NORTHERN MICHIGAN UNIVERSITY
Statements of Net Assets

DRAFT

	Northern Michigan University June 30		Component Unit Northern Michigan University Development Fund June 30	
ASSETS	**2004**	**2003**	**2004**	**2003**
Current Assets:				
Cash and cash equivalents	$ 11,539,443	$ 26,859,260	$ 348,120	$ 1,322,728
State appropriation receivable	16,625,760	9,011,707		
Accounts receivable (less allowance 2004--$1,557,879; 2003--$1,021,970)	6,894,104	6,457,354	52,597	973,033
Student notes receivable (less allowance 2004--$333,970; 2003$235,403)	1,838,000	1,748,036		
Investment receivable	62,762	78,737		
Pledges receivable (less allowance 2004--$38,253; 2003--$51,731)			677,792	868,813
Inventories	1,298,428	1,357,137	2,940	2,898
Other assets	1,084,472	972,352	146,213	134,743
Total current assets	39,342,969	46,484,583	1,227,662	3,302,215
Noncurrent Assets:				
Long-term investments	26,068,128	19,477,866	18,775,908	14,513,329
Student notes receivable (less allowance 2004--$1,001,912; 2003--$982,935)	7,292,096	7,351,753		
Other long-term investments	1,094,962	1,094,962		
Pledges receivable (less allowance 2004--$16,550; 2003--$8,527)			1,214,986	839,969
Capital assets, net	200,015,956	181,412,624	3,543	5,897
Total noncurrent assets	234,471,142	209,337,205	19,994,437	15,359,195
Total assets	273,814,111	255,821,788	21,222,099	18,661,410
LIABILITIES				
Current Liabilities:				
Accounts payable and accrued liabilities	6,745,439	5,629,966	698,407	521,377
Accrued payroll and benefits	6,969,930	6,619,239		
Deferred revenue (unearned student fees and deposits)	3,316,818	2,972,282		
Long-term liabilities-current portion	3,261,839	3,005,343		
Total current liabilities	20,294,026	18,226,830	698,407	521,377
Noncurrent Liabilities:				
Annuities payable			536,437	600,531
Long-term liabilities	77,635,761	79,947,718		
Total noncurrent liabilities	77,635,761	79,947,718	536,437	600,531
Total liabilities	97,929,787	98,174,548	1,234,844	1,121,908
NET ASSETS				
Invested in capital assets, net of related debt	137,306,849	122,437,622	3,543	5,897
Restricted for				
Nonexpendable				
Scholarships and fellowships	107,515	175,540		5,042,366
Loans	45,528	39,602		
Instruction	613,455	529,690		
Expendable				
Instruction	485,314	421,914		5,701,240
Scholarships and fellowships	422,283	341,135		5,586,017
Loans	2,531,201	2,466,586		
Research	33,999	31,711		
Academic, student and public service	59,679	44,924		249,852
Unrestricted	34,278,501	31,158,516	19,983,712	954,630
Total net assets	$175,884,324	$157,647,240	$19,987,255	$17,540,002

See notes to financial statements.

NORTHERN MICHIGAN UNIVERSITY
Statements of Revenues, Expenses, and Changes in Net Assets

DRAFT

	Northern Michigan University June 30		Component Unit Northern Michigan University Development Fund June 30	
REVENUES	**2004**	**2003**	**2004**	**2003**
Operating Revenues				
Student tuition and fees (less allowance 2004--$11,068,706; 2003--$9,966,545)	$ 37,348,387	$ 31,963,965		
Gifts and contributions			$ 2,053,537	$ 3,144,049
Endowment income				
Federal grants and contracts	11,211,593	10,603,463		
State and local grants and contracts	5,162,662	6,579,226		
Nongovernmental grants and contracts	949,236	504,359		
Sales and services of educational activities	7,907,489	6,883,003		
Auxiliary enterprise:				
Residential life (less allowance 2004--$3,240,633; 2003--$3,257,043)	11,823,528	11,262,283		
Other auxiliary	5,402,343	5,212,833		
Other operating revenues	232,173	248,066	158,173	98,381
Total operating revenues	80,037,411	73,257,198	2,211,710	3,242,430
EXPENSES				
Operating Expenses				
Educational and general:				
Instruction	32,796,633	32,925,722	672,568	702,435
Research	1,186,490	1,109,048		
Public Service	9,837,958	10,338,377	350,709	639,117
Academic support	12,456,097	13,025,847		
Student services	11,552,583	11,770,627	171,709	119,292
Institutional support	9,843,889	11,330,182	573,581	407,517
Operations and maintenance of plant	11,850,455	13,496,990		
Student Aid	7,808,262	6,948,355	343,246	411,000
Fundraising			464,713	731,467
Depreciation	8,389,664	7,555,915		
Auxiliary enterprise:				
Residential life	11,001,606	9,972,626		
Other	6,175,717	5,457,250		
Other expenses	293,128	203,287		
Total operating expenses	123,192,482	124,134,226	2,576,526	3,010,828
Operating loss	(43,155,071)	(50,877,028)	(364,816)	231,602
NON-OPERATING REVENUES (EXPENSES)				
Transfers				
State appropriations	44,824,131	50,192,382		
Gifts	1,624,186	2,173,804	424,565	717,738
Investment income (net of investment expense 2004--$110,765; 2003--$54,699)	2,071,011	953,362	2,387,504	502,145
Interest on capital asset-related debt	(2,695,869)	(2,747,801)		
Net non-operating revenues and expenses	45,823,459	50,571,747	2,812,069	1,219,883
Income (loss) before other revenues	2,668,388	(305,281)	2,447,253	1,451,485
Capital appropriations	15,224,642	727,642		
Capital grants and gifts	344,054	710,396		(445,932)
Additions to permanent endowments				
Total other revenues	15,568,696	1,438,038		(445,932)
Increase in net assets	18,237,084	1,132,757	2,447,253	1,005,553
NET ASSETS				
Net assets--beginning of year	157,647,240	163,127,098	17,540,002	16,534,449
Cumulative effect of change in accounting principle		(6,612,615)		
Net assets--balance at beginning of year as restated	157,647,240	156,514,483	17,540,002	16,534,449
Net assets--end of year	$175,884,324	$157,647,240	$19,987,255	$17,540,002

See notes to financial statements.

NORTHERN MICHIGAN UNIVERSITY
Statements of Cash Flows

DRAFT

	June 30	
	2004	**2003**
Cash Flows from Operating Activities		
Tuition and fees	$ 37,315,725	$ 32,150,387
Grants and contracts	17,780,060	17,524,061
Payments to suppliers	(33,673,016)	(37,599,855)
Payments to employees	(71,228,142)	(72,269,153)
Payments for scholarships and fellowships	(7,808,263)	(6,948,355)
Loans issued to students and employees	(1,876,695)	(2,147,270)
Collection of loans to students and employees	1,644,049	1,642,800
Auxiliary enterprise:		
Residential Life	11,735,124	11,289,241
Other	5,820,748	5,171,954
Other receipts	7,530,242	7,256,316
Net cash used by operating activities	(32,760,168)	(43,929,874)
Cash Flows from Noncapital Financing Activities		
State appropriations	45,834,843	50,712,528
William D. Ford direct lending receipts	25,254,412	22,351,880
William D. Ford direct lending disbursements	(25,284,275)	(22,349,847)
Gifts and grants received for other than capital purpose	306,856	227,890
Other	280,135	1,230,351
Net cash provided by noncapital financing activities	46,391,971	52,172,802
Cash Flows from Capital and Related Financing Activities		
Bonds issued		
Capital appropriations	6,599,877	967,752
Capital grants and gifts received	240,748	457,948
Purchases of capital assets	(25,118,749)	(12,841,692)
Principal paid on capital debt	(1,730,000)	(1,750,000)
Interest paid on capital debt	(2,856,396)	(2,745,408)
Net cash provided (used) by capital and related financing activities	(22,864,520)	(15,911,400)
Cash Flows from Investing Activities		
Proceeds from sales and maturities of investments		14,553,574
Interest on investments	503,162	(1,730,029)
Purchase of investments	(6,590,262)	(11,679,252)
Net cash provided (used) by investing activities	(6,087,100)	1,144,293
Net increase (decrease) in cash and cash equivalents	(15,319,817)	(6,524,179)
Cash and cash equivalents - beginning of the year	26,859,260	33,383,439
Cash and cash equivalents - end of year	$ 11,539,443	$ 26,859,260
Reconciliation of Operating Loss to Net Cash Used by Operating Activities		
Operating loss	$(43,155,071)	$(50,877,028)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Gifts of capital assets		
Depreciation expense	8,389,664	7,555,915
Loss on equipment disposal	138,367	575,975
Change in assets and liabilities:		
Receivables, net	40,287	(296,611)
Inventories	58,709	(199,399)
Other assets	20,445	(535,287)
Accounts payable	1,003,281	(1,025,973)
Deferred revenue	246,384	(75,507)
Compensated absences/Accrued payroll	497,766	948,041
Net cash used by operating activities	$(32,760,168)	$(43,929,874)

See notes to financial statements.

NOTE A--BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The University follows the "business-type" activities requirements of GASB Statement No. 34. rather than issuing fund-type financial statements and has the following components of the financial statements:

- Management's discussion and analysis
- Basic financial statements including statements of net assets, statements of revenues, expenses and changes in net assets, and statements of cash flows for the University as a whole
- Notes to the financial statements

The University is required to report revenues net of discounts and allowances. Discounts and allowances previously reported as scholarship expenditures are now reported as an allowance against tuition and related revenues.

REPORTING ENTITY

Northern Michigan University is an institution of higher education and is considered to be a component unit of the State of Michigan because its Board of Trustees is appointed by the Governor of the State of Michigan. Accordingly, the University is included in the State's financial statements as a discrete component unit. Transactions with the State of Michigan relate primarily to appropriations for operations, grants from various state agencies, payments to State retirement programs for University employees, and reimbursements for capital outlay projects.

The Northern Michigan University Development Fund (Development Fund) is a legally separate, tax-exempt organization supporting Northern Michigan University. The Development Fund acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The thirty-one-member Board of Trustees of the Development Fund is self-perpetuating and consists of graduates and friends of the University. Although the University does not control the timing or amount of receipts from the Development Fund, the majority of resources, or income thereon, that the Development Fund holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Development Fund can only be used by, or for the benefit of, the University, the Development Fund is considered a component unit of the University and is discretely presented in the University's financial statements.

During the year ended June 30, 2004, the Development Fund made distributions of $xx,xxx,xxx to or on behalf of the University for both restricted and unrestricted purposes. Complete financial statements for the Development Fund can be obtained from their office at 603 Cohodas Administrative Center, Marquette, MI 49855.

NOTE A--BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting—Northern Michigan University

The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting.

In accordance with GASB Statement No. 20, the University is required to follow all applicable GASB pronouncements. In addition, the University should apply 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.

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 income. Restricted and unrestricted resources are spent and tracked at the University level within the guidelines of donor restrictions.

Basis of Accounting—Component Unit

The Development Fund is a nonprofit 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 GASB revenue recognition criteria and presentation features. With the exception of necessary presentation adjustments, no modifications have been made to the Development Fund's financial information in the University's financial report for these differences.

Cash Equivalents

Cash equivalents are all investments with original maturity dates of 90 days or less.

Investments

Investments are stated at fair market value.

Institutional Physical Properties

Institutional physical properties are stated at cost when purchased and at appraised value for other acquisitions.

Depreciation is provided for physical properties on a straight line basis over the estimated useful lives, 50 years for buildings and 5 to 20 years for equipment.

Depreciation expense for 2004 and 2003 is approximately $8,390,000 and $7,556,000 respectively. The University capitalizes assets with a cost of $5,000 and greater.

Inventories

Inventories are stated at the lower of cost or market value as follows: office supplies, first-in, first-out method; and bookstore books and supplies, retail method.

NOTE A--BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

State Appropriations

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

Non-Exchange Transactions

In accordance with GASB Statement No. 33, gifts and grants are recognized at the later of the date pledged or when the eligibility requirements of the gifts and grants are met.

Reclassifications

Certain 2003 balances have been reclassified to conform to the 2004 presentation.

NOTE B--CASH AND INVESTMENTS

General Policies

University cash and investments are managed in accordance with the Michigan Compiled Laws.

The Board of Trustees established an Investment Policy for cash and investments which authorized the University to invest in various types of funds. Securities are to be highly liquid and convertible into cash at any time. All bonds shall have a quality rating of "A" or better at the time of purchase and the average quality of the short fixed income portfolio shall be between "AA" and "AAA".

Short Fixed Income funds are defined as investments with maturities of one year and no more than seven years with an average maturity portfolio between one and three years. It is expected that the total return over a three year moving period shall exceed the return of the Merrill Lynch 1-3 Year Bond Index.

Intermediate Fixed Income funds are defined as investments with maturities of three years and no more than fifteen years with an average maturity portfolio between three and six years. Securities are to be highly liquid and convertible to cash at any time. It is expected that the total return over a three year moving period shall exceed the return of the Lehman Intermediate Government/Corporate Bond Index.

The yields on the cash and investments were as follows:

	2004	2003
Short Term	**1.16%**	1.60%
Short Fixed Income	**1.21%**	5.55%
Intermediate Fixed Income	**1.67%**	9.39%
Endowment Funds	**16.10%**	1.10%

Investments and Deposits

GASB Statement No. 3 requires certain disclosures regarding policies and practices with respect to deposits, investments, and the custodial credit risk associated with them.

NOTE B--CASH AND INVESTMENTS (Continued)

Deposits:

In accord with the GASB Statement No. 3, deposits are classified into three categories of custodial credit risk, as follows:

Category 1: Insured or collateralized with securities held by the University or by its agent in the University's name

Category 2: Collateralized with securities held by the pledging financial institution's trust department or agent in the University's name

Category 3: Uncollateralized. (This includes any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent, but not in the University's name.)

Investments:

In accord with GASB Statement No. 3, investments are classified into three categories of custodial credit risk, as follows:

Category 1: Insured or registered, or securities held by the University or its agent in the University's name

Category 2: Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the University's name

Category 3: Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the University's name. (This includes the portion of the carrying amount of any repurchase agreement that exceeds the market value of the underlying securities.)

Certain types of investments are not categorized because they are not evidenced by securities that exist in physical or book entry form. Deposits classified as investments on the balance sheet are included in the investment table following and are categorized using the deposit risk category definitions.

NOTE B--CASH AND INVESTMENTS (Continued)

The following table shows the market values of investments, including deposits classified as investments on the Statement of Net Assets, by investment type and in total.

	GASB Category #3	Not Categorized	Market Value
Investments:			
Money market funds	$13,125,026		$13,125,026
Government agencies	24,338		24,338
Preferred stock	10,219	$ 900,000	910,150
Stock	20,000		20,000
Mutual funds		26,013,640	26,013,640
Real estate		194,962	194,962
Total Investments	$13,179,583	$27,108,602	40,288,116
Less Investments Reported as “Cash Equivalents” on Statement of Net Assets			(13,125,026)
Total Investment per Statement of Net Assets			$27,163,090

At June 30, 2004, the carrying amount of deposits, excluding those classified as investments above, was ($1,585,579). The deposits were reflected in the accounts of the banks at $701,362. For the deposits at the bank, $100,000 was Category 1 custodial credit risk.

Endowment Funds

According to the law of the State of Michigan, the governing board may appropriate for expenditure for the uses and purposes for which an endowment is established so much 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.

Investments in the Endowment Fund and their related beneficiary accounts are managed by trustees. Policies regarding investments and marketable securities, which are set forth by the Board of Trustees, authorize the trustee to invest in bonds rated A or better, common stock rated B or better, and cash equivalents. The bond and common stock components of investments are each to be kept between 20 and 60 percent of Endowment Fund assets.

The Board has established a Spending Policy for endowed funds to provide for stability in income growth together with preservation of purchasing power. Current operations for which the endowment was established shall have funds made available for spending using a payout factor of 5 percent applied to the weighted average market value for the last twelve quarters as of June 30 each year. The earliest four quarters market value is given a 25 percent weighting, the middle four quarters market value a 35 percent weighting and the latest four quarters a 40 percent weighting. Any gifts or additional deposits received during the last valuation period will be added to the prior quarter’s market values in order to be given full weight in the payout calculation. Payments will be made from income to the extent available and capital appreciation to make up any shortfall. Due to the inevitability of short-term market fluctuations, it is intended that the performance objectives will be achieved by the investment manager(s) over a five-year moving period, net of investment management fees. At June 30, 2004, net appreciation of $xx,xxx (2003--$19,311) was available to be spent and was restricted to specific purposes.

NOTE B--CASH AND INVESTMENTS (Continued)

NMU Development Fund

The purpose of the NMU Development Fund Endowment Spending Policy is to provide for stability in income together with preservation of purchasing power. Current operations for which the endowment was established shall have funds made available for spending according to the following rules:

1. Every Endowment Account shall annually be allocated an amount, available to be spent in accordance with the stated guidelines, equal to 5% of the prior 20 quarters moving average value, lagged to June 30th fiscal year.
2. All investment earnings in excess of 5% are to be reinvested, less an investment and administration fee assessed by the NMU Development Fund.
3. If earned income (interest and dividends) is insufficient to meet the spending rate, the amount will be taken from accumulated gains.
4. Original gift principal, consisting of the sum of all gifts designated to any specific endowment account, shall never be spent.

NOTE C--INVESTMENT IN COMMUNITY DEVELOPMENT

The other investments in the Endowment Fund include $900,000, 5% Cumulative Convertible Non-Voting Preferred Stock in the Shorebank Corporation (Shorebank). The proceeds of the Units were used by Shorebank, among other purposes, to capitalize and incorporate North Coast BIDCO, Inc. ("North Coast"), a rural business and industrial development corporation ("BIDCO") in the Upper Peninsula, and to develop a loan production office ("LPO") of South Shore Bank of Chicago ("South Shore"), Shorebank's wholly-owned banking subsidiary in the Upper Peninsula. All dividends have been paid to date.

NOTE D--RECEIVABLES

Receivables at June 30 were as follows:

	2004	**2003**
State appropriations	**$ 7,926,032**	$ 8,936,744
State capital appropriations	**8,699,728**	74,963
Student loans – net	**9,130,096**	9,099,789
Charter schools	**2,265,696**	2,154,040
NMU Development Fund	**537,624**	354,263
State and federal grants	**1,601,149**	1,986,372
Students, employees, and vendors	**2,489,635**	1,962,679
Investment receivable	**62,762**	78,737
Total	**$32,712,722**	$24,647,587

During the fiscal year, the University recorded revenue of $12,424,526 ($11,918,418 in 2003) for charter schools which was forwarded, net an administration fee, to five charter schools.

NOTE E--FIXED ASSETS

The following table summarizes, by major class of asset, the recorded costs of fixed assets as of June 30, 2004:

	Beginning Balance	Additions and Reclassifications	Retirements	Ending Balance
Land	$ 4,535,640	$ 259,230		$ 4,794,870
Land improvements	7,914,272	1,269,764		9,184,036
Buildings and improvements	197,179,208	5,396,481		202,575,689
Infrastructure	16,918,366	1,368,703		18,287,070
Equipment	25,995,545	1,501,001	$493,273	27,003,273
Books	12,512,893	744,931		13,257,824
Construction in progress	7,368,323	16,591,252		23,959,575
Totals at historical cost	272,424,247	27,131,362	493,273	299,062,337
Less accumulated depreciation for:				
Land improvements	2,214,599	290,409		2,505,008
Buildings and improvements	56,726,603	4,772,905		61,499,508
Infrastructure	5,614,618	802,624		6,417,242
Equipment	16,457,421	2,048,770	354,906	18,151,285
Books	9,998,382	474,956		10,473,338
Total accumulated depreciation	91,011,623	8,389,664	354,906	99,046,381
Capital assets, net	$181,412,624	$18,741,698	$138,367	$200,015,956

The following table summarizes, by major class of asset, the recorded costs of fixed assets as of June 30, 2003:

	Beginning Balance	Additions and Reclassifications	Retirements	Ending Balance
Land	$ 4,535,640			$ 4,535,640
Land improvements	7,581,930	$ 332,342		7,914,272
Buildings and improvements	185,554,458	11,624,750		197,179,208
Infrastructure	14,690,412	2,227,954		16,918,366
Equipment	24,639,772	1,459,547	$103,774	25,995,545
Books	12,426,583	745,413	659,103	12,512,893
Construction in progress	10,483,317	(3,114,994)		7,368,323
Totals at historical cost	259,912,112	13,275,012	762,877	272,424,247
Less accumulated depreciation for:				
Land improvements	1,828,724	385,875		2,214,599
Buildings and improvements	52,735,739	3,990,864		56,726,603
Infrastructure	4,975,042	639,576		5,614,618
Equipment	14,546,891	1,978,793	68,263	16,457,421
Books	9,556,214	560,807	118,639	9,998,382
Total accumulated depreciation	83,642,610	7,555,915	186,902	91,011,623
Capital assets, net	$176,269,502	$5,719,097	$575,975	$181,412,624

Fixed assets are capitalized at cost including ancillary charges necessary to place the asset into use. Interest expense, on debt incurred for construction, is included in the asset cost for the period of construction.

NOTE F--COLLECTIONS

The University has the Moses Coit Tyler Collection that has not been capitalized. This collection is maintained for public exhibition and education.

NOTE G--PAYABLES

Payables at June 30 were as follows:

	2004	2003
Accrued payroll and benefits	**$ 6,969,929**	$ 6,619,239
Construction contractors	**2,234,399**	1,650,423
Charter Schools	**2,265,656**	2,154,040
Vendors	**2,083,900**	1,659,784
Interest payable	**161,484**	165,719
Total	**$13,715,368**	$12,249,205

NOTE H--NONCANCELABLE LEASES

The University has entered into noncancelable leases for computers. The following table is a summary of the noncancelable operating lease payments:

Year ended June 30	Operating Leases
2005	$2,159,643
2006	176,490
Total	$2,336,133

NOTE I--BONDS AND NOTES PAYABLE

In 2001, the University sold a $30,000,000 General Revenue Bond issue for various renovations and construction needs on campus. The principal and interest on the 2001 Revenue Bonds are primarily payable from general University revenues, bear interest based on a daily rate, and mature in varying amounts through 2031. The interest rate at June 30, 2004 was 1.08%.

As a means to lower its borrowing costs, when compared against fixed-rate bonds at the time of issuance in 2001, the University entered into an interest rate swap for $20,000,000 of the Series 2001, General Revenue Variable Rate Demand Bonds. The intention of the swap was to effectively change the University's variable interest rate on the bonds to a synthetic fixed rate.

Under the swap, the University pays the counterparty a fixed payment of 4.015 percent and receives a variable payment computed as 67 percent of the U.S. Dollar – London Interbank Offered Rate (USD-LIBOR-BBA). The swap has a notional amount of $20 million and the associated variable-rate bond has a $30 million principal amount. The swap was entered into at the same time the bonds were issued (2001). The bonds mature on June 1, 2031. The related swap agreement matures on June 1, 2025, when the first $20,000,000 of the associated debt is repaid. As of June 30, 2004, rates were as follows:

	Terms	Rates
Interest rate swap:		
Fixed payment to counterparty	Fixed	4.015%
Variable payment from counterparty	67% of USD-LIBOR-BBA	(0.865%)
Net interest rate swap payments		3.150%
Variable rate bond coupon payments	Actual daily tax-exempt variable rate	1.080%
Synthetic interest rates on bonds		4.230%

NOTE I--BONDS AND NOTES PAYABLE (Continued)

The University has not calculated the fair value of the swap agreement. As of June 30, 2004, and as long as the variable rate portion of the swap being received by the University is less than the fixed rate being paid, the University will be in a negative position on the swap. That is, the University will be paying more in interest expense than they would had they not entered into the swap agreement. The University believes that the variable rate they receive on the swap agreement will eventually exceed the 4.015 percent fixed rate they pay and the swap agreement will reduce its overall interest expense in the future.

The University is exposed to credit risk, which is the risk that the counterparty will not fulfill its obligations, when the swap has a positive fair value. Since the University did not calculate the fair value of the swap, it is not known if there is any potential credit risk. However, as of June 30, 2004, the counterparty to the swap agreement was rated AAA by Standard & Poors.

As noted above, the swap exposes the University to basis risk should the relationship between LIBOR and the University's actual daily tax-exempt variable rate converge, changing the synthetic rate on the bonds. If a change occurs that results in the rates moving to convergence, the expected cost savings may not be realized.

The swap agreement uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Schedule to the Master Agreement includes an "optional termination rights." The University has the right to terminate the swap transaction at any time upon receipt of notice by the counterparty at least 20 calendar days and no more than 30 calendar days, prior to the specified date. The optional termination amount with respect to this transaction shall equal the present value of the difference on a monthly basis between the cash flows generated at the Settlement Rate and the Fixed Rate of a swap with the then remaining schedule for the notional amounts, discounted monthly to the date the optional termination amount shall be paid using a LIBOR curve of yields calculated under then prevailing industry standards subject to approval by the University and such approval is not to be unreasonably withheld.

In 1998, the University sold a $17,600,000 General Revenue Bond issue for various renovations and construction needs on campus, and to defease in substance $8,020,000 of outstanding 1993 bonds by depositing funds in an irrevocable trust with an escrow agent. All defeased 1993 bonds were called on June 1, 2003; therefore, the outstanding balance for these defeased bonds as of June 30, 2003 and 2002, was $0 and $8,020,000, respectively. The principal and interest on the 1998 Revenue Bonds are primarily payable from general University revenues, bear interest at rates from 4.25% to 5.00%, and mature in varying amounts through 2026. Also in 1998, the University sold a $24,560,000 General Revenue Bond issue for a portion of the University's 25% match of the $47 million State of Michigan funding for the Glenn T. Seaborg Center, and various other renovations and construction needs on campus, and to defease in substance $6,175,000 of outstanding 1992 bonds by depositing funds in an irrevocable trust with an escrow agent. All defeased 1992 bonds were called on June 1, 2002; therefore, there was no outstanding balance for these defeased bonds as of June 30, 2003 and 2002. The principal and interest on the 1997 Revenue Bonds are primarily payable from general University revenues, bear interest at rates from 4.25% to 5.13%, and mature in varying amounts through 2021.

In 1997, the University issued a $1,000,000 term note payable to construct a cable system for residence halls on campus. The note payable bears interest of 5.34% computed on a 360-day year with twelve 30-day months. Principal and interest payments were due annually through fiscal year 2003. This note was paid in full during fiscal year 2003.

In 1993, the University sold a $12,000,000 General Revenue Bond Issue for the renovation of various campus buildings. The principal and interest on revenue bonds were primarily payable from general University revenues. The bonds bore interest at 2.85% to 5.60% and matured at various dates through 2014. However, during fiscal year 2003, all remaining outstanding bonds either matured or were called; therefore, the outstanding balance due on the 1993 bonds was $0 at June 30, 2003.

NOTE I--BONDS AND NOTES PAYABLE (Continued)

Using rates as of June 30, 2004, debt service requirements of the long-term debt and interest rate swap, assuming current interest rates remain the same for their term, were as follows. As rates vary, variable-rate bond interest payments and net swap payments will vary.

		Interest		
Fiscal Year	**Principal**	**Bonds**	**Interest Rate Swap**	**Total**
2004-2005	$ 1,810,000	$ 2,218,050	$ 580,299	$ 4,608,349
2005-2006	1,890,000	2,156,891	561,861	4,608,752
2006-2007	1,955,000	2,092,321	542,635	4,589,956
2007-2008	2,055,000	2,025,189	524,067	4,604,256
2008-2009	2,140,000	1,952,306	501,819	4,594,125
Total five years	9,850,000	10,444,757	2,710,681	23,005,438
Thereafter				
2009-2014	12,265,000	8,517,110	2,165,001	22,947,111
2014-2019	15,290,000	5,949,608	1,493,043	22,732,651
2019-2024	16,995,000	2,797,682	666,141	20,458,823
2024-2029	10,130,000	528,384	19,514	10,677,898
2029-2031	3,370,000	51,930	-	3,421,930
Total	$67,900,000	$28,289,471	$7,054,380	$103,243,851

Long-term liability activity for the year ended June 30, 2004, was as follows:

	Beginning Balance	**Additions**	**Reductions**	**Ending Balance**	**Current Portion**
Leases and bonds payable:					
Bonds payable	$69,630,000		$1,730,000	$67,900,000	$1,810,000
Total notes and bonds payable	$69,630,000		$1,730,000	$67,900,000	$1,810,000
Other liabilities:					
Severance benefits	4,328,887	$558,277	936,643	3,950,521	1,292,998
Compensated absences	2,200,687	37,655	149,706	2,088,636	158,841
Federal portion of Perkins Loan Program	6,793,487	164,956		6,958,443	
Total other liabilities	13,323,061	760,888	1,086,349	12,997,600	1,451,839
Total long-term liabilities	$82,953,061	$760,888	$2,816,349	$80,897,600	$3,261,839

NOTE I--BONDS AND NOTES PAYABLE (Continued)

Long-term liability activity for the year ended June 30, 2003, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Leases and bonds payable:					
Note payable	$ 170,000		$ 170,000		
Bonds payable	71,210,000		1,580,000	$69,630,000	$1,730,000
Total notes and bonds payable	71,380,000		1,750,000	69,630,000	1,730,000
Other liabilities:					
Severance benefits	4,500,281	$457,244	628,638	4,328,887	1,021,541
Compensated absences	2,098,709	269,956	167,978	2,200,687	253,802
Federal portion of Perkins Loan Program	6,612,615	180,872		6,793,487	
Total other liabilities	13,211,605	908,072	796,616	13,323,061	1,275,343
Total long-term liabilities	$84,591,605	$908,072	$2,546,616	$82,953,061	$3,005,343

NOTE J--OPERATING EXPENSES

Operating expenses by natural classification for the year ended June 30 were as follows:

	2004	2003
Salaries, wages and benefits	**$ 71,887,017**	$ 72,614,750
Supplies and support services	**28,814,314**	32,582,320
Utilities	**6,293,225**	4,432,886
Depreciation expense	**8,389,664**	7,555,915
Scholarships	**7,808,262**	6,948,355
Total	**$123,192,482**	$124,134,226

NOTE K--RETIREMENT PLANS

The University has two retirement plans: the Michigan Public School Employees' Retirement System (MPSERS) and the Teachers Insurance and Annuities Association - College Retirement Equities Fund (TIAA-CREF).

The following represents the employer’s share of retirement contributions for MPSERS liability:

- Pension Normal Cost: This contribution rate is determined each year by the retirement system’s actuary and is charged to the seven universities formally participating in MPSERS as a percentage due on their covered MPSERS payroll. For the State’s fiscal year 2004, this rate is 6.47%, and is applied to payrolls occurring on or after October 1, 2003. For the State’s fiscal year 2003, this rate is 6.47%, and is applied to payrolls occurring on or after October 1, 2002.

- Pension Unfunded Liability: This contribution rate is determined each year by the retirement system’s actuary, and is charged to the covered universities as a percentage on their combined member and non-member/non-optional retirement programs payrolls. For the State’s fiscal year 2004, this rate is 0.88% and is applied to payrolls occurring on or after October 1, 2003. For the State’s fiscal year 2003, this rate is 0.88%, and is applied to payrolls occurring on or after October 1, 2002.

NOTE K--RETIREMENT PLANS (Continued)

- Retiree Health Insurance: This payment is computed annually, and each university is charged a portion of the total requirement due based on the number of retirees each university has, compared to the total number of all university retirees. For the State's fiscal year 2004, the total amount due for the University's retiree's health insurance is $1,981,970. For the State's fiscal year 2003, the total amount due for the University's retiree's health insurance was $2,107,033.

The TIAA-CREF plan is a defined contribution retirement plan. Substantially all full-time employees of the University are eligible to participate in the TIAA-CREF plan. Employee benefits vest immediately. The University contributes a specified percentage of employee wages, as defined by the appropriate labor contract, and has no liability beyond its own contribution.

The University contributed to the plans as follows for the year ended June 30, 2004:

	TIAA-CREF	MPSERS	University Total
University Contributions	$ 4,529,652	$ 3,054,232	$ 7,583,884
Employee Contributions		320,544	320,544
Covered Payroll	29,891,220	14,130,933	44,022,153

The University contributed to the plans as follows for the year ended June 30, 2003:

	TIAA-CREF	MPSERS	University Total
University Contributions	$ 4,624,440	$ 3,099,951	$ 7,724,391
Employee Contributions		330,676	330,676
Covered Payroll	30,493,467	14,510,496	45,003,963

NOTE L--EARLY RETIREMENT INCENTIVES

The University has in place a Severance Incentive Program (SIP) available to all active full-time salaried employees who have completed ten years of service. The enrollment period for the first SIP was December 15, 1995 through August 30, 1996. Approved employees were eligible for post-separation benefits consisting of health insurance benefits, if needed, and/or cash severance benefits in varying amounts based on years of service and separation date, but not to exceed 100 percent of annual salary. The remaining SIP liability as of June 30, 2004 and 2003, was $701,000 and $1,041,000, respectively.

The University established a second Severance Incentive Program (SIP) available to all active full-time salaried and clerical/technical employees who have completed ten years of service. The employee had to enroll and sever employment between July 1, 2000 and June 30, 2001. Approved employees were eligible for post-separation benefits consisting of health insurance benefits, if needed, and/or cash severance benefits. The remaining SIP liability as of June 30, 2004 and 2003, was $2,504,000 and $2,831,000, respectively. The SIP is expected to be paid over a ten-year period beginning in fiscal year 2000-01.

During fiscal year 2003, the University established a Reduction in Force (RIF) plan for those full-time employees whose positions were eliminated due to budget cuts by July 1, 2004. The employees could not exercise their bumping rights in accordance with their applicable collective bargaining agreement. Employees were eligible for post-separation benefits consisting of health insurance benefits and/or cash severance benefits. The remaining RIF liability as of June 30, 2004 and 2003, was $746,000 and $457,000 respectively.

NOTE M--NORTHERN MICHIGAN UNIVERSITY DEVELOPMENT FUND

Northern Michigan University Development Fund (not included in the University financial statements) is an independent corporation formed for the purpose of receiving funds for the sole benefit of the University. Unaudited financial information of the Northern Michigan University Development Fund at June 30, 2004, includes net assets of approximately $xx,xxx,xxx (2003–$17,540,000) and revenues for the year ended June 30, 2004, of approximately $x,xxx,xxx (2003–$4,462,000). Accounts receivable from the Northern Michigan University Development Fund at June 30, 2004, was $xxx,xxx (2003–$354,000).

NOTE N--LIABILITY INSURANCE

The University participates in the Michigan Universities Self-Insurance Corporation (M.U.S.I.C.), which provides indemnity to members against comprehensive general liability, property and casualty, and errors and omissions losses commonly covered by insurance and provides risk management and loss control services and programs. M.U.S.I.C. provides coverage for claims in excess of agreed upon deductibles.

Loss coverages are structured on a three layer basis with each member retaining a portion of its losses, M.U.S.I.C. covering the second layer 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.

M.U.S.I.C. was established on May 28, 1987, pursuant to the State of Michigan Constitution of 1963, Article 8, Sections 5 and 6. Eleven Michigan Public universities participate in M.U.S.I.C. All members have signed a participation agreement. Participant contributions are assessed on an annual basis to cover insurance risks retained as a group, costs related to excess coverage and general and administrative expenses. Members' equity totaled $16,632,724 at June 30, 2003, based on the last published financial statements.

NOTE O--CONTINGENCIES

The University is in the process of renovating various campus buildings. Contractual commitments relating to renovations were approximately $13,105,000 and $12,816,000 at June 30, 2004 and 2003, respectively.

University facilities including the Heating Plant, the Service Building, the Art Annex, and the Seaborg Center Complex, have been or are scheduled to be financed in whole or in part by State Building Authority bond issues which are 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 and the University will pay all operating and maintenance costs. At the expiration of the individual leases, the SBA has agreed to sell each building to the University for one dollar. The cost and accumulated depreciation for these assets are recorded in the Statement of Net Assets.

In the normal course of its activities, the University is a party in various legal actions. The University and its legal counsel are of the opinion that the outcome of asserted and unasserted claims outstanding will not have a material effect on the financial statements.

NOTE P--SUBSEQUENT EVENTS

Subsequent to year end, the University anticipated signing a $6,198,000 lease commitment with IBM for laptop computers.