



JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
OFFICE OF THE STATE BUDGET
LANSING

ROBERT L. EMERSON
DIRECTOR

June 19, 2007

Michigan State Senate
c/o Ms. Carol Morey-Viventi, Secretary
State Capitol
Lansing, Michigan 48909

Michigan House of Representatives
c/o Mr. Richard J. Brown, Clerk
State Capitol
Lansing, Michigan 48909

Dear Ms. Morey-Viventi and Mr. Brown:

Transmitted under this cover is a schedule entitled "Statement of Revenue Subject to Constitutional Limitation - Legal Basis." The statement is submitted pursuant to Sections 18.1350(a) through 18.1350(e) of the Michigan Compiled Laws for the purpose of demonstrating compliance with Article 9, Section 26 of the Michigan Constitution for the fiscal year 2006.

The statement has been reviewed by the Office of the Auditor General and a copy of the independent accountant's review is enclosed.

If you have questions regarding this report, please contact Mr. Michael J Moody, Director, Office of Financial Management, at 373-1010.

Sincerely,

Robert L. Emerson
State Budget Director

Enclosure

cc: T. Hughes, Legislative Affairs
Senate Appropriations Committee
House Appropriations Committee
Gary Olson, Senate Fiscal Agency
Mitchell Bean, House Fiscal Agency



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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

INDEPENDENT ACCOUNTANT'S REVIEW REPORT

The Honorable Jennifer M. Granholm, Governor
Members of the Legislature

We have reviewed the accompanying statement of revenue subject to constitutional limitation (legal basis) of the State of Michigan for the fiscal year ended September 30, 2006 in accordance with *Statements on Standards for Accounting and Review Services* issued by the American Institute of Certified Public Accountants. All information included in the accompanying statement is the representation of the State's management.

A review consists principally of inquiries of agency personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

As described in Note 1, the accompanying statement was prepared in accordance with Sections 18.1350a - 18.1350e of the *Michigan Compiled Laws*, which provide statutory language to implement Article IX, Sections 26 and 33 of the State Constitution. Accordingly, the financial statement is not intended to be presented in conformity with accounting principles generally accepted in the United States of America.

Based on our review, we are not aware of any material modifications that should be made to the accompanying statement of revenue subject to constitutional limitation (legal basis) of the State of Michigan for the fiscal year ended September 30, 2006 in order for it to be in conformity with the basis of accounting described in Note 1.

This report is intended for the information and use of the Legislature, the Governor, and the State's management. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Sincerely,

A handwritten signature in cursive script that reads 'Thomas H. McTavish'.

Thomas H. McTavish, C.P.A.
Auditor General
May 31, 2007

STATE OF MICHIGAN
STATEMENT OF REVENUE SUBJECT TO
CONSTITUTIONAL LIMITATION
(LEGAL BASIS)
FISCAL YEAR ENDED SEPTEMBER 30, 2006

Prepared by

Office of the State Budget
Office of Financial Management

May 31, 2007

STATE OF MICHIGAN
STATEMENT OF REVENUE SUBJECT TO CONSTITUTIONAL LIMITATION - LEGAL BASIS
 Fiscal Year Ended September 30, 2006
 (In Millions)

| | | |
|---|------------|---------------------|
| Total Revenue and Other Financing Sources - General, Special Revenue and Permanent Funds (Note #2) | | \$ 42,052.8 |
| Less Statutory Exclusions (Note #3): | | |
| Interfund transfers between General, special revenue, and permanent funds | \$ 1,645.2 | |
| Interfund borrowing costs | 24.6 | |
| Proceeds from bonds and notes | 1,004.8 | |
| Financing provided by capital leases | 34.1 | |
| Federal revenue | 11,986.4 | |
| Debt service | 115.0 | |
| Property tax credits (Note #4) | 832.6 | |
| Other statutory exclusions: | | |
| Special Medicaid reimbursements | 93.6 | |
| Tobacco settlement reimbursements | 251.5 | |
| Prior year expenditure reimbursements | 124.4 | |
| Other exclusions | 180.2 | (16,292.4) |
| Additions: | | |
| Nonrefundable tax credits (Note #4) | | 53.8 |
| Total Revenue Subject to Limitation | | <u>\$ 25,814.1</u> |
| 2004 Personal Income (Note #5) | | \$ 324,134.0 |
| Section 26 Base Ratio (Note #6) | | <u>x 9.49%</u> |
| Section 26 Revenue Limitation | | 30,760.3 |
| Total Actual Revenue Subject to Limitation | | <u>25,814.1</u> |
| Amount Over (Under) Limit | | <u>\$ (4,946.2)</u> |

The accompanying footnotes are an integral part of this financial statement.
 Column detail may not add to totals because of rounding.
 See Independent Accountant's Review Report.

NOTES TO THE STATEMENT OF REVENUE SUBJECT TO CONSTITUTIONAL LIMITATION - LEGAL BASIS

1 Basis of Accounting and Presentation

The Statement of Revenue Subject to Constitutional Limitation - Legal Basis is presented in compliance with P.A. 504 of 1988, primarily Sections 18.1350a through 18.1350e of the Michigan Compiled Laws. Public Act 504 provides statutory language to implement Article 9, Sections 26 and 33 of the State Constitution. These legal provisions, which prescribe how compliance with the revenue limitation is determined, are outlined in the notes that follow. This statement is not intended to be a presentation in accordance with generally accepted accounting principles.

Section 18.1350a provides that the calculation of State revenue shall not be adjusted after the filing of the report required for June 30, 1989, unless changes in generally accepted accounting principles would substantially distort the comparability of the base year. Because of changes in those principles and to provide comparability to the base year report, State revenues in this report include the General Fund, select special revenue funds, and permanent funds.

2. Total Revenue and Other Financing Sources

Public Act 504 defines total State revenue, for the purpose of determining the revenue limit, as the combined increase in net current assets of the General and special revenue funds. The amount on the line entitled "Total Revenue and Other Financing Sources – General, Special Revenue, and Permanent Funds" is calculated based on revenues reported in the *State of Michigan Comprehensive Annual Financial Report* (SOMCAFR). These revenues are derived using generally accepted accounting principles (GAAP). Additional information regarding the State's revenue recognition and accrual policies are included in Note #1 (Summary of Significant Accounting Policies) and Note #6 (Taxes Receivable) of the 2006 SOMCAFR.

3. Statutory Exclusions

Public Act 504 provides for exclusions from the revenue limit. These exclusions are provided for two primary reasons: 1) to eliminate those revenue sources which are excluded under Article 9, Section 33 of the State Constitution; and 2) to eliminate duplicate revenue arising from the methods used to account for the recognition of certain financial resources and the flow of these resources between the General Fund, special revenue, and permanent funds. The specific exclusions from the revenue limit are as follows:

- a. Financing sources which have previously been counted as revenue for purposes of the revenue limit, such as beginning fund balance, expenditure refunds including reimbursement of tobacco-related health costs and prior year accounts payable write-offs, and transfers from within the group of funds.

During fiscal year 2006, the General Fund incurred short-term interfund borrowing costs, resulting in interest income to select special revenue and permanent funds totaling \$24.6 million. This interest income has been excluded from the calculation of State revenue, similar to the treatment used for transfers.

- b. Current assets generated from transactions involving capital assets and long-term obligations in which total net assets do not increase, such as capital lease transactions and financing provided by bond proceeds.
- c. Revenues, such as Special Medicaid reimbursements and child support collections, which are not available for normal public functions of the General Fund, special revenue, and permanent funds.
- d. Federal aid is excluded in the line entitled "Federal revenue."

NOTES TO THE STATEMENT OF REVENUE SUBJECT TO
CONSTITUTIONAL LIMITATION - LEGAL BASIS (continued)

- e. Taxes imposed for the payment of principal and interest on voter approved bonds and loans to school districts authorized under Article 9, Section 16 of the State Constitution. This revenue is excluded in the line entitled "Debt service."

Tax credits based on actual tax liabilities including the imputed tax components of rental payments (See Note #4).

- g. Refunds or payments of revenues recognized in a prior period include out of period tax refunds.
- h. The effects of restatements of beginning fund balances required by changes in generally accepted accounting principles.

4. Tax Credits

General: The Constitution requires that "...Total State Revenues shall exclude the amount of any credits based on actual tax liabilities or the imputed tax components of rental payments, but shall include the amount of any credits not related to actual tax liabilities....". This language results in adjustments to the revenue reported in the GAAP-based SOMCAFR "Schedule of Revenue and Other Financing Sources" to compute the amount of revenue subject to the revenue limit.

The State has two general types of tax credits: refundable credits and nonrefundable credits. Refundable credits are tax credits that may be claimed by taxpayers regardless of their actual tax liability. Nonrefundable credits are tax credits that may be claimed by taxpayers only up to the taxpayer's actual tax liability.

Refundable credits: Refundable tax credits include the income tax property tax credit, the State-funded portion of the adoption credit, and the home heating income tax credit. All refundable tax credits must be included in income for purposes of computing total State revenue subject to limitation, except for the personal income tax property tax credit. Because all refundable credits are reported as revenue and expenditures, the property tax credits for the year are subtracted from total State revenue subject to limitation on the line "Property tax credits" on the Statement of Revenue Subject to Constitutional Limitation - Legal Basis.

Nonrefundable credits: Nonrefundable credits include the income tax credit for local income tax paid, the college tuition credit, the income tax credit for taxes paid to other states, and the income tax and single business tax credits for donations to community foundations and other public contributions. Because nonrefundable credits are recorded as revenue reductions, the income tax, the college tuition credit and single business tax credits for donations to community foundations and other public contributions must be added to total State revenue subject to limitation. The adjustment is reported on the line "Nonrefundable tax credits" on the Statement of Revenue Subject to Constitutional Limitation - Legal Basis.

5. Personal Income of Michigan

Personal income of Michigan is defined by Article 9, Section 33 of the State Constitution as total income received by persons in Michigan from all sources, as defined and officially reported by the United States Department of Commerce (USDOC), or its successor agencies. Article 9, Section 26 of the State Constitution requires that the personal income of Michigan for 1977 be used for computing the fiscal year 1979 limit. For each subsequent year's computation, personal income of Michigan for a calendar year is defined by Section 18.1350a(a) of the Michigan Compiled Laws as total annual personal income as officially reported by USDOC.

NOTES TO THE STATEMENT OF REVENUE SUBJECT TO
CONSTITUTIONAL LIMITATION - LEGAL BASIS (continued)

6. Section 26 Base Ratio

The Section 26 base year ratio is 9.49%. This is the ratio of fiscal year 1979 "Total Revenue Subject to Limitation," to the calendar year personal income of Michigan in 1977 (See Note #5).