

Audit Report

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**College Savings Plans of Maryland**

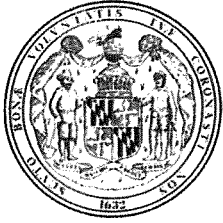
July 2012

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**OFFICE OF LEGISLATIVE AUDITS**  
DEPARTMENT OF LEGISLATIVE SERVICES  
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES  
OFFICE OF LEGISLATIVE AUDITS  
MARYLAND GENERAL ASSEMBLY

Karl S. Aro  
Executive Director

July 18, 2012

Bruce A. Myers, CPA  
Legislative Auditor

Senator James C. Rosapepe, Co-Chair, Joint Audit Committee  
Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee  
Members of Joint Audit Committee  
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the College Savings Plans of Maryland (CSPM) for the period beginning February 9, 2009 and ending August 2, 2011. CSPM provides savings plans to help Maryland citizens save for future college expenses and reduce dependence on student loans and other forms of debt.

Our audit disclosed that CSPM had not performed complete and timely bank reconciliations for the Maryland Prepaid College Trust and had not established adequate procedures to investigate a significant number of uncashed checks that remained outstanding for extended periods. In addition, blank checks for the Maryland Prepaid College Trust account were not sufficiently controlled.

CSPM's response to this audit is included in Appendix A to this report. Auditor comments related to CSPM's response can be found in Appendix B. We wish to acknowledge the cooperation extended to us during the course of this audit by CSPM.

Respectfully submitted,

A handwritten signature in black ink that reads "Thomas J. Barnickel III".

Thomas J. Barnickel III, CPA  
Acting Legislative Auditor



## **Background Information**

### **Agency Responsibilities**

The College Savings Plans of Maryland (CSPM) is an independent State agency that currently provides two separate plans (the Maryland Prepaid College Trust and the Maryland College Investment Plan) to help Maryland citizens save for future college expenses and reduce dependence on student loans and other forms of debt. Effective October 1, 2008, State law authorized the CSPM to establish a third option, the Maryland Broker-Dealer College Investment Plan; however, as of February 2012, the plan was not operating as CSPM had not yet decided whether to offer this plan. These plans are administered by the College Savings Plans of Maryland Board, which includes the Secretary of the Maryland Higher Education Commission, the State Superintendent of Schools, the State Treasurer, the State Comptroller, the Chancellor of the University System of Maryland, and five members of the public appointed by the Governor.

Individuals currently seeking to participate in a college savings plan may execute a prepaid tuition contract available through the Maryland Prepaid College Trust and/or establish an investment account in the Maryland College Investment Plan. Students may use their accounts at nearly any accredited college nationwide. According to the State's records, CSPM's operating expenditures totaled approximately \$2.1 million during fiscal year 2011.

### **Maryland Prepaid College Trust**

The Trust offers tuition contracts for the future payment of tuition and mandatory fees at any eligible institution of higher education. Contracts, which require scheduled payments, may be purchased by individuals on behalf of a designated beneficiary. The Trust is operated by the CSPM, which processes enrollments, invests funds, and makes disbursements. State law requires that either the account holder or the beneficiary be a resident of Maryland or the District of Columbia at the time that a contract is purchased.

State law provides State income tax benefits for Maryland taxpayers who elect to participate in the Trust. Specifically, the Tax-General Article, Section 10-208 of the Annotated Code of Maryland allows Maryland taxpayers to deduct up to \$2,500 for any taxable year, per prepaid tuition contract, for purposes of calculating their Maryland adjusted gross income.

CSPM does not guarantee that the assets of the Trust will be sufficient to pay the tuition and fees estimated under the contracts. However, in the event that the market value of the Trust's assets is not sufficient to fund its contract obligations, State law provides that State funds may be appropriated to fund the related difference or the Board may adjust the future contract payments to meet the Trust's contract obligations. CSPM must repay any related authorized appropriations during each of the two succeeding fiscal years. State law also specifies that the debts and contract obligations of the Trust are not debts of the State. An actuarial study conducted in October 2011 indicated that the Trust had a surplus of \$122.3 million as of June 30, 2011 and was 117 percent funded.

### **Maryland College Investment Plan**

The Maryland College Investment Plan was established to allow individuals to invest funds to help pay the cost of providing a college education to a designated beneficiary. A contract was executed with a private investment company that is responsible for managing the Plan by processing Plan enrollment applications, investing related payments, and disbursing funds. The current contract will expire in July 2013. Earnings on funds invested in the Plan, as well as the future principal value of individual accounts, are not guaranteed. Payments into the investment plan will be accepted provided the aggregate balance of all accounts for a designated beneficiary does not exceed \$320,000. Account holders and designated beneficiaries participating in the Maryland College Investment Plan are not required to be residents of Maryland or the District of Columbia.

State law provides State income tax benefits for Maryland taxpayers who elect to participate in the Plan based on their contributions. Specifically, the Tax-General Article, Section 10-208 of the Annotated Code of Maryland allows a taxpayer to deduct up to \$2,500 for any taxable year, per qualified beneficiary, for purposes of calculating his or her Maryland adjusted gross income. However, the law also provides that an individual who invests in both the Maryland College Investment Plan and the Maryland Broker-Dealer College Investment Plan will only be allowed one deduction of \$2,500 per qualified beneficiary.

### **Maryland Broker-Dealer College Investment Plan**

Chapter 548, Laws of Maryland 2008, effective October 1, 2008 authorized the CSPM to establish the Maryland Broker-Dealer College Investment Plan. This Plan allows contributions to an investment account, established for the purpose of meeting the qualified higher education expenses of the qualified designated beneficiary of the account, to be made through private investment firms selected by the account holder. Maryland taxpayers would be able to deduct contributions

to this Plan from their taxable income for purposes of State and local income taxes. Specifically, State law provides State income tax benefits for individuals who elect to participate in this Plan that are similar to the tax benefits available to those who participate in the Maryland College Investment Plan. As of February 2012, CSPM had not yet decided whether to offer this plan.

## **Financial Information**

According to its records, as of September 15, 2011, CSPM was administering approximately 32,400 prepaid tuition contracts applicable to the Maryland Prepaid College Trust. The market value of the Trust's investments (including cash) totaled approximately \$576 million as of June 30, 2011. These records also indicated that CSPM deposited contract application fees and related payments totaling approximately \$61 million into the Trust during fiscal year 2011.

As of June 30, 2011, CSPM's records indicated that approximately 134,000 participants had opened investment savings accounts in the Maryland College Investment Plan with balances totaling approximately \$2.4 billion.

CSPM engages an independent accounting firm to audit its annual financial statements for the Maryland Prepaid College Trust and for the Maryland College Investment Plan. Such statements are included in its annual reports. In the related audit reports for the fiscal years ended 2009, 2010, and 2011 the firms stated that the financial statements present fairly, in all material respects, the financial positions of the Maryland Prepaid College Trust and the Maryland College Investment Plan, and the results of their operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

## **Findings and Recommendations**

### **Bank Reconciliations**

#### **Finding 1**

**The College Savings Plans of Maryland (CSPM) had not performed complete and timely bank reconciliations for the Maryland Prepaid College Trust account.**

#### **Analysis**

CSPM had not performed complete and timely bank reconciliations for the Maryland Prepaid College Trust account. The purpose of these reconciliations is

to review for unauthorized disbursements, and to ensure that all collections and disbursements are properly recorded in both the bank's and CSPM's records. During our review, we noted the following conditions:

- CSPM did not reconcile the deposits received by the bank to its accounting records. Specifically, CSPM performed deposit verifications to ensure that all checks received directly by CSPM or at its lockbox were deposited; however, these verifications did not provide assurance that CSPM accurately recorded all receipts in its accounting records. As a result, errors in posting cash receipts to the Trust bank account or to CSPM records may remain undetected.
- CSPM did not reconcile its cash disbursements from the Trust account to its accounting records in a timely manner. Our test of 16 monthly cash disbursement reconciliations performed since August 2009 disclosed that, as of August 1, 2011, the reconciliations had been performed, on average, eight and one-half months after the month of the bank statements. For example, the bank reconciliation for December 2010 was not performed until August 19, 2011. Under this condition, erroneous or improper disbursements from the Trust account may not be detected timely, which could result in losses to CSPM.
- During its cash disbursement reconciliation for the Trust in June 2011 (the most current reconciliation performed as of September 2011), CSPM included, as a reconciling item, approximately 700 checks, totaling \$3.7 million, that had been written by CSPM but not cashed. Approximately 500 of these checks totaling \$2.3 million, made payable to account holders or schools the plan beneficiaries attended, were more than six months old, of which 67 checks totaling \$128,000 were more than three years old. However, CSPM had not investigated these uncashed checks; rather, we were advised that CSPM plans to wait for the checks to be eventually cashed by the recipients. Action to be taken based on the investigation of these uncashed checks includes cancelling checks and transferring abandoned funds to the Comptroller of Maryland.

As a result of the aforementioned conditions, cash deposits could be inaccurately recorded and unauthorized disbursements could occur without timely detection. Also, the Comptroller of Maryland's *Internal Control Manual* requires that agencies review and resolve reconciling items identified during reconciliations of its checking accounts. Furthermore, State law requires trusts to transfer funds that are abandoned to the Comptroller of Maryland for safekeeping until claimed by the owner. Funds are presumed to be abandoned if they have not been claimed by

the owner within three years. According to CSPM's audited financial statements, during fiscal year 2011, receipts and disbursements of the Trust account totaled approximately \$60.6 million and \$45.8 million, respectively.

### **Recommendation 1**

**We recommend that CSPM**

- a. perform comprehensive monthly bank reconciliations, including deposit activity, of its Trust records and the applicable bank statements;**
- b. perform the monthly bank reconciliations timely; and**
- c. investigate checks that remain outstanding for more than six months, including those noted above, and take appropriate action, including cancelling checks and transferring abandoned funds to the Comptroller of Maryland.**

### **Disbursements**

#### **Finding 2**

**Controls over blank checks for the Trust were not adequate.**

Controls over blank checks for the Trust were not adequate. Specifically, our audit disclosed the following conditions:

- Blank check stock used to pay tuition for account holders and refunds to account holders was accessible to all employees, including two employees designated as check signers.
- The check stock was not periodically accounted for as to issued, voided, or on hand.

As a result, unauthorized disbursements could be processed and may not be promptly detected. According to CSPM's audited financial statements, during fiscal year 2011, disbursements to schools and account holders totaled approximately \$45.8 million.

### **Recommendation 2**

**We recommend that CSPM**

- a. restrict access to blank checks to authorized employees who are not also responsible for signing checks; and**
- b. assign an employee independent of the distribution process to periodically account for the check stock as to issued, voided, or on hand, and document these verifications.**

## **Audit Scope, Objectives, and Methodology**

We have audited the College Savings Plans of Maryland (CSPM) for the period beginning February 9, 2009 and ending August 2, 2011. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine CSPM's financial transactions, records, and internal controls, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The primary areas addressed by the audit included cash receipts, disbursements, and accounts receivable. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of CSPM's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

CSPM engages an independent accounting firm to audit its annual financial statements for the Maryland Prepaid College Trust and for the Maryland College Investment Plan. In the related audit reports for the fiscal years ended 2009, 2010, and 2011 the firms stated that the financial statements present fairly, in all material respects, the financial positions of the Maryland Prepaid College Trust and the Maryland College Investment Plan, and the results of their operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. We have relied on the work of the independent accounting firm to provide audit coverage of the investments of the Maryland Prepaid College Trust. Our audit procedures for investments were generally limited, therefore, to obtaining a sufficient basis for that reliance.

CSPM contracts with an independent agent (a private investment company) to manage the Maryland College Investment Plan by processing Plan enrollment applications, investing related payments, and disbursing funds. CSPM also engaged an independent certified public accounting firm to perform certain

procedures to assist in evaluating the administration of the Plan for fiscal years 2009, 2010, and 2011. The purpose of the review is to provide assurances to all of the agent's users, including CSPM, concerning the design and effectiveness of internal controls related to processing of transactions. We have relied on the work of the independent accounting firm to provide audit coverage of the Plan's operations. Our audit procedures were generally limited, therefore, to obtaining a sufficient basis for that reliance.

In the related reports, the auditor stated that the description of controls relating to the transfer agent and shareowner servicing agent functions performed for the Maryland College Investment Plan by its independent agent is fairly presented and the controls, as described, are suitably designed to provide reasonable assurance that the specified control objectives would be achieved if the described controls were complied with satisfactorily, and the customers of the agent applied the internal controls contemplated in the design of controls. The auditor also stated that the controls that were tested were operating with sufficient effectiveness to provide reasonable but not absolute assurance that the specified control objectives were achieved during the respective periods.

CSPM's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

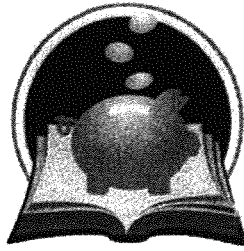
Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings relating to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect CSPM's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our audit also disclosed a significant instance of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to CSPM that did not warrant inclusion in this report.

CSPM's response to our findings and recommendations is included as an appendix to this report. As prescribed in the state Government Article, Section 2-1224 of the annotated Code of Maryland, we will advise CSPM regarding the results of our review of its response.

## APPENDIX A



# COLLEGE SAVINGS

## PLANS OF MARYLAND

*Save here. Go anywhere.®*

July 12, 2012

To: Office of the Legislative Audits

Re: Response to the Draft Legislative Audit Report for the period Feb. 9, 2009 to August 2, 2011

Below are our agency's responses to the Draft Report:

**Finding 1** - We disagree that CSPM has not performed complete bank account reconciliations for the Maryland Prepaid College Trust account. CSPM does reconcile deposits received by our bank on a daily basis to our accounting records. In addition, checks received by our office are reconciled on a daily basis. These processes are followed by a monthly reconciliation of deposit and disbursement activity once we receive our bank statement. As part of year-end closing process, cash receipts and disbursement are reconciled again to our accounting records as part of an annual reconciliation.<sup>1</sup>

We agree that the reconciliations were delayed due to a planned transitioning from an environment of manually prepared checks to an automated environment. The final stage of the transition was to enhance our internal controls over the reconciliation process by using data feed from our recordkeeping system, which caused delays in the reconciliations during the transition period. Subsequent to the completion of the transition, the bank account has been reconciled in a timely manner.

Regarding the matter of uncashed checks, we agree that a policy needs to be developed and implemented that classifies certain uncashed checks as Unclaimed Property and establishes the process for transferring such funds to the Comptroller's Officer. CSPM has developed a draft policy and has met with the Comptroller's Office to discuss the draft. The next steps are for the Comptroller's Office to review and comment on the draft policy so it can be finalized and implemented.

**Finding 2** – We agree that controls over the blank check stock should be increased. Access to blank checks had been restricted prior to the end of the legislative audit and will remain restricted to those individuals responsible for the preparation of the disbursements. In addition, we have implemented a procedure to have an individual not involved in the distribution process audit the blank check stock periodically.

Thank you for the opportunity to respond to the draft report. Please contact me if you have any questions or wish to discuss further.

Sincerely,

A handwritten signature in cursive script that reads "Joan E. Marshall". The signature is written in black ink and is positioned above the printed name and title.

Joan Marshall  
Executive Director

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<sup>1</sup>See Appendix B for related auditor comment.

## **APPENDIX B**

**Auditor's Comment:** In its response, CSPM does not concur with the audit finding that deposits were not reconciled to its accounting records and asserts that it performs a daily and monthly reconciliation of deposits to its accounting records. However, as explained during the audit, the accounting records being used for the reconciliation process are derived from the bank's records of deposit transactions, not from CSPM's automated accounting records of the applicable cash receipt activity. Accordingly, these processes would not detect erroneous postings and adjustments to CSPM's records. CSPM also stated that annual reconciliations are performed; however, no evidence of these reconciliations was provided during the audit.

AUDIT TEAM

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