3.6%) and targeted funding to enhance academic programs. Auxiliary enterprises (activities which provide services to students, faculty, staff, and the public) remained consistent with 2006 levels. Expenses for the operation and maintenance of plant increased $20 million (17.2%), primarily due to increased energy costs ($3 million) and development costs associated with the University's Enterprise Business Systems Project ($4 million).

Economic Outlook

The University's revenue mix is closely associated with the level of State support. As such, there is a direct relationship between the growth of State appropriations and the increase in the University's tuition and fee levels. Static or declining State appropriations generally result in increased tuition and fees. Due to economic pressures affecting the State of Michigan, $26 million in 2007 operating appropriation payments to the University have been deferred until fiscal year 2008. Further, the State's 2008 fiscal year budget (including appropriations to the University) is pending. As a result, the Board of Trustees approved a 9.6% across-the-board tuition increase for fall 2007 covering both undergraduate and graduate students. As a further protection of the quality of University programs, Board action provided the University President authorization to adjust tuition and fees during the 2007-08 academic year based upon level of State appropriation support received. If appropriations were to increase above anticipated levels, tuition would be reduced. However, should State appropriations for 2008 be inadequate to support the University's budget or should the deferred 2007 payments not be paid in a timely manner, tuition would increase.

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Independent Auditor's Report

To the Board of Trustees
Michigan State University

We have audited the accompanying balance sheet of Michigan State University (the "University") as of June 30, 2007 and 2006 and the related statements of revenue, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the financial statements of the Michigan State University Foundation (the "Foundation"), which present all the assets and revenues of the discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us and our opinion, insofar as it relates to the amounts included for the Foundation, is based on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Michigan State University and its component unit as of June 30, 2007 and 2006 and the results of their operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 5, 2007 on our consideration of Michigan State University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters for year ended June 30, 2007. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide opinions on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis presented on pages 1 through 9 is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and express no opinion on it.

Plante & Moran, PLLC

Kalamazoo, Michigan
October 5, 2007

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STATEMENTS OF NET ASSETS

Michigan State University

	June 30, 2007	June 30, 2006
ASSETS	(in thousands)	
Current assets:		
Cash and cash equivalents	$ 46,968	$ 9,973
Investments	161,658	167,487
Collateral from securities lending	71,932	100,221
Accounts and interest receivable, net	108,391	120,488
Student loans receivable, net	29,672	27,001
Pledges receivable, net	10,352	10,033
Inventories and other assets	16,214	14,964
Total current assets	445,187	450,167
Noncurrent assets:		
Restricted cash and cash equivalents	22,057	10,282
Restricted investments	60,689	18,310
Endowment investments	1,247,236	1,060,978
Other investments	313,334	301,753
Student loans receivable, net	29,592	29,406
Pledges receivable, net	37,690	13,869
Investments in joint ventures	5,975	6,179
Unamortized bond origination costs	3,303	4,180
Capital assets, net	1,293,480	1,204,774
Total noncurrent assets	3,013,356	2,649,731
TOTAL ASSETS	**$ 3,458,543**	**$ 3,099,898**
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts and interest payable	$ 52,195	$ 53,809
Accrued personnel costs	54,319	50,645
Obligations under securities lending	71,932	100,221
Accrued self-insurance liabilities	10,242	11,066
Payroll taxes and other payroll deductions	31,092	29,087
Deposits held for others	24,360	20,004
Deferred revenues	75,832	64,470
Current portion of long term debt and other obligations	30,121	27,395
Total current liabilities	350,093	356,697
Noncurrent liabilities:		
Accrued personnel costs	17,782	17,367
Accrued self-insurance liabilities	9,031	7,764
Long term debt and other obligations	563,468	450,752
Total noncurrent liabilities	590,281	475,883
Total liabilities	**940,374**	**832,580**
Net assets:		
Invested in capital assets, net of related debt	818,207	791,876
Restricted:		
Nonexpendable	472,062	383,852
Expendable	373,664	323,620
Unrestricted	854,236	767,970
Total net assets	**2,518,169**	**2,267,318**
TOTAL LIABILITIES AND NET ASSETS	**$ 3,458,543**	**$ 3,099,898**

See accompanying notes

STATEMENTS OF FINANCIAL POSITION
Michigan State University Foundation

	June 30, 2007	June 30, 2006
	(in thousands)	
ASSETS		
Cash equivalents	$ 6,434	$ 4,692
Interest and dividends receivable	224	141
Grants and contracts receivable - Net	718	1,692
Other receivables	948	953
Investments:		
Marketable securities	249,623	243,296
Investments in limited partnerships	106,991	73,788
Venture capital	23,302	20,805
Cash value of life insurance	1,210	1,518
Land held for investment	2,975	2,755
Other investments	1,216	1,197
Investment in IP Ventures LLC	476	525
Investment in Research Park	3,324	3,345
Prepaid expenses	149	55
Property and equipment - Net	11,847	7,591
Intangible assets - Net	845	881
Other assets	11	11
TOTAL ASSETS	**$ 410,293**	**$ 363,245**
LIABILITIES AND NET ASSETS		
Liabilities:		
Accrued expenses and other payables	$ 2,483	$ 2,323
Deferred compensation	525	525
Note payable - deferred compensation	196	196
Note payable	4,585	-
Trusts and annuities payable	11,003	7,786
Deferred gifts	433	433
Deposit held for Michigan State University	5,071	-
Obligations under life estate agreements	62	86
Total liabilities	24,358	11,349
Net assets:		
Unrestricted	356,200	323,250
Temporarily restricted	15,594	15,520
Permanently restricted	14,141	13,126
Total net assets	**385,935**	**351,896**
TOTAL LIABILITIES AND NET ASSETS	**$ 410,293**	**$ 363,245**

See accompanying notes

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

	Year ended June 30, 2007	2006
OPERATING REVENUES	(in thousands)	
Student tuition and fees	$ 462,996	$ 423,963
Less: scholarship allowances	56,952	51,236
Net student tuition and fees	406,044	372,727
State of Michigan grants and contracts	20,473	26,542
Federal grants and contracts	259,076	247,074
Local and private sponsored programs	55,448	49,307
Interest and fees on student loans	2,731	3,308
Departmental activities (net of scholarship allowances of $3,457 in 2007 and $3,535 in 2006)	137,744	129,186
Auxiliary activities (net of room and board allowances of $10,370 in 2007 and $10,055 in 2006)	252,895	245,521
TOTAL OPERATING REVENUES	**1,134,411**	**1,073,665**
OPERATING EXPENSES		
Instruction and departmental research	475,775	436,578
Research	243,763	247,061
Public services	185,709	171,944
Academic support	72,083	68,140
Student services	28,573	28,633
Scholarships and fellowships	32,312	32,490
Institutional support	68,569	64,502
Operation and maintenance of plant	135,830	115,654
Auxiliary enterprises	230,151	229,264
Depreciation	76,708	73,037
Other operating expenses, net	7,341	13,768
TOTAL OPERATING EXPENSES	**1,556,814**	**1,481,071**
Operating loss	(422,403)	(407,406)
NONOPERATING REVENUES (EXPENSES)		
State of Michigan appropriations	317,841	347,771
Gifts	54,830	42,827
Net investment income	244,290	154,126
Interest expense on capital asset related debt	(15,702)	(15,741)
Other nonoperating expenses, net	(480)	(1,833)
Net nonoperating revenues	600,779	527,150
INCOME BEFORE OTHER REVENUES	**178,376**	**119,744**
State capital appropriations	12,724	55,161
Capital grants and gifts	34,194	2,929
Additions to permanent endowments	25,557	19,206
Increase in net assets	250,851	197,040
Net assets, beginning of year	2,267,318	2,070,278
NET ASSETS, END OF YEAR	**$ 2,518,169**	**$ 2,267,318**

See accompanying notes

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

Michigan State University Foundation

	Year ended June 30, 2007			
	Unrestricted Funds	Temporarily Restricted	Permanently Restricted	Total
REVENUE, GAINS AND OTHER SUPPORT:		(in thousands)		
Contributions	$ (27)	$ 3,212	$ 150	$ 3,335
Equity earnings - subsidiaries	37			37
Income from investments	14,016	301	597	14,914
Royalty income	578			578
Rental income	76			76
Realized gain on sale of securities	21,527	236	155	21,918
Unrealized gain (loss) on securities	15,432	1,275	730	17,437
Grants and contracts	4,245			4,245
Other income	685			685
Net assets released from restrictions:				
Satisfaction of program restrictions	2,489	(2,485)	(4)	-
Current year transfers	3,078	(2,465)	(613)	-
TOTAL REVENUE, GAINS AND OTHER SUPPORT	62,136	74	1,015	63,225
EXPENSES AND LOSSES:				
Contributions to the University	16,563			16,563
Patent expense	915			915
Investment management fees	1,590			1,590
Adjustments to value of annuities payable	2,427			2,427
Management and general	3,934			3,934
Postretirement benefits				
Net periodic benefit cost	121			121
Changes other than net peiodic benefit cost	259			259
Operational expenses - Management Company	130			130
MBI program expenses	3,247			3,247
TOTAL EXPENSES	29,186	-	-	29,186
Change in net assets	32,950	74	1,015	34,039
Net assets at beginning of year	323,250	15,520	13,126	351,896
NET ASSETS, END OF YEAR	$ 356,200	$ 15,594	$ 14,141	$ 385,935

	Year ended June 30, 2006			
	Unrestricted Funds	Temporarily Restricted	Permanently Restricted	Total
REVENUE, GAINS AND OTHER SUPPORT:		(in thousands)		
Contributions	$ 49	$ 2,948	$ 222	$ 3,219
Equity earnings - subsidiaries	113			113
Income from investments	16,601	152	546	17,299
Royalty income	468			468
Realized gain on sale of securities	17,201	1,408	876	19,485
Unrealized gain (loss) on securities	8,463	(864)	(636)	6,963
Grants and contracts	5,805			5,805
Other income	1,141			1,141
Net assets released from restrictions:				
Satisfaction of program restrictions	38	(33)	(5)	-
Current year transfers	2,256	(2,313)	57	-
TOTAL REVENUE, GAINS AND OTHER SUPPORT	52,135	1,298	1,060	54,493
EXPENSES AND LOSSES:				
Contributions to the University	16,234			16,234
Patent expense	950			950
Investment management fees	1,338			1,338
Management and general	4,341			4,341
Net periodic postretirement benefit cost	80			80
Operational expenses - Management Company	61			61
MBI program expenses	3,970			3,970
TOTAL EXPENSES	26,974	-	-	26,974
Change in net assets	25,161	1,298	1,060	27,519
Net assets at beginning of year	298,089	14,222	12,066	324,377
NET ASSETS, END OF YEAR	$ 323,250	$ 15,520	$ 13,126	$ 351,896

See accompanying notes

STATEMENTS OF CASH FLOWS
Michigan State University

	Year ended June 30, 2007	2006
	(in thousands)	
Cash flows from operating activities		
Tuition and fees	$ 409,823	$ 374,024
Research grants and contracts	328,605	331,718
Auxiliary activities	252,988	248,764
Departmental activities	138,310	129,958
Interest and fees on student loans	2,731	3,308
Loans issued to students	(103,239)	(98,389)
Collection of loans from students	100,382	94,622
Scholarships and fellowships	(38,846)	(19,222)
Payments to suppliers	(387,654)	(385,689)
Payments to employees	(1,029,936)	(981,417)
Other payments	(8,063)	(22,384)
Net cash used by operating activities	(334,899)	(324,707)
Cash flows from noncapital financing activities		
State appropriations	353,896	345,717
Gifts	51,457	43,997
Endowment gifts	26,478	19,468
Federal Family Education Loan Program receipts	240,657	230,543
Federal Family Education Loan Program disbursements	(238,387)	(227,431)
Net cash provided by noncapital financing activities	434,101	412,294
Cash flows from capital and related financing activities		
Capital appropriations	361	(161)
Capital gifts and grants	12,506	5,911
Proceeds from issuance of debt and other long term obligations	124,505	-
Purchase of capital assets	(175,781)	(142,852)
Proceeds from sale of capital assets	565	753
Principal paid on capital debt	(11,332)	(8,988)
Interest paid	(15,202)	(15,868)
Other receipts	2,442	2,230
Net cash used by capital and related financing activities	(61,936)	(158,975)
Cash flows from investing activities		
Investment income, net	128,369	109,904
Proceeds from sales and maturities of investments	26,434,327	21,812,919
Purchase of investments	(26,551,192)	(21,861,994)
Net cash provided by investing activities	11,504	60,829
Net increase (decrease) in cash	48,770	(10,559)
Cash and cash equivalents, beginning of year	20,255	30,814
Cash and cash equivalents, end of year	$ 69,025	$ 20,255

See accompanying notes

Reconciliation of net operating loss to cash flows from operating activities:	Year ended June 30, 2007	2006
	(in thousands)	
Operating loss	$ (422,403)	$ (407,406)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation expense	76,708	73,037
Change in assets and liabilities:		
Accounts receivable	(12,613)	9,326
Student loans receivable	(2,857)	(3,767)
Inventories and other assets	(1,250)	(2,561)
Investments in joint ventures	204	441
Unamortized bond origination costs	877	188
Accounts payable	4,180	470
Accrued personnel costs	4,089	1,010
Payroll taxes and other payroll deductions	2,005	(2,170)
Deposits held for others	4,356	1,615
Deferred revenues	11,362	6,248
Accrued self-insurance liabilities	443	(1,138)
Net cash used by operating activities	$ (334,899)	$ (324,707)

See accompanying notes

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

Organization:

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

Basis of presentation:

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

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

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

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

- Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.

- Restricted:
  Nonexpendable – Net assets subject to externally imposed constraints that they be maintained permanently by the University. Such assets include the University's permanent endowment funds.

  Expendable – Net assets whose use by the University is subject to externally imposed constraints that can be fulfilled by actions of the University pursuant to those constraints or that expire by the passage of time.

- Unrestricted: Net assets that are not subject to externally imposed constraints. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees (the "Board") or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for academic, research, and outreach programs and initiatives, postemployment benefits, and capital asset renewals and replacements.

Reporting entity:

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

The Foundation is a private organization that reports under FASB standards, including FASB Statement No. 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from those under GASB. No modifications have been made to the Foundation financial information included in the University's financial report to account for these differences.

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

Summary of significant accounting policies:

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

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

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

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

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

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

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

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

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

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

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

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

Donor restricted endowments – For donor restricted endowments, the Uniform Management of Institutional Funds Act, as adopted in Michigan, permits the Board to appropriate an amount of realized and unrealized endowment appreciation that the Board determines to be prudent. Endowment realized and unrealized appreciation is reported consistent with the net asset categorization of the related endowment net of spending policy distributions. The Board chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the spending policy established by the

Board, 5.75% of the average market value of endowment investments for the twenty quarters of the five calendar years prior to the beginning of the fiscal year in which the spending is expected to occur has been authorized for expenditure.

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

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

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

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

2. Cash and cash equivalents

The University's cash and cash equivalents as of June 30, 2007 and 2006 were as follows:

	2007	2006
Cash and cash equivalents, current	$ 46,968	$ 9,973
Restricted cash and cash equivalents, noncurrent	22,057	10,282
Total cash and cash equivalents	$ 69,025	$ 20,255

Of the bank balances for cash, $100 of the total $2,676 in 2007 and $100 of the total $2,955 in 2006 were covered by federal depository insurance. The remaining amounts were uninsured and uncollateralized, as banks holding deposits of the University are legally prohibited from collateralizing these deposits.

3. Investments

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

Securities Lending Transactions: The University participates in a Board-authorized securities lending program whereby University securities are contractually loaned to approved borrowers against a pledge of collateral which is invested. The University had loaned securities with a market value of approximately $69,879 and $96,902 at June 30, 2007 and 2006, respectively. One of the University's custodians is an agent in lending the University's domestic securities for cash collateral of 102% and international securities for cash collateral of 105%. At June 30, 2007 and 2006, the University had no credit risk exposure to borrowers because the amounts the University owed the borrowers exceed the amounts the borrowers owed the University. The contract with the lending agent requires it to indemnify the University if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent). All securities loans can be terminated on demand by either the University or the borrower. As a means of managing the University's interest rate risk, the securities lending agreement limits the difference between the average weighted maturity of securities loans and the average weighted maturity of the cash collateral investment portfolio to a maximum of 90 days. At June 30, 2007 and 2006, the difference was less than 90 days.

As of June 30, 2007 and 2006, the University had the following investments:

	June 30, 2007					
Investment type	LP	IT	CIF	Securities Lending	Other	Total
Repurchase agreements	$ -	$ -	$ -	$ 21,932	$ -	$ 21,932
Investment pools	12,715	200,905	1,015,057	-	22,831	1,251,508
U.S. Treasury bonds	15,923	-	530	-	60	16,513
U.S. Government agencies	72,891	-	53,771	-	77	126,739
Corporate bonds	35,683	-	21,295	45,000	169	102,147
Asset-backed securities	85,135	-	19,935	5,000	-	110,070
Domestic common stock	-	-	208,538	-	854	209,392
International equities	-	-	16,548	-	-	16,548
Total	$ 222,347	$ 200,905	$ 1,335,674	$ 71,932	$ 23,991	$ 1,854,849

	June 30, 2006					
Investment type	LP	IT	CIF	Securities Lending	Other	Total
Repurchase agreements	$ -	$ -	$ -	$ 45,221	$ -	$ 45,221
Investment pools	13,511	190,762	772,056	-	19,855	996,184
U.S. Treasury bonds	-	-	13,823	-	60	13,883
U.S. Government agencies	30,245	-	83,027	-	77	113,349
Corporate bonds	52,300	-	36,602	55,000	272	144,174
Asset-backed securities	89,741	-	40,671	-	-	130,412
Domestic common stock	-	-	190,488	-	1,393	191,881
International equities	-	-	13,604	-	40	13,644
Total	$ 185,797	$ 190,762	$ 1,150,271	$ 100,221	$ 21,697	$ 1,648,748

Interest Rate Risk: As a means of managing its exposure to fair value losses arising from increasing interest rates, University investment policy limits the average duration of the LP portfolio to three years and the IT and CIF portfolios to six years. At June 30, 2007 and 2006, the University was in compliance with its investment policy with regard to average duration. University policy does not address average duration of investments by investment type.

The maturities of fixed income investments as of June 30, 2007 and 2006 are as follows:

	June 30, 2007 Fixed Income Investment Maturities				
Investment type	Less than 1 year	1-5 years	6-10 years	More than 10 years	Total
Repurchase agreements	$ 21,932	$ -	$ -	$ -	$ 21,932
Investment pools	-	2,255	276,193	1,419	279,867
U.S. Treasury bonds	-	16,085	36	392	16,513
U.S. Government agencies	11,489	19,920	7,858	87,472	126,739
Corporate bonds	19,529	70,211	7,819	4,588	102,147
Asset-backed securities	3,352	39,743	3,298	63,677	110,070
Total	$ 56,302	$ 148,214	$ 295,204	$ 157,548	$ 657,268

	June 30, 2006 Fixed Income Investment Maturities				
Investment type	Less than 1 year	1-5 years	6-10 years	More than 10 years	Total
Repurchase agreements	$ 45,221	$ -	$ -	$ -	$ 45,221
Investment pools	3,323	452	191,436	1,423	196,634
U.S. Treasury bonds	-	1,623	785	11,475	13,883
U.S. Government agencies	13,256	4,793	8,723	86,500	113,272
Corporate bonds	41,659	78,697	15,061	8,757	144,174
Asset-backed securities	650	54,356	7,498	67,908	130,412
Total	$ 104,109	$ 139,921	$ 223,503	$ 176,063	$ 643,596

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

Credit Risk: As a means of managing credit risk, University investment policy limits fixed income investments at time of purchase to the following ratings issued by nationally recognized statistical rating organizations: LP portfolio – short-term A1/P1, long-term BBB; IT portfolio – short-term A2/P2, long-term B; CIF portfolio – short-term A2/P2, long-term BB. Thereafter, the minimum quality for all three portfolios is limited to AA. At June 30, 2007 and 2006, the University was in compliance with its credit risk policy for each portfolio. University policy does not address credit risk by investment type.

The Standard & Poor's credit ratings for fixed income investments at June 30, 2007 and 2006 are as follows:

As of June 30, 2007

Rating	Repurchase agreements	Investment pools	U.S. Treasury bonds	U.S. Government agencies	Corporate bonds	Asset-backed securities	Total
AAA	$ -	$ -	$ -	$ 20,853	$ 33,382	$ 83,779	$ 138,014
AA	5,000	-	-	-	13,562	1,040	19,602
A	16,932	-	-	-	36,191	5,000	58,123
BBB	-	-	-	-	14,363	730	15,093
BB	-	-	-	-	1,500	-	1,500
Below BB	-	-	-	-	-	-	-
Not rated	-	279,867	16,513	105,886	3,149	19,521	424,936
Total	$ 21,932	$ 279,867	$ 16,513	$ 126,739	$ 102,147	$ 110,070	$ 657,268

As of June 30, 2006

Rating	Repurchase agreements	Investment pools	U.S. Treasury bonds	U.S. Government agencies	Corporate bonds	Asset-backed securities	Total
AAA	$ -	$ -	$ -	$ 16,537	$ 18,454	$ 111,499	$ 146,490
AA	22,221	-	-	-	26,252	94	48,567
A	23,000	322	-	-	64,438	306	88,066
BBB	-	-	-	-	31,243	502	31,745
BB	-	-	-	-	2,261	531	2,792
Below BB	-	-	-	-	-	-	-
Not rated	-	196,312	13,883	96,735	1,526	17,480	325,936
Total	$ 45,221	$ 196,634	$ 13,883	$ 113,272	$ 144,174	$ 130,412	$ 643,596

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

As of June 30, 2007 and 2006, not more than 5% of the University's total investments were invested in any one security.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. University investment policy does not limit the value of investments that may be held by an outside party. Of the University's investments, $89 of the U.S. Treasury bonds, $114,934 of the U.S. Government agencies, $56,978 of the Corporate bonds, $105,070 of the Asset-backed securities, $171,582 of the domestic equities, $11,902 of the international equities, and $29,052 of the investment pools are held by the University's counterparty, not in the name of the University. Consistent with the University's securities lending agreement, $71,932 was held by the counterparty that was acting as the University's agent in securities lending transactions.

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

4. Foundation investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statements of financial position.

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

Foundation investments as of June 30, 2007 and 2006, which are recorded at market value or estimated market value, are summarized as follows:

	2007		2006	
	Cost	Market	Cost	Market
Short-term investments	$ 1,241	$ 1,241	$ 1,191	$ 1,191
Domestic equities	62,021	80,583	50,552	60,183
Foreign equities	59,148	68,996	63,427	74,758
Other equities	797	1,183	787	972
Fixed income	63,188	63,588	61,611	60,352
Mutual funds – Equities	13,217	16,419	27,913	29,915
Mutual funds – Fixed	18,148	17,613	16,403	15,925
Limited partnerships	84,380	106,991	60,707	73,788
	$ 302,140	$ 356,614	$ 282,591	$ 317,084

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

Limited partnership investments: The carrying amount reported in the statements of financial position is stated at market value or estimated market value.

5. Accounts and interest receivable

The composition of accounts and interest receivable at June 30, 2007 and 2006 is summarized as follows:

	2007	2006
State operating appropriations	$ 27,231	$ 63,287
Research and sponsored programs	48,338	38,569
Departmental activities	16,813	16,108
State capital appropriations	12,724	361
Interest receivable	2,024	3,043
Other	10,943	8,822
	118,073	130,190
Less: allowance for doubtful accounts	9,682	9,702
Net accounts and interest receivable	$ 108,391	$ 120,488

6. Student loans receivable

Student loans receivable at June 30, 2007 and 2006 are summarized as follows:

Description	2006	Distributed	Collected	2007	Current Portion
Federal Family Education Loan Program	$ 15,061	$ 90,483	$ 88,143	$ 17,401	$ 17,401
Perkins Federal Loan Program	35,935	7,403	7,158	36,180	9,472
Other	9,511	5,353	5,038	9,826	2,991
	60,507	$ 103,239	$ 100,339	63,407	29,864
Allowance for uncollectible loans	(4,100)			(4,143)	(192)
Net student loan receivable	$ 56,407			$ 59,264	$ 29,672

Description	2005	Distributed	Collected	2006	Current Portion
Federal Family Education Loan Program	$ 12,544	$ 84,419	$ 81,902	$ 15,061	$ 15,061
Perkins Federal Loan Program	34,997	8,398	7,460	35,935	9,333
Other	9,099	5,572	5,160	9,511	2,787
	56,640	$ 98,389	$ 94,522	60,507	27,181
Allowance for uncollectible loans	(4,000)			(4,100)	(180)
Net student loan receivable	$ 52,640			$ 56,407	$ 27,001

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

The University serves as school as lender for graduate and professional degree student loans under the U.S. Department of Education Federal Family Education Loan Program. Under this program, the University loans funds directly to students and subsequently sells the loans at a premium to a third party 90 days after final disbursement. The University holds a bank line of credit to facilitate the distribution of the loans (see Footnote 8).

For the year ended June 30, 2007, the University distributed $132,797 for undergraduate student loans through the U.S. Department of Education Federal Family Education Loan Program. These distributions and related funding sources are not included as expenses and revenues in the accompanying financial statements.

7. Pledges receivable

Payments on pledges receivable at June 30, 2007, expected to be received in the following fiscal years ended June 30, are summarized below. The allowance for uncollectible pledges receivable is made based on prior collection experience and management judgment. Gift pledges expected to be collected in the future years are reported at the net present value of the related cash flows discounted at 5%.

2008	$ 11,576
2009	11,750
2010	9,094
2011	9,365
2012	5,699
2013 and beyond	6,104
Total discounted pledges receivable	53,588
Less: allowance for uncollectible pledges	5,546
Net pledges receivable, June 30, 2007	48,042
Less: current portion	10,352
Noncurrent portion	$ 37,690

8. Long term debt and other obligations

Long term debt and other obligations for the years ended June 30, 2007 and 2006 are summarized as follows:

	2006	Borrowed	Retired	2007	Current Portion
General Revenue Bonds:					
Series 2007A	$ -	$ 30,820	$ -	$ 30,820	$ -
Series 2007B	-	93,685	-	93,685	-
Series 2005	84,580	-	-	84,580	1,830
Series 2003A	78,835	-	1,730	77,105	1,790
Series 2003B	23,380	-	820	22,560	850
Series 2003C	10,670	-	190	10,480	200
Series 2002A	51,645	-	2,440	49,205	2,600
Series 2002B	10,405	-	1,115	9,290	1,155
Series 2000A	104,190	-	1,340	102,850	1,300
Series 1998A-1	7,305	-	2,320	4,985	2,430
Series 1998A-2	51,935	-	-	51,935	-
	422,945	124,505	9,955	537,495	12,155
Federal student loan deposits	35,346	572	-	35,918	-
Short term line of credit	16,163	107,264	105,567	17,860	17,860
Lease Obligations	3,693	-	1,377	2,316	106
	$ 478,147	$ 232,341	$ 116,899	$ 593,589	$ 30,121

	2005	Borrowed	Retired	2006	Current Portion
General Revenue Bonds:					
Series 2005	$ 84,580	$ -	$ -	$ 84,580	$ -
Series 2003A	80,570		1,735	78,835	1,730
Series 2003B	23,540	-	160	23,380	820
Series 2003C	10,850	-	180	10,670	190
Series 2002A	53,780	-	2,135	51,645	2,440
Series 2002B	11,480	-	1,075	10,405	1,115
Series 2000A	104,950	-	760	104,190	1,240
Series 1998A-2	51,935	-	-	51,935	-
Series 1998A-1	9,525	-	2,220	7,305	2,320
Series 1996A	625	-	625	-	-
	431,835	-	8,890	422,945	9,855
Federal student loan deposits	34,483	1,047	184	35,346	-
Short term line of credit	13,914	104,029	101,780	16,163	16,163
Lease Obligations	3,791	-	98	3,693	1,377
	$ 484,023	$ 105,076	$ 110,952	$ 478,147	$ 27,395

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

- Series 2007B: from fiscal 2020 through 2037
- Series 2005: through 2034
- Series 2003A and Series 2003C: through 2033
- Series 2003B: through 2026
- Series 2002A: through 2032
- Series 2002B: through 2022
- Series 2000A: through 2030

- Series 1998A-2: from fiscal 2009 through 2022

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

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

The Series 1998A-1 bonds bear interest at a rate of 5.00% with the final maturity in fiscal 2008.

Interest expense was $15,702 and $15,741 for 2007 and 2006, respectively.

Swap payments and associated debt: Using rates as of June 30, 2007, scheduled fiscal year maturities of bonds payable and related interest expense are as follows. As rates vary, variable-rate interest payments and net swap payments will vary (see Footnote 17):

Fiscal Year	Fixed-Rate Bonds		Variable-Rate Bonds		Interest Rate	
Ending June 30,	Principal	Interest	Principal	Interest	Swaps, Net	Total
2008	$ 2,430	$ 1,594	$ 9,725	$ 19,225	$ 1,653	$ 34,627
2009	2,555	1,468	10,050	18,831	1,644	34,548
2010	2,865	1,409	13,085	18,337	1,323	37,019
2011	2,985	1,293	11,385	17,896	1,285	34,844
2012	3,090	1,172	11,820	17,451	1,244	34,777
2013-2017	17,785	3,449	66,505	79,929	5,537	173,205
2018-2022	4,095	234	87,755	65,447	4,135	161,666
2023-2027	-	-	103,285	46,616	2,367	152,268
2028-2032	-	-	110,400	26,252	524	137,176
2033-2037	-	-	77,680	7,686	(93)	85,273
Total	$ 35,805	$ 10,619	$ 501,690	$ 317,670	$ 19,619	$ 885,403

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

At June 30, 2007, the University owed $17,860 on a short term $82,500 line of credit related to the University's distribution of graduate and professional degree student loans under the Federal Family Education Loan Program (see Footnote 6). Principal amounts outstanding under this line of credit bear interest equal to fifty basis points over a thirty-day trailing average of the one-month London Interbank Offering Rate (LIBOR), and accrued interest (average rate for the year ended June 30, 2007 was 5.89%) is payable monthly. Payment terms of the principal balance outstanding at June 30, 2007 vary, but do not exceed six months.

Accrued personnel costs include vacation and sick leave days earned but unused, including the University's share of payroll taxes, valued at the current rate of pay. Changes in the balances of accrued personnel costs during 2007 and 2006 were as follows:

	2007	2006
Balance, beginning of year	$ 68,012	$ 67,002
Additions	6,275	2,594
Reductions	(2,186)	(1,584)
Balance, end of year	72,101	68,012
Less: current portion	54,319	50,645
Noncurrent portion	$ 17,782	$ 17,367

9. Retirement benefits

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

Participating employees contribute 5% of their base salary or wages and the University contributes 10% of the employee's base salary or wages subject to applicable Internal Revenue Service limits. Participants may elect to contribute additional amounts to a supplemental plan and/or a deferred compensation plan, within specified limits, which are not matched by University contributions. Plan provisions and contribution requirements of plan members and the University are established and may be amended by the Board in accordance with University policies, union contracts, or plan provisions. Contributions under the base plan, excluding the participants' supplemental contributions, for the years ended June 30, 2007 and 2006 were as follows:

	2007	2006
University contributions	$ 56,236	$ 53,252
Employee contributions	28,118	26,626

In addition, the University has a single-employer, defined benefit plan covering 909 employees hired prior to January 1, 1973. The plan is closed to new entrants and monies have been internally reserved by the University to fully fund program costs. The benefits are based on the employee's compensation during the last three years of employment and/or years of service. There were no required annual contributions and no pension costs for each of the three preceding years ended June 30, 2007.

10. Other postemployment benefits

In addition to providing retirement benefits, the University contributes monthly health care and dental premiums for retired employees. Substantially all of the University's employees may become eligible for those benefits if they meet normal retirement requirements while still working for the University. The number of eligible retirees was approximately 4,010 in 2007 and 3,900 in 2006. The University recognizes the cost of providing those benefits on a pay-as-you-go basis. Those costs totaled $23,854 for 2007 and $23,168 for 2006 and are included in operating expenses in the Statements of Revenues, Expenses, and Changes in Net Assets (see Footnote 18).

11. Grants and contracts

The University receives grants and contracts from certain federal, state, and local agencies to fund research and other activities. Revenues from government grants and contracts are recognized when all eligibility requirements have been met. The University records indirect costs related to such grants and contracts at predetermined rates that are negotiated with the University's federal cognizant agency. Both direct and indirect costs charged to the grants or contracts are subject to audit and approval by the granting agencies. University management believes adjustments of costs, if any, resulting from such examination by the granting agency would be insignificant.

12. Commitments

At June 30, 2007, the University had initiated plans and incurred certain contractual commitments related to the construction or capital improvement of various facilities. The costs to complete the projects are estimated to be $70,604 and are to be funded from debt proceeds, other University funds, State of Michigan and State Building Authority (SBA) capital appropriations, and private gifts. Certain University facilities have been, or are scheduled to be, financed in whole or in part by SBA bond issues secured by a pledge of rentals to be received from the State of Michigan pursuant to lease agreements between the SBA, the State of Michigan, and the University. During the lease terms, the SBA will hold title to the respective buildings, the State of Michigan will make all lease payments to the SBA, and the University will pay certain operating and maintenance costs. The SBA will be obligated to sell each building to the University for one dollar, after full payment of all rentals due under the related lease.

At June 30, 2007, the University had entered into various limited partnerships with investment managers of oil and gas, real estate, venture capital, private equity, and restructuring funds. As of June 30, 2007, $135,551 of the initial $263,550 investment commitment remains outstanding.

13. Contingencies and risk management

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

The University's liability for various medical professional liability claims is funded based on actuarial valuations. The University carries excess commercial medical professional liability insurance to manage the liability. The liability is reported at its present value of $6,926 as of June 30, 2007. The discount rate used was 5%.

The University is also self-insured for various employee benefits which include health care and dental insurance, workers compensation, and unemployment compensation. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Those losses include an estimate of claims that have been incurred but not reported. The workers compensation liability, which will be settled by fixed payments over an extended period of time, is reported at its present value of $3,880 as of June 30, 2007. The discount rate used was 6%.

Changes in the total reported general, professional, and self-insured employee benefit liabilities during 2007, 2006, and 2005 were as follows:

	2007	2006	2005
Balance, beginning of year	$ 18,830	$ 19,967	$ 18,758
Claims incurred and changes in estimates	88,463	84,923	90,433
Claim payments	(88,020)	(86,060)	(89,224)
Balance, end of year	19,273	18,830	19,967
Less: current portion	10,242	11,066	13,455
Noncurrent portion	$ 9,031	$ 7,764	$ 6,512

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

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

14. Investments in joint ventures

The University is a member of several incorporated nonprofit joint ventures, most of which are accounted for under the equity method. The University and Sparrow Health System are members of Mid-Michigan MRI, Inc., which provides high technology cross-sectional diagnostic imaging services. University Rehabilitation Alliance, Inc. has the University and Peckham Vocational Industries of Lansing as members and is an enterprise for the treatment of persons with brain injury. The Clinical Cancer Research Center is a corporation formed with McLaren Health Care Corporation to bring cancer care and research opportunities to community-based cancer centers and physicians. The University is a 50% member in each of the foregoing nonprofit corporations. Additionally, the University is a one-third member in Radiation Oncology Alliance, a nonprofit corporation formed with Michigan Affiliated Healthcare System, Inc. and the University of Michigan to provide radiation oncology services. Copies of financial statements for these entities can be obtained by a written request to: Office of the Controller, Michigan State University, Room 305 John A. Hannah Administration Building, East Lansing, Michigan 48824-1046.

15. Capital assets and collections

Capital asset and collection activity for the years ended June 30, 2007 and 2006 follows:

	2006	Additions (Deductions)	Disposals	2007
Non-depreciated capital assets:				
Land	$ 19,517	$ 5,011	$ (135)	$ 24,393
Construction in progress	77,665	30,688	-	108,353
Museum Collections	5,877	723	-	6,600
Total non-depreciated capital assets	103,059	36,422	(135)	139,346
Depreciated capital assets:				
Buildings and site improvements	1,650,403	77,103	(1,208)	1,726,298
Equipment and other	456,065	55,375	(14,830)	496,610
Less: accumulated depreciation				
Buildings and site improvements	(650,194)	(44,503)	409	(694,288)
Equipment and other	(354,559)	(32,205)	12,278	(374,486)
Total depreciated capital assets	1,101,715	55,770	(3,351)	1,154,134
Total capital assets	$ 1,204,774	$ 92,192	$ (3,486)	$ 1,293,480

	2005	Additions (Deductions)	Disposals	2006
Non-depreciated capital assets:				
Land	$ 19,517	$ -	$ -	$ 19,517
Construction in progress	138,364	(60,699)	-	77,665
Museum Collections	5,404	473	-	5,877
Total non-depreciated capital assets	163,285	(60,226)	-	103,059
Depreciated capital assets:				
Buildings and site improvements	1,432,040	226,935	(8,572)	1,650,403
Equipment and other	434,738	35,436	(14,109)	456,065
Less: accumulated depreciation				
Buildings and site improvements	(612,157)	(43,396)	5,359	(650,194)
Equipment and other	(337,425)	(29,640)	12,506	(354,559)
Total depreciated capital assets	917,196	189,335	(4,816)	1,101,715
Total capital assets	$ 1,080,481	$ 129,109	$ (4,816)	$ 1,204,774

16. Net assets

Restricted and unrestricted net assets for the years ended June 30, 2007 and 2006 are as follows:

	2007	2006
Restricted - nonexpendable:		
Permanent endowments	$ 472,062	$ 383,852
Restricted - expendable:		
Gifts, endowment income and sponsored programs	$ 162,044	$ 164,072
Quasi and term endowments	164,907	139,218
Capital projects	39,164	12,809
Student loans	7,549	7,521
Total	$ 373,664	$ 323,620
Unrestricted:		
Designated	$ 876,031	$ 767,654
Uncommitted	(21,795)	316
Total	$ 854,236	$ 767,970

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

Unrestricted – Unrestricted net assets are not subject to externally imposed constraints. However, these net assets are subject to internal designations. Unrestricted net assets include amounts designated for specific purposes by action of the Board or management or may otherwise be subject to pending contractual commitments with external parties. Substantially all unrestricted net assets are internally designated for programmatic initiatives or capital asset renewals. The net uncommitted balance of ($21,795) at June 30, 2007 is a result of the State of Michigan's deferral of the $26,562 August 2007 operating appropriation payment to the State's 2008 fiscal year.

17. Derivatives not reported at fair value

The University is party to derivative financial instruments (interest rate swaps) that are not reported at fair value on the Statement of Net Assets at June 30, 2007.

Objective of the swaps: In order to protect against the potential of rising interest rates, the University has entered into twelve separate pay-fixed, receive-variable interest rate swaps at a cost less than what the University would have paid to issue fixed-rate debt. In order to benefit from expected changes in the relationship of short and long-term interest rates, the University also entered into three separate pay-variable receive-variable interest rate swaps which relate to ten of the twelve pay-fixed, receive-variable interest rate swaps. As an integral part of the 2007 pay-variable receive-variable interest rate swap which relates to two of the twelve pay-fixed, receive-variable interest rate swaps, the University also expects to benefit from the relationship between the BMA Municipal Swap Index and the one month USD-LIBOR-BBA Index.

Terms, fair values, and credit risk: The terms, fair values, and credit rating of the outstanding swaps as of June 30, 2007 are listed below. The notional amounts of the swaps match the principal amounts of the associated debt. The University's swap agreements contain scheduled reductions to outstanding notional amounts that are expected to follow scheduled or anticipated reductions in the associated "bonds payable" category:

Associated Bond Issue	Outstanding Notional Amount	Effective Date	Rate Paid	Rate Received	Fair Value	Swap Termination Date	Counterparty/ Counterparty Credit Rating
1998A-2	$ 51,935	7/1/1998	4.604%	BMA Municipal Swap Index	$ (3,669)	8/15/2022	Ambac Financial Services/Aaa
2000A-1 & 2000A-2	97,045	5/2/2002	4.074%	67% USD-LIBOR-BBA one month	(3,279)	8/15/2029	Lehman Brothers Special Financing Inc./A1
2002A	47,085	10/17/2002	3.390%	67% USD-LIBOR-BBA one month	1,266	8/15/2032	UBS AG/Aaa
2002A	2,120	10/17/2002	3.530%	67% USD-LIBOR-BBA one month	40	8/15/2022	UBS AG/Aaa
2002B	7,250	10/17/2002	4.330%	USD-LIBOR-BBA one month	225	8/15/2018	UBS AG/Aaa
2002B	2,040	10/17/2002	5.280%	USD-LIBOR-BBA one month	55	8/15/2022	UBS AG/Aaa
2003A	77,105	12/11/2003	3.618%	67% USD-LIBOR-BBA one month	886	2/15/2033	Lehman Brothers Special Financing Inc./A1
2003B	22,560	12/11/2003	3.479%	67% USD-LIBOR-BBA one month	338	2/15/2026	UBS AG/Aaa
2003C	10,480	12/11/2003	5.330%	USD-LIBOR-BBA one month	265	2/15/2033	Lehman Brothers Special Financing Inc./A1
2005	84,580	7/2/2007	3.647%	67% USD-LIBOR-BBA one month	1,680	2/15/2034	Lehman Brothers Special Financing Inc./A1
2000A-1, 2000A-2, 2002A, 2003A, & 2005	307,935	5/26/2006	67% USD-LIBOR-BBA one month	67% USD-LIBOR-BBA ten year less .407%	(2,656)	2/15/2034	UBS AG/Aaa
2002B & 2003C	19,770	5/26/2006	USD-LIBOR-BBA one month	USD-LIBOR-BBA ten year less .575%	(153)	2/15/2034	UBS AG/Aaa
2007B	22,000	5/17/2007	4.139%	67% USD-LIBOR-BBA three month plus .58%	601	2/15/2028	JP Morgan Chase Bank/Aaa
2007B	71,685	5/17/2007	4.226%	67% USD-LIBOR-BBA three month plus .63%	2,365	2/15/2028	JP Morgan Chase Bank/Aaa
2007A & 2007B	124,505	6/8/2007	BMA Municipal Swap Index	67% USD-LIBOR-BBA one month plus .0063% until 7/1/2009, then 67% USD-ISDA Swap Rate ten year plus .0063%	(1,257)	2/15/2037	JP Morgan Chase Bank/Aaa
Total	$ 948,095				$ (3,293)		

Fair Value: Primarily because of changes in interest rates and interest spreads since their execution, the swaps in total have a negative fair value as of June 30, 2007 (see 'Basis Risk' disclosures). The swaps' negative fair value may be countered by a reduction in total interest payments required under the variable-rate bonds, creating a lower synthetic rate. Because the coupons on the University's variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swaps, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. The payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the dates of each of the future net settlements on the swaps.

Credit Risk: The University executes swap transactions with various counterparties. Seven swaps, approximating 43% of the notional amount of swaps outstanding, are with UBS AG, which is rated Aaa, while four swaps, approximating 28% of the outstanding notional value, are with Lehman Brothers Special Financing, Inc, rated A1, and three swaps, approximating 23% of the outstanding notional value, are with JP Morgan Chase Bank, N.A., rated Aaa. The remaining swap is with AMBAC Financial Services, rated Aaa.

As of June 30, 2007, (1) the University's credit ratings were Aa2 as assigned by Moody's, and AA as assigned by Standard & Poor's, and (2) the University was exposed to net credit risk in the amount of $2,831 related to the pay-fixed, receive-variable interest rate swaps with Lehman Brothers Special Financing, Inc. associated with the 2003A, 2003C and 2005 bond issues and $1,709 related to the pay-fixed, receive-variable interest rate swaps with JP Morgan Chase Bank, N.A. associated with the 2007B bond issue. To mitigate credit risk, if the counterparties' credit quality falls below certain levels, collateralization is required. The following table demonstrates the thresholds and minimum transfers for collateralization:

					Lehman Brothers Special Financing, Inc.					
	AMBAC		UBS Warburg		Series 2000A*		Series 2003A & C, 2005		JP Morgan	
Credit Rating	Threshold	Minimum Transfer	Threshold	Minimum Transfer	Threshold	Minimum Transfer	Threshold	Minimum Transfer	Threshold	Minimum Transfer
Aaa/AAA	Unlimited	N/A	$ 40,000	$ 1,000	$ 1,000	$ 100	$ 40,000	$ 1,000	$ 40,000	$ 1,000
Aa3/AA- to Aa1/AA+	$ 6,000	$ 1,000	6,000	1,000	1,000	100	6,000	1,000	20,000	1,000
A3/A- to A1/A+	1,500	500	1,500	500	1,000	100	1,500	500	5,000	500
Above Baa2/BBB- up to Baa1/BBB+	500	250	500	250	1,000	100	500	250	500	250
Baa2/BBB	500	250	500	250	500	100	500	250	-	250
Below Baa2/BBB	-	250	-	250	-	100	-	250	-	250

*Unilateral collateralization - Lehman Brothers Special Financing, Inc. only.

Basis Risk: The pay-fixed receive-variable swaps expose the University to basis risk should the rates resulting from the BMA Municipal Swap Index for the 1998A-2 swap, 67% of USD-LIBOR-BBA for the 2000A-1, 2000A-2, 2002A, 2003A, 2003B and, 2005 swaps, and USD-LIBOR-BBA for the 2002B and 2003C swaps not equal the rate the University pays. The pay-variable receive-variable swaps expose the University to basis risk should (1) interest rate spreads between one month USD-LIBOR-BBA Index and ten year USD-ISDA Swap Rate or (2) the BMA Municipal Swap Index and 67% of the one month USD-LIBOR-BBA Index narrow.

Rollover risk: The University is exposed to rollover risk on its 1998A-2 swap that may be terminated on or after July 1, 2008, prior to the August 15, 2022 maturity of the associated debt, if certain interest rate conditions are met. If the counterparty is able to exercise its conditional termination option, the University will not realize the synthetic rate offered by the swap on the underlying debt issue.

Termination Risk: The University or any of the involved counterparties may terminate any of the swaps if the other party fails to perform under the terms of the contract. If a swap is terminated, the variable-rate bonds would no longer carry a synthetic fixed interest rate. Also, if at termination a swap has a negative fair value, the University would be liable to the appropriate counterparty for a payment equal to the swap's fair value.

18. New accounting pronouncements

The University will be required to implement the provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, effective with the fiscal year ending June 30, 2008. While the University has not yet determined the full impact of GASB Statement No. 45 on its financial statements, in accordance with this Statement, the University will address the accounting and financial reporting for the unfunded accumulated benefit obligations related to postemployment healthcare and other non-pension benefits. Based upon the latest actuarial calculation (completed July 2006), these obligations are estimated at $830 million.

The University will be required to implement the provisions of GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Equity Transfers of Assets and Future Revenues*, effective with the fiscal year ending June 30, 2008. The University will be required to determine whether certain transactions should be regarded as a sale or as a collateralized borrowing resulting in a liability. The University has not yet determined the full impact of GASB Statement No. 48 on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations,* effective with the fiscal year ending June 30, 2009. The University will be required to address the accounting and financial reporting for pollution (including contamination) remediation obligations. The University has not yet determined the full impact of GASB Statement No. 49 on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 51, Accounting and Financial Reporting for Intangible Assets, effective with the fiscal year ending June 30, 2010. The University will be required to address accounting and financial reporting for intangible assets with regard to recognition, initial measurement, and amortization. The University has not yet determined the full impact of GASB Statement No. 51 on its financial statements.

Financial report prepared under the direction of Fred L. Poston, Vice President for Finance and Operations and Treasurer; David B. Brower, Assistant Vice President, Chief Financial Officer and Controller; Glen J. Klein, Director of Investments and Financial Management; Vincent Schimizzi, Assistant Controller; Gregory J. Deppong, Chief Accountant; and Robert J. Patterson, Manager of Financial and Cost Analysis.

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

To the Board of Trustees
Michigan State University

We have audited the basic financial statements of Michigan State University as of and for the years ended June 30, 2007 and 2006 and have issued our report thereon dated October 5, 2007. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned function, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

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

Compliance and Other Matters

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

To the Board of Trustees
Michigan State University

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

Plante & Moran, PLLC

Kalamazoo, Michigan
October 5, 2007