

Audit Report

College Savings Plans of Maryland

May 2009



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
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Bruce A. Myers, CPA
Legislative Auditor

May 26, 2009

Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Senator Verna L. Jones, 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 January 17, 2006 and ending February 8, 2009. 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 did not disclose any findings that warrant mention in this report.

We wish to acknowledge the cooperation extended to us during the course of this audit by CSPM.

Respectfully submitted,

Bruce A. Myers, CPA
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 the Maryland Broker-Dealer College Investment Plan; CSPM is in the process of establishing investment options for 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 2008.

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 funds received are invested by the Trust. State law requires that either the purchaser or 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 individuals who elect to participate in the Trust. 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 prepaid tuition contract, for purposes of calculating his or her 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 2008 indicated that the Trust had a surplus of \$59 million as of June 30, 2008 and was 109 percent funded. Subsequently, an interim review conducted by the actuary of the Trust as of December 31, 2008 indicated the Trust had an unfunded liability of \$82.8 million and was 87.2 percent funded. We were advised by CSPM management that another actuarial study will be conducted as of June 30, 2009 and that appropriate actions will be taken based on the results of that study, including adjustments in the required payments if deemed necessary.

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 processing Plan enrollment applications and investing related payments. 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 (excluding credited investment earnings). 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 individuals 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.

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 2009, the CSPM was in the process of establishing the investment options applicable to this plan.

Financial Information

According to its records, as of December 31, 2008, CSPM was administering approximately 34,700 prepaid tuition contracts applicable to the Trust, and the market value of the Trust's investments (including cash) totaled approximately \$429 million. These records also indicated that CSPM deposited contract application fees and related payments totaling approximately \$65 million into the Trust during fiscal year 2008.

As of December 31, 2008, CSPM's records indicated that approximately 108,300 participants had opened 133,400 investment savings accounts in the Maryland College Investment Plan with balances totaling approximately \$1.3 billion.

CSPM engages an independent accounting firm to audit its annual financial statements and such statements are included in its annual report. In the related audit reports for the fiscal years ended 2006, 2007, and 2008, the firm stated that the financial statements present fairly, in all material respects, the financial positions of the Trust and the Maryland College Investment Plan, and the results of its 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

Our audit did not disclose any significant deficiencies in the design or operation of the College Savings Plans of Maryland's (CSPM) internal control. Nor did our audit disclose any significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to CSPM that did not warrant inclusion in this report.

A draft copy of this report was provided to CSPM. Since there are no recommendations in this report, a written response was not necessary.

Audit Scope, Objectives, and Methodology

We have audited the College Savings Plans of Maryland (CSPM) for the period beginning January 17, 2006 and ending February 8, 2009. 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 the CSPM's financial transactions, records and internal control, 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. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of the 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'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.

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