

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

Audited Financial Statements

*Year Ended September 30, 2018  
with Report of Independent Auditors*

Michigan Education Savings Program

Audited Financial Statements

Year Ended September 30, 2018

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## Report of Independent Auditors

Mr. Nick Khouri, Trustee, Michigan Education Savings Program,  
Michigan Department of Treasury  
Mr. Doug A. Ringler, CPA, CIA, Auditor General, State of Michigan  
Lansing, 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, 2018, 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 from 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, 2018, and the change 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, 2018, 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 on pages 3 through 5 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 21, 2018, 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 solely 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 effectiveness of the Michigan Education Savings Program's 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 21, 2018

# Michigan Education Savings Program

## Management's Discussion and Analysis

September 30, 2018

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, 2018. MESP is a fiduciary fund of the State of Michigan and consists of two components, the Direct-Sold Plan and the MI 529 Advisor Plan. Both components are managed by TIAA-CREF Tuition Financing, Inc. (TFI). 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 \$181.4 million in net contributions from account owners for the year ended September 30, 2018.

The Program earned approximately \$371.7 million from investment operations and paid out approximately \$8.7 million for operating expenses during the year ended September 30, 2018.

### **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 comprised 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, 2018. This statement, along with all of the Program's financial statements, is prepared using the accrual basis of accounting. Subscriptions are recognized when enrollment in the Program is finalized; subsequent subscriptions and redemptions are recognized on the trade date; expenses and liabilities are recognized when services are provided, regardless of when cash is disbursed.

# Michigan Education Savings Program

## Management's Discussion and Analysis

September 30, 2018

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.

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, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
<b>Assets</b>		
Investments	<b>\$ 6,152,786,314</b>	\$ 5,606,913,372
Cash	<b>190,277</b>	3,129
Receivables	<b>11,008,136</b>	7,562,731
Total assets	<b>6,163,984,727</b>	5,614,479,232
<b>Liabilities – payables</b>	<b>12,965,603</b>	7,935,802
Net position	<b>\$ 6,151,019,124</b>	\$ 5,606,543,430

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

Net position increased by 9.7% and 13.7% or \$544,475,694 and \$676,050,555 for the years ended September 30, 2018 and 2017, respectively. This increase is primarily due to participant subscriptions to the Direct-Sold Plan and the MI 529 Advisor Plan, as well as positive economic conditions in the marketplace during the year ended September 30, 2018.

## Michigan Education Savings Program

### Management's Discussion and Analysis

September 30, 2018

Investments in MESP are approximately 100% 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. Investments in the MI 529 Advisor Plan include 28 portfolios, including 9 age-based portfolios and 19 other portfolios. Each portfolio invests in varying percentages of TIAA-CREF and other mutual funds, as well as the funding agreements issued by TIAA-CREF Life Insurance Company to the Michigan Department of Treasury as the policyholder on behalf of the Program.

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

#### Changes in Net Position

The following is a condensed statement of changes in fiduciary net position for the years ended September 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
<b>Additions</b>		
Subscriptions	\$ 646,370,626	\$ 590,238,937
Interest and dividends	151,375,542	117,589,761
Net change in fair value of investments	220,320,152	375,654,567
Total additions	<u>1,018,066,320</u>	<u>1,083,483,265</u>
<b>Deductions</b>		
Redemptions	464,939,736	399,774,581
Operating expenses	8,650,890	7,658,129
Total deductions	<u>473,590,626</u>	<u>407,432,710</u>
<b>Change in net position</b>	<b>544,475,694</b>	<b>676,050,555</b>
<b>Net position</b> at beginning of year	<u>5,606,543,430</u>	<u>4,930,492,875</u>
<b>Net position</b> at end of year	<u>\$ 6,151,019,124</u>	<u>\$ 5,606,543,430</u>

Total additions decreased by \$65.4 million, from \$1.083 billion to \$1.018 billion. This decrease is due to the net change in fair value of investments being lower than in the prior year.

Total deductions increased \$66.2 million, from \$407.4 million to \$473.6 million due to an increase in redemptions, as well as an increase in operating expenses.

# Michigan Education Savings Program

## Statement of Fiduciary Net Position

September 30, 2018

	<b>The Direct-Sold Plan</b>	<b>MI 529 Advisor Plan</b>	<b>Total</b>
<b>Assets</b>			
Cash	\$ 102,216	\$ 88,061	\$ 190,277
Investments – at fair value (Note 4)	5,520,102,266	632,684,048	6,152,786,314
Dividends and interest receivable	4,281,702	832,764	5,114,466
Receivable from securities transactions	2,539,452	78,159	2,617,611
Receivable from Program units sold	2,835,306	440,753	3,276,059
Total assets	<u>5,529,860,942</u>	<u>634,123,785</u>	<u>6,163,984,727</u>
<b>Liabilities</b>			
Overdraft payable	282,380	10,484	292,864
Accrued Program manager fee	430,415	330,800	761,215
Accrued administrative fee	172,164	51,688	223,852
Accrued distribution and service fees	-	820,855	820,855
Payable for securities transactions	8,122,744	1,099,970	9,222,714
Payable for Program units redeemed	1,516,358	127,745	1,644,103
Total liabilities	<u>10,524,061</u>	<u>2,441,542</u>	<u>12,965,603</u>
<b>Net Position – Held in trust for participant education savings program</b>	<u>\$ 5,519,336,881</u>	<u>\$ 631,682,243</u>	<u>\$ 6,151,019,124</u>

*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, 2018

	<b>The Direct-Sold Plan</b>	<b>MI 529 Advisor Plan</b>	<b>Total</b>
<b>Additions</b>			
Subscriptions	\$ 546,162,182	\$ 100,208,444	\$ 646,370,626
Investment income:			
Interest and dividends	125,408,068	25,967,474	151,375,542
Net increase in fair value of investments	206,285,489	14,034,663	220,320,152
Total investment gain	331,693,557	40,002,137	371,695,694
 Total additions	 877,855,739	 140,210,581	 1,018,066,320
 <b>Deductions</b>			
Redemptions	422,530,596	42,409,140	464,939,736
Program manager fee	2,503,515	1,870,328	4,373,843
Administrative fee	1,001,405	292,240	1,293,645
Distribution and service fees	-	2,983,402	2,983,402
 Total deductions	 426,035,516	 47,555,110	 473,590,626
 <b>Change in net position</b>	 451,820,223	 92,655,471	 544,475,694
<b>Net position</b> at beginning of year	5,067,516,658	539,026,772	5,606,543,430
<b>Net position</b> at end of year	\$ 5,519,336,881	\$ 631,682,243	\$ 6,151,019,124

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

# Michigan Education Savings Program

## Notes to Financial Statements

September 30, 2018

### **1. Organization and Significant Accounting Policies**

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 pursuant to Public Act No. 161 of 2000 of the State of Michigan 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 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 subsidiary of Teachers Insurance and Annuity Association of America (TIAA), serves as the program manager for the Direct-Sold Plan and the MI 529 Advisor Plan under the direction of the Treasurer pursuant to a contract that it has entered into with the State of Michigan. Nuveen Fund Advisors, LLC, a subsidiary of TIAA, is registered with the Securities and Exchange Commission as an investment advisor and provides investment advisory services to the Nuveen Funds. Nuveen Securities LLC (Nuveen), a subsidiary of TIAA, is registered with the Securities and Exchange Commission as a broker-dealer and provides underwriting and distribution services to the MI 529 Advisor Plan. TIAA-CREF Individual & Institutional Services, LLC, a wholly-owned direct subsidiary of TIAA registered as a broker-dealer under the Securities Exchange Act of 1934, provides certain underwriting and distribution services to the Direct-Sold Plan.

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 assets in the Principal Plus Interest Option/Portfolio and certain other investment portfolios are allocated to funding agreements issued by TIAA-CREF Life Insurance Company (TIAA Life), an affiliate of TFI. The funding agreements guarantee to the Michigan Department of Treasury a minimum rate of interest and provide the opportunity for additional interest as declared periodically by TIAA Life.

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.

# Michigan Education Savings Program

## Notes to Financial Statements

September 30, 2018

### **1. Organization and Significant Accounting Policies (continued)**

#### **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 Life funding agreements within the Program, to which the Principal Plus Interest Option and certain other investment portfolios allocate assets, is stated at cost, which approximates fair value. The TIAA Life funding agreements have 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 is 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. The Unit Value for financial reporting purposes may differ from the Unit Value for processing transactions. The Unit Value for financial reporting purposes includes security and shareholder transactions through the date of the report. There are no distributions of net investment gains or net investment income to account owners or beneficiaries.

For the MI 529 Advisor Plan, an account may be opened by contacting any qualified broker or financial advisor licensed to market the Program. The units offered in the MI 529 Advisor Plan are: class A units and class C units. Each unit differs principally in its respective sales charges and account owner distribution expenses of the portfolio to which they belong, and have identical liquidation and other rights and the same terms and conditions, except for expenses specific to the units. Class A units are sold with an initial sales charge. Class C units are subject to a Contingent Deferred Sales Charge (CDSC) on withdrawals made in the first eight months after contribution. The units of the Principal Plus Interest Portfolio are not subject to sales charges. Income, non-class specific expenses, and realized and unrealized gains and losses of each portfolio are allocated daily to each class of units based on relative net position in each class.

For the MI 529 Advisor Plan, effective August 1, 2018, certain selling institutions may also make class AR units available for direct incoming rollovers. Class AR units are subject to their own fee and sales charge structure. Class AR units automatically convert to class A units after they have been owned for 12 months (converting after the close of business on the last day of the calendar month following the anniversary of the date of purchase). Immediately following the conversion, converted class AR units are subject to the fee structure applicable to class A units. No initial sales charges or CDSCs are imposed when class AR units convert to class A units.

# Michigan Education Savings Program

## Notes to Financial Statements

September 30, 2018

### **1. Organization and Significant Accounting Policies (continued)**

#### **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.

#### **Investment Income**

Dividend income and capital gain distributions from the underlying funds, if any, are recorded on the ex-dividend date. Capital gain distributions, if any, from underlying funds are a component of the net increase in the fair value of 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 and does not expect to have any unrelated business income subject to tax. Accordingly, no provision for federal income taxes has been made.

### **2. Fair Value Measurements**

The Program categorizes its fair value measurements within the fair value hierarchy established by accounting principles generally accepted in the United States of America. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets, Level 2 inputs are significant other observable inputs, and Level 3 inputs are significant unobservable inputs.

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Program's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

# Michigan Education Savings Program

## Notes to Financial Statements

September 30, 2018

### **2. Fair Value Measurements (continued)**

The Program has the following recurring fair value measurements as of September 30, 2018:

- Investments in registered investment companies totaling \$5,294,520,690 as of September 30, 2018 are valued at their net asset value on the valuation date based on quoted prices in active markets (Level 1 inputs).

The TIAA Life funding agreements in the Program valued at \$858,265,624 as of September 30, 2018 are considered nonparticipating interest-earning investment contracts and are accounted for at cost.

### **3. Program Fees**

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

#### **Direct-Sold Plan**

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 0.05% of the average daily net position of the Direct-Sold Plan invested in such portfolios.

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 a state administrative fee at an annual rate of 0.02% of the average daily net position held by that portfolio.

#### **MI 529 Advisor Plan**

Program units (excluding units in the Principal Plus Interest Portfolio) pay a program management fee and a service fee to the program manager. TFI receives management fees and service fees at an annual rate of 0.32% and 0.25%, respectively, of the average daily net position of the corresponding investment portfolios.

Class C units pay a distribution fee to Nuveen of either 0.40% or 0.75% of the average daily net position of the corresponding investment portfolios (excluding units in the Principal Plus Interest Portfolio). The multi-fund and individual fund portfolios are assessed a distribution fee of 0.40%. The age-based investment and target risk portfolios are assessed a distribution fee of 0.75%.

# Michigan Education Savings Program

## Notes to Financial Statements

September 30, 2018

### **3. Program Fees (continued)**

#### **MI 529 Advisor Plan (continued)**

Nuveen also receives the proceeds of the initial sales charge paid by the unit-holder upon the purchase of class A units and the CDSC paid by a unit-holder upon certain redemptions of class C and class AR units as described in detail in the current Program disclosure booklet. For the year ended September 30, 2018, Nuveen received \$244,429 in initial sales charges and received no CDSC. All or a substantial portion of the sales charges received by Nuveen may be paid to the selling financial intermediary through which the account owners make their investments.

All units (excluding units in the Principal Plus Interest Portfolio) pay a state administrative fee to Michigan Department of Treasury at an annual rate of 0.05% of the average daily net position of the corresponding investment portfolio.

All units indirectly bear the expenses for the underlying funds of the corresponding investment portfolios.

### **4. Investments**

As of September 30, 2018, 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. As of September 30, 2018, investments in the MI 529 Advisor Plan include 28 portfolios, including 9 age-based portfolios and 19 other portfolios. Each portfolio invests in varying percentages of TIAA-CREF and other mutual funds, as well as the funding agreements issued by TIAA-CREF Life Insurance Company to the Program.

#### **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, 2018, the Program's bank balance was \$190,277 with an insured amount of \$190,277.

# Michigan Education Savings Program

## Notes to Financial Statements

September 30, 2018

### 4. Investments (continued)

As of September 30, 2018, the Program's investments consisted of the following:

	Cost	Market Value
The Direct-Sold Plan:		
TIAA-CREF Funds (Institutional Class):		
Bond Index Fund	\$ 1,277,962,179	\$ 1,240,366,855
Emerging Markets Equity Index Fund	111,004,334	127,101,417
Equity Index Fund	1,089,445,042	2,004,530,306
High-Yield Fund	180,818,448	180,791,790
Inflation-Linked Bond Fund	338,864,655	327,655,094
International Equity Index Fund	547,424,918	679,982,796
Vanguard REIT Index Fund (Institutional Class)	174,269,131	183,423,479
TIAA-CREF Life Insurance Company:		
Funding Agreement	776,250,529	776,250,529
Subtotal	4,496,039,236	5,520,102,266
MI 529 Advisor Plan:		
TIAA-CREF Funds (Institutional Class):		
Bond Fund	92,693,063	89,090,519
Emerging Markets Debt Fund	7,628,819	6,871,230
Emerging Markets Equity Index Fund	13,786,602	13,243,444
High-Yield Fund	3,603,302	3,558,478
International Equity Index Fund	57,510,547	58,129,842
Large-Cap Value Fund	1,140,185	1,153,665
S&P 500 Index Fund	47,315,774	55,535,712
Small-Cap Equity Fund	29,858,292	32,451,682
Social Choice Bond Fund	96,415	95,378
Social Choice Equity Fund	82,176	88,404
Nuveen Funds (Class R6):		
Inflation Protected Securities Fund	24,530,894	23,739,550
Large Cap Core Fund	108,200,339	119,430,885
Real Asset Income Fund	16,988,789	16,172,784
Real Estate Securities Fund	17,780,331	16,254,130
Santa Barbara Dividend Growth Fund	26,426,079	28,288,479
Strategic Income Fund	42,074,690	40,342,748
Symphony Credit Opportunities Fund	3,772,809	3,763,169
Ariel Fund - Institutional Class	1,139,214	1,201,849
DFA Emerging Markets Core Equity Portfolio - Institutional Class	1,297,307	1,197,883
Harbor Capital Appreciation Fund - Retirement Class	2,905,877	3,182,379
Harding Loevner Global Equity Portfolio - Class Z	10,911,469	11,193,762
MetWest Total Return Bond Fund - P Share	11,816,402	11,359,520
Oakmark International Fund - Institutional Class	15,311,764	14,323,461
TIAA-CREF Life Insurance Company:		
Funding Agreements	82,015,095	82,015,095
Subtotal	618,886,234	632,684,048
Total	\$ 5,114,925,470	\$ 6,152,786,314

# Michigan Education Savings Program

## Notes to Financial Statements

September 30, 2018

### **4. Investments (continued)**

All transactions in the TIAA-CREF and Nuveen Funds, as well as the funding agreements, are related party transactions.

### **5. Investment Risks**

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.

#### **Investment Policy**

The Program does not have specific investment policies which address credit, interest rate, foreign currency, or custodial credit risk. The Program's portfolios are managed based on specific investment objectives and strategies which are disclosed in the current disclosure booklet for each respective component.

#### **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. 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 mitigated.

#### **Credit Risk**

The underlying mutual funds invested primarily in fixed-income securities are subject to credit risk. Credit risk refers to the ability of the issuer to make final payments of interest and principal. The underlying mutual funds do not carry a formal credit quality rating. The underlying Funding Agreements are guaranteed insurance products issued by TIAA Life. TIAA Life had a Standard & Poor's credit rating of AA+ as of September 30, 2018.



# Michigan Education Savings Program

## Notes to Financial Statements

September 30, 2018

### 5. Investment Risks (continued)

#### 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. As of September 30, 2018, the weighted average maturities for the underlying fixed-income mutual funds are as follows:

	<u>Market Value</u>	<u>Weighted Average Maturity</u>
The Direct-Sold Plan:		
TIAA-CREF Funds (Institutional Class):		
Bond Index Fund	\$ 1,240,366,855	8.33 years
High-Yield Fund	180,791,790	6.61 years
Inflation-Linked Bond Fund	327,655,094	5.43 years
MI 529 Advisor Plan:		
TIAA-CREF Funds (Institutional Class):		
Bond Fund	89,090,519	8.21 years
Emerging Markets Debt Fund	6,871,230	11.63 years
High-Yield Fund	3,558,478	6.61 years
Social Choice Bond Fund	95,378	9.26 years
Nuveen Funds (Class R6):		
Inflation Protected Securities Fund	23,739,550	7.72 years
Real Asset Income Fund	16,172,784	N/A
Strategic Income Fund	40,342,748	8.25 years
Symphony Credit Opportunities Fund	3,763,169	N/A
MetWest Total Return Bond Fund - P Share	11,359,520	7.59 years

#### 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 any direct investment in foreign securities. Certain investment portfolios allocate assets to underlying mutual funds that are exposed to foreign currency risk. As of September 30, 2018, the values of investments in underlying mutual funds that significantly invest in foreign dominated contracts are as follows:

	<u>Market Value</u>
The Direct-Sold Plan:	
TIAA-CREF Funds (Institutional Class):	
Emerging Markets Equity Index Fund	\$ 127,101,417
International Equity Index Fund	679,982,796
MI 529 Advisor Plan:	
TIAA-CREF Funds (Institutional Class):	
Emerging Markets Debt Fund	6,871,230
Emerging Markets Equity Index Fund	13,243,444
International Equity Index Fund	58,129,842
Nuveen Real Asset Income Fund - Class R6	16,172,784
DFA Emerging Markets Core Equity Portfolio - Institutional Class	1,197,883
Harding Loevner Global Equity Portfolio - Class Z	11,193,762
Oakmark International Fund - Institutional Class	14,323,461

# Michigan Education Savings Program

## Notes to Financial Statements

September 30, 2018

### **6. Guarantees and Indemnifications**

Under the Program's organizational documents, each officer, employee, or other agent of the Program (including TFI and Nuveen) is indemnified against certain liabilities that may arise out of performance of their duties to the Program. Additionally, in the normal course of business, the Program enters into contracts that contain a variety of indemnification clauses. The Program's maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the Program that have not yet occurred. However, the Program has not had prior claims or losses pursuant to these contracts, and management expects the risk of loss to be remote.

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  
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Mr. Nick Khouri, Trustee, Michigan Education Savings Program,  
Michigan Department of Treasury  
Mr. Doug A. Ringler, CPA, CIA, Auditor General, State of Michigan  
Lansing, 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, 2018, 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 21, 2018.

**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 from 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 that testing, and not to provide an opinion on the effectiveness of the entity'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Andrews Kloopa Pavlik PLC*

Okemos, Michigan  
December 21, 2018