MICHIGAN STATE
UNIVERSITY

FINANCIAL REPORT 2007–2008

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Michigan State University

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UNIVERSITY

This report presents the financial position and results of operations of Michigan State University for the fiscal years ended June 30, 2008, and June 30, 2007. The financial report has been adopted by the Board of Trustees and is provided as part of the commitment by Michigan State University to report annually on its fiscal affairs. These financial statements have been audited by Plante & Moran PLLC, Certified Public Accountants. Their audit report appears on page 17.

MSU has been advancing knowledge and transforming lives through teaching, research, and outreach for more than 150 years. More than 45,000 students from every county in the state, every state in the nation, and over 130 countries worldwide enroll at Michigan State each year in more than 200 programs of undergraduate and graduate study. MSU has been recognized for six consecutive years as one of the top 100 universities in the world by Shanghai Jiao Tong University's Institute of Higher Education in its annual Academic Ranking of World Universities. In addition, MSU is a national leader in study abroad participation among public universities, one of only four public universities in the nation that ranks in the top 10 for both study abroad participation and international student enrollment.

Both before and during the current global economic crisis, MSU has made necessary fiscal adjustments through a series of strategies with the objective of maintaining quality, while balancing the budget and providing needed liquidity. By adhering to its long-practiced stewardship philosophy, which requires that recurring expenses be funded with recurring revenue sources and that budget flexibility be provided through budget carry-forward practices and maintenance of reserves, MSU is positioned to weather the current financial turmoil. Using a three-year time horizon for financial planning, the University is situated to continue to achieve its institutional goals. This is possible by continuing to focus on cost controls, developing new revenue streams, pursuing a long-term investment strategy to maximize risk-adjusted total returns and appropriately utilizing debt and other resources to meet programmatic needs, including the maintenance and replacement of the University's infrastructure.

Despite difficult financial times, progress continues in a number of areas. In April 2008, MSU marked the beginning of a new era for medical education as construction began for the Secchia Center in downtown Grand Rapids, which will serve as the West Michigan home of the MSU College of Human Medicine, funded through private dollars. In June 2008, ground was broken for a new recycling center that will move the University toward its goal of becoming an exemplary steward of the environment. In August 2008, the MSU campus in Dubai International Academic City began offering selected bachelor's and master's degree programs, which will provide graduates to advance Dubai and the region.

The University's commitment to research, dedication to maximizing the student learning experience, and strong international agenda are what continue to make MSU one of the world's top research universities and a globally and responsibly engaged institution. Through the concerted efforts of its faculty, staff, alumni and worldwide supporters, Michigan State will continue to make a significant impact on Michigan, the nation and the world.

Fred L. Poston
Vice President for Finance and Operations and Treasurer
October 24, 2008

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VICE PRESIDENT FOR FINANCE AND OPERATIONS AND TREASURER

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Michigan State University

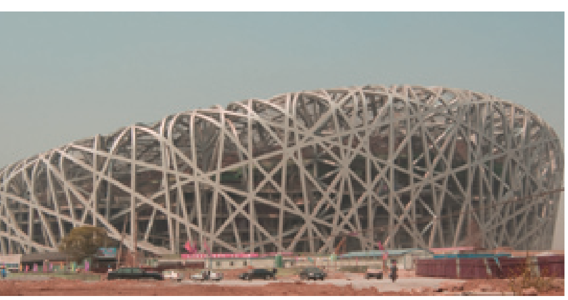
is making a significant impact in Michigan, across the nation, and around the world through world-class academics, pioneering research, and innovative outreach. MSU is committed to sharing knowledge created at the university that leads to practical solutions that make a positive difference in the lives of individuals and in communities from Michigan to Malawi. Learn more at **news.msu.edu**.

Following is a sampling of the ways MSU has worked to address the world's pressing challenges in 2007–08.

INTERNATIONAL IMPACT

- MSU is extending its international presence to the Middle East with the opening of MSU Dubai. In August 2008, the university campus in Dubai International Academic City began offering selected bachelor's and master's degree programs that add value to Dubai and the region. The first major North American university to establish a presence in Dubai, MSU is providing students in the region the opportunities of a world-class research university, while also opening the doors to academic and research partnerships.

- Epidemiologists at MSU dedicate much of their time and talent to researching malaria, which has led to partnerships in places like Malawi, a nation hard hit by the disease. Through the efforts of MSU physicians, General Electric donated an MRI unit to a hospital in Blantyre, Malawi. The unit, which arrived in April 2008, also will serve surrounding nations. In western Kenya, another MSU epidemiologist led a team of researchers who are studying how insecticide-treated bed nets can thwart the mosquitoes that cause malaria, with the support of a $1.7 million grant from the National Science Foundation.



- Michigan State maintains a rich tradition of research and education initiatives in China. As the world turned its attention to Beijing for the 2008 summer Olympics, China turned to a team of renowned MSU turfgrass experts for guidance to grow and install a portable athletic turf that was used in the Beijing National Stadium. In an ongoing partnership with the world's epicenter of giant panda research in China, researchers at MSU continue their quest to understand—and preserve—the giant panda's habitat. In the winter of 2008, an MSU graduate student traveled to the remote mountains of Sichuan, China, working with a research team to capture giant pandas and fit them with global positioning devices. Although no giant pandas were collared, the team came back with a tremendous amount of knowledge about the world in which the pandas live and about other lesser-known species.

PIONEERING RESEARCH

- Saving money and reducing impact on the environment are two concepts often at odds when it comes to a business's bottom line. But two MSU chemistry professors discovered a way to make both achievements possible and earned the 2008 Presidential Green Chemistry Challenge award from the U.S. Environmental Protection Agency as a result. Their work produced a new, environmentally friendly method for making chemical compounds, which streamlines the manufacturing of chemical building blocks, eliminates the need for environment-threatening starting materials, and significantly reduces the amounts of hazardous waste formerly associated with this process.

- A Michigan State researcher and his students have developed a nanomaterial that makes plastic stiffer, lighter, and stronger and could result in more fuel-efficient airplanes and cars, as well as more durable medical and sports equipment. The nanoparticles in the material are being manufactured by a new start-up company, XG Sciences Inc., located in mid-Michigan and a spin-off from intellectual property owned by MSU.

- The university continues to contribute sought-after expertise and research in efforts to advance the bioeconomy. Recently, MSU scientists discovered that an enzyme from a microbe that lives inside a cow's stomach is the key to turning corn plants into fuel. The enzyme that allows cows to digest grasses and other plant fibers can be used to turn other plant fibers into the same simple sugars that can be used to produce ethanol to power cars and trucks. MSU scientists have discovered a way to grow corn plants that contain this enzyme. Because of its success, a plant biotechnology company in Kansas that develops new crops for biofuels and environmental cleanup has licensed the technology and expects to release these corn varieties to growers.

- MSU is working to increase access to environmentally friendly foods and to enhance the vitality of rural Michigan communities by establishing a pasture-based dairy facility and composting program, as well as developing supply chains and markets for pasture-based dairy products. Funded by a $3.5 million grant from the W. K. Kellogg Foundation, the multidisciplinary research project at MSU's Kellogg Biological Station will strengthen distribution networks and increase the demand for locally produced animal products to help Michigan's small- and medium-scale farms maintain a value-added advantage.

ECONOMIC DEVELOPMENT

- As food trends increase demand for high-quality produce year-round, farmers in developing countries are fulfilling this appetite with the support of innovative partnerships led by MSU. Michigan State's Institute of International Agriculture and the U.S. Agency for International Development are bringing a consumer-driven system to farmers in Latin America, India, and Africa. The MSU-led program—Partnerships for Food Industry Development–Fruits and Vegetables—is an ongoing effort to provide small-scale farmers in developing countries with stable markets and paths to greater prosperity.

- In Michigan, the alliance formed by Michigan State, the University of Michigan, and Wayne State University—known as the University Research Corridor (URC)—continues to move forward to create a more vibrant state economy. In May 2008, the URC announced investments in new energy initiatives and released an independent analysis showing Michigan is ready to become a leader in alternative energy. The analysis by Anderson Economic Group LLC found the URC received more than $79.5 million in alternative energy research grants in 2007, with 77 percent from federal grants and 11 percent from the business sector, which currently invests $16.7 billion in Michigan R&D each year—more than in any state except California.

- Automakers in Michigan and throughout the United States are faced with the significant challenge of improving the fuel efficiency of their vehicles in a cost-effective manner. MSU is addressing such issues in the College of Engineering's Energy and Automotive Research Laboratories, a facility devoted to research that focuses on improving automobile engine efficiency, reducing vehicle emissions, and converting waste heat to electricity. MSU is a leader in energy and transportation research, with work cutting across many engineering disciplines and featuring partnerships with government agencies and businesses. In the area of engine efficiency, the university's thermoelectric research team is developing ways to turn waste heat from engines into electricity that has the potential to power vehicles.

- Scientists from MSU played an instrumental role in exploring possibilities in Sweden for growing Michigan's bioeconomy during an August 2007 trip with a delegation that included Michigan's governor. During the trip, Chemrec AB, a Swedish company, and the NewPage Corporation, which operates a paper mill in Escanaba, Michigan, signed a memorandum of understanding to explore developing a facility to produce fuels from woody biomass at the Escanaba plant. The technology, which would address the food versus fuel issue in the bioeconomy, could enable the Escanaba mill to produce as much as 13 million gallons of liquid biofuel per year.

GROWTH AND DEVELOPMENT

- The remodeled Snyder–Phillips residence halls mark the addition of MSU's newest residential college, the Residential College in the Arts and Humanities (RCAH), which welcomed its first class in fall 2007. RCAH, which offers students state-of-the art facilities and a forward-thinking approach to the arts and humanities, joins two other residential colleges on campus—James Madison and Lyman Briggs. MSU's residential colleges were cited by *U.S. News & World Report* as programs "linked to student success" among the magazine's "Programs to Look For" in its current rankings of America's best colleges.

- In June 2007, Michigan State announced that a new world-class art museum will be built on campus thanks to a gift of $26 million from philanthropist and MSU alumnus Eli Broad and his wife, Edythe. The Eli and Edythe Broad Art Museum, designed by world-renowned architect Zaha Hadid, will become integral to university life and the greater community. The Wharton Center for Performing Arts, which celebrated its 25th anniversary in 2007, broke ground in May 2008 for a 24,000-square-foot expansion—the first major renovation in the facility's history. The new space will accommodate increased demand for arts in education programs and distance learning, backstage amenities, and flexible space for on-site functions.

- Ground was broken in June 2008 for a new recycling center that will move the university toward its goal of becoming an exemplary steward of the environment. The new facility will accommodate three times the amount of materials the current recycling facility handles. A new, comprehensive recycling program, coupled with the facility—which will allow the university to expand recycling collection in 549 buildings on campus—will be key to a campuswide environmental stewardship initiative called Be Spartan Green, part of MSU's Boldness By Design strategic positioning.

- MSU marked the beginning of a new era for medical education as construction began in April 2008 for the Secchia Center in downtown Grand Rapids. Construction of the center, which will serve as the West Michigan home of the Michigan State University College of Human Medicine, is funded through private dollars. In addition to providing education to the next generation of physicians, the college will focus attention on biomedical research. Working with medical and educational partners in West Michigan, MSU faculty and students will conduct research in five "clusters": cancer, obesity, cardiovascular disease, arthritis, and neurobiology.

MSU RANKINGS AND RECOGNITIONS

- Ranks No. 30 among America's public universities (*U.S. News & World Report*)
- Recognized for six consecutive years as one of the top 100 universities in the world by Shanghai Jiao Tong University's Institute of Higher Education in its annual Academic Ranking of World Universities
- Record of Rhodes Scholars has led the Big Ten since the 1960s
- National leader in study abroad participation among public universities; one of only four public universities in the nation that ranks in the top 10 for both study abroad participation and international student enrollment
- Only university in the country with three on-campus medical schools, graduating allopathic (MD) and osteopathic (DO) physicians, as well as veterinarians (DVMs)
- Fifth largest producer overall of Peace Corps volunteers since the organization was founded in 1961 (2008 Peace Corps rankings)
- One of the nation's top five campuses for sustainability, according to the National Wildlife Federation's Campus Environment 2008 Report Card, which also indicates MSU has the greatest number of exemplary programs in sustainability among colleges and universities in Michigan
- Graduate programs in elementary and secondary education No. 1 in the nation for the 14th year in a row (*U.S. News & World Report*)
- Graduate program in nuclear physics No. 2 in the nation (*U.S. News & World Report*)
- College of Osteopathic Medicine No. 7 in primary care in the nation (*U.S. News & World Report*)
- Eli Broad College of Business No. 25 in the nation and five of its undergraduate specialty programs rank in the top 15 in their respective categories, including supply chain management at No. 2 (*U.S. News & World Report*)

Introduction

The following discussion provides an overview of the financial position of Michigan State University (the "University") for the years ended June 30, 2008 and 2007 and includes an analysis of the University's Statement of Net Assets, which presents the assets, liabilities, and net assets of the institution as of the end of the fiscal year, and Statement of Revenues, Expenses, and Changes in Net Assets, which reflects revenues and expenses recognized during the fiscal year. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) pronouncements.

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

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

Statement of Net Assets

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

A summarized comparison of the University's assets, liabilities and net assets at June 30, 2008, 2007, and 2006 follows:

	2008	2007	2006
		(in millions)	
Current assets	$ 609	$ 445	$ 450
Noncurrent assets:			
Restricted cash and cash equivalents and restricted investments	27	83	28
Endowment and other investments	1,596	1,561	1,363
Capital assets, net	1,375	1,293	1,205
Other	90	76	54
Total assets	3,697	3,458	3,100
Current liabilities	492	350	357
Noncurrent liabilities	623	590	476
Total liabilities	1,115	940	833
Total net assets	$ 2,582	$ 2,518	$ 2,267

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

Current assets:

Current assets consist of cash and cash equivalents, collateral from securities lending, investments, net accounts and interest receivable, and other assets. The net increase in current assets in 2008 is due in part to a net increase in accounts receivable due primarily to the State of Michigan's deferral of the University's August 2007 operating appropriations payment ($27 million) and operating budget rescission ($5 million) in the prior year. No such deferral and budget cut occurred in 2008. The net increase in current assets in 2008 also includes a net $8 million increase in cash and cash equivalents and investments (this increase is primarily a function of the University's operating, financing, and investing activities as reported in the Statement of Cash Flows), and a $130 million increase in collateral from the securities lending program. The increase in securities lending collateral is due primarily to a change in the makeup of the underlying investment holdings available for loan under the securities lending program as of June 30, 2008 and their related propensity for lending. The net decrease in current assets in 2007 was due in part to the net decrease in accounts receivable due primarily to the aforementioned State of Michigan appropriations deferral and operating budget rescission. The decrease in operating appropriations receivable was partially offset by a $12 million increase in State capital appropriations receivable. The net decrease in current assets in 2007 also included a $37 million increase in cash and cash equivalents (this increase was a function of the University's operating, financing, and investing activities as reported in the Statement of Cash Flows), and a $28 million decrease in collateral from the securities lending program.

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 decrease in 2008 represents the spending of Series 2007 bond proceeds consistent with their restricted purpose. The increase in 2007 was due to the Series 2007 issuance in May 2007.

Endowment and other investments

At June 30, 2008 and June 30, 2007, the University's endowment investments totaled $1,268 million (an increase of $21 million) and $1,247 million (an increase of $186 million), respectively. During 2008 and 2007, $60 million and $30 million, respectively, in investments were reallocated to designated endowment investments, consistent with the University's Board approved cash management and investment plan. Market value (realized and unrealized) changes within the investment portfolio accounted for a $73 million decrease and a $117 million increase in 2008 and 2007, respectively, while endowment gifts totaled $23 million in 2008 and $27 million in 2007.

Other investments consist primarily of the Intermediate Term Fixed Income Fund component of the University's Operating Cash Pool, which totaled $213 million and $201 million at June 30, 2008 and 2007, respectively. Funded retirement and postemployment benefit reserves ($88 million in 2008 and $90 million in 2007) substantially account for the remainder of other investments.

For the years ended June 30, 2008, 2007, and 2006, the total returns on investments were as follows:

	2008	2007	2006
Operating Cash Pool:			
Liquidity Pool	5.6%	5.1%	2.3%
Intermediate Term Fixed Income Fund	5.9%	5.8%	(0.7)%
Common Investment Fund	1.6%	19.0%	13.9%
Other Separately Invested Investments	(0.9)%	13.2%	3.2%

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, 2008, 2007, and 2006, the University's investment in capital assets was as follows:

	2008	2007	2006
		(in millions)	
Land	$ 25	$ 24	$ 20
Buildings and site improvements	1,856	1,726	1,650
Construction in progress	105	108	78
Equipment and other	526	497	456
Museum collections	8	7	6
Less: accumulated depreciation	(1,145)	(1,069)	(1,005)
	$ 1,375	$ 1,293	$ 1,205

Major additions to buildings and site improvements during 2008 include $45 million for Snyder-Phillips Hall renovations, $20 million for Chemistry Building renovations, and $17 million for reconstruction at University Village. Major additions to buildings and site improvements during 2007 included $19 million for the Grand River Parking Ramp, $8 million for the Shaw Lane to Munn Arena steam tunnel and road replacement, $8 million for the Energy and Automotive Research Laboratories, and $7 million each for building chiller projects (Erickson Hall, Fee Hall, and International Center) and for renovations to University apartments.

Construction in progress reflects multi-year projects which, once completed and placed into service, are categorized as buildings and site improvements. The 2008 balance includes $24 million for the Secchia Center, $21 million for the Farm Lane Underpass, $14 million for Duffy Daughtery Football Building renovations, and $11 million for MSU's Enterprise Business Systems Project. The 2007 balance included $40 million for Snyder-Phillips Hall renovations, $16 million for reconstruction at University Village, and $14 million for Chemistry Building renovations.

As of June 30, 2008, 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 $161 million and are to be funded from debt proceeds, other University funds, and private gifts.

Current liabilities:

Current liabilities consist primarily of trade accounts payable, accrued compensation and other personnel costs, obligations under securities lending, deferred revenues, and other liabilities payable within one year or less. The net increase in current liabilities in 2008 is due primarily to a $130 million increase in obligations under securities lending due primarily to a change in the make-up of the underlying investment holdings available for loan under the securities lending program as of June 30, 2008 and their related propensity for lending. The net decrease in current liabilities in 2007 was due primarily to a $28 million reduction in obligations under securities lending, offset by an $11 million increase in deferred revenues, due in part to the receipt of grant funds ($6 million) prior to the completion of the contracted work.

Noncurrent liabilities, primarily debt:

At June 30, 2008, the University had noncurrent debt and other obligations outstanding of $553 million compared with $563 million at June 30, 2007. This balance is comprised primarily of outstanding General Revenue Bonds of $513 million and $525 million in 2008 and 2007, respectively. The University periodically reviews its debt capacity and related capital asset needs to optimize the use of long-term resources. The University's outstanding bonds carry an investment grade bond rating from Moody's and Standard & Poor's of Aa2 and AA, respectively.

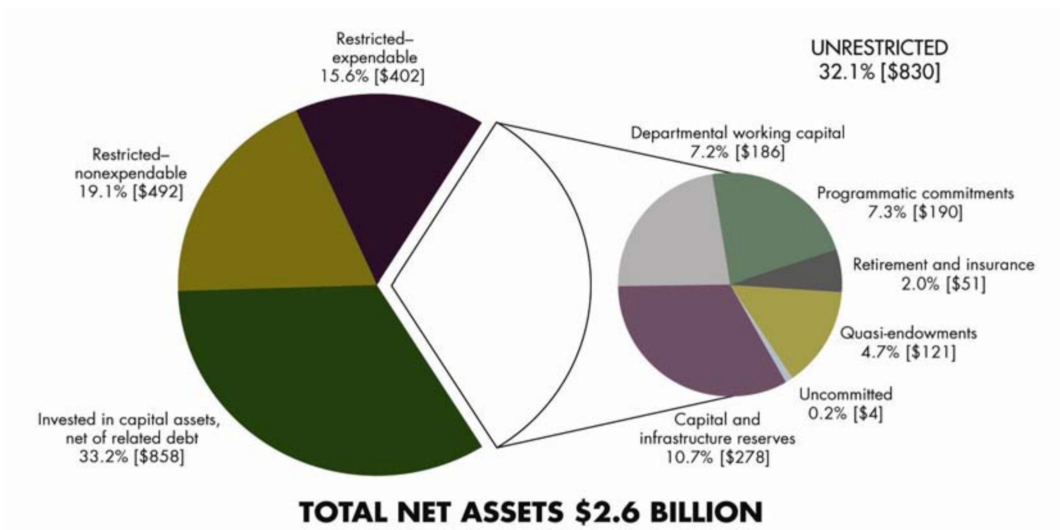
The University faces the continuing challenge of funding its increasing health care and dental benefits costs. This includes the cost of providing postemployment health and dental benefits to eligible employees. Effective July 1, 2007, the University adopted GASB Statement No. 45*, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (OPEB). For the year ended June 30, 2008, the University has estimated the cost (annual expense) of providing retiree health and dental care benefits through an actuarial valuation as of January 1, 2008. As allowed by 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 current year costs and amortize any unfunded actuarial liabilities over a period of thirty years. MSU's total unfunded OPEB obligation is estimated at $835 million, and the University has recorded a noncurrent liability of $43 million representing the net OPEB obligation (the annual required contribution for 2008 less actual retiree health and dental payments made during the fiscal year).

Net assets:

Net assets represent residual University assets after liabilities are deducted. The University’s net assets at June 30, 2008, 2007, and 2006 are summarized as follows:

	2008	2007 *(in millions)*	2006
Invested in capital assets, net of related debt	$ 858	$ 818	$ 792
Restricted:			
Nonexpendable	492	472	384
Expendable	402	374	323
Total restricted	894	846	707
Unrestricted	830	854	768
Total net assets	$ 2,582	$ 2,518	$ 2,267

The following is a breakdown of net assets at June 30, 2008. See footnote 16 for further information (amounts are presented in millions of dollars):



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

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

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

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

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

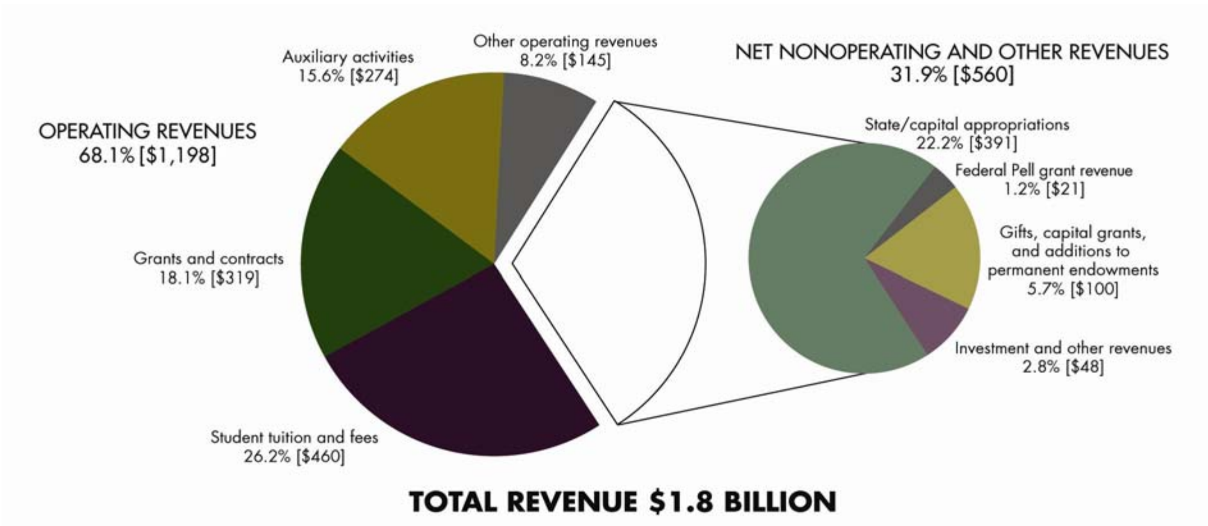
Statement of Revenues, Expenses, and Changes in Net Assets

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

A summarized comparison of the University's revenues, expenses, and changes in net assets for the years ended June 30, 2008, 2007, and 2006 follows:

	2008	2007	2006
		(in millions)	
Operating revenues:			
Student tuition and fees, net of allowances	$ 460	$ 406	$ 373
Grants and contracts	319	317	306
Auxiliary activities	274	253	246
Other operating revenues	145	140	132
Total operating revenues	1,198	1,116	1,057
Operating expenses:			
Instruction and departmental research	521	476	437
Research	260	244	247
Public services	200	186	172
Academic support	75	72	68
Student services	31	28	29
Scholarships and fellowships	36	32	32
Institutional support	83	68	64
Operation and maintenance of plant	145	136	116
Auxiliary enterprises	253	230	229
Depreciation	85	77	73
Other operating expenses, net	5	7	14
Total operating expenses	1,694	1,556	1,481
Operating loss	(496)	(440)	(424)
Nonoperating revenues (expenses):			
State operating appropriation	317	261	286
State agricultural experiment station appropriation	37	31	33
State cooperative extension service appropriation	32	26	29
Federal Pell grant revenue	21	18	17
Gifts	48	55	43
Net investment income	66	244	154
Interest expense on capital asset related debt	(20)	(16)	(16)
Other nonoperating revenues (expenses), net	2	-	(2)
Net nonoperating revenues	503	619	544
Income before other revenues	7	179	120
State capital appropriations	5	12	55
Capital grants and gifts	31	34	3
Additions to permanent endowments	21	26	19
Increase in net assets	64	251	197
Net assets, beginning of year	2,518	2,267	2,070
Net assets, end of year	$ 2,582	$ 2,518	$ 2,267

The following is a graphic illustration of total net revenue by source for the year ended June 30, 2008 (amounts are presented in millions of dollars):

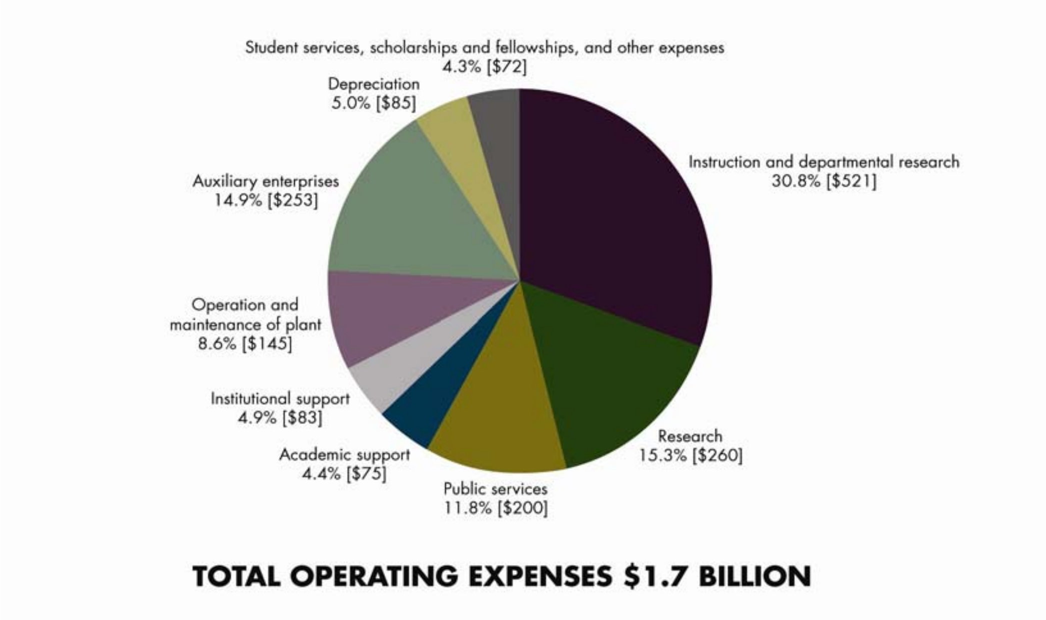


The University is supported by a diverse stream of revenue which supplements its student tuition and fees, including state appropriations, federal and state sponsored programs, private gifts and grants, and investment income. The University continues to seek funding from all possible sources consistent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

Operating revenues: The most significant source of operating revenue for the University is tuition and fees (net of scholarship allowances), totaling $460 million and $406 million in 2008 and 2007, respectively. Gross tuition and fees revenue increased 13.0% in 2008 which includes a 9.5% effective rate increase in tuition and fees and a 3.5% revenue increase from additional student credit hours taken and changes in the student blend. The 9.1% increase in 2007 reflected an 8.4% effective rate increase in tuition and fees and a 0.7% revenue increase from additional student credit hours taken and changes in the student blend. Other major revenue sources in 2008 include federal grants and contracts of $231 million (a decrease of $10 million), including $169 million for sponsored research programs, and auxiliary services of $274 million (an increase of $21 million).

Net nonoperating and other revenues: The primary source of this net revenue is State appropriations, which totaled $386 million in 2008, an increase of $68 million (21.4%). In 2008, the University received $290 million in funding for general operations (a 1% increase) and $27 million in payment of deferred 2007 appropriations. For 2007, $292 million in funding for general operations was initially appropriated, but subsequently reduced $5 million via an operating budget reduction by the State. Also, the State deferred the aforementioned 2007 operating appropriation payment to 2008. In 2008, Michigan State University Extension and Michigan Agricultural Experiment Station appropriations totaled $63 million (a .5% increase) and $6 million in payment of deferred 2007 funding was also received. In 2008, other significant components of net nonoperating revenues include gift revenue (decreased $7 million) and net investment income (decreased $178 million due to market conditions). In 2007, gift revenue increased $12 million and net investment income increased $90 million.

The following is a graphic illustration of operating expenses by source for the year ended June 30, 2008 (amounts are presented in millions of dollars):



During 2008, $981 million was expended for the core missions of the University, instruction and departmental research, research, and public services, an increase of $75 million (8.3%) over 2007. As previously discussed in the Noncurrent Liabilities section, 2008 is the first year in which the University must expense a portion of its net OPEB obligation. This resulted in an operating expense increase of $29 million across the core missions, and $43 million in total. Instruction and departmental research expenses increased $45 million (9.5%), in-part due to an increase in faculty/staff levels (4.3%) and salary increases (2.7%), and targeted funding to enhance academic programs. In addition, $17 million was charged to instruction and departmental research for net OPEB obligations. Auxiliary enterprises (activities which provide services to students, faculty, staff, and the public) and expenses for the operation and maintenance of plant increased $23 million (10.0%) and $9 million (6.6%), respectively.

Economic Outlook

The University's revenue mix is closely associated with the level of State support. As such, there is a direct relationship between the growth of State appropriations and the increase in the University's tuition and fee levels. Static or declining State appropriations generally result in increased tuition and fees. Due to economic pressures affecting the State of Michigan, 2008-09 fiscal year budgeted State appropriations will only be 1% higher than 2007-08 levels. As a result, the Board of Trustees approved a 6.8% increase for fall 2008 in-state undergraduate tuition. Sustained adverse economic pressures affecting the State will likely continue to result in minimal or declining adjustments in State appropriations for higher education. In addition, stresses on the American economy and financial markets may continue to impact, among other issues, the University's financing arrangements, investment returns, and energy costs.

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Independent Auditor's Report

To the Board of Trustees
Michigan State University

We have audited the accompanying statements of net assets of Michigan State University (the "University") as of June 30, 2008 and 2007 and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the financial statements of the Michigan State University Foundation (the "Foundation"), which present all the assets and revenues of the discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us and our opinion, insofar as it relates to the amounts included for the Foundation, is based on the report of the other auditors.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Michigan State University and its component unit as of June 30, 2008 and 2007 and the results of their operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As disclosed in Note 10 to the financial statements, the University adopted the provisions of Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, changing how the University accounts for its other postemployment benefits (OPEB) liability.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 3, 2008 on our consideration of Michigan State University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters for year ended June 30, 2008. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide opinions on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis presented on pages 8 through 16 is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and express no opinion on it.

Plante & Moran, PLLC

Kalamazoo, Michigan
October 3, 2008

STATEMENTS OF NET ASSETS
Michigan State University

	June 30,	
ASSETS	**2008**	**2007**
Current assets:	**(in thousands)**	
Cash and cash equivalents	$ 28,398	$ 46,968
Investments	188,360	161,658
Collateral from securities lending	201,824	71,932
Accounts and interest receivable, net	137,723	108,391
Student loans receivable, net	14,566	29,672
Pledges receivable, net	23,138	10,352
Inventories and other assets	14,928	16,214
Total current assets	608,937	445,187
Noncurrent assets:		
Restricted cash and cash equivalents	15,043	22,057
Restricted investments	12,286	60,689
Endowment investments	1,267,922	1,247,236
Other investments	328,101	313,334
Student loans receivable, net	30,892	29,592
Pledges receivable, net	49,887	37,690
Investments in joint ventures	6,335	5,975
Unamortized bond origination costs	3,322	3,303
Capital assets, net	1,374,869	1,293,480
Total noncurrent assets	3,088,657	3,013,356
TOTAL ASSETS	**$ 3,697,594**	**$ 3,458,543**
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts and interest payable	$ 55,205	$ 52,195
Accrued personnel costs	60,252	54,319
Obligations under securities lending	201,824	71,932
Accrued self-insurance liabilities	15,331	10,242
Payroll taxes and other payroll deductions	36,197	31,092
Deposits held for others	27,525	24,360
Deferred revenues	78,535	75,832
Current portion of long term debt and other obligations	16,903	30,121
Total current liabilities	491,772	350,093
Noncurrent liabilities:		
Accrued personnel costs	18,968	17,782
Accrued self-insurance liabilities	8,117	9,031
Net other postemployment benefit obligation	43,295	-
Long term debt and other obligations	552,846	563,468
Total noncurrent liabilities	623,226	590,281
Total liabilities	**1,114,998**	**940,374**
Net assets:		
Invested in capital assets, net of related debt	858,232	818,207
Restricted:		
Nonexpendable	492,207	472,062
Expendable	402,343	373,664
Unrestricted	829,814	854,236
Total net assets	**2,582,596**	**2,518,169**
TOTAL LIABILITIES AND NET ASSETS	**$ 3,697,594**	**$ 3,458,543**

See accompanying notes

STATEMENTS OF FINANCIAL POSITION
Michigan State University Foundation

	June 30, 2008	June 30, 2007
	(in thousands)	
ASSETS		
Cash equivalents	$ 4,636	$ 6,434
Interest and dividends receivable	301	224
Grants and contracts receivable, net	275	718
Other receivables	1,106	948
Investments:		
Marketable securities	234,176	249,623
Investments in limited partnerships	110,110	106,991
Venture capital	24,423	23,302
Cash value of life insurance	1,193	1,210
Land held for investment	2,879	2,975
Other investments	1,263	1,216
Investment in Spartan Ventures LLC	469	476
Investment in Research Park	3,327	3,324
Prepaid expenses	74	149
Property and equipment, net	11,856	11,847
Intangible assets, net	782	845
Other assets	51	11
TOTAL ASSETS	**$ 396,921**	**$ 410,293**
LIABILITIES AND NET ASSETS		
Liabilities:		
Accrued expenses and other payables	$ 2,535	$ 2,483
Deferred compensation	177	525
Note payable - deferred compensation	196	196
Note payable	4,505	4,584
Trusts and annuities payable	10,891	11,003
Deferred gifts	433	433
Deposit held for Michigan State University	1,576	-
Obligations under life estate agreements	38	62
Total liabilities	20,351	19,286
Net assets:		
Unrestricted	339,067	356,200
Temporarily restricted	24,339	20,666
Permanently restricted	13,164	14,141
Total net assets	**376,570**	**391,007**
TOTAL LIABILITIES AND NET ASSETS	**$ 396,921**	**$ 410,293**

See accompanying notes

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

	Year ended June 30, 2008	2007
OPERATING REVENUES	(in thousands)	
Student tuition and fees	$ 523,215	$ 462,996
Less: scholarship allowances	63,232	56,952
Net student tuition and fees	459,983	406,044
State of Michigan grants and contracts	25,956	20,473
Federal grants and contracts	231,346	241,117
Local and private sponsored programs	62,087	55,448
Interest and fees on student loans	2,374	2,731
Departmental activities (net of scholarship allowances of $4,102 in 2008 and $3,457 in 2007)	142,399	137,744
Auxiliary activities (net of room and board allowances of $12,513 in 2008 and $10,370 in 2007)	273,621	252,895
TOTAL OPERATING REVENUES	**1,197,766**	**1,116,452**
OPERATING EXPENSES		
Instruction and departmental research	521,342	475,775
Research	260,180	243,763
Public services	199,987	185,709
Academic support	75,128	72,083
Student services	31,186	28,573
Scholarships and fellowships	36,258	32,312
Institutional support	82,446	68,569
Operation and maintenance of plant	144,935	135,830
Auxiliary enterprises	253,464	230,151
Depreciation	84,464	76,708
Other operating expenses, net	4,882	7,341
TOTAL OPERATING EXPENSES	**1,694,272**	**1,556,814**
Operating loss	(496,506)	(440,362)
NONOPERATING REVENUES (EXPENSES)		
State operating appropriation	316,702	260,565
State agricultural experiment station appropriation	37,071	30,752
State cooperative extension service appropriation	31,975	26,524
Federal Pell grant revenue	21,005	17,959
Gifts	48,152	54,830
Net investment income	66,152	244,290
Interest expense on capital asset related debt	(19,803)	(15,702)
Other nonoperating revenues (expenses), net	1,788	(480)
Net nonoperating revenues	503,042	618,738
INCOME BEFORE OTHER REVENUES	**6,536**	**178,376**
State capital appropriations	5,184	12,724
Capital grants and gifts	31,432	34,194
Additions to permanent endowments	21,275	25,557
Increase in net assets	64,427	250,851
Net assets, beginning of year	2,518,169	2,267,318
NET ASSETS, END OF YEAR	**$ 2,582,596**	**$ 2,518,169**

See accompanying notes

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

Michigan State University Foundation

	Year ended June 30, 2008			
	Unrestricted Funds	Temporarily Restricted	Permanently Restricted	Total
REVENUE, GAINS AND OTHER SUPPORT:		(in thousands)		
Contributions	$ 109	$ 8,678	$ 98	$ 8,885
Equity earnings - subsidiaries	129			129
Income from investments	13,432	334	686	14,452
Royalty income	582			582
Rental income	1,103			1,103
Rental expenses	(2,780)			(2,780)
Realized gain on sale of securities	16,634	41	302	16,977
Unrealized loss on securities	(28,305)	(1,424)	(965)	(30,694)
Grants and contracts	2,527			2,527
Other income	87			87
Net assets released from restrictions:				
Satisfaction of program restrictions	535	(530)	(5)	-
Current year transfers	4,519	(3,426)	(1,093)	-
TOTAL REVENUE, GAINS AND OTHER SUPPORT	8,572	3,673	(977)	11,268
EXPENSES AND LOSSES:				
Contributions to the University	15,834			15,834
Patent expense	965			965
Investment management fees	2,578			2,578
Adjustments to value of annuities payable	408			408
Management and general	3,457			3,457
Postretirement benefits				
Net periodic benefit cost	171			171
Operational expenses - Management Company	79			79
Operational expenses - Spartan Ventures	384			384
MBI program expenses	1,829			1,829
TOTAL EXPENSES	25,705	-	-	25,705
Change in net assets	(17,133)	3,673	(977)	(14,437)
Net assets, beginning of year	356,200	20,666	14,141	391,007
NET ASSETS, END OF YEAR	$ 339,067	$ 24,339	$ 13,164	$ 376,570

	Year ended June 30, 2007			
	Unrestricted Funds	Temporarily Restricted	Permanently Restricted	Total
REVENUE, GAINS AND OTHER SUPPORT:		(in thousands)		
Contributions	$ (27)	$ 8,212	$ 150	$ 8,335
Equity earnings - subsidiaries	37			37
Income from investments	14,016	373	597	14,986
Royalty income	578			578
Rental income	76			76
Realized gain on sale of securities	21,527	236	155	21,918
Unrealized gain on securities	15,432	1,275	730	17,437
Grants and contracts	4,245			4,245
Other income	685			685
Net assets released from restrictions:				
Satisfaction of program restrictions	2,489	(2,485)	(4)	-
Current year transfers	3,078	(2,465)	(613)	-
TOTAL REVENUE, GAINS AND OTHER SUPPORT	62,136	5,146	1,015	68,297
EXPENSES AND LOSSES:				
Contributions to the University	16,563			16,563
Patent expense	915			915
Investment management fees	1,590			1,590
Adjustments to value of annuities payable	2,427			2,427
Management and general	3,934			3,934
Postretirement benefits				
Net periodic benefit cost	121			121
Changes other than net periodic benefit costs	259			259
Operational expenses - Management Company	130			130
MBI program expenses	3,247			3,247
TOTAL EXPENSES	29,186	-	-	29,186
Change in net assets	32,950	5,146	1,015	39,111
Net assets, beginning of year	323,250	15,520	13,126	351,896
NET ASSETS, END OF YEAR	$ 356,200	$ 20,666	$ 14,141	$ 391,007

See accompanying notes

STATEMENTS OF CASH FLOWS

Michigan State University

	Year ended June 30, 2008	2007
	(in thousands)	
Cash flows from operating activities		
Tuition and fees	$ 461,605	$ 409,823
Research grants and contracts	322,936	310,646
Auxiliary activities	271,182	252,988
Departmental activities	137,574	138,310
Interest and fees on student loans	2,374	2,731
Loans issued to students	(92,613)	(103,239)
Collection of loans from students	106,420	100,382
Scholarships and fellowships	(43,866)	(38,846)
Payments to suppliers	(451,297)	(387,654)
Payments to employees	(1,039,298)	(1,029,936)
Other payments	(9,797)	(8,063)
Net cash used by operating activities	(334,780)	(352,858)
Cash flows from noncapital financing activities		
State appropriations	348,715	353,896
Federal Pell grant revenue	21,005	17,959
Gifts	46,756	51,457
Endowment gifts	21,308	26,478
Federal Family Education Loan Program receipts	263,114	240,657
Federal Family Education Loan Program disbursements	(276,441)	(238,387)
Net cash provided by noncapital financing activities	424,457	452,060
Cash flows from capital and related financing activities		
Capital appropriations	17,434	361
Capital gifts and grants	7,812	12,506
Proceeds from issuance of debt and other long term obligations	1,892	124,505
Purchase of capital assets	(166,656)	(175,781)
Proceeds from sale of capital assets	439	565
Principal paid on capital debt	(12,406)	(11,332)
Interest paid	(17,498)	(15,202)
Other receipts	2,100	2,442
Net cash used by capital and related financing activities	(166,883)	(61,936)
Cash flows from investing activities		
Investment income, net	141,028	128,369
Proceeds from sales and maturities of investments	28,726,435	26,434,327
Purchase of investments	(28,815,841)	(26,551,192)
Net cash provided by investing activities	51,622	11,504
Net increase (decrease) in cash	(25,584)	48,770
Cash and cash equivalents, beginning of year	69,025	20,255
Cash and cash equivalents, end of year	$ 43,441	$ 69,025

See accompanying notes

Reconciliation of net operating loss to cash flows from operating activities:	Year ended June 30, 2008	2007
	(in thousands)	
Operating loss	$ (496,506)	$ (440,362)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation expense	84,464	76,708
Change in assets and liabilities:		
Accounts receivable	(4,266)	(12,613)
Student loans receivable	13,806	(2,857)
Inventories and other assets	1,286	(1,250)
Investments in joint ventures	(360)	204
Unamortized bond origination costs	(19)	877
Accounts payable	1,253	4,180
Accrued personnel costs	7,119	4,089
Payroll taxes and other payroll deductions	5,105	2,005
Deposits held for others	3,165	4,356
Deferred revenues	2,703	11,362
Accrued self-insurance liabilities	4,175	443
Net other postemployment benefit obligation	43,295	-
Net cash used by operating activities	$ (334,780)	$ (352,858)

See accompanying notes

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

Organization:

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

Basis of presentation:

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

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

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

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

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

- Restricted:

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

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

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

Reporting entity:

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

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

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

Summary of significant accounting policies:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2. Cash and cash equivalents

The University's cash and cash equivalents as of June 30, 2008 and 2007 were as follows:

	2008	2007
Cash and cash equivalents, current	$ 28,398	$ 46,968
Restricted cash and cash equivalents, noncurrent	15,043	22,057
Total cash and cash equivalents	$ 43,441	$ 69,025

Of the bank balances for cash, $100 of the total $1,835 in 2008 and $100 of the total $2,676 in 2007 were covered by federal depository insurance. The remaining amounts were uninsured and uncollateralized, as banks holding deposits of the University are legally prohibited from collateralizing these deposits.

3. Investments

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

Securities Lending Transactions: The University participates in a Board-authorized securities lending program whereby University securities are contractually loaned to approved borrowers against a pledge of collateral which is invested. The University had loaned securities with a market value of approximately $196,699 and $69,879 at June 30, 2008 and 2007, 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, 2008 and 2007, 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, 2008 and 2007, the difference was less than 90 days.

As of June 30, 2008 and 2007, the University had the following investments:

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

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

Interest Rate Risk: As a means of managing its exposure to fair value losses arising from increasing interest rates, University investment policy limits the average duration of the LP portfolio to three years and the IT and CIF portfolios to six years. At June 30, 2008 and 2007, the University was in compliance with its investment policy with regard to average duration. University policy does not address average duration of investments by investment type.

The maturities of fixed income investments as of June 30, 2008 and 2007 are as follows:

June 30, 2008
Fixed Income Investment Maturities

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

June 30, 2007
Fixed Income Investment Maturities

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

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

Credit Risk: As a means of managing credit risk, University investment policy limits fixed income investments at time of purchase to the following ratings issued by nationally recognized statistical rating organizations: LP portfolio – short-term A1/P1, long-term BBB; IT portfolio – short-term A2/P2, long-term B; CIF portfolio – short-term A2/P2, long-term BB. Thereafter, the minimum quality for all three portfolios is limited to AA. At June 30, 2008 and 2007, the University was in compliance with its credit risk policy for each portfolio. University policy does not address credit risk by investment type.

The Standard & Poor's credit ratings for fixed income investments at June 30, 2008 and 2007 are as follows:

As of June 30, 2008

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

As of June 30, 2007

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

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

As of June 30, 2008 and 2007, not more than 5% of the University's total investments were invested in any one security.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. University investment policy does not limit the value of investments that may be held by an outside party. Of the University's investments $84,427 of the U.S. Government agencies, $30,161 of the Corporate bonds, $45,010 of the Asset-backed securities, $145,308 of the domestic equities, $14,193 of the international equities, and $28,562 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, $201,824 was held by the counterparty that was acting as the University's agent in securities lending transactions.

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

4. Foundation investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the Statements of Financial Position.

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

Foundation investments at June 30, 2008 and 2007 are summarized as follows:

	2008		2007	
	Cost	Market	Cost	Market
Short-term investments	$ 611	$ 611	$ 1,241	$ 1,241
Domestic equities	68,669	71,209	62,021	80,583
Foreign equities	61,408	58,356	59,148	68,996
Other equities	-	-	797	1,183
Fixed income	68,325	70,337	63,188	63,588
Mutual funds – Equities	15,602	16,184	13,217	16,419
Mutual funds – Fixed	17,408	17,479	18,148	17,613
Limited partnerships	86,500	110,110	84,380	106,991
	$ 318,523	$ 344,286	$ 302,140	$ 356,614

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.

5. Accounts and interest receivable

The composition of accounts and interest receivable at June 30, 2008 and 2007 is summarized as follows:

	2008	2007
State appropriations	$ 64,265	$ 27,231
Research and sponsored programs	44,786	48,338
Departmental activities	20,285	16,813
State capital appropriations	474	12,724
Interest receivable	2,307	2,024
Other	14,016	10,943
	146,133	118,073
Less: allowance for doubtful accounts	8,410	9,682
Net accounts and interest receivable	$ 137,723	$ 108,391

6. Student loans receivable

Student loans receivable at June 30, 2008 and 2007 are summarized as follows:

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

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

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

During the year ended June 30, 2008, the University discontinued its participation as school as lender for graduate and professional degree student loans under the U.S. Department of Education Federal Family Education Loan Program. Under this program, the University loaned funds directly to students and subsequently sold the loans at a premium to a third party after 90 days. Sales of these loans were discontinued in April 2008. As such, MSU will hold and service the unsold loans receivable as of June 30, 2008. As of June 30, 2008, the University held a bank line of credit, which had been used to facilitate the distribution of the loans (see Footnote 8).

For the year ended June 30, 2008 and 2007, the University distributed $164,407 and $132,797, respectively, for undergraduate student loans through the U.S. Department of Education Federal Family Education Loan Program. These distributions and related funding sources are not included as expenses and revenues in the accompanying financial statements.

7. Pledges receivable

Payments on pledges receivable at June 30, 2008, 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%.

2009	$ 25,812
2010	14,073
2011	13,481
2012	14,147
2013	12,874
2014 and beyond	952
Total discounted pledges receivable	81,339
Less: allowance for uncollectible pledges	8,314
Net pledges receivable, June 30, 2008	73,025
Less: current portion	23,138
Noncurrent portion	$ 49,887

8. Long term debt and other obligations

Long term debt and other obligations for the years ended June 30, 2008 and 2007 are summarized as follows:

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

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

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

- Series 2007B: from fiscal 2020 through 2037
- Series 2005: through 2034
- Series 2003A and Series 2003C: through 2033
- Series 2003B: through 2026
- Series 2002A: through 2032
- Series 2002B: through 2022
- Series 2000A: through 2030
- Series 1998A-2: from fiscal 2009 through 2022

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

The Series 2007A bonds bear interest at rates of 4.00% and 5.00% and mature serially from fiscal 2010 through fiscal 2019.

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

Interest expense was $19,803 and $15,702 for 2008 and 2007, respectively.

Swap payments and associated debt: Using rates as of June 30, 2008, scheduled fiscal year maturities of bonds payable and related interest expense are as follows. As rates vary, variable-rate interest payments and net swap payments will vary (see Footnote 17):

Fiscal Year	Fixed-Rate Bonds		Variable-Rate Bonds		Interest Rate	
Ending June 30,	Principal	Interest	Principal	Interest	Swaps, Net	Total
2009	$ 2,555	$ 1,468	$ 10,050	$ 8,981	$ 9,798	$ 32,852
2010	2,865	1,409	13,085	8,758	5,092	31,209
2011	2,985	1,293	11,385	8,563	4,573	28,799
2012	3,090	1,172	11,820	8,365	4,440	28,887
2013	3,220	1,034	12,300	8,160	4,301	29,015
2014-2018	16,570	2,582	69,110	37,426	19,191	144,879
2019-2023	2,090	66	93,535	30,530	13,801	140,022
2024-2028	-	-	104,005	21,588	7,611	133,204
2029-2033	-	-	109,510	11,890	2,533	123,933
2034-2038	-	-	57,065	2,964	217	60,246
Total	$ 33,375	$ 9,024	$ 491,865	$ 147,225	$ 71,557	$ 753,046

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

At June 30, 2008, the University owed $4,077 on a short term $82,500 line of credit related to the University's distribution of graduate and professional degree student loans under the Federal Family Education Loan Program (see Footnote 6). Subsequent to year end, the University closed the short term line of credit and converted the outstanding balance to a one year, $4,100 non-revolving line of credit, bearing interest equal to two percentage points below the Bank's Prime Rate. Payments of accrued interest are due monthly beginning October 2008, with all unpaid accrued interest and principal due in August 2009.

At June 30, 2008, the University owed $1,300 on a $2,500 limited recourse loan related to the University's development of a campus in Dubai, United Arab Emirates. Beginning January 1, 2009, principal amounts outstanding under this term loan bear interest equal to seventy basis points over the London Interbank Offering Rate (LIBOR), and accrued interest is payable quarterly. Beginning September 30, 2010, minimum principal payments equal to 2.5% of the outstanding balance on the payment date are due quarterly.

In June 2008, the Board of Trustees authorized the issuance of Commercial Paper Notes, Series A (tax-exempt) and Series B (taxable) in an aggregate principal amount not to exceed $200,000. The funds can be used to finance or reimburse all or part of the costs of eligible capital projects, to refund previously issued debt, and to pay all or part of the costs incidental to the issuance of the Notes and any refunding. No amounts have been issued under this program to date.

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 2008 and 2007 were as follows:

	2008	2007
Balance, beginning of year	$ 72,101	$ 68,012
Additions	9,502	6,275
Reductions	(2,383)	(2,186)
Balance, end of year	79,220	72,101
Less: current portion	60,252	54,319
Noncurrent portion	$ 18,968	$ 17,782

9. Retirement benefits

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

Participating employees contribute 5% of their base salary or wages and the University contributes 10% of the employee's base salary or wages subject to applicable Internal Revenue Service limits. Participants may elect to contribute additional amounts to a supplemental plan and/or a deferred compensation plan, within specified limits, which are not matched by University contributions. Plan provisions and contribution requirements of plan members and the University are established and may be amended by the Board in accordance with University policies, union contracts, or plan provisions. Contributions under the base plan, excluding the participants' supplemental contributions, for the years ended June 30, 2008 and 2007 were as follows:

	2008	2007
University contributions	$ 59,508	$ 56,236
Employee contributions	29,754	28,118

In addition, the University has a single-employer, defined benefit plan covering 846 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, 2008.

10. Other postemployment benefits (OPEB)

Effective July 1, 2007, the University adopted GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.*

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

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

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

Annual required contribution	$ 69,946
Interest on the prior year's net OPEB obligation	-
Less adjustment to the annual required contribution	-
Annual OPEB cost	69,946
Amounts contributed:	
Payments of current premiums and claims	(26,651)
Advance funding	-
Increase in net OPEB obligation	43,295
OPEB obligation - beginning of year	-
OPEB obligation - end of year	$ 43,295

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

For Fiscal Year Ended June 30, 2008:		
Annual OPEB cost	$	69,946
Percentage contributed		38.1%
Net OPEB obligation	$	43,295

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

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

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

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

In the January 1, 2008 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions include a 7% investment rate of return (net of administrative expenses), which is a blended rate of the expected long-term and short-term investment returns on the University's own assets to be used for funding the current liability, and an annual health care cost trend rate of 7.6% initially, reduced by decrements to an ultimate rate of 5% after five years. Both rates included a 4% inflation assumption. The UAAL is being amortized over 30 years as a level percentage of projected payroll on a closed basis, with 29 years remaining.

11. Grants and contracts

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

12. Commitments

At June 30, 2008, 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 $161,064 and are to be funded from debt proceeds, other University funds, and private gifts. Certain University facilities have been, or are scheduled to be, financed in whole or in part by SBA bond issues secured by a pledge of rentals to be received from the State of Michigan pursuant to lease agreements between the SBA, the State of Michigan, and the University. During the lease terms, the SBA will hold title to the respective buildings, the State of Michigan will make all lease payments to the SBA, and the University will pay certain operating and maintenance costs. The SBA will be obligated to sell each building to the University for one dollar, after full payment of all rentals due under the related lease.

At June 30, 2008, 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, 2008, $178,879 of the initial $359,606 investment commitment remains outstanding.

13. Contingencies and risk management

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

The University's liability for various medical professional liability claims is funded based on actuarial valuations. The University carries excess commercial medical professional liability insurance to manage the liability. The liability is reported at its present value of $5,857 as of June 30, 2008. The discount rate used was 5%.

The University is also self-insured for various employee benefits which include health care and dental insurance, workers compensation, and unemployment compensation. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Those losses include an estimate of claims that have been incurred but not reported. The workers compensation liability, which will be settled by fixed payments over an extended period of time, is reported at its present value of $5,119 as of June 30, 2008. The discount rate used was 6%.

Changes in the total reported general, professional, and self-insured employee benefit liabilities during 2008, 2007, and 2006 were as follows:

	2008	2007	2006
Balance, beginning of year	$ 19,273	$ 18,830	$ 19,967
Claims incurred and changes in estimates	96,066	88,463	84,923
Claim payments	(91,891)	(88,020)	(86,060)
Balance, end of year	23,448	19,273	18,830
Less: current portion	15,331	10,242	11,066
Noncurrent portion	$ 8,117	$ 9,031	$ 7,764

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

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

14. Investments in joint ventures

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

15. Capital assets and collections

Capital asset and collection activity for the years ended June 30, 2008 and 2007 follows:

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

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

16. Net assets

Restricted and unrestricted net assets for the years ended June 30, 2008 and 2007 are as follows:

	2008	2007
Restricted - nonexpendable:		
Permanent endowments	$ 492,207	$ 472,062
Restricted - expendable:		
Gifts, endowment income and sponsored programs	$ 162,964	$ 162,044
Quasi and term endowments	168,081	164,907
Capital projects	63,442	39,164
Student loans	7,856	7,549
Total	$ 402,343	$ 373,664
Unrestricted:		
Designated	$ 826,605	$ 876,031
Uncommitted	3,209	(21,795)
Total	$ 829,814	$ 854,236

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

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

17. Derivatives not reported at fair value

The University is party to derivative financial instruments (interest rate swaps) that are not reported at fair value on the Statement of Net Assets at June 30, 2008.

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

Terms, fair values, and credit risk: The terms, fair values, and credit rating of the outstanding swaps as of June 30, 2008 are listed below. The notional amounts of the swaps match the principal amounts of the associated debt. The University's swap agreements contain scheduled reductions to outstanding notional amounts that are expected to follow scheduled or anticipated reductions in the associated "bonds payable" category:

Associated Bond Issue	Outstanding Notional Amount	Effective Date	Rate Paid	Rate Received	Fair Value	Swap Termination Date	Counterparty/ Counterparty Credit Rating
1998A-2	51,935	7/1/1998	4.604%	SIFMA Municipal Swap Index	(6,160)	8/15/2022	Ambac Financial Services/Aa3
2000A-1 & 2000A-2	95,745	5/2/2002	4.074%	67% USD-LIBOR-BBA one month	(9,593)	8/15/2029	Lehman Brothers Special Financing Inc./A1
2002A	44,485	10/17/2002	3.390%	67% USD-LIBOR-BBA one month	(1,185)	8/15/2032	UBS AG/Aa1
2002A	2,120	10/17/2002	3.530%	67% USD-LIBOR-BBA one month	(92)	8/15/2022	UBS AG/Aa1
2002B	6,095	10/17/2002	4.330%	USD-LIBOR-BBA one month	(81)	8/15/2018	UBS AG/Aa1
2002B	2,040	10/17/2002	5.280%	USD-LIBOR-BBA one month	(134)	8/15/2022	UBS AG/Aa1
2003A	75,315	12/11/2003	3.618%	67% USD-LIBOR-BBA one month	(3,817)	2/15/2033	Lehman Brothers Special Financing Inc./A1
2003B	21,710	12/11/2003	3.479%	67% USD-LIBOR-BBA one month	(804)	2/15/2026	UBS AG/Aa1
2003C	10,280	12/11/2003	5.330%	USD-LIBOR-BBA one month	(702)	2/15/2033	Lehman Brothers Special Financing Inc./A1
2005	82,750	7/2/2007	3.647%	67% USD-LIBOR-BBA one month	(4,430)	2/15/2034	Lehman Brothers Special Financing Inc./A1
2000A-1, 2000A-2, 2002A, 2003A, & 2005	288,500	8/15/2009	67% USD-LIBOR-BBA one month	67% USD-LIBOR-BBA ten year less .407%	742	2/15/2034	UBS AG/Aa1
2002B & 2003C	18,415	5/26/2006	USD-LIBOR-BBA one month	USD-LIBOR-BBA ten year less .575%	362	2/15/2034	UBS AG/Aa1
2007B	22,000	5/17/2007	4.139%	67% USD-LIBOR-BBA three month plus .58%	(1,142)	2/15/2028	JP Morgan Chase Bank/Aaa
2007B	71,685	5/17/2007	4.226%	67% USD-LIBOR-BBA three month plus .63%	(4,340)	2/15/2028	JP Morgan Chase Bank/Aaa
2007A & 2007B	124,505	6/8/2007	SIFMA Municipal Swap Index	67% USD-LIBOR-BBA one month plus .0063% until 7/1/2009, then 67% USD-ISDA Swap Rate ten year plus .0063%	(2,190)	2/15/2037	JP Morgan Chase Bank/Aaa
Total	$ 917,580				$ (33,566)		

Fair Value: Primarily because interest rates have increased since their execution, the swaps in total have a negative fair value as of June 30, 2008. The swaps' negative fair value may be countered by a reduction in total interest payments required under the variable-rate bonds, creating a lower synthetic rate. Because the coupons on the University's variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swaps, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. The payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the dates of each of the future net settlements on the swaps.

Credit Risk: The University executes swap transactions with various counterparties. Seven swaps, approximating 42% of the notional amount of swaps outstanding, are with UBS AG, which is rated Aa1, while four swaps, approximating 29% of the outstanding notional value, are with Lehman Brothers Commercial Bank, rated A1, and three swaps, approximating 24% of the outstanding notional value, are with JP Morgan Chase Bank, N.A., rated Aaa. The remaining swap is with AMBAC Financial Services, rated Aa3.

As of June 30, 2008, (1) the University's credit ratings were Aa2 as assigned by Moody's, and AA as assigned by Standard & Poor's, and (2) the University was not exposed to net credit risk related to the swaps. To mitigate credit risk, if the counterparties' credit quality falls below certain levels, collateralization is required. The following table demonstrates the thresholds and minimum transfers for collateralization:

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

*Unilateral collateralization - Lehman Brothers Commercial Bank only.

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

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

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

18. New accounting pronouncements

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

The University will be required to implement the provisions of GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, effective with the fiscal year ending June 30, 2009. The University will be required to address accounting and financial reporting for intangible assets with regard to recognition, initial measurement, and amortization. The University has not yet determined the full impact of GASB Statement No. 51 on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 52*, Land and Other Real Estate Held as Investments by Endowments*, effective with the fiscal year ending June 30, 2009. The University will be required to report endowments of land and other real estate investments at fair value. The University has not yet determined the full impact of GASB Statement No. 52 on its financial statements.

The University will be required to implement the provisions of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments,* effective with the fiscal year ending June 30, 2010. The University will be required to address accounting and financial reporting for derivative instruments with regard to recognition, measurement, and disclosure. The University has not yet determined the full impact of GASB Statement No. 53 on its financial statements.

19. Subsequent events

Subsequent to year end, there have been significant changes in the financial markets that impact the financial statements of the University as follows:

Lehman Brothers Holding Inc. (Lehman) filed bankruptcy and Lehman Brothers Commercial Bank (LBCB), a subsidiary of Lehman, was downgraded to a credit rating of B3 in mid September 2008. This resulted in the University analyzing its current investments, as well as its debt and swap counterparty relationships, with Lehman and its subsidiaries. The University plans to pursue all available remedies as a creditor in the bankruptcy proceedings.

- Regarding investments, the University has experienced permanent impairments estimated at $10,000 related to direct or indirect investments in Lehman bonds or stocks.
- Regarding debt, LBCB is the University's counterparty on several pay-fixed receive-variable interest rate swaps. The notional amount of the swaps at the date of bankruptcy approximated $263,000, with loss on fair value of the swaps approximating $28,000. The University is working with its bond counsel in an attempt to transfer the swaps to a new counterparty at no cost to the University except for legal and related professional fees. Lehman was also the remarketing agent for the University's 2000A variable rate demand bonds, which utilize a weekly floating rate of interest and have an outstanding balance of approximately $100,000. Effective September 23, 2008, J.P. Morgan Securities, Inc. became the remarketing agent for the University's 2000A Bonds.

In addition, subsequent to year end, the University's investment portfolio has incurred a significant decline in fair value, consistent with the general decline in financial markets. However, because the values of individual investments fluctuate with market conditions, the amount of losses that will be recognized in subsequent periods, if any, cannot be determined at this time.

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

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

To the Board of Trustees
Michigan State University

We have audited the basic financial statements of Michigan State University as of and for the years ended June 30, 2008 and 2007 and have issued our report thereon dated October 3, 2008. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

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

Compliance and Other Matters

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

To the Board of Trustee
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 3, 2008

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