MICHIGAN STATE UNIVERSITY

FINANCIAL REPORT 2008–2009

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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, 2009, and June 30, 2008. 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.

Michigan State University has been advancing knowledge and transforming lives through innovative teaching, research, and outreach for more than 150 years. More than 46,000 students from every state in the nation and more than 130 countries enroll at Michigan State each year in over 200 programs of undergraduate and graduate study. MSU is known internationally as a major public university with global reach and extraordinary impact. Its 17 degree-granting colleges attract scholars worldwide who are interested in combining education with practical problem solving.

The University has weathered the world-wide financial turmoil, maintaining adequate liquidity and avoiding the need to obtain working capital by liquidating investments at depressed market valuations. By adhering to its basic financial principals, including funding recurring operations with recurring revenues, the University has made necessary fiscal adjustments with the objectives of maintaining quality. The University continues to focus on cost controls, pursue a long-term investment strategy to maximize risk-adjusted total returns, and appropriately utilize debt and other resources to meet programmatic needs, including the maintenance and replacement of the University's infrastructure.

Significant achievements continue in a number of areas. In December 2008, the U.S. Department of Energy announced the selection of MSU as the site for the Facility for Rare Isotope Beams (FRIB), a cutting-edge research facility to advance understanding of rare nuclear isotopes and the evolution of the cosmos. This facility is expected to bring approximately $1 billion in economic activity and 400 jobs to Michigan. MSU proudly opened the new MSU Surplus Store and Recycling Center in September 2009. This facility demonstrates the University's dedication to becoming an exemplary steward of the environment. In October 2009, MSU celebrated its partnerships and presence in Detroit and Southeast Michigan with the opening of the new MSU Detroit Center, a symbol of our expanding commitment to make a difference in this critical region of our state.

As we move forward in difficult financial times, we continue to put every dollar possible into opportunities for students and developing critical programs and initiatives. We also continue to place great emphasis on controlling costs so that every dollar saved, not just new dollars, can be directed toward our strategic priorities and emerging opportunities. Through the concerted efforts of its faculty, staff, alumni and worldwide supporters, Michigan State will continue to make a significant impact on Michigan, the nation and the world.

Fred L. Poston
Vice President for Finance and Operations and Treasurer
October 30, 2009

OFFICE OF THE
VICE PRESIDENT FOR FINANCE AND OPERATIONS AND TREASURER

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Michigan State University

is making a significant positive impact in Michigan, across the nation, and around the world through world-class academics, pioneering research, and innovative outreach. MSU is committed to sharing knowledge created at the university that leads to practical solutions that make a difference in the lives of individuals and communities from Michigan to Malawi. While the university is expanding its global reach, it also is meeting challenges close to home and maintaining its commitment to values and vision through planning and decision making. Learn more at **news.msu.edu**.

PIONEERING RESEARCH

- MSU has been awarded a three-year, $2.1 million federal grant to serve as the data coordinating center for the largest-ever epidemiological study on autism. MSU's Biomedical Research Informatics Core will collect and create a repository for data from nearly 3,000 families as part of the congressionally mandated Study to Explore Early Development. The 10-year study will help identify what might put children at risk for autism spectrum disorders and other developmental disabilities.

- Michigan State's distinguished pool of education researchers is working with dozens of Detroit schools as they strive to improve student achievement. The Detroit-based Skillman Foundation selected MSU's College of Education to reestablish and operate its Good Schools Resource Center with a two-year, nearly $2 million grant. The foundation's Good Schools: Making the Grade initiative provides direct grants to schools located in the city. The resource center provides tailored guidance and training to teachers, administrators, and parents as they work toward meeting goals outlined by each grant. More than 15 MSU faculty and staff members conduct seminars and workshops, visit schools, analyze data, maintain a Web site of resources, and otherwise consult with educators.

- A researcher at MSU has developed a vaccine for a strain of *E.coli* that kills two million to three million children each year in the developing world. A. Mahdi Saeed, professor of epidemiology and infectious disease in MSU's Colleges of Veterinary Medicine and Human Medicine, has applied for a patent for his discovery and has made contact with pharmaceutical companies for commercial production. *Enterotoxigenic E. Coli* (ETEC), which is responsible for 60 percent to 70 percent of all *E. coli* diarrheal disease, also causes health problems for U.S. troops serving overseas and is responsible for what is commonly called traveler's diarrhea. ETEC affects millions of adults and children across the globe, mainly in Southern Hemisphere countries throughout Africa and South America.

World-leading science research at MSU

MSU is building on its half-century commitment to accelerator-based nuclear science as it moves forward with the Facility for Rare Isotope Beams (FRIB). The U.S. Department of Energy selected MSU—a world leader in rare isotope research and home to the nation's No. 2-ranked graduate program in nuclear physics—to design and establish FRIB. On June 12, 2009, MSU held a ceremony to mark a major expansion of MSU's National Superconducting Cyclotron Laboratory and to celebrate the coming of FRIB.

The $550 million FRIB facility will bring together an international community of top scientists to advance understanding of rare nuclear isotopes—helping unlock the mysteries of nature and the universe and fueling breakthrough applications for medicine, national security, and the environment. FRIB is expected to bring an estimated billion dollars in economic activity to Michigan over two decades. And as an investment in U.S. competitiveness, siting the facility on a university campus is a clear win for nuclear science education.

INTERNATIONAL IMPACT

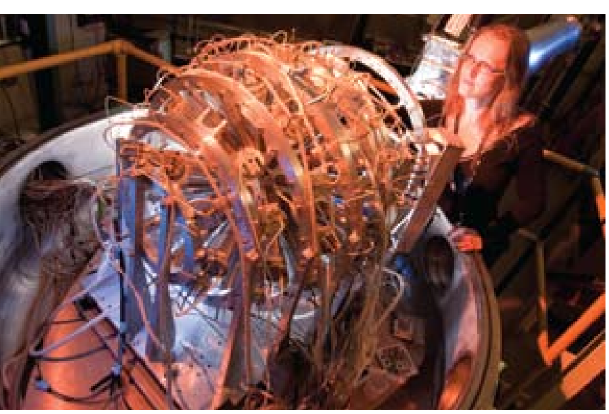
- MSU has a rich history of collaboration in Africa, with more than a half century of research and development efforts across the continent. The university is continuing its work there with a $4 million grant from the Bill and Melinda Gates Foundation to lead a project designed to improve research and analysis of agricultural markets in sub-Saharan Africa. Under the three-year project, MSU scientists will analyze the region's small-farm markets and infrastructure and develop strategies to increase agricultural productivity and create more-efficient, sustainable markets for small farmers.

- The university is a world leader in using environmental research to fight poverty and slow climate change. Under MSU's Carbon2Markets initiative, research that encompasses many collaborative projects with researchers and farmers in Thailand, Laos, and other Asian and African countries is incorporating new crops such as jatropha trees into farming operations. Each project is tailored to fit the agricultural, environmental, and economic needs of the region. The goal is to teach some of the world's poorest farmers to grow crops with high market value that can sequester carbon, allowing them to earn money from carbon offset credits in global carbon markets.

- A collaborative team from the MSU Museum and the Nelson Mandela Museum in South Africa has created a one-of-a-kind interactive exhibit that is inspiring young people around the world with its message of "ubuntu," a Zulu word that means literally "humanity to others." Dear Mr. Mandela, Dear Mrs. Parks: Children's Letters, Global Lessons features a collection of letters written by children from around the world to renowned human rights leaders Nelson Mandela and the late Rosa Parks. Designed to raise awareness of social justice challenges that South Africans and Americans have faced, the exhibit opened in South Africa in July 2008 to kick off a yearlong celebration of Mandela's 90th birthday.

ECONOMIC DEVELOPMENT

- Michigan's University Research Corridor (URC)—a partnership involving MSU, University of Michigan, and Wayne State University—has grown in all competitive categories during the last two years, rising among the nation's top research and development clusters for producing patents, businesses, and graduates with high-tech-related degrees, according to an annual report by Anderson Economic Group. The URC also injected more than $14 billion into Michigan's stagnant economy during fiscal year 2008. Research spending by the partner institutions grew to $1.4 billion, with most of that money coming into the state through federal grants. The URC also awarded the third-largest number of high-tech degrees (7,638), close behind Pennsylvania (7,713), and Southern California (8,266).



- An MSU technology spin-off company is the first tenant in MSU's new Bio-economy Institute, located in a former Pfizer Inc. laboratory in Holland, Michigan. Biochemistry professor Rawle Hollingsworth has operated his company, AFID Therapeutics Inc., in laboratory space in Lansing since 2004, developing technology licensed from MSU. It now will tap western Michigan talent and resources to expand development work. Hollingsworth's research on complex carbohydrates derived from biomass and sugars forms the basis for developing high-value chemical compounds that can be used to create drugs for infectious diseases and autoimmune, cardiovascular, and neurological disorders, as well as specialty chemicals for other purposes. The company is developing material for more than 100 companies around the world to use for testing and further development.

- A next-generation chemical company founded on MSU science has raised $21 million in new venture funding to commercialize chemical intermediates used to make nylon and other products with renewable resources instead of petrochemicals. Draths Corp. was founded in December 2005 by John Frost, a University Distinguished Professor on leave from the Department of Chemistry, and his wife, Karen Draths Frost, a former assistant professor of chemistry. Based in Plymouth, Minnesota, and operating a research laboratory in Okemos, Draths is commercializing a suite of technologies developed in the Frosts' MSU lab and licensed by the university. TPG, a global private investment firm, is the lead investor in the latest funding round, joined by CMEA Capital of San Francisco and Khosla Ventures of Menlo Park, California. Draths initially is targeting the $20 billion nylon chemical intermediates market, aiming to supply consumer goods makers using renewable resources.

GROWTH AND DEVELOPMENT AT MSU

- A partnership between Michigan State and technology giant IBM brought an application development center to campus. The first of its kind for the company in the United States, the IBM facility is the product of an agreement to expand MSU's recruiting, research, and educational partnerships with the company, which already is a top employer of MSU graduates. The IBM Global Delivery Center for Application Services is housed on the second floor of the former MSU Federal Credit Union headquarters on the south end of campus. State of Michigan estimates predict up to 1,500 new direct and indirect jobs will be created during the next five years.

- MSU extended its international reach and its reputation as a globally engaged university offering world-class academics with the opening of classes at MSU Dubai in August 2008. The first major North American research university with a presence in the Dubai International Academic City, Michigan State offers students from the region the opportunity to attend one of the world's top universities and also opens doors to academic and research partnerships. MSU Dubai also serves as a vehicle to engage the state of Michigan and its economic interests with the Middle East. As major Michigan corporations explore expansion into the region, MSU's presence provides an instant connection and support.

- At the same time Michigan and the rest of the nation are projecting physician and nurse shortages, MSU's medical colleges are undergoing vital expansions statewide that will help fill this void as well as establish Michigan as a leader in medical education and research. June 30, 2008, marked the first day of classes for students at two College of Osteopathic Medicine expansion sites in Southeast Michigan—the Macomb University Center in Clinton Township and the Detroit Medical Center in downtown Detroit—with 50 new students at each site. In Grand Rapids, the College of Human Medicine continues its progress with the construction of the Secchia Center, the seven-story, 18,000-square-foot facility that will serve as the college's West Michigan home and will include teaching laboratories, classrooms, offices, and student areas. In addition, MSU's College of Nursing received $7 million from Timothy and Bernadette Marquez—the largest gift in the college's history—that will be used to help fund a new nursing addition to the MSU Life Science Building.

MSU RANKINGS AND RECOGNITIONS

- Recognized for six consecutive years as one of the top 100 universities in the world (Shanghai Jiao Tong University's Academic Ranking of World Universities)
- Ranks 29th among the nation's public universities (*U.S. News & World Report*)
- Cited as one of the "top colleges for business" and featured with East Lansing as one of 10 leading examples of "universities and cities that are linking up in creative entrepreneurial initiatives" (October 2009 issue, *Entrepreneur* magazine)
- National leader in study abroad participation among public universities for fourth year in a row and one of only four public universities in the nation that rank in the top 10 for both study abroad participation and international student enrollment (Open Doors 2008)
- Residential college, study abroad, service-learning, and undergraduate research programs listed as "outstanding examples" of programs linked to student success (*U.S. News & World Report*)
- Among the 100 best national universities in freshman retention rate and most international students (*U.S. News & World Report*)
- Ranks third among the nation's largest universities in 2009 for producing Peace Corps volunteers and sixth among all-time producers of volunteers with 2,151 since 1961 (Peace Corps rankings)
- Record of Rhodes Scholars has led the Big Ten since the 1960s
- Graduate programs in elementary and secondary education No. 1 in the nation for 15th year in row (*U.S. News & World Report*)
- Graduate program in nuclear physics No. 2 in the nation (*U.S. News & World Report*)

Learn more: rankings-and-recognitions.msu.edu

Introduction

The following discussion provides an overview of the financial position of Michigan State University (the "University") for the years ended June 30, 2009 and 2008 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, 2009, 2008, and 2007 follows:

	2009	2008	2007
		(in millions)	
Current assets	$ 395	$ 609	$ 445
Noncurrent assets:			
Restricted cash and cash equivalents and restricted investments	-	27	83
Endowment and other investments	1,363	1,596	1,561
Capital assets, net	1,508	1,375	1,293
Other	93	90	76
Total assets	3,359	3,697	3,458
Current liabilities	483	492	350
Noncurrent liabilities	594	623	590
Total liabilities	1,077	1,115	940
Total net assets	$ 2,282	$ 2,582	$ 2,518

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 2009 is due in part to a net $84 million decrease in cash and cash equivalents and investments (this decrease is primarily a function of the University's operating, financing, and investing activities as reported in the Statement of Cash Flows), and a $133 million decrease in collateral from the securities lending program. The decrease in securities lending collateral is due primarily to the decrease in investments available for loan and a change in the makeup of the underlying investment holdings under the securities lending program as of June 30, 2009 and their related propensity for lending. The net increase in 2008 is due in part to a net increase in accounts receivable due primarily to the State of Michigan's deferral of the University's August 2007 operating appropriation payment ($27 million) and operating budget rescission ($5 million) in 2007. The net increase in current assets in 2008 also includes a net $8 million increase in cash and cash equivalents and investments (this increase is primarily a function of the University's operating, financing, and investing activities as reported in the Statement of Cash Flows), and a $130 million increase 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 decreases in 2009 and 2008 represent the spending of Series 2007 bond proceeds consistent with their restricted purpose.

Endowment and other investments

At June 30, 2009 and June 30, 2008, the University's endowment investments totaled $1,047 million (a decrease of $221 million) and $1,268 million (an increase of $21 million), respectively. During 2009 and 2008, $60 million of investments were reallocated to designated endowment investments, consistent with the University's Board approved cash management and investment plan. Market value (realized and unrealized) decreases within the investment portfolio accounted for $247 million and $4 million of the decreases in 2009 and 2008, respectively, while endowment gifts totaled $22 million in 2009 and $23 million in 2008. Unfavorable conditions in the global financial markets caused the 2009 and 2008 market value declines.

Other investments consist primarily of the Intermediate Term Fixed Income Fund component of the University's Operating Cash Pool, which totaled $208 million and $213 million at June 30, 2009 and 2008, respectively. Funded retirement and postemployment benefit reserves ($67 million in 2009 and $88 million in 2008) substantially account for the remainder of other investments.

For the years ended June 30, 2009, 2008, and 2007, the total returns on investments were as follows:

	2009	2008	2007
Operating Cash Pool:			
Liquidity Pool	3.6%	5.6%	5.1%
Intermediate Term Fixed Income Fund	(2.1)%	5.9%	5.8%
Common Investment Fund	(18.0)%	1.6%	19.0%
Other Separately Invested Investments	(3.2)%	(0.9)%	13.2%

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, 2009, 2008, and 2007, the University's investment in capital assets was as follows:

	2009	2008 (in millions)	2007
Land	$ 26	$ 25	$ 24
Buildings and site improvements	1,929	1,856	1,726
Construction in progress	204	105	108
Equipment and other	562	526	497
Museum collections	8	8	7
Less: accumulated depreciation	(1,221)	(1,145)	(1,069)
	$ 1,508	$ 1,375	$ 1,293

Major additions to buildings and site improvements during 2009 include $18 million for the Duffy Daugherty Football Building expansion and the following renovations: $11 million for Mary Mayo Hall, $9 million for Holden Hall public area, and $6 million for Old College Field. Major additions to buildings and site improvements during 2008 included $45 million for Snyder-Phillips Hall renovations, $20 million for Chemistry Building renovations, and $17 million for reconstruction at University Village.

Construction in progress reflects multi-year projects which, once completed and placed into service, are categorized as buildings and site improvements. The 2009 balance includes $51 million for the Secchia Center, $33 million for MSU's Enterprise Business Systems Project, $21 million for the Farm Lane Underpass, $12 million for Wharton Center for the Performing Arts alterations and expansion, and $12 million for MSU's Surplus Store & Recycling Center. The 2008 balance included $24 million for the Secchia Center, $21 million for the Farm Lane Underpass, $14 million for Duffy Daugherty Football Building expansion, and $11 million for MSU's Enterprise Business Systems Project.

As of June 30, 2009, 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 $195 million and are to be funded from debt proceeds, other University funds, 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 2009 is due primarily to a $124 million decrease in obligations under securities lending due primarily to the decrease in investments available for loan and a change in the make-up of the underlying investment holdings under the securities lending program as of June 30, 2009 and their related propensity for lending. This decrease is partially offset by an increase in the current portion of long term debt and other obligations ($95 million) due primarily to the issuance of General Revenue Notes Series 2008A and 2008B, a short-term commercial paper financing program used to finance or reimburse all or part of the costs of eligible capital projects, to refund previously issued debt, and to pay all or part of the costs incidental to the issuance of the Notes and any refunding. The net decrease in current liabilities in 2009 is also partially offset by an $18 million increase in accounts payable due primarily to an increase in construction related payables ($14 million). The net increase in current liabilities in 2008 was due primarily to a $130 million increase in obligations under securities lending.

Noncurrent liabilities, primarily debt:

At June 30, 2009, the University had noncurrent debt and other obligations outstanding of $468 million compared with $553 million at June 30, 2008. This balance is comprised primarily of outstanding General Revenue Bonds of $428 million and $513 million in 2009 and 2008, respectively. The decrease in noncurrent debt and other obligations is due in part to scheduled principal debt payments of $16 million on outstanding General Revenue Bonds. In addition, through a public tender offer made by the University, $69 million of General Revenue Bonds, Series 2007B, was refunded using $48 million of proceeds from the issuance of General Revenue Notes, Series 2008A, resulting in a $21 million gain recognized by the University (see footnote 8 for further information). The University periodically reviews its debt capacity and related capital asset needs to optimize the use of long-term resources. The University's outstanding General Revenue debt carry an investment grade credit rating from Moody's and Standard & Poor's of Aa2 and AA, respectively.

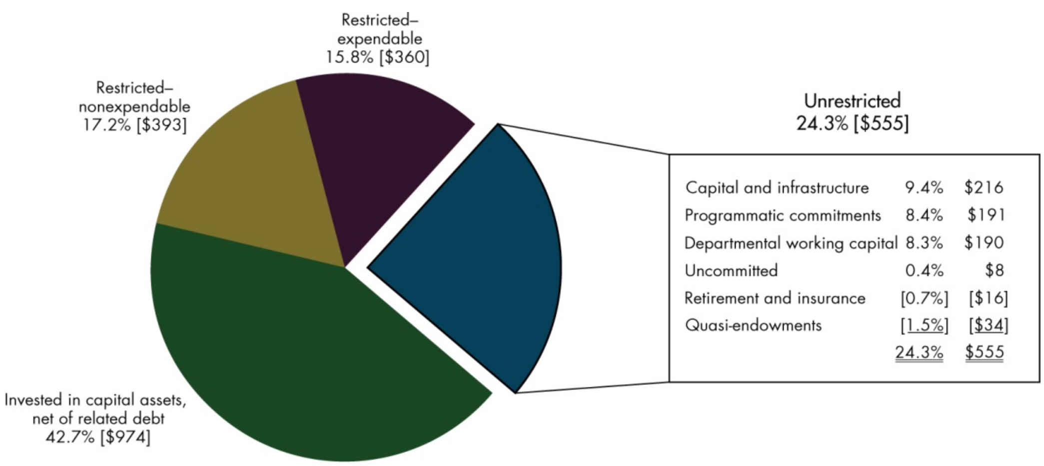
The University faces the continuing challenge of funding its increasing health care and dental benefits costs. This includes the cost of providing postemployment health and dental benefits to eligible employees (other postemployment benefits, or OPEB). For the year ended June 30, 2009, the University has estimated the cost (annual expense) of providing OPEB through an actuarial valuation as of January 1, 2008 and adjusted for 2008-09 health care cost experience. The actuarial valuation computes an annual required contribution, which represents a level of funding that, if paid on an ongoing basis, is projected to cover current year costs and amortize any unfunded actuarial liabilities over a period of thirty years. MSU's total unfunded OPEB obligation in 2009 and 2008 is estimated at $852 million and $835 million, respectively. The University has recorded a noncurrent liability of $88 million and $43 million for 2009 and 2008, respectively, representing the net OPEB obligation (the annual required contribution for 2009 and 2008 less actual retiree health and dental payments made during the respective fiscal years). This increase is due to the continued amortization (over thirty years) of the total unfunded OPEB obligation.

Net assets:

Net assets represent residual University assets after liabilities are deducted. The University's net assets at June 30, 2009, 2008, and 2007 are summarized as follows:

	2009	2008	2007
		(in millions)	
Invested in capital assets, net of related debt	$ 974	$ 858	$ 818
Restricted:			
Nonexpendable	393	492	472
Expendable	360	402	374
Total restricted	753	894	846
Unrestricted	555	830	854
Total net assets	$ 2,282	$ 2,582	$ 2,518

The following is a breakdown of net assets at June 30, 2009. See footnote 16 for further information (amounts are presented in millions of dollars):



TOTAL NET ASSETS $2.3 BILLION

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 subject to internal designation to meet various specific commitments, including maintaining reserves for capital projects, the continued recognition of the OPEB obligation, working capital for self-supporting departmental activities, and unrestricted quasi and term endowments.

Over time, increases or decreases in net assets are an indicator of the improvement or erosion of the University's financial health when considered with non-financial facts such as enrollment levels, strength of faculty, and condition of facilities. In addition, net assets are directly affected by the performance of the University's investments. For the fiscal year ending June 30, 2009, unfavorable conditions in the global financial markets significantly contributed to the decline in net assets. The University continues to focus on cost controls, pursuing a long-term investment strategy to maximize risk-adjusted total returns, and appropriately utilizing debt and other resources to meet programmatic needs, including the maintenance and replacement of the University's infrastructure.

The University's ongoing review of its infrastructure indicates a need to expend approximately $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.

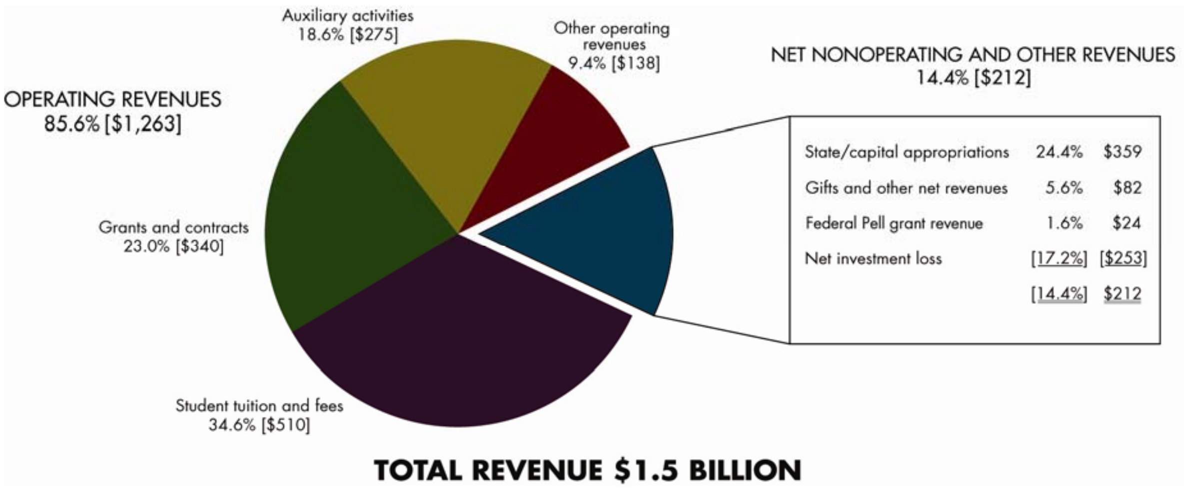
Statement of Revenues, Expenses, and Changes in Net Assets

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, 2009, 2008, and 2007 follows:

	2009	2008	2007
		(in millions)	
Operating revenues:			
Student tuition and fees, net of allowances	$ 510	$ 460	$ 406
Grants and contracts	340	319	317
Auxiliary activities	275	274	253
Other operating revenues	138	145	140
Total operating revenues	1,263	1,198	1,116
Operating expenses:			
Instruction and departmental research	551	521	476
Research	262	260	244
Public services	212	200	186
Academic support	77	75	72
Student services	31	31	28
Scholarships and fellowships	41	36	32
Institutional support	90	83	68
Operation and maintenance of plant	158	145	136
Auxiliary enterprises	256	253	230
Depreciation	91	85	77
Other operating expenses, net	6	5	7
Total operating expenses	1,775	1,694	1,556
Operating loss	(512)	(496)	(440)
Nonoperating revenues (expenses):			
State operating appropriation	293	317	261
State agricultural experiment station appropriation	34	37	31
State cooperative extension service appropriation	30	32	26
Federal Pell grant revenue	24	21	18
Gifts	55	48	55
Net investment income (loss)	(253)	66	244
Interest expense on capital asset related debt	(23)	(20)	(16)
Other nonoperating revenues (expenses), net	22	2	-
Net nonoperating revenues	182	503	619
Income (loss) before other revenues	(330)	7	179
State capital appropriations	2	5	12
Capital grants and gifts	12	31	34
Additions to permanent endowments	16	21	26
Increase (decrease) in net assets	(300)	64	251
Net assets, beginning of year	2,582	2,518	2,267
Net assets, end of year	$ 2,282	$ 2,582	$ 2,518

The following is a graphic illustration of total net revenue by source for the year ended June 30, 2009 (amounts are presented in millions of dollars):

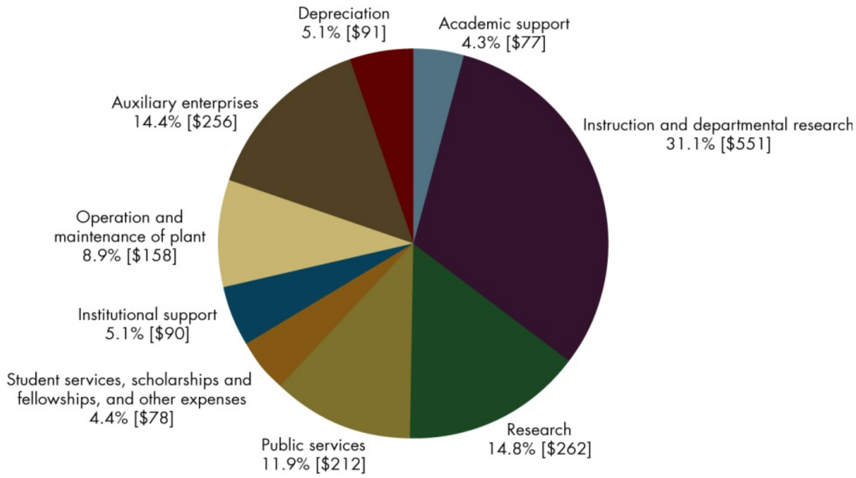


The University is supported by a diverse stream of revenue which supplements its student tuition and fees, including state appropriations, federal and state sponsored programs, private gifts and grants, and investment income. The University continues to seek funding from all possible sources consistent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

Operating revenues: The most significant source of operating revenue for the University is tuition and fees (net of scholarship allowances), totaling $510 million and $460 million in 2009 and 2008, respectively. Gross tuition and fees revenue increased 11.5% in 2009, which includes a 9.4% effective rate increase in tuition and fees and a 2.1% revenue increase from additional student credit hours taken and changes in the student blend. The 13.0% increase in 2008 reflected a 9.5% effective rate increase in tuition and fees and a 3.5% revenue increase from additional student credit hours taken and changes in the student blend. Other major revenue sources in 2009 include federal grants and contracts of $242 million (an increase of $11 million), including $225 million for sponsored research programs, and auxiliary services of $275 million (an increase of $1 million).

Net nonoperating and other revenues: The primary source of this net revenue is State appropriations, which totaled $357 million in 2009, a decrease of $29 million (7.5%), due primarily to the one-time receipt of $27 million in deferred 2007 appropriations in 2008. In 2009, the University received $293 million in funding for general operations, a 1.0% increase over 2008 general appropriations of $290 million. In 2009, Michigan State University Extension and Michigan Agricultural Experiment Station appropriations totaled $64 million (a 1.0% increase). Other significant components of net nonoperating revenues in 2009 include gift revenue (increased $7 million), net investment income (decreased $319 million due to market conditions) and other net nonoperating revenues (increased $20 million due primarily to a gain recognized as part of the public tender offer to refund General Revenue Bonds, Series 2007B). In 2008, gift revenue decreased $7 million and net investment income decreased $178 million.

The following is a graphic illustration of operating expenses by source for the year ended June 30, 2009 (amounts are presented in millions of dollars):



TOTAL OPERATING EXPENSES $1.8 BILLION

During 2009, $1,025 million was expended for the core missions of the University - instruction and departmental research, research, and public services, an increase of $44 million (4.5%) over 2008. Instruction and departmental research expenses increased $30 million (5.8%), in part due to an increase in faculty/staff levels (2.2%) and salary increases (2.5%), and targeted funding to enhance academic programs. Auxiliary enterprises (activities which provide services to students, faculty, staff, and the public) and expenses for the operation and maintenance of plant increased $3 million (1.2%) and $13 million (9.0%), respectively.

Economic Outlook

Due to economic pressures affecting the State of Michigan, the 2009-10 fiscal year recurring budget (including appropriations to the University) is still pending, and appropriation reductions are expected. Because of the Maintenance of Effort provision of the Federal Stimulus legislation, 2009-10 recurring State appropriation contraction was held to 3.0%, allowing the Board of Trustees to approve a limited (5.2%) increase for fall 2009 in-state undergraduate tuition. This protection cannot be sustained. Adverse economic pressures affecting the State may continue to result in declining adjustments in State appropriations for higher education. The impact of such appropriation adjustments on tuition or programmatic reductions cannot be determined at this time. In addition, stresses on the global economy and financial markets may continue to impact, among other issues, the University's financing arrangements, investment returns, and energy costs. Regardless of economic circumstances, the University is committed to providing students with the opportunity to enroll in high quality, internationally competitive academic programs.

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Independent Auditor's Report

To the Board of Trustees
Michigan State University

We have audited the accompanying statements of net assets of Michigan State University (the "University") as of June 30, 2009 and 2008 and the related statements of revenues, 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Michigan State University and its component unit as of June 30, 2009 and 2008 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 7, 2009 on our consideration of Michigan State University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters for the year ended June 30, 2009. 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 8 through 16 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 7, 2009

STATEMENTS OF NET ASSETS
Michigan State University

	June 30, 2009	June 30, 2008
ASSETS	(in thousands)	
Current assets:		
Cash and cash equivalents	$ 15,129	$ 28,398
Investments	117,303	188,360
Collateral from securities lending	68,779	201,824
Accounts and interest receivable, net	150,986	137,723
Student loans receivable, net	13,160	14,566
Pledges receivable, net	16,583	23,138
Inventories and other assets	13,325	14,928
Total current assets	395,265	608,937
Noncurrent assets:		
Restricted cash and cash equivalents	-	15,043
Restricted investments	-	12,286
Endowment investments	1,046,512	1,267,922
Other investments	316,839	328,101
Student loans receivable, net	32,641	30,892
Pledges receivable, net	50,675	49,887
Investments in joint ventures	5,982	6,335
Unamortized bond origination costs	3,248	3,322
Capital assets, net	1,508,116	1,374,869
Total noncurrent assets	2,964,013	3,088,657
TOTAL ASSETS	**$ 3,359,278**	**$ 3,697,594**
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts and interest payable	$ 72,882	$ 55,205
Accrued personnel costs	66,298	60,252
Obligations under securities lending	77,648	201,824
Accrued self-insurance liabilities	15,196	15,331
Payroll taxes and other payroll deductions	38,602	36,197
Deposits held for others	22,694	27,525
Deferred revenues	78,168	78,535
Current portion of long term debt and other obligations	111,522	16,903
Total current liabilities	483,010	491,772
Noncurrent liabilities:		
Accrued personnel costs	28,715	18,968
Accrued self-insurance liabilities	9,057	8,117
Net other postemployment benefit obligation	88,105	43,295
Long term debt and other obligations	468,375	552,846
Total noncurrent liabilities	594,252	623,226
Total liabilities	**1,077,262**	**1,114,998**
Net assets:		
Invested in capital assets, net of related debt	974,276	858,232
Restricted:		
Nonexpendable	393,018	492,207
Expendable	359,840	402,343
Unrestricted	554,882	829,814
Total net assets	**2,282,016**	**2,582,596**
TOTAL LIABILITIES AND NET ASSETS	**$ 3,359,278**	**$ 3,697,594**

See accompanying notes

STATEMENTS OF FINANCIAL POSITION
Michigan State University Foundation

	June 30, 2009	June 30, 2008
	(in thousands)	
ASSETS		
Cash equivalents	$ 18,941	$ 4,636
Interest and dividends receivable	171	301
Grants and contracts receivable, net	1,242	275
Other receivables	1,532	1,106
Investments:		
Marketable securities	167,182	234,176
Investments in limited partnerships	91,686	110,110
Venture capital	27,897	24,423
Cash value of life insurance	1,280	1,193
Land held for investment	3,114	2,879
Other investments	1,240	1,263
Investment in Spartan Ventures LLC	466	469
Investment in Research Park	4,218	3,327
Prepaid expenses	108	74
Property and equipment, net	11,554	11,856
Intangible assets, net	823	782
Other assets	46	51
TOTAL ASSETS	**$ 331,500**	**$ 396,921**
LIABILITIES AND NET ASSETS		
Liabilities:		
Accrued expenses and other payables	$ 3,741	$ 2,535
Deferred compensation	177	177
Note payable - deferred compensation	196	196
Note payable	4,419	4,505
Trusts and annuities payable	11,305	10,891
Deferred gifts	433	433
Deposit held for Michigan State University	2,890	1,576
Obligations under life estate agreements	18	38
Total liabilities	23,179	20,351
Net assets:		
Unrestricted	274,160	339,067
Temporarily restricted	22,183	24,339
Permanently restricted	11,978	13,164
Total net assets	**308,321**	**376,570**
TOTAL LIABILITIES AND NET ASSETS	**$ 331,500**	**$ 396,921**

See accompanying notes

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

	Year ended June 30, 2009	2008
OPERATING REVENUES	**(in thousands)**	
Student tuition and fees	$ 583,524	$ 523,215
Less: scholarship allowances	73,692	63,232
Net student tuition and fees	509,832	459,983
State of Michigan grants and contracts	22,996	25,956
Federal grants and contracts	242,113	231,346
Local and private sponsored programs	74,618	62,087
Interest and fees on student loans	841	2,374
Departmental activities (net of scholarship allowances of $4,184 in 2009 and $4,102 in 2008)	137,300	142,399
Auxiliary activities (net of room and board allowances of $13,696 in 2009 and $12,513 in 2008)	275,349	273,621
TOTAL OPERATING REVENUES	**1,263,049**	**1,197,766**
OPERATING EXPENSES		
Instruction and departmental research	550,654	521,342
Research	261,930	260,180
Public services	211,949	199,987
Academic support	76,783	75,128
Student services	31,463	31,186
Scholarships and fellowships	40,713	36,258
Institutional support	90,128	82,446
Operation and maintenance of plant	158,193	144,935
Auxiliary enterprises	256,659	253,464
Depreciation	90,514	84,464
Other operating expenses, net	6,237	4,882
TOTAL OPERATING EXPENSES	**1,775,223**	**1,694,272**
Operating loss	(512,174)	(496,506)
NONOPERATING REVENUES (EXPENSES)		
State operating appropriation	293,041	316,702
State agricultural experiment station appropriation	34,336	37,071
State cooperative extension service appropriation	29,616	31,975
Federal Pell grant revenue	24,166	21,005
Gifts	55,081	48,152
Net investment income (loss)	(253,740)	66,152
Interest expense on capital asset related debt	(23,488)	(19,803)
Other nonoperating revenues (expenses), net	21,896	1,788
Net nonoperating revenues	180,908	503,042
INCOME (LOSS) BEFORE OTHER REVENUES	**(331,266)**	**6,536**
State capital appropriations	2,088	5,184
Capital grants and gifts	12,184	31,432
Additions to permanent endowments	16,414	21,275
Increase (decrease) in net assets	(300,580)	64,427
Net assets, beginning of year	2,582,596	2,518,169
NET ASSETS, END OF YEAR	**$ 2,282,016**	**$ 2,582,596**

See accompanying notes

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

Michigan State University Foundation

	Year ended June 30, 2009			
	Unrestricted Funds	Temporarily Restricted	Permanently Restricted	Total
REVENUE, GAINS AND OTHER SUPPORT:	(in thousands)			
Contributions	$ 64	$ 5,805	$ 28	$ 5,897
Equity earnings - subsidiaries	66			66
Income from investments	7,886	425	742	9,053
Royalty income	1,088			1,088
Rental income	1,224			1,224
Rental expenses	(3,215)			(3,215)
Realized and unrealized gain (loss) on securities	(51,748)	(3,092)	(1,424)	(56,264)
Grants and contracts	2,849			2,849
Other income	59			59
Net assets released from restrictions:				
Satisfaction of program restrictions	414	(410)	(4)	-
Current year transfers	5,412	(4,884)	(528)	-
TOTAL REVENUE, GAINS AND OTHER SUPPORT	(35,901)	(2,156)	(1,186)	(39,243)
EXPENSES AND LOSSES:				
Contributions to the University	18,097			18,097
Patent expense	912			912
Investment consulting fees	3,080			3,080
Investment management fees	437			437
Adjustments to value of annuities payable	268			268
Management and general	4,082			4,082
Postretirement benefits				
Net periodic benefit cost	119			119
Operational expenses - Management Company	19			19
Operational expenses - Spartan Ventures	307			307
MBI program expenses	1,685			1,685
TOTAL EXPENSES	29,006	-	-	29,006
Change in net assets	(64,907)	(2,156)	(1,186)	(68,249)
Net assets, beginning of year	339,067	24,339	13,164	376,570
NET ASSETS, END OF YEAR	$ 274,160	$ 22,183	$ 11,978	$ 308,321

	Year ended June 30, 2008			
	Unrestricted Funds	Temporarily Restricted	Permanently Restricted	Total
REVENUE, GAINS AND OTHER SUPPORT:	(in thousands)			
Contributions	$ 109	$ 8,678	$ 98	$ 8,885
Equity earnings - subsidiaries	129			129
Income from investments	13,432	334	686	14,452
Royalty income	582			582
Rental income	1,103			1,103
Rental expenses	(2,780)			(2,780)
Realized and unrealized gain (loss) on securities	(11,671)	(1,383)	(663)	(13,717)
Grants and contracts	2,527			2,527
Other income	87			87
Net assets released from restrictions:				
Satisfaction of program restrictions	535	(530)	(5)	-
Current year transfers	4,519	(3,426)	(1,093)	-
TOTAL REVENUE, GAINS AND OTHER SUPPORT	8,572	3,673	(977)	11,268
EXPENSES AND LOSSES:				
Contributions to the University	15,834			15,834
Patent expense	965			965
Investment consulting fees	2,101			2,101
Investment management fees	477			477
Adjustments to value of annuities payable	408			408
Management and general	3,457			3,457
Postretirement benefits				
Net periodic benefit cost	171			171
Operational expenses - Management Company	79			79
Operational expenses - Spartan Ventures	384			384
MBI program expenses	1,829			1,829
TOTAL EXPENSES	25,705	-	-	25,705
Change in net assets	(17,133)	3,673	(977)	(14,437)
Net assets, beginning of year	356,200	20,666	14,141	391,007
NET ASSETS, END OF YEAR	$ 339,067	$ 24,339	$ 13,164	$ 376,570

See accompanying notes

STATEMENTS OF CASH FLOWS
Michigan State University

	Year ended June 30, 2009	2008
Cash flows from operating activities	(in thousands)	
Tuition and fees	$ 513,379	$ 461,605
Research grants and contracts	324,468	322,936
Auxiliary activities	273,077	271,182
Departmental activities	136,874	137,574
Interest and fees on student loans	841	2,374
Loans issued to students	(8,749)	(92,613)
Collection of loans from students	8,405	106,420
Scholarships and fellowships	(50,618)	(43,866)
Payments to suppliers	(455,147)	(451,297)
Payments to employees	(1,102,885)	(1,039,298)
Other payments	(15,544)	(9,797)
Net cash used by operating activities	(375,899)	(334,780)
Cash flows from noncapital financing activities		
State appropriations	356,350	348,715
Federal Pell grant revenue	24,166	21,005
Gifts	58,492	46,756
Endowment gifts	16,414	21,308
Federal Family Education Loan Program receipts	294,127	263,114
Federal Family Education Loan Program disbursements	(294,279)	(276,441)
Net cash provided by noncapital financing activities	455,270	424,457
Cash flows from capital and related financing activities		
Capital appropriations	2,562	17,434
Capital gifts and grants	8,413	7,812
Proceeds from issuance of debt and other long term obligations	200,341	1,892
Purchase of capital assets	(205,106)	(166,656)
Proceeds from sale of capital assets	566	439
Principal paid on capital debt	(190,041)	(12,406)
Interest paid	(24,662)	(17,498)
Other receipts	24,391	2,100
Net cash used by capital and related financing activities	(183,536)	(166,883)
Cash flows from investing activities		
Investment income (loss), net	(16,699)	141,028
Proceeds from sales and maturities of investments	6,957,369	28,726,435
Purchase of investments	(6,864,817)	(28,815,841)
Net cash provided by investing activities	75,853	51,622
Net decrease in cash	(28,312)	(25,584)
Cash and cash equivalents, beginning of year	43,441	69,025
Cash and cash equivalents, end of year	$ 15,129	$ 43,441

See accompanying notes

Reconciliation of net operating loss to cash flows from operating activities:	**Year ended June 30, 2009**	**2008**
	(in thousands)	
Operating loss	$ (512,174)	$ (496,506)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation expense	90,514	84,464
Change in assets and liabilities:		
Accounts receivable	(14,025)	(4,266)
Student loans receivable	(343)	13,806
Inventories and other assets	1,603	1,286
Investments in joint ventures	353	(360)
Unamortized bond origination costs	74	(19)
Accounts payable	(516)	1,253
Accrued personnel costs	15,793	7,119
Payroll taxes and other payroll deductions	2,405	5,105
Deposits held for others	(4,831)	3,165
Deferred revenues	(367)	2,703
Accrued self-insurance liabilities	805	4,175
Net other postemployment benefit obligation	44,810	43,295
Net cash used by operating activities	$ (375,899)	$ (334,780)

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

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

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

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

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

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

Auxiliary activities – Auxiliary activities primarily represent revenues generated from University 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 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, 2009 and 2008 were as follows:

	2009	2008
Cash and cash equivalents, current	$ 15,129	$ 28,398
Restricted cash and cash equivalents, noncurrent	-	15,043
Total cash and cash equivalents	$ 15,129	$ 43,441

Of the bank balances for cash, the entire balance of $2,462 in 2009 and $100 of the total $1,835 in 2008 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 in exchange for the receipt of collateral which is invested. The University had loaned securities with a market value of approximately $75,498 and $196,699 at June 30, 2009 and 2008, 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, 2009 and 2008, 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, 2009 and 2008, the difference was less than 90 days.

As of June 30, 2009 and 2008, the University had the following investments:

	June 30, 2009					
Investment type	LP	IT	CIF	Securities Lending	Other	Total
Investment pools	$ 9,400	$ 151,235	$ 888,294	$ 40,891	$ 25,320	$ 1,115,140
U.S. Treasury bonds	-	314	7,952	-	65	8,331
U.S. Government agencies	42,019	-	30,586	-	11,867	84,472
Municipal bonds	-	2,038	859	-	-	2,897
Corporate bonds	49,533	21,980	29,785	16,688	64	118,050
Asset-backed securities	16,351	32,752	28,340	11,200	-	88,643
Domestic common stock	-	-	128,473	-	-	128,473
International equities	-	-	3,427	-	-	3,427
Total	$ 117,303	$ 208,319	$ 1,117,716	$ 68,779	$ 37,316	$ 1,549,433

	June 30, 2008					
Investment type	LP	IT	CIF	Securities Lending	Other	Total
Repurchase agreements	$ -	$ -	$ -	$ 24,000	$ -	$ 24,000
Investment pools	9,220	213,200	1,069,232	50,500	18,780	1,360,932
U.S. Treasury bonds	103,628	-	9,947	-	64	113,639
U.S. Government agencies	61,327	-	40,843	-	79	102,249
Corporate bonds	9,303	-	21,956	64,307	116	95,682
Asset-backed securities	17,168	-	27,843	63,017	-	108,028
Domestic common stock	-	-	173,069	-	640	173,709
International equities	-	-	20,218	-	36	20,254
Total	$ 200,646	$ 213,200	$ 1,363,108	$ 201,824	$ 19,715	$ 1,998,493

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, 2009 and 2008, 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, 2009 and 2008 are as follows:

	June 30, 2009 Fixed Income Investment Maturities				
Investment type	Less than 1 year	1-5 years	6-10 years	More than 10 years	Total
Investment pools	$ 40,892	$ 64,822	$ 187,771	$ 15,121	$ 308,606
U.S. Treasury bonds	-	1,778	3,652	2,901	8,331
U.S. Government agencies	-	13,239	7,852	63,381	84,472
Municipal bonds	16	964	610	1,307	2,897
Corporate bonds	18,128	66,791	20,263	12,868	118,050
Asset-backed securities	13,990	10,341	2,486	61,826	88,643
Total	$ 73,026	$ 157,935	$ 222,634	$ 157,404	$ 610,999

	June 30, 2008 Fixed Income Investment Maturities				
Investment type	Less than 1 year	1-5 years	6-10 years	More than 10 years	Total
Repurchase agreements	$ 24,000	$ -	$ -	$ -	$ 24,000
Investment pools	50,500	-	299,147	1,531	351,178
U.S. Treasury bonds	4,458	106,183	1,747	1,251	113,639
U.S. Government agencies	7,648	35,860	4,492	54,249	102,249
Corporate bonds	43,635	38,139	8,933	4,975	95,682
Asset-backed securities	63,037	9,292	6,010	29,689	108,028
Total	$ 193,278	$ 189,474	$ 320,329	$ 91,695	$ 794,776

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, 2009 and 2008, 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, 2009 and 2008 are as follows:

As of June 30, 2009

Rating	Investment pools	U.S. Treasury bonds	U.S. Government agencies	Municipal bonds	Corporate bonds	Asset-backed securities	Total
AAA	$ 54,442	$ 446	$ 13,947	$ 1,085	$ 26,258	$ 72,512	$ 168,690
AA	-	-	-	824	17,327	859	19,010
A	-	-	-	367	39,302	2,187	41,856
BBB	-	-	-	621	31,770	2,729	35,120
BB	-	-	-	-	1,042	754	1,796
Below BB	-	-	-	-	-	5,384	5,384
Not rated	254,164	7,885	70,525	-	2,351	4,218	339,143
Total	$ 308,606	$ 8,331	$ 84,472	$ 2,897	$ 118,050	$ 88,643	$ 610,999

As of June 30, 2008

Rating	Repurchase agreements	Investment pools	U.S. Treasury bonds	U.S. Government agencies	Corporate bonds	Asset-backed securities	Total
AAA	$ -	$ 50,500	$ -	$ 43,228	$ 32,525	$ 50,788	$ 177,041
AA	24,000	-	-	-	20,778	613	45,391
A	-	-	-	-	21,022	51,818	72,840
BBB	-	-	-	-	15,607	130	15,737
BB	-	-	-	-	633	459	1,092
Not rated	-	300,678	113,639	59,021	5,117	4,220	482,675
Total	$ 24,000	$ 351,178	$ 113,639	$ 102,249	$ 95,682	$ 108,028	$ 794,776

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

As of June 30, 2009 and 2008, 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 $1,478 of the U.S. Treasury bonds, $72,605 of the U.S. Government agencies, $2,897 of the Municipal bonds, $96,250 of the Corporate bonds, $77,443 of the Asset-backed securities, $64,468 of the domestic equities, $1,620 of the international equities, and $38,696 of the external investment pools are held by the University's counterparty, not in the name of the University. Consistent with the University's securities lending agreement, $68,779 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 at June 30, 2009 and 2008 are summarized as follows:

	2009		2008	
	Cost	Market	Cost	Market
Short-term investments	$ 489	$ 489	$ 611	$ 611
Domestic equities	50,779	40,396	68,669	71,209
Foreign equities	22,823	22,445	61,408	58,356
Fixed income	74,406	73,176	68,325	70,337
Mutual funds – Equities	19,346	15,826	15,602	16,184
Mutual funds – Fixed	14,929	14,850	17,408	17,479
Limited partnerships	83,345	91,686	83,716	107,326
Venture capital	31,905	27,897	27,207	27,207
	$ 298,022	$ 286,765	$ 342,946	$ 368,709

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

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

Venture capital investments: The carrying amount reported in the Statement of Financial Position is stated at market value or estimated market value. Management, external consultants, and the Board of Directors evaluate these investments for impairments on a quarterly basis. As of June 30, 2009, the Foundation has an outstanding commitment to fund limited partnership and venture capital investments in the amount of $44,121.

In determining the fair value of investments, the Foundation utilizes a fair value hierarchy that ranks the quality and reliability of the information used to determine fair values and is based on certain assumptions that market participants would use in pricing the asset, including assumptions about risk and/or the risks inherent in the inputs to the valuation techniques. The Foundation's total investment fair value measurement is categorized by the following valuation techniques: (1) Valuations from quoted prices in active markets that are traded by dealers and brokers ($149,155); (2) Valuations obtained from third party pricing services for identical or similar assets ($90,266); (3) Valuations from other techniques including option pricing models, discounted cash flow models, and other similar techniques, and not based on market exchange transactions ($47,344).

Research park investment (not included in the above summary): The Foundation is also invested in a research park development, which consists of land transferred at historical cost from the University plus costs incurred to develop the infrastructure of the research park less amounts transferred to the Foundation's wholly-owned subsidiaries who manage the activities of the research park and are accounted for by the Foundation under the equity method.

5. Accounts and interest receivable

The composition of accounts and interest receivable at June 30, 2009 and 2008 is summarized as follows:

	2009	2008
State appropriations	$ 64,908	$ 64,265
Research and sponsored programs	60,052	44,786
Departmental activities	21,012	20,285
State capital appropriations	-	474
Interest receivable	1,377	2,307
Other	13,884	14,016
	161,233	146,133
Less: allowance for doubtful accounts	10,247	8,410
Net accounts and interest receivable	$ 150,986	$ 137,723

6. Student loans receivable

Student loans receivable at June 30, 2009 and 2008 are summarized as follows:

Description	2008	Distributed	Collected	2009	Current Portion
Federal Family Education Loan Program	$ 3,046	$ -	$ (19)	$ 3,065	$ 3,065
Perkins Federal Loan Program	36,702	4,273	4,154	36,821	5,314
Other	10,102	4,475	4,229	10,348	4,961
	49,850	$ 8,748	$ 8,364	50,234	13,340
Allowance for uncollectible loans	(4,392)			(4,433)	(180)
Net student loan receivable	$ 45,458			$ 45,801	$ 13,160

Description	2007	Distributed	Collected	2008	Current Portion
Federal Family Education Loan Program	$ 17,401	$ 82,131	$ 96,486	$ 3,046	$ 3,046
Perkins Federal Loan Program	36,180	5,150	4,628	36,702	8,802
Other	9,826	5,332	5,056	10,102	2,899
	63,407	$ 92,613	$ 106,170	49,850	14,747
Allowance for uncollectible loans	(4,143)			(4,392)	(181)
Net student loan receivable	$ 59,264			$ 45,458	$ 14,566

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

During the year ended June 30, 2008, the University discontinued its participation 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 loaned funds directly to students and subsequently sold the loans at a premium to a third party after 90 days. As of June 30, 2009 and 2008, the unsold loans receivable held and serviced by the University were $3,065 and $3,046, respectively. As of June 30, 2009, the University held a non-revolving line of credit, used to facilitate the servicing of the loans (see Footnote 8).

For the year ended June 30, 2009 and 2008, the University distributed $294,022 and $164,407, respectively, 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, 2009, 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%.

2010	$ 18,516
2011	16,645
2012	17,773
2013	20,835
2014	729
2015 and beyond	420
Total discounted pledges receivable	74,918
Less: allowance for uncollectible pledges	7,660
Net pledges receivable, June 30, 2009	67,258
Less: current portion	16,583
Noncurrent portion	$ 50,675

8. Long term debt and other obligations

Long term debt and other obligations for the years ended June 30, 2009 and 2008 are summarized as follows:

	2008	Borrowed	Retired	2009	Current Portion
General Revenue Bonds:					
Series 2007A	$ 30,820	$ -	$ -	$ 30,820	$ 2,865
Series 2007B	93,685	-	68,685	25,000	-
Series 2005	82,750	-	1,905	80,845	1,980
Series 2003A	75,315	-	1,850	73,465	1,915
Series 2003B	21,710	-	875	20,835	910
Series 2003C	10,280	-	210	10,070	220
Series 2002A	46,605	-	2,650	43,955	2,705
Series 2002B	8,135	-	1,190	6,945	1,235
Series 2000A	101,450	-	1,400	100,050	1,435
Series 1998A-1	2,555	-	2,555	-	-
Series 1998A-2	51,935	-	-	51,935	2,685
	525,240	-	81,320	443,920	15,950
General Revenue Notes:					
Series 2008A	-	60,000	-	60,000	60,000
Series 2008B	-	140,000	108,500	31,500	31,500
	-	200,000	108,500	91,500	91,500
Federal student loan deposits	36,375	82	-	36,457	-
Line of credit	4,077	-	235	3,842	3,842
Lease obligations and other	4,057	342	221	4,178	230
	$ 569,749	$ 200,424	$ 190,276	$ 579,897	$ 111,522

	2007	Borrowed	Retired	2008	Current Portion
General Revenue Bonds:					
Series 2007A	$ 30,820	$ -	$ -	$ 30,820	$ -
Series 2007B	93,685	-	-	93,685	-
Series 2005	84,580	-	1,830	82,750	1,905
Series 2003A	77,105	-	1,790	75,315	1,850
Series 2003B	22,560	-	850	21,710	875
Series 2003C	10,480	-	200	10,280	210
Series 2002A	49,205	-	2,600	46,605	2,650
Series 2002B	9,290	-	1,155	8,135	1,190
Series 2000A	102,850	-	1,400	101,450	1,370
Series 1998A-1	4,985	-	2,430	2,555	2,555
Series 1998A-2	51,935	-	-	51,935	-
	537,495	-	12,255	525,240	12,605
Federal student loan deposits	35,918	457	-	36,375	-
Line of credit	17,860	98,219	112,002	4,077	4,077
Lease obligations and other	2,316	1,892	151	4,057	221
	$ 593,589	$ 100,568	$ 124,408	$ 569,749	$ 16,903

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: 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% and 5.00% and mature serially from fiscal 2010 through fiscal 2019.

The Series 1998A-1 bonds bore interest at a rate of 5.00% with the final maturity in fiscal 2009.

Interest expense was $23,488 and $19,803 for 2009 and 2008, respectively.

Swap payments and associated debt: Using rates as of June 30, 2009, 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
2010	$ 2,865	1,409	13,085	$ 1,165	$ 8,055	$ 26,579
2011	2,985	1,293	11,385	1,137	7,841	24,641
2012	3,090	1,172	11,820	1,109	7,631	24,822
2013	3,220	1,034	12,300	1,080	7,412	25,046
2014	3,380	871	12,785	1,049	7,184	25,269
2014-2019	15,280	1,777	71,855	4,748	32,091	125,751
2020-2024	-	-	96,871	3,554	22,989	123,414
2025-2029	-	-	102,826	1,939	13,292	118,057
2030-2034	-	-	77,289	611	5,213	83,113
2035-2039	-	-	2,884	49	706	3,639
Total	$ 30,820	$ 7,556	$ 413,100	$ 16,441	$ 112,414	$ 580,331

During the year ended June 30, 2009, the University implemented its Board authorized $200,000 commercial paper program. The commercial paper notes are secured by General Revenues and allow for tax exempt and taxable issuances. Under this program:

> The University issued $60,000 of tax-exempt General Revenue Notes, Series 2008A, with $60,000 outstanding as of June 30, 2009. Proceeds of $47,593 were used to refund $68,685 of General Revenue Bonds, Series 2007B as agreed to through a public tender offer, resulting in $21,092 gain recognized in the Statement of Revenues, Expenses, and Changes of Net Assets. In addition, proceeds of $12,407 were used to finance or reimburse all or part of the costs of certain capital projects. Outstanding balances bear interest ranging from 0.15% to 0.30%, with principal and accrued interest payments due within a maximum of 270 days from the date of issuance.
>
> The University also issued $140,000 of taxable General Revenue Notes, Series 2008B, with $31,500 outstanding as of June 30, 2009. Proceeds of $108,500 were temporarily used to purchase a portion of the University's unremarketed variable rate demand bonds, all of which were subsequently remarketed prior to June 30, 2009. In addition, proceeds of $31,500 were used to finance or reimburse all or part of the costs of certain capital projects. Outstanding balances bear interest at 1.00%, with principal and accrued interest payments due within a maximum of 270 days from the date of issuance.

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

At June 30, 2009, the University owed $3,842 on a $4,100 non-revolving line of credit related to the University's servicing of unsold graduate and professional degree student loans under the Federal Family Education Loan Program (see Footnote 6). Subsequent to year end, the University amended the non-revolving line of credit agreement to bear interest equal to the British

Bankers Association (BBA) London Interbank Offering Rate (LIBOR) Daily Floating Rate plus one percent. Payments of accrued interest are due monthly, with all unpaid accrued interest and principal due in October 2011.

At June 30, 2009, the University owed $1,641 on a $2,500 limited recourse loan related to the University's development of a campus in Dubai, United Arab Emirates. Beginning January 1, 2010, principal amounts outstanding under this term loan bear interest equal to seventy basis points over LIBOR, and accrued interest is payable quarterly. Beginning September 30, 2010, minimum principal payments equal to 2.5% of the outstanding balance on the payment date are due quarterly.

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 2009 and 2008 were as follows:

	2009	2008
Balance, beginning of year	$ 79,220	$ 72,101
Additions	17,171	9,502
Reductions	(1,378)	(2,383)
Balance, end of year	95,013	79,220
Less: current portion	66,298	60,252
Noncurrent portion	$ 28,715	$ 18,968

9. Retirement benefits

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

Participating employees contribute 5% of their base salary or wages and the University contributes 10% of the employee's base salary or wages subject to applicable Internal Revenue Service limits. Participants may elect to contribute additional amounts to a supplemental program and/or a deferred compensation plan, within specified limits, which are not matched by University contributions. Plan provisions and contribution requirements of plan members and the University are established and may be amended in accordance with University policies, union contracts, or plan provisions. Contributions under the base program, excluding the participants' supplemental contributions, for the years ended June 30, 2009 and 2008 were as follows:

	2009	2008
University contributions	$ 63,093	$ 59,508
Employee contributions	31,547	29,754

In addition, the University has a single-employer, defined benefit plan covering 780 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, 2009.

10. Other postemployment benefits (OPEB)

Plan Description – The University provides retiree health and dental care benefits, including prescription drug coverage, to eligible retired employees and qualified spouses/beneficiaries. This is a single employer defined benefit plan administered by the University. Benefits are provided to all faculty, academic staff and support staff who meet normal retirement requirements while still working for the University. Currently, the plan has approximately 16,800 members. The plan does not issue a separate stand-alone financial statement.

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

Funding Progress – For the year ended June 30, 2009, the University has estimated the cost (annual expense) of providing retiree health and dental care benefits through an actuarial valuation as of January 1, 2008 and adjusted for 2008-09 health care cost experience. In accordance with GASB Statement No, 45, the valuation computes an annual required contribution, which represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period of thirty years. This valuation's computed contribution and actual funding are summarized as follows:

	2009	2008
Annual required contribution	$ 72,157	$ 69,946
Interest on the prior year's net OPEB obligation	3,031	-
Less adjustment to the annual required contribution	(2,236)	-
Annual OPEB cost	72,952	69,946
Amounts contributed:		
Payments of current premiums and claims	(28,142)	(26,651)
Advance funding	-	-
Increase in net OPEB obligation	44,810	43,295
OPEB obligation - beginning of year	43,295	-
OPEB obligation - end of year	$ 88,105	$ 43,295

The annual OPEB cost, the percentage contributed to the plan, and the net OPEB obligation for the current and previous year are as follows:

	Fiscal Year Ended June 30,	
	2009	2008
Annual OPEB cost	$ 72,952	$ 69,946
Percentage contributed	38.6%	38.1%
Net OPEB obligation	$ 88,105	$ 43,295

The funding progress of the plan as of the most recent valuation date is as follows:

	Valuation as of January 1,	
	2009	2008
Actuarial value of assets	$ -	$ -
Actuarial accrued liability (AAL)	852,360	835,432
Unfunded AAL (UAAL)	$ 852,360	$ 835,432
Funded ratio	0.0%	0.0%
Annual covered payroll (annual payroll of active employees covered by the plan)	$ 732,254	$ 690,428
UAAL as a percentage of covered payroll	116.4%	121.0%

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

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

In the January 1, 2008 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions include a 7% investment rate of return (net of administrative expenses), which is a blended rate of the expected long-term and short-term investment returns on the University's own assets to be used for funding the current liability, and an annual health care cost trend rate of 7.6% initially, reduced by decrements to an ultimate rate of 5% after five years. Both rates included a 4% inflation assumption. The UAAL is being amortized over 30 years as a level percentage of projected payroll on a closed basis, with 28 years remaining.

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, 2009, 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 $194,522 and are to be funded from debt proceeds, other University funds, and private gifts. Certain University facilities have been, or are scheduled to be, financed in whole or in part by SBA bond issues secured by a pledge of rentals to be received from the State of Michigan pursuant to lease agreements between the SBA, the State of Michigan, and the University. During the lease terms, the SBA will hold title to the respective buildings, the State of Michigan will make all lease payments to the SBA, and the University will pay certain operating and maintenance costs. The SBA will be obligated to sell each building to the University for one dollar, after full payment of all rentals due under the related lease.

At June 30, 2009, 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, 2009, $167,975 of the initial $375,106 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 $6,500 as of June 30, 2009. The discount rate used was 4%.

The University is also self-insured for various employee benefits which include health care and dental insurance, workers compensation, and unemployment compensation. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Those losses include an estimate of claims that have been incurred but not reported. The workers compensation liability, which will be settled by fixed payments over an extended period of time, is reported at its present value of $4,598 as of June 30, 2009. The discount rate used was 6%.

Changes in the total reported general, professional, and self-insured employee benefit liabilities during 2009, 2008, and 2007 were as follows:

	2009	2008	2007
Balance, beginning of year	$ 23,448	$ 19,273	$ 18,830
Claims incurred and changes in estimates	103,027	96,066	88,463
Claim payments	(102,222)	(91,891)	(88,020)
Balance, end of year	24,253	23,448	19,273
Less: current portion	15,196	15,331	10,242
Noncurrent portion	$ 9,057	$ 8,117	$ 9,031

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. Alliance Corporation is an enterprise formed with Spectrum Health System to support and direct the collaboration of physicians and researchers to enhance patient treatments and increase the investigation of leading-edge medical research. The University is a 50% member in each of the foregoing nonprofit corporations. Additionally, the University is a one-third member in Radiation Oncology Alliance, a nonprofit corporation formed with 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, 2009 and 2008 follows:

	2008	Additions (Deductions)	Disposals	2009
Non-depreciated capital assets:				
Land	$ 25,232	$ 1,049	$ -	$ 26,281
Construction in progress	104,851	99,181	-	204,032
Museum Collections	7,468	873	-	8,341
Total non-depreciated capital assets	137,551	101,103	-	238,654
Depreciated capital assets:				
Buildings and site improvements	1,856,263	76,986	(4,656)	1,928,593
Equipment and other	526,054	48,731	(12,973)	561,812
Less: accumulated depreciation				
Buildings and site improvements	(743,986)	(52,782)	3,838	(792,930)
Equipment and other	(401,013)	(37,732)	10,732	(428,013)
Total depreciated capital assets	1,237,318	35,203	(3,059)	1,269,462
Total capital assets	$ 1,374,869	$ 136,306	$ (3,059)	$ 1,508,116

	2007	Additions (Deductions)	Disposals	2008
Non-depreciated capital assets:				
Land	$ 24,393	$ 839	$ -	$ 25,232
Construction in progress	108,353	(3,502)	-	104,851
Museum Collections	6,600	868	-	7,468
Total non-depreciated capital assets	139,346	(1,795)	-	137,551
Depreciated capital assets:				
Buildings and site improvements	1,726,298	130,244	(279)	1,856,263
Equipment and other	496,610	38,156	(8,712)	526,054
Less: accumulated depreciation				
Buildings and site improvements	(694,288)	(49,976)	278	(743,986)
Equipment and other	(374,486)	(34,488)	7,961	(401,013)
Total depreciated capital assets	1,154,134	83,936	(752)	1,237,318
Total capital assets	$ 1,293,480	$ 82,141	$ (752)	$ 1,374,869

16. Net assets

Restricted and unrestricted net assets for the years ended June 30, 2009 and 2008 are as follows:

	2009	2008
Restricted - nonexpendable:		
Permanent endowments	$ 393,018	$ 492,207
Restricted - expendable:		
Gifts, endowment income and sponsored programs	$ 164,192	$ 162,964
Quasi and term endowments	127,723	168,081
Capital projects	59,894	63,442
Student loans	8,031	7,856
Total	$ 359,840	$ 402,343
Unrestricted:		
Designated	$ 547,344	$ 826,605
Uncommitted	7,538	3,209
Total	$ 554,882	$ 829,814

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.

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, 2009.

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 SIFMA Municipal Swap Index and the ten year USD-ISDA Index.

Terms, fair values, and credit risk: The terms, fair values, and counterparty credit ratings of the outstanding swaps as of June 30, 2009 are listed below. The notional amounts of the swaps match the principal amounts of the associated debt except for the 2007B swaps. As disclosed in Footnote 8, the University retired $68,685 of its Series 2007B debt with proceeds from its Series 2008A debt. The swaps associated with the retired 2007B debt were assigned to the University's Series 2008 debt. With the exception of the swaps associated with the $68,685 early retirement of the 2007B 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 long term debt and other obligations category.

Associated Debt Series	Outstanding Notional Amount	Effective Date	Rate Paid	Rate Received	Fair Value	Swap Termination Date	Counterparty/ Counterparty Credit Rating
1998A-2	51,935	2/15/2009	4.504%	SIFMA Municipal Swap Index	(5,248)	8/15/2022	Deutsche Bank AG/Aa1
2000A-1 & 2000A-2	94,375	11/3/2008	4.074%	67% USD-LIBOR-BBA one month	(15,742)	8/15/2029	Deutsche Bank AG/Aa1
2002A	41,835	10/17/2002	3.390%	67% USD-LIBOR-BBA one month	(3,574)	8/15/2032	UBS AG/Aa2
2002A	2,120	10/17/2002	3.530%	67% USD-LIBOR-BBA one month	(218)	8/15/2022	UBS AG/Aa2
2002B	4,905	10/17/2002	4.330%	USD-LIBOR-BBA one month	(304)	8/15/2018	UBS AG/Aa2
2002B	2,040	10/17/2002	5.280%	USD-LIBOR-BBA one month	(316)	8/15/2022	UBS AG/Aa2
2003A	73,465	11/3/2008	3.618%	67% USD-LIBOR-BBA one month	(8,479)	2/15/2033	Barclays Bank PLC/Aa3
2003B	20,835	12/11/2003	3.479%	67% USD-LIBOR-BBA one month	(1,868)	2/15/2026	UBS AG/Aa2
2003C	10,070	11/3/2008	5.330%	USD-LIBOR-BBA one month	(1,671)	2/15/2033	Barclays Bank PLC/Aa3
2005	80,845	11/3/2008	3.647%	67% USD-LIBOR-BBA one month	(9,635)	2/15/2034	Barclays Bank PLC/Aa3
2000A-1, 2000A-2, 2002A, 2003A, & 2005	288,500	8/15/2009	67% USD-LIBOR-BBA one month	67% USD-ISDA Swap Rate ten year less .407%	9,860	2/15/2034	UBS AG/Aa2
2002B & 2003C	17,015	5/26/2006	USD-LIBOR-BBA one month	USD-LIBOR-BBA ten year less .575%	1,090	2/15/2033	UBS AG/Aa2
2007B, 2008A & 2008B	22,000	5/17/2007	4.139%	67% USD-LIBOR-BBA three month plus .58%	(2,503)	2/15/2028	JP Morgan Chase Bank/Aa1
2007B, 2008A & 2008B	71,685	5/17/2007	4.226%	67% USD-LIBOR-BBA three month plus .63%	(10,375)	2/15/2037	JP Morgan Chase Bank/Aa1
2007A, 2007B, 2008A & 2008B	124,505	6/8/2007	SIFMA Municipal Swap Index	67% USD-ISDA Swap Rate ten year pluss .0063%	(2,001)	2/15/2037	JP Morgan Chase Bank/Aa1
Total	$ 906,130				$ (50,984)		

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Fair Value: Primarily because of changes in interest rates and interest rate spreads since their execution, the swaps in total have a negative fair value as of June 30, 2009. 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. Two swaps, approximating 16% of the outstanding notional value, are with Deutsche Bank AG, rated Aa1, and three swaps, approximating 18% of the outstanding notional value, are with Barclays Bank, rated Aa3. Three swaps, approximating 24% of the outstanding notional value, are with JP Morgan Chase Bank, N.A., rated Aa1. The remaining seven swaps, approximating 42% of the notional amount of swaps outstanding, are with UBS AG, which is rated Aa2.

As of June 30, 2009, (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 not exposed to net credit risk related to the swaps. 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:

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

*Threshold for the University is $13,500

Basis Risk: The pay-fixed receive-variable swaps expose the University to basis risk should the rates resulting from the SIFMA Municipal Swap Index for the 1998A-2 swap, 67% of USD-LIBOR-BBA for the 2000A-1, 2000A-2, 2002A, 2003A, 2003B, 2005, 2007B, 2008A, and 2008B assigned 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 SIFMA Municipal Swap Index and 67% of the ten year USD-ISDA Swap Rate narrow.

Rollover risk: The University is not exposed to rollover risk.

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. 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.

The University will be required to implement the provisions of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments,* effective with the fiscal year ending June 30, 2010. The University will be required to address accounting and financial reporting for derivative instruments with regard to recognition, measurement, and disclosure. The University has not yet determined the full impact of GASB Statement No. 53 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 John L. Thelen, 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, 2009 and 2008 and have issued our report thereon dated October 7, 2009. 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 7, 2009