

Annual Financial Report

Fiscal year 2011—2012



MICHIGAN STATE

U N I V E R S I T Y

TABLE OF CONTENTS

Michigan State University

	Page
Letter from Vice President for Finance and Operations and Treasurer	3
Management's Discussion and Analysis	4
Independent Auditor's Report.....	14
Basic Financial Statements:	
Statements of Net Assets - Michigan State University	15
Statements of Financial Position - Michigan State University Foundation	16
Statements of Revenues, Expenses, and Changes in Net Assets - Michigan State University	17
Statements of Activities and Changes in Net Assets - Michigan State University Foundation	18
Statements of Cash Flows - Michigan State University.....	19
Notes to the Financial Statements.....	21
Independent Auditors' 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.....	40

MICHIGAN STATE UNIVERSITY

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MICHIGAN STATE UNIVERSITY

October 26, 2012

This report presents the financial position and results of operations of Michigan State University (MSU) for the fiscal years ended June 30, 2012, and June 30, 2011. The financial report has been adopted by the Board of Trustees and is provided as part of the commitment by MSU 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 14.

MSU has been working to advance the common good in uncommon ways for more than 150 years. As one of the top research universities in the world, MSU focuses its vast resources on creating solutions to some of the world's most pressing challenges, while providing life-changing opportunities to a diverse and inclusive academic community through more than 200 programs of study in 17 degree-granting colleges.

Throughout the year ended June 30, 2012, the university continued focusing its resources where they count, maintaining one of the highest proportional shares of expenditures dedicated to instruction, research, and public service in the Big Ten. Through its long-term strategic planning initiative, "Shaping the Future," the university is positioned to continue to affect major societal issues and is committed to sustaining its land-grant mission of access to all who have the potential to succeed, preparing students to be part of a highly talented workforce, and providing cutting-edge research and outreach. By adhering to its basic financial principles, including funding recurring operations with recurring revenues, the university is committed to remaining a best value for students and stakeholders.



OFFICE OF THE VICE PRESIDENT FOR FINANCE AND OPERATIONS

Fred L. Poston
Vice President and
Treasurer

Michigan State University
426 Auditorium Rd, Rm 412
East Lansing, Michigan
48824-1046

Phone 517.355.5014
Fax 517.353.6772
www.vpfo.msu.edu

Significant achievements continue in a number of areas. MSU continues to work with the U.S. Department of Energy in developing the Facility for Rare Isotope Beams (FRIB). This important project will dramatically increase the reach of rare isotope research in the United States and enable scientists to better understand the fundamental interactions of nuclei and its application for society worldwide. Through the MSU Innovation Center and the Product Center at MSU, the university is assisting entrepreneurs in a variety of industries in creating and commercializing high-value, consumer responsive products and establishing sustainable businesses for years to come. The university is a key player in the development of Michigan's health care and life science sector, including educating both nurses and physicians. The university is involved in partnerships with dozens of hospitals across the State of Michigan, and has most recently completed the Bott Building for Nursing Education and Research, which will support the growth of the College of Nursing and help address the national shortage of nurses.

MSU, among the best research universities in the world, is uniquely positioned to contribute to critical challenges facing us. It is a site for creativity, invention, and discovery. The university is committed to recruiting highly talented students and faculty, concentrating on research and development activities, and working to facilitate public and private sector collaboration and an efficient system to transfer technology from the classroom to industry. Through the concerted efforts of its faculty, staff, alumni, and worldwide supporters, MSU continues to make a significant impact on Michigan, the nation, and the world.

Fred L. Poston
Vice President for Finance and Operations and Treasurer

MANAGEMENT'S DISCUSSION AND ANALYSIS

Michigan State University

Introduction

The following discussion provides an overview of the financial position of Michigan State University (the "University") for the years ended June 30, 2012 and 2011. It includes an analysis of the University's Statement of Net Assets, which presents the assets, liabilities, and net assets 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) principles.

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) 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. 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Michigan State University

A summarized comparison of the University's assets, liabilities and net assets at June 30, 2012, 2011, and 2010 follows:

	<u>2012</u>	<u>2011</u> <i>(in millions)</i>	<u>2010</u>
Current assets	\$ 444	\$ 428	\$ 420
Noncurrent assets:			
Restricted cash and cash equivalents and restricted investments	-	111	203
Endowment and other investments	1,771	1,773	1,465
Capital assets, net	1,819	1,703	1,622
Other	135	120	134
Total assets	<u>4,169</u>	<u>4,135</u>	<u>3,844</u>
Current liabilities	436	408	387
Noncurrent liabilities	1,057	1,003	989
Total liabilities	<u>1,493</u>	<u>1,411</u>	<u>1,376</u>
Total net assets	<u>\$ 2,676</u>	<u>\$ 2,724</u>	<u>\$ 2,468</u>

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 increase in current assets in 2012 is due in part to a net \$3 million increase in pledges receivable expected to be received in 2013 and \$37 million increase in cash and cash equivalents and investments (primarily a function of the University's operating, financing, and investing activities as reported in the Statement of Cash Flows). This increase is partially offset with a \$9 million decrease in State appropriation accounts receivable and \$20 million decrease in federal, state, and local sponsored program accounts receivable. Although total awards increased \$63 million to \$502 million in 2012, receivable balances vary from year to year due in part to timing differences between amounts expended in accordance with grant or contract guidelines and actual cash draws from the grantor.

The net increase in current assets in 2011 is due in part to a net \$15 million increase in federal, state, and local sponsored program accounts receivable, partially offset with \$10 million decrease in collateral from the securities lending program. The decrease in securities lending is due primarily to a change in the makeup of the underlying investment holdings under the securities lending program as of June 30, 2011 and their related propensity for lending.

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 2012 and 2011 represent the spending of Series 2010A bond proceeds consistent with their restricted purpose.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Michigan State University

Endowment and other investments

At June 30, 2012 and June 30, 2011, the University's endowment investments totaled \$1,369 million (a decrease of \$26 million) and \$1,395 million (an increase of \$259 million), respectively. Market value (realized and unrealized) changes within the investment portfolio accounted for a \$106 million decrease and a \$182 million increase in 2012 and 2011, respectively, while the spending policy draw on the endowment's accumulated net capital gains (net of reinvested funds) totaled \$24 million in 2012 and \$2 million in 2011. Offsetting these decreases were endowment gifts and University-designated additions to Endowment investments of \$40 million in 2012 and \$21 million in 2011. In addition, during 2012 and 2011, \$60 million of investments were reallocated to designated endowment investments, consistent with the University's Board approved cash management and investment plan.

Other investments consist primarily of the Liquidity Reserve Pool component of the University's Operating Cash Pool, which totaled \$257 million and \$244 million at June 30, 2012 and 2011, respectively. Funded retirement and postemployment benefit reserves (\$78 million in 2012 and \$86 million in 2011) are also included in other investments.

For the years ended June 30, 2012, 2011, and 2010, the total returns on investments were as follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Operating Cash Pool:			
Liquidity Pool	1.0%	1.4%	3.9%
Liquidity Reserve Pool	5.1%	5.0%	12.2%
Common Investment Fund	(2.8)%	20.6%	11.4%
Other Separately Invested Investments	(16.1)%	35.9%	(38.2)%

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, 2012, 2011, and 2010, the University's investment in capital assets was as follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
		<i>(in millions)</i>	
Land	\$ 35	\$ 32	\$ 32
Buildings and site improvements	2,309	2,156	2,125
Construction in progress	227	205	163
Software and other intangibles	91	87	-
Equipment and other	672	626	597
Museum collections	10	9	9
Less: accumulated depreciation	<u>(1,525)</u>	<u>(1,412)</u>	<u>(1,304)</u>
	<u>\$ 1,819</u>	<u>\$ 1,703</u>	<u>\$ 1,622</u>

Major additions to buildings and site improvements during 2012 include \$48 million for the Brody Hall renovation, \$44 million for Plant Science Building expansion, \$19 million for Case Hall First Floor Renovations of Dining Hall, and \$15 million for the Cyclotron Building Office Additions. Major additions to buildings and site improvements during 2011 include \$9 million for the Secchia Center, \$6 million for the Facility for Rare Isotope Beams Utility Relocation, and \$4 million for Hubbard Hall First Floor Commons Renovation.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Michigan State University

During 2012, the University added \$4 million of software and other intangibles through the implementation of various system enhancements to MSU's Enterprise Business Systems Project, which went live during 2011. This was a multi-year information system development project that updated and integrated the financial and human resource/payroll systems across the University.

Construction in progress reflects multi-year projects which, once completed and placed into service, are generally categorized as buildings and site improvements. The 2012 balance includes \$39 million for the Eli and Edythe Broad Art Museum, \$33 million for Wells Hall addition and Old Horticulture Building renovation, \$27 million for Bailey and Rather Hall renovations, \$24 million for the Facility for Rare Isotope Beams, \$16 million for T.B. Simon Power Plant Coal Handling Improvements, and \$14 million for the Bott Building for Nursing Education and Research. The 2011 balance includes \$45 million for the Brody Hall renovation, \$26 million for Plant Science Building expansion, \$24 million for the Eli and Edythe Broad Art Museum, and \$17 million for Wells Hall addition and Old Horticulture Building renovation.

As of June 30, 2012, 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 \$115 million and are to be funded from debt proceeds, capital grants, private gifts, and other University funds.

Current liabilities:

Current liabilities consist primarily of trade accounts and interest payable, accrued compensation and other personnel costs, obligations under securities lending, deferred revenues, and other liabilities payable within one year or less. The net increase in 2012 is due in part to a \$67 million increase in the current portion of long-term debt and other obligations, offset with decreases of \$25 million in trade accounts payable and \$15 million in balances held from employee payroll tax withholdings and benefit deductions. The net increase in the current portion of long-term debt and other obligations is due in part to a net issuance of \$43 million of General Revenue Commercial Paper (short term financing), Series B, which was used to finance or reimburse all or part of the costs of capital projects (\$34 million), and refund outstanding General Revenue Bonds, Series 2003C (\$9 million). In addition, a net issuance of \$8 million of General Revenue Commercial Paper, Series C and \$15 million of General Revenue Commercial Paper, Series D was used to finance or reimburse all or part of the costs of capital projects. Trade accounts payable balances vary from year to year due in part to timing of University initiatives and payments of related programmatic costs. Likewise, balances held for employee payroll tax withholdings and benefit deductions vary from year to year due in part to timing of remitting amounts to appropriate agencies.

The net increase in current liabilities in 2011 is due in part to a \$22 million increase in trade accounts payable and a \$7 million increase in debt interest payable. In addition, the current portion of long-term debt and other obligations increased \$23 million due in part to the issuance of \$14 million of General Revenue Commercial Paper, Series B, which was used to finance or reimburse all or part of the costs of capital projects (\$9 million) and refund outstanding General Revenue Bonds, Series 2002B (\$5 million). In addition, a net issuance of \$43 million of General Revenue Commercial Paper, Series C proceeds were used to refund outstanding General Revenue Commercial Paper, Series A (\$35 million) and finance or reimburse all or part of the costs of eligible capital projects (\$8 million). Partially offsetting these increases, is a decrease of \$24 million in accrued compensation and other personnel costs primarily due to realigning the timing of academic employee compensation payments to correspond with the nine month academic duty period (September – May annually), resulting in no accrual at June 30, 2011. In addition, obligations under

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Michigan State University

securities lending decreased \$11 million due primarily to a change in the make-up of the underlying investment holdings under the securities lending program as of June 30, 2011 and their related propensity for lending.

Noncurrent liabilities, primarily debt:

At June 30, 2012, the University had noncurrent debt and other obligations outstanding of \$734 million compared with \$758 million at June 30, 2011. This balance is comprised primarily of outstanding General Revenue Bonds of \$689 million and \$713 million in 2012 and 2011, respectively. The decrease in noncurrent debt and other obligations is due to scheduled principal debt payments of \$15 million on outstanding General Revenue Bonds and the current refunding of General Revenue Bonds, Series 2003C (\$9 million) with General Revenue Commercial Paper, Series B. The University periodically reviews its debt capacity and related capital asset needs to optimize the use of its long-term resources. The University's outstanding General Revenue debt carry an investment grade credit rating from Moody's and Standard & Poor's of Aa1 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) through a closed single employer defined benefit plan administered by the University. For the year ended June 30, 2012, the University has estimated the cost (annual expense) of providing OPEB through an actuarial valuation as of January 1, 2012. 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. The University's total unfunded OPEB obligation in 2012 and 2011 is estimated at \$851 million and \$792 million, respectively. Of these amounts, the University has recorded a noncurrent liability of \$217 million and \$170 million for 2012 and 2011, respectively, representing the net OPEB obligation (the cumulative difference between the annual required contribution less actual retiree health and dental payments made during the respective fiscal years). This increase of \$47 million represents the continued amortization (over thirty years) of the total unfunded OPEB obligation.

Net assets:

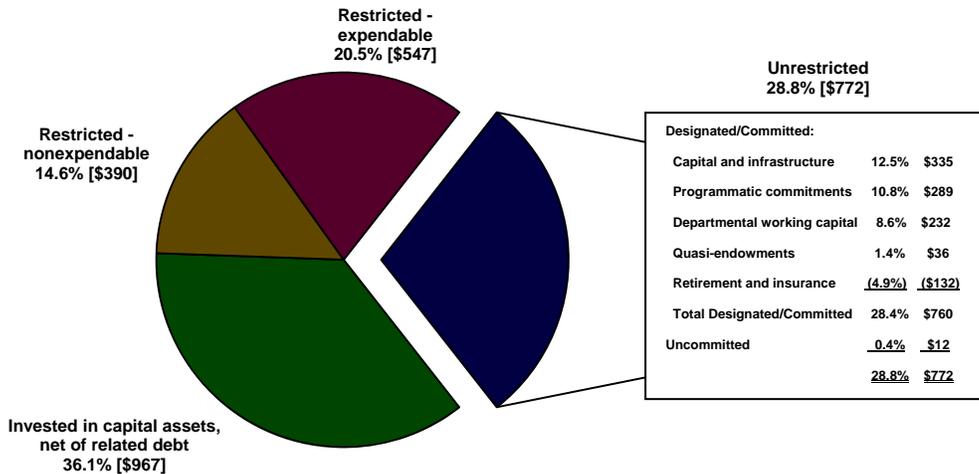
Net assets represent residual University assets after liabilities are deducted. The University's net assets at June 30, 2012, 2011, and 2010 are summarized as follows:

	<u>2012</u>	<u>2011</u> <i>(in millions)</i>	<u>2010</u>
Invested in capital assets, net of related debt	\$ 967	\$ 991	\$ 987
Restricted:			
Nonexpendable	390	353	447
Expendable	547	591	396
Total restricted	<u>937</u>	<u>944</u>	<u>843</u>
Unrestricted	772	789	638
Total net assets	<u>\$ 2,676</u>	<u>\$ 2,724</u>	<u>\$ 2,468</u>

MANAGEMENT’S DISCUSSION AND ANALYSIS (continued)

Michigan State University

The following is a breakdown of net assets at June 30, 2012. See footnote 15 for further information (amounts are presented in millions of dollars):



TOTAL NET ASSETS \$2.7 BILLION

Net assets invested in capital assets, net of related debt, represent the University’s land, buildings, software 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 subject to externally imposed stipulations that they be maintained permanently. Such net assets include the corpus portion (historical value) of gifts to the University’s permanent endowment funds and certain investment earnings stipulated by the donor to be reinvested permanently.

Restricted expendable net assets are subject to externally imposed restrictions governing their use. Such net assets include the net appreciation of the University’s permanent endowment funds that have not been stipulated by the donor to be reinvested permanently, 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. These commitments include funding the completion of the 2012 summer semester and the first quarter of fiscal year 2013, 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. The uncommitted balance is \$12 million.

The University’s ongoing review of its infrastructure indicates a need for approximately \$850 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Michigan State University

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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**Michigan State University**

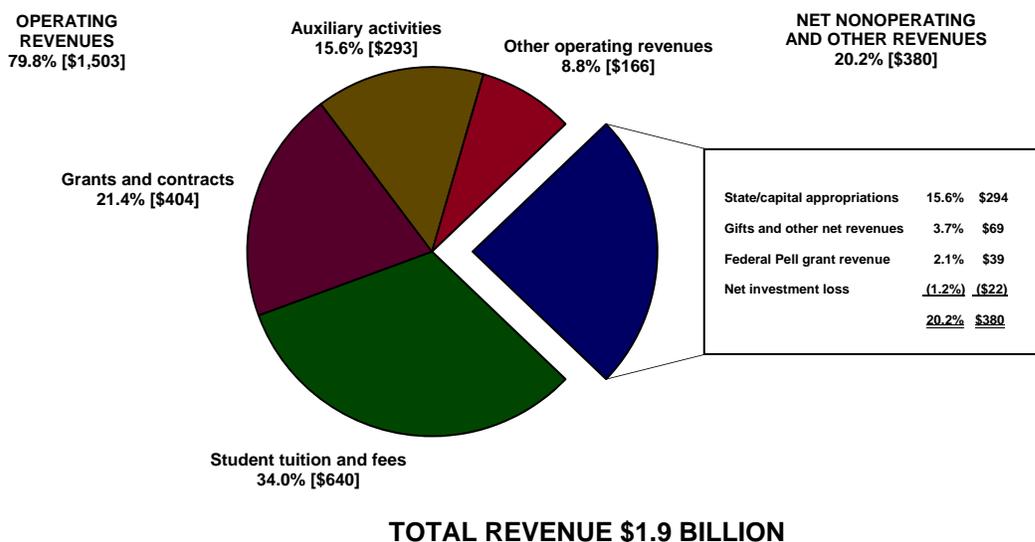
A summarized comparison of the University's revenues, expenses, and changes in net assets for the years ended June 30, 2012, 2011, and 2010 follows:

	<u>2012</u>	<u>2011</u> <i>(in millions)</i>	<u>2010</u>
Operating revenues:			
Student tuition and fees, net of allowances	\$ 640	\$ 568	\$ 542
Grants and contracts	404	373	373
Auxiliary activities	293	280	276
Other operating revenues	<u>166</u>	<u>168</u>	<u>148</u>
Total operating revenues	1,503	1,389	1,339
Operating expenses:			
Instruction and departmental research	575	561	556
Research	319	294	277
Public service	210	220	228
Academic support	82	78	75
Student services	32	32	32
Scholarships and fellowships	55	53	50
Institutional support	103	94	91
Operation and maintenance of plant	149	138	143
Auxiliary enterprises	275	269	256
Depreciation	128	116	98
Other operating expenses, net	<u>3</u>	<u>3</u>	<u>4</u>
Total operating expenses	1,931	1,858	1,810
Operating loss	(428)	(469)	(471)
Nonoperating revenues (expenses):			
State operating appropriation	241	284	284
State agricultural experiment station appropriation	28	33	18
State cooperative extension service appropriation	24	29	18
State appropriated federal fiscal stabilization funds	-	-	36
Federal Pell grant revenue	39	43	39
Gifts	52	46	53
Net investment income (loss)	(22)	289	164
Interest expense on capital asset related debt	(35)	(39)	(20)
Other nonoperating revenues, net	<u>7</u>	<u>5</u>	<u>2</u>
Net nonoperating revenues	334	690	594
Income (loss) before other revenues	(94)	221	123
State capital appropriations	1	-	1
Capital grants and gifts	15	18	28
Additions to permanent endowments	<u>30</u>	<u>17</u>	<u>25</u>
Increase (decrease) in net assets	(48)	256	177
Net assets, beginning of year	<u>2,724</u>	<u>2,468</u>	<u>2,291</u>
Net assets, end of year	<u>\$ 2,676</u>	<u>\$ 2,724</u>	<u>\$ 2,468</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Michigan State University

Total net revenue by source for the year ended June 30, 2012 is 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 revenue from all possible sources consistent with its mission and to manage the financial resources realized from these efforts to fund its operations.

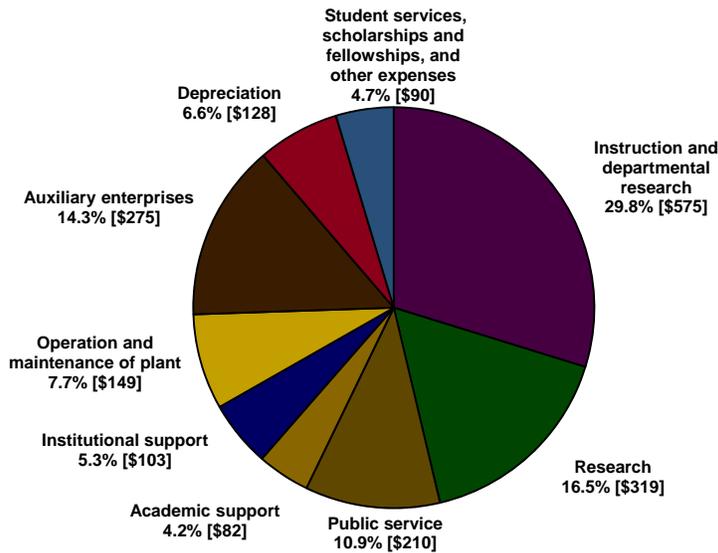
Operating revenues: The most significant source of operating revenue for the University is tuition and fees (net of scholarship allowances), totaling \$640 million and \$568 million in 2012 and 2011, respectively. Gross tuition and fees revenue increased 11.8% in 2012, due in part to increases in student credit hours and rates, and changes in the student blend. The 4.7% increase in 2011 reflected an increase in tuition and fees, additional student credit hours taken, and changes in the student blend. Other major revenue sources in 2012 include federal grants and contracts of \$330 million (an increase of \$33 million), including \$310 million for sponsored programs, and auxiliary activities of \$293 million (an increase of \$13 million).

Net nonoperating and other revenues: The primary source of this net revenue is State appropriations, which totaled \$294 million in 2012, a decrease of \$52 million (15.0%), in line with State of Michigan legislative reductions. In 2012, the University received \$241 million in funding for general operations, compared to \$284 million in 2011. Michigan State University Extension and MSU AgBioResearch appropriations totaled \$52 million, compared to \$62 million in 2011. In addition, the University received \$1 million in State capital appropriations in 2012, compared to no capital appropriations in 2011. Other significant components of net nonoperating revenues in 2012 include gift revenue (increased \$6 million), and net investment income (decreased \$311 million due to financial market conditions). In 2011, gift revenue decreased \$7 million, and net investment income increased \$125 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Michigan State University

Operating expenses by source for the year ended June 30, 2012 are presented in millions of dollars:



TOTAL OPERATING EXPENSES \$1.9 BILLION

During 2012, \$1,104 million was expended for the core missions of the University - instruction and departmental research, research, and public service, an increase of \$29 million (2.7%) over 2011. Instruction and departmental research expenses increased \$14 million (2.5%), due primarily to salary increases (1.4%) and increases in faculty/staff levels (0.6%). Research and public service expenses increased \$15 million (2.9%) due mostly to growth in sponsored programs (\$10 million). Auxiliary enterprises (activities which provide services to students, faculty, staff, and the public) increased \$6 million (2.2%), while expenses for the operation and maintenance of plant increased \$11 million (8.0%).

Economic Outlook

There is a direct relationship between the level of State appropriation support and the University's ability to mitigate tuition increases. Over the past decade, the continued economic pressures affecting the State have resulted in a decrease of approximately \$81 million in state appropriations. The University has worked to minimize the impact to students and other stakeholders by successfully focusing on creating operating efficiencies and controlling costs, while preserving existing programmatic strengths.

In accordance with prevailing legislative formulas for fiscal year 2012-13, the University approved a 3.5% increase in resident undergraduate tuition. Under the University's continued commitment to preserve access for all students, a 6.5% increase in student financial aid for fiscal year 2012-13 was approved. In response, the State approved a 1.6% increase in appropriations for fiscal year 2012-13. Regardless of economic circumstances, the University is committed to sustaining its land-grant mission and values, and making a significant positive impact in Michigan and around the world.

Independent Auditor's Report

To the Board of Trustees
Michigan State University

We have audited the accompanying financial statements of Michigan State University (the "University") as of and for the years ended June 30, 2012 and 2011. We did not audit the financial statements of the Michigan State University Foundation (the "Foundation"), which present all the balances and activity reported in 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. The University and the discretely presented component unit collectively comprise the basic financial statements. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and *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. The financial statements of the Michigan State University Foundation were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, based on our audit and the report of other auditors, 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, 2012 and 2011 and the results of their operations and cash flows, if applicable, 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 25, 2012 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, 2012. 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 audits.

Accounting principles generally accepted in the United States of America require that management's discussion and analysis, as identified on pages 4 through 13, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplemental information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

A handwritten signature in black ink that reads "Plante & Moran, PLLC".

Kalamazoo, Michigan
October 25, 2012

STATEMENTS OF NET ASSETS
Michigan State University

	June 30,	
	2012	2011
ASSETS		
Current assets:	(in thousands)	
Cash and cash equivalents	\$ 13,787	\$ 18,954
Investments	217,327	174,752
Collateral from securities lending	15,357	12,880
Accounts and interest receivable, net	142,871	170,114
Student loans receivable, net	9,409	8,566
Pledges receivable, net	27,568	24,109
Inventories and other assets	18,119	18,305
Total current assets	<u>444,438</u>	<u>427,680</u>
Noncurrent assets:		
Restricted cash and cash equivalents	-	23,219
Restricted investments	-	87,360
Endowment investments	1,368,659	1,395,282
Other investments	402,072	378,127
Student loans receivable, net	36,055	36,312
Pledges receivable, net	21,664	36,893
Investments in joint ventures	6,719	6,676
Deferred outflows from hedging derivative instruments	66,434	35,770
Unamortized bond origination costs	4,639	4,706
Capital assets, net	1,818,707	1,703,365
Total noncurrent assets	<u>3,724,949</u>	<u>3,707,710</u>
	TOTAL ASSETS	
	<u>\$ 4,169,387</u>	<u>\$ 4,135,390</u>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts and interest payable	\$ 66,649	\$ 87,913
Accrued personnel costs	40,887	49,256
Obligations under securities lending	15,357	20,317
Accrued self-insurance liabilities	13,619	15,073
Payroll taxes and other payroll deductions	7,500	22,188
Deposits held for others	27,619	31,754
Deferred revenues	101,949	86,155
Current portion of long term debt and other obligations	162,270	95,702
Total current liabilities	<u>435,850</u>	<u>408,358</u>
Noncurrent liabilities:		
Accrued personnel costs	32,742	31,937
Accrued self-insurance liabilities	7,249	6,881
Hedging derivative instruments	66,434	35,770
Net other postemployment benefit obligation	216,981	169,608
Long term debt and other obligations	733,604	758,304
Total noncurrent liabilities	<u>1,057,010</u>	<u>1,002,500</u>
Total liabilities	<u>1,492,860</u>	<u>1,410,858</u>
Net assets:		
Invested in capital assets, net of related debt	966,908	991,459
Restricted:		
Nonexpendable	389,884	352,696
Expendable	547,789	590,891
Unrestricted	771,946	789,486
Total net assets	<u>2,676,527</u>	<u>2,724,532</u>
	TOTAL LIABILITIES AND NET ASSETS	
	<u>\$ 4,169,387</u>	<u>\$ 4,135,390</u>

See accompanying notes

STATEMENTS OF FINANCIAL POSITION
Michigan State University Foundation

	June 30,	
	2012	2011
ASSETS	(in thousands)	
Cash equivalents	\$ 3,972	\$ 1,926
Interest and dividends receivable	172	212
Grants and contracts receivable, net	221	400
Other receivables, net	763	1,665
Investments:		
Marketable securities	189,454	209,297
Investments in limited partnerships	115,878	100,683
Venture capital	37,702	43,560
Cash value of life insurance	2,576	2,142
Land held for investment	4,269	3,944
Other investments	1,624	1,180
Investment in Research Park	5,908	5,920
Prepaid expenses	107	119
Property and equipment, net	12,508	10,055
Intangible assets, net	1,007	846
Other assets	44	4
TOTAL ASSETS	\$ 376,205	\$ 381,953
LIABILITIES AND NET ASSETS		
Liabilities:		
Accrued expenses and other payables	\$ 3,445	\$ 3,809
Deferred compensation	177	177
Note payable - deferred compensation	196	196
Notes payable	4,549	4,228
Trusts and annuities payable	9,374	9,501
Deferred gifts	433	433
Deposit held for Michigan State University	15,775	9,596
Obligations under life estate agreements	141	9
Total liabilities	34,090	27,949
Net assets:		
Unrestricted	296,935	309,392
Temporarily restricted	30,397	30,313
Permanently restricted	14,783	14,299
Total net assets	342,115	354,004
TOTAL LIABILITIES AND NET ASSETS	\$ 376,205	\$ 381,953

See accompanying notes

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

	Year ended June 30,	
	2012	2011
	(in thousands)	
OPERATING REVENUES		
Student tuition and fees	\$ 739,335	\$ 661,110
Less: scholarship allowances	98,845	92,665
Net student tuition and fees	<u>640,490</u>	<u>568,445</u>
State of Michigan grants and contracts	9,617	10,356
Federal grants and contracts	330,094	296,874
Local and private sponsored programs	64,592	65,816
Interest and fees on student loans	907	940
Departmental activities (net of scholarship allowances of \$4,617 in 2012 and \$4,476 in 2011)	164,972	166,897
Auxiliary activities (net of room and board allowances of \$19,862 in 2012 and \$16,460 in 2011)	292,752	280,227
TOTAL OPERATING REVENUES	<u>1,503,424</u>	<u>1,389,555</u>
OPERATING EXPENSES		
Instruction and departmental research	574,818	560,794
Research	318,952	293,705
Public service	210,245	220,549
Academic support	81,814	78,197
Student services	31,992	31,840
Scholarships and fellowships	54,755	53,357
Institutional support	102,733	93,646
Operation and maintenance of plant	148,968	137,919
Auxiliary enterprises	275,391	269,466
Depreciation	128,079	116,183
Other operating expenses, net	3,260	2,520
TOTAL OPERATING EXPENSES	<u>1,931,007</u>	<u>1,858,176</u>
Operating loss	(427,583)	(468,621)
NONOPERATING REVENUES (EXPENSES)		
State operating appropriation	241,121	283,685
State agricultural experiment station appropriation	28,260	33,243
State cooperative extension service appropriation	24,366	28,673
Federal Pell grant revenue	38,724	43,424
Gifts	52,040	46,196
Net investment income (loss)	(21,895)	288,510
Interest expense on capital asset related debt	(35,264)	(38,878)
Other nonoperating revenues, net	6,191	5,552
Net nonoperating revenues	<u>333,543</u>	<u>690,405</u>
INCOME (LOSS) BEFORE OTHER REVENUES	(94,040)	221,784
State capital appropriations	1,200	-
Capital grants and gifts	14,979	17,743
Additions to permanent endowments	29,856	17,227
Increase (decrease) in net assets	<u>(48,005)</u>	<u>256,754</u>
Net assets, beginning of year	2,724,532	2,467,778
NET ASSETS, END OF YEAR	<u>\$ 2,676,527</u>	<u>\$ 2,724,532</u>

See accompanying notes

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
Michigan State University Foundation

	Year ended June 30, 2012			Total
	Unrestricted Funds	Temporarily Restricted	Permanently Restricted	
REVENUE, GAINS AND OTHER SUPPORT:	(in thousands)			
Contributions	\$ 48	\$ 6,925	\$ 624	\$ 7,597
Equity earnings - subsidiaries	111			111
Income from investments	5,563	234	516	6,313
Royalty income	1,369			1,369
Rental income	1,246			1,246
Rental expenses	(3,070)			(3,070)
Net realized and unrealized loss on securities	(1,279)	(690)	(237)	(2,206)
Grants and contracts	2,714			2,714
Other income	68			68
Net assets released from restrictions:				
Satisfaction of program restrictions	299	(289)	(10)	-
Current year transfers	6,505	(6,096)	(409)	-
TOTAL REVENUE, GAINS AND OTHER SUPPORT	13,574	84	484	14,142
EXPENSES:				
Contributions to the University	15,135			15,135
Patent expense	965			965
Investment management fees	1,885			1,885
Investment consulting fees	383			383
Adjustments to value of annuities payable	81			81
Management and general	4,023			4,023
Postretirement benefits:				
Net periodic benefit cost	67			67
Provision for uncollectible receivables	500			500
MBI program expenses	2,992			2,992
TOTAL EXPENSES	26,031	-	-	26,031
Change in net assets	(12,457)	84	484	(11,889)
Net assets, beginning of year	309,392	30,313	14,299	354,004
NET ASSETS, END OF YEAR	\$ 296,935	\$ 30,397	\$ 14,783	\$ 342,115
	Year ended June 30, 2011			
	Unrestricted Funds	Temporarily Restricted	Permanently Restricted	Total
REVENUE, GAINS AND OTHER SUPPORT:	(in thousands)			
Contributions	\$ 67	\$ 4,871	\$ 152	\$ 5,090
Equity losses - subsidiaries	(143)			(143)
Income from investments	8,026	455	634	9,115
Royalty income	1,133			1,133
Rental income	1,076			1,076
Rental expenses	(3,234)			(3,234)
Net realized and unrealized gain on securities	37,483	2,689	1,124	41,296
Grants and contracts	2,523			2,523
Other income	62			62
Net assets released from restrictions:				
Satisfaction of program restrictions	22	(10)	(12)	-
Current year transfers	4,383	(4,036)	(347)	-
TOTAL REVENUE, GAINS AND OTHER SUPPORT	51,398	3,969	1,551	56,918
EXPENSES:				
Contributions to the University	11,418			11,418
Patent expense	908			908
Investment management fees	2,382			2,382
Investment consulting fees	460			460
Adjustments to value of annuities payable	(119)			(119)
Management and general	3,837			3,837
Postretirement benefits:				
Net periodic benefit cost	67			67
Changes other than net periodic benefit costs	(929)			(929)
MBI program expenses	2,409			2,409
TOTAL EXPENSES	20,433	-	-	20,433
Change in net assets	30,965	3,969	1,551	36,485
Net assets, beginning of year	278,427	26,344	12,748	317,519
NET ASSETS, END OF YEAR	\$ 309,392	\$ 30,313	\$ 14,299	\$ 354,004

See accompanying notes

STATEMENTS OF CASH FLOWS
Michigan State University

	Year ended June 30,	
	2012	2011
Cash flows from operating activities	(in thousands)	
Tuition and fees	\$ 644,138	\$ 571,968
Research grants and contracts	427,297	358,069
Auxiliary activities	294,918	285,989
Departmental activities	157,997	181,977
Interest and fees on student loans	907	940
Loans issued to students	(10,095)	(8,550)
Collection of loans from students	9,509	9,894
Scholarships and fellowships	(76,923)	(73,520)
Payments to suppliers	(446,169)	(447,204)
Payments to employees	(1,246,182)	(1,192,321)
Other payments	(23,951)	(18,574)
Net cash used by operating activities	<u>(268,554)</u>	<u>(331,332)</u>
Cash flows from noncapital financing activities		
State appropriations	303,175	340,919
Federal Pell grant revenue	38,724	43,424
Gifts	49,802	46,472
Endowment gifts	29,787	17,268
William D. Ford Direct Lending receipts	365,317	348,242
William D. Ford Direct Lending disbursements	(365,608)	(348,764)
Net cash provided by noncapital financing activities	<u>421,197</u>	<u>447,561</u>
Cash flows from capital and related financing activities		
Capital appropriations	1,200	-
Capital gifts and grants	29,056	29,250
Proceeds from issuance of debt and other long term obligations	102,875	65,809
Purchase of capital assets	(239,153)	(194,351)
Proceeds from sale of capital assets	424	367
Principal paid on capital debt	(61,484)	(63,559)
Interest paid	(39,260)	(34,384)
Other receipts (payments)	7,873	6,822
Net cash used by capital and related financing activities	<u>(198,469)</u>	<u>(190,046)</u>
Cash flows from investing activities		
Investment income, net	68,865	107,717
Proceeds from sales and maturities of investments	1,763,973	1,741,967
Purchase of investments	(1,815,398)	(1,797,615)
Net cash provided by investing activities	<u>17,440</u>	<u>52,069</u>
Net decrease in cash	(28,386)	(21,748)
Cash and cash equivalents, beginning of year	42,173	63,921
Cash and cash equivalents, end of year	<u>\$ 13,787</u>	<u>\$ 42,173</u>

See accompanying notes

STATEMENTS OF CASH FLOWS (Continued)
Michigan State University

	Year ended June 30,	
	2012	2011
	(in thousands)	
Reconciliation of net operating loss to cash flows from operating activities:		
Operating loss	\$ (427,583)	\$ (468,621)
<i>Adjustments to reconcile net loss to net cash used by operating activities:</i>		
Depreciation expense	128,079	116,183
<i>Change in assets and liabilities:</i>		
Accounts receivable	17,986	(14,838)
Student loans receivable	(586)	1,344
Inventories and other assets	186	(4,121)
Investments in joint ventures	(43)	(347)
Unamortized bond origination costs	67	154
Accounts payable	(22,354)	18,061
Accrued personnel costs	(7,564)	(22,871)
Payroll taxes and other payroll deductions	(14,688)	(4,653)
Deposits held for others	(4,135)	2,101
Deferred revenues	15,794	4,650
Accrued self-insurance liabilities	(1,086)	252
Net other postemployment benefit obligation	47,373	41,374
Net cash used by operating activities	\$ (268,554)	\$ (331,332)

NOTES TO THE FINANCIAL STATEMENTS (All dollar figures stated in these Notes are in thousands)

Michigan State University

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. Nonexpendable net assets include the corpus portion (historical value) of gifts to the University's permanent endowment funds and certain investment earnings stipulated by the donor to be reinvested permanently.
 - 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. Expendable net assets include net appreciation of the University's permanent endowment funds that have not been stipulated by the donor to be reinvested permanently.
- 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. 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

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 Liquidity Reserve Pool (LRP), 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.

Derivative instruments – Derivative instruments consist of interest rate swap agreements and are stated at fair value based on the zero coupon valuation method.

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 Residential and Hospitality Services, Intercollegiate Athletics, and various other departmental activities that provide services to the student body, faculty, staff, and general public.

Donor restricted endowments – Under Michigan law set forth in the Uniform Prudent Management of Institutional Funds Act, as adopted in Michigan in 2009 ("UPMIFA."), the Board acts in a fiduciary capacity as trustee of its endowment funds. UPMIFA

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

requires that the Board exercise its fiduciary duties prudently and consider both the charitable purposes and needs of the University and the purposes of the specific endowment regarding current expenditures and preservation of the purchasing power of the funds. Under the programmatic spending policy established by the Board, 5.00% 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, 2012 and 2011 were as follows:

	2012	2011
Cash and cash equivalents, current	\$ 13,787	\$ 18,954
Restricted cash and cash equivalents, noncurrent	-	23,219
Total cash and cash equivalents	<u>\$ 13,787</u>	<u>\$ 42,173</u>

Of bank balances for cash, no amounts or balances in 2012, and \$250 of the total \$27,154 in 2011 were covered by federal depository insurance. Any remaining amounts were uninsured and uncollateralized, as bank holding deposits of the University are legally prohibited from collateralizing these deposits.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

3. Investments

The University manages investments in accordance with the policy approved by the Board. The investment policy distinguishes guidelines for the Liquidity Pool (LP), Liquidity Reserve Pool (LRP), 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 \$14,912 and \$19,848 at June 30, 2012 and 2011, 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, 2012 and 2011, 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, 2012 and 2011, the difference was less than 90 days.

As of June 30, 2012 and 2011, the University had the following investments:

Investment type	June 30, 2012					
	LP	LRP	CIF	Securities Lending	Other	Total
Investment pools	\$ 10,600	\$ 256,964	\$ 1,162,341	\$ 9,157	\$ 44,667	\$ 1,483,729
U.S. Treasury bonds	35,225	-	24,663	-	19,625	79,513
U.S. Government agencies	21,449	-	36,811	-	-	58,260
Municipal bonds	-	-	1,067	-	-	1,067
Corporate bonds	99,870	-	22,140	-	2,425	124,435
Asset-backed securities	50,183	-	14,220	6,200	-	70,603
U.S. Equities	-	-	180,146	-	-	180,146
International equities	-	-	9,859	-	-	9,859
International governmental bonds	-	-	245	-	-	245
Investment derivatives	-	-	-	-	(4,442)	(4,442)
Total	<u>\$ 217,327</u>	<u>\$ 256,964</u>	<u>\$ 1,451,492</u>	<u>\$ 15,357</u>	<u>\$ 62,275</u>	<u>\$ 2,003,415</u>

Investment type	June 30, 2011					
	LP	LRP	CIF	Securities Lending	Other	Total
Investment pools	\$ 10,390	\$ 244,425	\$ 1,194,613	\$ 4,118	\$ 29,237	\$ 1,482,783
U.S. Treasury bonds	36,508	-	9,583	-	3,885	49,976
U.S. Government agencies	61,206	-	40,326	-	-	101,532
Municipal bonds	-	-	1,037	-	-	1,037
Corporate bonds	115,321	-	19,144	2,562	-	137,027
Asset-backed securities	35,891	-	14,884	6,200	-	56,975
U.S. Equities	-	-	195,881	-	-	195,881
International equities	-	-	10,526	-	-	10,526
International governmental bonds	2,796	-	816	-	-	3,612
Investment derivatives	-	-	-	-	9,052	9,052
Total	<u>\$ 262,112</u>	<u>\$ 244,425</u>	<u>\$ 1,486,810</u>	<u>\$ 12,880</u>	<u>\$ 42,174</u>	<u>\$ 2,048,401</u>

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 LRP and CIF portfolios to six years. At June 30, 2012 and 2011, 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

The maturities of fixed income investments as of June 30, 2012 and 2011 are as follows:

June 30, 2012					
Fixed Income Investment Maturities					
<u>Investment type</u>	Less than 1 year	1-5 years	6-10 years	More than 10 years	Total
Investment pools	\$ 9,157	\$ 130,606	\$ 190,371	\$ 20,392	\$ 350,526
U.S. Treasury bonds	3,501	67,476	4,898	3,638	79,513
U.S. Government agencies	-	10,383	5,174	42,703	58,260
Municipal bonds	-	71	128	868	1,067
Corporate bonds	17,795	92,819	6,161	7,660	124,435
International governmental bonds	-	-	101	144	245
Asset-backed securities	6,379	25,833	21,865	16,526	70,603
Total	<u>\$ 36,832</u>	<u>\$ 327,188</u>	<u>\$ 228,698</u>	<u>\$ 91,931</u>	<u>\$ 684,649</u>

June 30, 2011					
Fixed Income Investment Maturities					
<u>Investment type</u>	Less than 1 year	1-5 years	6-10 years	More than 10 years	Total
Investment pools	\$ 31,602	\$ 126,612	\$ 170,103	\$ 30,874	\$ 359,191
U.S. Treasury bonds	3,802	42,717	464	2,993	49,976
U.S. Government agencies	36,632	14,933	4,735	45,232	101,532
Municipal bonds	-	-	248	789	1,037
Corporate bonds	20,961	103,995	9,061	3,010	137,027
International governmental bonds	1,013	2,029	438	132	3,612
Asset-backed securities	10,809	13,546	17,004	15,616	56,975
Total	<u>\$ 104,819</u>	<u>\$ 303,832</u>	<u>\$ 202,053</u>	<u>\$ 98,646</u>	<u>\$ 709,350</u>

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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

At June 30, 2012 and 2011, the University is invested in six separate investment derivative instruments five of which are pay-variable, receive-variable interest rate swaps and one of which is a pay-fixed, receive-variable rate swap.

2012 Notional Amount	Rate Paid	Rate Received	Effective Date	Termination Date	Counterparty/ Counterparty Credit Rating	2012 Fair Value	2011 Fair Value
\$ 270,270	67% USD-LIBOR-BBA one month	67% USD-ISDA Sw ap Rate ten year less .407%	8/15/2009	2/15/2034	Deutsche Bank AG/A2	\$ 16,160	\$ 16,481
14,365	USD-LIBOR-BBA one month	USD-LIBOR-BBA ten year less .575%	5/26/2006	2/15/2033	Deutsche Bank AG/A2	1,269	1,359
69,240	SIFMA Municipal Sw ap Index	67% USD-LIBOR-BBA one month plus .44%	5/17/2010	8/15/2032	Bank of New York Mellon/Aa1	352	(71)
46,155	SIFMA Municipal Sw ap Index	67% USD-LIBOR-BBA one month plus .44%	5/17/2010	8/15/2032	Deutsche Bank AG/A2	235	(47)
71,685	4.226%	67% USD-LIBOR-BBA three month plus .63%	5/17/2007	2/15/2037	JP Morgan Chase Bank/Aa3	(26,856)	(11,751)
115,565	SIFMA Municipal Sw ap Index	67% USD-ISDA Sw ap Rate ten year plus .0063%	6/8/2007	2/15/2037	JP Morgan Chase Bank/Aa3	4,398	3,081
<u>\$ 587,280</u>						<u>\$ (4,442)</u>	<u>\$ 9,052</u>

During the year ended June 30, 2012, amendments to three of the University's pay-variable, receive-variable interest rate swaps became effective per the terms listed in the table below. After the amendment period, these interest rate swaps revert back to the original terms as outlined in the table above.

2012 Notional Amount	Rate Paid	Rate Received	Amendment Effective Date	Amendment Termination Date	Counterparty/ Counterparty Credit Rating
\$ 270,270	0%	1.407%	8/15/2011	8/14/2014	Deutsche Bank AG/A2
\$ 14,365	0%	2.1725%	8/15/2011	8/14/2014	Deutsche Bank AG/A2
\$ 115,565	SIFMA Municipal Sw ap Index	67% USD-LIBOR-BBA one month plus 1.8653%	8/1/2011	7/31/2014	JP Morgan Chase Bank/Aa3

Credit Risk: The University is exposed to credit risk on investment derivative instruments that are in asset positions. To minimize its exposure to loss related to credit risk, it is the University's policy to require counterparty collateral posting provisions; refer to Footnote 14 for thresholds and minimum transfers. The University has never failed to access collateral when required. The aggregate fair value of investment derivative instruments in asset positions at June 30, 2012 was \$22,414. This represents the maximum loss that would be recognized at the reporting date if the counterparty failed to perform as contracted. This maximum exposure is reduced by \$22,062 of negative hedging and investment derivative fair values included in netting arrangements with the counterparties and \$370 of collateral posted with the University, resulting in no significant net exposure to credit risk with any individual counterparty.

As a means of managing credit risk on its fixed income investments, University investment policy limits 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; LRP portfolio – short-term A2/P2, long-term B; CIF portfolio – short-term A2/P2, long-term BB. Thereafter, the minimum quality for separately managed funds in all three portfolios is limited to AA. At June 30, 2012 and 2011, the University was in compliance with its credit risk policy for each portfolio. University policy does not address credit risk by investment type.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

The Standard & Poor's credit ratings for fixed income investments at June 30, 2012 and 2011 are as follows:

June 30, 2012								
Rating	Investment pools	U.S. Treasury bonds	U.S. Government agencies	Municipal bonds	Corporate bonds	International governmental bonds	Asset-backed securities	Total
AAA	\$ 9,157	\$ -	\$ 2,066	\$ -	\$ 13,092	\$ -	\$ 28,068	\$ 52,383
AA	-	-	8,760	414	27,670	101	4,942	41,887
A	-	-	834	653	47,419	-	1,274	50,180
BBB	-	-	-	-	30,454	144	4,984	35,582
BB	-	-	-	-	1,460	-	4	1,464
Below BB	-	-	-	-	-	-	3,488	3,488
Not rated	341,369	79,513	46,600	-	4,340	-	27,843	499,665
Total	<u>\$ 350,526</u>	<u>\$ 79,513</u>	<u>\$ 58,260</u>	<u>\$ 1,067</u>	<u>\$ 124,435</u>	<u>\$ 245</u>	<u>\$ 70,603</u>	<u>\$ 684,649</u>

June 30, 2011								
Rating	Investment pools	U.S. Treasury bonds	U.S. Government agencies	Municipal bonds	Corporate bonds	International governmental bonds	Asset-backed securities	Total
AAA	\$ 4,117	\$ -	\$ 17,774	\$ -	\$ 14,568	\$ 1,013	\$ 34,036	\$ 71,508
AA	-	-	-	363	27,320	2,029	1,965	31,677
A	-	-	-	674	60,787	176	1,870	63,507
BBB	-	-	-	-	27,838	394	26	28,258
BB	-	-	-	-	2,042	-	40	2,082
Below BB	-	-	-	-	-	-	4,045	4,045
Not rated	355,074	49,976	83,758	-	4,472	-	14,993	508,273
Total	<u>\$ 359,191</u>	<u>\$ 49,976</u>	<u>\$ 101,532</u>	<u>\$ 1,037</u>	<u>\$ 137,027</u>	<u>\$ 3,612</u>	<u>\$ 56,975</u>	<u>\$ 709,350</u>

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 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. LRP portfolio – No more than 10% of the portfolio's market value may be invested in securities below BBB. 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, 2012 and 2011, not more than 5% of the University's total investments were invested in any one issuer except those which are obligations of, or fully guaranteed as to both principal and interest by, the U.S. Government or its agencies.

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 \$59,887 of the U.S. Treasury bonds, \$53,262 of the U.S. Government agencies, \$1,067 of the Municipal bonds, \$121,346 of the Corporate bonds, \$245 of the International governmental bonds, \$64,403 of the Asset-backed securities, \$173,608 of the U.S. Equities, \$9,573 of the International equities, and \$21,629 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, \$15,357 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 LRP portfolio to 30% of the portfolio's market value.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

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, 2012 and 2011 are summarized as follows:

	2012	2011
Short-term investments	\$ 530	\$ 1,096
Domestic equities	74,480	49,628
Foreign equities	28,596	21,961
Other equities	726	17,890
Fixed income	48,348	81,497
Mutual funds – Equities	17,410	17,666
Mutual funds – Fixed	19,364	19,559
Limited partnerships	115,878	100,683
Venture capital	37,702	43,560
	<u>\$ 343,034</u>	<u>\$ 353,540</u>

Certain 2011 amounts have been restated to conform with 2012 presentation.

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, 2012, the Foundation has an outstanding commitment to fund limited partnership and venture capital investments in the amount of \$28,602.

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 (\$150,584); (2) Valuations obtained from third party pricing services for identical or similar assets (\$38,870); (3) Valuations from other techniques including option pricing models, discounted cash flow models, and other similar techniques, and not based on market exchange transactions (\$153,580).

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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

5. Accounts and interest receivable

The composition of accounts and interest receivable at June 30, 2012 and 2011 is summarized as follows:

	2012	2011
State appropriations	\$ 53,408	\$ 62,837
Research and sponsored programs	59,273	83,231
Departmental activities	20,670	21,181
Interest receivable	1,626	1,454
Other	23,072	19,528
	<u>158,049</u>	<u>188,231</u>
Less: allowance for doubtful accounts	15,178	18,117
Net accounts and interest receivable	<u>\$ 142,871</u>	<u>\$ 170,114</u>

6. Student loans receivable

Student loans receivable at June 30, 2012 and 2011 are summarized as follows:

Description	2011	Distributed	Collected	2012	Current Portion
Federal Family Education Loan Program	\$ 2,497	\$ -	\$ 405	\$ 2,092	\$ 324
Perkins Federal Loan Program	37,090	5,403	4,492	38,001	4,537
Other	10,180	4,692	4,344	10,528	4,719
	<u>49,767</u>	<u>\$ 10,095</u>	<u>\$ 9,241</u>	<u>50,621</u>	<u>9,580</u>
Allowance for uncollectible loans	(4,889)			(5,157)	(171)
Net student loan receivable	<u>\$ 44,878</u>			<u>\$ 45,464</u>	<u>\$ 9,409</u>

Description	2010	Distributed	Collected	2011	Current Portion
Federal Family Education Loan Program	\$ 2,870	\$ -	\$ 373	\$ 2,497	\$ 183
Perkins Federal Loan Program	37,580	4,316	4,806	37,090	4,544
Other	10,444	4,234	4,498	10,180	4,022
	<u>50,894</u>	<u>\$ 8,550</u>	<u>\$ 9,677</u>	<u>49,767</u>	<u>8,749</u>
Allowance for uncollectible loans	(4,672)			(4,889)	(183)
Net student loan receivable	<u>\$ 46,222</u>			<u>\$ 44,878</u>	<u>\$ 8,566</u>

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.

The University holds and services student loans related to the discontinued U.S. Department of Education Federal Family Education Loan Program. As of June 30, 2012, the University held a non-revolving line of credit, used to facilitate the servicing of the loans (see Footnote 13).

For the year ended June 30, 2012 and 2011, the University distributed \$364,921 and \$347,760, respectively, for student loans through the U.S. Department of Education William D. Ford Direct Loan Program. These distributions and related funding sources are not included as expenses and revenues in the accompanying financial statements.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

7. Pledges receivable

Payments on pledges receivable at June 30, 2012, 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%.

2013	\$	31,170
2014		7,982
2015		5,536
2016		3,938
2017		2,701
2018 and beyond		4,317
Total discounted pledges receivable		<u>55,644</u>
Less: allowance for uncollectible pledges		<u>6,412</u>
Net pledges receivable, June 30, 2012		49,232
Less: current portion		<u>27,568</u>
Noncurrent portion	\$	<u><u>21,664</u></u>

8. 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 McLaren Greater Lansing 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, 426 Auditorium Rd., John A. Hannah Administration Building Room 305, East Lansing, Michigan 48824-1046.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

9. Capital assets and collections

Capital asset and collection activity for the years ended June 30, 2012 and 2011 follows:

	2011	Additions (Deductions)	Disposals	2012
Non-depreciated capital assets:				
Land	\$ 32,143	\$ 2,678	\$ -	\$ 34,821
Construction in progress	205,028	21,610	-	226,638
Museum collections	8,871	889	-	9,760
Total non-depreciated capital assets	<u>246,042</u>	<u>25,177</u>	<u>-</u>	<u>271,219</u>
Depreciated capital assets:				
Buildings and site improvements	2,155,955	157,912	(4,741)	2,309,126
Software and other intangibles	87,264	3,920	-	91,184
Equipment and other	625,836	57,169	(11,103)	671,902
Less: accumulated depreciation				
Buildings and site improvements	(909,712)	(68,056)	4,508	(973,260)
Software and other intangibles	(17,453)	(18,237)	-	(35,690)
Equipment and other	(484,567)	(41,785)	10,578	(515,774)
Total depreciated capital assets	<u>1,457,323</u>	<u>90,923</u>	<u>(758)</u>	<u>1,547,488</u>
Total capital assets	<u>\$ 1,703,365</u>	<u>\$ 116,100</u>	<u>\$ (758)</u>	<u>\$ 1,818,707</u>

	2010	Additions (Deductions)	Disposals	2011
Non-depreciated capital assets:				
Land	\$ 32,143	\$ -	\$ -	\$ 32,143
Construction in progress	162,670	42,358	-	205,028
Museum Collections	8,805	66	-	8,871
Total non-depreciated capital assets	<u>203,618</u>	<u>42,424</u>	<u>-</u>	<u>246,042</u>
Depreciated capital assets:				
Buildings and site improvements	2,125,025	31,799	(869)	2,155,955
Software and other intangibles	-	87,264	-	87,264
Equipment and other	597,401	37,959	(9,524)	625,836
Less: accumulated depreciation				
Buildings and site improvements	(849,582)	(60,996)	866	(909,712)
Software and other intangibles	-	(17,453)	-	(17,453)
Equipment and other	(454,931)	(37,734)	8,098	(484,567)
Total depreciated capital assets	<u>1,417,913</u>	<u>40,839</u>	<u>(1,429)</u>	<u>1,457,323</u>
Total capital assets	<u>\$ 1,621,531</u>	<u>\$ 83,263</u>	<u>\$ (1,429)</u>	<u>\$ 1,703,365</u>

10. 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 \$5,260 as of June 30, 2012. The discount rate used was 2%.

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

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 \$4,438 as of June 30, 2012. The discount rate used was 6%.

Changes in the total reported general, professional, and self-insured employee benefit liabilities during 2012, 2011, and 2010 were as follows:

	2012	2011	2010
Balance, beginning of year	\$ 21,954	\$ 21,702	\$ 24,253
Claims incurred and changes in estimates	90,052	100,822	103,170
Claim payments	(91,138)	(100,570)	(105,721)
Balance, end of year	20,868	21,954	21,702
Less: current portion	13,619	15,073	13,770
Noncurrent portion	\$ 7,249	\$ 6,881	\$ 7,932

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.

11. Retirement benefits

The University has a defined contribution base retirement program administered through TIAA-CREF and Fidelity Investments for all qualified employees. All regular employees are eligible to participate based on the service requirements specific to their employee group. Participants maintain individual accounts 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, 2012 and 2011 were as follows:

	2012	2011
University contributions	\$ 67,386	\$ 68,254
Employee contributions	33,693	34,127

In addition, the University has a single-employer, defined benefit plan covering 590 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, 2012.

12. 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 closed single employer defined benefit plan administered by the University. Benefits are provided to eligible faculty, academic staff and support staff who meet normal retirement requirements while still working for the University. Currently, the plan has approximately 17,600 members. The plan does not issue a separate stand-alone financial statement. Effective for new employees hired on or after July 1, 2010, the University discontinued providing retiree health and dental care benefits.

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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

Funding Progress: For the year ended June 30, 2012, the University has estimated the cost (annual expense) of providing retiree health and dental care benefits through an actuarial valuation as of January 1, 2012. 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 not to exceed thirty years. This valuation's computed contribution and actual funding are summarized as follows:

	2012	2011	2010
Annual required contribution	\$ 73,935	\$ 66,616	\$ 66,970
Interest on the prior year's net OPEB obligation	11,873	8,976	6,167
Less adjustment to the annual required contribution	<u>(9,413)</u>	<u>(6,939)</u>	<u>(4,654)</u>
Annual OPEB cost	76,395	68,653	68,483
Amounts contributed:			
Payments of current premiums and claims	(29,022)	(27,279)	(28,354)
Advance funding	<u>-</u>	<u>-</u>	<u>-</u>
Increase in net OPEB obligation	47,373	41,374	40,129
OPEB obligation - beginning of year	<u>169,608</u>	<u>128,234</u>	<u>88,105</u>
OPEB obligation - end of year	<u>\$ 216,981</u>	<u>\$ 169,608</u>	<u>\$ 128,234</u>

The annual OPEB cost, the percentage contributed to the plan, and the net OPEB obligation for the current and two preceding years are as follows:

	Fiscal Year Ended June 30,		
	2012	2011	2010
Annual OPEB cost	\$ 76,395	\$ 68,653	\$ 68,483
Percentage contributed	38.0%	39.7%	41.4%
Net OPEB obligation	\$ 216,981	\$ 169,608	\$ 128,234

The funding progress of the plan as of the most recent and two preceding valuation dates are as follows:

	2012	2011	2010
Actuarial value of assets	\$ -	\$ -	\$ -
Actuarial accrued liability (AAL)	<u>850,695</u>	<u>791,921</u>	<u>782,796</u>
Unfunded AAL (UAAL)	<u>\$ 850,695</u>	<u>\$ 791,921</u>	<u>\$ 782,796</u>
Funded ratio	0.0%	0.0%	0.0%
Annual covered payroll (annual payroll of active employees covered by the plan)	\$ 802,106	\$ 783,187	\$ 753,757
UAAL as a percentage of covered payroll	106.1%	101.1%	103.9%

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, 2012 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 5% which includes a 4% inflation assumption. The UAAL is being amortized over 30 years as a level percentage of projected payroll on a closed basis, with 25 years remaining.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

13. Long term debt and other obligations

Long term debt and other obligations for the years ended June 30, 2012 and 2011 are summarized as follows:

	2011	Borrowed	Retired	2012	Current Portion
General Revenue Bonds:					
Series 2010A	\$ 205,000	\$ -	\$ -	\$ 205,000	\$ -
Series 2010C	284,155	-	11,530	272,625	11,795
Series 2007A	24,970	-	3,090	21,880	3,220
Series 2007B	25,000	-	-	25,000	-
Series 2005	54,140	-	-	54,140	-
Series 2003A	48,205	-	-	48,205	-
Series 2003C	9,620	-	9,620	-	-
Series 2000A	77,140	-	5	77,135	-
	<u>728,230</u>	<u>-</u>	<u>24,245</u>	<u>703,985</u>	<u>15,015</u>
General Revenue Commercial Paper:					
Series B taxable	33,880	72,875	30,000	76,755	76,755
Series C tax-exempt	47,475	15,000	7,000	55,475	55,475
Series D tax-exempt	-	15,000	-	15,000	15,000
	<u>81,355</u>	<u>102,875</u>	<u>37,000</u>	<u>147,230</u>	<u>147,230</u>
Federal student loan deposits	37,298	396	-	37,694	-
Line of credit	2,428	-	686	1,742	-
Lease obligations and other	4,695	-	(528)	5,223	25
	<u>\$ 854,006</u>	<u>\$ 103,271</u>	<u>\$ 61,403</u>	<u>\$ 895,874</u>	<u>\$ 162,270</u>

	2010	Borrowed	Retired	2011	Current Portion
General Revenue Bonds:					
Series 2010A	\$ 205,000	\$ -	\$ -	\$ 205,000	\$ -
Series 2010C	289,230	-	5,075	284,155	11,530
Series 2007A	27,955	-	2,985	24,970	3,090
Series 2007B	25,000	-	-	25,000	-
Series 2005	54,140	-	-	54,140	-
Series 2003A	48,205	-	-	48,205	-
Series 2003C	9,850	-	230	9,620	245
Series 2002A	1,490	-	1,490	-	-
Series 2002B	5,710	-	5,710	-	-
Series 2000A	78,700	-	1,560	77,140	-
Series 1998A-2	2,815	-	2,815	-	-
	<u>748,095</u>	<u>-</u>	<u>19,865</u>	<u>728,230</u>	<u>14,865</u>
General Revenue Commercial Paper:					
Series A tax-exempt	34,929	-	34,929	-	-
Series B taxable	20,000	13,880	-	33,880	33,880
Series C tax-exempt	4,071	51,929	8,525	47,475	47,475
	<u>59,000</u>	<u>65,809</u>	<u>43,454</u>	<u>81,355</u>	<u>81,355</u>
Federal student loan deposits	36,838	460	-	37,298	-
Line of credit	3,410	-	982	2,428	-
Lease obligations and other	3,863	-	(832)	4,695	(518)
	<u>\$ 851,206</u>	<u>\$ 66,269</u>	<u>\$ 63,469</u>	<u>\$ 854,006</u>	<u>\$ 95,702</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

All bonds are secured by General Revenues and certain variable rate issues bear interest based on 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: from 2021 through 2034
- Series 2003A: from 2021 through 2033
- Series 2000A: from 2022 through 2031

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 2010A bonds bear interest at 6.17% and are subject to mandatory redemption from fiscal 2044 through 2050. In accordance with the Build America Bonds program, the University will receive semi-annual federal credit payments equal to 35.00% of actual interest expense incurred on the outstanding principal balance of the bonds.

The Series 2010C bonds bear interest at fixed rates from 2.00% to 5.13% and mature either serially through fiscal 2029 or are subject to mandatory redemption from 2030 through 2044.

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

The University utilizes variable-rate commercial paper to provide interim financing. The Board has authorized the issuance of up to \$250,000 in commercial paper secured by General Revenues and allows for tax-exempt and taxable issuances. Outstanding commercial paper debt is converted to long-term financing, as appropriate, within the normal course of business. Outstanding tax-exempt balances bear interest at rates from 0.14% to 0.20% and taxable balances bear interest at rates from 0.13% to 0.18%, with principal and accrued interest payments due within a maximum of 270 days from the date of issuance.

During the year ended June 30, 2012, the University used \$9,375 par value of Commercial Paper Series B to refund \$9,375 par value of Series 2003C bonds.

Hedging derivative instrument payments and hedged debt: Using rates as of June 30, 2012, scheduled fiscal year maturities of bonds payable and related interest expense are as follows. These amounts assume that current interest rates on variable-rate bonds and the current reference rates of hedging derivative instruments will remain the same for their term. As these rates vary, interest payments on variable-rate bonds and net receipts/payments on the hedging derivative instruments will vary. See Footnote 14 for information on derivative instruments.

Fiscal Year Ending June 30,	Fixed-Rate Bonds		Variable-Rate Bonds		Hedging	Total
	Principal	Interest	Principal	Interest	Derivatives, Net	
2013	\$ 15,015	\$ 26,670	\$ -	\$ 512	\$ 7,743	\$ 49,940
2014	15,595	25,914	-	512	7,714	49,735
2015	16,235	25,116	-	512	7,683	49,546
2016	16,915	24,285	-	512	7,651	49,363
2017	17,610	23,421	-	512	7,618	49,161
2018-2022	66,560	105,344	20,850	2,465	36,767	231,986
2023-2027	18,445	95,886	81,095	1,662	25,660	222,748
2028-2032	7,225	93,773	85,115	639	9,068	195,820
2033-2037	29,775	90,029	17,420	133	488	137,845
2038-2042	51,165	80,354	-	-	-	131,519
2043-2047	142,200	55,393	-	-	-	197,593
2048-2052	102,765	10,515	-	-	-	113,280
Total	\$ 499,505	\$ 656,700	\$ 204,480	\$ 7,459	\$ 110,392	\$ 1,478,536

Interest expense was \$35,264 (net of \$3,795 capitalized interest) and \$38,878 (net of \$2,291 capitalized interest) for 2012 and 2011, respectively.

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

At June 30, 2012, the University owed \$1,741 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). This line of credit bears interest equal to the British Bankers Association (BBA) London Interbank Offering Rate (LIBOR) Daily Floating Rate plus 1.00%. Payments of accrued interest are due monthly, with all unpaid accrued interest and principal due in October 2013.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

Lease obligations and other includes lease obligations of \$1,828 (\$216 current) and deferred bond premium of \$20,156 (\$943 current), net of deferred debt refunding costs of \$16,761 (\$1,134 current). Deferred amounts will be amortized over the applicable bond issue life.

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 2012 and 2011 were as follows:

	2012	2011
Balance, beginning of year	\$ 81,193	\$ 104,064
Additions	2,910	4,465
Reductions	<u>(10,474)</u>	<u>(27,336)</u>
Balance, end of year	73,629	81,193
Less: current portion	40,887	49,256
Noncurrent portion	<u>\$ 32,742</u>	<u>\$ 31,937</u>

14. Derivative instruments

The fair value and notional amounts of derivative instruments outstanding at June 30, 2012 and 2011, classified by type, and the changes in fair value of such derivative instruments are as follows:

June 30, 2012					
	Changes in Fair Value		Fair Value		Notional Amount
	Classification	Amount	Classification	Amount	
Hedging derivatives:					
Cash flow hedges:					
Pay-fixed interest rate sw aps	Deferred charges	\$ (30,664)	Debt	\$ (66,434)	\$ 210,245
Investment derivatives:					
Pay-variable interest rate sw aps	Net investment income (loss)	\$ 1,611	Investment	\$ 22,414	\$ 515,595
Pay-fixed interest rate sw aps	Net investment income (loss)	<u>(15,106)</u>	Investment	<u>(26,856)</u>	<u>71,685</u>
Total investment derivatives		<u>\$ (13,495)</u>		<u>\$ (4,442)</u>	<u>\$ 587,280</u>
June 30, 2011					
	Changes in Fair Value		Fair Value		Notional Amount
	Classification	Amount	Classification	Amount	
Hedging derivatives:					
Cash flow hedges:					
Pay-fixed interest rate sw aps	Deferred charges	\$ 7,115	Debt	\$ (35,770)	\$ 210,855
Investment derivatives:					
Pay-variable interest rate sw aps	Net investment income (loss)	\$ 7,331	Investment	\$ 20,803	\$ 535,005
Pay-fixed interest rate sw aps	Net investment income (loss)	3,064	Investment	<u>(11,751)</u>	<u>71,685</u>
Total investment derivatives		<u>\$ 10,395</u>		<u>\$ 9,052</u>	<u>\$ 606,690</u>

Fair Value: The fair values of the interest rate swaps were 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 future net settlement on the swaps.

Objective: The University is party to eight separate derivative instruments which are pay-fixed, receive-variable interest rate swaps that hedge the changes in cash flows on various variable-rate debt series. In order to protect against the potential of rising interest rates, the University entered into these derivative instruments at a cost less than what the University would have paid to issue fixed-rate debt. In order to benefit from both expected changes in the relationship of short and long-term interest rates and the relationships between the SIFMA Municipal Swap Index and both the ten-year USD-ISDA Index and the one-month USD-LIBOR-BBA Index, the University also entered into five separate derivative instruments which are pay-variable, receive-variable interest rate swaps which relate to various debt series. See Footnote 3 for more information on investment derivative instruments.

Terms, Fair Values, and Credit Risk: The following table displays the terms and fair values of the University's hedging derivative instruments outstanding at June 30, 2012 and 2011, along with the notional amounts and credit rating of the associated

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

counterparty as of June 30, 2012. As disclosed in Footnote 13, the University retired \$9,375 of its Series 2003C debt with proceeds from its Commercial Paper (CP) Series B. The related hedging derivative instrument was assigned to the portion of the University's CP Series B that was used to retire the Series 2003C debt.

Type	Cash Flow Hedge for Debt Series	2012 Notional Amount	Effective Date	Termination Date	Rate Paid	Rate Received	Counterparty/ Counterparty Credit Rating	2012 Fair Value	2011 Fair Value
Pay-fixed interest rate sw ap	2000A	\$ 71,535	11/3/2008	8/15/2029	4.074%	67% USD-LIBOR-BBA one month	Deutsche Bank AG/A2	\$ (24,742)	\$ (14,465)
Pay-fixed interest rate sw ap	CP Series B	2,950	10/17/2002	8/15/2018	4.330%	USD-LIBOR-BBA one month	Deutsche Bank AG/A2	(382)	(339)
Pay-fixed interest rate sw ap	CP Series B	2,040	10/17/2002	8/15/2022	5.280%	USD-LIBOR-BBA one month	Deutsche Bank AG/A2	(664)	(404)
Pay-fixed interest rate sw ap	2003A	48,205	11/3/2008	2/15/2033	3.618%	67% USD-LIBOR-BBA one month	Barclays Bank PLC/A2	(14,672)	(7,225)
Pay-fixed interest rate sw ap	CP Series B	9,375	11/3/2008	2/15/2033	5.330%	USD-LIBOR-BBA one month	Barclays Bank PLC/A2	(3,545)	(1,913)
Pay-fixed interest rate sw ap	2005	54,140	11/3/2008	2/15/2034	3.647%	67% USD-LIBOR-BBA one month	Barclays Bank PLC/A2	(16,715)	(8,318)
Pay-fixed interest rate sw ap	2007B & CP Series C	22,000	5/17/2007	2/15/2028	4.139%	67% USD-LIBOR-BBA three month plus .58%	JP Morgan Chase Bank/Aa3	(5,714)	(3,106)
		<u>\$ 210,245</u>						<u>\$ (66,434)</u>	<u>\$ (35,770)</u>

Credit Risk: The University is exposed to credit risk on hedging derivative instruments that are in asset positions. The aggregate fair value of hedging derivative instruments in asset positions at June 30, 2012 was zero and the University was not exposed to credit risk related to these swaps. Refer to Footnote 3 for information on credit risk of investment derivative instruments.

To mitigate credit risk, the University executes interest rate swaps with various counterparties and it is the University's policy to require collateralization. The following table demonstrates the thresholds and minimum transfers for collateralization:

Credit Rating	Deutsche Bank AG		JP Morgan Chase Bank N.A.		Bank of New York Mellon		Barclays Bank PLC	
	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
Below Baa1/BBB+	-	250	-	250	-	250	-	-

*Threshold for the University is \$20,000

Interest rate risk: The University is not exposed to interest rate risk on its derivative instruments.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

Basis Risk: The University is exposed to basis risk on its pay-fixed, receive-variable interest rate swap hedging derivative instruments because the variable-rate payments received by the University on these hedging derivative instruments are based on a rate or index other than interest rates the University pays on its variable-rate debt, which bear interest based on periodic rates determined by the trustee or remarketing agent. These pay-fixed, receive-variable swaps expose the University to basis risk should the rates resulting from the 67% of USD-LIBOR-BBA swaps not equal the rate the University pays on the 2000A, 2003A, 2005, 2007B, and CP Series C debt, and should the rates resulting from the USD-LIBOR-BBA swaps not equal the rate the University pays on the CP Series B debt.

Termination Risk: The University or any of the involved counterparties may terminate a derivative instrument if the other party fails to perform under the terms of the contract. If at the time of termination, a hedging derivative instrument is in a liability position, the University would be liable to the appropriate counterparty for a payment equal to the liability, subject to any netting arrangement.

Rollover Risk: The University is not exposed to rollover risk on its derivative instruments.

Contingencies: All of the University's derivative instruments include provisions that require the University to post collateral at certain thresholds depending on the University's credit rating. See the table under "Credit Risk" for thresholds and minimum transfers for collateralization. As of June 30, 2012, the University's credit ratings were Aa1 as assigned by Moody's and AA as assigned by Standard & Poor's. The aggregate fair value of all derivative instruments with these collateral posting provisions as of June 30, 2012 was (\$70,876). The related collateral postings totaled \$37,574 posted by the University to its counterparties and \$370 held by the University posted by its counterparties.

15. Net assets

Restricted and unrestricted net assets for the years ended June 30, 2012 and 2011 are as follows:

	2012	2011
Restricted - nonexpendable:		
Permanent endowments	\$ 389,884	\$ 352,696
Restricted - expendable:		
Gifts, endowment income and sponsored programs	\$ 328,363	\$ 351,085
Quasi and term endowments	159,941	166,101
Capital projects	51,259	65,539
Student loans	8,226	8,166
Total Restricted - expendable	<u>\$ 547,789</u>	<u>\$ 590,891</u>
Total Restricted Net Assets	<u>\$ 937,673</u>	<u>\$ 943,587</u>
Unrestricted:		
Designated/Committed	\$ 760,418	\$ 779,390
Uncommitted	11,528	10,096
Total Unrestricted Net Assets	<u>\$ 771,946</u>	<u>\$ 789,486</u>

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.

16. 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 not be material.

NOTES TO THE FINANCIAL STATEMENTS (continued)

Michigan State University

17. Commitments

At June 30, 2012, 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 \$115,233 and are to be funded from debt proceeds, capital grants, private gifts, and other University funds. 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, 2012, 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, 2012, \$165,656 of the initial \$483,230 investment commitment remains outstanding.

18. New accounting pronouncements

The University will be required to implement the provisions of GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements (SCAs)*, effective with the fiscal year ending June 30, 2013. The University will be required to address financial reporting related to service concession agreements which are a type of public-private or public-public partnership. The University has not yet determined the full impact of this standard on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 61, *The Financial Reporting Entity Omnibus*, effective with the fiscal year ending June 30, 2013. The University will be required to address modifications to certain requirements for inclusion of component units in the financial reporting entity. The University has not yet determined the full impact of this standard on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, effective with the fiscal year ending June 30, 2013. The University will be required to address certain FASB Statements and Interpretations, APB Opinions, and Accounting Research Bulletins of the AICPA Committee on Accounting Procedure that this standard incorporates into GASB literature. The University has not yet determined the full impact of this standard on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective with the fiscal year ending June 30, 2013. This Statement defines deferred outflows and inflows of resources as elements of consuming or acquiring net assets by the University that is applicable to a future reporting period. The standard also incorporates deferred outflows or inflows of resources into the definition of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The University has not yet determined the full impact of this standard on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, effective with the fiscal year ending June 30, 2014. The University will be required to address financial reporting related to the reclassification, as deferred outflows of resources or deferred inflows of resources, certain items that are currently reported as assets and liabilities and recognize, as outflows of resources or inflows of resources, certain items that are currently reported as assets and liabilities. The University has not yet determined the full impact of this standard on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 66, *Technical Corrections-2012-an amendment of GASB Statement No. 10 and No. 62*, effective with the fiscal year ending June 30, 2014. The University will be required to review changes to the financial reporting of risk financing and related insurance affecting GASB Statement No. 10 and changes to the financial reporting of loans and leases affecting GASB Statement No. 62. The University has not yet determined the full impact of this standard on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions-an amendment of GASB Statement No. 27*, effective with the fiscal year ending June 30, 2015. The University will be required to address modifications to certain requirements for financial reporting of pension plans. The University has not yet determined the full impact of this standard on its financial statements.

Financial report prepared under the direction of Fred L. Poston, Vice President for Finance and Operations and Treasurer; Mark P. Haas, Associate Vice President for Finance and Chief Financial Officer; Glen J. Klein, Director of Investments and Financial Management; Gregory J. Deppong, Controller; and John L. Thelen, Manager of Financial and Cost Analysis.

Michigan State University is an affirmative-action, equal-opportunity employer.
The Michigan State University IDEA is Institutional Diversity: Excellence in Action

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 financial statements of Michigan State University and its discretely presented component unit (the Michigan State University Foundation) as of and for the years ended June 30, 2012 and 2011, which collectively comprise Michigan State University's basic financial statements, and have issued our report thereon dated October 25, 2012. We conducted our audit 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. The financial statements of the Michigan State University Foundation were audited by other auditors, who did not perform that audit in accordance with *Government Auditing Standards*; accordingly, this report does not include reporting on internal control over financial reporting or instances of reportable noncompliance associated with the Foundation.

Internal Control Over Financial Reporting

Management of Michigan State University is responsible for establishing and maintaining an effective 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 deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the University's financial statements will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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 25, 2012

MICHIGAN STATE

U N I V E R S I T Y