Senator Edward J. Kasemeyer, Chair
Senate Budget and Taxation Committee
Miller Senate Office Building, 3 West Wing
11 Bladen Street
Annapolis, Maryland 21401

Delegate Maggie McIntosh, Chair
House Appropriations Committee
House Office Building, Room 121
6 Bladen Street
Annapolis, Maryland 21401

Dear Senator Kasemeyer and Delegate McIntosh:

The Office of Legislative Audits (OLA) has conducted a review of the actions taken by the Maryland Higher Education Commission (MHEC) to resolve the four repeat findings in our October 29, 2013 audit report. This review was conducted in accordance with a requirement specified in the April 2014 *Joint Chairmen's Report* (JCR), page 130. The JCR required that, prior to release of $100,000 of its administrative appropriation for fiscal year 2015, MHEC must take corrective action on all repeat audit findings. The JCR language further provided that OLA submit a report to the budget committees listing each repeat audit finding along with a determination that each repeat finding was corrected within sufficient time to allow 45 days for the budget committees to review and release the funds prior to the end of fiscal year 2015.

The October 29, 2013 MHEC audit report contained four repeat audit findings (findings 2, 3, 4, and 5) that were addressed by six recommendations. In accordance with the aforementioned JCR requirement, MHEC provided a report to OLA, dated October 31, 2014, detailing the corrective actions that MHEC has taken with respect to these repeat audit findings. We reviewed this report and related documentation, performed limited tests and analyses of the information, and held discussions with MHEC personnel, as deemed necessary, to assess the implementation status of the related recommendations. Our review did not constitute an audit conducted in accordance with generally accepted government auditing standards.

Exhibit 1 is MHEC's October 31, 2014 status report, which indicated that corrective action had been taken to address all four repeat findings. Our review determined that MHEC had taken the necessary corrective actions to implement the recommendations for two of four findings. For the remaining two findings, the actions taken did not satisfactorily address the recommendations.
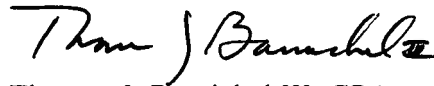
     A summary of OLA's assessment of the status of each of the repeat audit findings is included in the attached Exhibit 2. Exhibit 3 contains OLA's assessments regarding the two repeat findings that had not been resolved. After discussing our review results, MHEC generally agreed with the accuracy of the information presented and indicated that the remaining corrective actions will be taken. We wish to acknowledge the cooperation extended to us by MHEC during this review.

     We trust our response satisfactorily addresses the JCR requirement. Please contact me if you need additional information.

Sincerely,

Thomas J. Barnickel III, CPA
Legislative Auditor

cc: Senator Guy J. Guzzone, Co-Chair, Joint Audit Committee
       Delegate Craig J. Zucker, Co-Chair, Joint Audit Committee
       Joint Audit Committee Members and Staff
       Senator Thomas V. Mike Miller, Jr., President of the Senate
       Delegate Michael E. Busch, Speaker of the House of Delegates
       Governor Lawrence J. Hogan, Jr.
       Comptroller Peter V.R. Franchot
       Treasurer Nancy K. Kopp
       Attorney General Brian E. Frosh
       David R. Brinkley, Secretary, Department of Budget and Management
       Anwer Hasan, Chairman, Maryland Higher Education Commission
       Jennie C. Hunter-Cevera, Ph.D, Acting Secretary, MHEC
       Jeffrey F. Cann, Director of Budget and Administration, MHEC
       Joan Peacock, Manager, Audit Compliance Unit, DBM
       Karl S. Aro, Executive Director, Department of Legislative Services
       Garret T. Halbach, Policy Analyst, Department of Legislative Services

Exhibit 1 to March 12, 2015 Letter to Joint Chairmen

MHEC
Creating a state of achievement

Martin O'Malley
Governor

Anthony G. Brown
Lt. Governor

Anwer Hasan
Chairperson

Catherine M. Shultz
Acting Secretary

October 31, 2014

Thomas J. Barnickel III, CPA
Legislative Auditor
301 West Preston Street, Room 1202
Baltimore, MD 21201

> Re: Audit of the Maryland Higher Education
> Commission – October 29, 2013

Dear Mr. Barnickel:

Thank you for your June 25, 2014 letter regarding the April 2014 *Joint Chairmen Report* prohibiting the Maryland Higher Education Commission (MHEC) from spending $100,000 of its administrative appropriation unless corrective action is taken, on or before November 1, 2014. We appreciate the opportunity to discuss the corrective actions MHEC has taken to address the repeat audit findings contained in the audit report issued by the Office of Legislative Audits (OLA) covering the time period of August 3, 2009 through August 5, 2012.

Please be assured that MHEC is giving significant attention to all of the items identified in the audit report, and we anticipate that you and your staff will be satisfied with MHEC's progress. We appreciate the efforts and support from OLA audit staff and the Department of Budget and Management's Audit Compliance Unit in their suggestions and recommendations for the resolution of the repeat audit findings.

MHEC continues to review our internal policies in light of these findings and look forward to your feedback for further improvement. If you have any questions regarding this report, please feel free to contact me or Mr. Jeff Cann, Director of Budget and Administration, at 410-767-3044, or jeff.cann@maryland.gov. Thank you for your continued support of the Maryland Higher Education Commission.

Sincerely,

Catherine M. Shultz, J.D.
Acting Secretary of Higher Education

Enclosure:
Community College Audit Requirements

CS:jc

Recommendation 2
We recommend that MHEC
a. review financial aid award determinations, in accordance with its policy, to help ensure the propriety of the awards (repeat);
b. ensure that employees who do not have the ability to modify such data use MD CAPS output reports to verify that all critical changes recorded are accurate and properly authorized (repeat).

MHEC Response:

The Commission concurs with the recommendations. The following corrective actions have been taken.

The Director of Student Financial Assistance reviewed the policies for internal controls for financial aid programs administered by MHEC. Modifications to our internal Quality Assurance procedures have been implemented, as outlined below, to help ensure the propriety of awards processed by the Commission.

I. **Annual Awarding Quality Assurance Review Process**

   To ensure all awards are accurate, after awarding has been completed and prior to funds being disbursed, OSFA implemented a quality assurance process, where a sampling of students for each program is verified to ensure accuracy:

   1. Beginning with the 2014-2015 award year, OSFA implemented this quality assurance process and reviewed a sampling from all grant programs. During the review process, OSFA reports its findings on the newly created quality assurance worksheets for each program. This process is performed internally by the Program Manager, who is independent of the awarding process. The total number of student records reviewed during this process is a percentage based on the total number of students awarded.

   2. For the Educational Assistance and Guaranteed Access Grant, 50 students from each type of institution (private, public, community college, and career school) were randomly selected for a total of 400 student records reviewed (200 EA & 200 GA).

   3. For MHEC's smaller career based programs (Edward T. Conroy, Workforce Shortage Grant, and Veterans of Iraq & Afghanistan), all awards were verified.

   4. If there are any award errors noted during the award process, the Program Manager will report the errors to the Associate Director in order for the awards to

be updated correctly. At the end of the 2014-2015 review process, no errors were found.

II.   Manual Award Review Process

MHEC has taken the following steps below to ensure the accuracy of manual awards applied to the student's account:

1.   The Office of Student Financial Assistance (OSFA) has developed a report/query that is run monthly to identify all manual awards applied. This process was implemented beginning with the 2014-2015 academic year. This task is performed by the Program Manager, who is independent from the awarding process within OSFA, verifies the accuracy of each award.

2.   OSFA developed a quality assurance form for each grant program that is used during the review process. It is the responsibility of the Program Manager, who is independent from awarding to review each award, to ensure that the student has met all of the eligibility requirements.

3.   Since implementing this process beginning with the 2014-2015 award year, OSFA has reviewed about 1,665 manual awards and no adjustments have been made.

Finding 2 also noted that OSFA did not have an external audit process in place to validate higher education schools' eligibility verification process performed on select Educational Assistance Grant recipients. OSFA is in the process of establishing MHEC audit procedures as follows:

III.   Independent Audit Reviews of Financial Aid Awards

MHEC will perform audit reviews of schools' verification process to ensure their propriety:

1.   OSFA has revised its internal audit review policy. The new internal audit policy requires that the audit be performed on the Educational Assistance Grant Program (EA), Guaranteed Access Grant Program (GA), and the Campus Based Educational Assistance Grant programs. OSFA is developing an MHEC audit team (2 OSFA staff members) to audit and review state awards at institutions.

2.   These audits will occur on a rotating schedule of once every 4 years resulting in onsite audits of 13 institutions each year. There are 53 Maryland higher education institutions that award need-based grants.

3.   Beginning in March 2015, OSFA will perform preliminary sample audit reviews at 4 selected institutions for the 2013-2014 award year. There will be one each from these categories: career, public, private, and community college. During

these sample audit reviews, OSFA will use the newly developed internal audit review policy and procedures. Only a small sampling size, not to exceed 75 records, will be reviewed at each institution for this initial test of the audit process.

4. In addition, an OSFA State of Maryland student residency questionnaire is in development. All MHEC financial aid awardees will be required to complete the questionnaire prior to disbursement of any funds. This process will be implemented in May 2015 for the 2015-2016 award year.

5. MDCAPS will be updated to require institutions to indicate residency status of a student. This process will be performed at the same time the institution certifies the student's award for verification of enrollment and degree seeking status.

6. The internal audit review process will require institutions to document Maryland residency, financial need, family income, degree seeking status, full-time enrollment, and that the students meet all other eligibility requirements for the grant award. All of these items will be verified onsite for each student selected by MHEC for the audit. To gather this information, the OSFA audit team will rely on the FAFSA, MHEC student questionnaire, the institution's financial aid files, and any institutional documents used to determine the students eligibility.

7. To be consistent with MHEC OSFA policy, the auditing sample size will be approximately 5% of the total grants awarded during the prior award year. It is important to note that the sampling size will vary based on the number of awards made at each of the 13 institutions selected for that audit year. The Educational Assistance grant is the largest need based grant program, both the Campus Based and Guaranteed Access Grant have fewer awards per institution.

    Using FY14 as an example our sample size would be determined as follows:

Type of Grant	Number Awarded in FY 2014	Sample Size Percentage	Total Number of Grant Awards MHEC wil Audit	Total # of MD Insitutions that Award	Approximate # of Grants MHEC Audit per School
Educational Assistance Grant (EA)	33,864	5%	1693	13	130
Guaranteed Acces Grant (GA)	1,408	5%	70	Will vary based on # of schools	Will vary based on # of schools
Campus Based EA Grant	1,765	5%	88	Will vary based on # of schools	Will vary based on # of schools
			1852		

8. In October 2015, MHEC will begin its yearly audit review cycle, verifying the eligibility verification process of each higher education institution once every 4 years. This audit review period will be October through March. The OSFA audit team will have one week at each institution to review all selected students.

9. After OSFA has performed the audit review process for all institutions within that one year cycle, a preliminary report will be provided to each institution, highlighting any issues and allowing the institutions the opportunity to resolve any discrepancies before sending the final report. Institutions will have 45 days to perform any corrective actions noted in the preliminary report and submit a written report back to the OFSA. The final audit report will be provided to the institution no later than 60 days after receipt of the corrective action report. At that time, if an institution is not within compliance, the institution will be audited on a yearly basis for two consecutive years.

IV. Proper Monitoring Documentation

MHEC agrees that proper monitoring and documenting of employees' capabilities within the MDCAPS system is essential to ensure that access and authority levels are related to the employee's duties. OSFA has implemented regular review procedures that require approval of staff's access levels every 4 months.

The following corrective actions have been implemented to ensure access to the Maryland College Aid Processing System (MDCAPS) is monitored internally; OSFA implemented a quarterly review process on access/authority levels of agency users:

1. OSFA created a report that identifies all agency users who have a MDCAPS account and their access/authority levels. It is the responsibility of the Associate Director to review all agency user accounts quarterly and record any changes. During this process, the Associate Director is confirming that access levels for each account is accurate, as well as documenting any changes to access levels.

2. In addition to the report, OSFA created a user permission form for agency users to complete at the time their MDCAPS account is created or modified. The user must sign and date the agreement before logging into the system. If there are any changes to access levels after the form has been signed or after the initial account was created, a new form must be submitted and the new access levels must be noted on the report.

OLA Finding 3
MHEC did not adequately monitor student service obligation fulfillment as a condition for certain financial aid awards.

Recommendation 3

We recommend that MHEC
a. **ensure that service obligation notices and employer verifications are sent and returned in a timely manner (repeat);**
b. **take appropriate follow-up action when service obligations are not being performed, including placing the accounts into repayment status and properly transferring the accounts to the accounting department to initiate collection efforts (repeat); and**
c. **ensure its records reflect an accurate status of all service award recipients.**

MHEC Response:
The Commission concurs with the recommendation. The following corrective actions have been taken.

The OSFA Management Team has established an improved process for monitoring student fulfillment of service award obligations for each of the programs that it administers. This is a three step process: 1) OSFA is in the process of reviewing all service obligation records to verify that the current status for each program recipient is accurate; 2) service obligation letters and employer verification forms have been created and the notices are automatically generated by the MDCAP's system; and 3) OSFA is ensuring that service obligations are being performed through the timely review of returned forms. Those recipients that fail to complete the necessary service obligation will be forwarded to MHEC's accounting department to initiate collection efforts.

I. **Financial Advisory Work Group**
    In October 2013, a work group was established to address and resolve this finding. The work group monitors various career-based scholarships that require a service obligation. With the assistance of the work group, the following actions have been taken:

    1. The service obligation process was automated through the MDCAPs system in December 2013. Now all service obligation notifications are generated and tracked directly through the MDCAPs system for each student.

    2. Employer verification notifications are set to run every 21 days within the required sequence, not to exceed three notifications. If the employer verification questionnaire is not submitted after the third notice, the student is referred to accounting for repayment.

    3. OSFA developed an annual service obligation calendar that outlines when service obligations are generated. This calendar is monitored by the Career-Based Program Manager and Associate Director to ensure notifications are generated on time annually.

Weekly notifications are continuously generated for service questionnaires, employer verification forms, service obligation completions, and notification of the account being referred to accounting for payment. These notifications will continue to run weekly until all outstanding service obligations are current.

II. **Reporting Requirements**

A monthly report has been created that identifies all students who have a service obligation. This report allows OSFA to effectively monitor all students and their status.

The report details the following for each student:

a. Program
b. Status
c. Date of Disbursement
d. Total Disbursement
e. Original Obligation Years
f. Date Student Returned Last Questionnaire
g. Number of Service Questionnaires Sent
h. Employment Verified Date
i. Employment Verification Notification Count
j. Last Employment Verification Sent Date
k. In Repayment Date

Each month, the Career-Based Program Manager runs the service obligation report and then provides the report to the Career-Based Program Administrator. The Program Administrator performs a documented review to ensure all students have the correct status and notifications/questionnaires and employer verifications have been generated to all students who are "In Service". Service questionnaires and employment verification notifications are now sent out consistently.

Beginning January 2014, OSFA identified outstanding service obligations for students in the Hope and Science Technology programs and generated about 3,000 service questionnaire notifications.

1. Since there was a lapse in OSFA monitoring for student accounts with service obligations, OSFA assigned two individuals to review all students who have a service obligation.

a. Two staff members, beginning June 2014, perform a weekly review of at least 75 records to ensure the student is in the correct status as it pertains to their service obligation. A total of 24,000 records must be reviewed for accuracy.

b. Through this internal audit review process, OSFA has been able to send out service questionnaires and employer verification questionnaires if applicable for all career, occupational, and unique populations.

III. **Review of Duplicate Records**

Duplicate records have been identified through reviews of the Monthly Service Obligation Report, and the following corrective actions have been taken:

1.   The internal audit review group has identified duplicate records that are a direct result of students who have multiple service obligations through different programs. A student cannot fulfill more than one service obligation at a time.

2.   On all accounts reviewed by OSFA that are duplicates, comments have been placed in their Service Obligation (MDCAPS) record.

IV.   Review of Service Obligations

Follow-up action for Service Obligations is now being performed and appropriate action has been taken for student accounts that no longer meet the required service requirements:

1.   If a student fails to submit the service questionnaire or employer verification questionnaire after 3 notifications have been generated, the student's account is placed in a repayment status and referred directly to MHECs Accounting Department who initiates the repayment process.

2.   In addition, if the student submits an incomplete or inaccurate service questionnaire, the student is contacted and given the opportunity to resubmit. If the inaccuracies are not resolved, the student is referred directly to MHECs Accounting Department, which initiates the service obligation repayment process. The same practice is applied if MHEC receives any employer verification form that states employment in another field outside of their required field of employment (service) obligation.

OSFA will continue to generate service obligation notifications until all outstanding accounts are settled. After that, notifications will generate annually as required for each student with a service obligation.

OLA Finding 4
Delinquent accounts were not properly pursued for collection and referred to the Department of Budget and Management's Central Collection Unit.

Recommendation 4
We recommend that MHEC use available accounts receivable system reports and pursue delinquent service obligation accounts for collection in accordance with CCU regulations. Specifically, we recommend that
   a. written payment demands be sent at 30-day intervals, and
   b. delinquent accounts are referred to CCU for collection assistance as required (repeat).

MHEC Response:
MHEC corrective actions for this finding include a monthly review of student service obligation accounts receivable, including the generation of late pay letters and no response letters. These corrective actions have resulted in the processing and sending over 500 delinquent accounts totaling $2.7 million to the Central Collections Unit. In addition, consistent implementation of these corrective actions has resulted in the collection of more than $ 1 million in general fund revenue in FY 2014 from students who received service obligation scholarships, but did not fulfill their service obligations. We continue to process all student accounts within the timelines prescribed and will continue to forward delinquent accounts to the collections unit as recommended in the finding.

OLA Finding 5
MHEC did not ensure that retirement and pension contributions for certain community college employees were proper.

Recommendation 5
We recommend that MHEC
a. ensure reimbursements from community colleges for retirement and pension contributions are proper, and
b. establish procedures that will ensure the propriety of amounts paid by MHEC to the community colleges for employees enrolled in optional retirement plans (repeat).

MHEC Response:

The Commission concurs with the recommendation and is in the process of implementing the following corrective actions:

MHEC informed the community colleges of new audit requirements as a result of Senate Bill 358/House Bill 1088-Audit Responsibilities-Maryland Higher Education Commission. Enclosed, under separate cover, is the correspondence MHEC sent to all community colleges outlining the new audit requirements and the specific scope of work the auditors must perform in the annual audits. Specifically, beginning with the fiscal year 2015 audit cycle, community colleges are now required to prepare a Schedule of Community College Source of Salary Funds

for Staff Enrolled in State Retirement by Retirement Plan Type (*see attached example*), and a Community College State Retirement Benefit Reconciliation (*see attached example*). These new schedules must also be included in their annual financial statements.

These community college schedules must be independently audited in one of three ways:

- as a separately tested supplemental section of their existing annual financial audit
- as a separately tested supplemental section of their federally mandated single audit of federal assistance programs
- conduct a separate independent audit.

To ensure the additional testing of retirement and pension contributions will satisfy the audit requirements of OLA and to ensure the costs for these additional audit requirements are reasonable, MHEC provided the community colleges with specific audit objectives. The community colleges are required to provide a copy of the audit methodology, scope of work, and itemized costs prior to final audit procurement solicitation. These new guidelines will ensure the propriety of amounts paid by MHEC to the community colleges for employees enrolled in the optional retirement plans.

Exhibit 2 to March 12, 2015 Letter to Joint Chairmen

Status of Repeat Findings in OLA's October 29, 2013 Audit Report on the Maryland Higher Education Commission (MHEC)

Prior Recommendations Pertaining to Repeat Findings	Status Based on OLA Review
Financial Aid	
2. We recommend that MHEC	
a. review financial aid award determinations, in accordance with its policy, to help ensure the propriety of the awards; and	Not Resolved
b. ensure that employees who do not have the ability to modify such data use output reports from its automated Maryland College Aid Processing System (MD CAPS) to verify that all critical changes recorded are accurate and properly authorized.	Not Resolved
3. We recommend that MHEC	
a. ensure that service obligation notices and employer verifications are sent and returned in a timely manner; and	Not Resolved
b. take appropriate follow-up action when service obligations are not being performed, including placing the accounts into repayment status and properly transferring the accounts to the accounting department to initiate collection efforts.	Not Resolved
4b. We recommend that delinquent service obligation accounts be referred to the Department of Budget and Management's Central Collection Unit for collection assistance as required.	Corrected
Aid to Community Colleges	
5b. We recommend that MHEC establish procedures that will ensure the propriety of amounts paid by MHEC to the community colleges for employees enrolled in optional retirement plans.	Corrected

Shaded recommendations are more fully described in Exhibit 3.

Exhibit 3 to March 12, 2015 Letter to Joint Chairmen

OLA's Assessments Regarding Repeat Findings That Had Not Been Resolved

Financial Aid

Prior Report Recommendation – Finding 2
We recommend that MHEC
a. review financial aid award determinations, in accordance with its policy, to help ensure the propriety of the awards (repeat); and
b. ensure that employees who do not have the ability to modify such data use output reports from its automated Maryland College Aid Processing System (MD CAPS) to verify that all critical changes recorded are accurate and properly authorized (repeat).

Status: Not Resolved
Although MHEC implemented procedures for the review of the financial aid award determinations on a test basis by the Program Manager, who MHEC claimed was independent of the awarding process, our review found that this individual was assigned incompatible MD CAPS system capabilities. The Manager could make changes to awards on student accounts and create or edit system capabilities granted to other system users and, therefore was not independent of the award process.

According to its October 31, 2014 status report, MHEC has also established an internal audit process at the institutions to review awards from the Educational Assistance Grant Program, Guaranteed Access Grant Program, and the Campus Based Educational Assistance Grant programs on a test basis. This internal audit process is intended to supplement the aforementioned independent review of financial aid award determinations by verifying that the institutions documented certain award eligibility criteria (such as Maryland residency, family income, full-time enrollment). Since the internal audit process is not expected to begin until October 2015, we could not assess its effectiveness.

Finally, MHEC did not generate output reports from MD CAPS identifying critical changes to student data. These reports should be used by independent employees to ensure that critical changes affecting financial aid awards were authorized and accurately processed.

Prior Report Recommendation – Finding 3
We recommend that MHEC
a. ensure that service obligation notices and employer verifications are sent and returned in a timely manner (repeat); and
b. take appropriate follow-up action when service obligations are not being performed, including placing the accounts into repayment status and properly transferring the accounts to the accounting department to initiate collection efforts (repeat).

Status: Not Resolved
In December 2013, MHEC automated the service obligation process, including generating service obligation notices and employer verifications and tracking the notices for each student during the student's term of obligation, which could be multiple years. However, we noted that the automated system was set up to send notices for certain student awards only once in the student's lifetime rather than periodically during the period of service. Upon our inquiry, MHEC indicated that a programming error in the automated process resulted in the one-time only notification and, thereafter, the intended annual service obligation notices were not being generated to ascertain the current status of the student's service obligation. Relying on MHEC records, we estimate that more than 2,500 student accounts with awards totaling approximately $21 million could be affected by this error.

Furthermore, because of the programming error, there is no assurance that appropriate follow-up actions are being taken, including placing accounts into repayment status and initiating collection efforts when service obligations are not being performed by the students. Specifically, since there is no record of subsequent annual notices or the resultant responses or non-responses from the students in the automated system, there would be no prompt from the system for MHEC to initiate appropriate follow-up action.