

# **FINANCIAL REPORT**

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**2003 - 2004**

**NORTHERN MICHIGAN UNIVERSITY**

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## TABLE OF CONTENTS

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Board of Trustees, Executive Officers, and Finance and Administration Staff .....	1
Management's Discussion and Analysis.....	3
Report of Independent Auditors .....	11
Statements of Net Assets .....	13
Statements of Revenues, Expenses, and Changes in Net Assets .....	14
Statements of Cash Flows .....	15
Notes to Financial Statements .....	17

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## **Board of Trustees**

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Terms ending December 31 in year shown

Mary L. Campbell  
*Chair*  
Ann Arbor  
2004

Karl A. Weber  
*Vice Chair*  
Marquette  
2006

Alan T. Ackerman  
Bloomfield Hills  
2010

Samuel S. Benedict  
Rapid River  
2008

Scott L. Holman  
Bay City  
2004

Larry C. Inman  
Williamsburg  
2006

Mary C. Lukens  
Ann Arbor  
2008

Douglas B. Roberts  
East Lansing  
2010

Leslie E. Wong  
President of the University  
*Ex Officio*

## **Executive Officers**

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Leslie E. Wong  
President

Fred Joyal  
Provost and Vice President for Academic Affairs

Michael J. Roy  
Vice President for Finance and Administration and  
Treasurer of the Board of Trustees

## **Finance and Administration Staff**

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Felecia J. Flack  
Director of Support/Consulting Services

Kenneth G. Godfrey  
Athletic Director and Associate Vice President  
of Recreation and Athletics

Sandra S. Haavisto  
Controller

R. Gavin Leach  
Associate Vice President for Finance and Planning

David W. Maki  
Director of Technical Services

Carl S. Pace  
Associate Vice President for Business Services  
and Facilities

Arthur D. Pickering, Jr.  
Director of Human Resources

Matthew W. Riipi  
Internal Auditor

Andrew V. Wasilewski  
Associate Vice President for Auxiliary Services

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## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

### **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, 2004 and 2003. 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 Statement of Net Assets includes all assets and liabilities. It is prepared under the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged.

The Statement 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 \$43.7 million for the year ended June 30, 2004, and \$49.9 million for the year ended June 30, 2003. 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 Statement of Cash Flows presents information related to cash inflows and outflows summarized by operating, capital, financing and investing activities.

#### **Financial Highlights**

An increase of \$17.6 million in Net Assets for the year ended June 30, 2004, 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, 2003, operating and non-operating revenue of \$128.0 million exceeded operating and non-operating expenses by \$1.1 million. The increase in Net Assets, or the overall financial position of the University, primarily resulted from Northern's continued increase in enrollment and increases in tuition and fees that helped offset a \$1.8 million decrease in state appropriations.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Northern Michigan University**  
(continued)

**Financial Highlights (Continued)**

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, \$.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.

For the year ended June 30, 2003, operating expenses of \$123.1 million increased by \$7.4 million over the prior year and included an increase of \$4.6 million for compensation, \$1.3 million increase for additional notebook computers, \$1.4 million increase in scholarships, \$0.8 million for implementation costs for new administrative software, \$0.5 million increase in depreciation expense, and \$1.2 million decrease in various support costs. The University made reductions in its workforce that impacted 73 positions, including 20 layoffs, effective July 1, 2003, as the result of reduced state appropriations. Post-separation benefits of \$457,000 are included in compensation for employees whose positions were eliminated and signed severance agreements prior to June 30, 2003. Non-operating expenses totaled \$2.7 million for interest on capital asset-related debt.

The University changed its method of classifying the Federal Capital Contribution of its federal Perkins Loan program from restricted expendable net assets to a long-term liability. This represents a change from one generally accepted accounting principle to another generally accepted accounting principle that is the current preferred industry practice. The effect of the change was to reduce beginning net assets by \$6,612,615 for the year ended June 30, 2003.

**Condensed Financial Information**

Condensed Statement of Net Assets

	June 30	
	2004	2003
<b>ASSETS</b>		
Current Assets	\$ 39,342,969	\$ 46,484,583
Noncurrent Assets:		
Capital	200,340,355	182,423,624
Other	34,455,186	27,924,581
Total Noncurrent Assets	<u>234,795,541</u>	<u>210,348,205</u>
Total Assets	<u>274,138,510</u>	<u>256,832,788</u>
<b>LIABILITIES</b>		
Current Liabilities	20,294,026	18,226,830
Noncurrent Liabilities	77,635,761	79,947,718
Total Liabilities	<u>97,929,787</u>	<u>98,174,548</u>
<b>NET ASSETS</b>		
Invested in Capital Assets Net of Related Debt	137,631,248	123,448,622
Restricted		
Nonexpendable	769,569	673,013
Expendable	3,653,154	3,378,089
Unrestricted	34,154,752	31,158,516
Total Net Assets	<u>\$176,208,723</u>	<u>\$158,658,240</u>

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Northern Michigan University**  
(continued)

**Condensed Financial Information (Continued)**

Total current assets of \$39.3 million at June 30, 2004, included \$5.2 million in unspent bond proceeds that will be used for construction projects. At June 30, 2003, total current assets of \$46.5 million included \$10.7 million in unspent bond proceeds. After adjusting for unspent bond proceeds, the current ratio of current assets to current liabilities is 1.68 for the year ended June 30, 2004, and 1.97 for the year ended June 30, 2003.

The University's largest non-current asset is its investment in physical plant of \$200.3 million at June 30, 2004. Net capital assets increased \$17.9 million over the prior year after recognition of \$8.4 million in depreciation expense.

The state appropriations receivable totaled \$16.6 million at June 30, 2004, and included \$8.7 million in construction receivables. The state appropriation receivable at June 30, 2003, totaled \$9.0 million and included \$0.1 million in construction receivables.

University liabilities totaled \$97.9 million at June 30, 2004, and \$98.2 million at June 30, 2003. Long-term debt, the largest liability, totaled \$67.9 million at June 30, 2004, and \$69.6 million at June 30, 2003, consisted of notes and bonds payable.

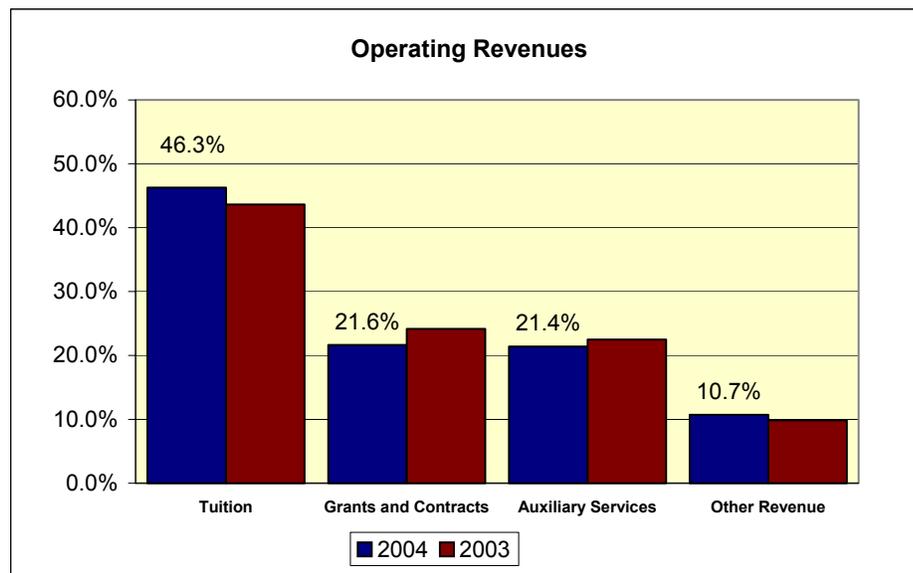
Condensed Statement of Revenues, Expenses and Changes in Net Assets

	June 30	
	2004	2003
Operating Revenues		
Tuition and Fees	\$ 37,028,944	\$ 31,963,965
Grants and Contracts	17,323,491	17,687,048
Auxiliary Enterprises	17,124,164	16,475,116
Other Operating Revenues	8,560,812	7,131,069
Total Operating Revenues	80,037,411	73,257,198
Operating Expenses	123,703,948	123,123,226
Operating Income/(Loss)	(43,666,537)	(49,866,028)
Non-operating Revenues (Expenses)		
State Appropriations	44,824,131	50,192,382
Other Non-operating Income and Expenses	999,328	379,365
Net Non-operating Revenues and Expenses	45,823,459	50,571,747
Income Before Other Revenues	2,156,922	705,719
Capital Appropriations	15,224,642	727,642
Capital Grants and Gifts	620,054	710,396
Loss on asset disposal	(451,135)	
Total Other Revenues	15,393,561	1,438,038
Total Increase in Net Assets	17,550,483	2,143,757
Net Assets		
Net assets—beginning of year	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	158,658,240	156,514,483
Net assets – end of year	\$176,208,723	\$158,658,240

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Northern Michigan University**  
**(continued)**

**Condensed Financial Information (Continued)**

Total operating revenues were \$80.0 million for fiscal 2004 and \$73.3 million for fiscal 2003. 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

	2003-2004	2002-2003
Undergraduate, resident	\$5,210	\$4,780
Undergraduate, nonresident	\$8,438	\$7,732
Graduate, resident	\$5,924	\$5,404
Graduate, nonresident	\$8,882	\$8,092

**Room and Board**

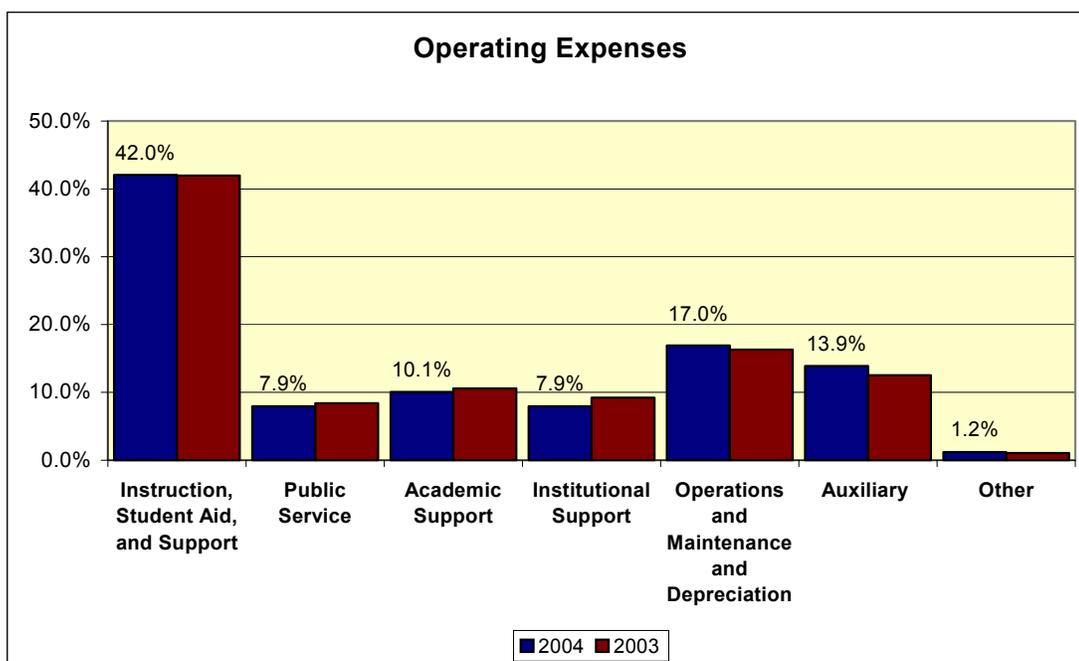
The annual cost of room and board, which includes laundry and other miscellaneous residence fees, was \$5,724 for 2003-2004 and \$5,630 for 2002-2003. The University provides on-campus residence hall and apartment facilities for students. Most students who are not living at home with their parents must live on campus through their first four semesters. Nine residence halls currently have a mean occupancy of 2,143 (2003 – 2,179) and are at a 95 percent capacity (2003 – 95 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.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Northern Michigan University**  
(continued)

**Operating Expenses**

Operating expenses for June 30, 2004, including depreciation of \$8.4 million, totaled \$123.7 million. Of this total, \$52.0 million, or 42.0 percent, was used for instruction, student aid, and student support, \$20.9 million, or 16.9 percent, was used for operation, maintenance, and depreciation, and \$17.2 million, or 13.9 percent, was used for auxiliary services. Operating expenses for June 30, 2003, including depreciation of \$7.6 million, totaled \$123.1 million.

The breakout by functional expense is highlighted below:



**Other**

The State appropriation of \$44.8 million for June 30, 2004 and \$50.2 million for June 30, 2003, 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 \$2.7 million for June 30, 2004 and \$2.7 million for June 30, 2003.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Northern Michigan University**  
**(continued)**

**The Statement of Cash Flows**

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

Condensed Statement of Cash Flows

	June 30	
	2004	2003
Cash Provided (Used) By:		
Operating Activities	\$(33,380,049)	\$(42,918,874)
Non-capital Financing Activities	46,391,971	52,172,802
Capital and Related Financing Activities	(23,828,463)	(16,922,400)
Investing Activities	(4,503,276)	1,144,293
Net Increase (Decrease) in Cash and Cash Equivalents	(15,319,817)	(6,524,179)
Cash and Cash Equivalents – Beginning of Year	26,859,260	33,383,439
Cash and Cash Equivalents – End of Year	\$ 11,539,443	\$ 26,859,260

Major sources of funds included in operating activities are student tuition and fees of \$37.3 million, grants and contracts of \$17.8 million, and auxiliary sales of \$17.6 million for June 30, 2004; and student tuition and fees of \$32.2 million, grants and contracts of \$17.5 million, and auxiliary sales of \$16.5 million, for June 30, 2003. The major source of funds included in non-capital financing activities is state appropriations of \$45.8 million for June 30, 2004, and \$50.7 million for June 20, 2003.

**Northern Michigan University Development Fund**

The mission of the Northern Michigan University Development Fund 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 of \$2.2 million was realized for the year ended June 30, 2004. The Development Fund 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.

<u>Academic Year</u>	<u>Fall Headcount Enrollment</u>			<u>Fiscal Year Equated Students</u>	<u>Annual Total Credit Hours Taken</u>
	<u>Undergraduate Students</u>	<u>Graduate Students</u>	<u>Total</u>		
1999	7,070	797	7,867	6,999	206,881
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

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Northern Michigan University**  
**(continued)**

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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.

For the 2003 academic year, fifty-nine percent (59%) of the University's students represented Upper Peninsula Michigan residents, twenty-five percent (25%) of the University's students came from Michigan's Lower Peninsula, and the remaining sixteen percent (16%) came 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

<u>Fall Semester</u>	<u>Applications Received</u>	<u>Applications Accepted</u>	<u>Percent Accepted</u>	<u>Total New Freshmen Enrolled</u>	<u>Percent Enrolled</u>
1999	3,619	3,098	85.6	1,593	51.4
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

Transfer Student Admissions

<u>Fall Semester</u>	<u>Applications Received</u>	<u>Applications Accepted</u>	<u>Percent Accepted</u>	<u>Students Enrolled</u>	<u>Percent Enrolled</u>
1999	1,118	874	78.1	493	56.4
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

By August 27, 2004, the University had received 5,014 freshman applications (as compared to 4,456 as of August 27, 2003) and had granted 4,155 acceptances (as compared to 3,753 as of August 27, 2003).

By August 27, 2004, the University had received 1,154 transfer applications (as compared to 1,123 as of August 27, 2003) and had granted 788 acceptances (as compared to 840 as of August 27, 2003).

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Northern Michigan University**  
**(concluded)**

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**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.

Beginning in January 2003, the University made a commitment to move its current mainframe administrative software system to a web accessible relational database system. The new software consists of six integrated modules that include finance, alumni, student, financial aid, human resources, and general shared data. Finance went live on July 1, 2003, and the remaining modules will phase into operation throughout this upcoming fiscal year with the final completion date of July 1, 2004.

Campus facilities continued to be renovated through the use of internal resources and funds from bonds issued during the fiscal year. The largest on-going project is the Renovation and Adaptive Re-Use of East Campus Facilities. The Fine and Practical Arts section totals \$21.2 million and includes an addition to the Art & Design Studios North building, the renovation of the Thomas Fine Arts facility, and a new pedestrian link to the Student Services building. The Student Services section totals \$15.8 million and includes the adaptive re-use of the C.B. Hedgcock Fieldhouse to a student service building. All departments in direct support of students will be consolidated into a one-stop service center with completion scheduled for August 2004.

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, conversion of Magers Hall from faculty offices back to a student residence hall, and construction of new student apartments.

**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, 2004, the University anticipates signing a \$6,198,000 lease with IBM for 6,300 computers.



**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, 2004 and 2003. 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 Development Fund, a discretely presented component unit of Northern Michigan University, which is the University's only 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 Development Fund, 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, 2004 and 2003, 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 5, 2004 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 5, 2004

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**NORTHERN MICHIGAN UNIVERSITY**  
**Statements of Net Assets**

	Northern Michigan University June 30		Component Unit Northern Michigan University Development Fund June 30	
			2004	2003
	2004	2003	2004	2003
<b>ASSETS</b>				
<b>Current Assets:</b>				
Cash and cash equivalents	\$ 11,539,443	\$ 26,859,260	\$ 348,120	\$ 690,755
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	66,284	326,098
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	<u>39,342,969</u>	<u>46,484,583</u>	<u>1,241,349</u>	<u>2,023,307</u>
<b>Noncurrent Assets:</b>				
Long-term investments	26,068,128	19,477,866	18,546,338	15,145,802
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	1,486,904
Capital assets, net	<u>200,340,355</u>	<u>182,423,624</u>	<u>3,543</u>	<u>5,897</u>
Total noncurrent assets	<u>234,795,541</u>	<u>210,348,205</u>	<u>19,764,867</u>	<u>16,638,603</u>
Total assets	<u>274,138,510</u>	<u>256,832,788</u>	<u>21,006,216</u>	<u>18,661,910</u>
<b>LIABILITIES</b>				
<b>Current Liabilities:</b>				
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	<u>3,261,839</u>	<u>3,005,343</u>		
Total current liabilities	<u>20,294,026</u>	<u>18,226,830</u>	<u>698,407</u>	<u>521,377</u>
<b>Noncurrent Liabilities:</b>				
Annuities payable			536,437	600,531
Long-term liabilities	<u>77,635,761</u>	<u>79,947,718</u>		
Total noncurrent liabilities	<u>77,635,761</u>	<u>79,947,718</u>	<u>536,437</u>	<u>600,531</u>
Total liabilities	<u>97,929,787</u>	<u>98,174,548</u>	<u>1,234,844</u>	<u>1,121,908</u>
<b>NET ASSETS</b>				
Invested in capital assets, net of related debt	137,631,248	123,448,622	3,543	5,897
Restricted for				
Nonexpendable				
Scholarships and fellowships	110,586	103,721	5,260,021	5,042,366
Loans	45,528	39,602		
Instruction	613,455	529,690		
Expendable				
Instruction	485,314	421,914	3,296,748	4,585,117
Scholarships and fellowships	542,961	412,954	6,436,085	5,586,017
Loans	2,531,201	2,466,586		
Research	33,999	31,711		
Academic, student and public service	59,679	44,924	3,258,056	1,365,975
Unrestricted	<u>34,154,752</u>	<u>31,158,516</u>	<u>1,516,919</u>	<u>954,630</u>
Total net assets	<u>\$176,208,723</u>	<u>\$158,658,240</u>	<u>\$19,771,372</u>	<u>\$17,540,002</u>

See notes to financial statements.

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

	Northern Michigan University		Component Unit	
	June 30		Northern Michigan University Development Fund	
	2004	2003	2004	2003
<b>REVENUES</b>				
<b>Operating Revenues</b>				
Student tuition and fees (less allowance 2004--\$11,068,706; 2003--\$9,966,545)	\$ 37,028,944	\$ 31,963,965		
Gifts and contributions			\$ 2,477,860	\$ 3,861,787
Endowment income			99,950	112,196
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	8,328,639	6,883,003		
Auxiliary enterprise:				
Residential life (less allowance 2004--\$3,240,633; 2003--\$3,257,043)	11,721,821	11,262,283		
Other auxiliary	5,402,343	5,212,833		
Other operating revenues	232,173	248,066	144,668	98,381
Total operating revenues	<u>80,037,411</u>	<u>73,257,198</u>	<u>2,722,478</u>	<u>4,072,364</u>
<b>EXPENSES</b>				
<b>Operating Expenses</b>				
Educational and general:				
Instruction	32,658,266	32,925,722		
Research	1,186,490	1,109,048		
Public Service	9,837,958	10,338,377		
Academic support	12,456,097	13,025,847		
Student services	11,552,583	11,770,627		
Institutional support	9,843,889	11,330,182	943,158	985,679
Operations and maintenance of plant	12,470,337	12,485,990		
Student Aid	7,808,262	6,948,355		
Depreciation	8,419,615	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	<u>123,703,948</u>	<u>123,123,226</u>	<u>943,158</u>	<u>985,679</u>
Operating loss	(43,666,537)	(49,866,028)	1,779,320	3,086,685
<b>NON-OPERATING REVENUES (EXPENSES)</b>				
State appropriations	44,824,131	50,192,382		
Gifts (including \$1,596,825 from the NMU Development Fund)	1,624,186	2,173,804		
Payments to the University			(1,596,825)	(2,025,149)
Investment income (net of investment expense for the University 2004--\$110,765 and 2003--\$54,699; and for the NMU Development Fund 2004--\$107,558 and 2003--\$71,467)	2,071,011	953,362	2,048,875	389,949
Interest on capital asset-related debt	(2,695,869)	(2,747,801)		
Net non-operating revenues and expenses	<u>45,823,459</u>	<u>50,571,747</u>	<u>452,050</u>	<u>(1,635,200)</u>
Income (loss) before other revenues	<u>2,156,922</u>	<u>705,719</u>	<u>2,231,370</u>	<u>1,451,485</u>
Capital appropriations	15,224,642	727,642		
Capital grants and gifts	620,054	710,396		(445,932)
Loss on asset disposal	(451,135)			
Total other revenues	<u>15,393,561</u>	<u>1,438,038</u>		<u>(445,932)</u>
Increase in net assets	<u>17,550,483</u>	<u>2,143,757</u>	<u>2,231,370</u>	<u>1,005,553</u>
<b>NET ASSETS</b>				
Net assets--beginning of year	158,658,240	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	<u>158,658,240</u>	<u>156,514,483</u>	<u>17,540,002</u>	<u>16,534,449</u>
Net assets--end of year	<u>\$176,208,723</u>	<u>\$158,658,240</u>	<u>\$19,771,372</u>	<u>\$17,540,002</u>

See notes to financial statements.

**NORTHERN MICHIGAN UNIVERSITY**  
**Statements of Cash Flows**

	June 30	
	2004	2003
<b>Cash Flows from Operating Activities</b>		
Tuition and fees	\$ 36,996,282	\$ 32,150,387
Grants and contracts	17,780,060	17,524,061
Payments to suppliers	(34,292,898)	(36,588,855)
Payments to employees	(71,350,885)	(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	7,849,685	7,256,316
Net cash used by operating activities	(33,502,793)	(42,918,874)
<b>Cash Flows from Noncapital Financing Activities</b>		
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	402,879	1,230,351
Net cash provided by noncapital financing activities	46,514,715	52,172,802
<b>Cash Flows from Capital and Related Financing Activities</b>		
Bonds issued		
Capital appropriations	6,599,877	967,752
Capital grants and gifts received	240,748	457,948
Purchases of capital assets	(26,082,692)	(13,852,692)
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	(23,828,463)	(16,922,400)
<b>Cash Flows from Investing Activities</b>		
Proceeds from sales and maturities of investments	6,863,483	14,553,574
Interest on investments	1,201,102	(1,730,029)
Purchase of investments	(12,567,861)	(11,679,252)
Net cash provided (used) by investing activities	(4,503,276)	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
<b>Reconciliation of Operating Loss to Net Cash Used by Operating Activities</b>		
Operating loss	\$(43,666,537)	\$(49,866,028)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	8,419,615	7,555,915
Loss on equipment disposal		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	375,023	948,041
Net cash used by operating activities	\$(33,502,793)	\$(42,918,874)

See notes to financial statements.

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**NOTES TO FINANCIAL STATEMENTS**  
**Northern Michigan University**  
**June 30, 2004**

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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 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 \$1.6 million 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.

**NOTES TO FINANCIAL STATEMENTS**  
**Northern Michigan University**  
**(continued)**

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**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.

**NOTES TO FINANCIAL STATEMENTS**  
**Northern Michigan University**  
**(continued)**

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**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. Construction in Progress and Operations and Maintenance of Plant expense at June 30, 2003, were adjusted by \$1,011,000 to reflect additional capital costs incurred.

**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 total return on the cash and investments was as follows:

	<u>2004</u>	<u>2003</u>
Short Term	<b>1.16%</b>	1.60%
Short Fixed Income	<b>1.21%</b>	5.55%
Intermediate Fixed Income	<b>1.67%</b>	9.39%
Endowment Funds	<b>16.10%</b>	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.

**NOTES TO FINANCIAL STATEMENTS**  
**Northern Michigan University**  
**(continued)**

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**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.

**NOTES TO FINANCIAL STATEMENTS**  
**Northern Michigan University**  
**(continued)**

**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.

	<b>GASB Category #3</b>	<b>Not Categorized</b>	<b>Market Value</b>
Investments:			
Money market funds	\$13,125,026		\$13,125,026
Government agencies	24,338		24,338
Preferred stock	10,150	\$ 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	<u>\$13,179,514</u>	<u>\$27,108,602</u>	40,288,116
Less Investments Reported as "Cash Equivalents" on Statement of Net Assets			<u>(13,125,026)</u>
Total Investment per Statement of Net Assets			<u><u>\$27,163,090</u></u>

At June 30, 2004, the carrying amount of deposits, excluding those classified as investments above, was (\$1,585,583). The deposits were reflected in the accounts of the banks at \$1,715,676. For the deposits at the bank, \$100,000 was Category 1 custodial credit risk and \$1,615,676 was Category 3 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 \$402,056 (2003--\$19,311) was available to be spent and was restricted to specific purposes.

**NOTES TO FINANCIAL STATEMENTS**  
**Northern Michigan University**  
**(continued)**

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**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, as of June 30 each 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, will be permanently held.

**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:

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

**NOTES TO FINANCIAL STATEMENTS**  
**Northern Michigan University**  
**(continued)**

**NOTE E--FIXED ASSETS**

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

	<b>Beginning Balance</b>	<b>Additions and Reclassifications</b>	<b>Retirements</b>	<b>Ending Balance</b>
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	<u>273,435,247</u>	<u>26,474,713</u>	<u>493,273</u>	<u>299,416,687</u>
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	<u>91,011,623</u>	<u>8,419,615</u>	<u>354,906</u>	<u>99,076,332</u>
Capital assets, net	<u>\$182,423,624</u>	<u>\$18,055,098</u>	<u>\$138,367</u>	<u>\$200,340,355</u>

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

	<b>Beginning Balance</b>	<b>Additions and Reclassifications</b>	<b>Retirements</b>	<b>Ending Balance</b>
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	(2,103,994)		8,379,323
Totals at historical cost	<u>259,912,112</u>	<u>14,286,012</u>	<u>762,877</u>	<u>273,435,247</u>
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	<u>83,642,610</u>	<u>7,555,915</u>	<u>186,902</u>	<u>91,011,623</u>
Capital assets, net	<u>\$176,269,502</u>	<u>\$6,730,097</u>	<u>\$575,975</u>	<u>\$182,423,624</u>

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.

**NOTES TO FINANCIAL STATEMENTS**  
**Northern Michigan University**  
**(continued)**

**NOTE G--PAYABLES**

Payables at June 30 were as follows:

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

<b>Year ended June 30</b>	<b>Operating Leases</b>
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:

	<b>Terms</b>	<b>Rates</b>
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%

**NOTES TO FINANCIAL STATEMENTS**  
**Northern Michigan University**  
**(continued)**

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**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 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.

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 and paid in full.

**NOTES TO FINANCIAL STATEMENTS**  
**Northern Michigan University**  
**(continued)**

**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.

Fiscal Year	Principal	Interest		Total
		Bonds	Rate Swap	
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
<b>Thereafter</b>				
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

**NOTES TO FINANCIAL STATEMENTS**  
**Northern Michigan University**  
**(continued)**

**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	\$ 71,876,785	\$ 72,614,750
Supplies and support services	30,649,457	32,582,320
Utilities	4,949,829	4,432,886
Depreciation expense	8,419,615	7,555,915
Scholarships	7,808,262	6,948,355
Total	\$123,703,948	\$124,134,226

**NOTE K--RETIREMENT PLANS**

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

The following represents the employer's share of retirement contributions for MPERS 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 MPERS as a percentage due on their covered MPERS 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.

**NOTES TO FINANCIAL STATEMENTS**  
**Northern Michigan University**  
**(continued)**

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**NOTE K--RETIREMENT PLANS (Continued)**

- 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. For 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, 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. For the year ended June 30, 2003, which encompasses 9 months of the State's fiscal year 2003 and 3 months of the State's fiscal year 2002, the University's total cost for retiree's health insurance was \$2,048,367.

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:

	<u>TIAA-CREF</u>	<u>MPSERS</u>	<u>University Total</u>
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:

	<u>TIAA-CREF</u>	<u>MPSERS</u>	<u>University Total</u>
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.

**NOTES TO FINANCIAL STATEMENTS**  
**Northern Michigan University**  
**(concluded)**

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**NOTE L--EARLY RETIREMENT INCENTIVES (Continued)**

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--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 N--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 O--SUBSEQUENT EVENTS**

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

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