MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

FINANCIAL AUDIT
OF THE

MICHIGAN EDUCATION TRUST PLAN D

(A Discretely Presented Component Unit of the State of Michigan)

October 1, 2006 through September 30, 2008

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

271-0283-09

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 can be accessed at:
http://audgen.michigan.gov

Michigan

Office of the Auditor General

REPORT SUMMARY

Financial Audit

Michigan Education Trust Plan D

(A Discretely Presented Component Unit of the State of Michigan)

October 1, 2006 through September 30, 2008

Report Number:
271-0283-09

Released:
March 2009

A financial audit determines if the financial statements are fairly presented; considers internal control over financial reporting; and determines compliance with 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 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://www.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
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

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

March 31, 2009

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) Plan D, a discretely presented component unit of the State of Michigan, for the period October 1, 2006 through September 30, 2008.

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. 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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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 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 (deficit); the statement of revenues, expenses, and changes in net assets (deficit); and the statement of cash flows of the Michigan Education Trust Plan D, a discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2008 and September 30, 2007. 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, or the Michigan Education Trust Plans B and C, as of September 30, 2008 and September 30, 2007 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, 2008 and September 30, 2007 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 March 9, 2009 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

March 9, 2009

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 years ended September 30, 2008 and September 30, 2007. MET Plan D is an Internal Revenue Code Section 529 qualified tuition program and is a discretely presented 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 (deficit) includes the assets, liabilities, and net assets (deficit) at the end of the fiscal year. The statement of revenues, expenses, and changes in net assets (deficit) 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.

Financial Analysis of MET Plan D

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 75% 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. After 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. Before that change, students had nine 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.

MET Plan D received 2,648 new contracts and $49.4 million in prepaid tuition amounts during fiscal year 2007-08. In fiscal year 2006-07, MET received 3,273 new contracts and $47.7 million in prepaid tuition amounts. In fiscal year 2005-06, MET received 3,338 new contracts and $51.8 million in prepaid tuition amounts.

Comparison of Current Year and Prior Year Results

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

	2008	2007	2006
Current assets	$ 70,129	$ 48,648	$ 43,241
Noncurrent assets	491,527	560,251	443,713
Total assets	$ 561,656	$ 608,899	$ 486,954
Current liabilities	$ 26,590	$ 16,656	$ 11,561
Noncurrent liabilities	660,953	604,062	520,486
Total liabilities	$ 687,544	$ 620,718	$ 532,048
Net assets (deficit) - Unrestricted	$ (125,887)	$ (11,819)	$ (45,094)
Total net assets (deficit)	$ (125,887)	$ (11,819)	$ (45,094)

Total net assets decreased by $114.1 million in fiscal year 2007-08 and increased by $33.3 million in fiscal year 2006-07. The net assets decreased during fiscal year 2007-08 because of the decline in investment fair value at year-end. In fiscal year 2006-07, the net assets increased primarily because of increases in the fair value of the assets at year-end.

Current assets increased by $21.5 million in fiscal year 2007-08 primarily because of the increase in cash and cash equivalents. Cash and cash equivalents include commercial paper investments. The increase resulted when various investments matured and the proceeds were not immediately reinvested in the long-term portfolio because of market volatility. Current assets increased by $5.4 million in fiscal year 2006-07 primarily because of the increase in cash and cash equivalents. The increase in fiscal year 2006-07 was due to an increase in tuition contracts receivable.

Total assets decreased by $47.2 million in fiscal year 2007-08 and increased by $121.9 million in fiscal year 2006-07. The decrease was due to the unexpected and significant decline in the fair value of investments as of September 30, 2008. The increase in fiscal year 2006-07 resulted from an increase in new contract prepaid tuition amounts received, which included lump-sum and monthly purchase contracts and increases in the fair value of investments. During fiscal year 2007-08, the MET Plan D target portfolio was 25% invested in short-term investments, U.S. government securities, and corporate bonds and 75% invested in equities. The actual portfolio was 25.02% fixed income investments, 66.32% equity, and the remaining 8.66% in cash and cash equivalents.

Total liabilities increased by $66.8 million in fiscal year 2007-08 and increased by $88.7 million in fiscal year 2006-07. Tuition benefits payable increases reflect the changes in the actuarial present value of the future tuition benefits obligation and increases for new contracts issued. Changes in the present value of the future tuition benefits obligation include 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 benefits obligations.

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

	2008	2007	2006
Operating revenues			
Interest and dividends income	$ 13,437	$ 12,456	$ 10,122
Net increase (decrease) in the fair value of investments	(92,552)	44,394	18,020
Other miscellaneous income	100	96	110
Total operating revenues	$ (79,014)	$ 56,946	$ 28,251
Operating expenses			
Salaries and other administrative expenses	$ 1,831	$ 1,655	$ 1,482
Tuition benefit expenses	33,223	22,016	27,526
Total operating expenses	$ 35,055	$ 23,671	$ 29,008
Operating income (loss)	$ (114,068)	$ 33,275	$ (757)
Increase (decrease) in net assets	$ (114,068)	$ 33,275	$ (757)
Net assets (deficit) - Beginning of fiscal year	(11,819)	(45,094)	(44,337)
Net assets (deficit) - End of fiscal year	$ (125,887)	$ (11,819)	$ (45,094)

Net increase (decrease) in the fair value of investments decreased by $136.9 million in fiscal year 2007-08 because of the decrease in the fair value of investments in equities during the fiscal year. The increase of $26.4 million in fiscal year 2006-07 was primarily because of an increase in the fair value of investments in equities during the fiscal year.

Tuition benefit expenses increased by $11.2 million in fiscal year 2007-08 and decreased by $5.5 million in fiscal year 2006-07. The increase in fiscal year 2007-08 was due to the actuarially determined tuition benefits obligation from the additional contracts sold and from actual tuition expenses that are greater than the weighted average tuition liability previously recorded. The decrease in fiscal year 2006-07 was due to the change in the discount rate used by the actuary to calculate expected future cash flow in the tuition benefits obligation.

The deficit in **net assets - end of fiscal year** increased by $114.1 million in fiscal year 2007-08 and decreased by $33.3 million in fiscal year 2006-07. The increase and decrease in both fiscal years resulted from the overall comparison of the market value of assets compared to 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)

	2008	2007	2006
Net cash provided (used) by:			
Operating activities	$ 56,427	$ 57,905	$ 65,677
Investing activities	(31,661)	(56,879)	(72,292)
Net cash provided (used) - All activities	$ 24,766	$ 1,025	$ (6,614)
Cash and cash equivalents - Beginning of fiscal year	26,990	25,964	32,579
Cash and cash equivalents - End of fiscal year	$ 51,756	$ 26,990	$ 25,964

Cash provided by operating activities decreased by $1.5 million in fiscal year 2007-08 and decreased $7.8 million in fiscal year 2006-07. The decreases were attributed primarily to a decrease in contract enrollment.

Cash used by investing activities decreased by $25.2 million in fiscal year 2007-08 and decreased by $15.4 million in fiscal year 2006-07. The decreases indicate that a greater percentage of new purchases of investments were funded with cash from the sale and maturities of prior investments instead of cash from operations.

Open enrollment for fiscal year 2007-08 resulted in a 3.6% increase in prepaid tuition amounts received compared to amounts received in the prior fiscal year. Open enrollment during fiscal year 2006-07 resulted in a 8.26% decrease in prepaid tuition amounts received compared to amounts in the prior fiscal year.

Factors Impacting Future Periods

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, market performance of investments, and factors affecting estimates of future tuition benefits. As stated in the actuary's report, MET Plan D is 81.6% funded and is expected to pay benefits through 2020 even if no new contracts are issued. MET Plan D actuary's cash flow report expects tuition payments to students activating their contracts to be:

Fiscal Years Ending	Expected Tuition Payments	Expected Number of Contracts
2009 - 2011	$112,425,631	7,304
2012 - 2014	$202,133,756	7,061
2015 - 2017	$230,256,507	5,443
2018 - 2020	$217,353,647	3,697
After 2020	$396,138,185	3,673

MET enrollment for 2006 was held from September 1, 2005 through August 31, 2006. The first 2007 enrollment period was October 1, 2006 through January 31, 2007. The second 2007 enrollment period was April 1, 2007 through July 31, 2007. The enrollment period for 2008 was from September 1, 2007 through August 31, 2008. The enrollment period for 2009 is from September 3, 2008 through August 31, 2009. New enrollment contract prices are adjusted annually to reflect changes in tuition costs and investment earnings and will increase cash, future tuition benefits payable, and the asset base of MET Plan D.

The MET Board of Directors reviews asset allocation and investment performance on a quarterly basis to balance investment risk and maximize rate of returns. At the beginning of fiscal year 2007-08, the Board changed the long-term investment portfolio strategy to address the unfunded liability issue. The new MET Plan D target portfolio for investment is now 25% in fixed income securities (short-term investments, U.S. government securities, and corporate bonds) and 75% in equities (mutual funds).

It is expected that Michigan public universities will continue to adopt higher tuition rates in subsequent years as the State appropriated funds remain flat. The average yearly tuition increase over the last 20 years has been 7.3% for four-year universities and 4.5% for two-year community colleges, compared to the actuarial assumption of 7.3% for both types of contracts.

FINANCIAL STATEMENTS

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

	2008	2007
ASSETS		
Current assets:		
Cash and cash equivalents (Note 3)	$ 51,755,827	$ 26,989,823
Tuition contracts receivable (Note 4)	16,773,375	19,929,724
Interest and dividends receivable	1,599,981	1,728,356
Total current assets	$ 70,129,183	$ 48,647,903
Noncurrent assets:		
Investments (Note 3)	444,164,691	505,054,895
Tuition contracts receivable (Note 4)	47,362,391	55,196,329
Total assets	$ 561,656,265	$ 608,899,127
LIABILITIES		
Current liabilities:		
Amounts due to MET Program (Plans B and C)	$ 2,590,273	$ 1,655,695
Tuition benefits payable (Note 5)	24,000,000	15,000,000
Total current liabilities	$ 26,590,273	$ 16,655,695
Noncurrent liabilities:		
Tuition benefits payable (Note 5)	660,953,319	604,062,030
Total liabilities	$ 687,543,592	$ 620,717,725
NET ASSETS		
Net assets (deficit) - Unrestricted	$ (125,887,327)	$ (11,818,598)
Total net assets (deficit)	$ (125,887,327)	$ (11,818,598)

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 (Deficit)
Fiscal Years Ended September 30

	2008	2007
OPERATING REVENUES		
Interest and dividends income	$ 13,437,302	$ 12,455,906
Net increase (decrease) in the fair value of investments	(92,551,569)	44,394,073
Other miscellaneous income	100,065	96,052
Total operating revenues	$ (79,014,202)	$ 56,946,031
OPERATING EXPENSES		
Salaries and other administrative expenses	$ 1,831,100	$ 1,655,030
Tuition benefit expenses	33,223,427	22,015,745
Total operating expenses	$ 35,054,527	$ 23,670,775
Operating income (loss)	$ (114,068,729)	$ 33,275,256
Increase (decrease) in net assets	$ (114,068,729)	$ 33,275,256
Net assets (deficit) - Beginning of fiscal year	(11,818,598)	(45,093,854)
Net assets (deficit) - End of fiscal year	$ (125,887,327)	$ (11,818,598)

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

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

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Contract receipts	$ 67,163,674	$ 62,559,289
Interest and dividends received	13,565,676	12,439,751
Contract payments	(23,505,524)	(15,629,887)
Administrative and other expenses paid	(896,522)	(1,560,390)
Application and other fees collected	100,065	96,052
Net cash provided (used) by operating activities	$ 56,427,369	$ 57,904,815
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities	$ (158,723,959)	$ (59,376,502)
Proceeds from sale and maturities of investment securities	127,062,594	2,497,033
Net cash provided (used) by investing activities	$ (31,661,365)	$ (56,879,469)
Net cash provided (used) - All activities	$ 24,766,004	$ 1,025,346
Cash and cash equivalents - Beginning of fiscal year	26,989,823	25,964,477
Cash and cash equivalents - End of fiscal year	$ 51,755,827	$ 26,989,823
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating income (loss)	$ (114,068,729)	$ 33,275,256
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Net increase (decrease) in the fair value of investments	92,551,569	(44,394,073)
Changes in assets and liabilities:		
Tuition contracts receivable	10,990,287	(19,630,430)
Interest and dividends receivable	128,375	(16,154)
Amounts due to MET Program (Plans B and C)	934,578	94,665
Tuition benefits payable	65,891,289	88,575,551
Net cash provided (used) by operating activities	$ 56,427,369	$ 57,904,815

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 accounting principles generally accepted in the United States of America as applicable to governmental units.

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 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, or MET Plans B and C, in conformity with accounting principles generally accepted in the United States of America as applicable to governmental units.

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, 2008, there have been 16 enrollment periods over 15 years 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, 2006, 2007, and 2008 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 accounting principles generally accepted in the United States of America as applicable to governmental units. 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 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 that are generally less than three months used for cash management rather than investing activities.

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 investments with investments of the State, such as the pension funds, for investment purposes. Investments are carried at fair value (see Note 3).

Tuition Contracts Receivable: The present value of the future monthly purchase contract payments is recorded as a current and noncurrent asset of MET. In both fiscal years 2007-08 and 2006-07, the discount rate applied to expected future cash flows to determine present value was 7.50%.

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

Net Assets (Deficit): 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 benefits obligation and expenses (see Note 5). Positive 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. Negative net assets are unrestricted. The enabling legislation for MET is Act 316, P.A. 1986. Section 17 of the Act indicates that the assets of the trust shall be preserved, invested, and expended solely pursuant to and for the purposes set forth in the Act and shall not be loaned or otherwise transferred or used by the State for any purpose other than the purposes of the Act.

Note 3 Deposits and Investments

a. General Information

In accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, policies and practices with respect to custodial credit risk, foreign currency risk, interest rate risk, credit risk, and concentration of credit 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. MET does not have a policy for custodial credit risk for deposits.

At the end of fiscal year 2007-08, the carrying amount of MET's deposits for Plan D and the amount reflected in the accounts of the banks was $2,774,868. At the end of fiscal year 2006-07, the carrying amount of MET's deposits for Plan D and the amount reflected in the accounts of the banks was $6,089,923. The September 30, 2008 and September 30, 2007 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, 2008 and September 30, 2007, MET had no foreign deposits.

c. <u>Investments</u>

(1) <u>Interest Rate Risk</u>

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 value of investments for Plan D by investment type and in total (in millions) at September 30, 2008:

		Investment Maturities			
	Fair Value	Less Than 1 Year	1 to 5 Years	6 to 10 Years	More Than 10 Years
Investments:					
Commercial paper	$ 49.0	$ 49.0	$	$	$
U.S. agencies - backed	11.2				11.2
U.S. agencies - sponsored	40.9			40.9	
Corporate bonds and notes	69.6		33.0	32.2	4.4
* Mutual funds	322.5				
Total investments	$ 493.1	$ 48.9	$ 33.0	$ 73.1	$ 15.6
Less investments reported as "cash equivalents" on statement of net assets	49.0				
Total investments	$ 444.2				
<u>As Reported on the Statement of Net Assets</u>					
Noncurrent investments	$ 444.2				
Total investments	$ 444.2				

* Mutual funds have no fixed income or duration and, therefore, are not segmented for time.

The following table shows the fair value of investments for Plan D by investment type and in total (in millions) at September 30, 2007:

	Fair Value	Investment Maturities: Less Than 1 Year	1 to 5 Years	6 to 10 Years	More Than 10 Years
Investments:					
Commercial paper	$ 20.9	$ 20.9	$	$	$
U.S. Treasury strips	9.5	2.4	7.1		
U.S. agencies - backed	1.3				1.3
U.S. agencies - sponsored	94.8	19.9	7.5	51.6	15.8
Corporate bonds and notes	55.3	1.7	29.5	14.2	9.9
* Mutual funds	344.2				
Total investments	$ 526.0	$ 44.9	$ 44.1	$ 65.8	$ 27.0
Less investments reported as "cash equivalents" on statement of net assets	(20.9)				
Total investments	$ 505.1				
<u>As Reported on the Statement of Net Assets</u>					
Noncurrent investments	$ 505.1				
Total investments	$ 505.1				

*Mutual funds have no fixed income or duration and, therefore, are not segmented for time.

(2) Credit Risk

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: ratings of A-1 and A-2 from Standard & Poor's and ratings of P-1 and P-2 from Moody's Investors Service. MET's policy also limits 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. Mutual funds are not rated and certain government sponsored investments are backed by government guarantees. As of September 30, 2008, the fair value and credit quality ratings of investments were as follows:

			Credit Quality Rating	
Investment		Fair Value	Standard & Poor's	Moody's Investors Services
Anheuser Busch	$	2,370,333	BBB+	Baa2
Burlington Northern Santa Fe Railway		1,242,772	A	Aa2
Cargill Inc.		4,784,800	A	A2
General Electric Capital Corp.		17,228,136	AAA	Aaa
Pfizer Inc.		2,375,353	AAA	Aa1
Seariver Maritime Financial Holdings, Inc.		20,685,776	AAA	Aaa
Precision Castparts Corp.		5,008,059	BBB+	Baa2
Federal Home Loan Mortgage Corp.		10,023,440	AAA	Aaa
Federal Home Loan Banks		30,868,094	AAA	Aaa
BellSouth Corporation		4,499,960	A	A2
IBM Corp.		6,668,500	A+	A1
Dow Chemical Company		4,748,500	A-	A3
Government National Mortgage Association		11,161,677	Backed	Backed
Dodge & Cox (Mutual fund)		36,629,577	Not rated	Not rated
John Hancock Funds, LLC (Mutual fund)		36,084,809	Not rated	Not rated
The Vanguard Group, Inc. (Mutual fund)		249,784,908	Not rated	Not rated
Total fair value	$	444,164,691		

As of September 30, 2007, the fair value and credit quality ratings of investments were as follows:

Investment	Fair Value	Credit Quality Rating: Standard & Poor's	Credit Quality Rating: Moody's Investors Services
Commercial paper	$ 20,899,900	A-1	P-2
CSX Transportation	1,708,291	A-	A2
Anheuser Busch	2,700,975	A	A2
Burlington Northern Santa Fe Railroad	1,249,564	A	Aa2
Cargill Inc.	4,862,915	A	A2
General Electric Capital Corp.	17,976,185	AAA	Aaa
Pfizer Inc.	2,327,505	AAA	Aa1
Seariver Maritime Financial Holdings, Inc.	19,403,303	AAA	Aaa
Precision Castparts Corp.	5,034,206	BBB+	Baa2
Federal Home Loan Mortgage Corp.	9,962,770	AAA	Aaa
Federal Farm Credit Banks	4,948,345	AAA	Aaa
Federal Home Loan Banks	79,891,952	AAA	Aaa
Government National Mortgage Association	1,302,217	Backed	Backed
United States Treasury	9,533,676	Backed	Backed
The Vanguard Group, Inc. (Mutual fund)	344,152,991	Not rated	Not rated
Total fair value	$ 525,954,795		

(3) <u>Custodial Credit Risk</u>

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's investments are registered in its name and, therefore, are not subject to custodial credit risk. 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 concentration of credit risk. At September 30, 2008, 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 Home Loan Banks	$ 30,868,094	AAA	Aaa

At September 30, 2007, 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 Services
Federal Home Loan Banks	$79,891,952	AAA	Aaa

(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, 2008 and September 30, 2007, MET had no foreign investments.

Note 4 Tuition Contracts Receivable

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

	2008	2007
Tuition contracts receivable	$ 64,135,766	$ 75,126,028
Present value discount	(16,773,375)	(19,929,699)
Net tuition contracts receivable	$ 47,362,391	$ 55,196,329

Note 5 Tuition Benefits Payable and Net Assets (Deficit)

The standardized measurement of the total tuition benefits obligation of MET is the actuarial present value of the future tuition benefits obligation that will be paid in future years. The tuition benefits obligation is actuarially calculated by projecting the weighted average tuition cost including mandatory fees at the assumed annual rate of increase and then calculating the expected present value of the future distributions from the trust based on the investment income and discount rate assumptions. The following table shows the net value of assets (total assets less nontuition liabilities), the present value of total tuition benefits obligation, and the net assets (deficit) of MET Plan D as of September 30:

	2008	2007
Net value of assets	$ 559,065,992	$ 607,243,432
Present value of total tuition benefits obligation	684,953,319	619,062,030
Net value of assets in excess of tuition benefits obligation	$ (125,887,327)	$ (11,818,598)
Net value of assets as a percentage of total tuition benefits obligation	81.6%	98.1%

The deficit in net assets is a direct result of the future tuition benefits obligation exceeding the value of assets (unfunded tuition benefit liability). Differences between future assumptions related to actual investment returns and actual tuition increases will affect the net assets or unfunded tuition liability.

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 7.50% for fiscal year 2007-08 and 7.50% for fiscal year 2006-07. This discount rate approximates the expected investment yield over the lifetime of the present tuition benefit contracts.

(2) For fiscal year 2007-08, 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 did not change from the fiscal year 2006-07 assumptions.

(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 Plan D:

	Fiscal Years				
	2007-08	2006-07	2005-06	2004-05	2003-04
Tuition increase	7.30%	7.30%	7.30%	7.00%	7.00%
Tuition increase - long-term	7.30%	7.30%	7.30%	7.30%	7.30%
Present value discount rate	7.50%	7.50%	7.35%	7.25%	7.25%

The following summarizes the tuition benefits payable as of and for the fiscal years ended September 30, 2008 and September 30, 2007:

Balance at October 1, 2006	$ 530,486,479
Expense provision	104,205,463
Payments	(15,629,912)
Balance at September 30, 2007	$ 619,062,030
Expense provision	89,396,813
Payments	(23,505,524)
Balance at September 30, 2008	$ 684,953,319

The amounts due within one year for tuition benefits payable for the fiscal years ended September 30, 2008 and September 30, 2007 were $24,000,000 and $15,000,000, 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. Tuition expense is recognized each year and reflects the increases in the present value of the tuition benefits payable from new contracts and for increases and decreases in tuition payments compared to actuarial tuition assumptions.

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 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 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 Defined Benefit or Defined Contribution Plans. Detail and data regarding the Plans' 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 Plans' detailed financial reports. State statutes provide retired employees with other postemployment benefits, such as health, dental, vision, and life insurance coverage based on vesting and other requirements. The cost of retiree health care and other benefits is allocated by the Office of Retirement Services and funded on a pay-as-you-go basis.

MET was billed and paid an average 29.1% and 21.0% of its payroll costs for pension charges and retiree postemployment benefits in fiscal years 2007-08 and 2006-07, respectively. The Plans' detailed financial statements can be obtained from the Office of Retirement Services, Department of Management and Budget, 7150 Harris Drive, P.O. Box 30171, Lansing, Michigan 48909.

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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 (deficit); the statement of revenues, expenses, and changes in net assets (deficit); and the statement of cash flows of the Michigan Education Trust Plan D, a discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2008 and September 30, 2007 and have issued our report thereon dated March 9, 2009. 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.

<u>Internal Control Over Financial Reporting</u>
In planning and performing our audit, we considered the Michigan Education Trust's internal control over financial reporting for Plan D as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Michigan Education Trust's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Michigan Education Trust's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined in the preceding paragraph.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Michigan Education Trust's financial statements for Plan D 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 management, the Michigan Education Trust's Board of Directors, others within the entity, 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

March 9, 2009

GLOSSARY

control deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.
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 presented fairly in all material respects in conformity with the disclosed basis of accounting.
GASB	Governmental Accounting Standards Board.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to 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 in internal control over financial reporting	A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial schedules and/or financial statements will not be prevented or detected.

MET	Michigan Education Trust.
significant deficiency in internal control over financial reporting	A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial schedules and/or financial statements that is more than inconsequential will not be prevented or detected.
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