

Certified Public Accountants  
& Consultants



**Alabama Prepaid Affordable  
College Tuition Program  
September 30, 2019**  
Annual Financial Report

## Alabama Prepaid Affordable College Tuition Program

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## Independent Auditor's Report

The Board of Trustees  
Alabama Prepaid Affordable College Tuition Program  
Montgomery, Alabama

### Report on the Financial Statements

We have audited the accompanying financial statements of the Alabama Prepaid Affordable College Tuition Program, a program of the Wallace-Folsom College Savings Investment Plan and a private-purpose trust fund of the State of Alabama, which are comprised of the statement of fiduciary net position and statement of changes in fiduciary net position, and the related notes to financial statements, as of and for the year ended September 30, 2019, 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.

### Auditor's 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 Alabama Prepaid Affordable College Tuition Program as of September 30, 2019, and the changes in its fiduciary net position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## **Other Matters**

### **Emphasis of Matter**

As discussed in Note 1, the financial statements present only the Alabama Prepaid Affordable College Tuition Program, a private-purpose trust fund, and do not purport to, and are not intended to present fairly the financial position of the State of Alabama, and the results of its operations and the cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

### **Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the schedule of funding progress be presented to supplement the financial statements. Such information, although not a part of the 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 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.

### **Supplementary Information**

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The combining schedule of fiduciary net position and the combining schedule of changes in fiduciary net position are presented for the purposes of additional analysis and are not a required part of the financial statements.

The combining schedule of fiduciary net position and the combining schedule of changes in fiduciary net position are the responsibility of management and were derived from and relate directly to the underlying accounting records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining schedule of fiduciary net position and the combining schedule of changes in fiduciary net position are fairly stated, in all material respects, in relation to the financial statements as a whole.

### **Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated February 7, 2020, on our consideration of the Alabama Prepaid Affordable College Tuition Program's internal control over financial reporting and 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Governmental Auditing Standards* in considering the Alabama Prepaid Affordable College Tuition Program's internal control over financial reporting and compliance.

*Jackson Thornton & Co. PC*

Prattville, Alabama  
February 7, 2020

# ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

## MANAGEMENT'S DISCUSSION AND ANALYSIS SEPTEMBER 30, 2019

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The following discussion is designed to provide an understanding of various factors related to the Alabama Prepaid Affordable College Tuition Program's (the "PACT Program") operations and financial condition. This information should be read in conjunction with the financial statements and related notes. The purpose of this information is to focus on significant changes in the financial condition during the fiscal year ended September 30, 2019, and highlight events that occurred during the year.

The Statement of Fiduciary Net Position presents information on the PACT Program's cash and investments, accounts payable and accrued liabilities, and net position at the end of the fiscal year. Assets less liabilities results in the net position at the end of the fiscal year.

The Statement of Changes in Fiduciary Net Position reports all additions and deductions of the PACT Program's recent fiscal year. Additions minus deductions provide the change in fiduciary net position for the fiscal year.

The Notes to the Financial Statements include the program descriptions, a summary of significant accounting policies, credit risk disclosures for cash and investments, concentration of investments disclosures, and additional actuarial information relevant to the latest actuarial valuations.

The Required Supplementary Information following the Notes to the Financial Statements includes the Schedule of Funding Progress, Combining Schedule of Fiduciary Net Position, and the Combining Schedule of Changes in Fiduciary Net Position.

The PACT Program is classified as a fiduciary fund in the State of Alabama Comprehensive Annual Financial Report (CAFR).

### **Assets**

The assets of the PACT Program include cash, receivables, investments, and other assets. Assets were \$97,913,826 and \$99,241,723 as of September 30, 2019 and 2018, respectively. The decrease was primarily due to reductions in cash and cash equivalents due to the timing of tuition benefits payments at the end of the year.

The composition of the PACT Program's investment securities portfolio reflects the Board's investment strategy to preserve capital by minimizing the probability of loss of principal over its investment horizon while maintaining an appropriate level of liquidity to meet tuition benefit obligations. The adopted asset allocation as of September 30, 2019 is 100% Short Duration Fixed.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

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The following table represents the PACT Program's investment portfolio and asset allocation as of September 30, 2019. Positions in various equity accounts totaling less than 0.01% of total assets are comprised of values remaining after liquidation, many of which are liabilities contingent on corporate action, the value of which (if any) cannot be immediately realized.

<u>ASSET CATEGORY</u>	<u>MARKET VALUE</u>	<u>PERCENT</u>
Fixed Income	\$ 64,312,657	65.91%
Cash/Cash Equivalents	33,267,301	34.09%

### **Liabilities**

Liabilities of the PACT Program consist of payables and accruals. Liabilities were \$15,993,228 and \$22,696,491 at September 30, 2019 and 2018, respectively. The decrease in liabilities was primarily due to timing of payments paid and invoicing at the end of the fiscal year.

### **Additions**

Additions totaled \$65,770,036 and \$64,441,871 for fiscal years ended September 30, 2019 and 2018, respectively. The 2.06% increase was largely due to an increase in the fair value of investments. Contract payments decreased 18.48% from \$867,233 to \$706,954 due to the continued reduction of monthly payments received on contracts not paid in full. Net investment income increased by \$2.83 million from \$561,855 to \$3,388,922, which includes the change in the fair value of investments.

### **Deductions**

Deductions totaled \$60,344,670 and \$58,048,004 for fiscal years ending September 30, 2019 and 2018, respectively. Deductions include salaries, professional services, contract cancellation refunds, and benefits paid to colleges and universities. The largest deduction from the PACT Program is the amount of monies paid to the colleges and universities for tuition and qualified fees.

For fiscal year ending 2019, the PACT Program paid \$56.6 million to 418 colleges and universities across the nation for 7,551 beneficiaries, as compared to \$54.2 million paid in fiscal year ending 2018 for approximately 8,122 beneficiaries.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

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### **Summary**

According to the actuarial report for fiscal year ending 2019, the PACT Program had assets of \$97.6 million. Adding the assets of \$97.6 million to the actuarial present value of future contract payments and future education trust fund payments of \$269.6 million and dividing by the actuarial present value of future tuition benefit payments and administrative costs of \$312.9 million, results in an actuarial funded status of 116.9%. This is a decrease from the 2018 actuarial funded status of 120.5%. The decrease in the trust funded ratio was primarily due to the 7% increase in tuition and fee payments in 2019 which reduced the actuarial surplus.

Actuarial assumptions are reviewed and approved by the Board annually to reflect expected results believed to be realistic based on terms of the settlement, historical information, economic data, and expert guidance. The 2019 Actuarial Report is available at [www.treasury.alabama.gov](http://www.treasury.alabama.gov). The report should be read in its entirety in conjunction with the financial statements so that projections can be properly interpreted.

During 2014, the PACT Program established a reserve for administrative costs within the PACT trust fund. Approximately \$12.9 million was allocated for the purpose of paying future administrative cost of the PACT Program effective October 2014. Any unexpended funds allocated for administrative expenses will remain available for payment of future PACT benefits. During fiscal year 2019, no funds were transferred from the Trust Fund to cover administrative costs.

During 2019, the PACT Program Board of Directors approved a 7% increase to the current rate paid by the PACT Program for benefit payments. This increase was effective fall semester of 2019. Under the 2011 Class action Settlement Agreement, PACT is required to pay tuition and qualified fees at the fall 2010 rates as certified by each respective Alabama public eligible educational institution. The agreement was negotiated to allow for an increase in benefit payments if the actuarial condition of the PACT Program improves. The first increase of 3.0% was made in 2015 followed by a 6.0% increase in 2016, 8.0% increase in 2017, 7.0% increase in 2018, and 7.0% increase in 2019, compounded.

### **Economic factors and fiscal year 2020 Budget**

Economic conditions for the PACT Program remain stable in the current environment.

- The PACT Program relies on the State of Alabama appropriation to fund its activities and finances. The primary source of funding is the transfer from the Education Trust Fund, which comprised 94% of additions in the fiscal year 2019. The transfer to the PACT Program from the Education Trust Fund in 2020 is projected to be \$60,738,300.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

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- The 2020 actuarial projected payment for tuition and qualified fees to colleges and universities from the PACT Program is projected to be \$75,800,000.

### **Requests for Information**

This financial report is designed to provide a general overview of the PACT Program's finances for all those with an interest in the PACT Program's activities and finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Office of State Treasurer at the Alabama State Capital, 600 Dexter Avenue, Room S-106, Montgomery, Alabama 36104.

**Alabama Prepaid Affordable College Tuition Program**  
**Statement of Fiduciary Net Position**  
**September 30, 2019**

**Assets**

Cash and cash equivalents	\$ 33,267,301
Interest and dividends receivable	333,868
Investments	<u>64,312,657</u>
Total assets	<u>97,913,826</u>

**Liabilities**

Accounts payable	15,887,540
Accrued liabilities	<u>45,688</u>
Total liabilities	<u>15,933,228</u>

**Net Position**

Held in trust for tuition payments and other purposes	<u><u>\$ 81,980,598</u></u>
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See accompanying notes to financial statements.

**Alabama Prepaid Affordable College Tuition Program**  
**Statement of Changes in Fiduciary Net Position**  
**For the Year Ended September 30, 2019**

<b>Additions</b>		
Contract income		\$ 706,954
Investment income		
Interest and dividend income		2,036,950
Gain on investments		1,351,972
Net investment income		<u>3,388,922</u>
Other income		135,160
Transfers from other funds		<u>61,539,000</u>
Total additions		<u>65,770,036</u>
<b>Deductions</b>		
Tuition benefits		56,625,651
Salaries and other administrative expenses		285,498
Professional services		169,070
Cancellation refunds		<u>3,254,451</u>
Total deductions		<u>60,334,670</u>
<b>Change in Net Position</b>		5,435,366
<b>Net Position at Beginning of Year</b>		<u>76,545,232</u>
<b>Net Position at End of Year</b>		<u><u>\$ 81,980,598</u></u>

See accompanying notes to financial statements.

**Alabama Prepaid Affordable College Tuition Program**  
**Notes to Financial Statements**  
**September 30, 2019**

**Note 1 - Summary of Significant Accounting Policies**

Description of Alabama Prepaid Affordable College Tuition Program (the PACT Program) - The PACT Program is a part of the Wallace-Folsom College Savings Investment Plan. The PACT Program includes the PACT Trust Fund and the PACT Administrative Fund. These financial statements do not include any other programs of the Wallace-Folsom College Savings Investment Plan.

The PACT Program operates under the provisions of the Code of Alabama 1975, Section 16-33C-1 through 9, as amended. The PACT Program is administratively located within the Alabama State Treasurer's office. The PACT Program's property, income, and operations have been statutorily exempted from all taxation by the State and its political subdivisions. The PACT Program Disclosure Statement provides that neither the contract purchaser nor beneficiary has any recourse against the Treasurer, the Board, the PACT Program, any other state or federal government agency, or the State of Alabama in connection with any obligations arising out of the PACT contracts.

The PACT Program is governed by a 15 member Board of Trustees consisting of the Director of Finance of the State of Alabama; the Treasurer of the State of Alabama; the Executive Director of the Alabama Commission on Higher Education, or designee; the Chancellor of the Alabama Community College System, or designee; the President of the Alabama Association of Independent Colleges or Universities, or designee; the President of the Council of College and University Presidents, or designee; the Chief Executive Officer of the RSA, or designee; two persons appointed by the Governor; two persons appointed by the Speaker of the House of Representatives; one member of the House appointed by the Speaker; one person appointed by the Lieutenant Governor; one member of the Senate appointed by the Lieutenant Governor; and one person appointed by the Senate President Pro Tempore.

The PACT Program was initially established to provide a mechanism whereby four years of undergraduate tuition and mandatory fees could be paid in advance. The PACT Program entered into contracts with contract purchasers which provided that, in return for a specified actuarially determined payment, the PACT Program would provide the contract beneficiary's undergraduate tuition (up to 128 or 135 semester hours) and mandatory fees (up to eight semesters) at any Alabama public university or community college. For beneficiaries that choose to attend private or out-of-state institutions, the PACT Program would provide tuition payments at the current weighted average cost of tuition at Alabama public four-year institutions. The purchase price of the contract was based on several factors, including tuition costs, the beneficiary's age and grade in school, anticipated investment earnings, and anticipated tuition rate increases. Enrollment in the PACT Program is closed permanently to new participants and no new applications will be accepted.

Following court-ordered mediation in April 2011, the PACT Program participants and the PACT Board reached a settlement to modify the terms of the PACT Program contracts. In July 2011, the proposed class action settlement was approved. Under the settlement, finite tuition and fee payments would be established as a baseline for all future payments by the PACT Program, and the PACT Program beneficiaries would be responsible for paying any tuition and fees in excess of the baseline rate. Two appeals were subsequently filed with the Alabama Supreme Court to challenge the settlement. During 2013, the Alabama Supreme Court upheld the settlement and tuition and fee payments are being made in the specified baseline amounts. The settlement also allowed for future increases to the baseline tuition rate based upon actuarial projections resulting in a surplus in the fund.

During 2014, the PACT Program established a reserve for administrative costs within the PACT Trust Fund and that approximately \$12.9 million will be allocated for the purpose of paying future administrative costs of the PACT Program effective October 2014. Any unexpended funds allocated for administrative expenses will remain available for payment of PACT benefits.

**Alabama Prepaid Affordable College Tuition Program**  
**Notes to Financial Statements**  
**September 30, 2019**

**Note 1 - Summary of Significant Accounting Policies (continued)**

During 2019, the PACT Program Board of Directors approved a 7% increase to the current rate paid by the PACT Program for benefit payments. This increase was effective fall semester of 2019. Under the 2011 Class action Settlement Agreement, PACT is required to pay tuition and qualified fees at the fall 2010 rates as certified by each respective Alabama public eligible educational institution. The agreement was negotiated to allow for an increase in benefit payments if the actuarial condition of the PACT Program improves. The first increase of 3.0% was made in 2015 followed by a 6.0% increase in 2016, 8.0% increase in 2017, 7.0% increase in 2018, and a 7% increase in 2019, compounded.

Reporting entity - The PACT Program is a part of the State of Alabama's reporting entity and is reported as a private-purpose trust fund in the State of Alabama Comprehensive Annual Financial Report (CAFR). The notes accompanying these financial statements relate directly to the PACT Program. The PACT Program issues separate financial statements.

The PACT Program is comprised of the following funds:

- Trust Fund (Fund 471) includes contract benefit payments, interest earnings from investments, and disbursements to universities and colleges for tuition.
- Administrative Fund (Fund 470) operates the administrative functions of the PACT Program.

Measurement focus and basis of accounting - The financial statements contained in this report have been prepared in conformity with accounting principles generally accepted (GAAP) in the United States of America as prescribed by the Government Accounting Standards Board (GASB). These statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recognized and recorded when earned and expenses are recorded when a liability is incurred.

Cash and cash equivalents - The PACT Program considers all highly liquid investments with a maturity of 12 months or less at the time of issuance to be cash equivalents. Cash and cash equivalents consist of bank deposits, amounts invested in repurchase agreements, money market mutual funds and commercial paper.

Contract income - Contract income represents the payments received from contract holders.

Fair value measurements - Fair value generally represents the price that would be received at the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GAAP establishes a fair value hierarchy that prioritizes inputs used to measure fair value into three levels:

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities that are available at the measurement date.

Level 2 - Prices that are based on other than exchange-quoted prices in active markets, which are observable for the asset or liability, either directly or indirectly; and the fair value is determined through the use of models or other valuation methodologies. A significant adjustment to a Level 2 input could result in the Level 2 measurement becoming a Level 3 measurement.

Level 3 - Pricing inputs are unobservable for the asset or liability and include situations where there is little, if any, market activity for the asset or liability. The inputs into the determination of fair value are based upon the best information available and may require significant management judgement or estimation.

**Alabama Prepaid Affordable College Tuition Program**  
**Notes to Financial Statements**  
**September 30, 2019**

Investment valuation - The PACT Program follows GASB Statement No. 31, Accounting and Reporting for Certain Investments and for External Investment Pools, which requires that investments in equity securities with readily determinable fair values, all investments in debt securities and open-end mutual funds to be reported at fair value with gains and losses included as a component of revenues and expenses. All plan investments are managed by a third-party money manager and are reported at fair value in the statement of fiduciary net position, with all investment income, including changes in fair value, reported as additions (reductions) in the statement of changes in fiduciary net position. Fair values for investment securities are based on quoted market prices, where available. Otherwise, fair values are based on quoted market prices of comparable instruments. Purchases and sales of securities are recorded by the PACT custodian on the trade date. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

The PACT Program's investments are exposed to various risks, such as interest rate, credit, and overall market volatility risks. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term would materially affect the amounts reported in the accompanying statement of fiduciary net position.

Income taxes - The Internal Revenue Code provides that state tuition plans that meet certain requirements are exempt from income taxation. The PACT Program's rules and regulations meet those requirements. Accordingly, no provision for income taxes has been made in these financial statements for accrual of income taxes for the year ended September 30, 2019, or for prior years.

Management estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during each period. Actual results could differ from those estimates.

New accounting pronouncements - In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* (Topic 606). ASU 2014-09 was issued to provide a framework for addressing revenue recognition issues and, upon its effective date, replaces almost all existing revenue recognition guidance in current accounting principles generally accepted in the United States of America. ASU 2014-09 is effective for reporting periods beginning after December 15, 2018. The PACT Program is evaluating the impact of the implementation of this standard on its financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments*. The most significant change in the new financial instruments' guidance is the elimination of the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities. ASU 2016-01 is effective for reporting periods beginning after December 15, 2018. The PACT Program is evaluating the impact of the implementation of this standard on its financial statements.

**Note 2 - Cash and Cash Equivalents**

The PACT Program maintains cash in bank deposit accounts, which at times may exceed federally insured limits. The PACT Program has not experienced any losses in such accounts. Bank deposits in amounts above the federally insured limits are fully collateralized through the Security for Alabama Funds Enhancement (SAFE) Act. Under the Act, financial institutions holding public deposits in excess of the amounts insured by the FDIC must pledge collateral to a collateral pool in the name of the State Treasurer. The State Treasurer is responsible for monitoring compliance with the collateralization and reporting requirements of the Act.

**Alabama Prepaid Affordable College Tuition Program**  
**Notes to Financial Statements**  
**September 30, 2019**

Cash and cash equivalents at September 30, 2019 consist of the following:

<u>Account Type</u>	<u>Fair Value</u>
Money market mutual funds and other cash	\$ 33,267,301

**Note 3 - Deposits and Investments**

Investment securities at September 30, 2019 consisted of the following:

	<u>Fair Value</u>
U.S. Treasuries	\$ 29,987,349
U.S. Agency securities	16,521,875
Mortgage and other asset-backed securities	6,713,696
Corporate securities	11,089,737
Total	<u>\$ 64,312,657</u>

As of September 30, 2019, the PACT Program had one external money manager to invest plan assets. The PACT Program's investments are presented in the statement of fiduciary net position in the aggregate at fair value and include the following at September 30, 2019:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<b>Fixed Maturity</b>				
U.S. Treasuries	\$ 29,987,349		\$ 29,987,349	
Mortgage and other asset-backed securities	6,713,696		6,713,696	
Corporate securities	11,089,737		10,043,823	\$ 1,045,914
U.S. Agency securities	16,521,875		16,521,875	
Totals	<u>\$ 64,312,657</u>	<u>\$ -</u>	<u>\$ 63,266,743</u>	<u>\$ 1,045,914</u>

Deposits and investments are subject to certain types of risk including interest rate risk, custodial credit risk, and credit risk. The following describes those risks:

Interest rate risk - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The fair value of fixed maturity investments fluctuates in response to changes in market interest rates. Increases in prevailing interest rates generally translate into decreases in fair value of those instruments. The fair value of interest sensitive instruments may also be affected by the creditworthiness of the issuer, prepayment options, relative values of alternative investments, and other general market conditions. Certain fixed maturity investments have call provisions that could result in shorter maturity periods.

Custodial credit risk - For an investment, custodial credit risk is the risk that an entity will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party if the counterparty fails. The PACT Program's custodian holds all investments of the PACT Program in the PACT Program's name, with the exception of repurchase agreements. The securities underlying repurchase agreements are held in trust for the PACT Program in the name of the custodian, not in the name of the PACT Program.

**Alabama Prepaid Affordable College Tuition Program**  
**Notes to Financial Statements**  
**September 30, 2019**

**Note 3 - Deposits and Investments (continued)**

Credit risk - Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. Nationally recognized statistical rating organizations provide ratings of debt securities' quality based on a variety of factors, such as the financial condition of the issuers, which provide investors with some idea of the issuer's ability to meet its obligations.

Concentration of credit risk - The investment policy limits the aggregate amount that can be invested in each class of investments and provides further limitations on investments by the money manager. The policy limits are as follows:

- General fixed income and cash:
  - No more than 5% of the total market value of the portfolio can be invested in the debt obligation of any one issuer (does not apply to U.S. Government and Agency securities).
  - Holdings of any individual issue must be 5% or less of the outstanding value of the total issue.
  - The average duration of the portfolio must be maintained within a range of +/- 20% of the benchmark index duration.
  - Turnover of securities should not exceed 200% in any rolling 12-month period. Fixed income managers shall be excluded from this restriction for the first six months of their retention.
  - The benchmark for the portfolio is the Bloomberg Barclay's 1-3 Year Government Index once fully transitioned.
  
- Short duration fixed income:
  - At the time of purchase, all securities purchased must be classified as investment grade by two of the three major rating services. For this purpose, the rating must be at least Baa3 by Moody's, BBB- by Standard & Poor's, and BBB- by Fitch. If only one rating exists, this one rating will determine investment grade status.
  - Securities downgraded below investment grade after purchase should be sold within six months of the downgrade.
  - The weighted average credit quality of the portfolio shall not fall below A or equivalent.
  - Agency residential and commercial mortgage backed securities, non-agency commercial mortgage backed securities, and agency collateralized mortgage obligations cannot comprise more than 50% of the portfolio combined.
  - Asset backed securities are limited to 10% of the portfolio.
  - Commercial mortgage backed securities are limited to 10% of the portfolio.
  - Rule 144A securities are limited to 10% of the portfolio.
  - Investments in collateralized bond obligations (CBOs) or similar pools of commercial loans are prohibited.

**Alabama Prepaid Affordable College Tuition Program**  
**Notes to Financial Statements**  
**September 30, 2019**

**Note 3 - Deposits and Investments (continued)**

- o Investments in Interest-Only (IO) and Principal-Only (PO) collateralized mortgage obligations are not allowed.
- o Investments in non-U.S. Dollar denomination securities are not permitted.
- o The maximum allowable maturity of any bullet security is 63 months. However, for securities with puts, sinking funds, or regular amortization/paydowns, the weighted average life will be used, and restricted to three years.

The overall portfolio design and asset allocation have been structured to provide the most appropriate structure and asset allocation from a risk and return perspective to meet the objectives of the PACT Board. The investment portfolio shall be diversified both by asset class and within asset classes, by economic sector and industry. The purpose of diversification is to reduce specific risk associated with any single security or class of securities. Asset allocation will be reviewed annually. The Board has established an asset allocation of 100% short duration fixed income for the life of the portfolio.

On September 30, 2019, the PACT Program did not have investments in any one organization which represents greater than 5% of plan net assets other than Federal Home Loan Mortgage and U.S. Treasury Notes.

The following table provides information as of September 30, 2019, concerning the fair value of investments and interest rate risk:

<b>Type of Investment</b>	<b>Investment Maturities at Fair Value (In Years)</b>				<b>Total Fair Value</b>
	<b>Less Than 1</b>	<b>1 - 5</b>	<b>6 - 10</b>	<b>More Than 10</b>	
<b>Fixed Maturity</b>					
U.S. Treasuries	\$ 4,121,356	\$ 25,865,993			\$ 29,987,349
U.S. Agency securities	1,847,157	14,674,718			16,521,875
Mortgage and other asset-backed securities		327,825	\$ 6,137,854	\$ 248,017	6,713,696
Corporate securities	1,506,367	9,450,096		133,274	11,089,737
Total investments	<u>\$ 7,474,880</u>	<u>\$ 50,318,632</u>	<u>\$ 6,137,854</u>	<u>\$ 381,291</u>	<u>\$ 64,312,657</u>

**Alabama Prepaid Affordable College Tuition Program**  
**Notes to Financial Statements**  
**September 30, 2019**

The following table provides information as of September 30, 2019, concerning credit risk:

<b>Moody's *</b> <b>Ratings</b>	<b>Standard and Poor's Ratings</b>	<b>Fair Value</b>	<b>Fair Value as a Percent of Total Fixed Maturity Fair Value</b>
A1		\$ 1,098,703	1.708%
A2		1,942,477	3.020%
A3		2,993,565	4.655%
Aa2		651,590	1.013%
Aaa		48,077,418	74.756%
Baa2		697	0.001%
	AA+	847,725	1.318%
	BBB-	854,080	1.328%
Not Rated		7,846,402	12.200%
		<u>\$ 64,312,657</u>	<u>100.000%</u>

\* Moody's ratings are used when available. Standard & Poor's rating is used when it is available and a Moody's rating is not.

Mortgage-backed securities - As of September 30, 2019, the PACT Program had investments in mortgage-backed securities. Embedded prepayment options cause these investments to be highly sensitive to changes in interest rates. Prepayments by the obligees of the underlying assets reduce the total interest payments to be received. Generally, when interest rates fall, obligees tend to prepay the mortgages thus eliminating the stream of interest payments that would have been received under the original amortization schedule. The resulting reduction in cash flow diminishes the fair value of mortgage-backed securities. Maturities may differ from contractual maturities (as shown in the table of investments) in mortgage-backed securities due to prepayment characteristics of these securities. Average life is an acceptable expected maturity. As of September 30, 2019, there were no investments held in forward settling TBA mortgage-backed securities.

**Note 4 - Interfund Transfers**

The PACT Program received funds transferred out of the State of Alabama Education Trust Fund in the amount of \$61,539,000 in compliance with legislative appropriation acts.

**Note 5 - Future Tuition Benefit Payments and Future Contract Payments**

An actuary determines future tuition benefit payments and future contract payments. The standardized measurement is the actuarial present value of such payments. This valuation method reflects the present value of estimated tuition benefits that will be paid in future years, the present value of estimated contract payments that will be received from installment contract purchasers in future years, and the present value of future payments from the State of Alabama. The net assets available for benefits exclude tuition paid after September 30, 2019.

**Alabama Prepaid Affordable College Tuition Program  
Notes to Financial Statements  
September 30, 2019**

**Note 5 - Future Tuition Benefit Payments and Future Contract Payments (continued)**

The funded status of the PACT Trust Fund as of the latest actuarial valuation is as follows:

Actuarial Valuation Date	Net Assets Available For Benefits	Actuarial Value of Future Contract Payments Less Expenses	Actuarial Value of Future State Payments	Total Assets	Actuarial Present Value of Future Tuition Benefit Payments	Assets in Excess of Tuition Benefit Payments	Assets as a Percentage of Tuition Benefit Payments
September 30, 2019	\$ 97,564,083	\$ (1,309,812)	\$ 269,644,592	\$ 365,898,863	\$ 312,940,496	\$ 52,958,367	116.9%

The schedules of funding progress, presented as required supplementary information (RSI) following the notes to financial statements, present multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liability.

The significant actuarial assumptions from the most recent valuation as of September 30, 2019 are as follows:

**Assumptions**

Investment Return Rate

<u>Fiscal Year Ending</u>	<u>Expected Rates of Return</u>
2020	1.00%
2021	1.00%
2022 - 2023	0.00%
2024	0.40%
2025	1.10%
2026	1.70%
2027	2.50%
2028	2.50%

Matriculation Schedule

<u>College Type</u>	<u>Percent Enrolled</u>
Private out-of-state	17.00%
Community College	15.00%
University of Alabama and Auburn University	53.00%
Other Alabama Universities	15.00%
Total	<u>100.00%</u>

Additional assumption: Beneficiaries who enroll in a community college will transfer to a four year university after two years.

The expected tuition and qualified fees to be paid were based on the published Fall 2010 tuition and fees increased 3% effective for the Fall of 2015 payments, 6% effective for the Fall of 2016 payments, 8% effective for the Fall of 2017 payments, 7% effective for the Fall of 2018, and 7% effective for the Fall of 2019 payments, compounded.

**Alabama Prepaid Affordable College Tuition Program  
Notes to Financial Statements  
September 30, 2019**

Contract cancellations: The actuarial valuation recognizes cancellations in accordance with the following schedule:

Age 0 through 9th grade	0% per year
10th grade	1%
11th grade	1%
12th grade	1%

Additionally, actuarial assumptions assume that beneficiaries who matriculate will utilize 128 hours out of the maximum of either 128 or 135 hours of contract benefits. It is assumed that each beneficiary will use 13 hours of contract benefit per semester for the first eight semesters and 11 hours of contract benefits in the ninth semester starting after the completion of the 12<sup>th</sup> grade.

Payment of tuition and qualified fees is assumed to occur three times annually: 45% on November 15<sup>th</sup>, 45% on March 15<sup>th</sup>, and 10% on August 15<sup>th</sup>.

For the 2019 actuarial valuation, a load of \$600,000 was included for administrative fees for future fiscal years through 2027. From 2028 to 2031 it is lowered \$100,000 per year.

The actuarial value of future contracts and state payments amount is anticipated to include approximately \$302 million of contributions from the Alabama Education Trust Fund. These contributions increased the present value of assets by \$270 million. These contributions range in various amounts beginning in 2020 through 2027 from \$31.9 million to \$60.7 million annually as follows:

<u>Fiscal Year Ending</u>	<u>Amount (in \$1,000's)</u>
2020	\$ 60,700
2021	31,900
2022	32,200
2023	33,500
2024	33,700
2025	38,400
2026	39,200
2027	32,500
Total	<u>\$ 302,100</u>

The trust funded ratio decreased from 120.5% in 2018 to 116.9% in 2019. The decrease was primarily due to the 7% increase in tuition and fee payments which reduced the actuarial surplus.

**Note 6 - Subsequent Events**

The PACT Program has evaluated subsequent events through February 7, 2020, which is the date these financial statements were available to be issued. All subsequent events requiring recognition as of September 30, 2019 have been incorporated into these financial statements.

**Alabama Prepaid Affordable College Tuition Program  
Required Supplementary Information  
Schedule of Funding Progress  
September 30, 2019**

Schedule of Funding Progress for the PACT Program through September 30, 2019 is as follows:

<b>Actuarial Valuation Date</b>	<b>Net Assets Available for Benefits</b>	<b>Actuarial Value of Future Contract Payments Less Expenses</b>	<b>Actuarial Value of Future State Payments</b>	<b>Total Assets</b>	<b>Actuarial Present Value of Future Tuition Benefit Payments</b>	<b>Assets in Excess (Deficit) of Tuition Benefit Payments</b>	<b>Assets as a Percentage of Tuition Benefit Payments</b>
September 30, 2006	\$ 691,595,188	\$ 54,404,134		\$ 745,999,322	\$ 806,535,334	\$ (60,536,012)	92.5%
September 30, 2007	763,858,689	53,309,201		817,167,890	836,909,570	(19,741,680)	97.6%
September 30, 2008	573,172,751	53,653,081		626,825,832	933,072,323	(306,246,491)	67.2%
September 30, 2009	526,132,496	45,050,792		571,183,288	916,849,385	(345,666,097)	62.3%
September 30, 2010	487,290,978	29,994,071	\$ 407,364,072	924,649,121	1,193,400,922	(268,751,801)	77.5%
September 30, 2011	416,417,090	12,875,192	456,764,049	886,056,331	866,180,215	19,876,116	102.3%
September 30, 2012	312,501,886	(8,947,203)	479,374,334	782,929,017	1,388,440,353	(605,511,336)	56.4%
September 30, 2013	233,795,658	2,169,881	485,606,200	721,571,739	655,095,894	66,475,845	110.1%
September 30, 2014	175,783,822	1,035,457	488,464,061	665,283,340	586,681,208	78,602,132	113.4%
September 30, 2015	121,034,200	1,643,003	475,753,759	598,430,962	515,580,416	82,850,546	116.1%
September 30, 2016	89,577,934	(102,863)	450,917,767	540,392,838	472,230,478	68,162,360	114.4%
September 30, 2017	90,881,156	(1,057,288)	373,712,526	463,536,394	400,614,126	62,922,268	115.7%
September 30, 2018	99,190,043	251,280	322,237,628	421,678,951	349,833,875	71,845,076	120.5%
September 30, 2019	97,564,083	(1,309,812)	269,644,592	365,898,863	312,940,496	52,958,367	116.9%

**Alabama Prepaid Affordable College Tuition Program**  
**Combining Schedule of Fiduciary Net Position**  
**September 30, 2019**

	<u>Trust Fund</u>	<u>Administrative Fund</u>	<u>Total</u>
<b>Assets</b>			
Cash and cash equivalents	\$ 32,868,561	\$ 398,740	\$ 33,267,301
Interest receivable	333,868		333,868
Investments	64,312,657		64,312,657
Total assets	<u>97,515,086</u>	<u>398,740</u>	<u>97,913,826</u>
<b>Liabilities</b>			
Accounts payable	15,887,540		15,887,540
Accrued liabilities		45,688	45,688
Total liabilities	<u>15,887,540</u>	<u>45,688</u>	<u>15,933,228</u>
<b>Net Position</b>			
Held in trust for tuition payments and other purposes	<u>\$ 81,627,546</u>	<u>\$ 353,052</u>	<u>\$ 81,980,598</u>

**Alabama Prepaid Affordable College Tuition Program**  
**Combining Schedule of Changes in Fiduciary Net Position**  
**September 30, 2019**

	<u>Trust Fund</u>	<u>Administrative Fund</u>	<u>Total</u>
<b>Additions</b>			
Contract income	\$ 706,954		\$ 706,954
Investment income			
Interest and dividend income	2,036,950		2,036,950
Loss on investments	<u>1,351,972</u>		<u>1,351,972</u>
Net investment income	<u>3,388,922</u>		<u>3,388,922</u>
Other income		\$ 135,160	135,160
Transfers from other funds	<u>61,539,000</u>		<u>61,539,000</u>
Total additions	<u>65,634,876</u>	<u>135,160</u>	<u>65,770,036</u>
<b>Deductions</b>			
Tuition benefits	56,625,651		56,625,651
Salaries and other			
Administrative expenses		285,498	285,498
Professional services		169,070	169,070
Cancellation refunds	<u>3,254,451</u>		<u>3,254,451</u>
Total deductions	<u>59,880,102</u>	<u>454,568</u>	<u>60,334,670</u>
<b>Change in Net Position</b>	5,754,774	(319,408)	5,435,366
<b>Net Position at Beginning of Year</b>	<u>75,872,772</u>	<u>672,460</u>	<u>76,545,232</u>
<b>Net Position at End of Year</b>	<u>\$ 81,627,546</u>	<u>\$ 353,052</u>	<u>\$ 81,980,598</u>

**Independent Auditor's 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**

The Board of Trustees  
Alabama Prepaid Affordable College Tuition Program  
Montgomery, Alabama

We have audited in accordance with the 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 Alabama Prepaid Affordable College Tuition Program (the PACT Program), which comprise the statement of fiduciary net position as of September 30, 2019, and the related statement of changes in fiduciary net position, and the related notes to financial statements, and have issued our report thereon dated February 7, 2020.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the PACT Program's internal control over financial reporting 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 PACT Program's internal control. Accordingly, we do not express an opinion on the effectiveness of the PACT 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 and was not designed to identify all deficiencies in internal control that might be material weaknesses. 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 PACT 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 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.

*Jackson Thornton & Co. PC*

Prattville, Alabama  
February 7, 2020