

Michigan Education Savings Program
(a fiduciary fund of the State of Michigan)

Audited Financial Statements

*Year Ended September 30, 2014
with Report of Independent Auditors*

Michigan Education Savings Program

Audited Financial Statements

Year Ended September 30, 2014

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Report of Independent Auditors

Mr. Kevin Clinton, Trustee, Michigan Education Savings Program, Michigan Department of Treasury
Mr. Doug A. Ringler, CPA, CIA, Auditor General, State of Michigan

Report on the Financial Statements

We have audited the accompanying financial statements of the Michigan Education Savings Program, a fiduciary fund of the State of Michigan, as of and for the year ended September 30, 2014, and the related notes to the financial statements, which collectively comprise the Michigan Education Savings Program's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Michigan Education Savings Program, a fiduciary fund of the State of Michigan, as of September 30, 2014, and the changes in fiduciary net position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the Michigan Education Savings Program, a fiduciary fund of the State of Michigan, and do not purport to, and do not present fairly the financial position of the State of Michigan in its entirety as of September 30, 2014, and the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 5, 2014, on our consideration of the Michigan Education Savings Program'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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Michigan Education Savings Program's internal control over financial reporting and compliance.

Andrews Hooper Pavlik PLC

Okemos, Michigan
December 5, 2014

Michigan Education Savings Program

Management's Discussion and Analysis

September 30, 2014

This section of the Michigan Education Savings Program's (MESP or Program) financial statements presents a discussion and analysis of the Program's financial performance during the year ended September 30, 2014. MESP consists of two components, a Direct-Sold Plan managed by TIAA-CREF Tuition Financing, Inc. (TFI) and the MI 529 Advisor Plan managed by TFI for which Allianz Global Investors Distributors, LLC is the plan administrator and distributor. MESP is a fiduciary fund of the State of Michigan. Readers should consider the information presented in this section in conjunction with the Program's financial statements and notes to financial statements.

Financial Highlights

The Program received approximately \$193.4 million in net contributions from account owners for the year ended September 30, 2014.

The Program earned approximately \$78.6 million from investment operations and paid out approximately \$6.8 million for operating expenses during the year ended September 30, 2014.

Overview of the Financial Statements

The Program's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

This report consists of two parts, management's discussion and analysis (this section) and the basic financial statements. The basic financial statements are composed of a statement of fiduciary net position, a statement of changes in fiduciary net position, and notes to financial statements that explain some of the information in the financial statements and provide more detailed information.

The statement of fiduciary net position presents information on the Program's assets and liabilities, with the difference between the two reported as net position as of September 30, 2014. This statement, along with all of the Program's financial statements, is prepared using the accrual basis of accounting. Contributions are recognized when enrollment in the Program is finalized; subsequent contributions and redemptions are recognized on the trade date; expenses and liabilities are recognized when services are provided, regardless of when cash is disbursed.

The statement of changes in fiduciary net position presents information showing how the Program's assets changed during the most recent fiscal period. Changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenue and expenses are reported in this statement for some items that will result in cash flows in future fiscal years.

Michigan Education Savings Program

Management's Discussion and Analysis (continued)

The notes to financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements.

This report presents the operating results and financial status of the Program, which the State of Michigan reports as a fiduciary fund. Fiduciary fund reporting is used to account for resources held for the benefit of parties outside the governmental entity.

Financial Analysis

Net Position

The following is a condensed statement of fiduciary net position as of September 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Assets		
Investments	\$ 4,234,190,281	\$ 3,723,418,298
Cash	509,037	222,671
Receivables	4,951,596	5,511,699
Total assets	<u>4,239,650,914</u>	<u>3,729,152,668</u>
Liabilities – payables	5,958,136	5,781,973
Net position	<u>\$ 4,233,692,778</u>	<u>\$ 3,723,370,695</u>

Net position represents total contributions from account owners, plus the net increase from operations, less withdrawals and expenses.

Net position increased by 13.7 percent and 16.8 percent or \$510,322,083 and \$535,163,772 for the years ended September 30, 2014 and 2013, respectively. This increase is primarily due to participant contributions to the Direct-Sold Plan and the Michigan 529 Advisor Plan as well as positive economic conditions in the marketplace.

Investments in MESP are approximately 100 percent of total net position, and consist of investments in the Direct-Sold Plan and investments in the MI 529 Advisor Plan. Investments in the Direct-Sold Plan include 33 investment portfolios, including 27 age-based portfolios (9 age-based portfolios for each of 3 risk strategies – conservative, moderate, and aggressive) and 6 other investment portfolios. Each portfolio invests in varying percentages in multiple TIAA-CREF funds, or the funding agreement issued by TIAA-CREF Life Insurance Company to the Program. Investments in the MI 529 Advisor Plan include 19 portfolios, including 6 age-based portfolios and 13 other portfolios. Each portfolio invests in various mutual funds.

Other assets consist of cash and receivables for securities sold, contributions, and accrued income. Liabilities consist mainly of payables for securities purchased, withdrawals, and accrued expenses.

Michigan Education Savings Program

Management's Discussion and Analysis (continued)

Changes in Net Position

The following is a condensed statement of changes in fiduciary net position for the years ended September 30, 2014 and 2013:

	2014	2013
Additions		
Subscriptions	\$ 475,134,926	\$ 1,635,527,733
Interest and dividends	78,593,159	63,679,363
Net increase in fair value of investments	245,059,188	259,012,356
Total additions – net	798,787,273	1,958,219,452
Deductions		
Redemptions	281,700,930	1,417,018,013
Operating expenses	6,764,260	6,037,667
Total deductions	288,465,190	1,423,055,680
Changes in net position	510,322,083	535,163,772
Net position – beginning of year	3,723,370,695	3,188,206,923
Net position – end of year	\$ 4,233,692,778	\$ 3,723,370,695

Subscriptions for the year ended September 30, 2013 included exchanges and transfers within the Program while subscriptions for the year ended September 30, 2014 excluded exchanges and transfers within the Program. If the 2014 subscriptions had included exchanges and transfers, total additions for 2014 would have been \$2.352 billion, which reflects an increase of \$393.6 million from 2013. This increase is largely due to new subscriptions, primarily as a result of increased account holders. This increase is also due to market appreciation as well as income and gains from the underlying investments.

Redemptions for the year ended September 30, 2013 included exchanges and transfers within the Program while redemptions for the year ended September 30, 2014 excluded exchanges and transfers within the Program. If the 2014 redemptions had included exchanges and transfers, total deductions for 2014 would have been \$1.841 billion, which reflects an increase of \$418.4 million from 2013. This increase is primarily due to an increase in redemptions, which can be attributed to an increase in the number of account holders. This increase is also due to an increase in operating expenses, which increased because they are based on percentages of net position and net position increased from the prior year.

Michigan Education Savings Program

Statement of Fiduciary Net Position

September 30, 2014

	The Direct-Sold Plan	MI 529 Advisor Plan	Total
Assets			
Cash	\$ 22,857	\$ 486,180	\$ 509,037
Investments – at fair market value (Note 4)	3,908,774,786	325,415,495	4,234,190,281
Dividends and interest receivable	1,931,214	231,733	2,162,947
Receivable for securities transactions	777,187	19,200	796,387
Receivable for Program units sold	1,510,224	482,038	1,992,262
Total assets	3,913,016,268	326,634,646	4,239,650,914
 Liabilities			
Accrued Program management fee	367,830	129,332	497,162
Payable for securities transactions	2,823,066	737,113	3,560,179
Payable for Program units redeemed	1,199,028	44,658	1,243,686
Other liabilities	524,856	132,253	657,109
Total liabilities	4,914,780	1,043,356	5,958,136
Net Position – Held in trust for participant education savings program	\$ 3,908,101,488	\$ 325,591,290	\$ 4,233,692,778

The notes to the financial statements are an integral part of this statement.

Michigan Education Savings Program

Statement of Changes in Fiduciary Net Position

Year Ended September 30, 2014

	The Direct-Sold Plan	MI 529 Advisor Plan	Total
Additions			
Subscriptions	\$ 392,688,666	\$ 82,446,260	\$ 475,134,926
Investment Income:			
Interest and dividends	72,246,505	6,346,654	78,593,159
Net increase in fair value of investments	231,328,232	13,730,956	245,059,188
Total investment income	303,574,737	20,077,610	323,652,347
 Total additions	 696,263,403	 102,523,870	 798,787,273
Deductions			
Redemptions	267,873,594	13,827,336	281,700,930
Operating expenses	3,849,759	2,914,501	6,764,260
Total deductions	271,723,353	16,741,837	288,465,190
 Changes in net position	 424,540,050	 85,782,033	 510,322,083
Net position – beginning of year	3,483,561,438	239,809,257	3,723,370,695
Net position – end of year	\$ 3,908,101,488	\$ 325,591,290	\$ 4,233,692,778

The notes to the financial statements are an integral part of this statement.

Michigan Education Savings Program

Notes to Financial Statements

September 30, 2014

1. Organization

The Michigan Education Savings Program (Program), a fiduciary fund of the State of Michigan, is designed to help people save for the costs of higher education. The Program was established by the Michigan Department of Treasury and is administered by the State Treasurer of Michigan (Treasurer), who acts as trustee of the Program. The Program constitutes a qualified tuition program under Section 529 of the Internal Revenue Code and was established pursuant to Section 529 and the Michigan Compiled Laws 390.1471 et seq. The Program consists of two components, the Direct-Sold Plan and the MI 529 Advisor Plan. Investment portfolios and allocations, as approved by the Treasurer, are described in the current disclosure booklet for each respective component. The Treasurer has the authority to enter into contracts for program management services, appoint a program manager, adopt policies and operating procedures to implement and administer the Program, and establish investment policies for the Program.

TIAA-CREF Tuition Financing, Inc. (TFI), a wholly-owned, indirect subsidiary of Teachers Insurance and Annuity Association of America (TIAA), manages the Direct-Sold Plan under the direction of the Treasurer pursuant to a contract that it has entered into with the State of Michigan. The assets in the Principal Plus Interest Option are allocated to a funding agreement issued by TIAA-CREF Life Insurance Company (TIAA-CREF Life), an affiliate of TFI. The funding agreement guarantees to the Michigan Department of Treasury a minimum rate of interest and provides the opportunity for additional interest as declared periodically by TIAA-CREF Life. Teachers Advisors, Inc. (Advisors), an affiliate of TFI, is registered with the Securities and Exchange Commission as an investment advisor and provides investment advisory services to the TIAA-CREF funds.

The MI 529 Advisor Plan component of the Michigan Education Savings Program was established under Public Act (PA) No. 161 of 2000 of the State of Michigan, which was amended by PA No. 153 of 2007. TFI acts as the program manager for the MI 529 Advisor Plan. TFI, per the State's approval, has delegated the responsibilities of being the administrator and distributor to Allianz Global Investors Distributors, LLC (AGID). AGID provides services to the MI 529 Advisor Plan including administration, distribution, and investment management services. AGID has delegated the investment-related functions for the Program to Allianz Global Investors U.S. LLC (AGI U.S.), an affiliate of AGID, including making recommendations to the Treasurer as to the formulation of the investment portfolios and the selection of the underlying funds and asset allocations among such funds.

Michigan Education Savings Program

Notes to Financial Statements (continued)

2. Significant Accounting Policies

The accompanying financial statements were prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB), which may require the use of estimates made by management. Actual results may differ from those estimates. The following is a summary of the significant accounting policies consistently followed by the Program.

Valuation of Investments

The market value of the investments in the underlying mutual funds is based on the net asset values of the respective classes of the mutual funds on the close of business on the valuation date. The value of the TIAA-CREF Life funding agreement (within the Direct-Sold Plan), to which the Principal Plus Interest Option allocates assets, is stated at cost, which approximates fair value. The TIAA-CREF Life funding agreement has a floating rate of interest that resets annually based on a projected rate of return.

Units

The beneficial interest for each account owner in the investment portfolios are represented by Program units. Subscriptions and redemptions are recorded upon receipt of the account owner's instructions in good order, based on the next determined daily net asset value per unit (Unit Value). Unit Values for each investment portfolio are determined at the close of business of the New York Stock Exchange.

Investment Transactions

Portfolio transactions, normally in shares of the underlying funds, are accounted for as of the trade date. Realized gains and losses are determined on the identified cost basis.

Withdrawals

The earnings portions of nonqualified and penalty-free withdrawals are taxable to the account owner or the beneficiary. Earnings portions of nonqualified withdrawals also may be subject to a federal penalty tax.

Distributions

All net investment income and net realized gains of the portfolios will be reinvested in the portfolios; distributions will not be declared.

Michigan Education Savings Program

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

Investment Income

Dividend income and capital gain distributions from the underlying funds, if any, is recorded on the ex-dividend date. Capital gain distributions, if any, from underlying funds are a component of net increase in fair value investments. Interest income is recorded as earned.

Income Taxes

The Program is exempt from federal income tax under Section 529 of the Internal Revenue Code of 1986. Accordingly, no provision for federal income taxes has been made.

3. Management Agreements

A separate management agreement exists for the Direct-Sold Plan and the MI 529 Advisor Plan.

Direct-Sold Plan

During the fiscal year, for its services as program manager of the Direct-Sold Plan, with respect to all investment portfolios (other than the Principal Plus Interest Option), TFI is paid an annual program management fee of 0.06% of the average daily net position of the Direct-Sold Plan invested in such portfolios. The program management fee will be reduced to 0.05% if and when total assets in the Direct-Sold Plan become equal to or greater than \$4.0 billion. In addition, Advisors is paid investment management fees on the underlying investments in the TIAA-CREF funds.

For its services related to administering the Direct-Sold Plan, each investment portfolio (with the exception of the Principal Plus Interest Option) pays to the Michigan Department of Treasury an administrative fee at an annual rate of 0.05% of the average daily net position held by that portfolio.

The Principal Plus Interest Option does not pay a fee to the program manager or to the Michigan Department of Treasury. TIAA-CREF Life, the issuer of the funding agreement in which this portfolio invests and an affiliate of TFI, makes payments to TFI. TIAA-CREF Life also pays the Michigan Department of Treasury a fee equal to 0.05% of the average daily net position held by the Principal Plus Interest Option.

Michigan Education Savings Program

Notes to Financial Statements (continued)

3. Management Agreements (continued)

MI 529 Advisor Plan

The State of Michigan has entered into a program management agreement with TFI, which has subcontracted with AGID to provide administrative, recordkeeping, marketing, and investment management services to the MI 529 Advisor Plan. Account owners bear expenses at the investment portfolio level and also indirectly bear the expenses in the underlying funds.

The MI 529 Advisor Plan compensates AGID for services provided and expenses incurred in connection with sales of units and services rendered to unit-holders and for maintenance of unit-holder accounts of A and C units. The Program paid AGID distribution and servicing and administration fees at an effective annual rate as set forth below (calculated as a percentage of each portfolio's average daily net position attributable to each class):

	Class A Units	Class C Units
Program management fee ^{1,5}	0.50%	0.50%
Servicing and administrative fee:		
TIAA-CREF Money Market Portfolio ⁵	0.10%	0.10%
Other portfolios	0.25%	0.08%, 0.15% ³
Distribution fee:		
TIAA-CREF Money Market Portfolio ⁵	None	None
Other portfolios	None	0.25%, 0.50% ²
State administration fee ^{4,5}	0.10%	0.10%

¹ A portion of the program management fee is paid by AGID to the program manager monthly.

² The Age-Based and Static Investment Portfolios are assessed a distribution fee of 0.50 percent. The individual Investment Portfolios are assessed a distribution fee of 0.25 percent.

³ The Age-Based and Static Investment Portfolios are assessed a servicing and administrative fee of 0.15 percent. The individual Investment Portfolios are assessed a servicing and administrative fee of 0.08 percent.

⁴ Paid directly to the State of Michigan to administer and maintain the State of Michigan's qualified tuition programs.

⁵ To maintain certain net yields for the TIAA-CREF Money Market Portfolio (Portfolio), AGID may temporarily and voluntarily waive all or a portion of the Portfolio's program management fee and servicing and administrative fee and reimburse all or a portion of the state administration fee and other expenses. AGID shall determine the amount and the time period of each such waiver. Such waivers may be discontinued by AGID at any time without notice. There is no guarantee that the Portfolio will maintain a positive net yield. For the year ended September 30, 2014, the effective program management fee and the effective servicing and administrative fee, net of waivers, paid by the Portfolio was 0.00% for A and C Units.

AGID also receives the proceeds of the initial sales charge paid by the unit-holders upon the purchase of A units and the contingent deferred sales charges paid (CDSC) by a unit-holder upon certain redemptions of C units as described in detail in the prevailing plan disclosure statement. Units of TIAA-CREF Money Market Portfolio are not subject to initial sales charge or CDSC.

Michigan Education Savings Program

Notes to Financial Statements (continued)

3. Management Agreements (continued)

MI 529 Advisor Plan (continued)

For the year ended September 30, 2014, AGID received approximately \$227,000 in initial sales charges and \$6,000 in CDSC. All or a substantial portion of the sales charges paid by the investor may be paid to the selling financial intermediary through which the account owners make their investments.

4. Investments

Investments in the Direct-Sold Plan include 33 investment portfolios, including 27 age-based portfolios (9 age-based portfolios for each of 3 risk strategies – conservative, moderate, and aggressive) and 6 other investment portfolios. Each portfolio invests in varying percentages in multiple TIAA-CREF funds, or the funding agreement issued by TIAA-CREF Life Insurance Company to the Program. Investments in the MI 529 Advisor Plan include 19 portfolios, including 6 age-based portfolios and 13 other portfolios. Each portfolio invests in various mutual funds.

Cash Deposits

Cash deposits were reflected in the accounts of the bank (without recognition of checks written, but not yet cleared, or of deposits in transit). As of September 30, 2014, the Program's bank balance was \$509,037 with an insured amount of \$272,857. The remaining balance of \$236,180 was uninsured and uncollateralized.

Michigan Education Savings Program

Notes to Financial Statements (continued)

4. Investments (continued)

As of September 30, 2014 the Program's investments consisted of the following:

	<u>Cost</u>	<u>Market Value</u>
The Direct-Sold Plan:		
TIAA-CREF Funds (Institutional Class):		
Bond Index Fund	\$ 946,102,874	\$ 937,942,388
Emerging Markets Equity Index Fund	83,070,792	86,227,422
Equity Index Fund	999,547,633	1,417,446,487
Inflation-Linked Bond Fund	298,400,010	280,497,984
International Equity Index Fund	429,499,625	522,521,243
Real Estate Securities Fund	116,664,212	133,103,513
TIAA-CREF Life Insurance Company:		
Funding agreement	531,035,749	531,035,749
Subtotal	3,404,320,895	3,908,774,786
MI 529 Advisor Plan:		
AllianzGI Behavioral Advantage Large Cap Fund	9,313,336	10,066,563
AllianzGI Emerging Markets Opportunities Fund	6,329,855	6,641,203
AllianzGI Global Natural Resources Fund	2,916,180	3,286,786
AllianzGI Income & Growth Fund	13,199,808	13,319,875
AllianzGI International Managed Volatility Fund	8,596,568	9,129,753
AllianzGI International Small-Cap Fund	3,594,980	3,738,834
AllianzGI NFJ Dividend Value Fund	15,400,087	18,760,219
AllianzGI NFJ Global Dividend Value Fund	4,096,798	4,196,081
AllianzGI NFJ International Value Fund	16,386,586	17,267,119
AllianzGI NFJ Large-Cap Value Fund	4,679,412	5,783,573
AllianzGI NFJ Mid-Cap Value	5,240,870	6,552,750
AllianzGI Short Duration High Income Fund	6,281,725	6,132,073
AllianzGI U.S. Managed Volatility Fund	6,245,212	6,972,261
AllianzGI U.S. Small-Cap Growth Fund	3,510,935	3,791,808
PIMCO CommoditiesPLUS® Strategy Fund	10,271,314	9,467,889
PIMCO Diversified Income Fund	4,894,938	4,802,535
PIMCO Floating Income Fund	14,892,571	14,709,296
PIMCO Foreign Bond Fund (U.S. Dollar-Hedged)	9,620,909	9,941,253
PIMCO Global Multi-Asset Fund	9,681,125	9,469,628
PIMCO Income Fund	14,787,341	15,300,248
PIMCO Low Duration Fund	12,897,203	12,783,631
PIMCO RealEstateRealReturn Strategy Fund	6,350,520	6,001,621
PIMCO Real Return Fund	8,834,274	8,571,725
PIMCO Senior Floating Rate Fund	4,558,040	4,494,446
PIMCO Short-Term Fund	23,089,421	23,206,059
PIMCO Total Return Fund	9,778,513	9,560,974
TIAA-CREF International Equity Index Fund	14,401,590	15,883,328
TIAA-CREF Money Market Fund	12,420,669	12,420,669
TIAA-CREF Small-Cap Blend Index Fund	8,616,931	9,610,833
TIAA-CREF S&P 500 Index Fund	36,792,509	43,552,462
Subtotal	307,680,220	325,415,495
Total	\$ 3,712,001,115	\$ 4,234,190,281

Michigan Education Savings Program

Notes to Financial Statements (continued)

4. Investments (continued)

An account owner has an investment in an investment portfolio and not a direct investment in any underlying mutual fund or other investment vehicle to which funds in that investment portfolio may be allocated.

Certain investments are subject to a variety of investment risks based on the amount of risk in the underlying funds. GASB requires that entities disclose certain essential risk information about deposits and investments. All of the Program's investment portfolios are uninsured and unregistered and are held by a custodian in the Program's name.

The mutual funds in which the portfolios invest are comprised of various investment securities, which include corporate debt and equity securities, obligations of the United States government and government agencies, and international equity securities. Certain underlying funds may invest in certain specified derivative securities, including interest rate and credit default swaps; caps and floors for hedging purposes; exchange-traded options; and over-the-counter options executed with primary dealers, including long calls and puts and covered calls and financial futures and options. Certain underlying funds may invest in restricted securities including: instruments issued by trusts, partnerships, or other issuers, including pass-through certificates representing participations in, or debt instruments backed by, the securities owned by such issuers. These underlying funds also may engage in securities lending, reverse repurchase agreements, and dollar roll transactions. In addition, certain underlying funds may invest in mortgage-backed securities, structured investment vehicles, below-investment grade debt, debt obligations of foreign issuers and stocks of foreign corporations, securities in foreign investment funds or trusts, foreign derivative securities including futures contracts, options, interest rate and currency swap transactions, and various other investment vehicles, each with inherent risks, including market, credit, interest rate, foreign currency leverage, and liquidity risks. Due to the level of risk associated with these investment securities, it is at least reasonably possible that changes in their fair values may occur in the near term and that such changes could materially affect account owner balances and the amounts reported in the Program's financial statements.

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a failure, the Program's deposits and investments may not be returned. The Program does not have formal custodial credit risk policies for investments. An account owner has an investment in an investment portfolio and not a direct investment in any underlying mutual fund or other investment vehicle to which funds in that investment portfolio may be allocated. Because of this ownership structure, the custodial credit risk is significantly mitigated.

Michigan Education Savings Program

Notes to Financial Statements (continued)

4. Investments (continued)

Credit Risk

The underlying funds investing primarily in fixed-income securities are subject to credit risk. Credit risk is the potential of failure of the other party to pay interest and principal when due as a result of adverse market or economic conditions. The Program does not have formal investment policies for managing credit risk. The underlying mutual funds do not carry a formal credit quality rating. The underlying funding agreement, to which the Principal Plus Interest Option of the Direct-Sold Plan allocates assets, is a guaranteed insurance product issued by TIAA-CREF Life. TIAA-CREF Life has a Standard & Poor's credit rating of AA+ as of September 30, 2014.

Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Program does not have a formal investment policy that limits maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. As of September 30, 2014, the average maturities for the underlying fixed-income mutual funds are as follows:

	Market Value	Average Maturity
The Direct-Sold Plan:		
TIAA-CREF Funds (Institutional Class):		
Bond Index Fund	\$ 937,942,388	7.30 years
Inflation-Linked Bond Fund	280,497,984	8.52 years
MI 529 Advisor Plan:		
AllianzGI Short Duration High Income Fund	6,132,073	1.97 years
PIMCO Commodities PLUS® Strategy Fund	9,467,889	1.30 years
PIMCO Diversified Income Fund	4,802,535	10.10 years
PIMCO Floating Income Fund	14,709,296	4.74 years
PIMCO Foreign Bond Fund (U.S. Dollar-Hedged)	9,941,253	10.28 years
PIMCO Global Multi-Asset Fund	9,469,628	1.42 years
PIMCO Income Fund	15,300,248	5.42 years
PIMCO Low Duration Fund	12,783,631	2.80 years
PIMCO RealEstateRealReturn Strategy Fund	6,001,621	12.06 years
PIMCO Real Return Fund	8,571,725	8.64 years
PIMCO Senior Floating Rate Fund	4,494,446	5.17 years
PIMCO Short-Term Fund	23,206,059	0.42 years
PIMCO Total Return Fund	9,560,974	7.74 years
TIAA-CREF Money Market Fund	12,420,669	n/a

Michigan Education Savings Program

Notes to Financial Statements (continued)

4. Investments (continued)

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments in foreign securities. The Program does not have formal foreign currency risk policies for investments. Certain investment portfolios allocate assets to underlying mutual funds that are exposed to foreign currency risk. The Program does not have any direct investment in foreign fixed-income securities. As of September 30, 2014, the values of investments in underlying mutual funds that primarily invest in foreign securities are as follows:

Investment	Market Value
The Direct-sold Plan:	
TIAA-CREF Funds (Institutional Class):	
Emerging Markets Index Fund	\$ 86,227,422
International Equity Index Fund	522,521,243
MI 529 Advisor Plan:	
AllianzGI Emerging Markets Opportunities Fund	6,641,203
AllianzGI Global Commodity Equity Fund	3,286,786
AllianzGI International Managed Volatility Fund	9,129,753
AllianzGI International Small-Cap Fund	3,738,834
AllianzGI NFJ Global Dividend Value Fund	4,196,081
AllianzGI NFJ International Value Fund	17,267,119
PIMCO Diversified Income Fund	4,802,535
PIMCO Floating Income Fund	14,709,296
PIMCO Foreign Bond Fund (U.S. Dollar-Hedged)	9,941,253
PIMCO Global Multi-Asset Fund	9,469,628
TIAA-CREF International Equity Index Fund	15,883,328

5. Accounting Change

For the year ended September 30, 2013, subscriptions and redemptions reported in the statement of changes in fiduciary net position included transfers and exchanges within the Program. During the year ended September 30, 2014, there was an accounting change to exclude such transfers and exchanges from subscriptions and redemptions reported in the statement of changes in fiduciary net position. For the year ended September 30, 2014, transfers and exchanges excluded from subscriptions and redemptions amounted to approximately \$1.6 billion. This accounting change had no impact on net position.

6. Subsequent Event

In November 2014, the total assets in the Direct-Sold Plan exceeded \$4.0 billion. Therefore, effective November 19, 2014, the program management fee for all investment portfolios (with the exception of the Principal Plus Interest Option) was reduced to 0.05% of the daily net position of the Direct-Sold Plan invested in such portfolios.

Independent Auditors' Report on Internal Control over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards*

Independent Auditors' Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards*

Mr. Kevin Clinton, Trustee, Michigan Education Savings Program, Michigan Department of Treasury
Mr. Doug A. Ringler, CPA, CIA, Auditor General, State of Michigan

We have audited, 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, the financial statements of the Michigan Education Savings Program (Program), a fiduciary fund of the State of Michigan, as of and for the year ended September 30, 2014, and the related notes to the financial statements, which collectively comprise the Program's basic financial statements, and have issued our report thereon dated December 5, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Program's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 Program's internal control. Accordingly, we do not express an opinion on the effectiveness of the Program's internal control.

A deficiency in internal control 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 and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of our testing, and not to provide an opinion on the effectiveness of the Program's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Program's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Andrews Hooper Pavlik PLC

Okemos, Michigan
December 5, 2014