

**Annual Report
of the
Alabama Prepaid Affordable
College Tuition (PACT) Program**



March 10, 2011

*Submitted by the Office of the State Treasurer in
accordance with Act 2010-725*

**Annual Report of the
Alabama Prepaid Affordable College Tuition (PACT) Program
March 10, 2011**

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YOUNG BOOZER
TREASURER

GLENDA ALLRED
Deputy Treasurer

DARIA STORY
Assistant Treasurer

March 10, 2011

TO: Governor Robert Bentley
Lieutenant Governor Kay Ivey
Speaker Mike Hubbard

RE: **Annual Report of PACT**

According to the most recent actuarial report dated December 31, 2010, the PACT Program will need more money.

The program was started in 1990 and was designed by the legislature as a defined benefit plan. Over the most recent few years, assets have grown at a rate much lower than forecasted and liabilities have increased at a rate much greater than expected. Today, projected obligations far exceed the assets necessary to meet those obligations.

In 2010 the Legislature passed Act No. 2010-725. It provided for appropriations from FY2015 to FY2028 in the total amount of \$548 million. It was the sum, as then projected, that would be sufficient to fully fund PACT.

Since the time the law was enacted, tuition increased significantly in the two major university systems. Auburn and Alabama account for 57% of all PACT students and 64% of all PACT tuition payments. In addition, their annual tuition increases are not limited.

At December 31, 2010, the PACT Program had \$460 million in investments. It is invested conservatively with an asset allocation of 80% fixed income securities and 20% equity securities. Given the forecasted tuition payments, it is predicted that the portfolio will be fully liquidated in or about FY2015.

In August 2010, the PACT Board modified the earnings and tuition rate assumptions in the plan's actuarial report to reflect current economic and market trends. Those changes resulted in an underfunded position of \$338 million at December 31, 2010.

The PACT Program is thus actuarially unsound.

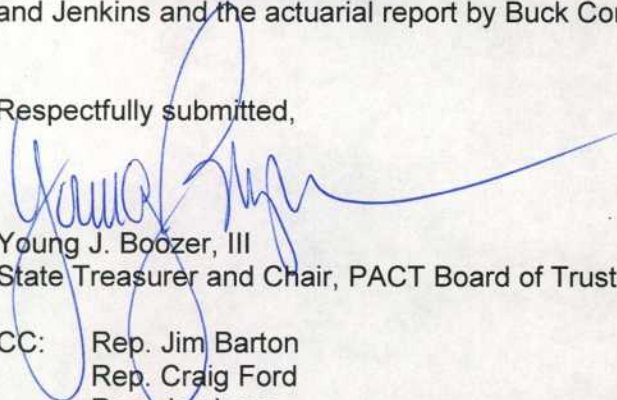
Based on this result, the legislature will need to make provisions to appropriate approximately \$437 million more to PACT. This amount combined with the previously identified balance of \$548 million will bring the anticipated monies for funding the plan to a total of approximately \$985 million.

At the February 2011 board meeting, the Chair provided a presentation to the Trustees. It consisted of charts showing where the Program has been, where it is now and where it is going. The updated presentation is included as a part of this report and the following bullet points describe the charts used in the discussion.

- **Chart 1** shows the fully funded status of PACT at June 2010.
- **Chart 2** itemizes the primary differences in assumptions between the June 2010 and the December 2010 actuarial reports.
- **Chart 3** indicates the distribution of PACT students and the institutions they attend.
- **Chart 4** shows the significant negative effect of the updated assumptions resulting in the \$338MM underfunded position.
- **Chart 5** quantifies and displays the approved (\$548MM) and future (\$437MM) cash flow needs of the program which total \$985MM.
- **Chart 6** focuses on the period from FY11 to FY16 when total assets are projected to go to zero and cash flows from ETF payments are not enough to meet tuition payments.
- **Chart 7** displays the "Point of No Return" which is the point when there would not be enough money in the program to fully refund the investment of all contract holders.

Act No. 2010-725 requires that the PACT Program prepare an annual report, including details regarding the actuarial soundness of the program, and transmit such report to the Governor, Lieutenant Governor and the Speaker of the House of Representatives. This memorandum and the attached reports consisting of the charts, the annual audit of the PACT Program by Mauldin and Jenkins and the actuarial report by Buck Consultants constitute the required annual report.

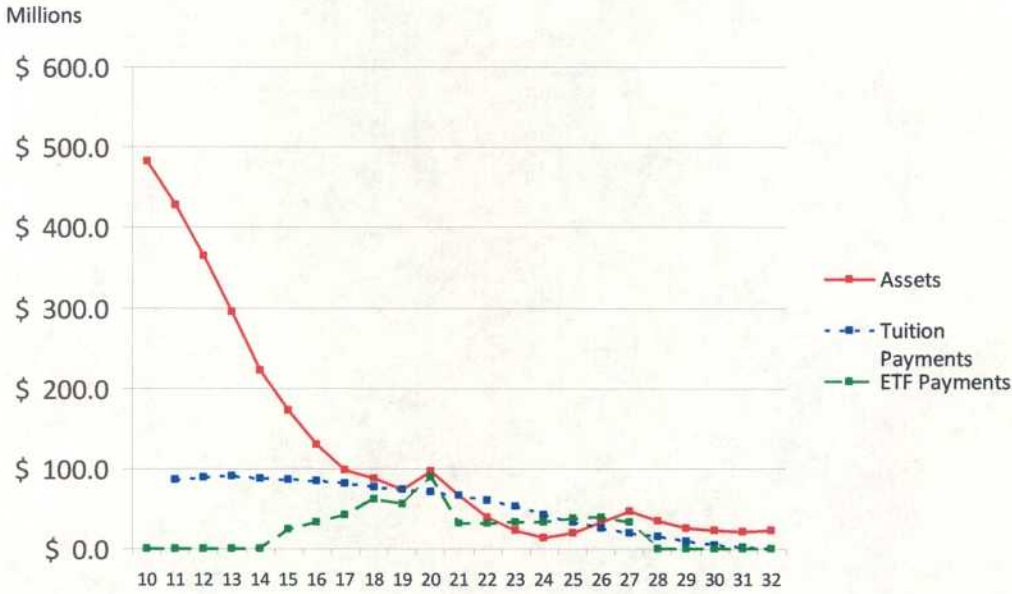
Respectfully submitted,



Young J. Boozer, III
State Treasurer and Chair, PACT Board of Trustees

CC: Rep. Jim Barton
Rep. Craig Ford
Rep. Jay Love
President Pro tem Del Marsh
Sen. Roger Bedford
Sen. Arthur Orr

PACT Actuarial Status June 2010 – Fully Funded



June 2010 vs. December 2010 Assumptions

	<u>June</u>	<u>December</u>
Investment Return	5.0%	3.0%*
Tuition: AU/UA	7.5%*	8.3%*
Tuition: Out-of-State/Private	2.5%*	6.5%*
Tuition: Regional/Community	2.5%	2.5%**
Funding: Education Trust Fund	\$547.6 million	\$547.6 million
Funding: Additional Monies Needed	\$0	\$338 million
Actuarial Funded Status	100.9%	72.6%

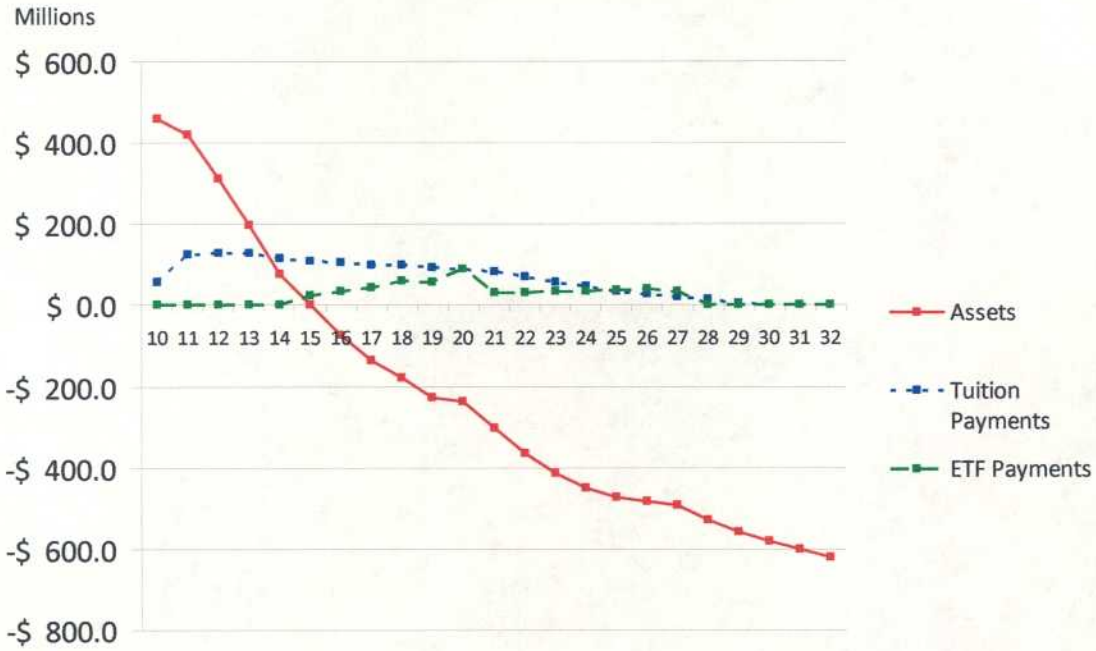
*Average over life of program

** Statute allows an annual 2.5% increase, IF the funding status is 90% or higher. The December 2010 actuarial report shows a funding status of 72.6%. Given the existing assumptions it is unlikely to ever exceed 90%. The regional institutions received a 2.5% tuition increase for Fall 2010 which may be the last one received over the life of PACT.

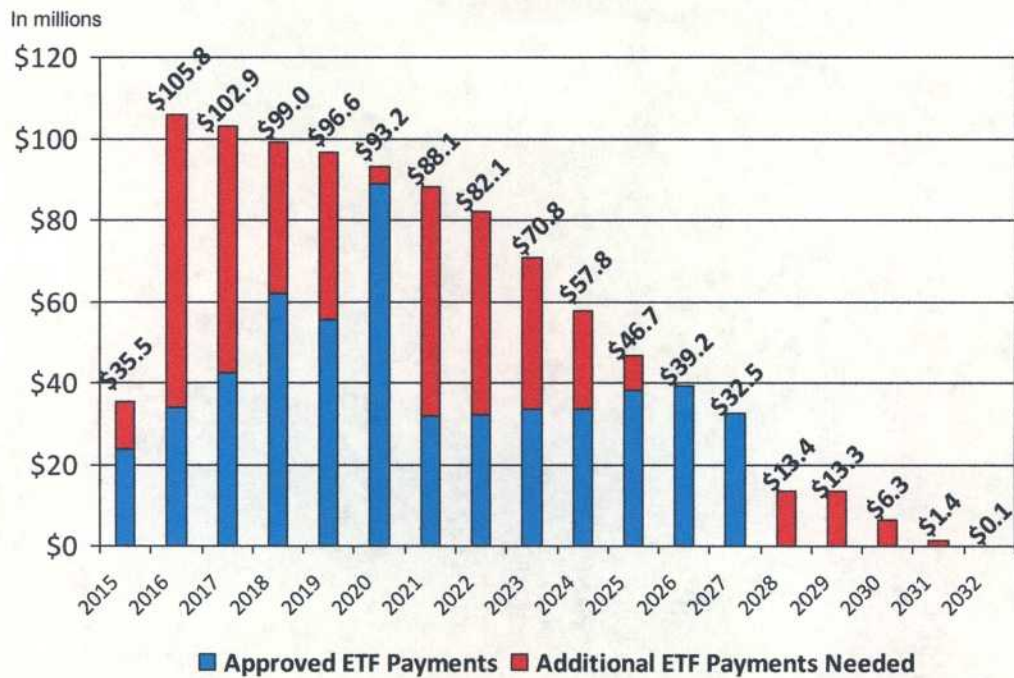
PACT Student Distribution Fall 2010

Universities/Colleges	# of Students	% of Students
Auburn	3,094	
AUM	401	
Total Auburn	3,495	22.17%
Alabama	3,455	
UAB	915	
UAH	417	
Total Alabama	4,787	30.37%
Alabama A&M	48	0.30%
West Alabama	49	0.31%
South Alabama	593	3.76%
Alabama State	44	0.28%
Troy	620	3.93%
North Alabama	357	2.27%
Jacksonville State	337	2.14%
Montevallo	316	2.00%
Out of State	1,994	12.65%
Private	774	4.91%
Two-Year	2,347	14.89%
Total All Schools	15,761	100.00%
Summary		
AU/UA Systems	8,282	52.55%
Regionals	2,364	15.00%
OOS/Private	2,768	17.56%
Two-Year	2,347	14.89%
Total All Schools	15,761	100.00%

PACT Actuarial Status December 31, 2010



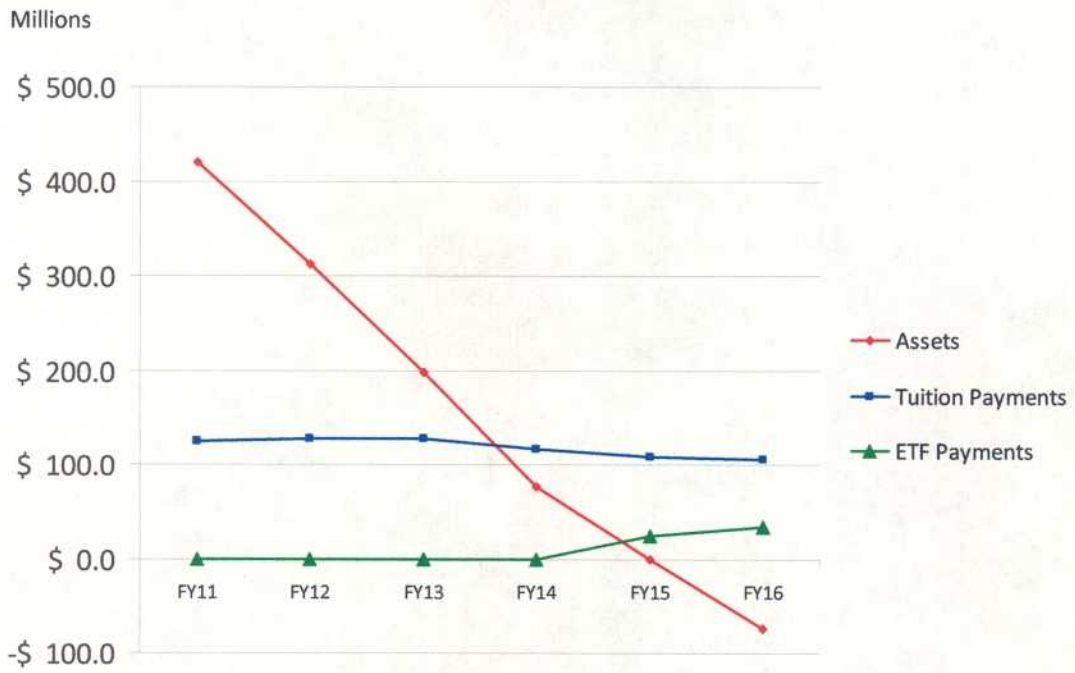
Total ETF Payments Needed to Fully Fund PACT



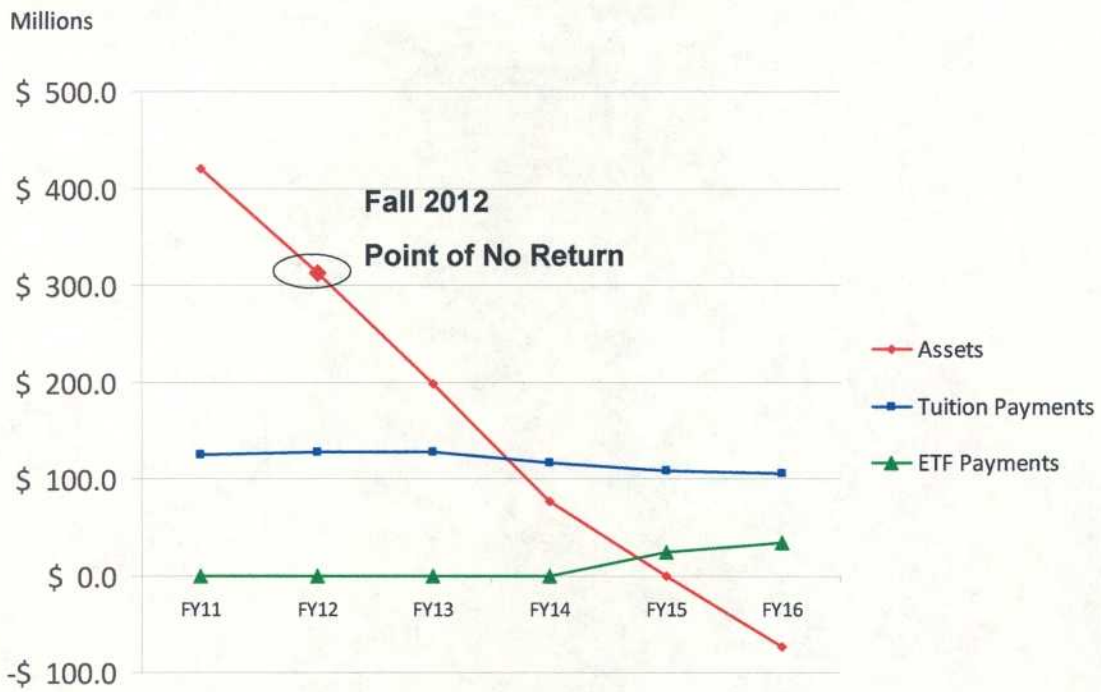
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as of December 31, 2010							
In millions	Benefit	Contract		ETF	Additional		Total
Fiscal Year	Payments	Holder	Income	Payments	ETF	EOY	ETF
		Payments		Act 2010-725	Payments	Assets	Payments
2015	-116.1	3.3	0.5	23.6	11.9	0.0	35.5
2016	-108.7	2.9	0.0	34.0	71.8	0.0	105.8
2017	-105.3	2.4	0.0	42.6	60.3	0.0	102.9
2018	-100.9	1.9	0.0	61.8	37.2	0.0	99.0
2019	-98.1	1.5	0.0	55.5	41.1	0.0	96.6
2020	-94.4	1.2	0.0	88.7	4.5	0.0	93.2
2021	-89.0	0.9	0.0	31.9	56.2	0.0	88.1
2022	-82.7	0.6	0.0	32.2	49.9	0.0	82.1
2023	-71.2	0.4	0.0	33.5	37.3	0.0	70.8
2024	-58.0	0.2	0.0	33.7	24.1	0.0	57.8
2025	-46.8	0.1	0.0	38.4	8.3	0.0	46.7
2026	-35.6	0.0	0.0	39.2	0.0	3.6	39.2
2027	-28.4	0.0	0.0	32.5	0.0	7.7	32.5
2028	-21.1	0.0	0.0	0.0	13.4	0.0	13.4
2029	-13.3	0.0	0.0	0.0	13.3	0.0	13.3
2030	-6.3	0.0	0.0	0.0	6.3	0.0	6.3
2031	-1.4	0.0	0.0	0.0	1.4	0.0	1.4
2032	-0.1	0.0	0.0	0.0	0.1	0.0	0.1
Total	-\$ 1,514.2	\$ 41.1	\$ 0.5	\$ 547.6	\$ 437.1		\$ 984.7

PACT Actuarial Status
December 31, 2010
FY11 – FY16



PACT Actuarial Status
December 31, 2010
FY11 – FY16



buckconsultants

A Xerox Company

Alabama PACT

12/31/2010 Quarterly Valuation

February 2011

buckconsultants

February 2011

Alabama PACT Board

Buck Consultants, LLC (Buck) was retained to report on the funding status and projected cash flows of the PACT as of December 31, 2010. Since this is a quarterly valuation, there is less detail provided than in the full valuation which will be done as of September 30, 2011. The Summary of Funding section on page 3 describes the current results and compares those results to the September 30, 2010 valuation.

Data Used

This valuation was performed using contract data supplied by the Plan Administrator as of December 31, 2010 and financial data reported to you as of December 31, 2010. Buck did not audit the data although they were reviewed for reasonableness and consistency with the September 30, 2010 information. The results of the valuation are dependent on the accuracy of the data. As of December 31, 2010 there are 42,733 active contracts as compared to the 43,262 active contracts on September 30, 2010.

Assumptions and Methods

The WAT for Private and Out-of-State schools was changed to \$6,680 compared to the WAT of \$6,076 used in the September 30, 2010 valuation. The reason for the change was a recent legal opinion that the calculation of the WAT must include Auburn University and University of Alabama.

The tuition inflation trend was also changed for Private and Out-of-State schools to reflect this change in the method of calculating the WAT as shown in the following table:

Fiscal Year Ending	Tuition Inflation	
	12/31/2010 Quarterly Valuation	9/30/2010 Valuation
2011	8.80%	0.00%
2012	8.42%	0.00%
2013	7.97%	0.00%
2014	7.46%	0.07%
2015	6.90%	2.50%
2016	6.30%	2.50%
2017	6.01%	2.50%
2018	6.06%	2.50%
2019	6.11%	2.50%
2020	6.15%	2.50%

All other assumptions and methods are those used in the September 30, 2010 valuation.

Similar to the September 30, 2010 valuation, we continue to assume the following Funding Schedule of contributions from the Education Trust Fund into the PACT Trust Fund, payable throughout the year:

- April 2015 – 23,558,000
- April 2016 – 33,952,000
- April 2017 – 42,622,000
- April 2018 – 61,783,000
- April 2019 – 55,539,000
- April 2020 – 88,738,300
- April 2021 – 31,881,600
- April 2022 – 32,181,600
- April 2023 – 33,494,400
- April 2024 – 33,728,700
- April 2025 – 38,449,500
- April 2026 – 39,201,000
- April 2027 – 32,500,000

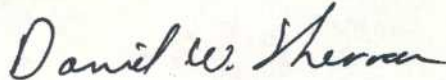
Purpose of This Report

This report is prepared for The State of Alabama PACT Board. It is expected that this report will be used to monitor the funding status and projected cash flows of the PACT. Use of this report for any other purpose may not be appropriate and may result in mistaken conclusions due to failure to understand applicable assumptions, methodologies, or inapplicability of the report for that purpose. No one may make any representations or warranties based on any statements or conclusions contained in this report without the written consent of Buck.

Qualifications

Daniel Sherman is an Associate of the Society of Actuaries, and a Member of the American Academy of Actuaries. He served as the actuary to the Alabama PACT plan for ten years, and is the current actuary for the Texas prepaid tuition programs. He meets the Qualification Standards of the Academy to render the actuarial opinions contained herein. This report has been prepared in accordance with all applicable Actuarial Standards of Practice, and we are available to answer questions concerning it.

BUCK CONSULTANTS, LLC



Daniel Sherman, ASA, MAAA, EA
Director and Consulting Actuary

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Summary of Funding

The table below is a summary of the results showing the total costs to the State of Alabama to maintain the program as of December 31, 2010.

	9/30/2010 Valuation	12/31/2010 Quarterly Results
Assets		
a. Market Value of Assets	487,290,978	459,660,668
b. Present Value of future contract purchaser payments	29,994,071	27,930,445
c. Present Value of Education Trust Fund payments	407,364,072	409,766,551
d. Subtotal (a + b + c)	924,649,121	897,357,664
Liabilities		
e. Present Value of tuition and cancellation payments	1,193,400,922	1,235,881,695
Funded Status		
f. Reserve as of December 31, 2010 (d – e)	-268,751,801	-338,524,031
g. Funded Ratio	77.5%	72.6%

INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees
Alabama Prepaid Affordable College Tuition Program
Montgomery, Alabama

We have audited the accompanying statement of fiduciary net assets 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, as of and for the year ended September 30, 2010 and the related statement of changes in fiduciary net assets for the year then ended. These financial statements are the responsibility of the Alabama Prepaid Affordable College Tuition Program. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the Alabama Prepaid Affordable College Tuition Program as of September 30, 2010 and the changes in net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 14, 2011, on our consideration of the Alabama Prepaid Affordable College Tuition 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 6 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Alabama Prepaid Affordable College Tuition Program. The supplementary information on pages 20 and 21 is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Alabama Prepaid Affordable College Tuition Program. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

Mauldin & Jenkins, LLC

Macon, Georgia
February 14, 2011

ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

MANAGEMENT'S DISCUSSION AND ANALYSIS SEPTEMBER 30, 2010

The following 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, 2010, and highlight events that occurred during the year.

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 \$486,827,711 and \$610,342,331 as of September 30, 2010 and 2009, respectively. The decrease of \$123,514,620 was a result of asset liquidations to pay tuition benefits and the reduction of securities lending collateral due to the elimination of the securities lending program.

The composition of the PACT Program's investment securities portfolio reflects the PACT Program Board's investment strategy of preserving capital by minimizing the probability of loss of principal over the investment horizon, while maintaining an appropriate level of liquidity to meet tuition benefit obligations. The asset allocation as of September 30, 2010 is comprised of 14% domestic equity, 6% international equity, and 80% domestic fixed income. Asset rebalancing of the investment portfolios occurs as markets fluctuate.

To minimize the risk associated with the dependence on the success of one enterprise, the PACT Program Board, through the competitive Request for Proposals process, selects managers to invest plan assets. During fiscal year 2010, Requests for Proposals were issued for a domestic core indexed equity manager and a domestic intermediate fixed income manager. Two domestic intermediate fixed income managers and one domestic core indexed equity manager were hired. A Request for Proposal was also issued for the trust fund custodian and the current provider was retained.

The Board retains an investment consultant to evaluate, monitor and report on the investment portfolio and investment manager returns, to provide risk/return assumptions on investments, to recommend diversification, and to monitor compliance with the adopted investment policy. During the year, the Board had extensive discussions with the consultant concerning manager performance and asset allocation. An Asset Allocation study was conducted and discussed with the PACT Program Board at the August 26, 2010 board meeting and resulted in a change in the asset allocation.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following table represents the PACT Program's investment portfolio, asset allocation, and corresponding annual rates of return as of September 30, 2010. Cash and cash equivalents are excluded.

<u>ASSET CATEGORY</u>	<u>MARKET VALUE</u>	<u>PERCENT</u>	<u>ANNUAL RETURN (NET OF FEES)</u>
Fixed income	\$ 339,511,454	75.11%	8.74%
Domestic equity	75,943,287	16.80%	10.10%
International equity	28,980,566	6.41%	8.11%
Commingled Bond Fund	7,567,025	1.68%	0.10%

The following table represents the PACT Program's investment portfolio, asset allocation and corresponding annual rates of return as of September 30, 2009. Cash and cash equivalents are excluded.

<u>ASSET CATEGORY</u>	<u>MARKET VALUE</u>	<u>PERCENT</u>	<u>ANNUAL RETURN (NET OF FEES)</u>
Fixed income	\$ 144,826,146	28.74%	15.16%
Domestic equity	256,617,890	50.92%	(7.45%)
International equity	102,440,231	20.34%	0.40%

Liabilities

Liabilities of the PACT Program consist of payables and accruals. Liabilities were \$36,173,270 and \$121,332,924 at September 30, 2010 and 2009, respectively. The decrease in liabilities was primarily due to the elimination of the securities lending program and a \$6.2 million decrease in other liabilities. Warrants and accounts payable include fall semester tuition benefits payable of \$36 million and \$31.6 million at September 30, 2010 and 2009, respectively.

Additions

Additions totaled \$56,146,139 and \$20,637,094 for fiscal years ended September 30, 2010 and 2009, respectively. The increase was due to an increase in the fair market value of the investments and the income from investing activities. The securities lending program, which was eliminated, resulted in net income to the PACT of \$106,089 for the fiscal year as compared to \$449,503 for 2009.

Contract payments decreased 65.57%, due to contract cancellations and the continued reduction of monthly payments received on contracts which are not paid in full. Other income, consisting primarily of account maintenance fees and cancellation fees, decreased 32.79%. Account maintenance fees decreased from \$301,000 in 2009 to \$221,000 in 2010 due to the decrease in active accounts of 2,456 from 2009 to 2010. Cancellation fees decreased from \$177,000 in 2009 to \$100,000 due to the decrease in contract cancellations.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Deductions

Deductions totaled \$94,501,105 and \$104,800,438 for fiscal years ending September 30, 2010 and 2009, respectively. Total deductions were reduced from the previous year primarily due to a reduction in cancellation refunds. 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. It is expected this amount will increase for the next few years due to an increase in contracts being eligible for benefit payments and due to college tuition increases. For fiscal year ending 2010, the PACT Program paid \$77.3 million to over 400 colleges and universities across the nation for approximately 15,700 beneficiaries, as compared to \$73.2 million paid in fiscal year ending 2009 for 15,500 beneficiaries.

Professional service expenses decreased approximately 29.32% over 2009. The decrease was largely due to the reduction of trust fund management fees, resulting from a reduction of invested assets.

Summary

For fiscal year ending 2010, the PACT Program had net assets of \$450,654,441. Adding the actuarial present value of future contract payments of \$30 million to net assets and dividing by the actuarial present value of future tuition benefit payments of \$1.2 billion, results in an actuarial funded status of 77.5%. This is an increase from the 2009 actuarial funded status of 62.3%. The increase in the actuarial funded status results from the inclusion of anticipated state funding.

Actuarial assumptions are reviewed and approved by the Board annually to reflect expected results believed to be realistic based on historical information, economic data and expert guidance. The 2010 Actuarial Report is available at 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.

Act 2010-725 was passed by the Alabama Legislature to provide funding to the PACT Program beginning in fiscal year 2015, and to establish a new PACT Program Board.

Litigation Report

The case of *Perdue v. Callan Associates, Inc.*, and the PACT Program Board was pending as of September 30, 2010; however, it was subsequently settled on February 4, 2011. The settlement was approved by the Circuit Court of Montgomery County, Alabama. The case was settled without any loss of PACT Program funds. The Supreme Court dismissed the Mandamus proceeding pending there.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The case of McVeigh and Whitten v. Callan Associates, Inc. and each of the investment managers is pending in the United States District Court, Northern District, Southern Division. Neither the Treasurer nor the PACT Board members are named. The Court has stayed action on this matter pending the outcome of the Alabama Supreme Court in the Perdue matter above.

The Green case was filed on January 6, 2010, and remains pending. This case is pending in Montgomery County, Alabama, Case Number CV-900013. The defendants are the PACT Board members. This suit seeks damages and a declaratory judgment, and formation of two class actions. PACT filed an Answer and Counterclaim in this proceeding. The trial judge has issued a Class Certification order to establish two classes: one for contract holders prior to 2001 and two for contract holders after 2001. Discovery is in process and several depositions have been taken.

Requests for Information

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

ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

STATEMENT OF FIDUCIARY NET ASSETS SEPTEMBER 30, 2010

ASSETS	
Cash and cash equivalents	\$ 31,853,275
Interest receivable	2,616,488
Foreign taxes receivable	355,616
Investments	<u>452,002,332</u>
Total assets	<u>486,827,711</u>
LIABILITIES	
Warrants and accounts payable	36,103,198
Accrued liabilities	<u>70,072</u>
Total liabilities	<u>36,173,270</u>
NET ASSETS	
Held in trust for tuition benefit payments and other purposes	<u>\$ 450,654,441</u>

See Notes to Financial Statements.

ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS SEPTEMBER 30, 2010

ADDITIONS (REDUCTIONS)	
Contract payments	\$ 8,235,828
Income from investment activities:	
From investing activities:	
Interest and dividend income	15,169,177
Net appreciation in fair value of investments	32,097,527
Net investment income from investing activities	<u>47,266,704</u>
From securities lending:	
Securities lending income	153,626
Less: securities lending expenses	
Borrower rebates	(45,211)
Management fees	(2,326)
Total securities lending expenses	<u>(47,537)</u>
Net income from securities lending activities	<u>106,089</u>
Total income from investment activities	<u>47,372,793</u>
Other income	537,518
Total additions	<u>56,146,139</u>
DEDUCTIONS	
Tuition benefits	77,315,665
Salaries and other administrative expenses	297,513
Professional services	1,954,686
Cancellation refunds	14,933,241
Total deductions	<u>94,501,105</u>
Change in net assets	<u>(38,354,966)</u>
Net assets, beginning	<u>489,009,407</u>
Net assets, ending	<u>\$ 450,654,441</u>

See Notes to Financial Statements.

ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

NOTES TO FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of the PACT Program:

The Alabama Prepaid Affordable College Tuition 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 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 and Treasurer of the State of Alabama; the executive director of the Alabama Commission on Higher Education; 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 provides, in return for a specified actuarially determined payment, a child's undergraduate tuition and mandatory fees at any Alabama public university or community college. For beneficiaries that choose to attend private or out-of-state institutions, the PACT Program will provide tuition payments at the current weighted average cost of tuition at Alabama public four-year institutions. The purchase amount is based on several factors, including tuition costs, the beneficiary's age and grade in school, anticipated investment earnings, and anticipated tuition rate increases. Enrollment to new participants is currently closed.

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.

NOTES TO FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus and Basis of Accounting:

The PACT Program's financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board. These statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are 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 issue to be cash equivalents. Cash and cash equivalents consist of bank deposits, amounts invested in repurchase agreements, money market mutual funds and securities rated A-1 by Moody's, P1 by Standard & Poor's or better by a recognized credit rating service.

Investments:

All plan investments are stated at fair value in the Statement of Fiduciary Net Assets and are managed by third-party money managers. All investment income, including changes in fair value, is reported as additions (reductions) in the Statement of Changes in Fiduciary Net Assets. 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 trustee on the trade date. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

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 recorded for the year ended September 30, 2010, nor 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 the period. Actual results could differ from those estimates.

NOTES TO FINANCIAL STATEMENTS

NOTE 2. CASH AND INVESTMENTS

Cash and cash equivalents at September 30, 2010 consist of the following:

<u>Account Type</u>	<u>Fair Value</u>
Money market mutual funds	\$ 28,183,906
Repurchase agreements	3,669,369
	<u>\$ 31,853,275</u>

As of September 30, 2010, the PACT Program had four money managers to invest plan assets. The PACT Program has an investment consultant who assists the Board of Directors in monitoring compliance with the PACT Program's investment policy and monitoring performance of the money managers.

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

Deposits – Custodial Credit Risk – The PACT Program maintains its cash in bank deposit accounts, which at times exceed federally insured limits. The PACT Program has not experienced any losses in such accounts. The PACT Program believes it is not exposed to any *significant credit risk*.

Investments – Interest Rate Risk – The fair value of fixed-maturity investments fluctuate 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.

Investments – 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 trustee, not in the name of the PACT Program.

NOTES TO FINANCIAL STATEMENTS

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

Foreign Currency Risk – For an investment, foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. In order for an international equity security to be eligible for purchase by the PACT Program, the issuing company must have an available operating history of at least three years, and have a market capitalization of at least \$100 million at the time of purchase.

Concentration of Credit Risk – The investment policies limit the aggregate amount that can be invested in each class of investments and provides further limitations on investments by individual money managers. The policy limits are as follows:

- Cash
 - Limited to 7% of the market value of the aggregate portfolio, plus or minus 3%.
- Domestic Fixed Income
 - Limited to 73% of the market value of the aggregate portfolio, plus or minus 8%. With the exception of those situations involving reorganization of fund assets, debt investments should only be made in issues with an outstanding value of at least \$50 million, valued at part, at the time of purchase.
 - On an individual money manager basis, no more than 5% of the total market value of all debt instruments should be invested in the debt obligations of any one issuer, with the exception of securities issued and collateralized by the United States Government, or its agencies, which may be held without limitation. Holdings of any individual issue must be 5% or less of the outstanding value of the total issue.
- Domestic Equity
 - Limited to 14% of the market value of the aggregate portfolio, plus or minus 3%.
 - The PACT Program's investment policy states that equity holdings will be restricted to readily marketable securities of corporations that are actively traded on major exchanges including the NASDAQ in the United States. Equity holdings may include American Depositary Receipts traded on U.S. exchanges. Preferred and convertible preferred stocks may be held.
 - On an individual money manager basis, no more than 5% of the total stock portfolio may be invested in the common stock of any one corporation at the time of purchase, and no more than 7% in any one corporation at fair market value. No more than 5% of the outstanding shares of any one company may be held. No more than the lesser of these times the sector weight in the index and 40% valued at market may be held in any one economic sector.

NOTES TO FINANCIAL STATEMENTS

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

Concentration of Credit Risk (Continued)

- International Equity
 - Limited to 6% of the market value of the aggregate portfolio, plus or minus 3%. Equity holdings may include American Depository Receipts and Global Depository Receipts traded on U.S. exchanges or major exchanges in countries outside the United States. Convertible and non-convertible preferred stocks may be held. The policy is to invest in equity securities of issuers with an available operating history of at least three years, and a market capitalization of at least \$100 million at the time of purchase.
 - On an individual money manager basis, no more than 5% of the total stock portfolio may be invested in the common stock of any one corporation at the time of purchase, and no more than 7% in any one corporation at fair market value. Furthermore, no more than 5% of the outstanding shares of any one company may be held. No more than the lesser of two times the sector weight in the index and 40% valued at market may be held in any one economic sector weight in the index and 4% valued at market may be held in any one economic sector as defined by Morgan Stanley Capital International, Inc. Exposure to emerging markets securities shall be limited to 20% of the market value of the portfolio.

On September 30, 2010, the PACT Program did not have debt or equity investments in any one organization which represented greater than 5% of plan net assets.

The following table provides information as of September 30, 2010, concerning the fair value of investments, interest rate risk, and foreign currency risk:

Type of Investment	Investments				Total Fair Value
	Investment Maturities at Fair Value (In Years)				
	Less Than 1	1 - 5	6 - 10	More Than 10	
<i>Fixed Maturity</i>					
<i>Domestic:</i>					
U.S. Government guaranteed	\$ -	\$ 91,283,334	\$ 60,008,376	\$ 5,066,636	\$ 156,358,346
U.S. Agency Securities	16,002,777	5,998,310	4,828,763	2,505,463	29,335,313
State and local government	-	-	-	202,147	202,147
Mortgage backed securities	-	3,331,757	4,800,577	59,932,527	68,064,861
Corporate bonds	1,929,464	37,729,618	34,008,491	9,692,747	83,360,320
Total domestic fixed maturity	<u>17,932,241</u>	<u>138,343,019</u>	<u>103,646,207</u>	<u>77,399,520</u>	<u>337,320,987</u>
<i>International:</i>					
Russia	-	1,942,032	29,744	218,691	2,190,467
Total international fixed maturity	-	<u>1,942,032</u>	<u>29,744</u>	<u>218,691</u>	<u>2,190,467</u>
Total fixed maturity	<u>\$ 17,932,241</u>	<u>\$ 140,285,051</u>	<u>\$ 103,675,951</u>	<u>\$ 77,618,211</u>	<u>\$ 339,511,454</u>

NOTES TO FINANCIAL STATEMENTS

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

Investments (Continued)

Type of Investment	Total Fair Value
<i>Equities</i>	
Domestic	\$ 75,943,287
International:	
Australia	1,457,762
Belgium	185,995
Canada	2,058,209
China	629,131
Denmark	743,823
Finland	494,651
France	1,796,260
Germany	2,993,583
Israel	366,726
Italy	517,210
Japan	4,888,733
Netherlands	838,363
Norway	848,464
Portugal	269,721
Singapore	587,969
Spain	527,472
Sweden	1,242,998
Switzerland	2,498,668
United Kingdom	6,034,828
Total international equities	28,980,566
Total equities	104,923,853
Commingled	7,567,025
Total investments	\$ 452,002,332

NOTES TO FINANCIAL STATEMENTS

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

The following table provides information as of September 30, 2010, concerning credit risk:

Moody's Ratings ⁽¹⁾ (Unless Noted)	Fair Value	Total Fixed Maturity Fair Value
Aaa	\$ 249,257,885	73.417 %
AAA (SP)	1,434,654	0.423
Aa1	2,952,353	0.870
Aa2	8,391,037	2.472
Aa3	4,964,909	1.462
A1	11,495,085	3.386
A+ (SP)	64,511	0.019
A2	7,993,847	2.355
A3	10,228,055	3.013
A- (SP)	105,846	0.031
BBB+ (SP)	247,626	0.073
Baa1	9,621,901	2.834
Baa2	10,312,476	3.037
Baa3	3,675,590	1.083
Ba1	2,889,841	0.851
Ba2	1,889,774	0.557
Ba3	2,828,189	0.833
BB- (SP)	45,477	0.013
B1	2,354,480	0.693
B2	928,820	0.274
B3	2,131,676	0.628
B- (SP)	13,214	0.004
C	246,522	0.073
Caa1	1,344,947	0.396
Caa2	321,846	0.095
CCC (SP)	349,768	0.103
Caa3	2,017,214	0.594
Ca	492,755	0.145
Not rated	911,156	0.268
	<u>\$ 339,511,454</u>	<u>100.000 %</u>

⁽¹⁾ Moody's ratings are used when available. Standard & Poor's rating is used when it is available and a Moody rating is not. Standard & Poor's ratings are denoted by (SP).

NOTES TO FINANCIAL STATEMENTS

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

Securities Lending Program – The PACT Program's investment policy approved by the Board of Trustees permitted the PACT Program to enter into securities lending transactions defined as loans of securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. There were no restrictions on the amount of loans that could be made. The PACT Program's custodian, Bank of New York, administered the program and acted as an agent for the PACT Program. Certain securities of the PACT Program were loaned to borrowers approved by the PACT Program. Approved borrowers of securities provided acceptable cash collateral in the form of federal funds or New York Clearing House funds as applicable for a particular loan. The Bank of New York provided loss indemnification to the PACT Program in the event that the borrower did not return the market value of the securities loaned. The PACT Program exited this program in June 2010.

Mortgage-backed Securities – During the year ended September 30, 2010, 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 obliges of the underlying assets reduce the total interest payments to be received. Generally, when interest rates fall, obliges 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, 2010, there were no investments held in forward settling TBA mortgage-backed securities.

NOTES TO FINANCIAL STATEMENTS

NOTE 3. 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 and the present value of estimated contract payments that will be received from installment contract purchasers in future years. The significant actuarial assumptions used and results from the most recent valuation are as follows:

Date of latest actuarial valuation September 30, 2010

Assumptions:

Rate of return on investments:

Fiscal Year Ending	Expected Rates of Return
2011	2.38%
2012	3.00%
2013	3.07%
2014	2.45%
2015+	3.00%

Enrollment of beneficiaries 10% will attend a Community or Technical College for the first two years following their high school graduation.

Matriculation Schedule

<u>College Type</u>	<u>Percent Enrolled</u>
Private/Out-of-State	9.00%
Community College	16.00%
University of Alabama and Auburn University	57.37%
Other Alabama Universities	<u>17.63%</u>
Total	<u>100.00%</u>

Additional assumption: Beneficiaries who enroll in a community college will transfer to a four-year university after two years. Contract beneficiaries are assumed to attend the various colleges and universities in the same proportion as they have historically. Thus, there is no bias load to higher tuition cost institutions.

NOTES TO FINANCIAL STATEMENTS

NOTE 3. FUTURE TUITION BENEFIT PAYMENTS AND FUTURE CONTRACT PAYMENTS (CONTINUED)

Future tuition increases:

Fiscal Year Ending	University of Alabama and Auburn University	Other Alabama 4-year Universities	Community Colleges	Private/ Out-of-State Universities
2011	13.00%	2.50%	2.50%	0.00%
2012	12.00%	2.50%	2.50%	0.00%
2013	11.00%	2.50%	2.50%	0.00%
2014	10.00%	2.50%	2.50%	0.07%
2015	9.00%	2.50%	2.50%	2.50%
2016	8.00%	2.50%	2.50%	2.50%
2017+	7.50%	2.50%	2.50%	2.50%

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 122 hours out of the maximum of either 132 or 135 hours of contract benefits. It is assumed that each beneficiary will use 15 hours of contract benefits per semester for the first eight semesters and two hours of contract benefits in the ninth semester starting after completion of the 12th grade.

Payment of tuition and qualified fees from the PACT Program is assumed to occur three times annually: 45% on November 15th (fall semester), 45% on March 15th (spring semester), and 10% on August 15th (summer semester).

Lastly, the actuarial value of future contract and state payments amount is anticipated to include approximately \$547.6 million of contributions from the Alabama Education Trust Fund. These contributions range in various amounts beginning in 2015 through 2027 from \$23.6 million to \$88.7 million annually.

NOTES TO FINANCIAL STATEMENTS

NOTE 3. FUTURE TUITION BENEFIT PAYMENTS AND FUTURE CONTRACT PAYMENTS (CONTINUED)

Results:

Actuarial present value of future payments expected to be made for tuition, fees and contract cancellations for all contracts sold	\$ 1,193,400,922
Actuarial present value of future payments expected to be received from installment contract purchasers and the state's Education Trust Fund	437,358,143

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress

Actuarial Valuation Date	Net Assets Available for Benefits	Actuarial Value of Future Contract & State Payments	Total Assets	Actuarial Present Value of Future Tuition Benefit Payments	Assets in Excess (Deficit) of Tuition Benefit Payments	Assets as a Percentage of Tuition Benefit Payments
09/30/06	\$ 691,595,188	\$ 54,404,134	\$ 745,999,322	\$ 806,535,334	\$ (60,536,012)	92.5 %
09/30/07	763,858,689	53,309,201	817,167,890	836,909,570	(19,741,680)	97.6
09/30/08	573,172,751	53,653,081	626,825,832	933,072,323	(306,246,491)	67.2
09/30/09	526,132,496	45,050,792	571,183,288	916,849,385	(345,666,097)	62.3
09/30/10	487,290,978	437,358,143	924,649,121	1,193,400,922	(268,751,801)	77.5

SUPPLEMENTARY INFORMATION

ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

COMBINING STATEMENT OF FIDUCIARY NET ASSETS SEPTEMBER 30, 2010

	Trust Fund	Administrative Fund	Total
ASSETS			
Cash and cash equivalents	\$ 31,491,609	\$ 361,666	\$ 31,853,275
Interest receivable	2,616,488	-	2,616,488
Foreign taxes receivable	355,616	-	355,616
Investments	452,002,332	-	452,002,332
Total assets	486,466,045	361,666	486,827,711
LIABILITIES			
Due to (from) other fund	20,909	(20,909)	-
Warrants and accounts payable	35,987,320	115,878	36,103,198
Accrued liabilities	-	70,072	70,072
Total liabilities	36,008,229	165,041	36,173,270
NET ASSETS			
Held in trust for tuition benefit payments and other purposes	\$ 450,457,816	\$ 196,625	\$ 450,654,441

ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

COMBINING STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS SEPTEMBER 30, 2010

	Trust Fund	Administrative Fund	Total
ADDITIONS			
Contract payments	\$ 8,235,828	\$ -	\$ 8,235,828
Investment income:			
From investing activities:			
Interest and dividend income	15,169,177	-	15,169,177
Net appreciation in fair value of investments	32,097,527	-	32,097,527
Net investment income from investing activities	47,266,704	-	47,266,704
From securities lending:			
Securities lending income	153,626	-	153,626
Less: securities lending expenses			
Borrower rebates	(45,211)	-	(45,211)
Management fees	(2,326)	-	(2,326)
Total securities lending expenses	(47,537)	-	(47,537)
Net income from securities lending activities	106,089	-	106,089
Total investment income	47,372,793	-	47,372,793
Other income	-	537,518	537,518
Total additions	55,608,621	537,518	56,146,139
DEDUCTIONS			
Tuition benefits	77,315,665	-	77,315,665
Salaries and other administrative expenses	426	297,087	297,513
Professional services	964,004	990,682	1,954,686
Cancellation refunds	14,933,241	-	14,933,241
Total deductions	93,213,336	1,287,769	94,501,105
Change in net assets before transfers	(37,604,715)	(750,251)	(38,354,966)
Transfers to (from)	(775,000)	775,000	-
Change in net assets	(38,379,715)	24,749	(38,354,966)
Net assets, beginning	488,837,531	171,876	489,009,407
Net assets, ending	\$ 450,457,816	\$ 196,625	\$ 450,654,441



**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**

To the Board of Trustees
Alabama Prepaid Affordable College Tuition Program
Montgomery, Alabama

We have audited the 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, as of and for the year ended September 30, 2010, and have issued our report thereon dated February 14, 2011. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Alabama Prepaid Affordable College Tuition Program's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Alabama Prepaid Affordable College Tuition Program's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Alabama Prepaid Affordable College Tuition Program's internal control over financial reporting.

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.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Alabama Prepaid Affordable College Tuition 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*.

This report is intended solely for the information and use of management, the Board of Trustees, others within the Alabama Prepaid Affordable College Tuition Program, and the State of Alabama, and is not intended to be and should not be used by anyone other than these specified parties.

Mauldin & Jenkins, LLC

Macon, Georgia
February 14, 2011

**PACT Board Member Demographic Information
(As of March 2011)**

Race:	14 Caucasian	1 African-American
Gender:	11 males	4 females
Urban or rural resident:	13 urban	2 rural
Employed:	15 - yes	0 - no
Highest education level completed:	Bachelor's Degree: 3 Master's Degree: 6 Juris Doctorate: 2 Ph.D.: 3 Other*: 1	<i>*veterinary medicine</i>
2010 combined household income:	0-\$999:	0
	\$1,000-\$9,999:	0
	\$10,000-\$49,999:	0
	\$50,000-\$149,999:	6
	\$150,000-\$249,999:	6
	\$250,000 or more:	3