MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

FINANCIAL AUDIT
OF THE

MICHIGAN EDUCATION TRUST PLAN D

(A Component Unit of the State of Michigan)

October 1, 2002 through September 30, 2004

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

27-283-05

"...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof."

– Article IV, Section 53 of the Michigan Constitution

Audit report information may be accessed at:
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Michigan

Office of the Auditor General

REPORT SUMMARY

Financial Audit

Michigan Education Trust Plan D

October 1, 2002 through September 30, 2004

Report Number:
27-283-05

Released:
June 2005

A financial audit determines if the financial statements are fairly presented; considers internal control over financial reporting; and determines compliance with State compliance requirements material to the financial statements. This financial audit of the Michigan Education Trust (MET) Plan D was conducted as part of the constitutional responsibility of the Office of the Auditor General.

Financial Statements:

Auditor's Report Issued

We issued an unqualified opinion on the MET Plan D financial statements.

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Internal Control Over Financial Reporting

We did not report any findings related to internal control over financial reporting.

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Noncompliance or Other Matters Material to the Financial Statements

We did not identify any instances of noncompliance or other matters applicable to the financial statements that are required to be reported under *Government Auditing Standards*.

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Background:

MET was created under Act 316, P.A. 1986, to operate a prepaid college tuition program that will provide a Michigan child's undergraduate tuition at any Michigan public university or community college. MET is governed by a Board of Directors consisting of 9 members, including 8 public members who are appointed by the Governor with the advice and consent of the Senate and 1 ex-officio member (the State Treasurer, acting as chairperson).

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: http://audgen.michigan.gov

Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General

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STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
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LANSING, MICHIGAN 48913
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

June 10, 2005

Mr. Jay B. Rising, Chair
Board of Directors
and
Ms. Robin R. McMillan, Executive Director
Michigan Education Trust
Treasury Building
Lansing, Michigan

Dear Mr. Rising and Ms. McMillan:

This is our report on the financial audit of the Michigan Education Trust (MET) Plan D for the period October 1, 2002 through September 30, 2004. MET is a component unit of the State of Michigan.

This report contains our report summary, our independent auditor's report on the financial statements, the MET management's discussion and analysis, and the MET Plan D financial statements and notes to the financial statements. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters and a glossary of acronyms and terms.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

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TABLE OF CONTENTS

MICHIGAN EDUCATION TRUST PLAN D

	Page
INTRODUCTION	
Report Summary	1
Report Letter	3
INDEPENDENT AUDITOR'S REPORT	
Independent Auditor's Report on the Financial Statements	8
MANAGEMENT'S DISCUSSION AND ANALYSIS	
Management's Discussion and Analysis	11
FINANCIAL STATEMENTS	
Michigan Education Trust Plan D Financial Statements	
Statement of Net Assets	18
Statement of Revenues, Expenses, and Changes in Net Assets	19
Statement of Cash Flows	20
Notes to the Financial Statements	21
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE	
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters	32

GLOSSARY

Glossary of Acronyms and Terms 35

INDEPENDENT AUDITOR'S REPORT

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on
the Financial Statements

Mr. Jay B. Rising, Chair
Board of Directors
and
Ms. Robin R. McMillan, Executive Director
Michigan Education Trust
Treasury Building
Lansing, Michigan

Dear Mr. Rising and Ms. McMillan:

We have audited the financial statements of the Michigan Education Trust Plan D, a component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2004 and September 30, 2003, as identified in the table of contents. These financial statements are the responsibility of the Michigan Education Trust's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 audit 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements present only the Michigan Education Trust Plan D and do not purport to, and do not, present fairly the financial position of the State of Michigan or its component units as of September 30, 2004 and September 30, 2003 and the changes in financial position and cash flows thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Michigan Education Trust Plan D as of September 30, 2004 and September 30, 2003 and the changes in financial position and cash flows for the fiscal 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 a report dated December 22, 2004 on our consideration of the Michigan Education Trust's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of the internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion 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 is not a required part of the basic financial statements but is supplementary 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 required supplementary information. However, we did not audit the information and express no opinion on it. The management's discussion and analysis for the fiscal year ended September 30, 2003 was not presented because this information was presented in the Michigan Education Trust Plan D's prior year's audited financial statements.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General
December 22, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

This is a discussion and analysis of the financial performance of the Michigan Education Trust (MET) Plan D for the fiscal year ended September 30, 2004. MET is an Internal Revenue Code Section 529 prepaid tuition program and is a component unit of the State of Michigan, administratively located within the Department of Treasury. MET's management is responsible for the financial statements, notes to the financial statements, and this discussion.

Using the Financial Report

This financial report includes the report of independent auditors, management's discussion and analysis, the basic financial statements, and notes to the financial statements.

The financial statements are interrelated and represent the financial status of MET.

The statement of net assets includes the assets, liabilities, and net assets at the end of the fiscal year.

The statement of revenues, expenses, and changes in net assets presents the revenues earned and expenses incurred during the fiscal year.

The statement of cash flows presents information related to cash inflows and outflows summarized by operating and investing activities.

Analysis of Financial Activities

The MET Board of Directors approves an annual budget and the investment portfolio allocation. The Bureau of Investments, Department of Treasury, under the direction of MET management, is responsible for short-term and long-term investment of MET funds. The MET portfolio for Plan D may be invested up to 30% in equities with the remainder invested in short-term investments, U.S. government securities, and corporate bonds.

MET funds are invested to coincide with the students' expected years of high school graduation. Once students activate their contracts, colleges and universities submit invoices to MET every semester for tuition and mandatory fees. Students have nine years from the expected year of high school graduation to completely use MET contract benefits.

Annually, the actuary determines the actuarial soundness of each MET plan. Key factors used in the soundness analysis are: tuition increases (short-term and long-term), investment performance, and college selections by students and purchasers.

Overall, MET Plan D experienced a 41% decrease in new contract enrollment from the prior year, which decreased the amount of cash received in comparison to fiscal year 2002-03. MET received 2,620 new contracts and approximately $31 million in prepaid tuition amounts during fiscal year 2003-04. In fiscal year 2002-03, MET received 4,462 new contracts and approximately $54 million in prepaid tuition amounts. The reason for the decrease from fiscal year 2002-03 was the shorter enrollment period in fiscal year 2003-04.

Comparison of Current Year and Prior Year Results

Condensed Financial Information
From the Statement of Net Assets
As of September 30
(in thousands)

	2004	2003
Current assets	$ 70,437	$ 59,941
Noncurrent assets	262,177	213,987
Total Assets	$ 332,614	$ 273,927
Current liabilities	$ 5,045	$ 3,274
Noncurrent liabilities	363,431	280,752
Total Liabilities	$ 368,476	$ 284,026
Net Assets - Restricted	$ (35,863)	$ (10,099)
Total Net Assets	$ (35,863)	$ (10,099)

Total net assets decreased by approximately $25.8 million. The net assets decreased primarily because the interest earnings assumption used by the actuary changed from 8.10% to 7.25% and the asset performance was lower than expected. The decrease in net assets was offset somewhat by lower-than-expected tuition and fee increases and longer-than-expected delays by beneficiaries in their usage of contracts.

Current assets increased primarily because of the increase in cash and cash equivalents. Cash and cash equivalents include short-term investments. This line item increased as of September 30, 2004 because some investments matured and the proceeds were not immediately reinvested in the long-term portfolio because of market volatility.

Noncurrent assets increased to reflect an increase in new contract prepaid tuition amounts received in fiscal year 2003-04, which included lump-sum and monthly purchase contracts.

The MET Plan D target portfolio is 70% invested in short-term investments, U.S. government securities, and corporate bonds and 30% invested in equities. The actual portfolio was 71.3% fixed income investments and 28.7% equity.

Current liabilities increased in fiscal year 2003-04. Amounts due to MET Program (Plans B and C) increased primarily because of an increase in marketing and other administrative expenses during fiscal year 2003-04.

Noncurrent liabilities increased in fiscal year 2003-04. The tuition benefits payable increase reflects the changes in the actuarial present value of the future tuition obligation and increases for new contracts issued. Changes in the present value of the future tuition benefit obligation include the changes in the present value discount due to the passage of time, differences between actual experience and the actuarial assumptions utilized, and any changes in actuarial assumptions. Current and noncurrent tuition benefits payable increased to reflect the increase in lump-sum and monthly purchase contracts received and the actuarial present value of future tuition benefit obligations.

Condensed Financial Information
From the Statement of Revenues, Expenses, and Changes in Net Assets
Fiscal Year Ended September 30
(in thousands)

	2004	2003
Operating Revenues		
Interest and dividend income	$ 5,674	$ 3,671
Net realized and unrealized appreciation (depreciation) in the fair value of investments	7,900	7,821
Other miscellaneous income	197	283
Total Operating Revenues	$ 13,771	$ 11,775
Operating Expenses		
Salaries and other administrative expenses	$ 1,056	$ 596
Tuition benefit expenses	38,479	8,404
Total Operating Expenses	$ 39,534	$ 9,000
Operating Income (Loss)	$ (25,764)	$ 2,775
Nonoperating Revenues (Expenses)	$ 0	$ 0
Transfers	$ 0	$ 0
Increase (Decrease) in Net Assets	$ (25,764)	$ 2,775
Net assets - Beginning of fiscal year	(10,099)	(12,874)
Net assets - End of fiscal year	$ (35,863)	$ (10,099)

Net realized and unrealized appreciation (depreciation) in the fair value of investments increased primarily because of an increase in market value of investments in equities during the fiscal year and contributed to an overall increase of operating revenues in fiscal year 2003-04.

Salaries and other administrative expenses increased. This increase is attributed to the increase in marketing cost and other administrative expenses.

Tuition benefit expenses increased because of the actuarially determined tuition benefit obligation. The primary reason for the increase related to the updating of actuarial assumptions used by the actuary to calculate the tuition benefit obligation.

The deficit in **net assets - end of fiscal year** increased from the prior fiscal year because actuarial assumptions for future interest earnings decreased from 8.10% in fiscal year 2002-03 to 7.25% in fiscal year 2003-04.

As stated in the actuary's 2004 report, MET Plan D is 90.2% funded and is able to pay benefits through 2020 even if no new contracts are issued.

Condensed Financial Information
From the Statement of Cash Flows
Fiscal Year Ended September 30
(in thousands)

	2004	2003
Cash provided (used) by:		
Operating activities	$ 50,998	$ 64,899
Investing activities	(38,410)	(63,487)
Net increase (decrease) in cash	$ 12,588	$ 1,412
Cash and cash equivalents - Beginning of fiscal year	45,269	43,857
Cash and cash equivalents - End of fiscal year	$ 57,857	$ 45,269

Cash provided by operating activities decreased primarily because of a decrease in contract enrollment in fiscal year 2003-04 from fiscal year 2002-03.

Cash used by investing activities decreased because of the decreased amount of cash available for investing purposes.

The stock market was volatile for the fifth consecutive year, which negatively impacted Plan D. Open enrollment for the year resulted in a 41.7% decrease in prepaid tuition amounts received compared to amounts received in the prior fiscal year. Prepaid tuition receipts translate into an increase in the tuition liability; however, the actuarial soundness of MET is based in part on new contracts being purchased.

Factors Impacting Future Periods

It is expected that Michigan public universities will adopt higher tuition increases next year if State appropriated funds decrease.

MET enrollment for 2004 was held December 15, 2003 through April 15, 2004. The 2005 enrollment began September 1, 2004 and will end June 15, 2005. New enrollments will increase cash, future tuition benefits payable, and the asset base of MET Plan D.

FINANCIAL STATEMENTS

MICHIGAN EDUCATION TRUST PLAN D
Statement of Net Assets
As of September 30

	2004	2003
ASSETS		
Current Assets:		
Cash and cash equivalents (Note 3)	$ 57,857,322	$ 45,268,985
Tuition contracts receivable (Note 4)	11,331,126	13,665,680
Interest and dividends receivable	1,248,907	1,006,187
Total Current Assets	$ 70,437,355	$ 59,940,852
Noncurrent Assets:		
Investments (Note 3)	220,340,083	174,030,438
Tuition contracts receivable (Note 4)	41,836,429	39,956,152
Total Assets	$ 332,613,867	$ 273,927,442
LIABILITIES		
Current Liabilities:		
Amounts due to MET Program (Plans B and C)	$ 1,045,404	$ 574,475
Tuition benefits payable (Note 5)	4,000,000	2,700,000
Total Current Liabilities	$ 5,045,404	$ 3,274,475
Noncurrent Liabilities:		
Tuition benefits payable (Note 5)	363,431,042	280,751,984
Total Liabilities	$ 368,476,446	$ 284,026,459
NET ASSETS		
Net Assets - Restricted	$ (35,862,579)	$ (10,099,017)
Total Net Assets	$ (35,862,579)	$ (10,099,017)

The accompanying notes are an integral part of the financial statements.

MICHIGAN EDUCATION TRUST PLAN D
Statement of Revenues, Expenses, and Changes in Net Assets
Fiscal Year Ended September 30

	2004	2003
OPERATING REVENUES		
Interest and dividend income	$ 5,674,231	$ 3,671,497
Net realized and unrealized appreciation (depreciation) in the fair value of investments	7,900,066	7,820,679
Other miscellaneous income	196,536	283,037
Total Operating Revenues	$ 13,770,833	$ 11,775,213
OPERATING EXPENSES		
Salaries and other administrative expenses	$ 1,055,887	$ 596,257
Tuition benefit expenses	38,478,508	8,404,209
Total Operating Expenses	$ 39,534,395	$ 9,000,467
Operating Income (Loss)	$ (25,763,562)	$ 2,774,746
Nonoperating Revenues (Expenses)	$ 0	$ 0
Transfers	$ 0	$ 0
Increase (Decrease) in Net Assets	$ (25,763,562)	$ 2,774,746
Net assets - Beginning of fiscal year	(10,099,017)	(12,873,763)
Net assets - End of fiscal year	$ (35,862,579)	$ (10,099,017)

The accompanying notes are an integral part of the financial statements.

MICHIGAN EDUCATION TRUST PLAN D
Statement of Cash Flows
Fiscal Year Ended September 30

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Contract receipts	$ 49,784,348	$ 65,467,274
Interest and dividends received	5,431,511	2,928,553
Contract payments	(3,829,522)	(3,161,841)
Administrative and other expenses paid	(584,958)	(617,650)
Application and other fees collected	196,536	283,037
Net cash provided (used) by operating activities	$ 50,997,915	$ 64,899,373
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities	$ (85,419,869)	$ (102,835,218)
Proceeds from sale and maturities of investment securities	47,010,290	39,348,153
Net cash provided (used) by investing activities	$ (38,409,579)	$ (63,487,064)
Net cash provided (used) - All activities	$ 12,588,336	$ 1,412,309
Cash and cash equivalents - Beginning of fiscal year	45,268,985	43,856,676
Cash and cash equivalents - End of fiscal year	$ 57,857,322	$ 45,268,985
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating income (loss)	$ (25,763,562)	$ 2,774,746
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Unrealized and realized (gains) losses	(7,900,066)	(7,820,679)
Changes in assets and liabilities:		
Tuition contracts receivable	454,277	(6,377,659)
Interest and dividends receivable	(242,720)	(742,944)
Amounts due to MET Program (Plans B and C)	470,929	(21,393)
Tuition benefits payable	83,979,058	77,087,301
Net cash provided (used) by operating activities	$ 50,997,915	$ 64,899,373

The accompanying notes are an integral part of the financial statements.

Note 1 Basis of Presentation and Reporting Entity

a. Basis of Presentation

The financial statements of the Michigan Education Trust (MET) Plan D have been prepared in accordance with generally accepted accounting principles applicable to governments.

b. Reporting Entity

MET was created under Act 316, P.A. 1986 (Sections 390.1421 - 390.1444 of the *Michigan Compiled Laws*) to operate a prepaid college tuition program. MET is governed by a Board of Directors consisting of 9 members, including 8 public members who are appointed by the Governor with the advice and consent of the Senate and 1 ex-officio member (the State Treasurer, acting as chairperson). MET is administratively located within the Department of Treasury. The State Treasurer, as MET's agent, may not commingle funds and must maintain a separate bank account for MET. MET is a proprietary component unit of the State of Michigan and is reported as such in the *State of Michigan Comprehensive Annual Financial Report*. The accompanying financial statements present only MET Plan D. Accordingly, they do not purport to, and do not, present fairly the financial position and changes in financial position and cash flows of the State of Michigan or its component units in conformity with generally accepted accounting principles applicable to governments.

Act 316, P.A. 1986, empowers MET, on behalf of itself and the State of Michigan, to enter into a contract with a purchaser which provides that, in return for a specified actuarial determined payment, MET will provide a Michigan child's undergraduate tuition at any Michigan public university or community college. The purchase amount is based on several factors, including tuition costs, anticipated investment earnings, anticipated tuition rate increases, and the type of contract purchased. MET offers a full benefits contract, a limited benefits contract, and a community college contract. MET's property, income, and operations have been statutorily exempted from all taxation by the State and its political subdivisions. The

Act and the contracts specifically provide that the State is not liable if MET becomes actuarially unsound. In that event, the contracts provide for refunds to participants.

As of September 30, 2004, there have been 11 enrollment periods for MET. The 1988, 1989, and 1990 enrollments are known as Plans B and C. The 1995, 1997, 1998, 1999, 2000, 2002, 2003, and 2004 enrollments are known as Plan D. The Plan D enrollments are accounted for and reported separately from the Plans B and C enrollments. This report covers the Plan D enrollments. A separate financial report and actuarial valuation of Plans B and C enrollments are available from the MET office at P.O. Box 30198, Lansing, Michigan 48909.

Note 2 Summary of Significant Accounting Policies

a. Measurement Focus and Basis of Accounting

The financial statements contained in this report are prepared using the economic resources measurement focus and the accrual basis of accounting as provided by generally accepted accounting principles applicable to governments. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. Tuition benefit expense represents accretion of the tuition benefits obligation (see Note 5).

As allowed by Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, MET follows all GASB pronouncements and those Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

b. Assets, Liabilities, and Net Assets

Cash and Cash Equivalents: Cash and cash equivalents reported on the statement of net assets include deposits with financial institutions and short-term investments with original maturities of less than three months used for cash management rather than investing activities.

Cash and Investments: MET's deposits and investments are held in a fiduciary capacity by the State Treasurer. Act 316, P.A. 1986, authorizes the MET Board of Directors to invest MET's assets in any instrument, obligation, security, or property that it considers to be appropriate. The Act also authorizes the pooling of MET's assets with assets of the State, such as the pension funds, for investment purposes.

Investments are carried at market value (see Note 3).

Act 316, P.A. 1986, requires all deposits of MET to be secured by obligations of the United States or of the State. The market value of these obligations must at all times be equal to or greater than the amount of the deposits of MET, and all banks and trust companies are authorized to give such security for such deposits.

Tuition Contracts Receivable: The present value of the future monthly purchase contract payments is recorded as a current and noncurrent asset of MET. In fiscal year 2003-04, the discount rate applied to expected future cash flows to determine present value is 7.25%. In fiscal year 2002-03, the discount rate was 8.10%.

Liabilities: The actuarial present value of the future tuition obligation is recorded as a current and noncurrent liability of MET (see Note 5).

Net Assets: MET's net assets represent the investment appreciation and the investment revenue in excess of (or less than) the actuarial present value of the future tuition obligation and expenses (see Note 5). Net assets are restricted because of the contractual obligations MET must adhere to on behalf of the purchasers and beneficiaries for which prepaid

tuition was collected and invested. The enabling legislation for MET is Act 316, P.A. 1986. Section 17 of the Act indicates:

> The assets of the trust shall be preserved, invested, and expended solely pursuant to and for the purposes set forth in this act and shall not be loaned or otherwise transferred or used by the state for any purpose other than the purposes of this act.

Note 3 Deposits and Investments

a. General Information

GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, requires certain disclosures regarding policies and practices with respect to deposits and investments and the custodial credit risk associated with them.

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

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

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

Category 3: Uncollateralized, including bank balances that are collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the entity's name.

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

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

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

Category 3: Uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the entity's name.

b. Deposits

At the end of fiscal year 2003-04, the carrying amount of MET's deposits for Plan D was $3,520,693. The deposits were reflected in the accounts of the banks at $3,520,693. The September 30, 2004 balances were covered by federal depository insurance or collateral held by MET's agent in MET's name and, accordingly, classified in GASB credit risk category 1.

At the end of fiscal year 2002-03, the carrying amount of MET's deposits for Plan D was $1,915,007. The deposits were reflected in the accounts of the banks at $1,915,007. The September 30, 2003 balances were covered by federal depository insurance or collateral held by MET's agent in MET's name and, accordingly, classified in GASB credit risk category 1.

c. Investments

The following table shows the carrying amounts and market values of investments for Plan D by investment type and in total (in millions) at September 30, 2004:

Investments	GASB Credit Risk Category 1	2	3	Not Categorized	Total Carrying Value	Market Value
Commercial paper	$ 54.3	$	$	$	$ 54.3	$ 54.3
Government securities	88.6				88.6	88.6
Corporate bonds and notes	68.6				68.6	68.6
Mutual funds				63.1	63.1	63.1
Total Investments	$ 211.5	$ 0.0	$ 0.0	$ 63.1	$ 274.6	$ 274.6

Less Investments Reported as Cash and Cash Equivalents on Statement of Net Assets	(54.3)
Total Investments Per Statement of Net Assets	$ 220.3
As Reported on Statement of Net Assets	
Cash and cash equivalents (net of deposits, see Note 3b)	$ 54.3
Noncurrent investments	220.3
Total Investments	$ 274.6

The following table shows the carrying amounts and market values of investments for Plan D by investment type and in total (in millions) at September 30, 2003:

Investments	GASB Credit Risk Category 1	2	3	Not Categorized	Total Carrying Value	Market Value
Commercial paper	$ 43.4	$	$	$	$ 43.4	$ 43.4
Government securities	118.2				118.2	118.2
Corporate bonds and notes	18.2				18.2	18.2
Mutual funds				37.6	37.6	37.6
Total Investments	$ 179.8	$ 0.0	$ 0.0	$ 37.6	$ 217.4	$ 217.4

Less Investments Reported as Cash and Cash Equivalents on Statement of Net Assets	(43.4)
Total Investments Per Statement of Net Assets	$ 174.0

As Reported on Statement of Net Assets	
Cash and cash equivalents (net of deposits, see Note 3b)	$ 43.4
Noncurrent investments	174.0
Total Investments	$ 217.4

Note 4 Tuition Contracts Receivable

The following table summarizes tuition contracts receivable for monthly purchase contracts as of September 30:

	2004	2003
Tuition contracts receivable	$ 64,498,679	$ 67,287,512
Present value discount	(11,331,126)	(13,665,680)
Net Tuition Contracts Receivable	$ 53,167,553	$ 53,621,832

Note 5 Tuition Benefits Payable

The standardized measurement of the total tuition benefits obligation of MET is the actuarial present value of the future tuition obligation. This valuation method reflects the present value of estimated tuition benefits that will be paid in future years and is adjusted for the effects of projected tuition increases and

termination of MET contracts. The following table shows the total tuition benefits obligation of MET as of September 30:

	2004	2003
Market value of net assets, excluding tuition benefits obligation	$ 331,568,463	$ 273,352,967
Present value of future benefits payable and expenses, assuming MET earns 7.25% (8.10% for 2003)	$ 367,431,042	$ 283,451,984
Net assets in excess of tuition benefits obligation	$ (35,862,579)	$ (10,099,017)
Net assets as a percentage of tuition benefits obligation	90%	96%

The most important assumptions used in the actuarial valuations include the following:

(1) For fiscal year 2003-04, the discount rate applied to expected future cash flows to determine present value was 7.25%. For fiscal year 2002-03, the discount rate applied was 8.10%. This discount rate approximates the expected investment yield over the lifetime of the present tuition benefit contracts.

(2) For fiscal year 2003-04, the projected tuition increase was 7.00% compounded annually for the next five years and 7.30% for the balance of the period. The MET Board of Directors continued with a two-tier formula for adjusting the tuition increase assumption. The short-term increase assumption of 7.00% (five years through 2010) was based on an extrapolation of recent experience. The Board also considered the relationship of tuition increases to the consumer price index in determining the long-term tuition increase assumption of 7.30%. The assumptions were unchanged from the fiscal year 2002-03 assumptions.

(3) There was no tax effect from the federal income tax.

(4) MET will pay 110% of the MET weighted average tuition in benefits and refunds.

Presented below are the key assumptions used in the actuarial valuation for Plan D:

	Fiscal Years				
	2003-04	2002-03	2001-02	2000-01	1999-2000
Tuition increase	7.00%	7.00%	5.84%	5.71%	5.81%
Tuition increase - Long-term	7.30%	7.30%	7.30%	7.30%	7.30%
Present value discount rate	7.25%	8.10%	7.00%	7.00%	6.83%

The following summarizes the tuition benefits payable as of and for the fiscal years ended September 30, 2004 and September 30, 2003:

Balance at October 1, 2002	$	206,364,683
Expense provision		80,249,142
Payments		(3,161,841)
Balance at September 30, 2003	$	283,451,984
Expense provision		87,808,580
Payments		(3,829,522)
Balance at September 30, 2004	$	367,431,042

The amounts due within one year for the fiscal years ended September 30, 2004 and September 30, 2003 are $4,000,000 and $2,700,000, respectively. The actuarial assumptions described in this note have a significant impact on the tuition benefit liability. Actual results may differ from the assumptions utilized.

Note 6 Tax Status

On November 8, 1994, the U.S. Court of Appeals for the Sixth Circuit ruled that MET is an integral part of the State of Michigan; thus, the investment income realized by MET is not currently subject to federal income tax.

Distributions made in excess of contributions (whether to the refund designee or beneficiary or to a college on behalf of the beneficiary) are taxable income to the refund designee or the beneficiary. After January 1, 2002, these excess distributions are no longer subject to federal income tax if used for qualified higher education expenses. The federal tax exemption is scheduled to expire in 2010.

On August 20, 1996, the Small Business Job Protection Act of 1996 (known as the "1996 Tax Act") was signed into law. The 1996 Tax Act included a provision adding a new section to the Internal Revenue Code of 1986 defining "qualified state tuition programs." A qualified state tuition program is generally exempt from income tax but is subject to unrelated business income tax. MET has no unrelated business income.

In May 1997, MET submitted a request for ruling to the Internal Revenue Service (IRS) for verification that MET is in compliance with the 1996 Tax Act. On December 23, 1997, the IRS issued a favorable ruling, which confirms that MET meets the requirements for exemption from federal income tax as a qualified state tuition program described in section 529 of the Internal Revenue Code.

Note 7 Risk Management

MET participates in the State of Michigan's (primary government) risk management program. The State is self-insured for most general liability and property losses; portions of its employee insurance benefit and bonding programs; and automobile liability, workers' compensation, and unemployment claims. The State Sponsored Group Insurance Fund and Risk Management Fund (internal service funds) have been established by the State to account for these self-insured risk management programs. As a participant, MET recognizes expenses for payments made to the State in a manner similar to purchasing commercial insurance. Charges to finance the self-insured programs are based on estimates of amounts needed to pay prior and current year claims as determined annually by the Department of Management and Budget.

Note 8 Pension Plans

MET employees are State classified employees who are covered by the State Employees' Retirement System plans. Detail and data regarding the plan descriptions, accounting policies, vesting and eligibility requirements, actuarial cost methods and assumptions, funding status and requirements, and 10-year historical trend information are provided in the *State of Michigan Comprehensive Annual Financial Report* and the plans' detailed financial reports, issued by the Office of Retirement Services, Department of Management and Budget.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

Mr. Jay B. Rising, Chair
Board of Directors
and
Ms. Robin R. McMillan, Executive Director
Michigan Education Trust
Treasury Building
Lansing, Michigan

Dear Mr. Rising and Ms. McMillan:

We have audited the financial statements of the Michigan Education Trust Plan D, a component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2004 and September 30, 2003, as identified in the table of contents, and have issued our report thereon dated December 22, 2004. We conducted our audit 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Michigan Education Trust's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Michigan Education Trust's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

This report is intended solely for the information and use of the Michigan Education Trust's Board of Directors and management and the Legislature and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General
December 22, 2004

GLOSSARY

financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
GASB	Governmental Accounting Standards Board.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
IRS	Internal Revenue Service.
material misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.
material weakness	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and/or financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
MET	Michigan Education Trust.
reportable condition	A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect

the entity's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements.

unqualified opinion An auditor's opinion in which the auditor states that the financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting.

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STATE OF MICHIGAN

OFFICE of the AUDITOR GENERAL