

Audit Report

Maryland Higher Education Commission

August 2010



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

-
- This report and any related follow-up correspondence are available to the public through the Office of Legislative Audits at 301 W. Preston Street, Room 1202, Baltimore, Maryland 21201. The Office may be contacted by telephone at 410-946-5900, 301-970-5900, or 1-877-486-9964.
 - Electronic copies of our audit reports can be viewed or downloaded from our website at <http://www.ola.state.md.us>.
 - Alternate formats may be requested through the Maryland Relay Service at 1-800-735-2258.
 - The Department of Legislative Services – Office of the Executive Director, 90 State Circle, Annapolis, Maryland 21401 can also assist you in obtaining copies of our reports and related correspondence. The Department may be contacted by telephone at 410 946-5400 or 301 970-5400.
-



DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

August 13, 2010

Karl S. Aro
Executive Director

Bruce A. Myers, CPA
Legislative Auditor

Senator Verna L. Jones, Co-Chair, Joint Audit Committee
Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Maryland Higher Education Commission (MHEC) for the period beginning July 1, 2006 and ending August 2, 2009. MHEC's key responsibilities are to provide statewide planning, administer aid programs to Maryland's postsecondary institutions, and provide financial assistance to students.

Our audit disclosed that MHEC did not fully report unfunded liabilities at the end of fiscal years 2008 and 2009 and did not request deficiency appropriations to resolve the deficits, which totaled \$11 million as of June 30, 2009. MHEC also did not fully report the deficits in its October 2009 report to the Joint Chairmen, as required. In addition, the amount of unexpended scholarship appropriations reported to the budget committees at the end of fiscal year 2009 was questionable. Specifically, MHEC reported unexpended funds budgeted for scholarships of \$4.3 million, yet the amount on the State accounting records totaled \$7.5 million.

Our audit further disclosed that MHEC lacked sufficient procedures and controls over financial aid awards and related recoveries, education aid payments to certain institutions, and procurements.

An executive summary of our findings can be found on page 5. MHEC's response to our findings and recommendations is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by MHEC.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

Table of Contents

| | |
|--|----------|
| Executive Summary | 5 |
| Background Information | 7 |
| Agency Responsibilities | 7 |
| Status of Findings From Preceding Audit Report | 7 |
| Local Retirement and Pension Contributions | 7 |
| Findings and Recommendations | 9 |
| Budgetary Closeout | |
| * Finding 1 – MHEC Did Not Report All Unfunded Liabilities or Request Deficiency Appropriations to Resolve Deficits | 9 |
| Finding 2 – Unexpended Scholarship Appropriations Reported to the Budget Committees Differed From Amounts Recorded in the State’s Accounting Records | 10 |
| Financial Aid | |
| * Finding 3 – Adequate Procedures and Controls Were Not Established Over Financial Aid Awards and Automated Financial Aid Records | 12 |
| * Finding 4 – MHEC Did Not Ensure That Service Obligations Were Fulfilled or That Related Awards Were Properly Recovered | 13 |
| * Finding 5 – Procedures and Controls Over Financial Aid Recoveries Were Inadequate | 14 |
| Aid to Community Colleges | |
| * Finding 6 – MHEC Did Not Ensure That Certain State Funding to Community Colleges Was Proper | 15 |
| Purchases | |
| Finding 7 – Proper Controls Over Purchases Were Not Established and MHEC Did Not Comply with Certain State Procurement Regulations | 16 |
| Audit Scope, Objectives, and Methodology | 19 |
| Agency Response | Appendix |

* Denotes item repeated in full or part from preceding audit report

Executive Summary

Legislative Audit Report on Maryland Higher Education Commission (MHEC) August 2010

- **Unfunded year-end liabilities of approximately \$4.2 million and \$1.8 million for fiscal years 2009 and 2008, respectively, were not reported to the Comptroller of Maryland - General Accounting Division. Subsequent year appropriations were used to cover the unfunded liabilities rather than requesting deficiency appropriations. As of June 30, 2009, the deficit (that is, unfunded liabilities that were reported and those that were not reported) totaled approximately \$11 million.**

MHEC should properly report all unfunded year-end liabilities and work in conjunction with the Department of Budget and Management to develop a plan to eliminate the aforementioned liabilities.

- **The amount of unexpended scholarship appropriations reported to the budget committees at the end of fiscal year 2009 differed from the amount of unexpended scholarships as recorded on the State's accounting records. Since MHEC management could not explain the difference, the amount of unused scholarship funds reported to the budget committees was questionable.**

MHEC should investigate and resolve the difference noted between unexpended scholarships as recorded on the State accounting records and the amounts reported to the budget committees and should ensure that the proper amount is reported in the future.

- **Financial aid award determinations were not periodically reviewed to ensure the propriety of the awards and the propriety of changes made to critical data recorded in the automated student financial aid system was not adequately verified.**

MHEC should take the recommended actions to ensure adequate controls are in place over financial aid awards and changes to its automated system were proper.

- **Adequate procedures and controls over certain financial aid programs that required students to complete a service obligation (such as work as a full-time nurse) or to repay the award were not established, resulting in a lack of assurance that recipients either fulfilled their obligation or repaid their awards.**

MHEC should ensure adequate controls are in place over service awards and recover any amounts for which a service obligation was not satisfied.

- **MHEC did not ensure the propriety of funding provided to community colleges for certain employer retirement contributions and nonresident fees.**

Procedures should be established to ensure the propriety of amounts paid to the community colleges for employees enrolled in optional retirement plans and nonresident fees.

- **MHEC did not establish adequate controls over the processing of certain purchases on the State's Financial Management Information System and did not procure certain printing services in accordance with State Procurement Regulations.**

MHEC should establish independent online approval requirements for all critical transactions, and comply with State Procurement Regulations.

Background Information

Agency Responsibilities

The Maryland Higher Education Commission (MHEC) provides statewide planning, leadership, coordination, and advocacy for Maryland's postsecondary educational institutions. MHEC also administers several aid programs to these institutions and provides financial assistance to students. According to the State's records, during fiscal year 2009, MHEC provided approximately \$269 million in financial assistance to public and non-public institutions (including community colleges) throughout the State, and awarded more than 58,000 grants and scholarships totaling approximately \$111.8 million to students pursuing postsecondary education. In addition, according to the State's records, MHEC's operating expenditures totaled approximately \$7 million during fiscal year 2009.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the six findings contained in our preceding audit report dated March 29, 2007. We determined that MHEC satisfactorily addressed two of these findings. The remaining four findings are repeated in this report. These four repeated findings appear as five findings in this report.

Local Retirement and Pension Contributions

The State (through MHEC) funds the employers' portion of the retirement and pension costs for certain community college employees who are members of the Maryland State Retirement and Pension System. In fiscal year 2009, this funding totaled approximately \$24 million. Since the local jurisdictions also receive federal financial assistance for some of these benefits, the local jurisdictions are required to reimburse MHEC for the portions of these costs paid on behalf of employees that were covered by federal funds (that is, for which they received duplicate payments). According to MHEC's records, during fiscal year 2009, the local jurisdictions remitted \$1.5 million to MHEC related to these duplicate payments.

Various sections of the Education Article of the Annotated Code of Maryland state that the State Retirement Agency (SRA) may examine the records of the local jurisdictions to determine whether the State's payments for retirement contributions are in accordance with the law and to recover any duplicate payments. Furthermore, in an opinion dated June 26, 2008, the Attorney General concluded that SRA retained the authority to audit the aforementioned records

and seek repayments for any duplicate payments made by the state, specifically mentioning those duplicate payments resulting from federal funds. In this regard, SRA contracts with an independent certified public accounting firm to perform a compliance review of the eligibility of the participants in the State retirement and pension system. However, the review does not include any formal procedures to ensure the propriety of the aforementioned remittances for duplicate payments. This condition was noted in our audit report of SRA dated April 13, 2009. In response, SRA agreed to work with MHEC to ensure full amounts are remitted by the local jurisdictions. However, we were advised by SRA personnel that, as of April 2010, no substantive actions have been taken to resolve this issue.

Finding and Recommendation

Budgetary Closeout

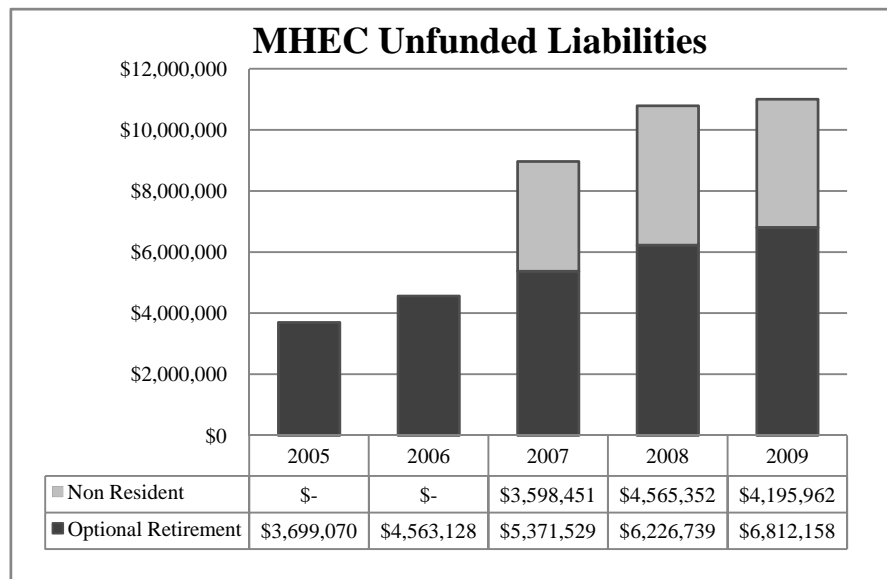
Finding 1
The Maryland Higher Education Commission (MHEC) did not report unfunded liabilities during the fiscal year 2008 and 2009 budget closeouts and did not request deficiency appropriations to resolve the year-end deficits.

Analysis

MHEC did not report certain unfunded liabilities during the fiscal year 2008 and 2009 budget closeout processes and did not request deficiency appropriations to resolve the deficits that existed at the end of those fiscal years. Specifically, our review disclosed the following conditions:

- MHEC did not report unfunded year-end liabilities of approximately \$4.2 million and \$1.8 million for fiscal years 2009 and 2008, respectively, to the Comptroller of Maryland—General Accounting Division (GAD) as required by the State’s budget closeout instructions. The unfunded liabilities related to amounts that MHEC is required to pay by law and specifically represented amounts due to community colleges for employer retirement contributions to certain optional retirement plans and for nonresident student fees (that is, the fee paid by the State for certain students attending a community college in a county other than their county of residence). Although MHEC reported

unfunded liabilities totaling \$6.8 million to GAD at the close of fiscal year 2009 related to employer retirement contributions, the amount reported was incomplete. MHEC did



not report approximately \$4.2 million in expenditures incurred by community colleges for nonresident students. The \$1.8 million in unreported unfunded liabilities in fiscal year 2008 related to employer retirement contributions.

- MHEC used subsequent year appropriations to pay the aforementioned unfunded liabilities rather than requesting a deficiency appropriation. This is significant because, as noted in the chart on page 9, the amount of the unfunded liabilities is increasing each year and totaled approximately \$11 million at June 30, 2009. Furthermore, we were advised that, due to a lack of funds, MHEC is not making payments to the community colleges in a timely manner. For example, as of December 5, 2009, MHEC had not paid \$4.2 million due to the colleges as of June 30, 2009 for fiscal year 2009 nonresident fees.

State law provides that if State appropriations for payment of nonresident fees are not sufficient to cover the related costs, the Governor shall include a deficiency appropriation in the following fiscal year to cover the costs. MHEC management advised us that it did not request a deficiency appropriation due to the State's current fiscal condition.

Similar conditions regarding the failure to properly disclose unfunded liabilities were noted in our preceding audit report.

Recommendation 1

We recommend that MHEC

- a. properly report all unfunded year-end liabilities at fiscal year end, as required (repeat); and**
- b. work, in conjunction with the Department of Budget and Management, to develop a plan to eliminate such liabilities (repeat).**

Finding 2

Unexpended scholarship appropriations reported to the budget committees at the end of fiscal year 2009 differed from the amount of unexpended scholarships recorded in the State's accounting records.

Analysis

Unexpended scholarship appropriations reported to the budget committees at the end of fiscal year 2009 differed from the amount of unexpended scholarships recorded in the State's accounting records. The April 2009 Joint Chairmen's Report requested MHEC to submit reports on the fiscal year 2009 working appropriation for MHEC scholarships by program. MHEC submitted the first report in October 2009. The report disclosed \$4.3 million in unused scholarship appropriations at the end of fiscal year 2009. However, according to the State's accounting records, unused scholarship appropriations totaled \$7.5 million at the end of fiscal year 2009. MHEC management could not provide us with an

explanation of the difference. As a result, the accuracy of the information reported to the budget committees was questionable.

State law provides that any unused appropriations (that is, amounts for which no grants have been awarded) were to be retained by MHEC and used for grants in the following fiscal year. However, there is no accounting mechanism available to retain unexpended general fund appropriations, which is the source for these grant funds. Consequently, MHEC created purchase orders identifying the vendor as the “State of Maryland” to encumber the remaining appropriations. In the following fiscal year, the amounts retained were reallocated to the appropriate grant programs, and MHEC processed a budget amendment reflecting the transfer. This process makes it difficult for the budget committees to monitor the use of scholarship funds across fiscal years.

Recommendation 2

We recommend that MHEC

- a. investigate and resolve the noted difference between unexpended appropriations for scholarships on the State’s accounting records and the amounts reported to the budget committees and, in the future, report the appropriate amounts to the budget committees; and**
- b. in conjunction with the Department of Budget and Management and the Comptroller of Maryland, identify an appropriate method for retaining the aforementioned funds in accordance with State law (Policy Issue).**

Financial Aid

Background

MHEC administers a number of financial aid programs that are funded by State and federal funds. MHEC staff use information from several sources including the application for financial aid, the Free Application for Federal Student Aid (FAFSA), and data received from the colleges to determine whether applicants are eligible for one of MHEC’s financial aid programs. According to the State’s records, MHEC made financial aid awards totaling \$111.8 million during fiscal year 2009. Several of the financial aid programs required students to complete a service obligation as a condition of the awards. We were advised by MHEC management that 1,995 service awards totaling approximately \$9.3 million were awarded in fiscal year 2009 and, according to MHEC’s records, approximately \$5.9 million in financial aid recoveries were outstanding as of June 30, 2009.

Finding 3

MHEC did not have adequate procedures and controls over financial aid awards or over critical information maintained in its automated financial aid system.

Analysis

MHEC did not have adequate procedures and controls over financial aid award determinations or over critical information maintained in its automated Student Aid Financial Evaluation and Record Keeping System (SAFERS). Specifically, our review disclosed the following conditions:

- MHEC could not document that financial aid award determinations were periodically reviewed to ensure the propriety of the awards. MHEC staff process applications for financial aid, determine the applicants' eligibility, and enter the information into SAFERS. Although MHEC had a policy for supervisors to review the propriety of the awards on a test basis, documentation was not available of any reviews being conducted during the audit period. As a result, there was a lack of assurance that financial aid awards were properly processed.
- MHEC did not verify the propriety of changes made to critical data, such as financial aid award eligibility, recorded in SAFERS. Specifically, MHEC did not obtain output reports that listed the changes made to the data on the system to be used for verification purposes. As a result, MHEC lacked assurance that all such changes were authorized and accurately recorded. This condition has been commented upon in our two preceding audit reports.

Recommendation 3

We recommend that MHEC

- a. review and document financial aid award determinations in accordance with its policy to help ensure the propriety of the awards;**
- b. generate output reports identifying all changes made to student data maintained in SAFERS (repeat); and**
- c. ensure that employees, who do not have the ability to modify such data, use the output reports to verify that all critical changes recorded are accurate and properly authorized (repeat).**

Finding 4

MHEC did not ensure that student service obligations were fulfilled as a condition for a financial aid award or that related financial aid awards were properly recovered.

Analysis

MHEC did not ensure that service obligations were fulfilled or that related financial aid awards were properly recovered. For example, students receiving nursing scholarships are required to work as a full-time nurse in Maryland for one year for each year the scholarship was received or they have to repay their award. Each award recipient is initially placed in deferral while they are enrolled as a student (deferral mode). If the recipient does not maintain their enrollment due to withdrawal or graduation, they must either fulfill their service obligation (service mode) or repay the award (repayment mode). Our review disclosed the following conditions:

- MHEC could not provide us with a listing of service award recipients that included their related current status (such as deferral, service, or repayment mode). As a result, there was a lack of assurance that students were either fulfilling their service obligations or were repaying their award. Our test of these records disclosed that MHEC did not always maintain adequate documentation of service awards. We tested 40 past awards totaling \$160,957 for which there should have been some activity during our audit period (that is, fulfillment of service obligation or award repayment) and found that MHEC could not locate any documentation relating to awards totaling \$6,000 made to two recipients during calendar years 2002 and 2003. MHEC had no record of these students' enrollments, fulfillment of the related service obligations, or repayment of the awards which would have been due during the audit period.
- MHEC did not always send obligation letters to awardees requesting information on whether they were fulfilling their service obligation and did not take appropriate corrective action when awardees did not reply to the obligation letters that were sent. In addition, MHEC did not take appropriate follow-up action when it failed to receive responses to employment verification letters verifying that the recipient was actually fulfilling their service obligations. For example, our test of 40 past awardees disclosed that, for 6 awardees who received \$28,380, employment verifications were never received to substantiate that the service obligation was being fulfilled, and MHEC did not take additional follow-up actions.

- MHEC lacked procedures for ensuring that recipients identified as having failed to meet their service obligations were invoiced for the repayment of the related awards. In this regard, our test of 14 recipients identified as having failed to meet their service obligation disclosed that, as of October 2009, MHEC had not yet recorded accounts receivable for 5 recipients totaling approximately \$32,000 although the receivables had been incurred before May 2006. A similar condition was noted in our preceding audit report.

Recommendation 4

We recommend that MHEC

- a. maintain a listing of all service award recipients including their current status and investigate the status of any recipients with missing award documentation,**
- b. ensure that service obligation letters and employment verification forms are sent and returned in a timely manner and take appropriate follow up action when responses are not received, and**
- c. establish procedures to ensure that accounts receivable are established for past and future award recipients who have not fulfilled their financial aid service obligation and initiate collection efforts for all students who have outstanding financial aid service obligations (repeat).**

Finding 5

Procedures and controls over financial aid recoveries were inadequate.

Analysis

MHEC lacked adequate procedures and controls over accounts receivable related to students who did not fulfill their service obligations. Our review disclosed the following conditions:

- Delinquent accounts were not referred to the Department of Budget and Management's Central Collection Unit (CCU) as required by its regulations. Specifically, we were advised by MHEC management that no accounts were forwarded to CCU during fiscal years 2007 and 2008 and only a limited number were referred during fiscal year 2009. In this regard, our test of 20 past due accounts totaling approximately \$125,000 disclosed 17 accounts totaling \$115,000, for which no payment had been received for more than one year, that had not been forwarded to CCU. This condition was caused in part by MHEC's inability to generate aging reports to help monitor delinquent accounts. CCU regulations generally require that three written demands for payment be made on accounts at 30-day intervals and, if no payments are

received, the accounts be considered delinquent and immediately referred to CCU for collection assistance.

- Non-cash credit adjustments to accounts, which totaled approximately \$83,000 during fiscal year 2009, were not approved by supervisory personnel and independently verified to related source documentation. As a result, unauthorized adjustments could be recorded.

Similar conditions were commented upon in our preceding audit report.

Recommendation 5

We recommend that

- a. all delinquent accounts be referred to CCU for collection assistance as required by CCU regulations (repeat), and**
- b. independent supervisory personnel verify and approve non-cash credit adjustments posted to the accounts receivable records by examining the related supporting documentation and that the verifications performed be documented (repeat).**

Aid to Community Colleges

Finding 6

MHEC did not ensure that certain State funding to community colleges was proper.

Analysis

MHEC did not ensure that State funding to community colleges to reimburse the colleges' for certain employer retirement contributions and nonresident student fees was proper. Specifically, our review disclosed the following conditions:

- MHEC did not ensure the propriety of State funding provided for certain employer retirement contributions. Employees at the community colleges may enroll in the State's retirement system¹ or a private optional retirement plan. For those employees who elected to participate in an optional retirement plan, MHEC periodically made payments to the colleges to fund the related employer contributions. These payments totaled \$12 million during fiscal year 2009. Although these payments were to be calculated based on each enrollee's annual salary, MHEC did not verify the eligibility of the enrolled individuals or the accuracy of related salary information reported by the

¹Information regarding the oversight of the payments for community college employees enrolled in the State's retirement system are addressed in the informational comment earlier in this report.

colleges. This condition has been commented upon in our three preceding audit reports.

- MHEC did not ensure that nonresident fees paid to community colleges were proper. State law provides that MHEC shall pay any applicable nonresident fees for students enrolled in an instructional program that MHEC designates as a health manpower shortage program or a statewide or regional program. The colleges periodically submit invoices for the nonresident fees which include a list of the students and related programs for which fees are being billed. Although MHEC verified that the programs listed on the invoices were approved health manpower shortage or statewide or regional programs, it did not verify that the students listed on the invoices were actually enrolled in these programs. This is significant because these fees totaled \$6.6 million during fiscal year 2009 and, as noted in Finding 1, the unfunded liability related to these fees was approximately \$4.2 million as of June 30, 2009.

Recommendation 6

We recommend that MHEC

- a. establish procedures that will ensure the propriety of amounts paid by MHEC to the community colleges for employees enrolled in optional retirement plans (repeat); and**
- b. establish procedures to verify the propriety of amounts invoiced for nonresident fees. Specifically, we recommend that MHEC verify, at least on a test basis, that students for whom the State is paying nonresident fees were actually enrolled in approved programs.**

Purchases

Finding 7

Proper controls over purchases were not established, and MHEC did not comply with certain State Procurement Regulations.

Analysis

MHEC did not establish proper controls over purchases and did not comply with certain State regulations for certain procurements. Specifically, our review disclosed the following conditions:

- MHEC did not establish adequate controls over the processing of certain purchases on the State's Financial Management Information System (FMIS). Specifically, approval rules were not sufficiently comprehensive and, as a

result, two employees could initiate and approve certain purchase orders without any independent approval.

- MHEC did not procure certain services in accordance with State Procurement Regulations. Specifically, our test of 10 procurements totaling \$840,885, disclosed that MHEC did not solicit bids on *eMaryland Marketplace* for 2 procurements for printing services totaling \$90,200 and lacked a purchase order or documentation of competitive procurement for 1 of these 2 procurements totaling \$54,000. The failure to follow State Procurement Regulations is significant because the Department of General Services delegated authority to procure printing services to MHEC and, accordingly, these transactions were not subject to any control agency approval.

According to the State's accounting records, in fiscal year 2009, MHEC used FMIS to process disbursements totaling \$357 million, of which approximately \$1 million related to purchase orders. State Procurement Regulations generally require that contract solicitations be published on *eMaryland Marketplace*, that agencies maintain bid documentation, and that procurements over \$5,000 be supported by a written contract or purchase order.

Recommendation 7

We recommend that MHEC

- a. establish independent online approval requirements for all critical purchasing transactions, and**
- b. comply with the aforementioned requirements of the State Procurement Regulations.**

Audit Scope, Objectives, and Methodology

We have audited the Maryland Higher Education Commission (MHEC) for the period beginning July 1, 2006 and ending August 2, 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 MHEC's financial transactions, records and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the findings contained in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by the audit included procedures and controls over financial aid, grants to nonpublic and community colleges, as well as budgetary closeout transactions, payroll, cash receipts, accounts receivable, and information systems. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of MHEC'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.

MHEC'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.

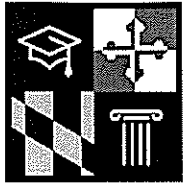
Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

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 MHEC's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to MHEC that did not warrant inclusion in this report.

MHEC'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 MHEC regarding the results of our review of its response.

APPENDIX



MHEC

Creating a state of achievement

Martin O'Malley
Governor

Anthony G. Brown
Lt. Governor

Kevin M. O'Keefe
Chairman

James E. Lyons, Sr.
Secretary of Higher Education

August 6, 2010

Bruce A. Myers, CPA
Legislative Auditor
Department of Legislative Audits
Maryland General Assembly
301 West Preston Street, Room 1202
Baltimore, Maryland 21201

Dear Mr. Myers:

Attached is the Maryland Higher Education Commission response to the draft audit report on the Maryland Higher Education Commission in accordance with your letter dated July 29, 2010.

If you have any questions, do not hesitate to call me.

Sincerely,

A handwritten signature in black ink, appearing to read 'James E. Lyons', written over a horizontal line.

Dr. James E. Lyons
Secretary of Higher Education

AUDIT RESPONSES

Finding 1, Page 9 (The Maryland Higher Education Commission (MHEC) did not report unfunded liabilities during the fiscal year 2008 and 2009 budget closeouts and did not request deficiency appropriations to resolve the year-end deficits.)

MHEC concurs with the audit finding but disagrees with the reported \$1.8 million in unreported unfunded liabilities in fiscal year 2008 related to employer retirement contributions. MHEC did report all unfunded employer retirement contributions that were billed to the agency prior to the fiscal year 2008 closeout.¹

MHEC pays the nonresident student fees as part of the agency's scheduled payments as requested by the General Accounting Division (GAD) for large disbursements. At the beginning of each fiscal year, MHEC sends a list of payments and when these payments will be made to enable GAD to have sufficient funds on hand for disbursements. The nonresident student fees are part of the scheduled payments and these scheduled payments are made in December and April of each fiscal year and for this reason the payments were not made until December. All unfunded liabilities for fiscal year 2010 have been reported to GAD and paid by the end of July 2010.

MHEC will continue to work with the Department of Budget and Management to develop a plan to eliminate such liabilities.

Finding 2, Page 10 (Unexpended scholarship appropriations reported to the budget committees at the end of fiscal year 2009 differed from the amount of unexpended scholarships recorded in the State's Accounting System.)

MHEC concurs with the audit finding. The Office of Student Financial Assistance (OSFA) reported amounts not consistent with those reported through the agency State accounting records. The difference reported was a result of inconsistent data obtained from the OSFA financial aid processing system (SAFERS), data from prior years, and matching that data with the State accounting records. Before any reports are filed using unexpended scholarship appropriations, OSFA will verify the data and resolve any inconsistencies with the agency accounting department.

Finding 3, Page 12 (MHEC did not have adequate procedures and controls over financial aid awards or over critical information in its automated financial aid system.)

MHEC concurs with the finding that there were inadequate procedures and controls with financial aid award information maintained in the financial aid processing system. The

¹ **Auditor's Comment:** MHEC's response indicates that it disagrees that \$1.8 million of unreported unfunded liabilities existed as related to fiscal year 2008 since it did report all unfunded employer retirement contributions that were billed prior to the fiscal year 2008 closeout. However, instructions for completing the State's fiscal year-end budget closeout process require that accrued expenditures be recorded even when the related invoices have not been received.

number of aid programs administered by OSFA during the past 8 years has grown substantially while the number of staff decreased. This combined with an inadequate financial aid processing system contributed to established procedures not being followed. OSFA will have a new financial aid processing system (MD CAPS) fully implemented on August 31, 2010. The new system will allow processes to be automated so that reports are generated based on multiple variables. This will enable supervisors to manage and perform required quality assurance evaluation of staff use of, and access to, the system data. In addition MD CAPS will allow assignment of user privileges based on functional need and will automatically track changes made by each staff and when changes are made.

Finding 4, page 13 (MHEC did not ensure that student service obligations were fulfilled as a condition for a financial aid award or that related financial aid awards were properly recovered.)

MHEC concurs with the finding that some service obligations were not fulfilled as required under the condition of awarding and some financial aid awards were not recovered in a timely manner. As the number of service obligations and programs grew, the manual processes in place were not adequate, nor staff size sufficient, to manage the service obligation portion of the programs. Also service obligation programs were not part of the original SAFERS system, but managed through an Access database that did not provide the type of automated support required for these programs. With the new financial aid processing (MD CAPS), management of these programs will be automated and tracking will become routine with minimal input from staff. The system will also allow notifications to be automated by event and date, thus allowing tighter control over service obligation management. Staff has already begun the process of updating all service obligation data for migration to MD CAPS.

Finding 5, page 14 (Procedures and controls over financial aid recoveries were inadequate.)

MHEC concurs with the finding that control over financial aid recoveries were inadequate for obligations that resulted from unfulfilled service obligations. As stated in the response to finding 4, management of the increasing number of service obligations without the benefit of adequate OSFA staff or an automated processing system contributed to the difficulty in assuring all processes and controls were being followed as required. The automation provided by MD CAPS will allow OSFA staff to manage the service obligations more efficiently and prevent delays in defaulted service obligations referrals to accounting to fulfill the required collection activities. The accounting department will also have direct access to MD CAPS, which will enhance processing of delinquent accounts.

Finding 6, page 15 (MHEC did not ensure that certain State funding to community colleges was proper.)

In accordance with statutory provisions, only employees of a community college holding positions certified by the Appointing Authority to be professional positions are eligible to elect participation in the Optional Retirement Programs. When the Optional Retirement form is completed, the form along with a certification is signed by the President of the community college, or a designee, certifying that the employee is in a professional position and the yearly salary of that employee. The form is then sent to the Active Life Unit, Maryland State Retirement Agency, 120 East Baltimore Street, Baltimore, MD 21202-1600. Once the information is approved by the Active Life Unit, the form is sent to MHEC.

Each month the community college submits an invoice to MHEC, which includes the name of the employee, social security number, yearly salary and the amount billed for that month. The community college again certifies the accuracy of the information on the invoice including the salary. MHEC checks the salary with the amount certified by the President on the original application and verifies the salary with the list of salaries provided by the community college at the beginning of each fiscal year, based on these verification results pays the community college. If any employee on the list included with the invoice has not been approved by the Active Life Unit of the Maryland State Retirement Agency, the community college is not paid for that employee until the proper certification is received.

For the past three audits, it has been recommended that MHEC verify the eligibility of the enrolled individual and the accuracy of related salary information reported by the community colleges. MHEC is of the opinion that the above checks are adequate to determine the proper reimbursement to the community colleges for the optional retirement program. This procedure was also recommended by OLA in a previous audit. Since the Office of Legislative Audits has not found evidence that the payments are not proper and the costs of auditing all community colleges would not be cost effective, the propriety of auditing the community colleges at this point in time is not deemed by MHEC to be a viable option. In addition, MHEC does not have the staff to perform these audits, does not have the funding to hire outside auditors, and cannot justify requesting additional money to perform these audits by creating additional staff of outside auditors.

Each year MHEC determines the courses that are eligible for reimbursement through the Designated Health Manpower Shortage Programs and Designated Statewide Programs. The list of courses is sent to the institutions for them to determine those courses that can be reimbursed under the two programs. The community colleges prepare an invoice that includes the student's social security number, name, county of residence, name of program, credit hours, tuition differential per credit hour and total to be reimbursed for each student and a total. The information on this invoice is certified by the preparer and the president of the community college. When MHEC receives the invoice, it is checked to insure that the program listed is on the list of approved programs to be reimbursed and the calculation of the reimbursement amount is verified.

As with the optional retirement program, the auditors have not identified any improper payments made to the community colleges. And again with considerable reductions to the MHEC staff, the auditing of the community colleges is not a viable option due to lack of employees and lack of funds.²

Finding 7, page 16 (Proper controls over purchases were not established, and MHEC did not comply with certain State Procurement Regulations.)

MHEC concurs with the finding that in two cases the procurements were not published on *eMaryland Marketplace* at the time of the purchases and in one case the documentation supporting the procurement was not found. In both cases competitive bids were solicited and the low bid was selected for the printing of booklets for OSFA. In the three years, since these purchases, MHEC has replaced procurement staff and has complied with the requirements of the State Procurement Regulations with all procurements over \$5,000 published on eMaryland Marketplace.

² **Auditor's Comment:** MHEC's response indicates that, considering its limited resources, it believes it has adequate controls to ensure the propriety of certain aid payments to community colleges. However, we continue to believe that the controls are not sufficient as the current procedures are primarily dependent on the community colleges' assurances that information supporting the aid payments is accurate.

AUDIT TEAM

Brian S. Tanen, CPA, CFE
Audit Manager

Stephen P. Jersey, CPA, CISA
Information Systems Audit Manager

Ronnette L. Bailey, CFE
Senior Auditor

Amanda L. Roller
Information Systems Senior Auditor

Henry H. Startzman, IV
Staff Auditor

Jacquelyn M. Tindall
Information Systems Staff Auditor