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## Independent Auditor's Report

To the Board of Trustees  
Western Michigan University

We have audited the accompanying balance sheet of Western Michigan University (a component unit of the State of Michigan) and its discretely presented component units as of June 30, 2006 and 2005 and the related statements of revenue, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Western Michigan University and its discretely presented component units as of June 30, 2006 and 2005 and the results of its operations and cash flows 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 21, 2006 on our consideration of Western Michigan University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide opinions on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis presented on pages 4 through 11 is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and express no opinion on it.

*Plante & Moran, PLLC*

August 21, 2006

# Western Michigan University

## Management's Discussion and Analysis

The following discussion and analysis of Western Michigan University's financial statements provides an overview of the University's financial activities for the year ended June 30, 2006. Management has prepared the financial statements and the related footnote disclosures along with the discussion and analysis. Responsibility for the completeness and fairness of this information rests with University management.

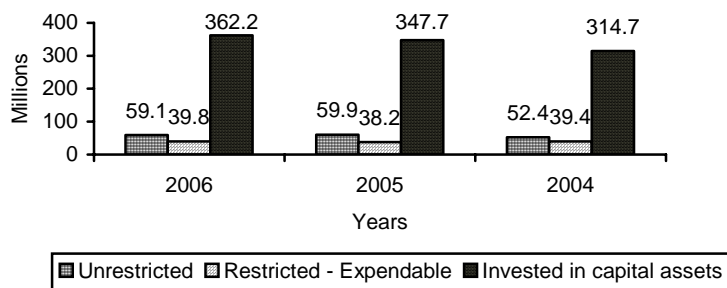
The Carnegie Foundation for the Advancement of Teaching places Western Michigan University among the 76 public institutions in the nation designated as research universities with high research activity. With an enrollment of almost 25,000, the University is one of the 50 largest universities in the nation and is now recognized as the fourth largest university in the state of Michigan. *U.S. News & World Report's* annual ranking of American colleges and universities includes Western Michigan University as one of the nation's top-100 public universities.

### Financial Highlights

The University's financial position remained strong at June 30, 2006, with assets of \$827 million and liabilities of \$366 million. Net assets increased \$15 million during the past fiscal year.

The University invests its working capital to maximize total return, with an appropriate level of risk. The University holdings are mostly invested in relatively short duration assets, with a smaller allocation in equities. While the investment strategy governing the endowment assets seeks to maximize total return over the long run.

The following chart provides a graphical breakdown of net assets by category for the fiscal years ended June 30, 2006, 2005 and 2004.



The University has committed the unrestricted net assets to provide for identified future needs. These needs include contractual obligations, debt service, student loans, capital outlay, insurance reserves, and academic programming needs.

The University's financial statements were prepared in accordance with criteria established by the Governmental Accounting Standards Board (GASB) for determining the various governmental organizations to be included in the reporting entity (GASB Statement No. 39). These criteria include significant operational or financial relationships. Based on the application of the criteria, the University has three component units. The Western Michigan University Foundation, Paper Technology Foundation, and Western Michigan University Research Foundations' statements are discretely presented as part of the University's reporting entity. The Foundations' statements are prepared in accordance with generally accepted accounting principles as prescribed by the Financial Accounting Standards Board (FASB).

# Western Michigan University

## Management's Discussion and Analysis (Continued)

### The Balance Sheet and the Statement of Revenues, Expenses, and Changes in Net Assets

The University's financial report includes three financial statements: the balance sheet, the statement of revenues, expenses, and changes in net assets, and the statement of cash flows.

These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector institutions. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

Following is a summary of the major components of the net assets and operating results of the University for the years ended June 30, 2006, 2005, and 2004:

#### Net Assets as of June 30 (in millions)

	2006	2005	2004
Current assets	\$ 89.8	\$ 95.9	\$ 56.8
Noncurrent assets:			
Capital assets - Net of depreciation	631.2	626.8	614.1
Other	105.8	99.1	78.5
Total assets	<u>\$ 826.8</u>	<u>\$ 821.8</u>	<u>\$ 749.4</u>
Current liabilities	\$ 62.7	\$ 65.1	\$ 62.3
Long-term liabilities	303.0	310.9	280.6
Net assets:			
Invested in capital assets	362.2	347.7	314.7
Restricted	39.8	38.2	39.4
Unrestricted	59.1	59.9	52.4
Total net assets	<u>461.1</u>	<u>445.8</u>	<u>406.5</u>
Total liabilities and net assets	<u>\$ 826.8</u>	<u>\$ 821.8</u>	<u>\$ 749.4</u>

# Western Michigan University

## Management's Discussion and Analysis (Continued)

### Operating Results for the Year Ended June 30 (in millions)

	2006	2005	2004
<b>Operating Revenues</b>			
Tuition and fees - Net	\$ 168.6	\$ 159.2	\$ 152.1
Grants and contracts	41.7	41.1	48.2
Auxiliary activities - Net	81.7	82.7	89.1
Other	28.2	18.6	21.4
<b>Total Operating Revenues</b>	<b>320.2</b>	<b>301.6</b>	<b>310.8</b>
<b>Operating Expenses</b>			
Instruction	128.2	125.3	123.3
Departmental research	25.4	24.3	21.0
Public service	8.9	8.7	9.9
Academic support	36.7	40.2	37.4
Student services	19.8	20.3	21.1
Institutional support	38.2	28.2	30.0
Operations and maintenance of plant	33.1	29.7	29.9
Scholarships and fellowships	28.7	25.4	27.6
Auxiliary activities	74.3	73.4	72.8
Depreciation	25.8	24.4	21.9
Other expenditures	4.6	7.8	8.9
<b>Total Operating Expenses</b>	<b>423.7</b>	<b>407.7</b>	<b>403.8</b>
<b>Net Operating Loss</b>	<b>(103.5)</b>	<b>(106.1)</b>	<b>(93.0)</b>
<b>Nonoperating Revenues (Expenses)</b>			
State appropriations	110.6	113.4	108.0
Gifts	9.8	15.6	12.4
Other nonoperating expenses	(7.2)	(5.7)	(6.5)
<b>Net Nonoperating Revenues</b>	<b>113.2</b>	<b>123.3</b>	<b>113.9</b>
<b>Other Revenues</b>			
Capital appropriations	1.9	17.9	27.6
Capital grants and contracts and other	3.7	4.2	1.0
<b>Total Other Revenues</b>	<b>5.6</b>	<b>22.1</b>	<b>28.6</b>
<b>Increase in Net Assets</b>	<b>15.3</b>	<b>39.3</b>	<b>49.5</b>
<b>Net Assets - Beginning of year</b>	<b>445.8</b>	<b>406.5</b>	<b>357.0</b>
<b>Net Assets - End of year</b>	<b>\$ 461.1</b>	<b>\$ 445.8</b>	<b>\$ 406.5</b>

# Western Michigan University

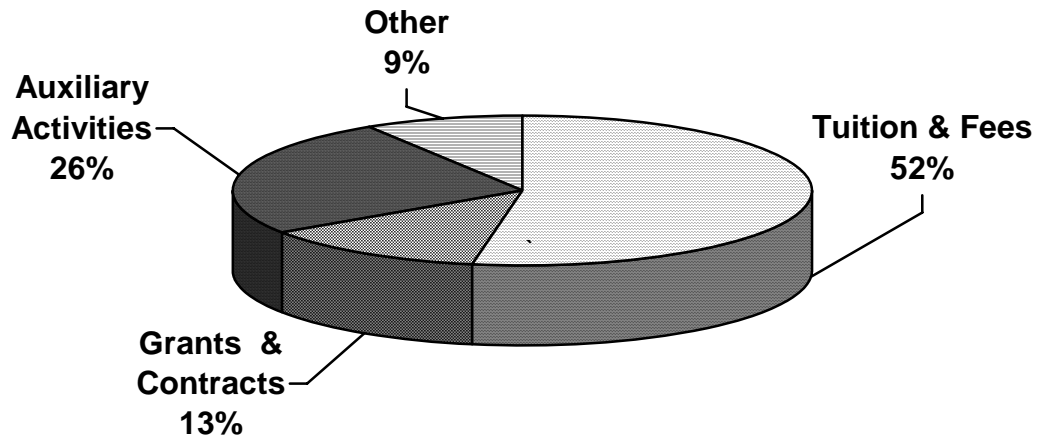
## Management's Discussion and Analysis (Continued)

### Operating Revenues

Operating revenues include all transactions that result in the sales and/or receipts from goods and services such as tuition and fees, housing, and bookstore operations. In addition, certain federal, state, and private grants are considered operating if they are not for capital purposes and are considered a contract for services.

Student tuition and fees revenue increased as a result of the board of trustees raising the rates by 14.3 percent for resident and non-resident undergraduate students. For resident undergraduate student enrolled in 32 credit hours during an academic year, this increase equates to an additional \$405 of tuition and fees.

The following is a graphic illustration of operating revenues by source:



### Operating Expenses

Operating expenses are all the costs necessary to perform and conduct the programs and primary purposes of the University. Operating expenses were significantly impacted by increases in the costs of compensation, utilities, student financial aid, library acquisitions, and academic programming.

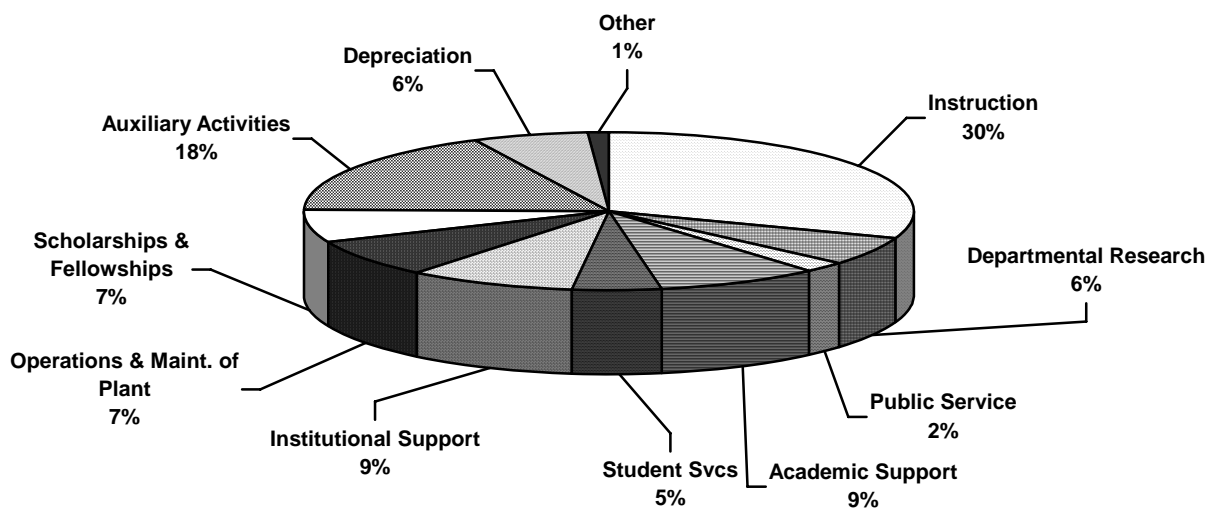
# Western Michigan University

## Management's Discussion and Analysis (Continued)

The University is equally committed to providing financial support to students. In each fiscal year, funds made available for scholarship grow in the same proportion as the rate increase for tuition. The University has long sponsored its prestigious Medallion Scholarship program which attracts some of the brightest and most promising students.

As part of its cost constraint efforts, the University targeted a \$10 million budget reduction for the 2005-2006 fiscal year.

The following is a graphic illustration of operating expenses by source:



### Nonoperating Revenues

Nonoperating revenues are all revenue sources that are primarily non-exchange in nature. They would consist primarily of state appropriations and investment income (including realized and unrealized gains and losses), and grants and contracts that do not require any services to be performed.

Nonoperating revenue was significantly impacted by the following factors:

- The state appropriation decreased approximately 2.5 percent from the prior year, or \$2.8 million. The state appropriation for the fiscal year 2005 had increased 5 percent, or \$5.4 million from the prior year, and for the fiscal year 2004, it had decreased \$13.3 million, or 11 percent.
- Investment income decreased approximately 11.6 percent from the prior year. This is a result of an increase in net unrealized losses from the prior year in the amount of \$2.6 million.
- Gifts decreased \$5.8 million, or 37 percent, from the prior year. During 2004-05, the University received \$5.8 million in gifts for capital projects that were subsequently completed.

# Western Michigan University

## Management's Discussion and Analysis (Continued)

### Other Revenues

Other revenues consist of items that are typically nonrecurring, extraordinary, or unusual to the University. An example would be capital appropriations from the state or federal government and transfers from related entities.

Other revenues were significantly impacted by the following:

Capital state appropriations revenue totaled \$1.9 million in 2006, in comparison to \$17.9 million in 2005. These capital outlays supported the College of Health and Human Services. However, the significant decrease reflects that several state-supported projects were completed in the 2005 fiscal year. Capital grants, contracts, and other revenue amounted to \$3.7 million in 2006, \$4.2 million in 2005, and \$1.0 million in 2004.

### Statement of Cash Flows

Another way to assess the financial health of the University is to look at the statement of cash flows. Its primary purpose is to provide relevant information about the cash receipts and cash payments of an entity during a period. The statement of cash flows also helps users assess:

- An entity's ability to generate future net cash flows
- Its ability to meet obligations as they come due
- Its needs for external financing

### Cash Flows for the Year Ended June 30 (in millions)

	2006	2005	2004
<b>Cash Provided by (Used in)</b>			
Operating activities	\$ (92.9)	\$ (79.7)	\$ (67.2)
Noncapital financing activities	119.5	121.4	119.5
Capital and related financing activities	(33.1)	(22.9)	(27.2)
Investing activities	(4.3)	(11.8)	(22.6)
<b>Net Increase (Decrease) in Cash</b>	(10.8)	7.0	2.5
<b>Cash - Beginning of year</b>	16.8	9.8	7.3
<b>Cash - End of year</b>	<u>\$ 6.0</u>	<u>\$ 16.8</u>	<u>\$ 9.8</u>

The most significant components of cash flows provided from operating activities are tuition and fees, auxiliary activities, and grants and contracts. Tuition and fees generated more cash than in the prior year, reflecting the tuition rate increase. However, net cash used in operating activities was \$92.9 million. To offset this, the net cash provided from non-capital financing activities, which consisted primarily of state appropriations, was \$119.5 million. This is compared to net cash used in operating activities in the amount of \$79.7 million and \$67.2 million for the years ended June 30, 2005 and 2004, respectively. Net cash provided by non-capital financing activities was \$121.4 million and \$119.5 million for the years ended June 30, 2005 and 2004, respectively. Cash used in capital and related financing activities amounted to \$33.1 million, primarily the result of capital additions during the year in the amount of \$47.7 million and proceeds of \$24.7 million from the sale of an apartment complex.

# Western Michigan University

## Management's Discussion and Analysis (Continued)

### Capital Assets

At June 30, 2006, the University had \$631.2 million invested in capital assets, net of accumulated depreciation of \$329.9 million. Depreciation charges totaled \$25.8 million for the current fiscal year compared to \$24.4 million last year.

	2006	2005	2004
Land, land improvements, and infrastructure	\$ 60,594,561	\$ 56,842,881	\$ 52,210,681
Buildings and improvements	686,047,594	698,723,390	649,904,048
Buildings under capital lease	10,578,574	10,578,574	10,578,574
Furniture, fixtures, and equipment	78,413,496	73,870,226	69,578,794
Library collections	89,497,746	82,530,716	76,905,954
Construction in progress	35,950,099	13,748,659	41,080,913
Total	<u>\$961,082,070</u>	<u>\$936,294,446</u>	<u>\$900,258,964</u>

The University completed the new 195,000 square-foot College of Health and Human Services. This building will be the center for health and human services education and research in the area and was funded through gifts, grants, state capital outlay, and general revenue bonds. The University neared completion on a new chemistry building which should be ready for classes in January 2007. The University began construction on a new art facility with 60 percent of the construction complete and an expected completion date of November 2006.

### Debt

At June 30, 2006, the University had \$288.4 million in bonded debt obligations outstanding versus \$295 million the previous year, a decrease of 2.2 percent. At June 30, 2004, the University had \$263.9 million in bonded debt obligations, a decrease of 2 percent from the previous year. The University did not issue general revenue bonds in 2006 but did issue general revenue bonds in the amount of \$37.6 million during the 2005 fiscal year. The 2005 issuance was to finance the construction and renovation of several existing buildings on campus. All of the outstanding debt instruments are general revenue obligations. Also, debt repayments of \$6.6 million were made. The University's revenue bond rating of A+ has not changed from the prior year. More detailed information about the University's long-term liabilities is presented in the notes to the financial statements.

During the 2006 fiscal year, the University repaid a net amount of \$0.8 million on a line of credit. The University had a balance due on the line of credit in the amount of \$8.3 million and \$9.1 million as of June 30, 2006 and June 30, 2005, respectively. The line of credit balance at June 30, 2004 was \$6.9 million. The University has elected to use the line of credit to fund a specific project. It is not used to finance operations.

# **Western Michigan University**

## **Management's Discussion and Analysis (Continued)**

### **Economic Factors that Will Affect the Future**

Acting in its July meeting, the Western Michigan University Board of Trustees adopted a \$295.2 million General Fund operating budget for the 2006-07 year as well as a tuition and fees rate increase.

The new budget reflects that Western's state appropriation for the 2006-07 year is expected to be \$112.9 million. Our state appropriation increased \$3.2 million, or 2.9 percent, and is the first increase in appropriations to be realized by the University in recent years. Tuition and fees for resident undergraduate students will increase 6 percent. Additional revenue from this rate increase as well as enrollment changes will result in a projected net revenue increase of \$2.1 million for the 2006-07 year. Increases in costs for compensation, utilities, financial aid, and debt service have necessitated a \$7.0 million base budget reduction that will be implemented during the year.

During 2007-08 fiscal year, Western will adopt Statement No. 45 of the Governmental Accounting Standards Board (GASB 45). This statement will require Western to accrue the cost of retiree life, medical, prescription drug, dental, and vision benefits currently offered by Western Michigan University to its retirees, their spouses and survivors. Earlier adoption of this Statement is recommended but not required. The University has engaged AON Consulting to perform actuarial valuations of the existing obligation. Once this liability is recognized, funding is strongly encouraged. Western expects that the calculated value for postretirement benefits and annual required contributions will be significant.

Western Michigan University does not have any plans during the 2006-07 year to issue new public debt.

Western's tuition cost will continue to rank only ninth among the state's 15 public universities, even though it is one of Michigan's four largest, most complex and highly regarded research institutions. We continue to offer exceptional value to our students.

# Western Michigan University

## Balance Sheet

	June 30	
	2006	2005
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents (Note 2)	\$ 6,002,381	\$ 16,827,656
Short-term investments (Note 2)	39,570,090	41,664,347
Accounts receivable - Net (Note 3)	34,918,232	30,636,893
Due from depositors	-	63,575
Inventories	5,563,111	5,028,433
Deposits, prepaid expenses, and other assets	3,725,076	1,679,975
Total current assets	89,778,890	95,900,879
<b>Long-term Investments</b> (Note 2)	91,151,008	86,169,482
<b>Student Loans Receivable</b> (Note 3)	9,130,401	8,940,019
<b>Other Receivables</b>	2,369,907	808,456
<b>Other Assets</b>	3,127,768	3,207,012
<b>Capital Assets - Net</b> (Note 4)	631,214,608	626,752,785
Total assets	<b><u>\$ 826,772,582</u></b>	<b><u>\$ 821,778,633</u></b>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Line of credit (Note 5)	\$ 8,339,071	\$ 9,111,246
Current portion of debt obligations (Note 6)	8,872,902	7,157,312
Accounts payable	9,915,147	12,092,761
Due to depositors	125,889	-
Accrued payroll and withholdings	12,368,133	10,884,008
Employee retirement	5,458,933	8,153,300
Insurance and other claims payable (Note 7)	6,984,672	7,640,848
Tuition and fees received in advance	4,180,092	6,187,153
Other liabilities	6,453,694	3,865,095
Total current liabilities	62,698,533	65,091,723
<b>Long-term Obligations</b> (Note 6)	302,977,883	310,854,741
Total liabilities	365,676,416	375,946,464
<b>Net Assets</b>		
Unrestricted	59,177,520	59,993,363
Restricted for:		
Expendable scholarships, fellowships, and research	3,899,440	1,881,419
Loans	9,167,700	8,915,710
Capital projects	1,443,446	369,419
Debt service	2,919,827	5,289,720
Other	22,294,468	21,769,615
Invested in capital assets - Net of related debt	362,193,765	347,612,923
Total net assets	461,096,166	445,832,169
Total liabilities and net assets	<b><u>\$ 826,772,582</u></b>	<b><u>\$ 821,778,633</u></b>

# Western Michigan University

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

	Year Ended June 30	
	2006	2005
<b>Revenues</b>		
Operating revenues:		
Tuition and fees	\$ 190,016,132	\$ 176,583,988
Scholarship allowance	(21,462,185)	(17,352,437)
Net tuition and fees	168,553,947	159,231,551
Governmental grants and contracts	31,878,872	33,087,100
Other grants and contracts	9,806,989	8,038,526
Departmental and other educational activities	19,066,293	15,552,818
Auxiliary activities	86,408,353	86,491,884
Scholarship allowance	(4,711,211)	(3,809,071)
Net auxiliary activities	81,697,142	82,682,813
Other revenues	9,113,478	3,061,718
Total operating revenues	320,116,721	301,654,526
<b>Expenses</b>		
Operating expenses:		
Instruction	128,191,279	125,235,559
Departmental research	25,353,122	24,333,374
Public service	8,914,277	8,690,732
Academic support	36,738,183	40,203,081
Student services	19,825,081	20,301,922
Institutional support	38,168,558	28,168,778
Operations and maintenance of plant	33,101,747	29,739,415
Scholarships and fellowships	28,669,406	25,447,019
Auxiliary activities	74,342,570	73,359,201
Depreciation	25,759,658	24,442,231
Other expenditures	4,570,720	7,755,281
Total operating expenses	423,634,601	407,676,593
<b>Operating Loss</b>	(103,517,880)	(106,022,067)
<b>Nonoperating Revenues (Expenses)</b>		
State appropriations	110,571,200	113,364,400
Gifts	9,799,054	15,559,829
Investment income and other interest income	6,485,209	7,339,630
Interest on capital asset-related debt	(13,707,487)	(13,039,948)
Net nonoperating revenues	113,147,976	123,223,911
<b>Income - Before other revenues</b>	9,630,096	17,201,844
<b>Other Revenues</b>		
State capital appropriations	1,908,999	17,902,486
Other revenues and capital gifts and grants	3,724,902	4,186,137
Total other revenues	5,633,901	22,088,623
<b>Increase in Net Assets</b>	15,263,997	39,290,467
<b>Net Assets</b>		
Beginning of year	445,832,169	406,541,702
End of year	<b>\$ 461,096,166</b>	<b>\$ 445,832,169</b>

# Western Michigan University

## Statement of Cash Flows

	Year Ended June 30	
	2006	2005
<b>Cash Flows from Operating Activities</b>		
Tuition and fees	\$ 187,050,098	\$ 177,471,781
Grants and contracts	42,721,540	41,430,288
Payments to suppliers	(180,377,081)	(161,051,206)
Payments to employees	(252,396,044)	(242,295,013)
Loans issued to students	(2,528,835)	(2,024,920)
Collection of loans from students	2,386,879	1,863,654
Student loan interest	112,165	99,845
Auxiliary enterprise charges	85,810,895	88,379,978
Other	24,302,127	16,421,318
Net cash used in operating activities	(92,918,256)	(79,704,275)
<b>Cash Flows from Noncapital Financing Activities</b>		
Private gifts for endowment purposes	643,762	840,992
Gifts and contributions for other than capital purposes	9,155,292	7,513,145
William D. Ford direct lending receipts	75,545,134	75,083,683
William D. Ford direct lending disbursements	(75,545,134)	(75,083,683)
PLUS loan receipts	34,255,522	29,872,129
PLUS loan disbursements	(34,255,522)	(29,872,129)
Agency transactions	286,792	(165,509)
State appropriations	109,489,671	113,237,836
Net cash provided by noncapital financing activities	119,575,517	121,426,464
<b>Cash Flows from Capital and Related Financing Activities</b>		
Purchase of capital assets	(47,740,068)	(39,964,904)
Proceeds net of deposits from disposal of assets	206,622	119,410
Principal paid on capital debt	(6,590,000)	(6,520,000)
Proceeds from issuance of debt	-	37,600,000
Net borrowings (repayments) on line of credit	(772,175)	2,225,783
Capital grant, gift, and other proceeds	3,529,032	9,458,636
Capital appropriations	3,275,088	18,667,663
Withdrawals from trustee to purchase capital assets	29,061,711	5,740,788
Bond issuance costs	-	(490,491)
Deposit with trustee for bond proceeds	-	(37,212,229)
Interest paid on capital debt	(14,113,428)	(12,501,928)
Net cash used in capital and related financing activities	(33,143,218)	(22,877,272)
<b>Cash Flows from Investing Activities</b>		
Proceeds from sales and maturities of investments	81,643,346	31,564,976
Interest on investments	9,017,336	6,632,640
Purchase of investments	(95,000,000)	(50,000,000)
Net cash used in investing activities	(4,339,318)	(11,802,384)
<b>Net (Decrease) Increase in Cash and Cash Equivalents</b>	(10,825,275)	7,042,533
<b>Cash and Cash Equivalents - Beginning of year</b>	16,827,656	9,785,123
<b>Cash and Cash Equivalents - End of year</b>	<u>\$ 6,002,381</u>	<u>\$ 16,827,656</u>

# Western Michigan University

## Statement of Cash Flows (Continued)

	Year Ended June 30	
	2006	2005
<b>Reconciliation of Operating Loss to Net Cash from Operating Activities</b>		
Operating loss	\$ (103,517,880)	\$ (106,022,067)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	25,759,658	24,442,231
Amortization of bond issuance costs	145,828	147,122
Disposal/adjustments of fixed assets	(4,590,102)	17,664
(Increase) decrease in assets:		
Federal and state grants receivable	(2,493,253)	304,662
Accounts receivable (net)	(2,819,951)	(1,031,670)
Inventories	(534,678)	(533,043)
Prepaid assets and other current assets	(2,045,101)	(282,435)
Loans to students	(190,382)	(234,247)
Increase (decrease) in liabilities:		
Accounts payable	415,046	1,314,444
Accrued payroll and other compensation	(2,014,422)	3,183,203
Other liabilities	1,618,119	58,936
Line of credit	(772,175)	2,225,783
Unearned tuition and fees	(1,878,963)	(3,294,858)
Net cash used in operating activities	<b><u>\$ (92,918,256)</u></b>	<b><u>\$ (79,704,275)</u></b>

# Western Michigan University

## Discretely Presented Component Unit Foundations Balance Sheet and Statement of Activities

Balance Sheet	Western Michigan University Foundation		Paper Technology Foundation, Inc.		Western Michigan University Research Foundation	
	June 30		June 30		June 30	
	2006	2005	2006	2005	2006	2005
<b>Assets:</b>						
Cash and short-term investments	\$ 11,145,466	\$ 1,646,593	\$ 1,062,346	\$ 180,417	\$ (473,980)	\$ (459,788)
Investments (Note 2)	161,239,769	151,321,725	4,791,789	5,558,277	600,000	600,000
Pledges receivable (Note 3)	16,005,136	19,806,923	36,064	73,151	-	-
Cash surrender value of life insurance	1,169,223	1,056,375	-	-	-	-
Land, land contracts, and other property	1,133,885	1,150,735	-	-	-	-
<b>Total Assets</b>	<b>\$ 190,693,479</b>	<b>\$ 174,982,351</b>	<b>\$ 5,890,199</b>	<b>\$ 5,811,845</b>	<b>\$ 126,020</b>	<b>\$ 140,212</b>
<b>Liabilities - Accounts payable</b>	<b>\$ 13,843</b>	<b>\$ 1,297</b>	<b>\$ 8,783</b>	<b>\$ 17,807</b>	<b>\$ -</b>	<b>\$ 1,125</b>
<b>Net Assets</b>						
Unrestricted:						
Unrestricted	115,912,540	3,378,153	173,165	130,234	-	-
Designated	-	100,370,550	2,535,791	2,322,851	126,020	139,087
Temporarily restricted	22,765,217	22,172,221	1,447,516	1,651,210	-	-
Permanently restricted	52,001,879	49,060,130	1,724,944	1,689,743	-	-
<b>Total Net Assets</b>	<b>190,679,636</b>	<b>174,981,054</b>	<b>5,881,416</b>	<b>5,794,038</b>	<b>126,020</b>	<b>139,087</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 190,693,479</b>	<b>\$ 174,982,351</b>	<b>\$ 5,890,199</b>	<b>\$ 5,811,845</b>	<b>\$ 126,020</b>	<b>\$ 140,212</b>
<b>Statement of Activities and Changes in Net Assets</b>						
	Year Ended June 30		Year Ended June 30		Year Ended June 30	
	2006	2005	2006	2005	2006	2005
<b>Revenue, Gains, and Other</b>						
Gifts and contributions and other	\$ 9,619,698	\$ 16,290,704	\$ 119,145	\$ 999,027	\$ 1,200	\$ -
Investment income	2,716,464	2,232,885	76,538	64,860	-	-
Net gain from security and other investment transactions	15,036,167	10,400,081	436,529	322,861	-	-
Increase in cash surrender value of life insurance policies	112,848	68,983	-	-	-	-
Net transfers from Western Michigan University	4,052,062	1,057,224	178,780	157,927	150,320	145,175
Total revenue, gains, and other support	31,537,239	30,049,877	810,992	1,544,675	151,520	145,175
<b>Expenditures and Distributions</b>						
Program services	124,895	59,820	100,952	217,389	-	-
Management and general	1,910,086	975,042	107,283	51,736	74,726	12,666
Fund-raising	-	-	92,167	144,996	-	-
Total expenditures paid	2,034,981	1,034,862	300,402	414,121	74,726	12,666
Distributions	13,803,676	17,538,054	423,212	387,394	89,861	-
Total expenditures and distributions	15,838,657	18,572,916	723,614	801,515	164,587	12,666
<b>Change in Net Assets</b>	15,698,582	11,476,961	87,378	743,160	(13,067)	132,509
<b>Net Assets - Beginning of year</b>	174,981,054	163,504,093	5,794,038	5,050,878	139,087	6,578
<b>Net Assets - End of year</b>	<b>\$ 190,679,636</b>	<b>\$ 174,981,054</b>	<b>\$ 5,881,416</b>	<b>\$ 5,794,038</b>	<b>\$ 126,020</b>	<b>\$ 139,087</b>

### Note I - Basis of Presentation and Significant Accounting Policies

#### Basis of Presentation

The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The University follows the "business-type" activities reporting requirements of GASB Statement No. 34.

GASB 34 establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following categories:

Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement in those assets.

Restricted: Net assets subject to externally imposed constraints that they may be maintained permanently by the University, or net assets whose use by the University is subject to externally imposed constraints that can be fulfilled by actions of the University pursuant to those constraints or that expire by the passage of time.

Unrestricted: Net assets that are not subject to externally imposed constraints. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees (the "Board") or may otherwise be limited by contractual agreements with outside parties. The University has committed the unrestricted net assets to provide for identified future needs, such as debt service, contractual obligations, capital outlay, academic programming and post-employment benefits.

These statements have also been prepared in accordance with criteria established by GASB for determining the various governmental organizations to be included in the reporting entity (GASB Statement No. 39). These criteria include significant operational or financial relationships with the University. Based on application of the criteria, the University has three component units.

#### Summary of Significant Accounting Policies

**Component Unit** - Western Michigan University is an institution of higher education located in Kalamazoo, Michigan, and is considered to be a component unit of the State of Michigan (the "State") 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, and payments to state retirement programs for the benefit of University employees.

### **Note I - Basis of Presentation and Significant Accounting Policies (Continued)**

**Component Units of the University** - The Western Michigan University Foundation, Paper Technology Foundation, Inc. and Western Michigan University Research Foundation's statements are discretely presented as part of the University's reporting entity. These statements are prepared in accordance with generally accepted accounting principles as prescribed by the Financial Accounting Standards Board (FASB). The officers of Western Michigan University Foundation and Paper Technology Foundation include certain University administrative officials, but the University does not have controlling interest in those Foundations' boards. The University does have controlling interest in the Western Michigan University Research Foundation. The Internal Revenue Service has determined that the Foundations are tax exempt under Section 501(c)(3) of the Internal Revenue Code.

Western Michigan University Foundation exists for the sole purpose of soliciting, collecting, and investing donations for the benefit of Western Michigan University.

Paper Technology Foundation, Inc. was established to aid and promote, by financial assistance and guidance, education and research in paper technology and related areas at Western Michigan University. The University has paid certain expenses of Paper Technology Foundation, Inc.

A complete copy of the audited financial statements of the Western Michigan University Foundation and Paper Technology Foundation, Inc. are available at the Foundation offices located on the campus of the University.

Western Michigan University Research Foundation operates for the benefit of Western Michigan University to promote, encourage, and aid scientific investigation and research as well as commercialization endeavors. The University has paid certain expenses of Western Michigan Research Foundation.

**Cash and Investments** - As a matter of cash management, the University invests substantially all of its cash in interest-bearing instruments which are readily convertible into cash. Investments are reported at fair value, based on quoted market prices, with changes in fair value reported as investment income in the statement of revenue, expenses, and changes in net assets.

**Inventories** - Inventories consist primarily of supplies, food, pharmaceuticals, and bookstore items, and are stated at the lower of cost or market, with cost determined by the retail method.

### Note 1 - Basis of Presentation and Significant Accounting Policies (Continued)

**Capital Assets** - Capital assets are stated at cost if purchased or at appraised value at the date of the gift for donated property. Certain net assets have been designated to provide for significant repair and maintenance costs to residence facilities. Physical properties, with the exception of land, are depreciated on the straight-line method over the estimated useful service lives of the respective assets. Estimated service lives are as follows:

Land improvements	20 years
Buildings	50 years
Equipment	3-15 years
Library holdings	10 years

**Bond Issuance Costs** - Bond issuance costs are amortized over the life of the related bonds using the straight-line method.

### Note 2 - Cash and Investments

The University uses the "pooled cash" method of accounting for substantially all of its cash and investments. In order to maximize earnings, the cash and investments of the Western Michigan University Foundation, Western Michigan University Research Foundation, and Paper Technology Foundation, Inc. are pooled with those of the University. External investment managers are provided with an investment policy statement, as set forth by the board of trustees.

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

	Fair Market Value	Less Than One Year	1-5 years	6-10 years	More Than 10 years
Certificates of deposit	\$ 139,411	\$ -	\$ 139,411	\$ -	\$ -
Equity investments	1,493,451	-	-	-	1,493,451
Corporate bond funds	412,963	-	412,963	-	-
Money market funds	45,572,471	45,572,471	-	-	-
Intermediate-term mutual funds	49,852,500	-	49,852,500	-	-
Equity index mutual funds	4,895,962	-	-	-	4,895,962
Equity funds	29,567,907	-	-	-	29,567,907
Bond funds	3,235,905	-	-	3,235,905	-
Land and land contracts	257,909	-	-	-	257,909
Venture capital	1,295,000	-	-	-	1,295,000
Total	<u>\$ 136,723,479</u>	<u>\$ 45,572,471</u>	<u>\$ 50,404,874</u>	<u>\$ 3,235,905</u>	<u>\$ 37,510,229</u>

### Note 2 - Cash and Investments (Continued)

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

	Fair Market Value	Less Than One Year	1-5 years	6-10 years	More Than 10 years
Certificates of deposit	\$ 142,249	\$ -	\$ 142,249	\$ -	\$ -
Equity investments	1,576,377	-	-	-	1,576,377
Corporate bond funds	577,477	-	577,477	-	-
Money market funds	58,492,003	58,492,003	-	-	-
Intermediate-term mutual funds	58,224,990	-	58,224,990	-	-
Equity index mutual funds	20,271,874	-	-	-	20,271,874
Equity funds	806,568	-	-	-	806,568
Bond funds	3,110,788	-	-	3,110,788	-
Land and land contracts	257,909	-	-	-	257,909
Venture capital	1,201,250	-	-	-	1,201,250
Total	<u>\$ 144,661,485</u>	<u>\$ 58,492,003</u>	<u>\$ 58,944,716</u>	<u>\$ 3,110,788</u>	<u>\$ 24,113,978</u>

**Interest Rate Risk** - As a means of limiting its exposure to fair value losses arising from rising interest rates, the University's operating investment policy provides for a diversified portfolio comprised of short-, intermediate-, and long-term investments. The investment policy does not specifically limit or restrict asset allocation except for the long-term investment pool. The asset allocation, as a percentage of the total market value of the long-term investment pool, is targeted as follows:

<u>Asset Category</u>	<u>Target</u>
U.S. Equities	80%
International Equities	20%

The University is also exposed to risk indirectly since its mutual fund investees hold investments such as futures, options, and collateralized mortgage obligations (generally referred to as "derivatives").

The annuity and life income funds are invested on the policy that they are held to maturity; therefore, the interest rate risk is not considered in its decisions.

### Note 2 - Cash and Investments (Continued)

**Credit Risk** - For investments in non-mutual and non-pooled funds, no more than 10 percent of the portfolio, at cost, can be invested in any single issue, except the investments in U.S. government securities. The weighted average credit quality is to be no less than "AAA" (or its equivalent rating by two national rating agencies) for the short-term investment pool accounts and "AA" for the intermediate-term investment pool accounts. In addition, the minimum acceptable credit quality at the time of purchase for individual securities shall be "AA" for the short-term pool accounts and "BBB" for the intermediate-term investment pool accounts. At June 30, 2006 and 2005, the University's debt instruments (subject to fluctuations in interest rates) and related ratings consisted of the following:

	2006		2005	
	Market Value	NRSRO Rating	Market Value	NRSRO Rating
Bond mutual funds:				
Western Asset Intermediate Bond Portfolio	\$ 24,427,018	AA-	\$ 47,129,498	AA-
Commonfund Intermediate Term Fund	25,425,482	AA+	11,095,492	AA+
SSGA Bond Market Fund	2,783,581	Aaa	2,659,530	AAA
SSGA High Yield Bond Fund	74,783	B1/B2	72,700	B
Vanguard Total Bond Fund	377,541	AA1/AA2	378,558	AA
Corporate bonds	339,322	AA	502,664	AA
U.S. government agency bonds	73,641	AAA	74,813	AAA
Total	<u>\$ 53,501,368</u>		<u>\$ 61,913,255</u>	

The nationally recognized statistical rating organization (NRSRO) utilized was primarily Moody's Investors Services. The corporate bonds NRSRO rating is based on a weighted average of the individual investment ratings.

**Custodial Credit Risk** - Custodial credit risk is the risk that in the event of the failure of the bank or counterparty, the University will not be able to recover the value of its deposits or investments that are in the possession of an outside party. The University's cash investment policy does not limit the value of deposits or investments that may be held by an outside party. Investments in external investment pools and in open-ended mutual funds are not exposed to custodial credit risk because their existence is not evidenced by securities that exist in physical or book entry form. At June 30, 2006 and 2005, the carrying amount of the University's deposits was \$11,307,842 and \$8,114,214, respectively. Of that amount, \$267,154 and \$300,000 was insured as of June 30, 2006 and 2005, respectively. The remaining \$11,040,688 and \$7,814,214 at June 30, 2006 and 2005, respectively, was uninsured and uncollateralized. The University does not require deposits to be insured or collateralized.

### Note 2 - Cash 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 cash investment policy provides that investment pool direct placements are to be sufficiently diversified and provides that no more than 10 percent of its assets can be in any particular issue. The foregoing restrictions do not apply to securities that are issued or fully guaranteed by the United States government. The University did not have investments in any single issuer that equaled 5 percent or more in 2006 or 2005.

**Foreign Currency Risk** - Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. At June 30, 2006 and 2005, the University had approximately \$6,700,000 and \$1,085,000, respectively, invested in mutual funds that have funds invested in various countries throughout the world and therefore, expose the University to foreign currency risk indirectly. The University did not have any direct investments or deposits denominated in foreign currencies at June 30, 2006 and 2005.

Investments at Western Michigan University Foundation, Paper Technology Foundation, Inc. and Western Michigan University Research Foundation are as follows:

	Western Michigan University Foundation		Paper Technology Foundation, Inc.		Western Michigan University Research Foundation	
	2006	2005	2006	2005	2006	2005
Corporate stocks	\$ 8,910,780	\$ 10,930,020	\$ 261,487	\$ 323,052	\$ -	\$ -
Corporate bonds	5,177,708	5,899,820	146,636	174,378	-	-
Treasury/federal securities	17,409,770	13,979,771	510,891	413,192	-	-
Venture capital	-	-	-	-	600,000	600,000
Real estate	537,469	-	-	-	-	-
Mutual funds	<u>129,204,042</u>	<u>120,512,114</u>	<u>3,872,775</u>	<u>4,647,655</u>	-	-
Total	<u>\$ 161,239,769</u>	<u>\$ 151,321,725</u>	<u>\$ 4,791,789</u>	<u>\$ 5,558,277</u>	<u>\$ 600,000</u>	<u>\$ 600,000</u>

Net gains/losses from security transactions for the years ended June 30, 2006 and 2005 are as follows for each Foundation:

	Western Michigan University Foundation		Paper Technology Foundation, Inc.	
	2006	2005	2006	2005
Unrealized appreciation	\$ 6,214,146	\$ 4,763,037	\$ 177,734	\$ 155,429
Realized gains	<u>8,822,021</u>	<u>5,637,044</u>	<u>258,795</u>	<u>167,432</u>
Total	<u>\$ 15,036,167</u>	<u>\$ 10,400,081</u>	<u>\$ 436,529</u>	<u>\$ 322,861</u>

# Western Michigan University

## Notes to Financial Statements June 30, 2006 and 2005

### Note 2 - Cash and Investments (Continued)

Trustee and brokerage fees associated with the maintenance of the endowment securities portfolio were \$1,595,592 and \$1,691,756 and \$49,348 and \$52,322 for the years ended June 30, 2006 and 2005 for Western Michigan University Foundation and Paper Technology Foundation, respectively. For recording purposes, these fees have been netted with investment income.

### Note 3 - Receivables

As of June 30, 2006 and 2005, accounts receivable consisted of the following:

	2006	2005
Appropriations from the State of Michigan for operations	\$ 20,359,545	\$ 19,278,016
Sponsored research grants receivable	3,036,296	543,043
Student accounts receivable	7,253,603	5,917,322
Other	<u>9,011,203</u>	<u>7,384,683</u>
Total	39,660,647	33,123,064
Less allowances for doubtful accounts	<u>(2,372,508)</u>	<u>(1,677,715)</u>
Total accounts receivable	<u>\$ 37,288,139</u>	<u>\$ 31,445,349</u>

As of June 30, 2006 and 2005, student loans receivable consisted of the following:

Student loans receivable	\$ 9,303,658	\$ 9,161,702
Less allowance for doubtful accounts	<u>(173,257)</u>	<u>(221,683)</u>
Net student loans receivable	<u>\$ 9,130,401</u>	<u>\$ 8,940,019</u>

As of June 30, 2006 and 2005, pledges receivable at the Foundations consisted of the following:

	Western Michigan University Foundation		Paper Technology Foundation, Inc.	
	2006	2005	2006	2005
Pledges expected to be collected within 1 year	\$ 5,995,080	\$ 7,697,304	\$ 20,853	\$ 43,852
Pledges expected to be collected in 1-5 years	<u>12,375,108</u>	<u>14,653,986</u>	<u>23,000</u>	<u>38,838</u>
	18,370,188	22,351,290	43,853	82,690
Less:				
Allowance for uncollectible contributions	(638,502)	(838,891)	(1,754)	(3,308)
Present value discount	<u>(1,726,550)</u>	<u>(1,705,476)</u>	<u>(6,035)</u>	<u>(6,231)</u>
Net pledges receivable	<u>\$ 16,005,136</u>	<u>\$ 19,806,923</u>	<u>\$ 36,064</u>	<u>\$ 73,151</u>

### Note 3 – Receivables (Continued)

Pledges receivable are presented net of a discount for the value of future cash flows and an allowance for uncollectible contributions. The discount to present value was calculated using the yield on a three-year Treasury bill, equal to 5.19 percent and 3.67 percent as of June 30, 2006 and 2005, respectively. The allowance for uncollectible contributions is a general valuation allowance of 4 percent established based on historical contribution collection history. Estate gifts receivable at Western Michigan University Foundation of \$1,445,748 and \$1,379,017 at June 30, 2006 and 2005, respectively, included in the total pledges receivable, have no allowance for uncollectible contributions. Pledges deemed uncollectible are charged against the allowance for uncollectible contributions in the period in which the determination is made.

### Note 4 - Capital Assets

The following table presents the changes in the various fixed asset class categories for the year ended June 30, 2006:

	Beginning Balance	Additions	Deletions	Ending Balance
Capital assets:				
Land	\$ 13,591,381	\$ 1,092,596	\$ 1,512,900	\$ 13,171,077
Construction in progress	13,748,659	43,608,606	21,407,166	35,950,099
Total nondepreciable property	27,340,040	44,701,202	22,920,066	49,121,176
Land improvements	43,251,500	4,530,352	358,368	47,423,484
Buildings	698,723,390	8,463,667	21,139,463	686,047,594
Buildings under capitalized lease	10,578,574	-	-	10,578,574
Equipment	73,870,226	8,927,235	4,383,965	78,413,496
Library holdings	82,530,716	6,967,030	-	89,497,746
Total depreciable property	908,954,406	28,888,284	25,881,796	911,960,894
Total capital assets	936,294,446	73,589,486	48,801,862	961,082,070
Less accumulated depreciation:				
Land improvements	13,351,943	1,890,190	20,681	15,221,452
Buildings	183,529,472	13,681,428	1,147,798	196,063,102
Buildings under capitalized lease	872,467	211,385	-	1,083,852
Equipment	56,885,626	5,409,173	4,265,378	58,029,421
Library holdings	54,902,153	4,567,482	-	59,469,635
Total accumulated depreciation	309,541,661	\$ 25,759,658	\$ 5,433,857	329,867,462
Capital assets - Net	\$ 626,752,785			\$ 631,214,608

### Note 4 - Capital Assets (Continued)

The following table presents the changes in the various fixed asset class categories for the year ended June 30, 2005:

	Beginning Balance	Additions	Deletions	Ending Balance
Capital assets:				
Land	\$ 13,591,381	\$ -	\$ -	\$ 13,591,381
Construction in progress	41,080,913	34,580,990	61,913,244	13,748,659
Total nondepreciable property	54,672,294	34,580,990	61,913,244	27,340,040
Land improvements	38,619,300	4,632,200	-	43,251,500
Buildings	649,904,048	48,819,342	-	698,723,390
Buildings under capitalized lease	10,578,574	-	-	10,578,574
Equipment	69,578,794	5,483,662	1,192,230	73,870,226
Library holdings	76,905,954	5,624,762	-	82,530,716
Total depreciable property	845,586,670	64,559,966	1,192,230	908,954,406
Total capital assets	900,258,964	99,140,956	63,105,474	936,294,446
Less accumulated depreciation:				
Land improvements	11,673,668	1,678,275	-	13,351,943
Buildings	170,344,463	13,185,009	-	183,529,472
Buildings under capitalized lease	661,082	211,385	-	872,467
Equipment	52,731,275	5,244,836	1,090,485	56,885,626
Library holdings	50,750,155	4,151,998	-	54,902,153
Total accumulated depreciation	286,160,643	\$ 24,471,503	\$ 1,090,485	309,541,661
Capital assets - Net	\$ 614,098,321			\$ 626,752,785

The estimated cost to complete major construction projects in progress and scheduled to begin is approximately \$69,000,000 as of June 30, 2006. These projects are scheduled to be completed through the year ending June 30, 2009. These projects will be funded from internally designated sources, state-provided funds, and external long-term financing.

### Note 5 - Line of Credit

The University used its revolving line of credit to finance a new student information system for the years ended June 30, 2006 and 2005. Line of credit activity for the years ended June 30, 2006 and 2005 is as follows:

	Beginning Balance	Draws	Repayments	Ending Balance
2006	\$ 9,111,246	\$ 4,382,723	\$ 5,154,898	\$ 8,339,071
2005	6,885,463	6,786,583	4,560,800	9,111,246

### Note 6 - Long-term Obligations

Long-term obligation activity for the year ended June 30, 2006 is as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
<b>Bonds Payable:</b>					
General Revenue Bonds, Series 2005, with interest ranging from 3.00% to 5.00%, maturing November 15, 2035	\$ 37,600,000	\$ -	\$ -	\$ 37,600,000	\$ 670,000
General Revenue and Refunding Bonds, Series 2003, with interest ranging from 2.25% to 5.00%, maturing November 15, 2023	46,330,000	-	1,850,000	44,480,000	1,915,000
General Revenue Variable Rate Demand Bonds, Series 2002B, with interest ranging from 4.41% to 5.42%, maturing November 15, 2032	18,720,000	-	315,000	18,405,000	330,000
General Revenue Bonds, Series 2002A, with interest at variable rates (4.27% at June 30, 2006), maturing November 15, 2032	47,350,000	-	850,000	46,500,000	1,150,000
General Revenue Bonds, Series 2001, with interest ranging from 4.00% to 5.00%, maturing July 15, 2021	22,840,000	-	885,000	21,955,000	920,000
General Revenue Bonds, Series 2000, with interest at variable rates (5.08% at June 30, 2006), maturing November 15, 2030	71,300,000	-	900,000	70,400,000	1,400,000
General Revenue and Refunding Bonds, Series 1997, with interest ranging from 4.65% to 5.13%, maturing November 15, 2022	50,885,000	-	1,790,000	49,095,000	1,875,000
<b>Notes and Leases Payable:</b>					
Capital lease payable for Grand Rapids building, with an effective rate of 4.59%, monthly payments ranging from \$77,754 to \$96,677 for 15 years with two five-year renewal options and a buy-out purchase option	8,903,958	-	567,312	8,336,646	612,902
Total bonds, notes, and leases payable	303,928,958	-	7,157,312	296,771,646	8,872,902
<b>Other Long-term Obligations:</b>					
Annuities payable	1,307,572	23,136	-	1,330,708	-
Accrued compensated absences	12,775,523	986,146	13,238	13,748,431	-
Total long-term obligations	\$ 318,012,053	\$ 1,009,282	\$ 7,170,550	\$ 311,850,785	\$ 8,872,902

### Note 6 - Long-term Obligations (Continued)

Long-term obligation activity for the year ended June 30, 2005 is as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
<b>Bonds Payable:</b>					
General Revenue Bonds, Series 2005, with interest ranging from 3.00% to 5.00%, maturing November 15, 2035	\$ -	\$ 37,600,000	\$ -	\$ 37,600,000	\$ -
General Revenue and Refunding Bonds, Series 2003, with interest ranging from 2.25% to 5.00%, maturing November 15, 2023	48,125,000	-	1,795,000	46,330,000	1,850,000
General Revenue Variable Rate Demand Bonds, Series 2002B, with interest ranging from 4.41% to 5.42%, maturing November 15, 2032	19,020,000	-	300,000	18,720,000	315,000
General Revenue Bonds, Series 2002A, with interest at variable rates (4.27% at June 30, 2005), maturing November 15, 2032	48,500,000	-	1,150,000	47,350,000	850,000
General Revenue Bonds, Series 2001, with interest ranging from 4.00% to 5.00%, maturing July 15, 2021	23,210,000	-	370,000	22,840,000	885,000
General Revenue Bonds, Series 2000, with interest at variable rates (5.08% at June 30, 2005), maturing November 15, 2030	72,500,000	-	1,200,000	71,300,000	900,000
General Revenue and Refunding Bonds, Series 1997, with interest ranging from 4.65% to 5.13%, maturing November 15, 2022	52,590,000	-	1,705,000	50,885,000	1,790,000
<b>Notes and Leases Payable:</b>					
Capital lease payable for Grand Rapids building, with an effective rate of 4.59%, monthly payments ranging from \$77,754 to \$96,677 for 15 years with two five-year renewal options and a buy-out purchase option	9,428,049	-	524,091	8,903,958	567,312
Total bonds, notes, and leases payable	273,373,049	37,600,000	7,044,091	303,928,958	7,157,312
<b>Other Long-term Obligations:</b>					
Annuities payable	1,630,654	21,889	344,971	1,307,572	-
Accrued compensated absences	12,631,357	340,114	195,948	12,775,523	-
Total long-term obligations	\$ 287,635,060	\$ 37,962,003	\$ 7,585,010	\$ 318,012,053	\$ 7,157,312

During fiscal year 2005, the \$18,720,000 outstanding balance of the General Revenue Variable Rate Demand Bonds, Series 2002 B (taxable) was converted to the fixed rate period. From the conversion date (January 27, 2005) through the maturity date (November 15, 2032), the bonds will accrue interest at fixed rates ranging from 4.41 percent to 5.42 percent.

# Western Michigan University

## Notes to Financial Statements June 30, 2006 and 2005

### Note 6 - Long-term Obligations (Continued)

During prior years, the University in-substance defeased (extinguished) \$36,270,000 of principal related to the 1991A General Revenue bonds, \$18,450,000 of principal related to the 1991B General Revenue bonds, \$49,500,000 of principal related to the 1992A General Revenue bonds, and \$37,240,000 of principal related to the 1993A General Revenue bonds.

Since a portion of the General Revenue bonds Series 1991A, Series 1991B, 1992A and 1993A was in-substance defeased (extinguished), neither the assets of the irrevocable trust nor the bonds are reflected in the University's statements of financial condition. Future principal and interest due on these bonds will be paid from the funds placed in the irrevocable trust, and the interest earned on these funds. Of the various bonds in-substance defeased, \$128,310,000 remains outstanding at June 30, 2006.

The bonds and notes payable are generally callable by the University. The principal and interest amounts are payable as follows:

	Bonds and Notes Payable			Obligations Under Capital Lease
	Principal	Interest	Total	
2007	\$ 8,260,000	\$ 13,318,661	\$ 21,578,661	\$ 975,594
2008	8,095,000	13,311,311	21,406,311	995,105
2009	8,715,000	12,804,758	21,519,758	1,015,008
2010	8,865,000	12,580,958	21,445,958	1,035,307
2011	9,550,000	12,007,774	21,557,774	1,056,014
2012-2016	55,060,000	52,753,845	107,813,845	5,309,618
2017-2021	70,740,000	37,502,493	108,242,493	-
2022-2026	52,895,000	21,285,092	74,180,092	-
2027-2031	48,595,000	10,107,287	58,702,287	-
2032-2036	17,660,000	1,643,182	19,303,182	-
Total	<u>\$ 288,435,000</u>	<u>\$ 187,315,361</u>	<u>\$ 475,750,361</u>	10,386,646
Less amount representing interest				<u>(2,050,000)</u>
Present value of net minimum lease payments				<u>\$ 8,336,646</u>

Interest expense paid by the University on all indebtedness was \$13,707,487 and \$13,039,948 for the years ended June 30, 2006 and 2005, respectively. This includes construction period interest which is capitalized as part of the cost of the assets constructed of \$621,170 and \$587,461 for the years ended June 30, 2006 and 2005, respectively.

### Note 6 - Long-term Obligations (Continued)

#### Interest Rate Swap Agreements

During the year ended June 30, 2003, the University entered into a fixed interest rate swap agreement expiring in 2032 to hedge against the outstanding par value of the Series 2002A bonds which were variable rate based. At June 30, 2006, the total notional principal amount outstanding under this agreement was \$46,500,000.

Under the swap, the University pays the counterparty a fixed payment of 4.27 percent and receives a variable payment equal to the BMA Municipal Bond Index. No amounts were paid or received when the swap was initiated.

During the year ended June 30, 2001, the University entered into a fixed interest rate swap agreement expiring in 2030 to hedge against the outstanding par value of the Series 2000 bonds. At June 30, 2006, the total notional principal amount outstanding under this agreement is \$70,400,000.

Under the swap, the University pays the counterparty a fixed payment of 5.08 percent and receives a variable payment equal to the SAVRS rate. No amounts were paid or received when the swap was initiated.

As of June 30, 2006, the 2003 and 2001 swap agreements had negative fair values of approximately \$2,420,000 and \$6,780,000, respectively. The fair values were obtained using market data as of June 30, 2006. 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 had it not entered into the swap agreements. However, the University believes that the variable rates it receives on the swap agreements will eventually exceed the 4.27 percent and 5.08 percent fixed rates the University pays, and the swap will reduce its overall interest expense in the future.

During the year ended June 30, 2005, the University entered into a fixed rate swaption related to the Series 1997 bonds. At June 30, 2006, the total principal amount outstanding on the 1997 bonds was \$49,095,000, while the total notional amount of this agreement was \$45,850,000.

Under the swaption, the University received \$2,055,000 from the counterparty in exchange for a one-time option to put the University into a fixed rate swap on the call date of the 1997 bonds. The exercise date is October 15, 2007.

As of June 30, 2006, the swaption had a negative fair value of approximately \$1,280,000. This fair value was determined using market data as of June 30, 2006.

### Note 6 - Long-term Obligations (Continued)

As of June 30, 2006, the University was not exposed to credit risk because the swaps had a negative fair value. However, should interest rates change and the fair value of the swaps become positive, the University would be exposed to credit risk in the amount of the derivative's fair value. As of June 30, 2006, the counterparty to the swap agreements was rated AAA by Standard & Poor's and Fitch Ratings.

The swaps expose the University to basis risk, which is the risk that arises when variable interest rates on a derivative and an associated bond or other interest-paying financial instruments are based on different indexes. As these rates change, the overall synthetic rate on the bonds will change.

The swap agreements use the International Swaps and Derivatives Association, Inc. Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. In addition, the Master Agreement includes additional termination events. If the swaps are terminated, the variable rate bonds would no longer carry a synthetic interest rate and the University may be required to pay an amount equal to the swaps' fair value, if it is negative.

Using rates as of June 30, 2006, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their term, were as follows.

	Variable Rate Bonds		Interest Rate	Total
	Principal	Interest	Swaps, Net	
2007	\$ 2,550,000	\$ 3,915,696	\$ 1,349,857	\$ 7,815,553
2008	2,100,000	4,073,610	1,419,296	7,592,906
2009	2,500,000	3,896,487	1,331,083	7,727,570
2010	2,400,000	3,905,981	1,362,384	7,668,365
2011	2,800,000	3,723,269	1,273,333	7,796,602
2012-2016	16,000,000	17,032,905	5,893,700	38,926,605
2017-2021	20,850,000	13,821,436	4,790,807	39,462,243
2022-2026	27,000,000	9,712,427	3,362,509	40,074,936
2027-2031	35,550,000	4,038,291	1,344,132	40,932,423
2032-2033	5,150,000	172,613	43,027	5,365,640
Total	<u>\$ 116,900,000</u>	<u>\$ 64,292,715</u>	<u>\$ 22,170,128</u>	<u>\$ 203,362,843</u>

As rates vary, variable-rate bond interest payments and net swap payments will vary.

### Note 7 - Insurance

The University is a participant in the Michigan Universities Self-Insurance Corporation ("MUSIC"). This organization provides insurance coverage for errors and omissions liability, comprehensive general liability, and all risk property insurance. In fiscal year 2006, there are 11 universities that participate in MUSIC. Each participating university is responsible for a first tier of losses up to a level that has been actuarially determined. MUSIC is financially responsible for a second tier of losses. For comprehensive general liability errors and omissions and all risk property insurance, MUSIC has purchased excess insurance coverage with commercial insurance carriers to cover a third tier of losses. However, in the event the insurance reserves established by MUSIC are insufficient to meet its second tier obligations, each of the participating universities share this obligation by agreements with MUSIC.

The University is essentially self-insured for hospital/medical, life, long-term disability, and workers' compensation coverage. Stop-loss coverage has been purchased by the University for hospital/medical, workers' compensation, and life insurance claims. Liabilities associated with expected unpaid claims have also been determined and are accrued on the balance sheet.

### Note 8 - Retirement Plans

The University provides non-contributory retirement plans for all qualified employees through plans offered by the Michigan Public School Employees' Retirement System ("MPSERS") or the Teachers' Insurance and Annuity Association and College Retirement Equities Fund ("TIAA-CREF").

#### Defined Benefit Pension Plan

**Plan Description** - The MPSERS plan is a statewide, cost-sharing, multiple-employer defined benefit public employee retirement system governed by the State of Michigan that covers some employees of the University. The system provides retirement, survivor, and disability benefits to plan members and their beneficiaries. The Michigan Public School Employees' Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the system. That report may be obtained by writing to the System at P.O. Box 30171, Lansing, MI 48909-7671.

**Funding Policy** - State statute requires the University to contribute the full actuarially determined amount to fund pension benefits. The pension benefit rate totaled 6.52 percent for the period July 1, 2005 through September 30, 2005, and 6.30 percent for the period October 1, 2005 through June 30, 2006 of the covered payroll to the plan. The University's contribution to the MPSERS plan for the year ended June 30, 2006 was approximately \$3,400,000. Contributions were \$2,800,000 and \$2,400,000 for the years ended June 30, 2005 and 2004, respectively.

### **Note 8 - Retirement Plans (Continued)**

**Postemployment Benefits** - Under the MPSERS Act, all retirees participating in the MPSERS Pension Plan have the option of continuing health, dental, and vision coverages. Retirees having these coverages contribute an amount equivalent to the monthly cost for Part B Medicare and 10 percent of the monthly premium amount for the health, dental, and vision coverages. The University's required contributions for postemployment health care benefits, which are funded on a cash basis, were approximately \$4,200,000 and \$3,900,000 for the years ended June 30, 2006 and 2005, respectively.

#### **Defined Contribution Plan**

As an alternative pension option, the University offers all employees eligible for benefits the opportunity to participate in the TIAA-CREF Plan. Funding for the plan consists of an employer contribution of 11 percent of covered compensation and has no liability beyond its contribution. Benefits vest immediately for eligible salaried employees and vest after a five-year period for eligible hourly non-exempt participants. Contributions for the years ended June 30, 2006, 2005, and 2004 were approximately \$14,000,000, \$13,200,000, and \$14,000,000, respectively.

#### **2003 Window Severance Incentive Plan**

The University offered a severance plan to bargaining unit faculty employees who had met certain requirements during the fiscal year ended June 30, 2004. The application period was only available during a specific period of time in fiscal year 2004. Installments will be paid annually over a five-year period with few exceptions, starting with fiscal year 2005. The University's liability for the years ended June 30, 2006 and 2005 was \$4,089,361 and \$7,276,087, respectively.

### **Note 9 - Commitments and Contingencies**

In the normal course of its activities, the University is a party in various legal and regulatory actions. The University believes that the outcome of these actions will not have a material effect on the financial statements.

### **Note 10 - New Accounting Pronouncement**

The Governmental Accounting Standards Board (GASB) issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, in 2004.

Statement No. 43 requires actuarial determination and recording of other postretirement benefits (OPEB) for plans sponsored by the University. GASB 43 will be effective for the University for the year ending June 30, 2007.

### **Note 10 - New Accounting Pronouncement (Continued)**

Statement No. 45 establishes standards for the measurement, recognition, and display of other postretirement benefits (OPEB) and related liabilities, note disclosures, and if applicable, required supplementary information for other plans in which the University participates. GASB 45 will be effective for the University for the year ending June 30, 2008.

The University retained an independent actuarial consulting firm to prepare a valuation of the post-retirement obligations as of July 1, 2005. Using a 4.9 percent discount rate, the annual required contribution and the actuarial accrued liability were calculated at approximately \$11 million and \$139 million, respectively. The discount rate at the time of implementation will increase. A 1 percent change in the discount rate to 5.9 percent results in an annual required contribution and actuarial accrued liability of \$10 million and \$118 million, respectively.