# FINANCIAL REPORT

## FISCAL YEAR 2009-2010

MICHIGAN STATE
UNIVERSITY

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# MICHIGAN STATE UNIVERSITY



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MICHIGAN STATE UNIVERSITY

This report presents the financial position and results of operations of Michigan State University for the fiscal years ended June 30, 2010, and June 30, 2009. The financial report has been adopted by the Board of Trustees and is provided as part of the commitment by Michigan State University to report annually on its fiscal affairs. These financial statements have been audited by Plante & Moran PLLC, Certified Public Accountants. Their audit report appears on page 17.

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

Throughout the year ended June 30, 2010, the University maintained its commitment to its values and vision, while continuing to adjust to a challenging economic environment. By adhering to its basic financial principles, including funding recurring operations with recurring revenues, the University has made necessary fiscal adjustments with the objective of maintaining quality. The University continues to focus on cost controls, pursue a long-term investment strategy to maximize risk-adjusted total returns, and appropriately utilize debt and other resources to meet programmatic needs, including the maintenance and replacement of the University's infrastructure.

The University continues to strategically review its programs and look for opportunities to increase its status among the best research universities in the world. Areas of significant achievement include the opening of the Secchia Center in Grand Rapids, now the administrative home of the College of Human Medicine, in partnership with community health systems, economic development organizations, and civic leaders. In addition, expansion of the College of Nursing through the development of the Bott Building will provide enhanced education and research programs, helping to establish Michigan as a leader in medical education and research. The University continues the development of the Facility for Rare Isotope Beams (FRIB). On track for completion in 2017, FRIB is expected to provide unique and important insight into the creation of the cosmos, while also enhancing Michigan's knowledge economy and positioning the University as a world center for high-energy physics.

As we move forward in a challenging economic environment, we continue to put every dollar possible into opportunities for students and developing critical programs and initiatives. Since its founding, Michigan State University has been a leader and innovator for education and social improvement and a catalyst for economic development. 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
November 5, 2010

OFFICE OF THE VICE PRESIDENT FOR FINANCE AND OPERATIONS

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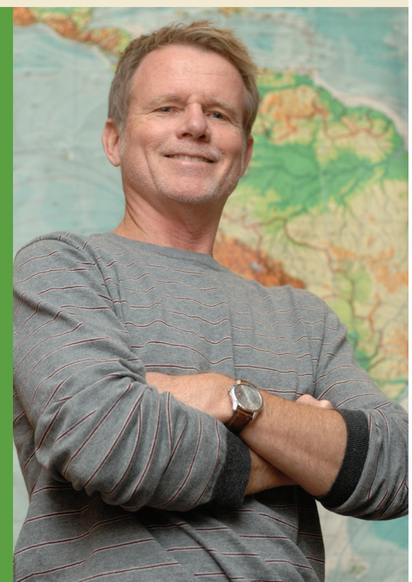
# Spartans work every day to advance the common good in uncommon ways.

Together, with tireless determination, we tackle some of the world's toughest challenges to find solutions that make life better. Crossing disciplines, cultures, and continents, we work side by side with individuals and fellow universities, corporations, communities, and countries in partnerships that produce enduring commitments and inspiring results. Learn more at **news.msu.edu**.

Michigan State University is making a difference near and far, including studying the impact of deforestation on the Amazon, utilizing green construction on campus and at Kellogg Biological Station's dairy operation, improving crop quality and agricultural practices from Michigan to Africa, expanding its presence in Southeast Michigan through efforts such as the Community Music School Detroit, and monitoring underwater environments as part of Great Lakes restoration efforts.



## LIFE-CHANGING RESEARCH

- A collaborative team of chemists, mathematicians, and engineers at MSU is the driving force behind **work to improve solar panel technology**, backed by a $1.9 million grant from the National Science Foundation. The three-year grant comes from American Recovery and Reinvestment Act monies and will focus on developing methods for making a new class of solar cells based on a design that combines a dye with an inexpensive semiconductor—titanium dioxide—instead of silicon.

- MSU scientists are leading a four-year, $14.4 million grant-funded research project to improve the quality of apples, peaches, cherries, and strawberries—key species in the globally important botanical family Rosaceae. The RosBREED project—recipient of the largest grant ever awarded by the U.S. Department of Agriculture's Specialty Crop Research Initiative—involves scientists from 11 U.S. institutions whose aim is to use **selective breeding methods to grow more robust fruit crops**. Michigan could benefit considerably from such advancements in agriculture—the state's second largest industry.

- Inspired by nature, an engineering professor and a zoologist at MSU partnered to develop robotic fish that use advanced materials to probe underwater environments. The fish carry sensors that record temperature and oxygen levels and detect pollutants and harmful algae to provide a more consistent level of data collection than has previously been possible. The robotic swimmers could play an **important role in Great Lakes restoration efforts**—a high-priority component of MSU's water research.

- MSU's College of Engineering is **working to improve the world's alternative energy future**. Supported by grants totaling $144 million, researchers in the college are building thermoelectric devices that harvest and use wasted energy, developing the next generation of advanced battery and capacitor technology, and creating biofuels from nonfood sources. Others are working to develop an advanced hybrid engine that can dramatically improve efficiencies and reduce costs of electric hybrid vehicles.

## GLOBAL IMPACT

- An MSU geography professor and his team conducted the **first research expedition of the western-most leg of Brazil's Transamazon**—a 700-mile dirt road that is scientifically unexplored territory—to determine the **impact of deforestation on the Amazon**. While Brazil has become a major global exporter of wood, beef, soybeans, and the ethanol used in biofuels, researchers fear massive development along the western Transamazon could eventually push the Amazon to its tipping point—when the rainforest ceases to exist.

- MSU launched the **nation's first comprehensive research and training program that is designed to address product counterfeiting**, which the FBI has called "the crime of the 21st century." The counterfeiting of products—from pharmaceuticals to food additives to auto parts—accounts for hundreds of billions of dollars in global trade and has a major impact on health and safety, the economy, the environment, and national security. The Anti-Counterfeiting and Product Protection Program will address counterfeiting and protection of products in regions around the globe.

- Hundreds of scientists from around the world are involved in an initiative at MSU to **improve research on the increasingly fragile relationship between humans and the environment**. The National Science Foundation has selected MSU to lead the effort, called the International Network of Research on Coupled Human and Natural Systems, or CHANS-Net. The research focuses on everything from panda habitat in China to development along Nicaragua's Mosquito Coast.

The New Partnership for Africa's Development (NEPAD) and MSU are using a five-year, $10.4 million grant from the Bill and Melinda Gates Foundation to connect African biosafety regulators with advances in technology—an **initiative aimed at reducing poverty through improved agricultural practices**. MSU and NEPAD—a socioeconomic development program of the African Union—will use grant money to convene workshops and provide regulators with the most current science-based information to regulate biotechnology while protecting farmers, consumers, and the environment.

## ECONOMIC ADVANCEMENT

West Michigan and MSU have become the **new home for a $6.8 million Center for Women's Health and Reproduction Research**, thanks to the collaborative efforts of MSU, Spectrum Health, and the Van Andel Institute. The new center is one of 15 nationwide and is housed in the Van Andel Institute, also home of the College of Human Medicine's $6.8 million Udall Center for Parkinson's Disease Research.

MSU is **bringing a leading social media company to mid-Michigan** in a new research and development partnership with INgage Networks. INgage develops enterprise social media solutions to help companies, nonprofits, and governments collaborate online. The company, which will occupy space on campus, will collaborate with researchers to produce online social media solutions to challenges faced by government, corporate, and nonprofit organizations, while equipping participants to engage in the global knowledge economy.

Michigan's University Research Corridor (URC)—an alliance of MSU, the University of Michigan, and Wayne State University—has grown in all competitive categories during the past two years, **rising among the nation's top research and development clusters** for producing patents, businesses, and graduates with high-tech-related degrees and injecting more than $14 billion into Michigan's stagnant economy, according to Empowering Michigan, the latest annual study of URC impact conducted by Anderson Economic Group.

A company founded by Thomas Pinnavaia, University Distinguished Professor of chemistry, won the **$100,000 top prize in the Statewide Business Plan Competition** from the Great Lakes Entrepreneur's Quest. The company, InPore Technologies, a maker of inorganic, submicron-sized particles, is in the early stages of manufacturing its Silapore product for applications in the plastics industry—including blades for wind turbines and the manufacturing of automotive components—using technology developed in Pinnavaia's MSU lab.

## MSU RANKINGS AND RECOGNITIONS

- Recognized for eight consecutive years as one of the top 100 universities in the world (Shanghai Jiao Tong University's Academic Ranking of World Universities)
- Cited as the national leader in study abroad participation among public universities for fifth year in a row (Institute of International Education's Open Doors)
- Included among the institutions with the highest number of faculty to receive Fulbright U.S. Scholar awards for the 2009–10 academic year
- Ranked 51st among public universities based on academic quality and tuition costs for in-state students (Kiplinger's Best Values in Public Colleges)
- Recognized for demonstrating "an exemplary commitment to sustainability" in terms of campus infrastructure, activities, and initiatives (Princeton Review's Guide to 286 Green Colleges)

## MSU GROWTH AND DEVELOPMENT

- MSU has been **awarded one of five highly coveted National Science Foundation (NSF) Science and Technology Centers**, officially titled BEACON, an NSF Science and Technology Center for the Study of Evolution in Action. It will serve as a resource for academia and industry through basic research and creation of new technologies to solve real-world problems ranging from the development of safer, more efficient cars to systems that detect computer intrusions.

- MSU's College of Nursing has been **awarded nearly $7.45 million in federal stimulus money to expand its research facilities and capacity** in a new building. The funding, from the National Institutes of Health's National Center for Research Resources, will enable the relocation of the college's Nursing Research Center and faculty into the Bott Building for Nursing Education and Research. College of Nursing researchers conduct research in critical areas such as obesity prevention, symptom management, cancer, gerontology, and health promotion.

- Expanding its Southeast Michigan presence and strengthening key partnerships in the region, the university **opened the MSU Detroit Center**, which houses Community Music School Detroit and new headquarters for College of Education teaching interns. Located at 3408 Woodward Avenue in the heart of downtown Detroit, the 22,000-square-foot facility is **a hub for an array of MSU programs**, **activities, and opportunities** for the neighborhood, community, and region.

- MSU opened its new Surplus Store and Recycling Center, a $13 million **state-of-the-art facility outfitted with a host of green features** that accommodates three times the amount of materials as the former MSU recycling facility. In other examples of green construction, the Chemistry Building addition is MSU's first Leadership in Energy and Environmental Design (LEED)-certified project on campus, and the W. K. Kellogg Biological Station's pasture-based dairy facility earned silver LEED certification—the only agricultural operation of its kind to earn such recognition.

Learn more: **msu.edu/about/rankings-and-recognitions**

- Ranked fourth among the nation's largest universities for producing Peace Corps volunteers and sixth among all-time producers of volunteers with 2,185 since 1961 (Peace Corps rankings)
- Ranked first in the nation for the 16th year in a row for graduate programs in elementary and secondary education (*U.S. News & World Report*)
- Ranked first in the nation for graduate program in nuclear physics in the College of Natural Science (*U.S. News & World Report*)
- Ranked 14th among the top places to work in academia (*The Scientist*)
- Named the champion of the 64th annual National Debate Tournament

## Introduction

The following discussion provides an overview of the financial position of Michigan State University (the "University") for the years ended June 30, 2010 and 2009 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.

Effective for the year ended June 30, 2010, the University adopted GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.* This standard primarily impacts the University's financial reporting for the market value of interest rate swap agreements, which historically had been disclosed in the footnotes to the financial statements. The University is now required to record the market value of these derivative instruments as either an asset or liability within the financial statements depending on the market value position at June 30. Annual changes in market value are either recognized as current investment income or loss or deferred as future investment income or loss depending on the classification of the derivative instrument as established by the standard (see footnote 15 for further information). As prescribed by GASB 53, certain prior period amounts have been restated to retroactively adopt the requirements of this standard.

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, 2010, 2009, and 2008 follows:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | | *(in millions)* | |
| Current assets | $ 420 | $ 395 | $ 609 |
| Noncurrent assets: | | | |
| Restricted cash and cash equivalents and restricted investments | 203 | - | 27 |
| Endowment and other investments | 1,465 | 1,372 | 1,595 |
| Capital assets, net | 1,622 | 1,508 | 1,375 |
| Other | 134 | 153 | 123 |
| Total assets | 3,844 | 3,428 | 3,729 |
| Current liabilities | 387 | 483 | 492 |
| Noncurrent liabilities | 989 | 654 | 656 |
| Total liabilities | 1,376 | 1,137 | 1,148 |
| Total net assets | $ 2,468 | $ 2,291 | $ 2,581 |

**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 2010 is due in part to a net $61 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 net $13 million increase in the amount of pledges receivable expected to be collected in the next fiscal year. These increases are partially offset by a $46 million decrease in collateral from the securities lending program. The decrease in securities lending collateral is due primarily to the decrease in investments available for loan and a change in the makeup of the underlying investment holdings under the securities lending program as of June 30, 2010 and their related propensity for lending. The net decrease in 2009 is due in part to a net $84 million decrease in cash and cash equivalents and investments, including $60 million of investments being reallocated to noncurrent designated endowment investments. In addition, collateral from the securities lending program decreased $133 million.

**Noncurrent assets:**

**Restricted cash and cash equivalents and restricted investments**

All balances represent unspent bond proceeds which are externally restricted for the construction or purchase of capital assets. The increase in 2010 is due to the Series 2010A issuance in April 2010. The decrease in 2009 represents the spending of Series 2007 bond proceeds consistent with their restricted purpose.

**Endowment and other investments**

At June 30, 2010 and June 30, 2009, the University's endowment investments totaled $1,136 million (an increase of $90 million) and $1,047 million (a decrease of $221 million), respectively. During 2010, market value (realized and unrealized) increases within the investment portfolio accounted for $103 million, while in

2009, market value (realized and unrealized) decreased $247 million. In addition, endowment gifts totaled $29 million in 2010 and $22 million in 2009, while endowment spending policy distributions totaled $41 million in 2010 and $46 million in 2009. During 2009, $60 million of investments were reallocated to designated endowment investments, consistent with the University's Board approved cash management and investment plan. No allocation was made in 2010.

Other investments consist primarily of the Liquidity Reserve Pool component of the University's Operating Cash Pool, which totaled $233 million and $208 million at June 30, 2010 and 2009, respectively. Funded retirement and postemployment benefit reserves ($72 million in 2010 and $67 million in 2009) substantially account for the remainder of other investments.

For the years ended June 30, 2010, 2009, and 2008, the total returns on investments were as follows:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Operating Cash Pool: | | | |
| Liquidity Pool | 3.9% | 3.6% | 5.6% |
| Liquidity Reserve Pool | 12.2% | (2.1)% | 5.9% |
| Common Investment Fund | 11.4% | (18.0)% | 1.6% |
| Other Separately Invested Investments | (38.2)% | 23.4% | 17.6% |

**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, 2010, 2009, and 2008, the University's investment in capital assets was as follows:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | | *(in millions)* | |
| Land | $ 32 | $ 26 | $ 25 |
| Buildings and site improvements | 2,125 | 1,929 | 1,856 |
| Construction in progress | 163 | 204 | 105 |
| Equipment and other | 597 | 562 | 526 |
| Museum collections | 9 | 8 | 8 |
| Less: accumulated depreciation | (1,304) | (1,221) | (1,145) |
| | $ 1,622 | $ 1,508 | $ 1,375 |

Major additions to buildings and site improvements during 2010 include $71 million for the Secchia Center, $23 million for the Farm Lane Underpass, $16 million for Wharton Center for the Performing Arts alterations and expansion, $17 million for the Cyclotron Low Energy Experimental Research and Office additions, and $13 million for MSU's Surplus Store & Recycling Center. Major additions to buildings and site improvements during 2009 include $18 million for the Duffy Daugherty Football Building expansion and the following renovations: $11 million for Mary Mayo Hall, $9 million for Holden Hall public area, and $6 million for Old College Field.

Construction in progress reflects multi-year projects which, once completed and placed into service, are categorized as buildings and site improvements. The 2010 balance includes $69 million for MSU's Enterprise Business Systems Project, $34 million for the Brody Hall renovation, and $8 million for the Eli and Edythe Broad Art Museum. The 2009 balance includes $51 million for the Secchia Center, $33 million for MSU's Enterprise Business Systems Project, $21 million for the Farm Lane Underpass, $12 million for

Wharton Center for the Performing Arts alterations and expansion, and $12 million for MSU's Surplus Store & Recycling Center.

As of June 30, 2010, 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 $150 million and are to be funded from debt proceeds, other University funds, and private gifts.

**Current liabilities:**

Current liabilities consist primarily of trade accounts payable, accrued compensation and other personnel costs, obligations under securities lending, deferred revenues, and other liabilities payable within one year or less. The net decrease in 2010 is due in part to a $47 million decrease in obligations under securities lending due primarily to the decrease in investments available for loan and a change in the make-up of the underlying investment holdings under the securities lending program as of June 30, 2010 and their related propensity for lending. In addition, the net decrease is due in part to a $39 million net decrease in the current portion of long-term debt and other obligations. This decrease is due primarily to converting $116 million of General Revenue Commercial Paper (short-term financing) to long-term debt, offset by a net issuance of $84 million of new General Revenue Commercial Paper, which the University has used to finance or reimburse all or part of the costs of eligible capital projects. The net decrease in current liabilities in 2009 is due primarily to a $124 million decrease in obligations under securities lending. Partially offsetting this decrease were increases in the current portion of long-term debt and other obligations ($95 million) due primarily to the issuance of General Revenue Commercial Paper Series A and B and an increase in accounts payable ($18 million) due primarily to an increase in construction related payables.

**Noncurrent liabilities, primarily debt:**

At June 30, 2010, the University had noncurrent debt and other obligations outstanding of $779 million compared with $468 million at June 30, 2009. This balance is comprised primarily of outstanding General Revenue Bonds of $734 million and $428 million in 2010 and 2009, respectively. The increase is primarily due to the issuance of $205 million of Series 2010A Build America Bonds to be used to fund all or part of the costs of eligible capital projects. In addition, the University used $310 million of bond proceeds from the issuance of Series 2010C bonds (including a net original issue premium of $21 million), which was primarily used to convert $116 million of General Revenue Commercial Paper to long-term debt and refund $192 million of other long-term General Revenue Bonds and related interest rate swap agreements (see footnote 13 for further information). The University periodically reviews its debt capacity and related capital asset needs to optimize the use of long-term resources. The University's outstanding General Revenue debt carry an investment grade credit rating from Moody's and Standard & Poor's of Aa1 and AA, respectively.

The University faces the continuing challenge of funding its increasing health care and dental benefits costs. This includes the cost of providing postemployment health and dental benefits to eligible employees (other postemployment benefits, or OPEB). For the year ended June 30, 2010, the University has estimated the cost (annual expense) of providing OPEB through an actuarial valuation as of January 1, 2010. The actuarial valuation computes an annual required contribution, which represents a level of funding that, if paid on an ongoing basis, is projected to cover current year costs and amortize any unfunded actuarial liabilities over a period of thirty years. The University's total unfunded OPEB obligation in 2010 and 2009 is estimated at $783 million and $852 million, respectively, with the decrease resulting primarily from plan design changes. The University has recorded a noncurrent liability of $128 million and $88 million for 2010 and

2009, respectively, representing the net OPEB obligation (the annual required contribution for 2010 and 2009 less actual retiree health and dental payments made during the respective fiscal years). This increase is due to the continued amortization (over thirty years) of the total unfunded OPEB obligation.

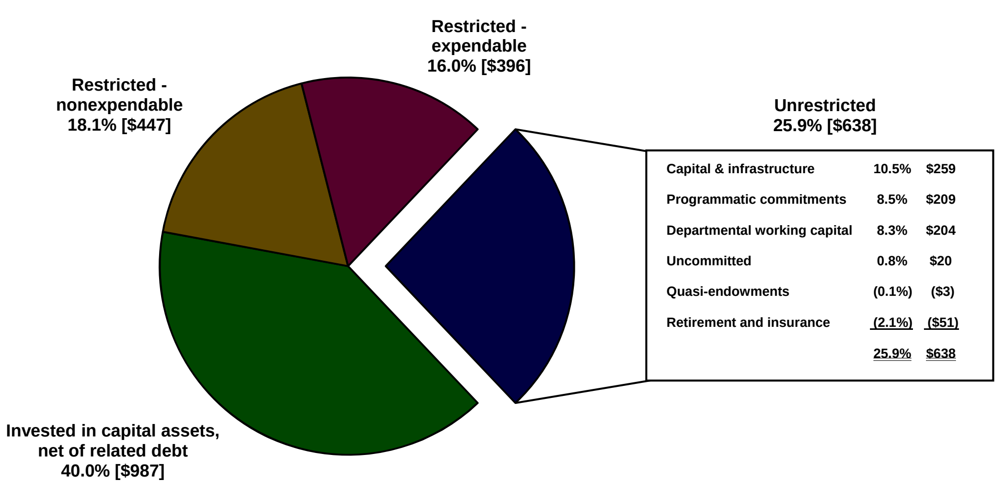
As the University continues to evaluate its long-term financial health, the increasing financial burden of providing full employer-paid retiree health and dental benefits poses competitive challenges and significant difficulty in preserving programmatic quality. Over time, postemployment health and dental benefit expenses will diminish available institutional assets, increasing reliance on annual budget reductions and tuition income. To assure the long-term financial stability of the University, effective for new employees hired on or after July 1, 2010, the University has discontinued providing retiree health and dental care benefits. MSU will continue to amortize the unfunded liability attributable to eligible employees/beneficiaries over the remaining amortization period.

**Net assets:**

Net assets represent residual University assets after liabilities are deducted. The University's net assets at June 30, 2010, 2009, and 2008 are summarized as follows:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | | *(in millions)* | |
| Invested in capital assets, net of related debt | $ 987 | $ 974 | $ 858 |
| Restricted: | | | |
| Nonexpendable | 447 | 393 | 492 |
| Expendable | 396 | 360 | 402 |
| Total restricted | 843 | 753 | 894 |
| Unrestricted | 638 | 564 | 829 |
| Total net assets | $ 2,468 | $ 2,291 | $ 2,581 |

The following is a breakdown of net assets at June 30, 2010. See footnote 16 for further information (amounts are presented in millions of dollars):




**TOTAL NET ASSETS $2.5 BILLION**

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

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

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

Although unrestricted net assets are not subject to externally imposed restrictions, virtually all of the University’s unrestricted net assets are subject to internal designation to meet various specific commitments, including maintaining reserves for capital projects, the continued recognition of the OPEB obligation, working capital for self-supporting departmental activities, and unrestricted quasi and term endowments.

Over time, increases or decreases in net assets are an indicator of the improvement or erosion of the University’s financial health when considered with non-financial facts such as enrollment levels, strength of faculty, and condition of facilities. In addition, net assets are directly affected by the performance of the University’s investments. Net assets increased during 2010 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. In 2009, unfavorable conditions in the global financial markets significantly contributed to the decline in net assets.

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.

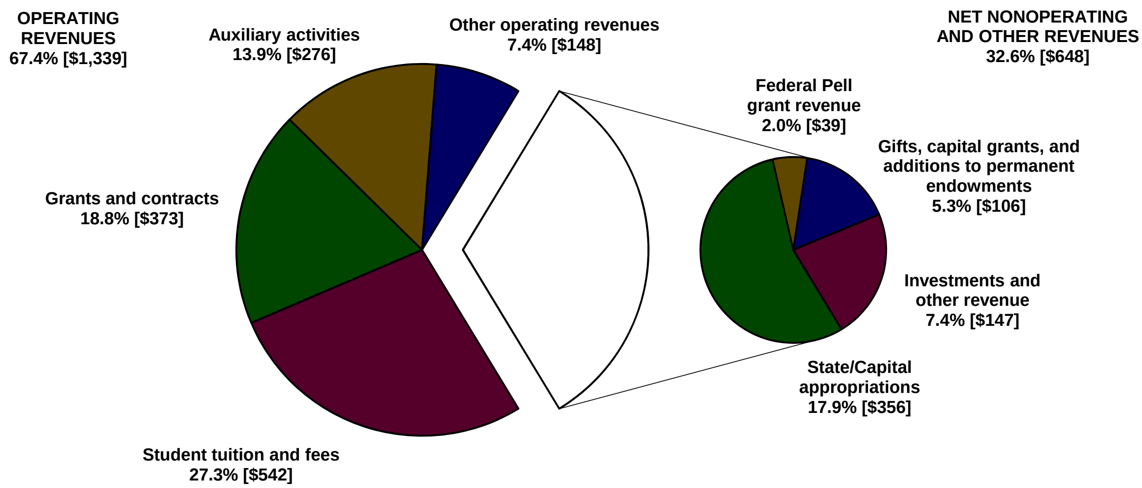
## Statement of Revenues, Expenses, and Changes in Net Assets

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, 2010, 2009, and 2008 follows:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| | | *(in millions)* | |
| **Operating revenues:** | | | |
| Student tuition and fees, net of allowances | $ 542 | $ 510 | $ 460 |
| Grants and contracts | 373 | 340 | 319 |
| Auxiliary activities | 276 | 275 | 274 |
| Other operating revenues | 148 | 138 | 145 |
| **Total operating revenues** | 1,339 | 1,263 | 1,198 |
| **Operating expenses:** | | | |
| Instruction and departmental research | 556 | 551 | 521 |
| Research | 277 | 262 | 260 |
| Public services | 228 | 212 | 200 |
| Academic support | 75 | 77 | 75 |
| Student services | 32 | 31 | 31 |
| Scholarships and fellowships | 50 | 41 | 36 |
| Institutional support | 91 | 90 | 83 |
| Operation and maintenance of plant | 143 | 158 | 145 |
| Auxiliary enterprises | 256 | 256 | 253 |
| Depreciation | 98 | 91 | 85 |
| Other operating expenses, net | 4 | 6 | 5 |
| **Total operating expenses** | 1,810 | 1,775 | 1,694 |
| **Operating loss** | (471) | (512) | (496) |
| **Nonoperating revenues (expenses):** | | | |
| State operating appropriation | 284 | 293 | 317 |
| State agricultural experiment station appropriation | 18 | 34 | 37 |
| State cooperative extension service appropriation | 18 | 30 | 32 |
| State appropriated federal fiscal stabilization funds | 36 | - | - |
| Federal Pell grant revenue | 39 | 24 | 21 |
| Gifts | 53 | 55 | 48 |
| Net investment income (loss) | 164 | (243) | 69 |
| Interest expense on capital asset related debt | (20) | (23) | (20) |
| Other nonoperating revenues (expenses), net | 2 | 22 | 2 |
| **Net nonoperating revenues** | 594 | 192 | 506 |
| **Income (loss) before other revenues** | 123 | (320) | 10 |
| State capital appropriations | 1 | 2 | 5 |
| Capital grants and gifts | 28 | 12 | 31 |
| Additions to permanent endowments | 25 | 16 | 21 |
| **Increase (decrease) in net assets** | 177 | (290) | 67 |
| **Net assets, beginning of year** | 2,291 | 2,581 | 2,514 |
| **Net assets, end of year** | $ 2,468 | $ 2,291 | $ 2,581 |

The following is a graphic illustration of total net revenue by source for the year ended June 30, 2010 (amounts are presented in millions of dollars):



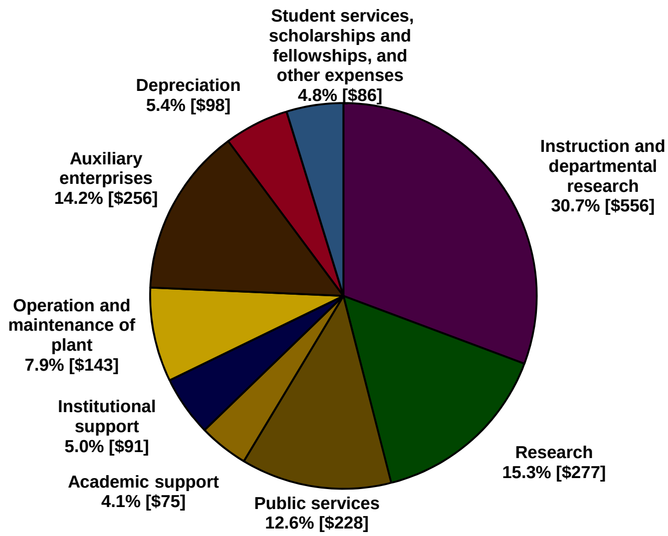

**TOTAL REVENUE $2.0 BILLION**

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 $542 million and $510 million in 2010 and 2009, respectively. Gross tuition and fees revenue increased 8.3% in 2010, which includes a 7.5% effective rate increase in tuition and fees and a 0.8% revenue increase from additional student credit hours taken and changes in the student blend. The 11.5% increase in 2009 reflected a 9.4% effective rate increase in tuition and fees and a 2.1% revenue increase from additional student credit hours taken and changes in the student blend. Other major revenue sources in 2010 include auxiliary activities of $276 million (an increase of $1 million) and federal grants and contracts of $281 million (an increase of $39 million), including $265 million for sponsored programs.

Net nonoperating and other revenues: The primary source of this net revenue is State appropriations, which totaled $356 million in 2010, a decrease of $1 million (0.4%). Base appropriations funded directly by the State declined $37 million in line with approved legislative reductions. To offset this decrease, $36 million of one-time federal fiscal stabilization funds authorized by the American Recovery and Reinvestment Act of 2009 (ARRA) was awarded to the University through the State. In 2010, the University received $284 million from the State for general operations, a 3.1% decrease over 2009 general appropriations ($293 million), offset by $8 million in one-time ARRA funding. In 2010, Michigan State University Extension and Michigan Agricultural Experiment Station state funded appropriations totaled $36 million, a 43.8% decrease over 2009 appropriations ($64 million), offset by $28 million in one-time ARRA funding. Other significant components of net nonoperating revenues in 2010 include gift revenue (decreased $2 million), and net investment income (increased $408 million due to recovery in market conditions from 2009). In 2009, gift revenue increased $7 million, net investment income decreased $319 million due to market conditions, and net nonoperating revenues increased $20 million due primarily to a gain recognized as part of a public tender offer to refund General Revenue Bonds, Series 2007B.

The following is a graphic illustration of operating expenses by source for the year ended June 30, 2010 (amounts are presented in millions of dollars):




**TOTAL OPERATING EXPENSES $1.8 BILLION**

During 2010, $1,061 million was expended for the core missions of the University - instruction and departmental research, research, and public services, an increase of $36 million (3.5%) over 2009. Instruction and departmental research expenses increased $5 million (1.0%), due primarily to salary increases (2.0%), offset by decreases in faculty/staff levels (1.0%). Research and public service expenses increased $31 million due in part to growth in sponsored programs ($22 million). Auxiliary enterprises (activities which provide services to students, faculty, staff, and the public) remained consistent with 2009 levels, while expenses for the operation and maintenance of plant decreased $15 million (9.3%).

## 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 or reduction of State appropriations and changes in the University's tuition and fee levels. Static or declining State appropriations generally result in increased tuition and fees. The 2010-11 fiscal year Higher Education appropriations bill has been approved with a 2.8% cut in state aid for operations. No ARRA funds are included in 2010-11 and recurring funding exceeds budgeted operating funds based on earlier proposed budget bills by almost $1 million for an actual decrease in recurring funds of less than 0.1%. The Board of Trustees approved a 2.5% increase for fall 2010 in-state undergraduate tuition. To protect the quality of the University programs, this Board action also provided the University President authorization to adjust tuition and fees during the 2010-11 academic year should the level of State appropriation support vary from expectations. Regardless of economic circumstances, the University is committed to making a significant positive impact in Michigan and around the world. This commitment will require that the University's long-term values be maintained through disciplined planning and decision making.

plante moran

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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, 2010 and 2009 and the related statements of revenue, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the financial statements of the Michigan State University Foundation (the "Foundation"), which present all the assets and revenue 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, 2010 and 2009 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 discussed in Note 15 to the financial statements, the University has changed its method of accounting for derivative instruments in 2010 and 2009 due to the adoption of GASB 53 – *Accounting and Financial Reporting for Derivative Instruments*.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 14, 2010 on our consideration of Michigan State University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters for the year ended June 30, 2010. 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 14, 2010

## STATEMENTS OF NET ASSETS
### Michigan State University

| | June 30, 2010 | June 30, 2009 |
|---|---|---|
| **ASSETS** | **(in thousands)** | |
| Current assets: | | |
| Cash and cash equivalents | $ 19,811 | $ 15,129 |
| Investments | 173,653 | 117,303 |
| Collateral from securities lending | 22,801 | 68,779 |
| Accounts and interest receivable, net | 150,386 | 150,986 |
| Student loans receivable, net | 9,224 | 13,160 |
| Pledges receivable, net | 29,719 | 16,583 |
| Inventories and other assets | 14,184 | 13,325 |
| Total current assets | 419,778 | 395,265 |
| Noncurrent assets: | | |
| Restricted cash and cash equivalents | 44,110 | - |
| Restricted investments | 159,122 | - |
| Endowment investments | 1,136,440 | 1,046,512 |
| Other investments | 328,417 | 325,788 |
| Student loans receivable, net | 36,998 | 32,641 |
| Pledges receivable, net | 43,106 | 50,675 |
| Investments in joint ventures | 6,329 | 5,982 |
| Deferred outflows from hedging derivative instruments | 42,885 | 59,933 |
| Unamortized bond origination costs | 4,860 | 3,248 |
| Capital assets, net | 1,621,531 | 1,508,116 |
| Total noncurrent assets | 3,423,798 | 3,032,895 |
| **TOTAL ASSETS** | **$ 3,843,576** | **$ 3,428,160** |
| **LIABILITIES AND NET ASSETS** | | |
| Current liabilities: | | |
| Accounts and interest payable | $ 58,855 | $ 72,882 |
| Accrued personnel costs | 73,223 | 66,298 |
| Obligations under securities lending | 30,853 | 77,648 |
| Accrued self-insurance liabilities | 13,770 | 15,196 |
| Payroll taxes and other payroll deductions | 26,841 | 38,602 |
| Deposits held for others | 29,653 | 22,694 |
| Deferred revenues | 81,505 | 78,168 |
| Current portion of long term debt and other obligations | 72,623 | 111,522 |
| Total current liabilities | 387,323 | 483,010 |
| Noncurrent liabilities: | | |
| Accrued personnel costs | 30,841 | 28,715 |
| Accrued self-insurance liabilities | 7,932 | 9,057 |
| Hedging derivative instruments | 42,885 | 59,933 |
| Net other postemployment benefit obligation | 128,234 | 88,105 |
| Long term debt and other obligations | 778,583 | 468,375 |
| Total noncurrent liabilities | 988,475 | 654,185 |
| **Total liabilities** | **1,375,798** | **1,137,195** |
| Net assets: | | |
| Invested in capital assets, net of related debt | 986,891 | 974,276 |
| Restricted: | | |
| Nonexpendable | 447,289 | 393,018 |
| Expendable | 395,368 | 359,840 |
| Unrestricted | 638,230 | 563,831 |
| **Total net assets** | **2,467,778** | **2,290,965** |
| **TOTAL LIABILITIES AND NET ASSETS** | **$ 3,843,576** | **$ 3,428,160** |

See accompanying notes

## STATEMENTS OF FINANCIAL POSITION
### Michigan State University Foundation

| | June 30, 2010 | June 30, 2009 |
|---|---|---|
| | (in thousands) | |
| **ASSETS** | | |
| Cash equivalents | $ 3,252 | $ 18,941 |
| Interest and dividends receivable | 159 | 171 |
| Grants and contracts receivable, net | 778 | 1,242 |
| Other receivables | 1,781 | 1,532 |
| Investments: | | |
| Marketable securities | 177,828 | 167,182 |
| Investments in limited partnerships | 97,245 | 91,686 |
| Venture capital | 33,257 | 27,897 |
| Cash value of life insurance | 1,484 | 1,280 |
| Land held for investment | 3,830 | 3,114 |
| Other investments | 1,400 | 1,240 |
| Investment in Spartan Ventures LLC | 460 | 466 |
| Investment in Research Park | 5,625 | 4,218 |
| Prepaid expenses | 111 | 108 |
| Property and equipment, net | 10,752 | 11,554 |
| Intangible assets, net | 850 | 823 |
| Other assets | 1 | 46 |
| **TOTAL ASSETS** | **$ 338,813** | **$ 331,500** |
| **LIABILITIES AND NET ASSETS** | | |
| Liabilities: | | |
| Accrued expenses and other payables | $ 3,181 | $ 3,741 |
| Deferred compensation | 177 | 177 |
| Note payable - deferred compensation | 196 | 196 |
| Note payable | 4,327 | 4,419 |
| Trusts and annuities payable | 9,163 | 11,305 |
| Deferred gifts | 433 | 433 |
| Deposit held for Michigan State University | 3,804 | 2,890 |
| Obligations under life estate agreements | 13 | 18 |
| **Total liabilities** | 21,294 | 23,179 |
| Net assets: | | |
| Unrestricted | 278,427 | 274,160 |
| Temporarily restricted | 26,344 | 22,183 |
| Permanently restricted | 12,748 | 11,978 |
| **Total net assets** | **317,519** | **308,321** |
| **TOTAL LIABILITIES AND NET ASSETS** | **$ 338,813** | **$ 331,500** |

See accompanying notes

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

| | Year ended June 30, 2010 | 2009 |
|---|---|---|
| **OPERATING REVENUES** | (in thousands) | |
| Student tuition and fees | $ 631,665 | $ 583,524 |
| Less: scholarship allowances | 89,276 | 73,692 |
| Net student tuition and fees | 542,389 | 509,832 |
| State of Michigan grants and contracts | 19,152 | 22,996 |
| Federal grants and contracts | 280,744 | 242,113 |
| Local and private sponsored programs | 73,190 | 74,618 |
| Interest and fees on student loans | 837 | 841 |
| Departmental activities (net of scholarship allowances of $4,644 in 2010 and $4,184 in 2009) | 146,752 | 137,300 |
| Auxiliary activities (net of room and board allowances of $16,237 in 2010 and $13,696 in 2009) | 276,215 | 275,349 |
| **TOTAL OPERATING REVENUES** | **1,339,279** | **1,263,049** |
| **OPERATING EXPENSES** | | |
| Instruction and departmental research | 556,404 | 550,654 |
| Research | 276,580 | 261,930 |
| Public services | 228,084 | 211,949 |
| Academic support | 74,924 | 76,783 |
| Student services | 31,802 | 31,463 |
| Scholarships and fellowships | 49,943 | 40,713 |
| Institutional support | 90,979 | 90,128 |
| Operation and maintenance of plant | 143,467 | 158,193 |
| Auxiliary enterprises | 255,933 | 256,659 |
| Depreciation | 98,429 | 90,514 |
| Other operating expenses, net | 3,527 | 6,237 |
| **TOTAL OPERATING EXPENSES** | **1,810,072** | **1,775,223** |
| Operating loss | (470,793) | (512,174) |
| **NONOPERATING REVENUES (EXPENSES)** | | |
| State operating appropriation | 283,909 | 293,041 |
| State agricultural experiment station appropriation | 18,116 | 34,336 |
| State cooperative extension service appropriation | 17,825 | 29,616 |
| State appropriated federal fiscal stabilization funds | 35,688 | - |
| Federal Pell grant revenue | 39,313 | 24,166 |
| Gifts | 52,839 | 55,081 |
| Net investment income (loss) | 164,110 | (243,706) |
| Interest expense on capital asset related debt | (19,467) | (23,488) |
| Other nonoperating revenues (expenses), net | 2,100 | 21,896 |
| Net nonoperating revenues | 594,433 | 190,942 |
| **INCOME (LOSS) BEFORE OTHER REVENUES** | **123,640** | **(321,232)** |
| State capital appropriations | 500 | 2,088 |
| Capital grants and gifts | 28,095 | 12,184 |
| Additions to permanent endowments | 24,578 | 16,414 |
| Increase (decrease) in net assets | 176,813 | (290,546) |
| Net assets, beginning of year | 2,290,965 | 2,581,511 |
| **NET ASSETS, END OF YEAR** | **$ 2,467,778** | **$ 2,290,965** |

See accompanying notes

## STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

**Michigan State University Foundation**

| | Year ended June 30, 2010 | | | |
|---|---|---|---|---|
| | Unrestricted Funds | Temporarily Restricted | Permanently Restricted | Total |
| **REVENUE, GAINS AND OTHER SUPPORT:** | | (in thousands) | | |
| Contributions | $ 39 | $ 5,916 | $ 108 | $ 6,063 |
| Equity earnings - subsidiaries | 59 | | | 59 |
| Income from investments | 2,674 | 25 | 386 | 3,085 |
| Royalty income | 1,416 | | | 1,416 |
| Rental income | 1,161 | | | 1,161 |
| Rental expenses | (3,112) | | | (3,112) |
| Realized and unrealized gain (loss) on securities | 22,504 | 1,858 | 825 | 25,187 |
| Grants and contracts | 2,706 | | | 2,706 |
| Other income | 222 | | | 222 |
| Net assets released from restrictions: | | | | |
| Satisfaction of program restrictions | (1,672) | 1,677 | (5) | - |
| Current year transfers | 5,859 | (5,315) | (544) | - |
| **TOTAL REVENUE, GAINS AND OTHER SUPPORT** | 31,856 | 4,161 | 770 | 36,787 |
| **EXPENSES AND LOSSES:** | | | | |
| Contributions to the University | 19,504 | | | 19,504 |
| Patent expense | 914 | | | 914 |
| Investment management fees | 2,665 | | | 2,665 |
| Investment consulting fees | 373 | | | 373 |
| Adjustments to value of annuities payable | (1,821) | | | (1,821) |
| Management and general | 3,560 | | | 3,560 |
| Postretirement benefits | | | | |
| Net periodic benefit cost | 119 | | | 119 |
| Operational expenses - Spartan Ventures | 37 | | | 37 |
| MBI program expenses | 2,238 | | | 2,238 |
| **TOTAL EXPENSES AND LOSSES** | 27,589 | - | - | 27,589 |
| Change in net assets | 4,267 | 4,161 | 770 | 9,198 |
| Net assets, beginning of year | 274,160 | 22,183 | 11,978 | 308,321 |
| **NET ASSETS, END OF YEAR** | $ 278,427 | $ 26,344 | $ 12,748 | $ 317,519 |

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

See accompanying notes

## STATEMENTS OF CASH FLOWS
### Michigan State University

| | Year ended June 30, 2010 | 2009 |
|---|---|---|
| **Cash flows from operating activities** | (in thousands) | |
| Tuition and fees | $ 547,036 | $ 513,379 |
| Research grants and contracts | 367,459 | 324,468 |
| Auxiliary activities | 273,625 | 273,077 |
| Departmental activities | 152,038 | 136,874 |
| Interest and fees on student loans | 837 | 841 |
| Loans issued to students | (9,728) | (8,749) |
| Collection of loans from students | 9,308 | 8,405 |
| Scholarships and fellowships | (59,507) | (50,618) |
| Payments to suppliers | (437,890) | (455,147) |
| Payments to employees | (1,161,752) | (1,102,885) |
| Other payments | (14,917) | (15,544) |
| **Net cash used by operating activities** | (333,491) | (375,899) |
| | | |
| **Cash flows from noncapital financing activities** | | |
| State appropriations | 362,291 | 356,350 |
| Federal Pell grant revenue | 39,313 | 24,166 |
| Gifts | 53,116 | 58,492 |
| Endowment gifts | 24,545 | 16,414 |
| William D. Ford Direct Lending receipts | 332,470 | 294,127 |
| William D. Ford Direct Lending disbursements | (332,521) | (294,279) |
| **Net cash provided by noncapital financing activities** | 479,214 | 455,270 |
| | | |
| **Cash flows from capital and related financing activities** | | |
| Capital appropriations | 500 | 2,562 |
| Capital gifts and grants | 15,290 | 8,413 |
| Proceeds from issuance of debt and other long term obligations | 611,090 | 200,341 |
| Purchase of capital assets | (214,950) | (205,106) |
| Proceeds from sale of capital assets | 641 | 566 |
| Principal paid on capital debt | (320,702) | (190,041) |
| Interest paid | (21,485) | (24,662) |
| Other receipts (payments) | (17,114) | 24,391 |
| **Net cash provided (used) by capital and related financing activities** | 53,270 | (183,536) |
| | | |
| **Cash flows from investing activities** | | |
| Investment income (loss), net | 69,653 | (16,699) |
| Proceeds from sales and maturities of investments | 4,206,642 | 6,957,369 |
| Purchase of investments | (4,426,496) | (6,864,817) |
| **Net cash provided (used) by investing activities** | (150,201) | 75,853 |
| | | |
| **Net increase (decrease) in cash** | 48,792 | (28,312) |
| | | |
| **Cash and cash equivalents, beginning of year** | 15,129 | 43,441 |
| **Cash and cash equivalents, end of year** | $ 63,921 | $ 15,129 |

See accompanying notes

## STATEMENTS OF CASH FLOWS (Continued)

**Michigan State University**

| | Year ended June 30, | |
|---|---|---|
| **Reconciliation of net operating loss to** | **2010** | **2009** |
| **cash flows from operating activities:** | **(in thousands)** | |
| Operating loss | $ (470,793) | $ (512,174) |
| *Adjustments to reconcile net loss to net cash used by operating activities:* | | |
| Depreciation expense | 98,429 | 90,514 |
| *Change in assets and liabilities:* | | |
| Accounts receivable | (4,647) | (14,025) |
| Student loans receivable | (421) | (343) |
| Inventories and other assets | (859) | 1,603 |
| Investments in joint ventures | (347) | 353 |
| Unamortized bond origination costs | (1,612) | 74 |
| Accounts payable | 1,595 | (516) |
| Accrued personnel costs | 9,051 | 15,793 |
| Payroll taxes and other payroll deductions | (11,761) | 2,405 |
| Deposits held for others | 6,959 | (4,831) |
| Deferred revenues | 3,337 | (367) |
| Accrued self-insurance liabilities | (2,551) | 805 |
| Net other postemployment benefit obligation | 40,129 | 44,810 |
| **Net cash used by operating activities** | $ (333,491) | $ (375,899) |

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 Liquidity Reserve Pool (LRP), Common Investment Fund (CIF), and other investment funds are included in investments because the intent of these funds is long-term appreciation. Any cash balances held in these funds at the date of the financial statements are due to timing of reinvesting the proceeds within the fund.

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

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

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

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

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

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

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

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

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

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

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

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

**Donor restricted endowments –** Under Michigan law set forth in the Uniform Prudent Management of Institutional Funds Act, as adopted in Michigan in 2009 ("UPMIFA."), the Board acts in a fiduciary capacity as trustee of its endowment funds. UPMIFA requires that the Board exercise its fiduciary duties prudently and consider both the charitable purposes and needs of the University and the purposes of the specific endowment regarding current expenditures and preservation of the purchasing power of the funds. Under the spending policy established by the Board, 5.00% of the average market value of endowment investments for the twenty quarters of the five calendar years prior to the beginning of the fiscal year has been authorized for expenditure. Endowment realized and unrealized appreciation is reported consistently with the net asset categorization of the related endowment net of spending policy distributions.

**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.

**Change in accounting policy –** Effective with the fiscal year ended June 30, 2010 the University adopted GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This statement requires derivative instruments to be measured and recorded at fair value. To the extent the derivative instruments are effective hedges, recognition of annual changes in fair value are deferred (deferred inflow or outflow); otherwise, the annual changes are recognized as a component of net investment income (loss). Prior to the change, the University's derivative instruments (interest rate swaps) were disclosed in the footnotes without recognition on the balance sheet. This new pronouncement will recognize the asset or liability that is represented by the derivative instruments, and will better match the income or loss to the appropriate reporting period. In accordance with the Statement, the University has also retroactively applied and restated prior periods presented in these financial statements. Net assets as of July 1, 2009 were increased by $8,949, while the July 1, 2008 net assets were reduced by $1,085. This change has impacted the amount reported as change in net assets by reducing the year ended June 30, 2010 by $10,292, while increasing the year ended June 30, 2009 by $10,034 (see footnote 15 for additional disclosures).

### 2. Cash and cash equivalents

The University's cash and cash equivalents as of June 30, 2010 and 2009 were as follows:

| | 2010 | 2009 |
|---|---|---|
| Cash and cash equivalents, current | $ 19,811 | $ 15,129 |
| Restricted cash and cash equivalents, noncurrent | 44,110 | - |
| Total cash and cash equivalents | $ 63,921 | $ 15,129 |

Of the bank balances for cash, $250 of the total $11,186 in 2010 and the entire balance of $2,462 in 2009 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), Liquidity Reserve Pool (LRP), and Common Investment Fund (CIF). In addition, the University has other investments that are restricted by external agreements or by special donor limitations (Other).

Securities Lending Transactions: The University participates in a Board-authorized securities lending program whereby University securities are contractually loaned to approved borrowers in exchange for the receipt of collateral which is invested. The University had loaned securities with a market value of approximately $30,083 and $75,498 at June 30, 2010 and 2009, 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, 2010 and 2009, 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, 2010 and 2009, the difference was less than 90 days.

As of June 30, 2010 and 2009, the University had the following investments:

| | June 30, 2010 | | | | | |
|---|---|---|---|---|---|---|
| Investment type | LP | LRP | CIF | Securities Lending | Other | Total |
| Investment pools | $ 10,052 | $ 232,706 | $ 982,785 | $ 9,653 | $ 13,445 | $ 1,248,641 |
| U.S. Treasury bonds | 37,662 | - | 22,767 | - | 1,203 | 61,632 |
| U.S. Government agencies | 124,796 | - | 25,482 | - | 2,123 | 152,401 |
| Municipal bonds | - | - | 388 | - | - | 388 |
| Corporate bonds | 106,854 | - | 18,662 | 1,950 | - | 127,466 |
| Asset-backed securities | 50,776 | - | 16,447 | 11,198 | - | 78,421 |
| U.S. Equities | - | - | 147,008 | - | - | 147,008 |
| International equities | - | - | 2,388 | - | - | 2,388 |
| International governmental bonds | 2,635 | - | 796 | - | - | 3,431 |
| Investment derivatives | - | - | - | - | (1,343) | (1,343) |
| Total | $ 332,775 | $ 232,706 | $ 1,216,723 | $ 22,801 | $ 15,428 | $ 1,820,433 |

| | June 30, 2009 | | | | | |
|---|---|---|---|---|---|---|
| Investment type | LP | LRP | CIF | Securities Lending | Other | Total |
| Investment pools | $ 9,400 | $ 151,235 | $ 888,294 | $ 40,891 | $ 25,320 | $ 1,115,140 |
| U.S. Treasury bonds | - | 314 | 7,952 | - | 65 | 8,331 |
| U.S. Government agencies | 42,019 | - | 30,586 | - | 11,867 | 84,472 |
| Municipal bonds | - | 2,038 | 859 | - | - | 2,897 |
| Corporate bonds | 49,533 | 21,980 | 29,785 | 16,688 | 64 | 118,050 |
| Asset-backed securities | 16,351 | 32,752 | 28,340 | 11,200 | - | 88,643 |
| Domestic common stock | - | - | 128,473 | - | - | 128,473 |
| International equities | - | - | 3,427 | - | - | 3,427 |
| Investment derivatives | - | - | - | - | 8,949 | 8,949 |
| Total | $ 117,303 | $ 208,319 | $ 1,117,716 | $ 68,779 | $ 46,265 | $ 1,558,382 |

Interest Rate Risk: As a means of managing its exposure to fair value losses arising from increasing interest rates, University investment policy limits the average duration of the LP portfolio to three years and the LRP and CIF portfolios to six years. At June 30, 2010 and 2009, 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, 2010 and 2009 are as follows:

| | June 30, 2010 Fixed Income Investment Maturities | | | | |
|---|---|---|---|---|---|
| Investment type | Less than 1 year | 1-5 years | 6-10 years | More than 10 years | Total |
| Investment pools | $ 13,694 | $ 123,096 | $ 169,099 | $ 34,680 | $ 340,569 |
| U.S. Treasury bonds | - | 55,050 | 2,878 | 3,704 | 61,632 |
| U.S. Government agencies | 84,239 | 28,633 | 8,321 | 31,208 | 152,401 |
| Municipal bonds | - | - | - | 388 | 388 |
| Corporate bonds | 56,821 | 60,806 | 6,897 | 2,942 | 127,466 |
| International governmental bonds | - | 3,028 | 122 | 281 | 3,431 |
| Asset-backed securities | 21,244 | 37,534 | 3,330 | 16,313 | 78,421 |
| Total | $ 175,998 | $ 308,147 | $ 190,647 | $ 89,516 | $ 764,308 |

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

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.

At June 30, 2010, the University is invested in six separate investment derivative instruments five of which are pay-variable, receive-variable interest rate swaps and one of which is a pay-fixed, receive-variable rate swap. At June 30, 2009, the University was invested in three separate investment derivative instruments which were pay-variable, receive-variable interest rate swaps.

| 2010 Notional Amount | Rate Paid | Rate Received | Effective Date | Termination Date | Counterparty/ Counterparty Credit Rating | 2010 Fair Value | 2009 Fair Value |
|---|---|---|---|---|---|---|---|
| $ 76,595 | SIFMA Municipal Swap Index | 67% USD-LIBOR-BBA one month plus .44% | 5/17/2010 | 8/15/2032 | Bank of New York Mellon/Aaa | $ (826) | $ - |
| 51,060 | SIFMA Municipal Swap Index | 67% USD-LIBOR-BBA one month plus .44% | 5/17/2010 | 8/15/2032 | Deutsche Bank AG/Aa3 | (551) | - |
| 15,560 | USD-LIBOR-BBA one month | USD-LIBOR-BBA ten year less .575% | 5/26/2006 | 2/15/2033 | UBS AG/Aa3 | 1,192 | 1,090 |
| 284,605 | 67% USD-LIBOR-BBA one month | 67% USD-ISDA Swap Rate ten year less .407% | 8/15/2009 | 2/15/2034 | UBS AG/Aa3 | 14,204 | 9,860 |
| 121,640 | SIFMA Municipal Swap Index | 67% USD-ISDA Swap Rate ten year plus .0063% | 6/8/2007 | 2/15/2037 | JP Morgan Chase Bank/Aa1 | (547) | (2,001) |
| 71,685 | 4.226% | 67% USD-LIBOR-BBA three month plus .63% | 5/17/2007 | 2/15/2037 | JP Morgan Chase Bank/Aa1 | (14,815) | - |
| $ 621,145 | | | | | | $ (1,343) | $ 8,949 |

Credit Risk: The University is exposed to credit risk on investment derivative instruments that are in asset positions. To minimize its exposure to loss related to credit risk, it is the University's policy to require counterparty collateral posting provisions; refer to Footnote 15 for thresholds and minimum transfers. The University has never failed to access collateral when required. The aggregate fair value of investment derivative instruments in asset positions at June 30, 2010 was $15,396. This represents the maximum loss that would be recognized at the reporting date if the counterparty failed to perform as contracted. This maximum exposure is reduced by $851 of negative hedging derivative fair values included in a netting arrangement with the counterparty and $13,266 of collateral posted with the University, resulting in a net exposure to credit risk of $1,279.

As a means of managing credit risk on its fixed income investments, University investment policy limits investments at time of purchase to the following ratings issued by nationally recognized statistical rating organizations: LP portfolio – short-term A1/P1, long-term BBB; LRP portfolio – short-term A2/P2, long-term B; CIF portfolio – short-term A2/P2, long-term BB. Thereafter, the minimum quality for all three portfolios is limited to AA. At June 30, 2010 and 2009, 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, 2010 and 2009 are as follows:

As of June 30, 2010

| Rating | Investment pools | U.S. Treasury bonds | U.S. Government agencies | Municipal bonds | Corporate bonds | International governmental bonds | Asset-backed securities | Total |
|---|---|---|---|---|---|---|---|---|
| AAA | $ 9,653 | $ - | $ 42,920 | $ - | $ 5,329 | $ 806 | $ 57,300 | $ 116,008 |
| AA | - | - | - | 266 | 20,783 | 1,293 | 1,547 | 23,889 |
| A | - | - | - | 122 | 62,960 | 1,060 | 6,293 | 70,435 |
| BBB | - | - | - | - | 34,522 | 272 | 47 | 34,841 |
| BB | - | - | - | - | 342 | - | 54 | 396 |
| Below BB | - | - | - | - | - | - | 4,846 | 4,846 |
| Not rated | 330,916 | 61,632 | 109,481 | - | 3,530 | - | 8,334 | 513,893 |
| Total | $ 340,569 | $ 61,632 | $ 152,401 | $ 388 | $ 127,466 | $ 3,431 | $ 78,421 | $ 764,308 |

As of June 30, 2009

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

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. LRP 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, 2010 and 2009, not more than 5% of the University's total investments were invested in any one issuer.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. University investment policy does not limit the value of investments that may be held by an outside party. Of the University's investments $59,552 of the U.S. Treasury bonds, $150,279 of the U.S. Government agencies, $388 of the Municipal bonds, $123,171 of the Corporate bonds, $3,431 of the International governmental bonds, $67,223 of the Asset-backed securities, $119,929 of the U.S. Equities, $1,833 of the International equities, and $24,533 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, $22,801 was held by the counterparty that was acting as the University's agent in securities lending transactions.

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

#### 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, 2010 and 2009 are summarized as follows:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | Cost | Market | Cost | Market |
| Short-term investments | $ 238 | $ 238 | $ 489 | $ 489 |
| Domestic equities | 35,493 | 28,939 | 50,779 | 40,396 |
| Foreign equities | 22,100 | 25,573 | 22,823 | 22,445 |
| Other equities | 20,285 | 20,785 | - | - |
| Fixed income | 66,657 | 69,649 | 74,406 | 73,176 |
| Mutual funds – Equities | 16,741 | 15,293 | 19,346 | 15,826 |
| Mutual funds – Fixed | 16,372 | 17,351 | 14,929 | 14,850 |
| Limited partnerships | 84,940 | 97,245 | 83,345 | 91,686 |
| Venture capital | 34,667 | 33,257 | 31,905 | 27,897 |
| | $ 297,493 | $ 308,330 | $ 298,022 | $ 286,765 |

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

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

Venture capital investments: The carrying amount reported in the Statement of Financial Position is stated at market value or estimated market value. Management, external consultants, and the Board of Directors evaluate these investments for impairments on a quarterly basis. As of June 30, 2010, the Foundation has an outstanding commitment to fund limited partnership and venture capital investments in the amount of $36,138.

In determining the fair value of investments, the Foundation utilizes a fair value hierarchy that ranks the quality and reliability of the information used to determine fair values and is based on certain assumptions that market participants would use in pricing the asset, including assumptions about risk and/or the risks inherent in the inputs to the valuation techniques. The Foundation’s total investment fair value measurement is categorized by the following valuation techniques: (1) Valuations from quoted prices in active markets that are traded by dealers and brokers ($110,945); (2) Valuations obtained from third party pricing services for identical or similar assets ($66,883); (3) Valuations from other techniques including option pricing models, discounted cash flow models, and other similar techniques, and not based on market exchange transactions ($130,502).

Research park investment (not included in the above summary): The Foundation is also invested in a research park development, which consists of land transferred at historical cost from the University plus costs incurred to develop the infrastructure of the research park.

### 5. Accounts and interest receivable

The composition of accounts and interest receivable at June 30, 2010 and 2009 is summarized as follows:

| | 2010 | 2009 |
|---|---|---|
| State appropriations | $ 58,155 | $ 64,908 |
| Research and sponsored programs | 64,074 | 60,052 |
| Departmental activities | 21,553 | 21,012 |
| Interest receivable | 2,108 | 1,377 |
| Other | 14,885 | 13,884 |
| | 160,775 | 161,233 |
| Less: allowance for doubtful accounts | 10,389 | 10,247 |
| Net accounts and interest receivable | $ 150,386 | $ 150,986 |

### 6. Student loans receivable

Student loans receivable at June 30, 2010 and 2009 are summarized as follows:

| Description | 2009 | Distributed | Collected | 2010 | Current Portion |
|---|---|---|---|---|---|
| Federal Family Education Loan Program | $ 3,065 | $ - | $ 195 | $ 2,870 | $ 207 |
| Perkins Federal Loan Program | 36,821 | 5,071 | 4,312 | 37,580 | 4,365 |
| Other | 10,348 | 4,657 | 4,561 | 10,444 | 4,833 |
| | 50,234 | $ 9,728 | $ 9,068 | 50,894 | 9,405 |
| Allowance for uncollectible loans | (4,433) | | | (4,672) | (181) |
| Net student loan receivable | $ 45,801 | | | $ 46,222 | $ 9,224 |

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

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

The University holds and services student loans related to the discontinued U.S. Department of Education Federal Family Education Loan Program. As of June 30, 2010, the University held a non-revolving line of credit, used to facilitate the servicing of the loans (see Footnote 13).

For the year ended June 30, 2010 and 2009, the University distributed $322,087 and $294,022, respectively, for student loans through the U.S. Department of Education William D. Ford Direct Loan Program. These distributions and related funding sources are not included as expenses and revenues in the accompanying financial statements.

### 7. Pledges receivable

Payments on pledges receivable at June 30, 2010, 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%.

| | | |
|---|---|---|
| 2011 | $ | 33,109 |
| 2012 | | 20,391 |
| 2013 | | 21,301 |
| 2014 | | 4,274 |
| 2015 | | 1,151 |
| 2016 and beyond | | 871 |
| Total discounted pledges receivable | | 81,097 |
| Less: allowance for uncollectible pledges | | 8,272 |
| Net pledges receivable, June 30, 2010 | | 72,825 |
| Less: current portion | | 29,719 |
| Noncurrent portion | $ | 43,106 |

### 8. Investments in joint ventures

The University is a member of several incorporated nonprofit joint ventures, most of which are accounted for under the equity method. The University and Sparrow Health System are members of Mid-Michigan MRI, Inc., which provides high technology cross-sectional diagnostic imaging services. University Rehabilitation Alliance, Inc. has the University and Peckham Vocational Industries of Lansing as members and is an enterprise for the treatment of persons with brain injury. Alliance Corporation is an enterprise formed with Spectrum Health System to support and direct the collaboration of physicians and researchers to enhance patient treatments and increase the investigation of leading-edge medical research. The University is a 50% member in each of the foregoing nonprofit corporations. Additionally, the University is a one-third member in Radiation Oncology Alliance, a nonprofit corporation formed with Ingham Regional Medical Center 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.

### 9. Capital assets and collections

Capital asset and collection activity for the years ended June 30, 2010 and 2009 follows:

| | 2009 | Additions (Deductions) | Disposals | 2010 |
|---|---|---|---|---|
| Non-depreciated capital assets: | | | | |
| Land | $ 26,281 | $ 5,862 | $ - | $ 32,143 |
| Construction in progress | 204,032 | (41,362) | - | 162,670 |
| Museum collections | 8,341 | 464 | - | 8,805 |
| Total non-depreciated capital assets | 238,654 | (35,036) | - | 203,618 |
| Depreciated capital assets: | | | | |
| Buildings and site improvements | 1,928,593 | 200,536 | (4,104) | 2,125,025 |
| Equipment and other | 561,812 | 47,573 | (11,984) | 597,401 |
| Less: accumulated depreciation | | | | |
| Buildings and site improvements | (792,930) | (60,756) | 4,104 | (849,582) |
| Equipment and other | (428,013) | (37,673) | 10,755 | (454,931) |
| Total depreciated capital assets | 1,269,462 | 149,680 | (1,229) | 1,417,913 |
| Total capital assets | $ 1,508,116 | $ 114,644 | $ (1,229) | $ 1,621,531 |

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

### 10. Contingencies and risk management

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

The University's liability for various medical professional liability claims is funded based on actuarial valuations. The University carries excess commercial medical professional liability insurance to manage the liability. The liability is reported at its present value of $5,108 as of June 30, 2010. The discount rate used was 4%.

The University is also self-insured for various employee benefits which include health care and dental insurance, workers compensation, and unemployment compensation. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Those losses include an estimate of claims that have been incurred but not reported. The workers compensation liability, which will be settled by fixed payments over an extended period of time, is reported at its present value of $4,701 as of June 30, 2010. The discount rate used was 6%.

Changes in the total reported general, professional, and self-insured employee benefit liabilities during 2010, 2009, and 2008 were as follows:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Balance, beginning of year | $ 24,253 | $ 23,448 | $ 19,273 |
| Claims incurred and changes in estimates | 103,170 | 103,027 | 96,066 |
| Claim payments | (105,721) | (102,222) | (91,891) |
| Balance, end of year | 21,702 | 24,253 | 23,448 |
| Less: current portion | 13,770 | 15,196 | 15,331 |
| Noncurrent portion | $ 7,932 | $ 9,057 | $ 8,117 |

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

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

### 11. Retirement benefits

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

Participating employees contribute 5% of their base salary or wages and the University contributes 10% of the employee's base salary or wages subject to applicable Internal Revenue Service limits. Participants may elect to contribute additional amounts to a supplemental program and/or a deferred compensation plan, within specified limits, which are not matched by University contributions. Plan provisions and contribution requirements of plan members and the University are established and may be amended in accordance with University policies, union contracts, or plan provisions. Contributions under the base program, excluding the participants' supplemental contributions, for the years ended June 30, 2010 and 2009 were as follows:

| | 2010 | 2009 |
|---|---|---|
| University contributions | $ 65,396 | $ 63,093 |
| Employee contributions | 32,698 | 31,547 |

In addition, the University has a single-employer, defined benefit plan covering 724 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, 2010.

### 12. Other postemployment benefits (OPEB)

Plan Description: The University provides retiree health and dental care benefits, including prescription drug coverage, to eligible retired employees and qualified spouses/beneficiaries. This is a 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 17,300 members. The plan does not issue a separate stand-alone financial statement. Effective for new employees hired on or after July 1, 2010, the University has discontinued providing retiree health and dental care benefits.

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

Funding Progress: For the year ended June 30, 2010, the University has estimated the cost (annual expense) of providing retiree health and dental care benefits through an actuarial valuation as of January 1, 2010. In accordance with GASB Statement No. 45, the valuation computes an annual required contribution, which represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years. This valuation's computed contribution and actual funding are summarized as follows:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Annual required contribution | $ 66,970 | $ 72,157 | $ 69,946 |
| Interest on the prior year's net OPEB obligation | 6,167 | 3,031 | - |
| Less adjustment to the annual required contribution | (4,654) | (2,236) | - |
| Annual OPEB cost | 68,483 | 72,952 | 69,946 |
| Amounts contributed: | | | |
| Payments of current premiums and claims | (28,354) | (28,142) | (26,651) |
| Advance funding | - | - | - |
| Increase in net OPEB obligation | 40,129 | 44,810 | 43,295 |
| OPEB obligation - beginning of year | 88,105 | 43,295 | - |
| OPEB obligation - end of year | $ 128,234 | $ 88,105 | $ 43,295 |

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

| | Fiscal Year Ended June 30, | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| Annual OPEB cost | $ 68,483 | $ 72,952 | $ 69,946 |
| Percentage contributed | 41.4% | 38.6% | 38.1% |
| Net OPEB obligation | $ 128,234 | $ 88,105 | $ 43,295 |

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

| | Valuation as of January 1, | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| Actuarial value of assets | $ - | $ - | $ - |
| Actuarial accrued liability (AAL) | 782,796 | 852,360 | 835,432 |
| Unfunded AAL (UAAL) | $ 782,796 | $ 852,360 | $ 835,432 |
| Funded ratio | 0.0% | 0.0% | 0.0% |
| Annual covered payroll (annual payroll of active employees covered by the plan) | $ 753,757 | $ 732,254 | $ 690,428 |
| UAAL as a percentage of covered payroll | 103.9% | 116.4% | 121.0% |

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

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

In the January 1, 2010 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions include a 7% investment rate of return (net of administrative expenses), which is a blended rate of the expected long-term and short-term investment returns on the University's own assets to be used for funding the current liability, and an annual health care cost trend rate of 5% which includes a 4% inflation assumption. The UAAL is being amortized over 30 years as a level percentage of projected payroll on a closed basis, with 27 years remaining.

### 13. Long term debt and other obligations

Long term debt and other obligations for the years ended June 30, 2010 and 2009 are summarized as follows:

| | 2009 | Borrowed | Retired | 2010 | Current Portion |
|---|---|---|---|---|---|
| General Revenue Bonds: | | | | | |
| Series 2010A | $ - | $ 205,000 | $ - | $ 205,000 | $ - |
| Series 2010C | - | 289,230 | - | 289,230 | 5,075 |
| Series 2007A | 30,820 | - | 2,865 | 27,955 | 2,985 |
| Series 2007B | 25,000 | - | - | 25,000 | - |
| Series 2005 | 80,845 | - | 26,705 | 54,140 | - |
| Series 2003A | 73,465 | - | 25,260 | 48,205 | - |
| Series 2003B | 20,835 | - | 20,835 | - | - |
| Series 2003C | 10,070 | - | 220 | 9,850 | 230 |
| Series 2002A | 43,955 | - | 42,465 | 1,490 | 1,490 |
| Series 2002B | 6,945 | - | 1,235 | 5,710 | 355 |
| Series 2000A | 100,050 | - | 21,350 | 78,700 | 1,505 |
| Series 1998A-2 | 51,935 | - | 49,120 | 2,815 | 2,815 |
| | 443,920 | 494,230 | 190,055 | 748,095 | 14,455 |
| General Revenue Commercial Paper: | | | | | |
| Tax-exempt | 60,000 | 95,071 | 116,071 | 39,000 | 39,000 |
| Taxable | 31,500 | - | 11,500 | 20,000 | 20,000 |
| | 91,500 | 95,071 | 127,571 | 59,000 | 59,000 |
| Federal student loan deposits | 36,457 | 381 | - | 36,838 | - |
| Line of credit | 3,842 | - | 432 | 3,410 | - |
| Lease obligations and other | 4,178 | 2,621 | 2,936 | 3,863 | (832) |
| | $ 579,897 | $ 592,303 | $ 320,994 | $ 851,206 | $ 72,623 |

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

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: from 2021 through 2034
- Series 2003A: from 2021 through 2033
- Series 2003C: through 2033
- Series 2002A: 2011
- Series 2002B: through 2023
- Series 2000A: 2011 and from 2022 through 2031
- Series 1998A-2: 2011

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

During 2010, the University issued two series of General Revenue Bonds. Series 2010A was $205,000 of fixed-rate taxable Build America Bonds. Proceeds provided $203,604 for capital projects and $1,396 for debt issuance costs. The University also issued Series 2010C for $289,230 of fixed-rate bonds with a net original issue premium of $20,585. Bond proceeds were used to convert $116,071 of commercial paper to long-term debt and $174,136 was for refunding variable-rate bonds (See Footnote 14 for information regarding the refunding resulting in the defeasance of debt). Proceeds also provided $19,608 for capital projects, swap termination costs, and debt issuance costs.

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

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

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

The University utilizes variable-rate commercial paper to provide interim financing. The Board has authorized the issuance of up to $200,000 in commercial paper secured by General Revenues and allows for tax-exempt and taxable issuances. Outstanding commercial paper debt is converted to long-term financing, as appropriate, within the normal course of business. Outstanding tax-exempt balances bear interest from 0.27% to 0.30% and taxable balances bear interest at 0.25%, with principal and accrued interest payments due within a maximum of 270 days from the date of issuance.

Hedging derivative instrument payments and hedged debt: Using rates as of June 30, 2010, scheduled fiscal year maturities of bonds payable and related interest expense are as follows. These amounts assume that current interest rates on variable-rate bonds and the current reference rates of hedging derivative instruments will remain the same for their term. As these rates vary, interest payments on variable-rate bonds and net receipts/payments on the hedging derivative instruments will vary. See Footnote 15 for information on derivative instruments.

| Fiscal Year | Fixed-Rate Bonds | | Variable-Rate Bonds | | Hedging | |
|---|---|---|---|---|---|---|
| Ending June 30, | Principal | Interest | Principal | Interest | Derivatives, Net | Total |
| 2011 | $ 8,060 | $ 27,664 | $ 6,395 | $ 703 | $ 7,659 | $ 50,482 |
| 2012 | 14,620 | 27,255 | 610 | 699 | 7,626 | 50,810 |
| 2013 | 15,015 | 26,670 | 635 | 696 | 7,598 | 50,615 |
| 2014 | 15,595 | 25,914 | 665 | 693 | 7,569 | 50,437 |
| 2015 | 16,235 | 25,116 | 690 | 690 | 7,540 | 50,271 |
| 2016-2020 | 83,060 | 112,928 | 5,906 | 3,392 | 37,174 | 242,460 |
| 2021-2025 | 32,115 | 98,045 | 67,397 | 2,726 | 30,960 | 231,243 |
| 2026-2030 | 8,600 | 94,412 | 94,605 | 1,367 | 14,958 | 213,941 |
| 2031-2035 | 18,320 | 92,064 | 47,045 | 359 | 2,525 | 160,312 |
| 2036-2040 | 43,435 | 85,041 | 1,962 | 22 | - | 130,461 |
| 2041-2045 | 102,565 | 68,958 | - | - | - | 171,523 |
| 2046-2050 | 164,565 | 27,552 | - | - | - | 192,117 |
| Total | $ 522,185 | $ 711,620 | $ 225,910 | $ 11,349 | $ 123,608 | $ 1,594,672 |

Interest expense was $19,467 (net of $3,226 capitalized interest) and $23,488 for 2010 and 2009, respectively.

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

At June 30, 2010, the University owed $3,410 on a $4,100 non-revolving line of credit related to the University's servicing of unsold graduate and professional degree student loans under the Federal Family Education Loan Program (see Footnote 6). This line of credit bears interest equal to the British Bankers Association (BBA) London Interbank Offering Rate (LIBOR) Daily Floating Rate plus 1.00%. Payments of accrued interest are due monthly, with all unpaid accrued interest and principal due in October 2011.

Lease obligations and other includes lease obligations of $2,306 ($239 current) and deferred bond premium of $20,585 ($63 current), net of deferred debt refunding costs of $19,028 ($1,134 current). Deferred amounts will be amortized over the applicable bond issue life.

During the year ended June 30, 2010, the University discontinued all undergraduate degree programs at its campus in Dubai, United Arab Emirates. In accordance with the terms of a limited recourse note, an outstanding principal balance of $2,845 owed by the University does not require repayment. Accordingly, the University has recognized this amount as revenue in the Statement of Revenues, Expenses, and Changes in Net Assets as nonoperating revenue. The University has also accrued certain personnel and facility costs totaling $2,340, which is based on contractual commitments as of June 30, 2010.

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 2010 and 2009 were as follows:

| | 2010 | 2009 |
|---|---|---|
| Balance, beginning of year | $ 95,013 | $ 79,220 |
| Additions | 10,556 | 17,171 |
| Reductions | (1,505) | (1,378) |
| Balance, end of year | 104,064 | 95,013 |
| Less: current portion | 73,223 | 66,298 |
| Noncurrent portion | $ 30,841 | $ 28,715 |

### 14. Defeasance of debt

During the year ended June 30, 2010, the University used $289,230 par value of the Series 2010C bonds plus $931 of a net original issue premium to defease debt through a current refunding by depositing U.S. Government securities with a debt service trustee to provide for scheduled refunding payments for the following outstanding debt series:

| Debt Series | Par Value |
|---|---|
| Series 2008A commercial paper | $ 116,071 |
| Series 1998A-2 bonds | 46,435 |
| Series 2000A bonds | 19,900 |
| Series 2002A bonds | 39,760 |
| Series 2003A bonds | 23,345 |
| Series 2003B bonds | 19,925 |
| Series 2005 bonds | 24,725 |
| | $ 290,161 |

The undiscounted cash flow to service the new debt decreased $896. The economic gain resulting from this transaction amounted to $985. As of June 30, 2010, $142,726 of debt principal remained outstanding and was paid off in July 2010. Accordingly, the related assets and liabilities are not included in the financial statements of the University.

### 15. Derivative instruments

The fair value balances and notional amounts of derivative instruments outstanding at June 30, 2010 and 2009, classified by type, and the changes in fair value of such derivative instruments are as follows:

| | June 30, 2010 | | | | |
|---|---|---|---|---|---|
| | Changes in Fair Value | | Fair Value | | |
| | Classification | Amount | Classification | Amount | Notional |
| Hedging derivatives: | | | | | |
| Cash flow hedges: | | | | | |
| Pay-fixed interest rate swaps | Deferred charges | $ 17,049 | Debt | $ (42,885) | $ 212,945 |
| Investment derivatives: | | | | | |
| Pay-variable interest rate swaps | Net investment income (loss) | $ 4,524 | Investment | $ 13,473 | $ 549,460 |
| Pay-fixed interest rate swaps | Net investment income (loss) | (14,815) | Investment | (14,815) | 71,685 |
| Total investment derivatives | | $ (10,292) | | $ (1,343) | $ 621,145 |

| | June 30, 2009 | | | | |
|---|---|---|---|---|---|
| | Changes in Fair Value | | Fair Value | | |
| | Classification | Amount | Classification | Amount | Notional |
| Hedging derivatives: | | | | | |
| Cash flow hedges: | | | | | |
| Pay-fixed interest rate swaps | Deferred charges | $ (27,453) | Debt | $ (59,933) | $ 476,110 |
| Investment derivatives: | | | | | |
| Pay-variable interest rate swaps | Net investment income (loss) | $ 10,034 | Investment | $ 8,949 | $ 430,020 |

As of June 30, 2010, the University determined that one pay-fixed interest rate swap previously treated as a hedging derivative instrument no longer met the criteria for effectiveness. Accordingly, the accumulated changes in fair value of the swap that was reported as deferred charges of $(10,375) at June 30, 2009, and the decrease in the fair value of the swap in fiscal year 2010 of $(4,440) totaling $(14,815) are reported within the net investment income (loss) classification for the year ended June 30, 2010. In addition, four pay-fixed interest rate swaps where terminated during the year.

Fair Value: The fair values of the interest rate swaps were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swaps, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. The payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the dates of each future net settlement on the swaps.

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

Terms, Fair Values, and Credit Risk: The following table displays the terms and fair values of the University's hedging derivative instruments at June 30, 2010 and 2009, along with the notional amounts, credit rating of the associated counterparty, and other terms as of June 30, 2010.

| Type | Cash Flow Hedge for Debt Series | 2010 Notional Amount | Effective Date | Termination Date | Rate Paid | Rate Received | Counterparty/ Counterparty Credit Rating | 2010 Fair Value | 2009 Fair Value |
|---|---|---|---|---|---|---|---|---|---|
| Pay-fixed interest rate swap | 1998A-2 | $ - | 2/15/2009 | 5/7/2010 | 4.504% | SIFMA Municipal Swap Index | Deutsche Bank AG/Aa1 | $ - | $ (5,248) |
| Pay-fixed interest rate swap | 2000A | 73,040 | 11/3/2008 | 8/15/2029 | 4.074% | 67% USD-LIBOR-BBA one month | Deutsche Bank AG/Aa1 | (16,994) | (15,742) |
| Pay-fixed interest rate swap | 2002A | - | 10/17/2002 | 5/5/2010 | 3.390% | 67% USD-LIBOR-BBA one month | UBS AG/Aa2 | - | (3,574) |
| Pay-fixed interest rate swap | 2002A | - | 10/17/2002 | 5/5/2010 | 3.530% | 67% USD-LIBOR-BBA one month | UBS AG/Aa2 | - | (218) |
| Pay-fixed interest rate swap | 2002B | 3,670 | 10/17/2002 | 8/15/2018 | 4.330% | USD-LIBOR-BBA one month | UBS AG/Aa2 | (390) | (304) |
| Pay-fixed interest rate swap | 2002B | 2,040 | 10/17/2002 | 8/15/2022 | 5.280% | USD-LIBOR-BBA one month | UBS AG/Aa2 | (461) | (316) |
| Pay-fixed interest rate swap | 2003A | 48,205 | 11/3/2008 | 2/15/2033 | 3.618% | 67% USD-LIBOR-BBA one month | Barclays Bank PLC/Aa3 | (8,881) | (8,479) |
| Pay-fixed interest rate swap | 2003B | - | 12/11/2003 | 5/5/2010 | 3.479% | 67% USD-LIBOR-BBA one month | UBS AG/Aa2 | - | (1,868) |
| Pay-fixed interest rate swap | 2003C | 9,850 | 11/3/2008 | 2/15/2033 | 5.330% | USD-LIBOR-BBA one month | Barclays Bank PLC/Aa3 | (2,326) | (1,671) |
| Pay-fixed interest rate swap | 2005 | 54,140 | 11/3/2008 | 2/15/2034 | 3.647% | 67% USD-LIBOR-BBA one month | Barclays Bank PLC/Aa3 | (10,192) | (9,635) |
| Pay-fixed interest rate swap | 2007B & General Revenue Commercial Paper | 22,000 | 5/17/2007 | 2/15/2028 | 4.139% | 67% USD-LIBOR-BBA three month plus .58% | JP Morgan Chase Bank/Aa1 | (3,641) | (2,503) |
| Pay-fixed interest rate swap | 2007B & General Revenue Commercial Paper | - | 5/17/2007 | 2/15/2037 | 4.226% | 67% USD-LIBOR-BBA three month plus .63% | JP Morgan Chase Bank/Aa1 | - | (10,375) |
| | | $ 212,945 | | | | | | $ (42,885) | $ (59,933) |

Credit Risk: The University is exposed to credit risk on hedging derivative instruments that are in asset positions. The aggregate fair value of hedging derivative instruments in asset positions at June 30, 2010 was zero and the University was not exposed to credit risk related to these swaps. Refer to Footnote 3 for information on credit risk of investment derivative instruments.

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

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

*Threshold for the University is $20,000

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

Basis Risk: The University is exposed to basis risk on its pay-fixed, receive-variable interest rate swap hedging derivative instruments because the variable-rate payments received by the University on these hedging derivative instruments are based on a rate or index other than interest rates the University pays on its variable-rate debt, which bear interest based on weekly or quarterly rates determined by the trustee or remarketing agent. The pay-fixed receive-variable swaps expose the University to basis risk should the rates resulting from the 67% of USD-LIBOR-BBA for the 2000A-1, 2000A-2, 2003A, 2005, 2007B, and General Revenue Commercial Paper assigned swaps, and USD-LIBOR-BBA for the 2002B and 2003C swaps not equal the rate the University pays.

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

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

Contingencies: All of the University's derivative instruments include provisions that require the University to post collateral at certain thresholds depending on the University's credit rating. See the table under "Credit Risk" for thresholds and minimum transfers for collateralization. As of June 30, 2010, the University's credit ratings were Aa1 as assigned by Moody's and AA as assigned by Standard & Poor's. The aggregate fair value of all derivative instruments with these collateral posting provisions at June 30, 2010 is $44,227. The University had $14,396 in collateral posted to its counterparties and held $13,266 in collateral posted by its counterparties.

### 16. Net assets

Restricted and unrestricted net assets for the years ended June 30, 2010 and 2009 are as follows:

| | 2010 | 2009 |
|---|---|---|
| Restricted - nonexpendable: | | |
| Permanent endowments | $ 447,289 | $ 393,018 |
| | | |
| Restricted - expendable: | | |
| Gifts, endowment income and sponsored programs | $ 185,981 | $ 164,192 |
| Quasi and term endowments | 136,069 | 127,723 |
| Capital projects | 65,190 | 59,894 |
| Student loans | 8,128 | 8,031 |
| Total | $ 395,368 | $ 359,840 |
| | | |
| Unrestricted: | | |
| Designated | $ 618,085 | $ 556,293 |
| Uncommitted | 20,145 | 7,538 |
| Total | $ 638,230 | $ 563,831 |

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

**Unrestricted –** Unrestricted net assets are not subject to externally imposed constraints. However, these net assets are subject to internal designations. Unrestricted net assets include amounts designated for specific purposes by action of the Board or management or may otherwise be subject to pending contractual commitments with external parties. Substantially all unrestricted net assets are internally designated for programmatic initiatives or capital asset renewals.

### 17. Grants and contracts

The University receives grants and contracts from certain federal, state, and local agencies to fund research and other activities. Revenues from government grants and contracts are recognized when all eligibility requirements have been met. The University records indirect costs related to such grants and contracts at predetermined rates that are negotiated with the University's federal cognizant agency. Both direct and indirect costs charged to the grants or contracts are subject to audit and approval by the granting agencies. University management believes adjustments of costs, if any, resulting from such examination by the granting agency would not be material.

### 18. Commitments

At June 30, 2010, 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 $149,780 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, 2010, 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, 2010, $165,537 of the initial $393,230 investment commitment remains outstanding.

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, 2010 and 2009 and have issued our report thereon dated October 14, 2010. 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 deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the University's financial statements will not be prevented or detected and corrected on a timely basis.

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

**Compliance and Other Matters**

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

To the Board of Trustees
Michigan State University

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

Plante & Moran, PLLC

Kalamazoo, Michigan
October 14, 2010

MICHIGAN STATE
UNIVERSITY