

Audit Report

College Savings Plans of Maryland

June 2015



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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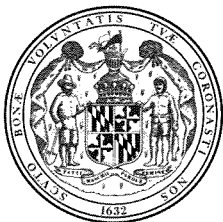
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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Karl S. Aro
Executive Director

June 23, 2015

Thomas J. Barnickel III, CPA
Legislative Auditor

Senator Guy J. Guzzone, Co-Chair, Joint Audit Committee
Delegate Craig J. Zucker, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the College Savings Plans of Maryland (CSPM) for the period beginning August 3, 2011 and ending November 17, 2014. CSPM provides savings plans to help individuals save for future college expenses and to reduce dependence on student loans and other forms of debt.

Our audit disclosed that CSPM did not determine the disposition of checks that remained uncashed for an extended period nor did CSPM take action to transfer funds determined to be abandoned to the Comptroller of Maryland as required. In addition, CSPM did not ensure that certain sensitive account holder data maintained by a third-party service provider were adequately secured.

CSPM's response to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by the CSPM.

Respectfully submitted,

Thomas J. Barnickel III, 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 (MPCT) and the Maryland College Investment Plan (MCIP) – to help individuals save for future college expenses and to reduce dependence on student loans and other forms of debt. 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. Effective October 1, 2008, State law authorized the CSPM to establish a third plan option, the Maryland Broker-Dealer College Investment Plan, which allows contributions to an investment account through private investment firms selected by the account holder; however, as of February 2015, the plan was not operating as CSPM's Board had not opted to offer this plan.

Individuals seeking to participate in a college savings plan may execute a prepaid tuition contract available through MPCT and/or establish an investment account in the MCIP. Students may use their accounts at nearly any accredited college nationwide. According to the State's records, CSPM's operating expenditures totaled approximately \$2.6 million during fiscal year 2014.

Maryland Prepaid College Trust

MPCT 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. MPCT is operated directly by 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 MPCT. Specifically, the Tax-General Article, Section 10-208 of the Annotated Code of Maryland allows a Maryland taxpayer to deduct up to \$2,500 for any tax year, per prepaid tuition contract, for the purpose of calculating his or her Maryland adjusted gross income.

CSPM does not guarantee that the assets of MPCT will be sufficient to pay the tuition and fees estimated under the contracts. However, in the event that the market value of MPCT'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 MPCT'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 MPCT are not debts of the State. An actuarial study conducted in October 2014 indicated that MPCT had a surplus of \$321.5 million as of June 30, 2014 and was 142.5 percent funded.

The Education Article, Section 18-1906 of the Annotated Code of Maryland provides that the Board may authorize a refund to MPCT account holders should the funded status of MPCT exceed 130 percent and if certain other conditions are met. The College Savings Plans of Maryland Board has not authorized a refund at this time. The Board attributes the current surplus to strong market performance and lower than projected tuition increases at Maryland's public colleges; however, the Board believes there is a significant likelihood that these trends may not continue at the same levels over the next few years.

Maryland College Investment Plan

MCIP was established to allow individuals to invest funds to help pay the cost of providing a college education for a designated beneficiary. CSPM executed a contract with a private investment company that is responsible for managing MCIP by processing Plan enrollment applications, investing related payments, and disbursing funds. The current contract will expire in June 2017. Earnings on funds invested in MCIP and 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 \$350,000. Account holders and designated beneficiaries participating in MCIP 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 MCIP 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 tax year, per qualified beneficiary, for the purpose of calculating his or her Maryland adjusted gross income.

Financial Information

According to its records, as of June 30, 2014, CSPM was administering approximately 31,600 prepaid tuition contracts applicable to MPCT. The market value of the MPCT's investments (including cash) totaled approximately \$895 million as of June 30, 2014. CSPM records also indicated that CSPM deposited contract application fees and related payments totaling approximately \$58 million into MPCT during fiscal year 2014.

As of June 30, 2014, CSPM's records indicated that approximately 145,700 participants had opened investment savings accounts in MCIP with balances totaling approximately \$3.9 billion.

CSPM engages an independent accounting firm to audit its annual financial statements for MPCT and MCIP. Such statements are included in CSPM's annual reports. In the related audit reports for the fiscal years ended 2012, 2013, and 2014, the firm stated that the financial statements present fairly, in all material respects, the financial positions of MPCT and MCIP, and the changes in their financial positions and cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the two findings contained in our preceding audit report dated July 18, 2012. We determined that CSPM satisfactorily addressed these two findings.

Findings and Recommendations

Abandoned Funds

Finding 1

The College Savings Plans of Maryland (CSPM) did not determine the disposition of uncashed checks nor did it take action to transfer funds determined to be abandoned to the Comptroller of Maryland as required.

Analysis

CSPM did not determine the disposition of uncashed checks nor did it take action to transfer funds determined to be abandoned to the Comptroller of Maryland as required by its Board *Policy Regarding Outstanding Checks*. CSPM issues checks from the Maryland Prepaid College Trust (MPCT) that are made payable

to account holders or to the colleges the plan beneficiaries attend. CSPM's records indicated that, as of August 2014, there were 448 uncashed checks totaling approximately \$1.7 million that were more than three years old. Although CSPM determined that certain of these checks, such as those with stop payment action, may no longer be properly classified as outstanding, CSPM had not determined and specified which funds from the aforementioned \$1.7 million should be classified as abandoned and, accordingly, transferred to the Comptroller.

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. Board *Policy* provides further guidance regarding monitoring, due diligence notification, determination of abandonment, and transfer procedures. CSPM advised us it never implemented the Board *Policy* due to subsequent concerns about certain legal and tax implications associated with disbursing funds from the trust. Disbursements from MPCT to colleges and account holders during fiscal year 2014 totaled approximately \$51 million.

Recommendation 1

We recommend that CSPM

- a. determine the disposition of uncashed checks, and**
- b. ensure funds determined to be abandoned are transferred to the Comptroller of Maryland in accordance with State law unless formal legal advice is obtained to otherwise authorize CSPM to retain the funds.**

System Security

Finding 2

CSPM lacked assurance that certain security controls were addressed by the service provider administering the Maryland College Investment Plan (MCIP).

Analysis

CSPM lacked assurance that sensitive account holder data maintained by the third-party service provider used to administer the MCIP was properly processed and secured. The private investment company that administered MCIP by processing plan enrollment applications, investing related payments, and disbursing funds, obtained a Service Organization Control 1 (SOC 1) Type 2 review from an independent accounting firm. The resulting report addressed the company's recordkeeping system and the suitability of the design and operating effectiveness of its controls for the year ending June 30, 2014.

Although obtaining this type of review is appropriate because the company's services and related internal controls impact the financial statements for MCIP, the review does not provide assurance regarding the company's system security, availability, processing integrity, data confidentiality, and privacy. Therefore, because of the nature and sensitivity of the MCIP information (such as, personal identifiable information), we believe CSPM should also require the company to obtain a SOC 2 Type 2 review to address certain key security controls. Appropriate controls would ensure, for example, that

- data backups and data at rest are encrypted;
- intrusion detection, malware prevention, data loss prevention, and antivirus protection have been implemented;
- user account and password controls for applications and databases are in accordance with an agreed-upon standard;
- restrictions of connections between trusted and untrusted networks are reviewed at planned intervals; and
- production data are not used in development environments.

The American Institute of Certified Public Accountants has issued guidance concerning examinations of service organizations. Based on this guidance, service providers may contract for an independent review of controls, resulting in an independent auditor's report referred to as a SOC report. There are several types of SOC reports with varying scope and levels of review and auditor testing. The SOC 2 Type 2 report includes the results of the auditor's review of controls placed in operation and tests of operating effectiveness for the period under review and could include an evaluation of the company's information technology security, availability (such as, business continuity management), processing integrity (completeness, accuracy, and timeliness), confidentiality (data protection), and privacy (data access and monitoring) .

Recommendation 2

We recommend that CSPM

- a. seek to amend the existing contract and ensure that future agreements with contractors processing MCIP data to also include provisions requiring the contractor to regularly obtain a SOC 2 Type 2 review pertaining to the contractor's system operations; and**
- b. obtain copies and review these SOC 2 Type 2 reports from the contractors, and ensure that the related independent reviews adequately address critical security concerns and that contractors implement all critical report recommendations.**

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the College Savings Plan of Maryland (CSPM) for the period beginning August 3, 2011 and ending November 17, 2014. 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 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 significance and risk. The areas addressed by the audit included cash receipts and disbursements. We also determined the status of the findings included in our preceding audit report.

CSPM engages an independent accounting firm to audit its annual financial statements for the Maryland Prepaid College Trust (MPCT) and for the Maryland College Investment Plan (MCIP). In the related audit reports for the fiscal years ended 2012, 2013, and 2014 the firm stated that the financial statements present fairly, in all material respects, the financial positions of the MPCT and the MCIP, and the changes in their financial positions and cash flows for the years then ended, in accordance 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 MPCT. Our audit procedures for investments were generally limited, therefore, to obtaining a sufficient basis for that reliance.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of CSPM's operations, and tests of transactions. We also performed various data extracts of pertinent information from the State's Financial Management Information System (such as expenditure data). The extracts are performed as part of ongoing internal processes established by the Office of Legislative Audits and were subject to various tests to determine data reliability. We determined that the data extracted from this source were sufficiently reliable for the purposes the data were used during this audit. Finally, we performed other auditing procedures

that we considered necessary to achieve our objectives. The reliability of data used in this report for background or informational purposes was not assessed.

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.

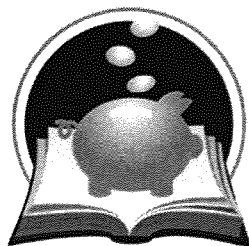
Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

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 a finding relating to a condition that we consider to be a significant deficiency 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 report also includes a finding regarding a significant instance of noncompliance with applicable laws, rules, or regulations. A less significant finding was 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



COLLEGE SAVINGS PLANS OF MARYLAND

Save here. Go anywhere.®

Mr. Thomas J. Barnickel III, CPA
Legislative Auditor
Office of Legislative Audits
301 West Preston Street
Room 1202
Baltimore, Maryland 21201

June 17, 2015

Dear Mr. Barnickel:

Thank you for this opportunity to respond to the findings of your recent audit. On behalf of the College Savings Plans of Maryland, I want to express my appreciation for the important work conducted by the Office of Legislative Audits (OLA) on behalf of the public and acknowledge the professionalism demonstrated by OLA staff throughout this audit process.

Finding 1

The College Savings Plans of Maryland (CSPM) did not determine the disposition of uncashed checks nor did it take action to transfer funds determined to be abandoned to the Comptroller of Maryland as required.

College Savings Plans of Maryland staff have undertaken a labor intensive exercise to research older physical check stubs, review old bank statements that pre-date the passage of the policy and to cross-reference the check log against account holder information within our database in order to update agency records and resolve uncashed check issues to the greatest extent possible. This effort is a top priority for the College Savings Plans of Maryland that we expect to have completely resolved before the end of the current fiscal year.

While CSPM disagrees with the figures used in this finding since they are no longer current, the agency agrees with the finding of the auditors concerning the disposition of uncashed checks and the need to transfer funds determined to be abandoned to the Comptroller of Maryland as required by College Savings Plans of Maryland's Policy Regarding Outstanding Checks. This policy was passed by the Board in 2012; however, its implementation was delayed in order to research the tax implications to affected account holders and due to limited staffing. Both concerns have since been addressed, and management is in the process of developing a standardized procedure. The College Savings Plans has made significant progress in reducing the number and amount of outstanding checks. Specifically, the current number of outstanding checks has been reduced from 448 to 235 and the value of those checks has been reduced from the nearly \$1.7 million cited in the report to \$313,089.49.

CSPM is fully committed to resolving this finding and expects to fully implement the agency's Policy Regarding Outstanding Checks by December 31, 2015.

Finding 2

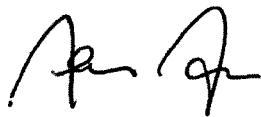
CSPM lacked assurance that certain security controls were addressed by the service provider administering the Maryland College Investment Plan (MCIP).

At the time when CSPM's current Program Manager RFP was written in 2006, state requirements and industry standards with respect to data security were very different than they are today. The MCIP program manager does currently conduct SOC 1 Type 2 certification for CSPM, but does not currently perform SOC 2 Type 2 certifications for CSPM or any of its other clients. However, recognizing the rapidly changing landscape of data security today versus 2006, the agency has obtained a binding, written commitment from the MCIP program manager to conduct a SOC 2 Type 2 certification by an outside party and has been in discussions to formally amend the existing contract to include SOC 2 Type 2 certification as a continued requirement. The agency will review these SOC 2 Type 2 reports, and ensure that the related independent reviews adequately address security concerns and that critical report recommendations are fully implemented. While conducting this report is a large undertaking, CSPM expects it to be completed in Fiscal Year 2016.

Furthermore, CSPM will be issuing a new Program Manager RFP during Fiscal Year 2016 and the agency is including SOC 2 Type 2 reporting a requirement for the new program manager agreement.

Again, please accept my appreciation for the important work that you and your staff do each day on behalf of the public.

Sincerely,



Andrew Friedson
Interim Executive Director
College Savings Plans of Maryland

Cc: Hon. Nancy K. Kopp, CSPM Board Chair
Mr. John Kenney, CSPM Audit and Finance Chair

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