MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

FINANCIAL AUDIT
OF THE

MICHIGAN EDUCATION TRUST PLANS B AND C
(A Component Unit of the State of Michigan)

October 1, 2004 through September 30, 2006

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

271-0284-07

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

Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit

Michigan Education Trust Plans B and C
(A Component Unit of the State of Michigan)
October 1, 2004 through September 30, 2006

Report Number:
271-0284-07

Released:
March 2007

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) Plans B and C 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 Plans B and C 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 and 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 9-member Board of Directors that consists of the State Treasurer and 8 public members who are appointed by the Governor with the advice and consent of the Senate.

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

March 30, 2007

Mr. Robert J. Kleine, Chair
Board of Directors
and
Ms. Robin R. Lott, Executive Director
Michigan Education Trust
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Kleine and Ms. Lott:

This is our report on the financial audit of the Michigan Education Trust (MET) Plans B and C for the period October 1, 2004 through September 30, 2006. 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 Plans B and C 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.

AUDITOR GENERAL

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MICHIGAN EDUCATION TRUST PLANS B AND C

GLOSSARY

INDEPENDENT AUDITOR'S REPORT

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

Independent Auditor's Report on the Financial Statements

Mr. Robert J. Kleine, Chair
Board of Directors
and
Ms. Robin R. Lott, Executive Director
Michigan Education Trust
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Kleine and Ms. Lott:

We have audited the statement of net assets; the statement of revenues, expenses, and changes in net assets; and the statement of cash flows of the Michigan Education Trust Plans B and C, a component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2006 and September 30, 2005. 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 Plans B and C 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, 2006 and September 30, 2005 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 Plans B and C as of September 30, 2006 and September 30, 2005 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 our report dated December 22, 2006 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 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.

AUDITOR GENERAL

December 22, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

This is a discussion and analysis of the financial performance of the Michigan Education Trust (MET) Plans B and C for the fiscal year ended September 30, 2006 and September 30, 2005. MET is an Internal Revenue Code Section 529 qualified 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 Plans B and C is invested 100% in fixed income investments.

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. In 2006, the MET Board approved an amendment allowing students 15 years from the expected year of high school graduation to completely use MET contract benefits. Prior to that change, students had 9 years to 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 selection by students and purchasers.

Comparison of Current Year and Prior Year Results

Condensed Financial Information
From the Statement of Net Assets
As of September 30
(In Thousands)

	2006	2005	2004
Current assets	$ 118,013	$ 55,516	$ 139,677
Noncurrent assets	391,033	520,574	501,337
Total Assets	$ 509,046	$ 576,089	$ 641,014
Current liabilities	$ 93,008	$ 80,008	$ 82,008
Noncurrent liabilities	394,522	469,609	518,231
Total Liabilities	$ 487,531	$ 549,617	$ 600,239
Net Assets - Restricted	$ 21,515	$ 26,472	$ 40,775
Total Net Assets	$ 21,515	$ 26,472	$ 40,775

The overall financial position of MET Plans B and C for the fiscal years ended September 30, 2006 September 30, 2005 is positive and shows net assets of $21.5 million and $26.5 million, respectively. The net assets decreased by $5.0 million in fiscal year 2005-06 and by $14.3 million in fiscal year 2004-05 because the asset performance was lower than expected. The lower performance of assets was somewhat offset by lower-than-expected increases in tuition and fees and longer-than-expected delays by beneficiaries in the use of their contracts.

Current assets increased by $62.5 million in fiscal year 2005-06 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, 2006 because the proceeds were not reinvested in the long-term portfolio. Current assets decreased by

$84.2 million in fiscal year 2004-05 primarily because of the decrease in cash and cash equivalents. This line item decreased as of September 30, 2005 because the proceeds were reinvested in the long-term portfolio.

Noncurrent assets decreased by $129.5 million in fiscal year 2005-06 and increased by $19.2 million in fiscal year 2004-05. The decrease in fiscal year 2005-06 resulted because the proceeds from the long-term portfolio were used to make increased tuition benefit payments. The increase in fiscal year 2004-05 resulted primarily from reinvestments of short-term proceeds into the long-term portfolio.

Total liabilities decreased by $62.1 million in fiscal year 2005-06 and by $50.6 million in fiscal year 2004-05. The decreases resulted from increased tuition benefit payments. The tuition benefits payable decrease reflects the changes in the actuarial present value of the future tuition benefits obligation. Changes in the present value of the future tuition benefits obligation include the changes in the present value discount because of the passage of time, differences between actual experience and the actuarial assumptions utilized, and any changes in actuarial assumptions.

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

	2006	2005	2004
Operating Revenues			
Interest and dividends income	$ 22,256	$ 22,542	$ 24,932
Net realized and unrealized appreciation (depreciation) in the fair value of investments	(955)	(11,070)	(1,339)
Other miscellaneous income	48	44	40
Total Operating Revenues	$ 21,349	$ 11,516	$ 23,633
Operating Expenses			
Salaries and other administrative expenses	$ 1,075	$ 1,162	$ 1,162
Tuition benefit expenses	25,231	24,657	26,991
Total Operating Expenses	$ 26,306	$ 25,819	$ 28,153
Operating Income (Loss)	$ (4,957)	$ (14,303)	$ (4,520)
Nonoperating Revenues (Expenses)	$ 0	$ 0	$ 0
Transfers	$ 0	$ 0	$ 0
Increase (Decrease) in Net Assets	$ (4,957)	$ (14,303)	$ (4,520)
Net Assets - Beginning of Fiscal Year	26,472	40,775	45,295
Net Assets - End of Fiscal Year	$ 21,515	$ 26,472	$ 40,775

Interest and dividends income decreased by $286,000 in fiscal year 2005-06 and by $2.4 million in fiscal year 2004-05. The decreases were attributed to lower average yields of investments.

Net realized and unrealized appreciation (depreciation) in the fair value of investments increased by $10.1 million in fiscal year 2005-06 and decreased by $9.7 million in fiscal year 2004-05 because of change in investment market values.

Salaries and other administrative expenses decreased slightly in fiscal year 2005-06 because of an overall decrease in the cost of printing and MET information technology maintenance. Administrative expenses remained the same in fiscal year 2004-05 as compared to fiscal year 2003-04.

Tuition benefit expenses increased by $573,000 in fiscal year 2005-06 and decreased by $2.3 million in fiscal year 2004-05. The increase and decrease in both fiscal years resulted from the change in the present value of the future tuition benefit obligation.

Condensed Financial Information
From the Statement of Cash Flows
Fiscal Years Ended September 30
(In Thousands)

	2006	2005	2004
Net Cash Provided (Used) by:			
Operating activities	$ (66,666)	$ (54,410)	$ (44,345)
Investing activities	128,585	(30,307)	109,560
Net Cash Provided (Used) - All Activities	$ 61,919	$ (84,717)	$ 65,215
Cash and Cash Equivalents - Beginning of Fiscal Year	46,965	131,681	66,466
Cash and Cash Equivalents - End of Fiscal Year	$ 108,884	$ 46,965	$ 131,681

The **net cash used by operating activities** increased by $12.3 million in fiscal year 2005-06 and by $10.1 million in fiscal year 2004-05. The increases were primarily the result of the increase in tuition contract payments to colleges and refund designees.

The **net cash provided by investing activities** increased by $158.9 million in fiscal year 2005-06 and the cash used by investing activities increased by $139.9 million in fiscal year 2004-05. The increase in cash provided in fiscal year 2005-06 resulted when some investments matured and the proceeds from the long-term portfolio were used to make increased tuition benefit payments. The increase in cash used in fiscal year 2004-05 was because of the reinvestment of short-term proceeds into the long-term portfolio.

Overall, the **cash and cash equivalents at the end of the fiscal year** increased by $61.9 million in fiscal year 2005-06 and decreased by $84.7 million in fiscal year 2004-05.

Factors Impacting Future Periods

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

MET Plans B and C reached the peak matriculation period during fiscal year 2005-06. During 2006, 10,513 students will be eligible to begin using MET contracts to attend college along with 13,159 students currently in the process of using MET contracts. After 2007, the number of students expected to enroll in college under MET Plans B and C will decrease because MET has fulfilled its contractual obligations for the majority of these contract holders and has not offered additional enrollments in these plans since 1990.

FINANCIAL STATEMENTS

MICHIGAN EDUCATION TRUST PLANS B AND C
Statement of Net Assets
As of September 30

	2006	2005
ASSETS		
Current Assets:		
Cash and cash equivalents (Note 3)	$ 108,884,093	$ 46,964,574
Amounts due from MET Program (Plan D)	1,561,054	1,281,486
Amounts due from primary government	1,776,281	1,501,270
Interest and dividends receivable	5,791,278	5,768,362
Total Current Assets	$ 118,012,707	$ 55,515,692
Noncurrent Assets:		
Investments (Note 3)	391,033,262	520,573,581
Total Assets	$ 509,045,968	$ 576,089,273
LIABILITIES		
Current Liabilities:		
Tuition benefits payable (Note 4)	$ 93,000,000	$ 80,000,000
Undistributed charitable tuition	4,784	4,784
Compensated absences	3,517	3,517
Total Current Liabilities	$ 93,008,301	$ 80,008,301
Noncurrent Liabilities:		
Tuition benefits payable (Note 4)	394,421,757	469,515,356
Compensated absences	100,490	93,263
Total Liabilities	$ 487,530,548	$ 549,616,920
NET ASSETS		
Net Assets - Restricted	$ 21,515,420	$ 26,472,353
Total Net Assets	$ 21,515,420	$ 26,472,353

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

MICHIGAN EDUCATION TRUST PLANS B AND C
Statement of Revenues, Expenses, and Changes in Net Assets
Fiscal Years Ended September 30

	2006	2005
OPERATING REVENUES		
Interest and dividends income	$ 22,255,836	$ 22,542,248
Net realized and unrealized appreciation (depreciation) in the fair value of investments	(954,994)	(11,069,988)
Other miscellaneous income	47,918	44,235
Total Operating Revenues	$ 21,348,760	$ 11,516,495
OPERATING EXPENSES		
Salaries and other administrative expenses	$ 1,074,917	$ 1,161,885
Tuition benefit expenses	25,230,775	24,657,447
Total Operating Expenses	$ 26,305,692	$ 25,819,332
Operating Income (Loss)	$ (4,956,933)	$ (14,302,836)
Nonoperating Revenues (Expenses)	$ 0	$ 0
Transfers	$ 0	$ 0
Increase (Decrease) in Net Assets	$ (4,956,933)	$ (14,302,836)
Net Assets - Beginning of Fiscal Year	26,472,353	40,775,189
Net Assets - End of Fiscal Year	$ 21,515,420	$ 26,472,353

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

MICHIGAN EDUCATION TRUST PLANS B AND C
Statement of Cash Flows
Fiscal Years Ended September 30

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest and dividends received	$ 22,232,920	$ 22,370,262
Contract payments	(87,324,374)	(75,295,003)
Administrative and other expenses paid	(1,622,270)	(1,529,400)
Application and other fees collected	47,918	44,235
Net Cash Provided (Used) by Operating Activities	$ (66,665,806)	$ (54,409,905)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities	$	$ (200,778,377)
Proceeds from sale and maturities of investment securities	128,585,325	170,471,766
Net Cash Provided (Used) by Investing Activities	$ 128,585,325	$ (30,306,611)
Net Cash Provided (Used) - All Activities	$ 61,919,519	$ (84,716,517)
Cash and Cash Equivalents - Beginning of Fiscal Year	46,964,574	131,681,090
Cash and Cash Equivalents - End of Fiscal Year	$ 108,884,093	$ 46,964,574
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating income (loss)	$ (4,956,933)	$ (14,302,836)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Unrealized and realized (gains) losses	954,994	11,069,988
Changes in assets and liabilities:		
Amounts due from primary government	(275,011)	(146,766)
Interest and dividends receivable	(22,916)	(171,987)
Amounts due from MET Program (Plan D)	(279,569)	(236,082)
Compensated absences	7,227	15,334
Tuition benefits payable	(62,093,599)	(50,637,556)
Net Cash Provided (Used) by Operating Activities	$ (66,665,806)	$ (54,409,905)

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) Plans B and C 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 9-member Board of Directors that consists of 1 ex-officio member (the State Treasurer, acting as chairperson) and 8 public members who are appointed by the Governor with the advice and consent of the Senate. 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 Plans B and C. 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 actuarially 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, 2006, there have been 13 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, 2004, 2005, and 2006 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 Plans B and C enrollments. A separate financial report and actuarial valuation of the Plan D 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 expenses represent accretion of the tuition benefits obligation (see Note 4).

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.

Liabilities: The actuarial present value of the future tuition benefits obligation is recorded as a current and noncurrent liability of MET (see Note 4).

Net Assets: MET's net assets represent the investment appreciation and the investment revenue in excess of the actuarial present value of the future tuition benefits obligation and expenses (see Note 4). 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

During the fiscal year ended September 30, 2005, MET adopted GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, which requires certain disclosures regarding policies and practices with respect to the risks associated with them. The interest rate risk, the credit risk, the custodial credit risk, the concentration of credit risk, and the foreign currency risk, are discussed in the following paragraphs.

b. Deposits

(1) Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, MET will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party.

At the end of fiscal year 2005-06, the carrying amount of MET's deposits for Plans B and C and the amount reflected in the accounts of the banks was $3,350,051. At the end of fiscal year 2004-05, the carrying amount of MET's deposits for Plans B and C and the amount reflected in the accounts of the banks was $2,788,025. The September 30, 2006 and September 30, 2005 balances were covered by federal depository insurance or collateral held with MET's agent in MET's name and, therefore, are not exposed to custodial credit risk.

(2) Foreign currency risk

Foreign currency risk for deposits is the risk that changes in exchange rates will adversely affect the fair value of a deposit. As of September 30, 2006 and September 30, 2005, MET had no foreign deposits.

c. Investments

(1) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. MET does not have a policy to restrict interest rate risk for long-term investments.

The following table shows the fair values of investments for Plans B and C by investment type and in total (in millions) at September 30, 2006:

		Investment Maturities			
	Fair Value	Less Than 1 Year	1 to 5 Years	6 to 10 Years	More Than 10 Years
Investments:					
Commercial paper	$ 105.6	$ 105.6	$	$	$
U.S. agencies - sponsored	265.7	15.5	158.8	59.2	32.2
Corporate bonds and notes	125.3	19.8	96.2	9.3	
Total Investments	$ 496.7	$ 140.9	$ 255.0	$ 68.5	$ 32.2
Less investments reported as "cash equivalents" on statement of net assets	(105.6)				
Total Investments	$ 391.0				

As Reported on the Statement of Net Assets	
Noncurrent restricted investments	$ 391.0
Total Investments	$ 391.0

The following table shows the fair values of investments for Plans B and C by investment type and in total (in millions) at September 30, 2005:

	Fair Value	Investment Maturities: Less Than 1 Year	1 to 5 Years	6 to 10 Years	More Than 10 Years
Investments:					
Commercial paper	$ 44.2	$ 44.2	$	$	$
U.S. Treasury bonds	4.9			4.9	
U.S. agencies - sponsored	307.1	39.9	135.0	70.8	61.4
Corporate bonds and notes	208.6	14.8	108.5	85.3	
Total Investments	$ 564.8	$ 98.8	$ 243.5	$ 161.0	$ 61.4
Less investments reported as "cash equivalents" on statement of net assets	(44.2)				
Total Investments	$ 520.6				
<u>As Reported on the Statement of Net Assets</u>					
Noncurrent restricted investments	$ 520.6				
Total Investments	$ 520.6				

(2) <u>Credit Risk</u>

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. MET limits investments in commercial paper, at the time of purchase, to the top two ratings issued by two national rating services: A-1 and A-2 from Standard & Poor's and rating of P-1 and P-2 from Moody's Investors Service. MET's policy also limited investments in corporate bonds and mutual bond funds, at the time of purchase, to the top four ratings of the two rating services: AAA, AA, A, and BBB from Standard & Poor's and Aaa, Aa, A, and Baa, from Moody's Investors Service. As of

September 30, 2006, the fair value (in millions) and credit quality ratings of investments are as follows:

Investment	Fair Value	Credit Quality Rating: Standard & Poor's	Credit Quality Rating: Moody's Investors Service
CSX Transportation	$ 7,056,770	A	A1
First Chicago Corp.	7,747,168	A	A1
Caterpillar Financial Services	5,152,880	A	A2
McDonalds Corp.	5,095,347	A	A2
American Honda Finance Corp.	4,861,810	A+	A1
Associates Corp.	5,166,550	A+	Aa2
Cargill Inc.	8,167,068	A+	A2
Dayton Hudson Corp.	5,245,760	A+	A1
Norfolk Southern	4,804,425	A+	Aa3
Home Depot	8,674,344	AA	Aa3
Gillette Company	5,855,929	AA-	Aa3
General Electric Corp.	9,341,410	AAA	Aaa
Seariver Maritime	20,245,140	AAA	Aaa
Ralston Purina Co.	11,055,955	BBB+	WR
Burlington Northern	11,425,000	NR	WR
Knight Ridder Inc.	5,444,545	BBB	Bb1
Federal Farm Credit Banks	91,933,258	AAA	Aaa
Federal Home Loan Banks	164,653,862	AAA	Aaa
Israel Trust	8,106,970	AAA	NA
First Military Housing	999,071	Not rated	Not rated
Total Fair Value	$ 391,033,262		

As of September 30, 2005, the market value (in millions) and credit quality ratings of investments are as follows:

Investment	Fair Value	Credit Quality Rating	
		Standard & Poor's	Moody's Investors Service
CSX Transportation	$ 7,287,632	A	A1
First Chicago Corp.	7,963,581	A	A1
Caterpillar Financial Services	5,152,849	A	A2
McDonalds Corp.	5,107,876	A	A2
American Honda Finance Corp.	4,888,850	A+	A1
Associates Corp.	5,323,255	A+	Aa2
Cargill Inc.	8,370,197	A+	A2
Dayton Hudson Corp.	5,508,150	A+	A2
Norfolk Southern	4,908,304	A+	Aa3
Home Depot	8,723,295	AA	Aa3
Gillette Company	5,852,421	AA-	Aa3
General Electric Capital Corp.	34,583,320	AAA	Aaa
Seariver Maritime	48,323,750	AAA	Aaa
Ralston Purina Co.	11,505,745	AAA	WR
General Motors Acceptance Corp.	27,413,732	BB	Ba1
Burlington Northern	11,923,176	BBB+	A3
Knight Ridder Inc.	5,751,540	BBB+	A3
Federal Farm Credit Banks	92,591,726	AAA	Aaa
Federal Home Loan Banks	205,127,493	AAA	Aaa
Israel Trust	7,857,796	AAA	NA
First Military Housing	1,534,537	Not rated	Not rated
Certificates of Accrual on Treasury Securities	4,874,355	Backed	Backed
Total Fair Value	$ 520,573,581		

(3) Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of failure of the counterparty to a transaction, MET will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. MET does not have an investment policy for custodial credit risk.

(4) Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of MET's investments with a single issuer. MET does not have a policy to limit the concentration of credit risk. At September 30, 2006, MET had the following investments that represented 5% or more of total investments:

		Credit Quality Rating	
Investment	Fair Value	Standard & Poor's	Moody's Investors Service
Federal Farm Credit Bank	$ 91,933,258	AAA	Aaa
Federal Home Loan Bank	$164,653,862	AAA	Aaa
Seariver Maritime	$ 20,245,140	AAA	Aaa

At September 30, 2005, MET had the following investments that represented 5% or more of total investments:

		Credit Quality Rating	
Investment	Fair Value	Standard & Poor's	Moody's Investors Service
Federal Farm Credit Bank	$ 92,591,726	AAA	Aaa
Federal Home Loan Bank	$205,127,493	AAA	Aaa
General Electric Capital Corp.	$ 34,583,320	AAA	Aaa
Seariver Maritime	$ 48,323,750	AAA	Aaa
General Motors Acceptance Corp.	$ 27,413,732	BB	Ba1

(5) Foreign Currency Risk

Foreign currency risk for investments is the risk that changes in exchange rates will adversely affect the fair value of investments. As of September 30, 2006 and September 30, 2005, MET had no foreign investments.

Note 4 Tuition Benefits Payable

The standardized measurement of the total benefits obligation of MET is the actuarial present value of the future tuition benefits 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 obligations of MET as of September 30:

	2006	2005
Actuarially determined net value of assets	$ 508,937,177	$ 575,987,709
Present value of total tuition benefits obligation	487,421,757	549,515,356
Net Value of Assets in Excess of Tuition Benefits Obligation	$ 21,515,420	$ 26,472,353
Net value of assets as a percentage of total tuition benefits obligation	104%	105%

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

(1) The discount rate applied to expected future cash flows to determine present value was 4.75% as of September 30, 2006 and 5.00% as of September 30, 2005. This discount rate approximates the expected investment yield over the lifetime of the present tuition benefit contracts.

(2) For fiscal year 2005-06, the projected tuition increase was 7.30% compounded annually for all future years. The MET Board of Directors considered the relationship of tuition increases to the consumer price index in determining the tuition increase assumption of 7.30%. The assumption was changed from the fiscal year 2004-05 assumptions. For fiscal year 2004-05, the Board used a two-tier formula for adjusting the tuition increase assumption. The projected tuition increase was 7.00% compounded annually for the next five years and

7.30% for the balance of the periods. The short-term increase assumption of 7.00% (five years through 2011) 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 fiscal year 2004-05 assumptions were unchanged from the prior year.

(3) There was no tax effect from 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 valuations for Plans B and C:

	Fiscal Years				
	2005-06	2004-05	2003-04	2002-03	2001-02
Tuition increase	7.30%	7.00%	7.00%	7.00%	5.84%
Tuition increase - long-term	7.30%	7.30%	7.30%	7.30%	7.30%
Present value discount rate	4.75%	5.00%	5.00%	5.00%	5.27%

The following summarizes the tuition benefits payable as of and for the fiscal years ended September 30, 2006 and September 30, 2005:

Balance at October 1, 2004	$ 600,152,912
Expense provision	24,657,447
Payments	(75,295,003)
Balance at September 30, 2005	$ 549,515,356
Expense provision	25,230,775
Payments	(87,324,374)
Balance at September 30, 2006	$ 487,421,757

The amounts due within one year for tuition benefits payable for the fiscal years ended September 30, 2006 and September 30, 2005 are $93,000,000 and $80,000,000, respectively. The actuarial assumptions described in this note have a significant impact on the tuition benefits liability. Actual results may differ from the assumptions utilized.

Note 5 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 the 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 Pension Protection Act enacted in August 2006 provides permanent tax exemption for Internal Revenue Code Section 529 qualified tuition programs.

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 tuition programs." A qualified 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 state qualified tuition program described in Section 529 of the Internal Revenue Code.

Note 6 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 7 Pension Plans

MET employees are State classified employees and 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.

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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. Robert J. Kleine, Chair
Board of Directors
and
Ms. Robin R. Lott, Executive Director
Michigan Education Trust
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Kleine and Ms. Lott:

We have audited the statement of net assets; the statement of revenues, expenses, and changes in net assets; and the statement of cash flows of the Michigan Education Trust Plans B and C, a component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2006 and September 30, 2005 and have issued our report thereon dated December 22, 2006. 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.

AUDITOR GENERAL

December 22, 2006

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