

LAKE SUPERIOR STATE UNIVERSITY

ANNUAL FINANCIAL REPORT

**FISCAL YEARS ENDED
JUNE 30, 2006 AND 2005**

LAKE SUPERIOR STATE UNIVERSITY

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Lake Superior State University

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**Lake Superior State University
Management's Discussion and Analysis
Fiscal Years Ended June 30, 2006 and 2005**

This section of the Lake Superior State University ("University") annual financial report presents management's discussion and analysis of the financial condition of the University as of June 30, 2006 and 2005 and its financial performance during the fiscal years then ended. This discussion should be read in conjunction with the accompanying financial statements and footnotes. The financial statements, footnotes and this discussion are the responsibility of University management.

Reporting Entity

Lake Superior State University is an institution of higher education and is considered to be a component unit of the State of Michigan. The Governor of the State of Michigan appoints the University's Board of Trustees. The University is included in the State's financial statements as a discrete component unit. Transactions with the State of Michigan primarily relate to appropriations for operations, appropriations for Charter Schools, receipt of grants, payments to State retirement programs on behalf of certain University employees, and reimbursements for capital outlay projects.

The basic financial statements include not only the University itself, but also a legally separate entity, the Lake Superior State University Foundation, for which the University is financially accountable. Financial statement information for this *component unit* is reported separately from the financial information presented for the University.

Using the Annual Financial Report

This annual report includes financial statements prepared in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities*. The accompanying financial statements, which focus on the financial condition, results of operations and cash flows of the University as a whole, present financial information in a form similar to that used by commercial enterprises. The financial statements are prepared using the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged.

The Statements of Net Assets includes all assets and liabilities. Over time, increases or decreases in net assets (the difference between assets and liabilities) is one indicator of the improvement or erosion of the University's financial health when considered with operating measures such as enrollment levels and the physical condition of facilities.

The Statements of Revenues, Expenses and Changes in Net Assets presents the revenues earned and expenses incurred during both years. Activities are reported as either operating or nonoperating. A public University's dependency on State aid and grants will result in operating deficits because the financial reporting model classifies State appropriations and grants as nonoperating revenues. The utilization of capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

The Statements of Cash Flows presents information related to cash inflows and outflows summarized by operating, noncapital financing, capital and related financing, and investing activities, and helps measure the University's ability to meet its financial obligations as they mature.

Summary of Selected Financial Data

**Lake Superior State University
Condensed Statements of Net Assets**

	June 30		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Assets:			
Current assets	\$10,587,997	\$10,099,022	\$11,922,986
Capital assets	74,189,197	76,531,422	77,380,346
Other noncurrent assets	<u>10,538,925</u>	<u>9,745,363</u>	<u>8,538,675</u>
Total Assets	<u>\$95,316,119</u>	<u>\$96,375,827</u>	<u>\$97,842,007</u>
Liabilities:			
Current liabilities	\$ 4,251,755	\$ 3,936,250	\$ 4,886,497
Noncurrent liabilities	<u>32,510,606</u>	<u>31,883,735</u>	<u>31,757,658</u>
Total liabilities	<u>36,762,361</u>	<u>35,819,985</u>	<u>36,644,155</u>
Net Assets:			
Invested in capital assets, net of related debt	45,248,314	48,177,482	50,543,709
Restricted, nonexpendable	205,327	205,327	205,327
Restricted, expendable	11,232,662	11,091,742	9,856,894
Unrestricted, undesignated	<u>1,867,455</u>	<u>1,081,291</u>	<u>591,922</u>
Total net assets	<u>58,553,758</u>	<u>60,555,842</u>	<u>61,197,852</u>
Total Liabilities and Net Assets	<u>\$95,316,119</u>	<u>\$96,375,827</u>	<u>\$97,842,007</u>

Changes from 2005 to 2006:

Total current assets increased by approximately \$500,000. This increase is a result of an increase in cash reserves of \$750,000 which reflects an increase of \$1.5 million that was secured to finance Central Heating Plant renovations and was offset by \$800,000 that was used on several other capital projects. The other capital projects during fiscal 2006 were primarily related to the continued implementation of a new administrative software system, upgrades to the University computer network infrastructure and the replacement of a fifty year old electrical loop that services one half of the University campus. Receivables from the State of Michigan decreased by \$200,000 which reflects the lower state appropriations received by the University. Other receivables decreased by \$100,000 and reflect an increase to the allowance for uncollectible accounts. Inventories increased by \$100,000 which reflects the increased cost of natural gas inventories held by the University.

Capital assets decreased by \$2.3 million as a result of the annual depreciation charge of \$5.3 million which exceeded the value of new assets placed into service of \$3.0 million.

Other noncurrent assets increased by \$800,000. This is due to appreciation of investments of \$60,000 and appreciation of endowment investments of \$850,000. Student loans receivable decreased by \$120,000 because of heavy activity in loan consolidations as interest rates for consolidated student loans remained relatively low throughout most of the year.

Total liabilities increased by \$940,000 primarily as a net result of increased debt in the form of capital lease purchase agreements for office equipment and central heating plant renovations amounting to \$1.8 million offset by \$977,000 of debt retired during the year.

Total net assets decreased by \$2.0 million. The University's net investment in capital assets decreased by \$2.9 million. Restricted, expendable scholarship net assets increased by \$740,000, capital projects and debt service net assets decreased by \$630,000 and unrestricted reserves increased by \$790,000. The June 30, 2006 unrestricted reserves of \$1,867,000 consist of designated fund reserves of \$734,000, auxiliary fund reserves of \$256,000, insurance and benefit reserves of \$1,446,000 and a general fund deficit of \$569,000.

Changes from 2004 to 2005:

Total current assets decreased by \$1.8 million. This decrease is a result of a decrease in cash reserves of \$1.1 million that have been held for the financing of several capital projects. During fiscal 2005, the University progressed with the implementation of a new administrative software system and upgrades to the University computer network infrastructure. Receivables from the State of Michigan decreased by \$500,000 as reimbursements to the University for construction costs on the Fine Arts Building have declined significantly as this project approaches final completion. Inventories decreased by \$100,000 as the University eliminated the final inventories of the campus bookstore. The management and operations of the bookstore were contracted to a third party effective July 1, 2004.

Capital assets decreased by \$800,000 as a result of the annual depreciation charge of \$4.4 million exceeding the value of new assets of \$3.6 million.

Other noncurrent assets increased by \$1.2 million. This is due to proceeds of \$839,000 from an interest rate swap transaction being deposited in a diversified investment portfolio. The proceeds of this investment will be used to contribute to debt service payments in future years. Also an increase of \$400,000 to the University endowment investment portfolio is a result of additional contributions and portfolio earnings.

Total liabilities decreased by \$800,000 primarily as a result of a \$900,000 decrease of accounts payable. Due to the implementation of the finance module of the University's new administrative software system, purchasing activity for fiscal year 2005 was virtually terminated in mid-May. This meant that purchasing normally done in June, and payable at June 30, was completed in May, thus eliminating much of the accounts payable at June 30, 2005. Although noncurrent liabilities increased by only \$100,000, the long-term portion of bond debt was reduced by \$700,000 and the University has recorded an interest rate swap liability of \$800,000 (see the related footnote on page 31 of the financial statements).

Total net assets decreased by \$600,000. The University's net investment in capital assets decreased by \$2.4 million. Restricted, expendable scholarship net assets increased by \$600,000, capital projects and debt service net assets increased by \$500,000 and unrestricted reserves increased by \$500,000. The June 30, 2005 unrestricted reserves of \$1,081,000 consist of designated fund reserves of \$451,000, auxiliary fund reserves of \$183,000, insurance and benefit reserves of \$1.56 million and a general fund deficit of \$1.11 million.

Lake Superior State University
Condensed Statements of Revenues, Expenses and Changes in Net Assets

	<u>Year Ended June 30</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Total operating revenues	\$26,831,052	\$26,067,559	\$28,798,636
Total operating expenses	<u>41,694,101</u>	<u>39,560,111</u>	<u>41,938,597</u>
Operating loss	(14,863,049)	(13,492,552)	(13,139,961)
Net nonoperating revenues	<u>11,966,721</u>	<u>11,787,531</u>	<u>11,605,549</u>
Loss before other revenues	(2,896,328)	(1,705,021)	(1,534,412)
Total other revenues	<u>894,244</u>	<u>1,063,011</u>	<u>10,721,107</u>
(Decrease) increase in net assets	(2,002,084)	(642,010)	9,186,695
Net assets, beginning of year	<u>60,555,842</u>	<u>61,197,852</u>	<u>52,011,157</u>
Net assets, end of year	<u>\$58,553,758</u>	<u>\$60,555,842</u>	<u>\$61,197,852</u>

Changes from 2005 to 2006:

Operating revenues increased by \$764,000. Revenues from tuition and fees increased by \$1.4 million. This is a result of increased tuition rates and level enrollments. Revenues from grants and contracts decreased by \$440,000. Auxiliary revenues decreased by \$240,000 due to lower occupancy levels in residence halls.

Operating expenses increased overall by \$2.1 million. The most significant increase was \$900,000 in additional depreciation expense related to the completed Fine Arts Center. Salaries increased by \$600,000 as a result of several position restorations and utilities increased by \$400,000 due to increasing energy rate costs.

Nonoperating revenues increased by \$180,000 as a result of an increase in investment income of \$330,000 offset by a decrease in state appropriations of \$170,000.

Changes from 2004 to 2005:

Operating revenues decreased by \$2.7 million. The most significant change is a \$1.9 million decrease in auxiliary revenues. This is due to the University no longer operating the campus bookstore. Operations of the bookstore were contracted to a third party effective July 1, 2004. A \$700,000 decrease in tuition and fees is the result of lower enrollments for fiscal year 2005.

Operating expenses decreased overall by \$2.4 million. Again this is a result of outsourcing of bookstore operations. This alone reduced operating expenses by \$2.0 million. There were three new administrative positions added during fiscal year 2005 which are considered vital to the growth of the University. These positions were Dean of Enrollment Management, Webmaster and Director of Public Safety. Again in fiscal year 2005, operational spending was tightly controlled and departmental managers underspent their allotted supply budgets by \$200,000.

Nonoperating and Other revenues decreased a total of \$9.5 million. Capital appropriations decreased by \$9.8 million due to the absence of major construction funded by the State of Michigan. After initial appropriations, executive order appropriations reductions, supplemental appropriations and restoration of executive order reductions, State appropriations for fiscal year 2005 did increase by \$200,000.

**Lake Superior State University
Condensed Statements of Cash Flows**

	Year Ended June 30		
	2006	2005	2004
Cash provided by (used in):			
Operating activities	\$(9,249,464)	\$(9,814,357)	\$(7,972,715)
Noncapital financing activities	12,426,178	12,779,744	12,723,262
Capital and related financing activities	(2,564,121)	(3,531,175)	(1,113,850)
Investing activities	<u>130,191</u>	<u>(565,799)</u>	<u>(294,620)</u>
Net change in cash and cash equivalents	742,784	(1,131,587)	3,342,077
Cash and cash equivalents, beginning of year	<u>6,270,351</u>	<u>7,401,938</u>	<u>4,059,861</u>
Cash and cash equivalents, end of year	<u>\$ 7,013,135</u>	<u>\$ 6,270,351</u>	<u>\$ 7,401,938</u>

Changes from 2005 to 2006:

Net cash used for operations decreased by \$570,000. Cash received from operations increased by \$770,000; this includes sources of cash including tuition and fees, grants and contract awards and auxiliary activities. Cash used for operations increased by only \$200,000 for the year; uses of cash include payments to employees, vendors and students.

Cash provided by noncapital financing activities decreased by \$350,000 primarily as a result of cash received from state appropriations decreasing by \$210,000 and cash received for endowment gifts decreasing by \$140,000.

Cash used in capital and related financing activities decreased by \$1.0 million as capital construction payments decreased by \$600,000 and cash received from state sources for capital appropriations decreased by \$130,000. The University did receive \$1.5 million from financing sources to be used for the capital renovations of the Central Heating Plant.

Overall, cash and cash equivalents increased by approximately \$740,000 for the year ended June 30, 2006.

Changes from 2004 to 2005:

Cash and cash equivalents decreased by \$1.1 million for the year ended June 30, 2005. Cash used in operations increased by \$1.8 million. This is a result of cash received from operations (tuition, grants, and auxiliary activities) decreasing by \$2.7 million and cash used for operations (payments to employees and vendors) decreasing by \$700,000. Fluctuations of cash flows in financing and investing activities are the result of capital project costs on the administrative software and the network infrastructure projects which are not funded with capital appropriations.

A Year in Review...A Look Ahead

Fiscal Year 2005-2006 was highlighted by several significant accomplishments at Lake Superior State University.

The Arts Center was opened as a classroom facility and faculty office center. The classroom environment improves upon the classroom experience for several academic disciplines such as arts, music, theatre, foreign languages and humanities. The Arts Center also hosted several entertainers in its inaugural year including The Butch Thompson Trio, Second City, Three Men and a Tenor, Maya Angelou as well as several student and community productions.

The year also demonstrated the continuation of the academic achievements of our students as they competed with other larger universities in various academic based competitions. Our students regularly perform at a very high level during these academic events and demonstrate the quality of education they receive at Lake Superior State University.

Amongst the more significant student achievements were:

- **Athletic Training:** students took second place among 27 teams in a quiz bowl competition. Two LSSU athletic training students were selected to work in Honolulu at the 2006 Hula Bowl.
- **Computer Programming:** three LSSU teams placed in the top six out of nineteen teams at a computer programming competition at Algoma University.
- **French:** Six LSSU students passed a 13-hour examination in Business French and received diplomas of excellence from the Chamber of Commerce and Industry of Paris.
- **Fisheries and Wildlife Management:** An LSSU student was one of only 18 citizens appointed to address the issue of decreasing revenue in the state's Game and Fish Protection Fund.

As for our alumni, three former Laker hockey players participated on the Olympic hockey team. Only one other university had as many players and no university had more.

Lake Superior State University also strengthened its academic offerings with the initiation of a BS in Spanish, a BS in Engineering Technology, a BS in Physical Science-Teaching and a Master of Arts-Curriculum Development and Instruction. All four degrees are a response for focused educational development to meet today's job markets.

Enrollment, although projected to post a moderate decrease, remained level with the enrollment of the previous year. The strength of this enrollment outcome was the most significant factor contributing to the financial performance of the current year.

State appropriations declined again for this fiscal year due to the 2005-2006 appropriations being set at the base level of the previous year after the February 2005 executive order cut. Setting the base appropriations at the level after the executive order cut has the effect of making this budget cut a permanent reduction to base appropriations. During the year, the February budget cut was restored to the universities; however, the cut was not restored to the base appropriations. It is expected that Lake Superior State University will receive an increase in state appropriations of approximately 3.5%. Based on the projected state appropriations for the next fiscal year, our appropriations will match the appropriations level of fiscal year 1997-1998.

During the year, the University also settled labor contracts with both the classified personnel and the faculty. Although it was necessary, the University regrettably negotiated concessions in several areas, predominately health care costs through agreements for employees to participate in the cost of health care coverage.

The year also saw a strengthening of the executive administrative team with a focus on enrollment and marketing. An experienced Vice President of Enrollment Services joined Lake Superior State University in July 2006. Also added to the executive staff was the position of Vice President of University Relations and Marketing. Together, the addition of these two executive level positions, are a focus on enhancing and strengthening the image and recognition of Lake Superior State University in order to build enrollment and constituency support.

During the summer and fall of 2006 the University will also complete two major physical plant improvement projects. The first is a replacement of one of the two main electrical loops that serve the campus. The replacement of this fifty year old electrical service line will stabilize the electrical service that feeds approximately one half of the campus. We will also replace the number one boiler in our central heating plant which has served the campus for over forty years. Modernization of the remaining heating plant equipment will also be included in this project and will include remote monitoring controls, boiler economizers and emissions stack replacement.



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INDEPENDENT AUDITORS' REPORT

September 29, 2006

Board of Trustees
Lake Superior State University
Sault Ste. Marie, Michigan

We have audited the accompanying financial statements of the business-type activities and the discretely presented component unit of *Lake Superior State University* ("*the University*"), a component unit of the State of Michigan, as of June 30, 2006 and 2005 and for the years then ended, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the discretely presented component unit of *Lake Superior State University* as of June 30, 2006 and 2005 and the respective changes in financial position and cash flows of the University for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued under separate cover our report dated September 29, 2006, on our consideration of Lake Superior State University's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. 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 an opinion on the internal control over financial reporting or on compliance. That report, which is included in the University's single audit report, is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The Management's Discussion and Analysis (MD&A) presented on pages 2 to 8 is not a required part of the basic financial statements but is supplementary 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 this required supplementary information. However, we did not audit the information and express no opinion on it.

LAKE SUPERIOR STATE UNIVERSITY

STATEMENTS OF NET ASSETS

Assets	June 30	
	2006	2005
Current assets		
Cash and cash equivalents	\$ 5,507,663	\$ 6,270,351
Restricted cash and cash equivalents	1,505,472	-
Accounts receivable, net	893,166	1,015,436
State appropriations receivable	2,277,200	2,501,861
Inventories	375,752	269,309
Other	28,744	42,065
Total current assets	10,587,997	10,099,022
Noncurrent assets		
Student loans receivable, net	2,512,293	2,638,767
Investments	910,677	847,761
Endowment investments	7,115,955	6,258,835
Land and construction in progress	6,680,008	19,840,373
Depreciable capital assets, net	67,509,189	56,691,069
Total noncurrent assets	84,728,122	86,276,805
Total assets	\$ 95,316,119	\$ 96,375,827
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	\$ 2,024,525	\$ 1,746,077
Deferred revenue	759,663	818,094
Deposits	104,121	105,229
Current portion of long-term debt	1,085,358	961,035
Current portion of employee benefit programs	278,088	305,815
Total current liabilities	4,251,755	3,936,250
Interest rate swap liability	839,000	839,000
Long-term debt, net of current portion	30,326,284	29,615,954
Employee benefit programs, net of current portion	1,345,322	1,428,781
Total liabilities	36,762,361	35,819,985
Net assets		
Invested in capital assets, net of related debt	45,248,314	48,177,482
Restricted		
Nonexpendable		
Scholarships and research	205,327	205,327
Expendable		
Scholarships and research	7,384,652	6,643,002
Loans	3,159,531	3,132,576
Capital projects and debt service	688,479	1,316,164
Unrestricted	1,867,455	1,081,291
Total net assets	58,553,758	60,555,842
Total liabilities and net assets	\$ 95,316,119	\$ 96,375,827

The accompanying notes are an integral part of these financial statements.

LAKE SUPERIOR STATE UNIVERSITY

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Year Ended June 30	
	2006	2005
Operating revenues		
Tuition and fees (net of scholarship allowances of \$4,397,885 and \$4,220,065 in 2006 and 2005, respectively)	\$ 12,616,887	\$ 11,255,142
Federal grants and contracts	3,464,260	4,277,045
State grants and contracts	215,838	221,368
Nongovernmental grants and contracts	2,192,707	1,813,355
Auxiliary activities	7,474,253	7,715,825
Other	867,107	784,824
Total operating revenues	26,831,052	26,067,559
Operating expenses		
Instruction	11,677,756	12,118,631
Research	479,409	450,589
Public service	681,907	742,806
Academic support	2,500,091	2,378,092
Student services	2,150,274	1,879,369
Student aid	1,489,507	1,620,258
Institutional support	4,743,596	4,331,140
Operation and maintenance of plant	4,339,920	3,907,421
Auxiliary activities	7,449,771	7,305,808
Depreciation	5,349,098	4,486,318
Other	832,772	339,679
Total operating expenses	41,694,101	39,560,111
Operating loss	(14,863,049)	(13,492,552)
Nonoperating revenues (expenses)		
State appropriations	12,461,216	12,631,309
Interest on capital debt and leases	(1,524,251)	(1,571,912)
Investment income, net of investment expenses	1,050,227	722,629
(Loss) gain on assets sold or retired	(20,471)	5,505
Net nonoperating revenues	11,966,721	11,787,531
Loss before other revenues	(2,896,328)	(1,705,021)
Other revenues		
Capital grants and gifts	422,670	469,270
Additions to expendable endowments	36,100	180,153
Capital appropriations	435,474	413,588
Total other revenues	894,244	1,063,011
Decrease in net assets	(2,002,084)	(642,010)
Net assets, beginning of year	60,555,842	61,197,852
Net assets, end of year	\$ 58,553,758	\$ 60,555,842

The accompanying notes are an integral part of these financial statements.

LAKE SUPERIOR STATE UNIVERSITY

STATEMENTS OF CASH FLOWS

	Year Ended June 30	
	2006	2005
Cash flows from operating activities		
Tuition and fees	\$ 12,604,744	\$ 11,229,376
Grants and contracts	5,914,636	6,260,168
Payments to employees	(23,821,500)	(23,469,866)
Payments to vendors	(10,947,475)	(10,794,520)
Payments for financial aid	(1,489,507)	(1,620,258)
Loans issued to students	(515,094)	(686,239)
Collections of interest and principal on loans to students	641,568	767,979
Auxiliary activities	7,401,076	7,755,086
Other receipts	962,088	743,917
Net cash used in operating activities	(9,249,464)	(9,814,357)
Cash flows from noncapital financing activities		
State appropriations	12,390,078	12,599,591
Gifts for endowments	36,100	180,153
Federal Direct Lending receipts	9,012,902	8,834,062
Federal Direct Lending disbursements	(9,012,902)	(8,834,062)
Net cash provided by noncapital financing activities	12,426,178	12,779,744
Cash flows from capital and related financing activities		
Capital appropriations	731,273	963,510
Capital grants and gifts received	410,798	407,746
Purchases and construction of capital assets	(2,714,240)	(3,302,797)
Proceeds from interest rate swap transaction	-	839,000
Proceeds from capital lease	1,500,000	-
Proceeds from disposal of capital assets	21,491	76,708
Principal paid on capital debt and leases	(976,811)	(939,080)
Interest paid on capital debt and leases	(1,536,632)	(1,576,262)
Net cash used in capital and related financing activities	(2,564,121)	(3,531,175)
Cash flows from investing activities		
Proceeds from sales and maturities of investments	396	453,269
Purchases of investments	(460,775)	(1,335,016)
Interest on investments	590,570	315,948
Net cash provided by (used in) investing activities	130,191	(565,799)
Net increase (decrease) in cash and cash equivalents	742,784	(1,131,587)
Cash and cash equivalents, beginning of year	6,270,351	7,401,938
Cash and cash equivalents, end of year	\$ 7,013,135	\$ 6,270,351

The accompanying notes are an integral part of these financial statements.

LAKE SUPERIOR STATE UNIVERSITY

STATEMENTS OF CASH FLOWS

(Concluded)

Reconciliation of net operating loss to net cash used in operating activities	Year Ended June 30	
	2006	2005
Operating loss	\$ (14,863,049)	\$ (13,492,552)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation	5,349,098	4,486,318
Change in assets and liabilities:		
Accounts receivable, net	111,031	(15,063)
Student loans receivable, net	126,474	81,740
Inventories	(106,443)	128,930
Other	13,321	44,530
Accounts payable and accrued liabilities	290,829	(862,794)
Deferred revenue	(58,431)	(35,223)
Deposits	(1,108)	(28,726)
Employee benefit programs	(111,186)	(121,517)
Net cash used in operating activities	\$ (9,249,464)	\$ (9,814,357)
Supplemental disclosures of non-cash financing and investing activities		
Gifts in-kind received and recorded as capital assets	\$ 23,110	\$ 77,300
Entered into capital lease to purchase capital equipment	\$ 311,464	\$ 328,520
Statement of Net Assets Classification of Cash and cash equivalents		
Cash and cash equivalents	\$ 5,507,663	\$ 6,270,351
Restricted cash and cash equivalents	1,505,472	-
Cash and cash equivalents, end of year	\$ 7,013,135	\$ 6,270,351

The accompanying notes are an integral part of these financial statements.

LAKE SUPERIOR STATE UNIVERSITY FOUNDATION

STATEMENTS OF NET ASSETS

	June 30	
	2006	2005
Assets		
Cash and cash equivalents	\$ 1,143,718	\$ 1,245,765
Investments	3,928,298	3,411,343
Other current assets	572	37
Unconditional promises to give, net	201,269	240,904
Beneficial interest in charitable remainder trust	263,104	229,623
Total assets	\$ 5,536,961	\$ 5,127,672
Liabilities		
Accounts payable and accrued expenses	\$ 32,064	\$ 19,791
Employee benefit programs	21,961	22,342
Annuity obligations	67,455	70,093
Total liabilities	121,480	112,226
Net assets		
Unrestricted	988	53,856
Temporarily restricted	1,265,760	1,220,916
Permanently restricted	4,148,733	3,740,674
Total net assets	5,415,481	5,015,446
Total liabilities and net assets	\$ 5,536,961	\$ 5,127,672

The accompanying notes are an integral part of these financial statements.

LAKE SUPERIOR STATE UNIVERSITY FOUNDATION

STATEMENTS OF ACTIVITIES

	Year Ended June 30	
	2006	2005
Revenue and support		
Contributions	\$ 1,012,689	\$ 1,242,639
Investment income	223,089	148,031
Net unrealized gains on investments	188,828	132,441
Change in value of split interest agreements	37,537	77,765
Total revenue and support	1,462,143	1,600,876
LSSU distributions and expenses		
Distributions to Lake Superior State University	612,823	496,006
Operating expenses	449,285	362,850
Total LSSU distributions and expenses	1,062,108	858,856
Increase in net assets	400,035	742,020
Net assets, beginning of year	5,015,446	4,273,426
Net assets, end of year	\$ 5,415,481	\$ 5,015,446

The accompanying notes are an integral part of these financial statements.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Lake Superior State University (“the University”) is an institution of higher education and is considered a discrete component unit of the State of Michigan because its Board of Trustees is appointed by the Governor. Accordingly, the University's financial statements are included in those of the State. Transactions with the State of Michigan relate primarily to appropriations for operations, appropriations for charter schools, grants from various State agencies, State Building Authority (SBA) revenues and payments to the State retirement program on behalf of certain University employees.

As required by Governmental Accounting Standards Board Statement No. 39, the University's basic financial statements include the financial statements of both the University and its component unit, the Lake Superior State University Foundation (the “Foundation”) which is a legally separate tax-exempt component unit of the University. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation's Board of Directors includes members of the University's Board of Trustees, certain officers of the University and other community representatives elected by the Foundation Board. Although the University does not necessarily control the timing or amount of receipts from the Foundation, the majority of its resources or income earned thereon are restricted by the donors to the activities of the University. Because these restricted resources held by the Foundation can be used only by, or for the benefit of, the University, the Foundation is considered a component unit of the University. The Foundation financial statements are reported on separate pages to emphasize that a) it is legally separate from the University and b) its assets are not necessarily available to satisfy all liabilities of the University. However, the Foundation's financial position and activities are summarized with those of the University in the notes to the financial statements.

Contributions to the University by the Foundation (reported primarily as other revenues-capital gifts and grants) have been made in the amount of \$612,823 for fiscal 2006 and \$496,006 for fiscal 2005. Support from the University provided to the Foundation amounted to \$230,137 and \$274,546 during fiscal 2006 and 2005, respectively.

Basis of Presentation - University

The accompanying University financial statements have been prepared using the economic resource measurement focus and the accrual basis of accounting with the exception that certain investment income and interest earned on the Federal Perkins student loan program are recorded only when received.

In accordance with Governmental Accounting Standards Board (“GASB”) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and other Governmental Entities that Use Proprietary Fund Accounting*, 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

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

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.

In applying these accounting pronouncements, the University follows the guidance for special purpose governments engaged only in “business type” activities rather than issuing financial statements that focus on accountability of individual funds.

Basis of Presentation - Foundation

The Foundation is a nonprofit organization that reports under Financial Accounting Standards Board (FASB) standards, including FASB Statement No. 116, Accounting for Contributions Received and Contributions Made, and FASB Statement No. 117, Financial Reporting for Not-for-Profit Organizations. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. With the exception of necessary presentation adjustments, no modifications have been made to the Foundation’s financial information in the University’s financial report for these differences.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid investments, excluding noncurrent investments, with an original maturity when purchased of three months or less.

Restricted Cash and Cash Equivalents

Restricted cash and cash equivalents consist of capital lease proceeds that have been placed on deposit with a financial institution that are restricted to use on the central heating plant project.

University Endowment Investments / Investments

University endowment investments consist primarily of long-term mutual funds and are stated at fair value.

Foundation Investments

Foundation investments consist primarily of long-term mutual funds and are stated at fair value.

Inventories

Inventories, consisting primarily of supplies and petroleum products, are valued at cost (using the specific identification method) not in excess of market.

Capital Assets

Capital assets, consisting of institutional physical properties used in University operations, are stated at cost when purchased and at estimated fair value at date of receipt for other acquisitions. Building additions and improvements with a cost in excess of \$10,000 are capitalized if the life of the building is extended. Equipment with a cost in excess of \$2,500 with a useful life of 3 or more years is

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

capitalized. Certain maintenance and replacement reserves have been established to provide for significant repair and maintenance costs to residence halls and certain other facilities.

Depreciation is provided on a straight-line basis over the estimated useful life of the related capital assets as follows:

<u>Classification</u>	<u>Life</u>
Buildings	40 years
Land improvements	20 years
Infrastructure	20 years
Equipment	7 years
Personal computers	3 years
Library books	7 years
Vehicles	7 years

Revenue Recognition

Revenues are recognized when earned and expenses are recognized when the service is provided or when materials are received. Restricted grant revenue is recognized only to the extent expended. Operating revenues of the University consist of tuition and fees, grants and contracts, sales and services of educational activities and auxiliary enterprise revenues. Transactions related to capital and financing activities, noncapital financing activities, investing activities and State appropriations are components of nonoperating revenue. Restricted and unrestricted resources are allocated to the appropriate departments within the University which are responsible for adhering to any donor restrictions.

State appropriation revenue is recognized in the period for which it is appropriated.

During fiscal 2006 and 2005 the University received \$18,739,383 and \$14,914,236 (net of a 3% administrative fee retained by the University), respectively, of State appropriations which were forwarded to seven charter schools. The University also received \$100,000 in State appropriations for Bay Mills Community College during fiscal 2006 which were forwarded to Bay Mills Community College immediately upon receipt. Appropriations received and related disbursements passed on to the charter schools and Bay Mills Community College are considered agency transactions and, accordingly, are not reported in the accompanying financial statements.

Deferred Revenue

Deferred revenue consists primarily of advance payment for sports camps, room and board, sales for athletic events and summer school tuition not earned during the current year.

Income Taxes

The University is classified as a State instrumentality under Internal Revenue Code Section 115, and is also classified as a charitable organization under Internal Revenue Code section 501 (c) (1), and is therefore exempt from federal income taxes. Certain activities of the University may be subject to taxation as unrelated business income under Internal Revenue Code Sections 511 to 514. No such taxes were incurred for either fiscal year 2006 or 2005.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

The Foundation is also exempt from federal income taxes under Section 501(c) (3) and qualifies as a nonprofit foundation under Section 509 (a) (1) of the Internal Revenue Code. Accordingly, no provision for income taxes has been recorded in the accompanying financial statements.

Split-Interest Agreements

The Foundation's split-interest agreements with donors consist of irrevocable charitable remainder trusts for which the Foundation is a beneficiary. Contribution revenue was recognized at the date the trust was established based on the expected present value of the Foundation's interest in the trust assets. Changes in the value of the assets and other changes in the estimates of future receipts are recognized in the statement of activities of the Foundation.

Annuity Obligations Payable

The Foundation's annuity and life income agreements require payments during the life of the annuitant at various rates up to 7% of the principal amounts. The obligation for annuity obligations payable is reported at the present value of the future payments based on the life expectancy tables and an implied rate of discount of 5.8%. Changes in the value of annuity obligations payable are reported in the statement of activities of the Foundation.

2. CASH AND CASH EQUIVALENTS AND INVESTMENTS - UNIVERSITY

Cash and short-term investments - The University utilizes the "pooled cash" method of accounting for substantially all of its cash and short-term investments. Investment policies for cash and short-term investments, as set forth by the Board of Trustees, authorize the University to invest, with limitations, in commercial paper of companies with a rating within the two highest classifications of prime as established by at least one of the standard rating services. Investments may also be made in securities of the U.S. Treasury and federal agencies and in time savings accounts. Short-term investments are stated at fair value.

Investments - The Board of Trustees has authorized certain University administrators to invest in short, intermediate and long-term pools of investments, depending on the nature and need of funds. An established Board policy is followed for the investment of University funds. The primary investment objective for the investment pools is as follows:

- *Short-term investment pool* - to provide for the preservation of capital. Funds needed for expenditures in less than one year will be considered short-term.
- *Intermediate investment pool* - to provide for preservation of capital and maximization of income without undue exposure to risk. Funds needed for expenditures within one to five years will be considered intermediate term.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

- Long-term investment pool - to provide for long-term growth of principal and income without undo exposure to risk. Funds not needed for expenditures within five years will be considered long-term. The University's general policy toward the long-term investment pool shall be to diversify investments within both equity and fixed income securities so as to provide a balance that will enhance total return. The University invests with selected money managers as part of an institutional mutual fund or in segregated accounts.

Performance objectives for each pool of investments have been established to measure the total return of a manager against a comparable index, as well as the amount of risk the manager is taking. The University uses the service of outside investment counsel in providing performance measurements and asset allocation recommendations.

Reports are submitted to the Board of Trustees on an annual basis to ensure compliance with the prescribed policy.

Investment income and realized gains or losses are distributed using an average balance method on accounts designated to receive investment earnings. Unrealized gains or losses are distributed based on cash balances on June 30.

Cash and Cash Equivalents

University cash and cash equivalents consist of the following amounts at June 30:

	<u>2006</u>	<u>2005</u>
Disbursement accounts (deposits)	\$ 5,029,815	\$ 4,325,591
Money market funds	1,983,320	1,930,733
Equities	--	14,027
Total cash and cash equivalents	<u>\$ 7,013,135</u>	<u>\$ 6,270,351</u>

The University utilizes the "pooled" method of accounting for substantially all investments, which consisted of the following amounts at June 30:

	<u>2006</u>	<u>2005</u>
<u>University endowment investments</u>		
Mutual funds		
Equity funds	\$ 5,502,508	\$ 4,699,755
Bond/fixed income funds	<u>1,613,447</u>	<u>1,559,080</u>
Total University endowment investments	<u>7,115,955</u>	<u>6,258,835</u>

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

	2006	2005
<u>University investments</u>		
Mutual funds		
Money market funds	2,961	126,414
Equity funds	651,358	508,891
Bond/fixed income funds	256,358	212,456
Total University investments	910,677	847,761
Total investments	\$ 8,026,632	\$ 7,106,596

Interest Rate Risk – The University’s investment policy does not limit investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The maturity dates for each investment type (including investment types classified as cash and cash equivalents) susceptible to interest rate risk are identified below for investments held at year end.

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

	Maturities (in Years)			
	Fair Market Value	Less Than 1	1-5	6-10
Government money market funds	\$ 1,986,281	\$ 1,986,281	\$ -	\$ -
Mutual bond funds	1,869,805	-	-	1,869,805
Total debt investments	\$ 3,856,086	\$ 1,986,281	\$ -	\$ 1,869,805

As of June 30, 2005, the University had the following debt investments and maturities:

	Maturities (in Years)			
	Fair Market Value	Less Than 1	1-5	6-10
Government money market funds	\$ 2,057,147	\$ 2,057,147	\$ -	\$ -
Mutual bond funds	1,771,536	-	-	1,771,536
Total debt investments	\$ 3,828,683	\$ 2,057,147	\$ -	\$ 1,771,536

Credit Risk - State law limits investments to specific government securities, certificates of deposits and bank accounts with qualified financial institutions, commercial paper with specific maximum maturities and ratings when purchased and qualified mutual funds. The University’s investment policy does not have specific limits in excess of state law on investment credit risk.

Custodial Credit Risk – Deposits - Custodial credit risk is the risk that in the event of a bank failure, the University’s deposits may not be returned. State law does not require a policy for deposit custodial credit risk. The University believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits. As a

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

result, management evaluates each financial institution it deposits University funds with and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories. As of year-end, \$7,230,619 of the University's bank balance of \$7,430,619 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Custodial Credit Risk – Investments - 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. State law does not require and the University does not have a policy for investment custodial credit risk. Custodial credit risk for the University's mutual fund investments cannot be determined as these investments are not evidenced by specifically identifiable securities.

Concentration of Credit Risk - State law limits allowable investments but does not limit concentration of credit risk. The University's investment policy does not have specific limits in excess of state law on concentration of credit risk. None of the investments held by the University exceeds 5 percent of the University's investments.

Foreign Currency Risk – The University's exposure to foreign currency risk is derived from its positions in international investments consisting solely of foreign currency denominated mutual fund equity investments. The University's investment policy permits it to invest in these asset types. At June 30, 2006 the University held 29,471 units of the EuroPacific Growth Fund Class F (Security identifier: AEGFX) with a fair value of \$1,289,344. The University holds no other assets which may be subject to the risks of foreign currency.

There is no foreign currency risk with any holdings under the caption "cash and cash equivalents" in the accompanying statements of net assets and all international investments are equity investments held through mutual funds.

Policies regarding marketable securities in the University endowment investments, as set forth by the Board of Trustees, authorize the investment manager to invest in high-grade equities, bonds or other marketable securities. The University endowment income spending policy is 100% of the cash earnings of each endowment. The annual spending income allocation cannot reduce the original gift principal. The spending policy is reviewed periodically by the finance committee, which recommends changes to the Board of Trustees. The net appreciation on investments of donor-restricted endowments approximated \$1,173,000 and \$736,000 at June 30, 2006 and 2005, respectively. The net appreciation is a component of restricted, expendable net assets. The yields of the University endowment investments were as follows for the year ended June 30:

	<u>2006</u>	<u>2005</u>
Interest and dividends	4.2 %	1.7 %
Net realized and unrealized gains	6.8	6.7
Total return	<u>11.0%</u>	<u>8.4%</u>

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

According to the law of the State of Michigan, the Board of Trustees may appropriate for expenditure for the uses and purposes for which an endowment is established an allocation of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment over the historic dollar value as is prudent under the facts and circumstances prevailing at the time of the action or decision.

3. INVESTMENTS - FOUNDATION

The Foundation also utilizes the "pooled" method of accounting for substantially all investments, which consisted of the following amounts at June 30:

	<u>2006</u>	<u>2005</u>
Mutual funds		
Money market funds	\$ 18	\$ 100,067
Equity funds	2,828,313	2,487,239
Bond/fixed income funds	<u>1,090,587</u>	<u>813,812</u>
Subtotal	3,918,918	3,401,118
Marketable securities	<u>9,380</u>	<u>10,225</u>
Total Foundation investments	<u>\$ 3,928,298</u>	<u>\$ 3,411,343</u>

4. ACCOUNTS, STATE APPROPRIATIONS AND STUDENT LOAN RECEIVABLES

Accounts receivable result primarily from student tuition and fee billings and auxiliary enterprise sales, such as food service and student residence. In addition, receivables arise from grant awards, financial aid and State Building Authority ("SBA") revenues. These receivables are reported net of an allowance for collection losses in the amount of \$523,935 and \$361,186 at June 30, 2006 and 2005, respectively.

University accounts receivable consist of the following net amounts at June 30:

	<u>2006</u>	<u>2005</u>
Tuition and fees	\$ 278,398	\$ 257,246
Auxiliary activities	170,737	129,899
Governmental grants and contracts	397,258	544,932
Private grants and contracts	12,641	3,674
Other	<u>34,132</u>	<u>79,685</u>
Accounts receivable, net	<u>\$ 893,166</u>	<u>\$ 1,015,436</u>

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Based on Senate Bill 905, PA 273 of 1998, State appropriations are recorded on the accrual basis, when earned. As a result, the University recorded State appropriations receivable in the following amounts at June 30:

	<u>2006</u>	<u>2005</u>
State appropriations - operations	\$ 2,277,200	\$ 2,206,062
State appropriations - other	<u> --</u>	<u> 295,799</u>
Total State appropriations receivable	<u>\$ 2,277,200</u>	<u>\$ 2,501,861</u>

In addition, the University has student loans receivable, in the amount of \$2,512,293 and \$2,638,767, which are recorded net of an allowance for uncollectible loans of \$326,411 and \$265,534 as of June 30, 2006 and 2005, respectively. Approximately 80% of student loans receivable are expected to be collected in periods beyond one year.

5. PROMISES RECEIVABLE

The following is a summary of promises receivable for the Foundation as of June 30:

	<u>2006</u>	<u>2005</u>
Total promises receivable	\$ 332,904	\$ 389,889
Less discounts to net present value at 8%	<u> 122,124</u>	<u> 132,277</u>
Present value of promises receivable	210,780	257,612
Less allowance for uncollectible amounts	<u> 9,511</u>	<u> 16,708</u>
Net promises receivable	<u>\$ 201,269</u>	<u>\$ 240,904</u>

6. CHARITABLE REMAINDER TRUST

A donor having a charitable remainder unitrust managed by a third party named the Foundation as the remainder beneficiary. Under the terms of the split-interest agreement, the third party trustee must pay to the donor in each taxable year of the trust during the donor's life the lesser of the trust income for the taxable year or five percent (5%) of the net fair market value of the assets of the trust valued as of the first day of each taxable year of the trust. At the time of the donor's death, the trust is to terminate, and the remaining trust assets are to be distributed to the Foundation.

At June 30, 2006 and 2005 based on the donor's life expectancy and an assumed 5.8% discount rate, the present value of the future benefits expected to be received by the Foundation were estimated to be \$263,104 and \$229,623, respectively.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

7. CAPITAL ASSETS

Changes in the components of capital assets are as follows for the years ended June 30:

	2006			Balance June 30, 2006
	Balance July 1, 2005	Additions	Reductions	
Capital assets not being depreciated				
Land - restricted	\$ 838,684	\$ --	\$ --	\$ 838,684
Land	1,164,644	--	(29,300)	1,135,344
Art collection	542,475	--	--	542,475
Construction-in-progress	<u>17,294,570</u>	<u>1,701,111</u>	<u>(14,832,176)</u>	<u>4,163,505</u>
Total capital assets not being depreciated	<u>19,840,373</u>	<u>1,701,111</u>	<u>(14,861,476)</u>	<u>6,680,008</u>
Capital assets being depreciated				
Land improvements	5,424,733	--	--	5,424,733
Infrastructure	1,364,888	70,622	--	1,435,510
Building and building improvements	97,921,092	14,902,371	--	112,823,463
Equipment and other	<u>17,687,047</u>	<u>1,359,160</u>	<u>(4,885,408)</u>	<u>14,160,799</u>
Total capital assets being depreciated	122,397,760	16,332,153	(4,885,408)	133,844,505
Less accumulated depreciation	<u>(65,706,691)</u>	<u>(5,349,098)</u>	<u>4,720,473</u>	<u>(66,335,316)</u>
Total capital assets being depreciated, net	<u>56,691,069</u>	<u>10,983,055</u>	<u>(164,935)</u>	<u>67,509,189</u>
Total capital assets, net	<u>\$ 76,531,442</u>	<u>\$ 12,684,166</u>	<u>\$(15,026,411)</u>	<u>\$ 74,189,197</u>

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

	2005			Balance June 30, 2005
	Balance July 1, 2004	Additions	Reductions	
Capital assets not being depreciated				
Land - restricted	\$ 838,684	\$ --	\$ --	\$ 838,684
Land	1,186,744	--	(22,100)	1,164,644
Art collection	542,475	--	--	542,475
Construction-in-progress	<u>14,752,821</u>	<u>2,541,749</u>	<u>--</u>	<u>17,294,570</u>
Total capital assets not being depreciated	<u>17,320,724</u>	<u>2,541,749</u>	<u>22,100</u>	<u>19,840,373</u>
Capital assets being depreciated				
Land improvements	5,424,733	--	--	5,424,733
Infrastructure	1,343,648	21,240	--	1,364,888
Building and building improvements	97,841,105	94,987	(15,000)	97,921,092
Equipment and other	<u>17,140,900</u>	<u>1,050,641</u>	<u>(504,494)</u>	<u>17,687,047</u>
Total capital assets being depreciated	121,750,386	1,166,868	(519,494)	122,397,760
Less accumulated depreciation	<u>(61,690,764)</u>	<u>(4,486,318)</u>	<u>470,391</u>	<u>(65,706,691)</u>
Total capital assets being depreciated, net	<u>60,059,622</u>	<u>(3,319,450)</u>	<u>(49,103)</u>	<u>56,691,069</u>
Total capital assets, net	<u>\$ 77,380,346</u>	<u>\$ (777,701)</u>	<u>\$ (71,203)</u>	<u>\$ 76,531,442</u>

At June 30, 2006, construction-in-progress consists of work performed on four projects; the Banner software implementation, the electrical loop upgrade, the network fiber upgrade and extension, and the Central Heating Plant boiler replacement project. The anticipated completion dates for the projects are: June 2007, October 2006, January 2007 and January 2007, respectively.

Construction-in-progress

Estimated cost of construction	\$ 6,069,566
Costs incurred through June 30, 2006	<u>4,163,505</u>
Estimated cost to complete	<u>\$ 1,906,061</u>
Expected sources of financing:	
State funds	\$ 163,100
University funds and other sources	<u>1,742,961</u>
Total	<u>\$ 1,906,061</u>

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

University accounts payable and accrued expenses consisted of the following liabilities at June 30:

	<u>2006</u>	<u>2005</u>
Accounts payable to vendors	\$ 632,782	\$ 595,798
Payroll and payroll taxes	1,067,067	813,222
Interest	179,676	192,057
Workers' compensation claims	<u>145,000</u>	<u>145,000</u>
Total accounts payable and accrued expenses	<u>\$ 2,024,525</u>	<u>\$ 1,746,077</u>

Worker's Compensation

The University is self-insured for workers' compensation claims up to \$500,000 per claim. The accrued workers' compensation obligation represents claims made prior to June 30, 2006 and 2005, which remain unpaid at those dates. The University's third party administrator bases these amounts upon an analysis of workers' compensation claims, which includes historical incident rates and other related factors.

Changes in the workers' compensation claims liability are summarized as follows for the years ended June 30:

	<u>2006</u>	<u>2005</u>
Claims liability at beginning of year	\$ 145,000	\$ 383,927
Claims and damages incurred	117,091	132,403
Claims payments	<u>(117,091)</u>	<u>(371,330)</u>
Claims liability at end of year	<u>\$ 145,000</u>	<u>\$ 145,000</u>

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

9. LONG-TERM DEBT

Changes in the components of long term debt are as follows for the years ended June 30:

	Interest Rate	Maturity	2006				
			July 1 2005	Outstanding Principal		June 30 2006	Current Portion
				Additions	Reductions		
Bonds payable							
General Revenue							
Bonds, Series 2001							
Series bonds	4.00%-5.00%	2007-2017	\$ 4,510,000	\$ --	\$ 295,000	\$ 4,215,000	\$ 305,000
Term bonds	5.125%-5.5%	2018-2031	16,525,000	--	--	16,525,000	--
General Revenue							
Bonds, Series 1997							
Series bonds	4.80%-5.00%	2007-2010	2,370,000	--	575,000	1,795,000	575,000
Term bonds	5.00%-5.125%	2012-2019	<u>6,805,000</u>	--	--	<u>6,805,000</u>	--
Total –bonds payable			30,210,000	--	870,000	29,340,000	880,000
Capital leases			<u>366,989</u>	<u>1,811,464</u>	<u>106,811</u>	<u>2,071,642</u>	<u>205,358</u>
Total – long-term debt			<u>\$ 30,576,989</u>	<u>\$ 1,811,464</u>	<u>\$ 976,811</u>	31,411,642	<u>\$1,085,358</u>
Less current portion						<u>1,085,358</u>	
Long-term debt, net of current portion						<u>\$ 30,326,284</u>	

	Interest Rate	Maturity	2005				
			July 1 2004	Outstanding Principal		June 30 2005	Current Portion
				Additions	Reductions		
Bonds payable							
General Revenue							
Bonds, Series 2001							
Series bonds	4.00%-5.00%	2006-2017	\$ 4,795,000	\$ --	\$ 285,000	\$ 4,510,000	\$ 295,000
Term bonds	5.125%-5.5%	2018-2031	16,525,000	--	--	16,525,000	--
General Revenue							
Bonds, Series 1997							
Series bonds	4.40%-5.00%	2006-2010	2,890,000	--	520,000	2,370,000	575,000
Term bonds	5.00%-5.125%	2012-2019	<u>6,805,000</u>	--	--	<u>6,805,000</u>	--
Total –bonds payable			31,015,000	--	805,000	30,210,000	870,000
Capital leases			<u>172,549</u>	<u>328,520</u>	<u>134,080</u>	<u>366,989</u>	<u>91,035</u>
Total – long-term debt			<u>\$ 31,187,549</u>	<u>\$ 328,520</u>	<u>\$ 939,080</u>	30,576,989	<u>\$961,035</u>
Less current portion						<u>961,035</u>	
Long-term debt, net of current portion						<u>\$ 29,615,954</u>	

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Bonded Debt

General Revenue Bonds, Series 2001

As of June 30, 2006, bonds payable in the amount of \$20,740,000 are payable from general revenues and consist of \$4,215,000 in serial bonds maturing in varying amounts through November 2017, with interest charged at annual rates ranging from 4% to 5%. Also, four term bonds are outstanding in the amounts of \$1,170,000, \$2,700,000, \$5,535,000 and \$7,120,000, respectively. The term bonds mature in November 2018, 2021, 2026 and 2031 and accrue interest at 5.125%, 5.5%, 5.125% and 5.25%, respectively. All of the bonds are callable after November 15, 2012. The serial and term bonds were issued under the same official statement dated May 15, 2001.

General Revenue Bonds, Series 1997

As of June 30, 2006, bonds payable in the amount of \$8,600,000 are payable from general revenues and consist of \$1,795,000 in serial bonds maturing in varying amounts through November 2008, with interest charged at annual rates ranging from 4.8% to 5%. Also, two term bonds are outstanding in the amounts of \$2,835,000 and \$3,970,000, respectively. The term bonds mature in November 2012 and 2019 and accrue interest at 5.00% and 5.125%, respectively. All the bonds are callable after November 15, 2008. The serial and term bonds were issued under the same official statement dated November 1, 1997.

Debt Service Requirements

Principal and interest on the bonds are payable only from certain general revenues. The following table summarizes debt service requirements by years of scheduled maturity:

<u>Year ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 880,000	1,475,418	2,355,418
2008	915,000	1,433,668	2,348,668
2009	955,000	1,390,628	2,345,628
2010	1,005,000	1,345,118	2,350,118
2011	1,050,000	1,296,383	2,346,383
2012-2016	6,080,000	5,621,842	11,701,842
2017-2021	4,850,000	4,220,644	9,070,644
2022-2026	5,260,000	2,885,788	8,145,788
2027-2031	6,775,000	1,336,017	8,111,017
2032	<u>1,570,000</u>	<u>41,213</u>	<u>1,611,213</u>
Total – bonds payable	<u>\$29,340,000</u>	<u>\$21,046,719</u>	<u>\$50,386,719</u>

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Defeased Bonds

In May 2001, the University issued \$21,850,000 of General Revenue Bonds, Series 2001 with yields ranging from 3.1% to 5.43%. A portion of the proceeds were used to refund and defease a portion of the Board's General Revenue Bonds, Series 1997 maturing at varying amounts each November 15 through 2019 in the amount of \$8,160,000. The outstanding balance for these defeased bonds was \$6,310,000 and \$6,735,000 as of June 30, 2006 and 2005, respectively.

Interest Rate Swap

On April 12, 2005, the University entered into a twenty-six year forward-looking basis interest rate swap agreement for a notional amount of \$20,115,000. The intention of the swap was to effectively change the fixed interest rate on the University's bonds to a variable rate. The effective date of the swap agreement is May 15, 2008. The stated maturity date of the swap is November 15, 2031.

Under the terms of the swap agreement, the University will pay interest based on the Bond Market Association ("BMA") rate. In return, the University will receive interest calculated at the outstanding notional amount times 68% of the one-month London Interbank Offered Rate ("LIBOR"). Only the net difference in interest payments will be actually exchanged each month. The University will continue to pay interest to the bondholders at the fixed rate on the outstanding bonds. However, during the term of the swap agreement, the University effectively pays a variable rate on the debt based on the economics of the swap agreement. The swap exposes the University to basis risk should the relationship between LIBOR, BMA and the fixed interest rate on the outstanding bonds diverge changing the effective fixed rate of the bonds. As of June 30, 2006, 68% of the one-month LIBOR was 3.64% whereas the BMA rate was 3.97%.

When the swap transaction was initiated, the University received a payment from the issuer in the amount of \$839,000, which is included in the accompanying statements of net assets at June 30, 2006 and 2005 under the caption "Investments". Since the University can terminate the swap agreement at its option prior to the effective date, under which circumstance a termination payment would be required, this amount is also included as a liability under the caption "Interest rate swap liability" in the accompanying statements of net assets at June 30, 2006 and 2005. As of June 30, 2006, the fair value of the required termination payment is \$1,053,255 which represents the amount that the University would be required to pay as of June 30, 2006 if the swap was terminated. The University does not intend to terminate the swap agreement.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Obligations Under Capital Leases

The University leases certain equipment with a net book value of \$805,677 at June 30, 2006 under lease agreements which meet the capitalization criteria specified by generally accepted accounting principles.

The following is a schedule of annual future minimum lease payments required under capitalized leases obligations as of June 30, 2006:

<u>Year ending June 30</u>	<u>Amount</u>
2007	\$ 315,341
2008	350,736
2009	337,551
2010	336,551
2011	320,717
After 2011	<u>885,370</u>
Total minimum payments due	2,546,266
Less amounts representing interest, imputed at annual rates ranging from 5.0% to 7.0%	<u>474,624</u>
Present value of net minimum lease payments	<u>\$2,071,642</u>

Commitments and related rental expenses under operating leases with initial or remaining non-cancelable lease terms in excess of one year as of and for the years ended June 30, 2006 and 2005 are insignificant.

10. EMPLOYEE RETIREMENT PLANS AND OTHER POSTEMPLOYMENT BENEFITS

Pension Plan

The University provides noncontributory retirement plans for all qualified employees. In December 1995, the State enacted Public Act 272 of 1995 that precludes University employees hired after January 1, 1996 from participating in the Michigan Public School Employees Retirement System (MPSERS). MPSERS and the Teachers Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF) were the two retirement plans offered by the University to its eligible employees. Employees currently covered under the MPSERS plan will continue to remain in that plan. The University will contribute to MPSERS the percentage mandated by state statute of their eligible wages.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Employees represented by the United Steelworkers of America, Local 997 hired after January 1, 1996, faculty and administrative employees are eligible for the TIAA-CREF plan. TIAA-CREF is a defined contribution plan where the University contributes an amount equal to 12.0 percent of administrative and faculty group employees' pay, and 10.0 percent of Steelworkers employees' pay. The University contributed approximately \$1,253,000 and \$1,228,000 to this plan for the years ended June 30, 2006 and 2005, respectively. Plan participants maintain individual annuity contracts with TIAA-CREF, the plan administrator, which are fully vested. All eligible employees hired after January 1, 1996 elected TIAA-CREF.

Plan provisions and contribution requirements of the TIAA-CREF plan are established and may be amended by the University's Board of Trustees.

MPSERS is a noncontributory cost-sharing multiple-employer defined benefit plan administered by the Michigan State Employees' Retirement System. The cost of the MPSERS plan allocated to the University was approximately \$1,254,000, \$1,094,000 and \$974,000, for the years ended June 30, 2006, 2005 and 2004, respectively, all of which was contributed during the applicable year.

Beginning October 1, 2006 the University is required to contribute 6.38% (6.30% during the period of October 1, 2005 through September 30, 2006) of MPSERS covered payroll for normal pension costs and 6.85% (3.65% during the period of October 1, 2005 through September 30, 2006) for unfunded pension liability. In addition, separately computed supplemental contributions will be required for retiree health care benefits. Future contribution requirements, which depend on the level of MPSERS covered payroll, cannot be determined. Additional pension data for MPSERS is contained in MPSERS's comprehensive Annual Financial Report, which may be obtained by writing to the Office of Retirement Systems, 7150 Harris Dr., P. O. Box 30026, Lansing, MI 48901.

Benefit provisions and contribution requirements of MPSERS are established and may be amended by state statute.

Compensated Absences

The University has a policy to pay eligible employees for their unused accumulated vacation, up to a maximum of 288 hours, upon termination of employment with the University.

Accumulated Sick Leave Benefits

The University has a policy to pay eligible employees for their unused accumulated sick leave, up to a maximum of 800 hours, at retirement from the University, if the employee has met certain vesting and age requirements at that date. Employees in the Faculty and Administrative and Professional groups hired after June 30, 1987 and employees in the Educational Support Personnel group hired after December 31, 1989 are not eligible for participation in the program.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Deferred Compensation

The University has deferred compensation agreements for certain employees which call for the University to fund a specified amount each year into an investment vehicle selected by the participant. Upon fulfillment of the deferred compensation agreement, the balances accumulated in these accounts will be disbursed to the employee. Each agreement has an investment equal to the liability, which is included with cash and cash equivalents on the accompanying statements of net assets. As of June 30, 2006 the requirements of all deferred compensation agreements have been satisfied.

Early Retirement Severance Program

During the year ended June 30, 2000, twenty-two faculty members elected to participate in a early retirement severance incentive program (the "program") offered by the University. The University is required to make payments to each participant as directed by the contract entered into under the program. The University does not fund the program under a formal plan. However, beginning in January 2000, the University began funding the program with current operating cash or investments. Amounts paid under the terms of the program during the years ended June 30, 2006 and 2005, respectively, amounted to \$144,795 and \$188,292 to reduce the liability and \$16,550 and \$11,786 which was recorded as additional salary expense.

Activity in University accrued employee benefit programs is summarized below for the years ended June 30:

	2006				
	July 1 2005	Additions	Payments	June 30 2006	Current Portion
Compensated absences	\$ 617,510	\$ 53,175	\$ 54,797	\$ 615,889	\$ 60,000
Accumulated sick leave benefits	670,824	142,000	109,228	703,596	100,000
Deferred compensation	14,091	--	14,091	--	--
Early retirement severance program	432,171	16,550	144,795	303,925	118,088
Total employee benefit programs	\$ 1,734,596	\$ 211,725	\$ 322,911	\$ 1,623,410	\$ 278,088
	2005				
	July 1 2004	Additions	Payments	June 30 2005	Current Portion
Compensated absences	\$ 633,608	\$ 39,913	\$ 56,011	\$ 617,510	\$ 60,000
Accumulated sick leave benefits	604,079	142,000	75,255	670,824	80,000
Deferred compensation	9,749	4,342	--	14,091	14,091
Early retirement severance program	608,677	11,786	188,292	432,171	151,724
Total employee benefit programs	\$ 1,856,113	\$ 198,041	\$ 319,558	\$ 1,734,596	\$ 305,815

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

Post Employment Health Benefits

The University provides post-retirement health benefits, per the requirements of the University's personnel policy and union contracts. Retirees are required to pay all monthly premiums. As the University is self-insured (see Note 11), the University provides coverage for up to a maximum of \$75,000 for each health insurance claim and purchases commercial insurance for health insurance claims in excess of coverage provided. At June 30, 2006, 20 retirees were receiving post-employment health benefits. Benefit payments made for the years ended June 30, 2006 and 2005 were \$247,995 and \$226,897, respectively.

11. SELF INSURANCE

Liability and Property

The University participates with 10 other Michigan universities in the Michigan Universities Self-Insurance Corporation ("MUSIC"). MUSIC's purpose is to provide indemnity to members against auto, comprehensive general liability, errors and omissions and property losses commonly covered by insurance. MUSIC also provides risk management and loss control services and programs.

Loss coverages are structured on a three-layer basis with each member retaining a portion of its losses, MUSIC covering the second layer of losses and commercial carriers covering the third layer. Comprehensive general liability coverage is provided on an occurrence basis; errors and omissions coverage is provided on a claims-made basis.

Premiums are assessed annually for (1) insurance risks retained by MUSIC, (2) costs related to excess coverage and (3) general and administrative expenses. The amount assessed reflects the claims experience of each University.

Insurance Reserves

The University provides coverage for up to a maximum of \$500,000 for each workers' compensation claim and \$75,000 for each health insurance claim. The University purchases commercial insurance for workers' compensation and health insurance claims in excess of coverage provided by the self insurance reserves. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years.

The University reserves an amount within unrestricted net assets for health and maintenance reserves and records a liability for workers' compensation insurance. These reserves are determined by MUSIC for losses relating to catastrophes. These reserves amounted to \$1,446,213 and \$1,556,817 at June 30, 2006 and 2005, respectively. The workers' compensation claims liability of \$145,000 at June 30, 2006 and 2005, which is included in accounts payable and accrued expenses, is based on the requirements of GASB Statement No. 10, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Health insurance claims incurred but not reported at June 30, 2006 were not significant and, accordingly, a related liability has not been recorded in the accompanying financial statements.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

12. CONTINGENCIES AND COMMITMENTS

Union Contracts

The University has three groups of employees, two of which are covered under union collective bargaining agreements. The employee groups covered and the expiration of the contracts are as follows:

<u>Employee Group</u>	<u>Union Name</u>	<u>Contract Expires</u>
Support Personnel	United Steelworkers of America	September 30, 2009
Faculty	Michigan Education Association/ National Education Association	August 31, 2007
Administrative and Professional	N/A	N/A

Legal Matters

In the normal course of its activities, the University is a party to various legal and administrative actions. Although some actions have been brought for substantial amounts, the University has not experienced significant losses or costs. After taking into consideration legal counsel's evaluation of pending actions and information relative to potential future claims based on past events, University management is of the opinion that the outcome thereof will not have a material effect on the financial statements.

MPSERS Unfunded Liability

Certain employees of the University are covered under the MPSERS retirement plan. As of June 30, 2006 and 2005 the unfunded portion of the related pension benefits is significant. The University's portion of this obligation is not determinable at June 30, 2006 or 2005. While the University has continued to pay the required monthly payments as determined by MPSERS, it is management's position that the University is not responsible for any shortfall in the fund as a result of changes in benefits made by MPSERS.

LAKE SUPERIOR STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

13. NATURAL CLASSIFICATION OF EXPENSES

Operating expenses by natural classification for the University are summarized as follows for the years ended June 30:

2006							
	Salaries, Wages, Benefits	Supplies and Equipment	Utilities	Scholarship Expenses	Depreciation	Other	Total
Instruction	\$ 10,629,594	1,048,162	\$ --	\$ --	\$ --	\$ --	\$ 11,677,756
Research	330,199	149,210	--	--	--	--	479,409
Public service	360,486	321,421	--	--	--	--	681,907
Academic support	1,975,462	524,629	--	--	--	--	2,500,091
Student services	1,751,312	398,962	--	--	--	--	2,150,274
Student aid	--	--	--	1,489,507	--	--	1,489,507
Institutional support	3,107,997	1,635,599	--	--	--	--	4,743,596
Plant operations	2,254,989	563,365	1,521,566	--	--	--	4,339,920
Auxiliary activities	3,550,654	2,709,293	1,189,824	--	--	--	7,449,771
Depreciation	--	--	--	--	5,349,098	--	5,349,098
Other	--	--	--	--	--	832,772	832,772
Total operating expenses	\$ 23,960,693	\$ 7,350,641	\$ 2,711,390	\$ 1,489,507	\$ 5,349,098	\$ 832,772	\$ 41,694,101

2005							
	Salaries, Wages, Benefits	Supplies and Equipment	Utilities	Scholarship Expenses	Depreciation	Other	Total
Instruction	\$ 10,779,266	\$ 1,339,365	\$ --	\$ --	\$ --	\$ --	\$ 12,118,631
Research	294,239	156,350	--	--	--	--	450,589
Public service	473,204	269,602	--	--	--	--	742,806
Academic support	1,903,273	474,819	--	--	--	--	2,378,092
Student services	1,415,079	464,290	--	--	--	--	1,879,369
Student aid	--	--	--	1,620,258	--	--	1,620,258
Institutional support	2,922,351	1,408,789	--	--	--	--	4,331,140
Plant operations	2,108,492	461,377	1,337,552	--	--	--	3,907,421
Auxiliary activities	3,478,806	2,823,761	1,003,241	--	--	--	7,305,808
Depreciation	--	--	--	--	4,486,318	--	4,486,318
Other	--	--	--	--	--	339,679	339,679
Total operating expenses	\$ 23,374,710	\$ 7,398,353	\$ 2,340,793	\$ 1,620,258	\$ 4,486,318	\$ 339,679	\$ 39,560,111

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