FINANCIAL REPORT

2004 - 2005

NORTHERN MICHIGAN UNIVERSITY

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This section of Northern Michigan University's (the "University") annual financial report presents our discussion and analysis of the financial performance of the University during the fiscal years ended June 30, 2005 and 2004. This discussion has been prepared by management along with the financial statements and related footnote disclosures and should be read in conjunction with and is qualified in its entirety by the financial statements and footnotes. The financial statements, footnotes and this discussion are the responsibility of management.

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.

Using the Annual Report

This annual report consists of a series of financial statements, prepared in accordance with the Governmental Accounting Standards Board (GASB) Statement No. 35, Basic Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities. The financial statements presented focus on the financial condition of the University, the results of operations, and cash flows of the University as a whole.

The Statements of Net Assets includes all assets and liabilities. It is prepared under 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 Revenues, Expenses and Changes in Net Assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or non-operating. Under the new reporting model, State appropriations and gifts are reported as non-operating revenues and results in the University showing an operating loss of $44.9 million for the year ended June 30, 2005, and $43.7 million for the year ended June 30, 2004. The utilization of long-lived assets, referred to as 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, capital, financing and investing activities.

Financial Highlights

An increase of $14.4 million in Net Assets for the year ended June 30, 2005, primarily resulted from a net increase in capital items of $11.9 million. Operating and non-operating revenues exceeded operating and non-operating expenses by $2.5 million when excluding a net increase in capital items of $11.9 million.

For the year ended June 30, 2005, operating and non-operating revenues, excluding capital revenues of $13.5 million, increased by $5.6 million and includes a $2.6 million increase in student tuition and fees resulting from continued enrollment increases along with an increase in tuition and fees, a $1.5 million increase in auxiliary enterprises, a $1.3 million increase in state appropriations, and $0.2 million increase in other areas.

For the year ended June 30, 2005, operating and non-operating expenses, excluding loss on asset disposals of $1.6 million, increased by $5.2 million and includes a $3.1 million increase in supplies and support services, a $1.4 million increase in utilities, and a $0.7 million increase across other areas. Supplies and support services increased due to one-time purchases of instructional supplies and smaller non-capital items related to the addition to the Art and Design Studios North building and renovations of the Student Services building, the Thomas Fine Arts facility, and Magers Hall.

Financial Highlights (Continued)

For the year ended June 30, 2004, an increase of $17.6 million in Net Assets primarily resulted from $15.8 million in capital appropriations and capital gifts primarily for the renovation and adaptive reuse of east campus facilities. Operating and non-operating revenues excluding capital appropriations and capital gifts of $128.6 million exceeded operating and non-operating expenses by $1.7 million for the year ended June 30, 2004. Enrollment increases along with an increase in tuition and fees totaling $5.1 million offset a $5.4 million decrease in state appropriations.

For the year ended June 30, 2004, operating expenses of $123.7 million increased $0.6 million or .05% over the prior year. The minimal increase was the direct result of a University-wide effort to reduce costs. Included in operating expenses was $1.7 million increase in auxiliary enterprise expense, $0.9 million increase in scholarship expense, $0.9 million increase in depreciation expense, and $2.9 million decrease across all other functional areas.

The University made additional reductions in its workforce for the year ended June 30, 2004 that impacted 23 established positions, including 11 layoffs, effective July 1, 2004. Post-separation benefits of $558,000 are included in compensation for employees whose positions were eliminated and signed severance agreements prior to June 30, 2004.

Condensed Financial Information

Condensed Statements of Net Assets

	June 30		
	2005	2004	2003
ASSETS			
Current Assets	$ 39,596,073	$ 39,342,969	$ 46,484,583
Noncurrent Assets:			
Capital	212,166,926	200,340,355	182,423,624
Other	53,932,134	34,455,186	27,924,581
Total Noncurrent Assets	266,099,060	234,795,541	210,348,205
Total Assets	305,695,133	274,138,510	256,832,788
LIABILITIES			
Current Liabilities	19,381,978	20,294,026	18,226,830
Noncurrent Liabilities	95,683,554	77,635,761	79,947,718
Total Liabilities	115,065,532	97,929,787	98,174,548
NET ASSETS			
Invested in Capital Assets Net of Related Debt	144,690,077	137,631,248	123,448,622
Restricted			
Nonexpendable	798,028	769,569	673,013
Expendable	3,640,842	3,653,154	3,378,089
Unrestricted	41,500,654	34,154,752	31,158,516
Total Net Assets	$190,629,601	$176,208,723	$158,658,240

Condensed Financial Information (Continued)

Total current assets of $39.6 million at June 30, 2005, included $19.4 million in unspent bond proceeds that will be used for construction projects. At June 30, 2004, total current assets of $39.3 million included $5.2 million in unspent bond proceeds. After adjusting for unspent bond proceeds, the current ratio of current assets to current liabilities is 1.04 for the year ended June 30, 2005, and 1.68 for the year ended June 30, 2004.

The University's largest non-current asset is its investment in physical plant of $212.2 million at June 30, 2005. Net capital assets increased $11.8 million over the prior year after recognition of $8.4 million in depreciation expense.

The state appropriations receivable totaled $9.1 million at June 30, 2005, and included $1.1 million in construction receivables. The state appropriation receivable at June 30, 2004, totaled $16.6 million and included $8.7 million in construction receivables.

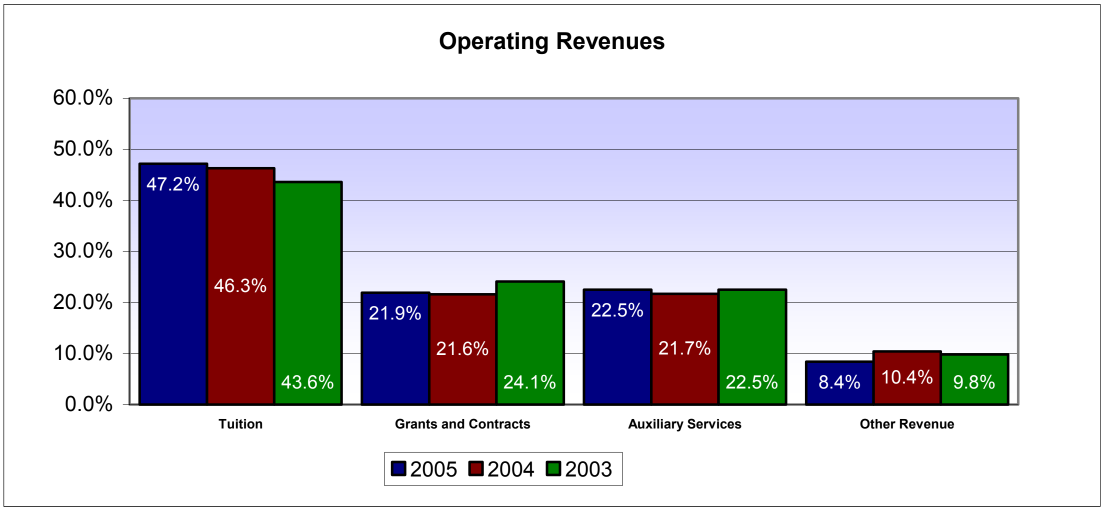
Long-term debt consisting of notes and bonds payable is the largest liability totaling $86.9 million at June 30, 2005, and $67.9 million at June 30, 2004.

Condensed Statements of Revenues, Expenses and Changes in Net Assets

	June 30		
	2005	2004	2003
Operating Revenues			
Tuition and Fees	$ 39,625,035	$ 37,028,944	$ 31,963,965
Grants and Contracts	18,343,500	17,323,491	17,687,048
Auxiliary Enterprises	18,867,981	17,124,164	16,475,116
Other Operating Revenues	7,060,500	8,560,812	7,131,069
Total Operating Revenues	83,897,016	80,037,411	73,257,198
Operating Expenses	128,799,143	123,703,948	123,123,226
Operating Income/(Loss)	(44,902,127)	(43,666,537)	(49,866,028)
Non-operating Revenues (Expenses)			
State Appropriations	46,115,649	44,824,131	50,192,382
Other Non-operating Income and Expenses	1,301,399	999,328	379,365
Net Non-operating Revenues and Expenses	47,417,048	45,823,459	50,571,747
Income Before Other Revenues	2,514,921	2,156,922	705,719
Capital Appropriations	12,067,891	15,224,642	727,642
Capital Grants and Gifts	253,928	620,054	710,396
Capital Gifts from the NMU Foundation	1,217,333		
Loss on Asset Disposal	(1,633,195)	(451,135)	
Total Other Revenues	11,905,957	15,393,561	1,438,038
Total Increase in Net Assets	14,420,878	17,550,483	2,143,757
Net Assets			
Net assets—beginning of year	176,208,723	158,658,240	163,127,098
Cumulative effect of change in accounting principle			(6,612,615)
Net assets—balance at beginning of year as restated	176,208,723	158,658,240	156,514,483
Net assets – end of year	$190,629,601	$176,208,723	$158,658,240

Condensed Financial Information (Continued)

Total operating revenues were $83.9 million for fiscal year 2005 and $80.0 million for fiscal year 2004. The most significant sources of operating revenue for the University are tuition and fees, auxiliary services, and grants and contracts, as shown below:



Tuition and Fees

The University currently has the second lowest annual tuition and fees out of the 15 state universities in Michigan. As part of tuition and fees, each full-time undergraduate student is provided the use of a notebook computer. A full-time undergraduate student normally takes 15 credit hours per semester and a full-time graduate student 12 credit hours per semester. The following table sets forth the average annual student fees for full-time on-campus students, plus the registration fees for the academic year indicated.

Average Annual Full-Time Student Tuition and Fees

	2004-2005	2003-2004	2002-2003
Undergraduate, resident	$5,334	$5,210	$4,780
Undergraduate, nonresident	$8,742	$8,438	$7,732
Graduate, resident	$6,198	$5,924	$5,404
Graduate, nonresident	$9,270	$8,882	$8,092

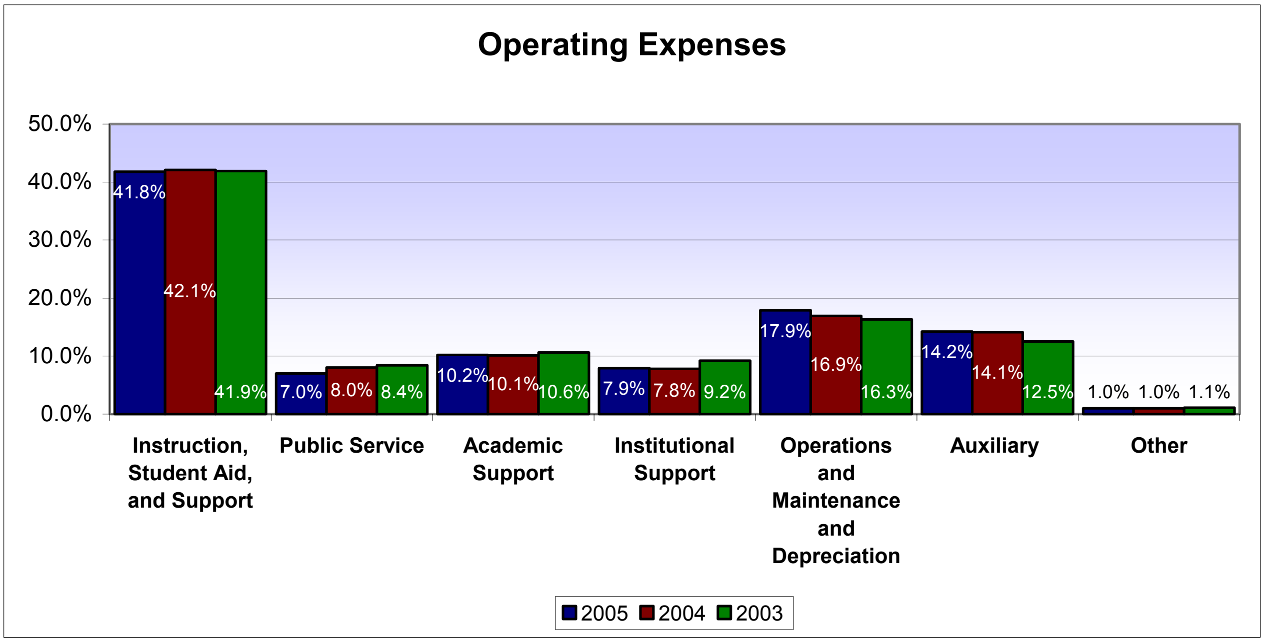
Room and Board

The annual cost of room and board, which includes laundry and other miscellaneous residence fees, was $6,012 for 2004-2005, $5,724 for 2003-2004 and $5,630 for 2002-2003. The University provides on-campus residence hall and apartment facilities for students. Most students who are not living at home with their parents must live on campus through their first four semesters. Nine residence halls currently have a mean occupancy of 2,143 (2004 – 2,143) and are at a 93 percent capacity (2004 – 90 percent capacity). Campus apartments total 278 units with occupancy varying depending on the ratio of single students to student families and the size of the household. Approximately 90 percent of apartments are rented during the academic year. A constant pass meal plan is available which can be used at two on-campus dining facilities.

Operating Expenses

Operating expenses for June 30, 2005, including depreciation of $8.4 million, totaled $128.8 million. Of this total, $53.8 million, or 41.8 percent, was used for instruction, student aid, and student support, $23.0 million, or 17.9 percent was used for operation, maintenance, and depreciation, and $18.3 million, or 14.2 percent, was used for auxiliary services. Operating expenses for June 30, 2004, including depreciation of $8.4 million, totaled $123.7 million.

The breakout by functional expense is highlighted below:



Other

The State appropriation of $46.1 million for June 30, 2005 and $44.8 million for June 30, 2004, is the largest source of non-operating revenues. The appropriation is recognized in the period for which it is appropriated.

Interest expense on outstanding debt was $2.8 million for June 30, 2005 and $2.7 million for June 30, 2004.

The Statements of Cash Flows

The Statements of Cash Flows provides relevant information about the cash receipts and cash payments of the University during the period.

Condensed Statements of Cash Flows

	June 30		
	2005	2004	2003
Cash Provided (Used) By:			
Operating Activities	$(36,947,656)	$(33,502,793)	$(42,918,874)
Non-capital Financing Activities	46,080,619	46,514,715	52,172,802
Capital and Related Financing Activities	15,385,446	(23,828,463)	(16,922,400)
Investing Activities	(16,699,782)	(4,503,276)	1,144,293
Net Increase (Decrease) in Cash and Cash Equivalents	8,601,035	(15,319,817)	(6,524,179)
Cash and Cash Equivalents – Beginning of Year	11,539,443	26,859,260	33,383,439
Cash and Cash Equivalents – End of Year	$ 20,140,478	$ 11,539,443	$ 26,859,260

Major sources of funds included in operating activities are student tuition and fees of $40.0 million, grants and contracts of $18.8 million, and auxiliary sales of $18.6 million for June 30, 2005; and student tuition and fees of $37.0 million, grants and contracts of $17.8 million, and auxiliary sales of $17.6 million, for June 30, 2004. The major source of funds included in non-capital financing activities is state appropriations of $46.1 million for June 30, 2005, and $45.8 million for June 30, 2004.

Northern Michigan University Foundation

The mission of the Northern Michigan University Foundation (Foundation) is to cultivate and promote the private philanthropic support of NMU's mission through a comprehensive advancement effort. Through these efforts an increase in net assets was realized of $0.7 million was realized for the year ended June 30, 2005 and $2.2 million for the year ended June 30, 2004. The Foundation continues to engage in activities that increase donor awareness of giving opportunities to support the University by providing scholarships, facilities, and learning opportunities.

Factors Impacting Future Periods

Enrollment

The University projects that total enrollment will continue to grow as we move toward our goal of 10,330 students by 2007. The following table indicates the total fall headcount enrollment of undergraduate and graduate students. Also indicated are the fiscal year equated students and total annual credit hours for all students attending the University.

	Fall Headcount Enrollment				
Academic Year	Undergraduate Students	Graduate Students	Total	Fiscal Year Equated Students	Annual Total Credit Hours Taken
2000	7,257	887	8,144	7,134	211,060
2001	7,575	853	8,428	7,396	219,017
2002	7,724	853	8,577	7,718	228,551
2003	8,113	903	9,016	8,047	238,349
2004	8,536	790	9,326	8,304	246,149
2005	8,603	728	9,331	*	*

* Not yet available

For the 2005 academic year, it is projected that fifty-seven percent (57%) of the University's students represents Upper Peninsula Michigan residents, twenty-four percent (24%) of the University's students come from Michigan's Lower Peninsula, and the remaining nineteen percent (19%) comes from other states and foreign countries.

For the 2004 academic year, it is projected that fifty-six percent (56%) of the University's students represents Upper Peninsula Michigan residents, twenty-three percent (23%) of the University's students come from Michigan's Lower Peninsula, and the remaining twenty-one percent (21%) comes from other states and foreign countries.

Admissions

Given the projected decline in Upper Peninsula high school enrollments, NMU is expanding its recruiting in the Lower Peninsula of Michigan, as well as in targeted regions of Illinois and Wisconsin, which have relatively large population densities. While the potential for more student enrollments is high, we convert a lower percentage of admitted students to enrolled students the farther away we recruit from Marquette. Thus, we are likely to see an increase in enrollment despite a drop in the admitted to enrolled conversion rate.

The tables below set forth the total number of first year (including associate degree and vocational and one-year certificate students) and transfer applications received and accepted and the number of students enrolled for the fall semesters indicated.

First Year Student Admissions

Fall Semester	Applications Received	Applications Accepted	Percent Accepted	Total New Freshmen Enrolled	Percent Enrolled
2000	4,179	3,543	84.8	1,771	50.0
2001	4,473	3,776	84.4	1,818	48.1
2002	4,421	3,780	85.5	1,801	47.6
2003	4,461	3,762	84.3	1,835	48.8
2004	5,001	4,154	83.1	1,939	46.7

Transfer Student Admissions

Fall Semester	Applications Received	Applications Accepted	Percent Accepted	Students Enrolled	Percent Enrolled
2000	1,243	948	76.3	512	54.0
2001	1,186	878	74.0	494	56.3
2002	1,070	780	72.9	474	60.8
2003	1,131	850	75.2	530	62.4
2004	1,144	787	68.8	533	67.7

By August 29, 2005, the University had received 4,789 freshman applications (as compared to 5,014 as of August 27, 2004) and had granted 3,993 acceptances (as compared to 4,155 as of August 27, 2004).

By August 29, 2005, the University had received 1,136 transfer applications (as compared to 1,154 as of August 27, 2004) and had granted 747 acceptances (as compared to 788 as of August 27, 2004).

Capital Plan

The University has in place a five-year strategic capital plan focusing on renovation and transformation of existing facilities to provide state-of-the-art learning environments. A connected learning environment requires that we continue to improve our support systems, technology infrastructure, and facilities. Campus facilities continued to be renovated through the use of internal resources and funds from bond proceeds.

Projects completed during the current fiscal year include the Renovation and Adaptive Re-Use of East Campus Facilities and the renovation of Magers Hall from faculty offices to a student residence hall. Magers Hall will provide housing for an additional 300 students to help accommodate the University's enrollment growth.

During the fiscal year ended June 30, 2005, the University issued $44.2 million in General Revenue Auction Rate Bonds to defease in substance $22.0 million of its previous bonds and to finance the construction of a new 300-bed student apartment complex, renovation and improve residence halls, and renovation and/or upgrade campus infrastructure. As a means of lowering borrowing costs, the University entered into an interest rate swap of $44.2 million to effectively change the variable rate on the bonds to a synthetic fixed rate.

A second phase of this project will begin in June 2006 when the University anticipates selling $19.5 million in General Revenue Variable Rate Bonds. The University has entered into a forward interest rate swap for $19.5 million to effectively change the variable rate on these bonds to a synthetic fixed rate.

The University has in place a plan to grow our enrollment to 10,330 by 2007. In support of our enrollment growth, future renovation projects include conversion of space vacated in the Cohodas Administrative Center by student service departments into faculty offices, general purpose classrooms, and a conference center, and renovation of the Learning Resource Center to provide an interactive and multi-media instructional development center for students and faculty.

Teaching, Learning, and Communication (TLC) Initiative

The University believes that providing high-quality technology to students as part of full-time enrollment will assist in preparing our graduates to easily move into the increasingly technology driven, global workplace. The NMU campus is a connected learning community with over 9,000 notebook computers distributed to students. Wireless technology throughout campus provides improved student access in an out-of-the classroom while reducing renovation costs for University facilities and enabling greater efficiency in the delivery of student services via the internet. The Teaching, Learning, and Communications (TLC) program is one of many steps the University has made toward its vision and goal of students becoming independent lifelong learners.

NMU's plan to keep current in technology has all student and staff notebook and desktop computers replaced on a two-year cycle. Subsequent to June 30, 2005, the University anticipates signing $3,179,368 in leases for 3,600 computers.

State Appropriations

The University does not have a set funding level for State Appropriations in the upcoming fiscal year. Several funding models for higher education in the State of Michigan have identified reductions for State universities. The University anticipates that the State will finalize funding for higher education by the end of the State's fiscal year, September 30, 2005.

ANDREWS HOOPER & PAVLIK P.L.C.
Certified Public Accountants

Report of Independent Auditors

Board of Trustees
Northern Michigan University
Marquette, Michigan

We have audited the accompanying basic financial statements of Northern Michigan University, a component unit of the State of Michigan, as of and for the years ended June 30, 2005 and 2004. These basic financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these basic financial statements based on our audits. We did not audit the financial statements of the Northern Michigan University Foundation, a discretely presented component unit of Northern Michigan University, which represents 100 percent of the assets and revenues of the component unit. Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for the Northern Michigan University Foundation, is based solely on the reports of the other auditors.

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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic 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 and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the basic financial statements referred to above present fairly, in all material respects, the financial position of Northern Michigan University and its discretely presented component unit as of June 30, 2005 and 2004, and the respective changes in its financial position for the years then ended and the cash flows of Northern Michigan 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 our report dated August 4, 2005 on our consideration of Northern Michigan University's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis (MD&A) on pages 3 to 10 is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this supplemental information. However, we did not audit the information and express no opinion on it.

Andrews Hooper & Pavlik P.L.C.

Saginaw, Michigan
August 4, 2005

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NORTHERN MICHIGAN UNIVERSITY
Statements of Net Assets

	Northern Michigan University June 30		Component Unit Northern Michigan University Foundation June 30	
ASSETS	**2005**	**2004**	**2005**	**2004**
Current Assets:				
Cash and cash equivalents	$ 20,140,478	$ 11,539,443	$ 354,754	$ 348,120
State appropriation receivable	9,071,234	16,625,760		
Accounts receivable (less allowance 2005--$2,284,279; 2004--$1,557,879)	6,696,368	6,894,104	32,685	66,284
Student notes receivable (less allowance 2005--$374,826; 2004--$333,970)	1,466,155	1,838,000		
Investment receivable	170,786	62,762		
Pledges receivable (less allowance 2005--$34,277; 2004--$38,253)			295,013	677,792
Inventories	1,355,840	1,298,428		2,940
Other assets	695,212	1,084,472	164,350	146,213
Total current assets	39,596,073	39,342,969	846,802	1,241,349
Noncurrent Assets:				
Long-term investments	44,930,063	26,068,128	19,352,894	18,546,338
Student notes receivable (less allowance 2005--$1,124,478; 2004--$1,001,912)	7,907,109	7,292,096		
Other long-term investments	1,094,962	1,094,962		
Pledges receivable (less allowance 2005--$21,022; 2004--$16,550)			1,092,167	1,214,986
Capital assets, net	212,166,926	200,340,355	1,354	3,543
Total noncurrent assets	266,099,060	234,795,541	20,446,415	19,764,867
Total assets	305,695,133	274,138,510	21,293,217	21,006,216
LIABILITIES				
Current Liabilities:				
Accounts payable and accrued liabilities	6,936,496	6,745,439	308,471	698,407
Accrued payroll and benefits	5,275,416	6,969,930		
Deferred revenue (unearned student fees and deposits)	3,959,919	3,316,818		
Long-term liabilities-current portion	3,210,147	3,261,839		
Total current liabilities	19,381,978	20,294,026	308,471	698,407
Noncurrent Liabilities:				
Annuities payable			468,506	536,437
Long-term liabilities	95,683,554	77,635,761		
Total noncurrent liabilities	95,683,554	77,635,761	468,506	536,437
Total liabilities	115,065,532	97,929,787	776,977	1,234,844
NET ASSETS				
Invested in capital assets, net of related debt	144,690,077	137,631,248	1,354	3,543
Restricted for				
Nonexpendable				
Scholarships and fellowships	116,581	110,586	5,476,570	5,260,021
Loans	48,358	45,528		
Instruction	633,089	613,455		
Expendable				
Instruction	500,802	485,314	3,273,117	3,296,748
Scholarships and fellowships	494,752	542,961	6,731,694	6,436,085
Loans	2,540,277	2,531,201		
Research	34,963	33,999		
Academic, student and public service	70,048	59,679	3,326,249	3,258,056
Unrestricted	41,500,654	34,154,752	1,707,256	1,516,919
Total net assets	$190,629,601	$176,208,723	$20,516,240	$19,771,372

See notes to financial statements.

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

	Northern Michigan University June 30		Component Unit Northern Michigan University Foundation June 30	
REVENUES	**2005**	**2004**	**2005**	**2004**
Operating Revenues				
Student tuition and fees (less allowance 2005--$11,536,787; 2004--$11,068,706)	$ 39,625,035	$ 37,028,944		
Gifts and contributions			$ 3,310,387	$ 2,477,860
Endowment income			141,922	99,950
Federal grants and contracts	11,716,965	11,211,593		
State and local grants and contracts	5,429,407	5,162,662		
Nongovernmental grants and contracts	1,197,128	949,236		
Sales and services of educational activities	6,825,938	8,101,041		
Auxiliary enterprise:				
Residential life (less allowance 2005--$3,492,151; 2004--$3,240,633)	12,790,855	11,721,821		
Other auxiliary	6,077,126	5,629,941		
Other operating revenues	234,562	232,173	178,015	144,668
Total operating revenues	83,897,016	80,037,411	3,630,324	2,722,478
EXPENSES				
Operating Expenses				
Educational and general:				
Instruction	33,399,706	32,658,266		
Research	923,431	1,186,490		
Public Service	9,035,748	9,837,958		
Academic support	13,146,723	12,456,097		
Student services	12,050,268	11,552,583		
Institutional support	10,228,726	9,616,291	657,543	943,158
Operations and maintenance of plant	14,596,093	12,470,337		
Student Aid	8,360,888	7,808,262		
Depreciation	8,434,496	8,419,615		
Auxiliary enterprise:				
Residential life	11,741,219	11,001,606		
Other	6,577,515	6,403,315		
Other expenses	304,330	293,128		
Total operating expenses	128,799,143	123,703,948	657,543	943,158
Operating loss	(44,902,127)	(43,666,537)	2,972,781	1,779,320
NON-OPERATING REVENUES (EXPENSES)				
State appropriations	46,115,649	44,824,131		
Gifts (including 2005--$1,823,888 and 2004--$1,596,825 from the NMU Foundation	1,861,303	1,624,186		
Payments to the University			(3,362,430)	(1,596,825)
Investment income (net of investment expense for the University 2005--$158,991 and 2004--$110,765; and for the NMU Foundation 2005--$90,391 and 2004--$107,558)	2,270,176	2,071,011	1,134,517	2,048,875
Interest on capital asset-related debt	(2,830,080)	(2,695,869)		
Net non-operating revenues and expenses	47,417,048	45,823,459	(2,227,913)	452,050
Income (loss) before other revenues	2,514,921	2,156,922	744,868	2,231,370
Capital appropriations	12,067,891	15,224,642		
Capital grants and gifts	253,928	620,054		
Capital gifts from the NMU Foundation	1,217,333			
Loss on asset disposal	(1,633,195)	(451,135)		
Total other revenues	11,905,957	15,393,561		
Increase in net assets	14,420,878	17,550,483	744,868	2,231,370
NET ASSETS				
Net assets--beginning of year	176,208,723	158,658,240	19,771,372	17,540,002
Net assets--end of year	$190,629,601	$176,208,723	$20,516,240	$19,771,372

See notes to financial statements.

NORTHERN MICHIGAN UNIVERSITY
Statements of Cash Flows

	June 30	
	2005	**2004**
Cash Flows from Operating Activities		
Tuition and fees	$ 40,032,229	$ 36,996,282
Grants and contracts	18,749,197	17,780,060
Payments to suppliers	(40,103,977)	(34,292,898)
Payments to employees	(73,311,875)	(71,350,885)
Payments for scholarships and fellowships	(7,999,151)	(7,808,263)
Loans issued to students and employees	(1,698,448)	(1,876,695)
Collection of loans to students and employees	1,272,524	1,644,049
Auxiliary enterprise:		
Residential Life	12,502,226	11,735,124
Other	6,107,085	6,048,346
Other receipts	7,502,534	7,622,087
Net cash used by operating activities	(36,947,656)	(33,502,793)
Cash Flows from Noncapital Financing Activities		
State appropriations	46,080,619	45,834,843
William D. Ford direct lending receipts	25,546,095	25,254,412
William D. Ford direct lending disbursements	(26,019,695)	(25,284,275)
Gifts and grants received for other than capital purpose	1,861,303	306,856
Other	(605,295)	402,879
Net cash provided by noncapital financing activities	46,863,027	46,514,715
Cash Flows from Capital and Related Financing Activities		
Bonds issued	44,225,000	
Capital appropriations	19,657,447	6,599,877
Capital grants and gifts received	1,480,081	240,748
Purchases of capital assets	(21,647,367)	(26,082,692)
Principal paid on capital debt	(25,282,122)	(1,730,000)
Interest paid on capital debt	(3,047,593)	(2,856,396)
Net cash provided (used) by capital and related financing activities	15,385,446	(23,828,463)
Cash Flows from Investing Activities		
Proceeds from sales and maturities of investments	10,434,163	6,863,483
Interest on investments	1,915,684	1,201,102
Purchase of investments	(29,049,629)	(12,567,861)
Net cash provided (used) by investing activities	(16,699,782)	(4,503,276)
Net increase (decrease) in cash and cash equivalents	8,601,035	(15,319,817)
Cash and cash equivalents - beginning of the year	11,539,443	26,859,260
Cash and cash equivalents - end of year	$ 20,140,478	$ 11,539,443
Reconciliation of Operating Loss to Net Cash Used by Operating Activities		
Operating loss	$(44,902,127)	$(43,666,537)
Depreciation expense	8,434,496	8,419,615
Change in assets and liabilities:		
Receivables, net	45,942	40,287
Inventories	(57,413)	58,709
Other assets	256,494	20,445
Accounts payable	90,423	1,003,281
Deferred revenue	880,243	246,384
Compensated absences/Accrued payroll	(1,695,714)	375,023
Net cash used by operating activities	$(36,947,656)	$(33,502,793)

See notes to financial statements.

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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 Foundation (Foundation), which was formerly known as the Northern Michigan University Development Fund, is a legally separate, tax-exempt organization supporting Northern Michigan 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 thirty-one-member Board of Trustees of the Foundation 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 Foundation, the majority of resources, or income thereon, that the Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Foundation can only be used by, or for the benefit of, the University, the Foundation is considered a component unit of the University and is discretely presented in the University's financial statements.

During the years ended June 30, 2005 and 2004, the Foundation made distributions of $3.4 million and $1.6 million respectively, to or on behalf of the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from their office at 603 Cohodas Administrative Center, Marquette, MI 49855.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

<u>Basis of Accounting—Northern Michigan University</u>

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

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

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 Foundation 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 Foundation’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 2005 and 2004 is approximately $8,434,000 and $8,420,000 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 according to the first-in, first-out method.

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.

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

Reclassifications

Certain 2004 balances have been reclassified to conform to the 2005 presentation.

NOTE B--DEPOSITS AND INVESTMENTS

The University has adopted GASB Statement No. 40, Deposits and Investment Risk Disclosures.

The University's cash and investments are included in the Statement of Net Assets under the following classification:

	2005	2004
Cash and cash equivalents	**$20,140,478**	$11,539,443
Long-term investments	**44,930,063**	26,068,128
Other long-term investments	**1,094,962**	1,094,962
Total	**$66,165,503**	$38,702,533

Deposits

Custodial Credit Risk – Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. The University does not have a deposit policy for custodial credit risk. At June 30, 2005 and 2004, the carrying amount of the University's deposits was $1,088,044 and $(1,585,583), respectively. The bank balance of the University's deposits at June 30, 2005 and 2004, was $4,284,561 and $1,715,676, respectively. Of that amount, $200,000 and $100,000, respectively, were insured. The remaining, $4,084,561 and $1,615,676, respectively, was uninsured and uncollateralized.

Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of a deposit. The University does not have a deposit policy for foreign currency risk. The University did not have any deposits denominated in foreign currencies at June 30, 2005 and 2004.

Investments

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. As a means of limiting its exposure to fair value losses resulting from rising interest rates, the University's investment policy limits the average weighted maturities and the maximum maturities of its investments. For investments expected to be expended within one year, the average weighted maturity cannot exceed one year. For investments expected to be liquidated within one and three years, the average weighted maturity must be between one and three years and the maximum maturity of any investment cannot exceed seven years. The average weighted maturity of investments not anticipated to be liquidated for at least three years can be between three and six years, while the maximum maturity cannot exceed fifteen years.

The NMU Foundation's (Foundation) investments are not managed by the University and are invested under a separate investment policy of the Foundation. The Foundation's investment policy does not specifically address interest rate risk. The Foundation's policy prohibits investment in warrants, options, futures, collectibles, leveraging the portfolio, convertible securities, mutual funds (money market funds exempted), hedge funds, LLCs, unit investment trusts, margin purchases or short sales, and loaning or pledging securities. The target portfolio composition is seventy-five percent equities, twenty-five percent fixed income securities, and zero percent cash equivalents.

NOTE B--DEPOSITS AND INVESTMENTS (Continued)

At June 30, 2005, the University had the following investments and maturities:

	Fair Market Value	Less Than 1	1-5	6-10	More Than 10
Money Market Mutual Funds	$19,052,432	$19,052,432			
Bond Mutual Funds	35,246,728		$32,173,398	$3,073,330	
Mortgage Backed Security Funds	16,463				$16,463
Equity Mutual Funds	9,666,874				9,666,874
Preferred Stock	900,000				900,000
Real Estate	194,962				194,962
Total	65,077,459	$19,052,432	$32,173,398	$3,073,330	$10,778,299
Less Investments Reported as "Cash Equivalents" on Statements of Net Assets	(19,052,434)				
Total Investments	$46,025,025				

At June 30, 2004, the University had the following investments and maturities:

	Fair Market Value	Less Than 1	1-5	6-10	More Than 10
Money Market Mutual Funds	$13,122,238	$13,122,238			
Bond Mutual Funds	16,796,653		$13,828,691	$2,967,962	
Mortgage Backed Security Funds	24,338				$24,338
Equity Mutual Funds	9,249,925				9,249,925
Preferred Stock	900,000				900,000
Real Estate	194,962				194,962
Total	40,288,116	$13,122,238	$13,828,691	$2,967,962	$10,369,225
Less Investments Reported as "Cash Equivalents" on Statements of Net Assets	(13,125,926)				
Total Investments	$27,163,090				

Credit Risk – Credit risk is the risk that an issuer of or counterparty to an investment will not fulfill its obligations. To limit its exposure to credit risk, the University's investment policy limits the average credit rating of its portfolios as well as the minimum acceptable credit rating of individual investments. For investments expected to be expended within one year, the average weighted credit rating must be AAA and the minimum acceptable credit rating of any security is AA. For other University investments, the average credit rating must be between AA and AAA and the minimum credit rating of any investment must be at least A. Investments in the endowment portfolio shall have a weighted average credit rating of A or better, and the minimum acceptable credit rating is Baa/BBB.

The Foundation's investments are not managed by the University and are invested under a separate investment policy of the Foundation. The Foundation's investment policy allows up to twenty-five percent of the portfolio to be invested in debt investments rated between BB and CCC, with at least eighty percent of these securities being rated BB or B.

At June 30, 2005 and 2004, the University's bond mutual funds and money market funds were rated AAA. Its mortgage backed security mutual funds were either rated AAA or were guaranteed by the full faith and credit of the U. S. government and were therefore not subject to credit risk.

NOTE B--DEPOSITS AND INVESTMENTS (Continued)

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributed to the magnitude of investment in a single issuer. The University's investment policy limits investment in any single company or issuer to ten percent of the total investment, except there is no limit on investments issued by the U.S. government. No more than eight percent of the endowment portfolio may be invested in one issuer or company, except investment in U.S. government securities is not limited.

The Foundation's investments are not managed by the University and are invested under a separate investment policy of the Foundation. The Foundation's investment policy limits investments to not more than five percent of the outstanding securities of one issuer and not more than five percent of their portfolios' assets in the outstanding securities of one issuer at the time of purchase, except for Treasury and Agency securities.

Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The University's investment policy does not address foreign currency risk. The University did not have any investments denominated in foreign currencies at June 30, 2005 and 2004.

The Foundation's investments are not managed by the University and are invested under a separate investment policy of the Foundation. The Foundation's investment policy allows up to ten percent of its portfolio to be invested in foreign-denominated securities; all other investments must be denominated in U.S. dollars.

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:

	2005	**2004**
State appropriations	**$ 7,961,062**	$ 7,926,032
State capital appropriations	**1,110,172**	8,699,728
Student loans – net	**9,373,264**	9,130,096
Charter schools	**2,365,252**	2,265,696
NMU Foundation	**280,931**	537,624
State and federal grants	**1,398,333**	1,601,149
Students, employees, and vendors	**2,651,852**	2,489,635
Investment receivable	**170,786**	62,762
Total	**$25,311,652**	$32,712,722

NOTE D—RECEIVABLES (Continued)

For the years ended June 30, 2005 and 2004, the University received $12,996,372 and $12,424,526, respectively, for charter schools which was forwarded, net an administrative 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, 2005:

	Beginning Balance	Additions and Reclassifications	Retirements	Ending Balance
Land	$ 4,794,870	$ 425,844		$ 5,220,714
Land improvements	9,184,036	1,374,352	$485,182	10,073,206
Buildings and improvements	202,654,039	40,194,565	4,274,588	238,574,016
Infrastructure	18,287,070			18,287,070
Equipment	27,279,273	1,678,911	60,682	28,897,502
Books	13,257,824	451,495	399,759	13,309,560
Construction in progress	23,959,575	(22,226,905)		1,732,670
Totals at historical cost	299,416,687	21,898,262	5,220,211	316,094,738
Less accumulated depreciation for:				
Land improvements	2,505,008	441,862	206,201	2,740,669
Buildings and improvements	61,501,859	4,853,714	2,979,912	63,375,661
Infrastructure	6,417,242	729,660		7,146,902
Equipment	18,178,885	1,842,452	54,615	19,966,722
Books	10,473,338	566,808	342,288	10,697,858
Total accumulated depreciation	99,076,332	8,434,496	3,583,016	103,927,812
Capital assets, net	$200,340,355	$13,463,766	$1,637,195	$212,166,926

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	5,474,831		202,654,039
Infrastructure	16,918,366	1,368,704		18,287,070
Equipment	25,995,545	1,777,001	$493,273	27,279,273
Books	12,512,893	744,931		13,257,824
Construction in progress	8,379,323	15,580,252		23,959,575
Totals at historical cost	273,435,247	26,474,713	493,273	299,416,687
Less accumulated depreciation for:				
Land improvements	2,214,599	290,409		2,505,008
Buildings and improvements	56,726,603	4,775,256		61,501,859
Infrastructure	5,614,618	802,624		6,417,242
Equipment	16,457,421	2,076,370	354,906	18,178,885
Books	9,998,382	474,956		10,473,338
Total accumulated depreciation	91,011,623	8,419,615	354,906	99,076,332
Capital assets, net	$182,423,624	$18,055,098	$138,367	$200,340,355

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:

	2005	2004
Accrued payroll and benefits	**$ 5,275,416**	$ 6,969,930
Construction contractors	**2,141,778**	2,234,399
Charter Schools	**2,365,252**	2,265,656
Vendors	**2,300,124**	2,083,900
Interest payable	**129,342**	161,484
Total	**$12,211,912**	$13,715,369

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
2006	$3,105,758
2007	419,881
Total	$3,525,639

NOTE I--BONDS AND NOTES PAYABLE

In June 2006, the University anticipates selling a $19,525,000 General Revenue Bond issue for various renovations and construction needs on campus. The principal and interest on the 2006 Revenue Bonds will be payable primarily from general University revenues, will bear interest based on a monthly rate, and mature in varying amounts through 2035.

As a means to lower its borrowing costs, when compared against fixed-rate bonds, the University has already entered into an interest rate swap for $19,525,000 of the Series 2006, General Revenue Variable Rate Demand Bonds. The intention of the swap is 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 3.72625 percent and receives a variable payment computed as 69 percent of the U.S. Dollar – London Interbank Offered Rate (USD-LIBOR-BBA). The swap has a notional amount of $19.525 million and the associated variable-rate bond has a $19.525 million principal amount. The bonds are planned to mature on December 1, 2035. The related swap agreement matures on December 1, 2035. As of June 30, 2005, rates were as follows:

	Terms	Rates
Interest rate swap:		
Fixed payment to counterparty	Fixed	3.726%
Variable payment from counterparty	69% of USD-LIBOR-BBA	(2.236%)
Net interest rate swap payments		1.490%
Variable rate bond coupon payments	Actual monthly auction variable rate	N/A%
Synthetic interest rates on bonds		N/A%

NOTE I--BONDS AND NOTES PAYABLE (Continued)

The University has not calculated the fair value of the swap agreement. As of June 30, 2005, 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 3.72625% 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, 2005, the counterparty to the swap agreement was rated A+ 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 2005, the University sold a $44,225,000 General Revenue Bond issue to in substance defease $21,970,000 of its previous bonds and for various renovations and construction needs on campus. The principal and interest on the 2005 Revenue Bonds are primarily payable from general University revenues, bear interest based on a monthly rate, and mature in varying amounts through 2035. The interest rate at June 30, 2005 was 2.75%.

As a means to lower its borrowing costs, when compared against fixed-rate bonds at the time of issuance in 2005, the University entered into an interest rate swap for $44,225,000. 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 3.2 percent and receives a variable payment computed as 69 percent of the U.S. Dollar – London Interbank Offered Rate (USD-LIBOR-BBA). The swap has a notional amount of $44.225 million and the associated variable-rate bond has a $44.225 million principal amount. The swap was entered into at the same time the bonds were issued (2005). The bonds and related swap both mature on December 1, 2035. As of June 30, 2005, rates were as follows:

	Terms	Rates
Interest rate swap:		
Fixed payment to counterparty	Fixed	3.200%
Variable payment from counterparty	69% of USD-LIBOR-BBA	(2.236%)
Net interest rate swap payments		0.964%
Variable rate bond coupon payments	Actual monthly auction variable rate	2.750%
Synthetic interest rates on bonds		3.714%

NOTE I--BONDS AND NOTES PAYABLE (Continued)

The University has not calculated the fair value of the swap agreement. As of June 30, 2005, 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 3.2 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, 2005, the counterparty to the swap agreement was rated A+ 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 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, 2005 was 2.30%.

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, 2005, 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	(2.211%)
Net interest rate swap payments		1.804%
Variable rate bond coupon payments	Actual daily tax-exempt variable rate	2.300%
Synthetic interest rates on bonds		4.104%

NOTE I--BONDS AND NOTES PAYABLE (Continued)

The University has not calculated the fair value of the swap agreement. As of June 30, 2005, 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, 2005, the counterparty to the swap agreement was rated A+ 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 and paid in full on June 1, 2003. The principal and interest on the 1998 Revenue Bonds are primarily payable from general University revenues, bear interest at rates from 4.20% 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 and paid in full on June 1, 2002. The principal and interest on the 1997 Revenue Bonds are primarily payable from general University revenues, bear interest at rates from 4.45% to 5.13%, and mature in varying amounts through 2021.

Using rates as of June 30, 2005, debt service requirements of the long-term debt and interest rate swaps, 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.

NOTE I--BONDS AND NOTES PAYABLE (Continued)

		Interest		
Fiscal Year	**Principal**	**Bonds**	**Interest Rate Swap**	**Total**
2005-2006	$ 1,976,855	$ 2,610,148	$ 747,316	$ 5,334,319
2006-2007	1,966,855	2,534,514	735,037	5,236,406
2007-2008	2,581,855	2,456,197	719,135	5,757,187
2008-2009	2,551,855	2,367,790	693,221	5,612,866
2009-2010	2,811,855	2,283,838	666,388	5,762,081
Total five years	11,889,275	12,252,487	3,561,097	27,702,859
Thereafter				
2011-2015	15,404,275	10,030,260	2,894,311	28,328,846
2016-2020	18,814,275	7,390,569	2,016,973	28,221,817
2021-2025	20,193,921	4,299,765	1,004,424	25,498,110
2026-2030	12,600,514	1,884,559	404,206	14,889,279
2031-2035	6,820,000	544,746	178,305	7,543,051
2036-2040	1,150,000	13,343	4,679	1,168,022
Total	$86,872,260	$36,415,729	$10,063,995	$133,351,984

Long-term liability activity for the year ended June 30, 2005, was as follows:

	Beginning Balance	**Additions**	**Reductions**	**Ending Balance**	**Current Portion**
Leases and bonds payable:					
Bonds payable	$67,900,000	$44,225,000	$23,780,000	$88,345,000	$2,065,000
Loss on bond defeasance		(1,502,122)	(29,382)	(1,472,740)	(88,145)
Total notes and bonds payable	$67,900,000	$42,722,878	$23,750,618	$86,872,260	$1,976,855
Other liabilities:					
Severance benefits	3,950,521	275,171	1,343,898	2,881,794	1,084,335
Compensated absences	2,088,636	83,748	-	2,172,384	148,957
Federal portion of Perkins Loan Program	6,958,443	8,820	-	6,967,263	-
Total other liabilities	12,997,600	367,739	1,343,898	12,021,441	1,233,292
Total long-term liabilities	$80,897,600	$43,090,617	$25,094,516	$98,893,701	$3,210,147

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 J--OPERATING EXPENSES

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

	2005	2004
Salaries, wages and benefits	**$ 71,961,185**	$ 71,876,785
Supplies and support services	**34,024,246**	30,649,457
Utilities	**6,380,065**	4,949,829
Depreciation expense	**8,434,496**	8,419,615
Scholarships	**7,999,151**	7,808,262
Total	**$128,799,143**	$123,703,948

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). New University employees hired after January 1, 1996, can only participate in TIAA-CREF based on changes in state legislation during 1995.

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 2005, this rate is 6.52%, and is applied to payrolls occurring on or after October 1, 2004. For the State's fiscal year 2004, this rate is 6.47%, and is applied to payrolls occurring on or after October 1, 2003.

- 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 2005, this rate is 4.46% and is applied to payrolls occurring on or after October 1, 2004. For the State's fiscal year 2004, this rate is 0.88%, and is applied to payrolls occurring on or after October 1, 2003.

- Retiree Health Insurance: For its fiscal year 2004, the State changed its method for calculating retiree health insurance. Prior to 2004, the Office of Retirement Systems calculated the annual cost for each university, based on the relative percentage of retirees for each university to the total number of all university retirees. This annual cost was divided into equal monthly payments. The new calculation is based on the University's retirees who are covered on the Retirement System's health plan including specific insurance coverage and corresponding premium subsidy. Beginning with the State's fiscal year 2004, the University has been asked to pay the lower of the monthly amount of the calculated annual cost or the amount calculated monthly under the new method. The new method is expected to reduce the University's overall payment. For the year ended June 30, 2005, which encompasses 9 months of the State's fiscal year 2005 and 3 months of the State's fiscal year 2004, the University's total cost for retiree's health insurance was $2,138,555. For the year ended June 30, 2004, which encompasses 9 months of the State's fiscal year 2004 and 3 months of the State's fiscal year 2003, the University's total cost for retiree's health insurance was $1,981,970.

NOTE K--RETIREMENT PLANS (Continued)

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, 2005:

	TIAA-CREF	MPSERS	University Total
University Contributions	$ 4,724,719	$ 3,409,571	$ 8,134,290
Employee Contributions		402,987	402,987
Covered Payroll	31,222,129	14,407,737	45,629,866

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

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, 2005 and 2004, was $347,000 and $701,000, 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, 2005 and 2004, was $2,094,000 and $2,504,000, 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, 2005 and 2004, was $441,000 and $746,000 respectively.

NOTE M--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 and subsequently they incorporated as a Michigan nonprofit corporation pursuant to the provisions of Act 162 Public Acts of 1982. 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 $16,009,290 at June 30, 2004, based on the last published financial statements.

NOTE N--CONTINGENCIES

The University is in the process of renovating various campus buildings. Contractual commitments relating to renovations were approximately $2,629,000 and $13,105,000 at June 30, 2005 and 2004, respectively.

University facilities including the Heating Plant, the Service Building, the Art Annex, the Seaborg Center Complex, the Art and Design addition, the Student Services Center, and the Thomas Fine Arts have been or are scheduled to be financed in whole or in part by State Building Authority (SBA) 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 O--SUBSEQUENT EVENTS

Subsequent to year end, the University anticipated signing lease commitments of $3,179,000 for laptop computers.