MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

FINANCIAL AUDIT
OF THE

MICHIGAN EDUCATION TRUST PLANS B AND C

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

October 1, 2007 through September 30, 2009

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

271-0284-10

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 Discretely Presented Component Unit of the State of Michigan)

October 1, 2007 through September 30, 2009

Report Number:
271-0284-10

Released:
March 2010

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) 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://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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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

March 4, 2010

Mr. Robert J. Kleine, State Treasurer and Chair
Michigan Education Trust 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, a discretely presented component unit of the State of Michigan, for the fiscal years ended September 30, 2009 and 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 Plans B and C 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, State Treasurer and Chair
Michigan Education Trust 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 discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2009 and September 30, 2008. 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, or the Michigan Education Trust Plan D, as of September 30, 2009 and September 30, 2008 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, 2009 and September 30, 2008 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 February 25, 2010 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

February 25, 2010

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 years ended September 30, 2009 and September 30, 2008. MET 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 reporting standards in Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, require a statement of net assets; a statement of revenues, expenses, and changes in net assets; and a statement of cash flows. These financial statements are interrelated and represent the financial status of MET Plans B and C.

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.

Financial Analysis of MET Plans B and C

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.

During fiscal year 2008-09, the MET Board of Directors approved changes to key actuarial assumptions: the investment yield and the rate of increase in tuition.

The investment yield that is applied to expected future cash flows to determine present value was changed to 2.20% as of September 30, 2009. This is a decrease from the 4.75% as of September 30, 2008. The investment yield approximates the expected investment earnings over the lifetime of the present tuition benefit contracts. Because the number of tuition benefit contracts is decreasing each year, the expected investment yield for the fixed income portfolio was also decreased. However, it is premised that expected benefit payments will be diversified in duration to allow MET to invest at the assumed investment yield of 2.20% and to also be able to liquidate its investments in order to meet future benefit payments while still earning the investment yield of 2.20%.

The tuition and fees inflation assumption was changed to 6.50% for all future years. This is a decrease from 7.30% as of September 30, 2008. The MET Board of Directors considers the relationship of tuition increases to the consumer price index in determining the tuition and fees inflation assumption. In addition, the MET Board of Directors changed the tuition and fees inflation adjustment basis from a 21-year average to a 14-year average to reflect more current trends in tuition and fees.

Comparison of Current Year and Prior Year Results

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

	2009	2008	2007
Current assets	$ 156,918	$ 201,816	$ 79,866
Noncurrent assets	142,442	164,292	360,633
Total assets	$ 299,360	$ 366,108	$ 440,499
Current liabilities	$ 95,008	$ 100,012	$ 99,012
Noncurrent liabilities	181,850	237,708	318,699
Total liabilities	$ 276,858	$ 337,721	$ 417,710
Net assets - Restricted	$ 22,502	$ 28,388	$ 22,789
Total net assets	$ 22,502	$ 28,388	$ 22,789

The overall financial position of MET Plans B and C for the fiscal years ended September 30, 2009 and September 30, 2008 is positive and shows net assets of $22.5 million and $28.4 million, respectively. The net assets decreased by $5.9 million in fiscal year 2008-09 primarily due to the operating loss of $5.9 million. Interest and dividends income decreased in fiscal year 2008-09 due to MET's decision not to reinvest proceeds from the sale of long-term investments in the long-term portfolio, thus resulting in less interest and dividends income. The operating expenses increased in fiscal year 2008-09 due to the increase in the tuition benefit expense (see Note 5), which increased as a result of the change in actuarial assumptions utilized during fiscal year 2008-09. The net assets increased by $5.6 million in fiscal year 2007-08 primarily as a result of an actual investment return of 4.65%.

Current assets decreased by $44.9 million in fiscal year 2008-09 primarily because of the decrease in cash and cash equivalents that were used to pay tuition benefit payments. Current assets increased by $122.0 million in fiscal year 2007-08 primarily because of the increase in cash and cash equivalents from the proceeds of the sale of long-term investments that were not reinvested in the long-term portfolio.

Noncurrent assets decreased by $21.9 million in fiscal year 2008-09 and decreased by $196.3 million in fiscal year 2007-08. The decreases were a result of the MET Plans B and C being closed to new contracts and the liquidation of investments to meet the increased tuition benefit payments.

Total liabilities decreased by $60.9 million in fiscal year 2008-09 and by $80.0 million in fiscal year 2007-08. The tuition benefits payable decrease reflects the increase in tuition contract payments made to colleges.

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

	2009	2008	2007
Operating revenues			
Interest and dividends income	$ 7,393	$ 14,591	$ 20,388
Net increase (decrease) in the fair value of investments	7,749	3,334	5,625
Other miscellaneous income	39	56	38
Total operating revenues	$ 15,181	$ 17,981	$ 26,051
Operating expenses			
Salaries and other administrative expenses	$ 792	$ 851	$ 965
Tuition benefit expense	20,275	11,531	23,813
Total operating expenses	$ 21,067	$ 12,382	$ 24,778
Operating income (loss)	$ (5,886)	$ 5,599	$ 1,273
Increase (Decrease) in net assets	$ (5,886)	$ 5,599	$ 1,273
Net assets - Beginning of fiscal year	28,388	22,789	21,515
Net assets - End of fiscal year	$ 22,502	$ 28,388	$ 22,789

Interest and dividends income decreased by $7.2 million in fiscal year 2008-09 and by $5.8 million in fiscal year 2007-08. The decreases were attributed to decreases in investments held during the fiscal year.

The fair value of investments increased by $7.7 million in fiscal year 2008-09 and increased by $3.3 million in fiscal year 2007-08 because of changes in investment fair values and gains and losses on sold investments.

Tuition benefit expense increased by $8.7 million in fiscal year 2008-09 and decreased by $12.3 million in fiscal year 2007-08. 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)

	2009	2008	2007
Net cash provided (used) by:			
Operating activities	$ (75,260)	$ (77,969)	$ (73,517)
Investing activities	29,599	199,675	36,025
Net cash provided (used) - All activities	$ (45,661)	$ 121,706	$ (37,492)
Cash and cash equivalents - Beginning of fiscal year	193,099	71,392	108,884
Cash and cash equivalents - End of fiscal year	$ 147,437	$ 193,099	$ 71,392

The **net cash used by operating activities** decreased by $2.7 million in fiscal year 2008-09 and increased by $4.5 million in fiscal year 2007-08. The decrease in cash used in fiscal year 2008-09 was primarily the result of decreases in tuition contract payments to colleges and refund designees. The increase in cash used in fiscal year 2007-08 was primarily the result of increases in tuition contract payments to colleges and refund designees.

The **net cash provided by investing activities** decreased by $170.1 million in fiscal year 2008-09 and increased by $163.7 million in fiscal year 2007-08. The decrease in cash provided in fiscal year 2008-09 resulted when some investments matured and the proceeds were used to reinvest those proceeds into investment securities. The increase in cash provided in fiscal year 2007-08 resulted when some of the investments matured and the proceeds from the long-term portfolio were used to make increased tuition benefit payments.

Overall, the **cash and cash equivalents at the end of the fiscal year** decreased by $45.7 million in fiscal year 2008-09 and increased by $121.7 million in fiscal year 2007-08.

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 2009, 4,521 students will be eligible to begin using MET contracts to attend college along with 11,015 students currently in the process of using MET contracts. After 2009, the number of students expected to enroll in college under MET Plans B and C will continue to decrease significantly 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

	2009	2008
ASSETS		
Current assets:		
Cash and cash equivalents (Note 3)	$ 147,437,351	$ 193,098,656
Amounts due from MET Program (Plan D)	3,386,117	2,590,273
Amounts due from primary government	4,843,910	2,551,095
Interest and dividends receivable	1,188,111	3,513,754
Amounts due from others	62,445	62,445
Total current assets	$ 156,917,934	$ 201,816,223
Noncurrent assets:		
Investments (Note 3)	142,442,238	164,292,133
Total assets	$ 299,360,172	$ 366,108,356
LIABILITIES		
Current liabilities:		
Tuition benefits payable (Note 4)	$ 95,000,000	$ 100,000,000
Undistributed charitable tuition		4,784
Compensated absences	7,950	7,533
Total current liabilities	$ 95,007,950	$ 100,012,317
Noncurrent liabilities:		
Tuition benefits payable (Note 4)	181,698,790	237,562,616
Compensated absences	151,629	145,652
Total liabilities	$ 276,858,369	$ 337,720,585
NET ASSETS		
Net assets - Restricted	$ 22,501,803	$ 28,387,771
Total net assets	$ 22,501,803	$ 28,387,771

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

	2009	2008
OPERATING REVENUES		
Interest and dividends income	$ 7,393,424	$ 14,590,604
Net increase (decrease) in the fair value of investments	7,748,650	3,334,102
Other miscellaneous income	39,277	56,208
Total operating revenues	$ 15,181,351	$ 17,980,914
OPERATING EXPENSES		
Salaries and other administrative expenses	$ 792,079	$ 851,136
Tuition benefit expense (Note 5)	20,275,240	11,530,837
Total operating expenses	$ 21,067,319	$ 12,381,973
Operating income (loss)	$ (5,885,968)	$ 5,598,941
Increase (Decrease) in net assets	$ (5,885,968)	$ 5,598,941
Net assets - Beginning of fiscal year	28,387,771	22,788,830
Net assets - End of fiscal year	$ 22,501,803	$ 28,387,771

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

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest and dividends received	$ 9,719,068	$ 16,140,250
Contract payments	(81,139,066)	(91,553,827)
Administrative and other expenses paid	(3,879,128)	(2,611,540)
Application and other fees collected	39,277	56,208
Net cash provided (used) by operating activities	$ (75,259,849)	$ (77,968,909)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities	$ (113,165,144)	
Proceeds from sale and maturities of investment securities	142,763,688	$ 199,675,084
Net cash provided (used) by investing activities	$ 29,598,544	$ 199,675,084
Net cash provided (used) - All activities	$ (45,661,305)	$ 121,706,175
Cash and cash equivalents - Beginning of fiscal year	193,098,656	71,392,481
Cash and cash equivalents - End of fiscal year	$ 147,437,351	$ 193,098,656
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating income (loss)	$ (5,885,968)	$ 5,598,941
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Unrealized and realized (gains) losses	(7,748,650)	(3,334,102)
Changes in assets and liabilities:		
Amounts due from MET Program (Plan D)	(795,844)	(934,604)
Amounts due from others		(62,445)
Amounts due from primary government	(2,292,815)	(796,627)
Interest and dividends receivable	2,325,643	1,549,646
Undistributed charitable tuition	(4,784)	
Compensated absences	6,395	33,272
Tuition benefits payable	(60,863,826)	(80,022,990)
Net cash provided (used) by operating activities	$ (75,259,849)	$ (77,968,909)

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 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 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, or MET Plan D, 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, 2009, there have been 17 enrollment periods over 16 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, 2008, and 2009 enrollments are known as Plan D. The Plan D enrollments are accounted for and reported separately from the Plans B and C enrollments. These financial statements report only Plans B and C enrollments. Separate financial statements 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 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 expense represents 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

(1) 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.

(2) 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 fair value (see Note 3).

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

(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 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 2008-09, the carrying amount of MET's deposits for Plans B and C and the amount reflected in the accounts of the banks was $ 7,120,771. At the end of fiscal year 2007-08, the carrying amount of MET's deposits for Plans B and C and the amount reflected in the accounts of the banks was $14,237,245. The September 30, 2009 and September 30, 2008 balances were covered by federal depository insurance or collateral held with MET's agent in MET's name and, therefore, were 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, 2009 and September 30, 2008, 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 value of investments for Plans B and C by investment type and in total (in millions) at September 30, 2009:

			Investment Maturities							
	Fair Value		Less Than 1 Year		1 to 5 Years		6 to 10 Years		More Than 10 Years	
Investments:										
Commercial paper	$	140.3	$	140.3	$		$		$	
U.S. agencies - sponsored		38.1		13.1		16.3		8.6		
Corporate bonds and notes		104.4		7.5		76.3		20.5		
Total investments	$	282.8	$	161.0	$	92.6	$	29.1	$	0
Less investments reported as "cash equivalents" on statement of net assets		(140.3)								
Total investments	$	142.4								

As Reported on the Statement of Net Assets		
Noncurrent restricted investments	$	142.4
Total investments	$	142.4

The following table shows the fair value of investments for Plans B and C by investment type and in total (in millions) at September 30, 2008:

	Fair Value	Investment Maturities: Less Than 1 Year	1 to 5 Years	6 to 10 Years	More Than 10 Years
Investments:					
Commercial paper	$ 178.9	$ 178.9	$	$	$
U.S. agencies - sponsored	83.2		21.5	61.7	
Corporate bonds and notes	81.1	44.4	27.9	8.8	
Total investments	$ 343.2	$ 223.3	$ 49.4	$ 70.5	$ 0
Less investments reported as "cash equivalents" on statement of net assets	(178.9)				
Total investments	$ 164.3				
As Reported on the Statement of Net Assets					
Noncurrent restricted investments	$ 164.3				
Total investments	$ 164.3				

(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 limited investments in corporate bonds and mutual bond funds, at the time of purchase, to the top four ratings of the two rating services: ratings of AAA, AA, A, and BBB from Standard & Poor's and ratings of Aaa, Aa, A, and Baa from

Moody's Investors Service. As of September 30, 2009, the fair value (in millions) and credit quality ratings of investments were as follows:

Investment	Fair Value	Credit Quality Rating: Standard & Poor's	Credit Quality Rating: Moody's Investors Service
Federal National Mortgage Association	$ 3,015,534	AAA	Aaa
Federal Home Loan Mortgage Corp.	14,076,874	AAA	Aaa
Federal Home Loan Bank	7,824,522	AAA	Aaa
Federal Farm Credit Banks	3,744,976	AAA	Aaa
Israel Trust	9,401,299	AAA	Not rated
American Honda Finance Corp.	5,544,862	A+	A1
Avon Products, Inc.	2,480,895	A	A2
BP Capital Markets	4,241,221	AA	Aa1
Bank of America Corp.	4,100,672	A	A2
Caterpillar Financial Services Corp.	4,506,460	A	A2
John Deere Capital Corp.	3,045,819	A	A2
Dell Inc.	2,590,482	A-	A2
Walt Disney Company	3,201,627	A	A2
Eaton Corp.	3,180,312	A-	A3
Estee Lauder Companies Inc.	3,144,000	A	A2
Illinois Tool Works Inc.	3,221,640	A+	A1
Oracle Corp.	1,577,978	A	A2
Pfizer Inc.	3,186,663	AAA	Aa2
Procter & Gamble Company	3,072,267	AA-	Aa3
Ralston Purina Co.	5,010,870	AA	Not rated
Shell International Finance B.V.	4,201,664	AA	Aa1
TJX Companies, Inc.	2,582,873	A	A3
Target Corp.	2,706,627	A+	A2
Textron Financial Corp.	2,500,215	BB+	Baa3
Toyota Motor Credit Corp.	2,862,621	AA	Aa1
Wal-Mart Stores, Inc.	2,552,513	AA	Aa2
General Electric Capital Corp.	9,797,550	AA+	Aa2
Seariver Maritime Financial Holdings, Inc.	25,069,203	AAA	Aaa
Total fair value	$ 142,442,238		

As of September 30, 2008, the fair value (in millions) and credit quality ratings of investments were as follows:

Investment	Fair Value	Credit Quality Rating: Standard & Poor's	Credit Quality Rating: Moody's Investors Service
First Chicago Corp.	$ 7,598,071	A+	Aa3
American Honda Finance Corp.	4,991,245	A+	Aa3
Associates Corp.	4,984,530	A+	A1
Cargill, Inc.	7,993,817	A	A2
Norfolk Southern	4,717,630	A+	Aa3
Home Depot	8,790,102	BBB+	Baa1
General Electric Capital Corp.	8,829,200	AAA	Aaa
Seariver Maritime Financial Holdings, Inc.	22,621,140	AAA	Aaa
Ralston Purina Co.	10,454,575	AA	Not rated
Knight Ridder Inc.	104,640	CCC+	Caa1
Federal Farm Credit Bank	28,961,777	AAA	Aaa
Federal Home Loan Bank	45,033,289	AAA	Aaa
Israel Trust	9,212,117	AAA	Not rated
Total fair value	$ 164,292,133		

(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'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 the concentration of credit risk. At

September 30, 2009, MET had the following investments that represented 5% or more of total investments:

Investment	Fair Value	Credit Quality Rating	
		Standard & Poor's	Moody's Investors Service
Federal Home Loan Mortgage Corp.	$14,076,874	AAA	Aaa
Federal Home Loan Bank	$ 7,824,522	AAA	Aaa
Seariver Maritime Financial Holdings, Inc.	$25,069,203	AAA	Aaa
General Electric Capital Corp.	$ 9,797,550	AA+	Aa2
Israel Trust	$ 9,401,299	AAA	Not rated

At September 30, 2008, MET had the following investments that represented 5% or more of total investments:

Investment	Fair Value	Credit Quality Rating	
		Standard & Poor's	Moody's Investors Service
Federal Farm Credit Bank	$28,961,777	AAA	Aaa
Federal Home Loan Bank	$45,033,289	AAA	Aaa
Seariver Maritime Financial Holdings, Inc.	$22,621,140	AAA	Aaa
Home Depot	$ 8,790,102	BBB+	Baa1
General Electric Capital Corp.	$ 8,829,200	AAA	Aaa
Israel Trust	$ 9,212,117	AAA	Not rated
Ralston Purina Co.	$10,454,575	AA	Not rated

(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, 2009 and September 30, 2008, 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 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 of MET Plans B and C as of September 30:

	2009	2008
Net value of assets	$299,200,593	$365,950,387
Present value of total tuition benefits obligation	276,698,790	337,562,616
Net value of assets in excess of tuition benefits obligation	$ 22,501,803	$ 28,387,771
Net value of assets as a percentage of total tuition benefits obligation	108.1%	108.4%

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

(1) The investment yield applied to expected future cash flows to determine present value was 2.20% as of September 30, 2009 and 4.75% as of September 30, 2008. This investment yield approximates the expected investment earnings over the lifetime of the present tuition benefit contracts. Because the number of tuition benefit contracts is decreasing each year, the expected investment yield for the fixed income portfolio was also decreased. However, it is premised that expected benefit payments will be diversified in duration to allow MET to invest at the assumed investment yield of 2.20% and to also be able to liquidate its investments in order to meet future benefit payments while still earning the investment yield of 2.20%.

(2) For fiscal year 2008-09, the projected tuition increase was 6.50% 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 6.50%. In addition, the MET Board of Directors changed the tuition and fees inflation adjustment basis from a 21-year average to a 14-year average to reflect more current trends in tuition and fees.

(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				
	2008-09	2007-08	2006-07	2005-06	2004-05
Tuition increase	6.50%	7.30%	7.30%	7.30%	7.00%
Tuition increase - long-term	6.50%	7.30%	7.30%	7.30%	7.30%
Present value discount rate	2.20%	4.75%	4.75%	4.75%	5.00%

The following summarizes the tuition benefits payable as of and for the fiscal years ended September 30, 2009 and September 30, 2008:

Balance at October 1, 2007	$	417,585,606
Tuition benefit expense provision		11,530,837
Payments		(91,553,827)
Balance at September 30, 2008	$	337,562,616
Tuition benefit expense provision		20,275,240
Payments		(81,139,066)
Balance at September 30, 2009	$	276,698,790

The amounts due within one year for tuition benefits payable for the fiscal years ended September 30, 2009 and September 30, 2008 are $95,000,000 and $100,000,000, 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 Tuition Benefit Expense

Tuition benefit expense is recognized each year and reflects changes in the present value of the tuition benefits payable for increases or decreases in tuition payments compared to actuarial tuition assumptions. The actuarial assumptions adopted by the MET Board of Directors have a significant impact on the calculation of the tuition benefit expense.

During fiscal year 2008-09, the tuition benefit expense increased from fiscal year 2007-08 as a result of the change in the actuarial assumptions adopted by the MET Board of Directors. Even though the long-term tuition increase assumption decreased from 7.30% to 6.50%, the expected investment return also decreased from 4.75% to 2.20%, reflecting the earning potential of a 100% fixed income portfolio.

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 30.6% and 28.3% of its payroll costs for pension charges and retiree postemployment benefits in fiscal years 2008-09 and 2007-08, 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
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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, State Treasurer and Chair
Michigan Education Trust 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 discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2009 and September 30, 2008 and have issued our report thereon dated February 25, 2010. 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 Plans B and C 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 Plans B and C 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 Governor, the Legislature, the Michigan Education Trust Board of Directors, management, and others within the entity 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

February 25, 2010

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