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INDEPENDENT STATE AUDITOR'S REPORT ON
CERTAIN ACTIVITIES OF THE
MASSACHUSETTS EDUCATIONAL FINANCING
AUTHORITY
JULY 1, 2007 TO MARCH 31, 2009

OFFICIAL AUDIT
REPORT
AUGUST 21, 2009

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In accordance with Chapter 11, Section 12, of the General Laws we conducted an audit of the Massachusetts Educational Financing Authority's (MEFA) oversight of its financial and program activities. Our audit covered the period July 1, 2007 to March 31, 2009, and was conducted in accordance with applicable generally accepted government auditing standards. Our objective was to review and analyze MEFA's financial and program activities to determine if they are operating efficiently and effectively and in compliance with its enabling legislation (Chapter 15C of the Massachusetts General Laws). In addition, we reviewed certain administrative expenses including, travel, conferences, employee use of credit cards, employee bonuses and consultant payments to determine whether those costs were appropriate, allowable, and in compliance with applicable laws, rules, and regulations. We also reviewed the most recent Independent Public Accountant's audit report and management letter and followed up on any issues identified in said reports. Finally, we reviewed our prior audit (No. 2005-1301-3A) to determine if corrective action had been implemented.

AUDIT RESULTS

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PRIOR AUDIT RESULTS RESOLVED

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Our prior audit indicated that MEFA (a) had not developed a board approved internal policy, internal executive memorandum, or written methodology for bonus allocations, and (b) had not established policies and procedures regarding discretionary expenses including the need for appropriate supporting documentation and stated business purpose regarding these expenses. Our follow-up review revealed that these prior audit issues have been adequately addressed, as discussed below:

a. Employee Bonus Criteria Properly Documented

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Our follow-up review disclosed MEFA satisfactorily resolved the issue reported in our prior audit relating to MEFA's need to develop a written policy that clearly establishes bonus eligibility requirements, and the need to seek board approval for all individual bonus awards. Our current audit determined that MEFA has established a policy addressing bonuses effective fiscal year 2006 and included this policy in its Employee Handbook.

b. Administrative Expenses Properly Documented

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Our follow-up review disclosed that MEFA satisfactorily resolved the issue reported in our prior audit relating to MEFA's need to establish policies and procedures regarding discretionary expenses, and the need to require appropriate supporting documentation as well as the business purpose for these expenses. Our current audit revealed that MEFA took corrective action to improve upon its procedures regarding administrative expenses, and detailed the procedures in its Accounting Policy and Procedures Manual established in fiscal year 2006 and updated annually.

INTRODUCTION

Background

The Massachusetts Educational Financing Authority (MEFA) was created by Chapter 803 of the Acts of 1981, which appears as Chapter 15C of the Massachusetts General Laws, to assist borrowers and institutions for higher education in the financing and refinancing of the costs of education, and to provide students and parents with a convenient and effective state-supported supplemental education loan program. The program consists of medium and long-range fixed rate and variable rate loan programs. The program's goals are to administer effective rates of interest and other terms that are more attractive than conventional supplemental education lenders. MEFA's loan program is developed and operated in conjunction with participating institutions of higher education and is designed to assist such institutions in attracting and retaining students. The program is designed to make loans available on affordable terms to families or individuals who, because of a high debt-to-income ratio, may otherwise be ineligible for credit-based supplemental education loans.

Since inception, MEFA has been engaged in loan purchase programs under which participating colleges and universities originate student loans, in accordance with common criteria and procedures, for sale to MEFA. The programs are funded using proceeds from Educational Loan Revenue Bonds issued by MEFA. In addition to the loan programs, MEFA offers two college savings programs: the U-Plan and the U-Fund. The U-Plan, launched in February 1995, is a pre-paid tuition program offered at participating colleges and universities in the Commonwealth. The U-Fund, launched in March 1999, is a tax-advantaged method of savings for higher education costs through the investments in mutual funds. The U-Fund is professionally administered and managed by Fidelity Investments of Boston on behalf of the account owners. MEFA's Board is composed of nine members who receive no compensation but are paid all necessary expenses incurred while engaged in the performance of their duties. As of calendar year 2009, there were 47 full-time and two part-time MEFA employees servicing approximately \$1.4 billion in educational loans and in excess of \$2.8 billion in savings programs. Funding for MEFA's operating costs are derived from net investments earnings, interest on issued loans, and application fees.

Audit Scope, Objectives, and Methodology

The scope of our audit included a review and analysis of MEFA's financial and program activities to determine if they are operating efficiently and effectively and in compliance with their enabling

legislation (Chapter 15C of Massachusetts General Laws) and established policies and procedures. Our audit, which covered the period July 1, 2007 to March 31, 2009, was conducted in accordance with generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States, and included such procedures and tests as we considered necessary to meet those standards.

Our objectives were to review and analyze:

- MEFA's financial and program activities to determine if they are operating efficiently and effectively and in compliance with their enabling legislation.
- Certain administrative expenditures, including, travel, conferences, employee use of credit cards, employee bonuses, and consultant payments, to determine whether these costs were appropriate, reasonable, and allowable.
- MEFA's Corrective Action Plan in regards to our prior audit (No. 2005-1301-3A).

To achieve our audit objectives, we reviewed (1) how MEFA is funded and determined the methods and procedures utilized to process expenditures; (2) administrative expenses (e.g., travel, conferences, employee use of credit cards, employee bonuses, and consultant payments); and (3) the Corrective Action Plan regarding prior audit results and to determine its effectiveness.

Our review indicated that MEFA had adequate internal controls over administrative and operating expenses and complied with applicable laws, rules, and regulations for the areas audited. We also determined that MEFA had put controls in place to resolve the prior audit results, and noted that the Independent Public Accountant's report for fiscal year ended June 30, 2008, contained no comments on Internal Control deficiencies.

AUDIT RESULTS

PRIOR AUDIT RESULTS RESOLVED

Our prior audit indicated that MEFA (a) had not developed a board approved internal policy, internal executive memorandum or written methodology for bonus allocations and (b) had not established policies and procedures regarding discretionary expenses including the need for appropriate supporting documentation and stated business purpose regarding these expenses. Our follow-up review revealed that these prior audit issues have been adequately addressed, as discussed below:

a. Employee Bonus Criteria Properly Documented

Our prior audit also revealed that, employee bonuses were issued to all full-time employees regardless of length of service. As a result, one employee received a bonus after only eight weeks of employment in 2003, and another employee received a bonus after 15 weeks of employment in 2004. During this two-year period, MEFA spent \$505,939 or 11% of its salary budget on bonuses.

Our current audit determined that MEFA has followed the recommendations in our prior audit and established a policy addressing bonuses effective fiscal year 2006 and included this policy in its Employee Handbook. MEFA now requires the approval of the Board for all bonus awards. MEFA has defined the employees eligible for bonuses (MEFA senior team, chief financial officer, director of human resources, director of loan operations, director of information technology, and the director of college savings), and the criteria (meritorious performance – as evaluated in the annual performance process and appropriately documented in personnel files). The Executive Director's and the assistant Executive Director's bonus is recommended by the executive committee and submitted to the Board of Director's for approval.

During our current audit period MEFA spent \$154,244 or 1.7% of its salary budget on bonuses.

b. Administrative Expenses Properly Documented

Our prior audit revealed questionable administrative expenses for such items as a holiday party (\$15,140), a holiday open house (\$4,865), and board meetings held at a conference/resort facility (\$31,577). In addition, we found a lack of sufficient documentation and stated business purpose regarding these transactions. Since MEFA had not established formal written guidelines,

policies, and procedures regarding discretionary expenses, there was inadequate assurance that these expenses were allowable, necessary, and consistent with MEFA's overall objectives.

Our current audit revealed no questionable administrative expenses. All expenses selected for testing followed the procedures as outlined in MEFA's Accounting Policy and Procedures Manual. The invoice-approved process requires that the expense be within budget and approved by a department head. In addition, all employee checks and vendor payments in excess of \$5,000 require dual signatures. MEFA has also updated its Business Travel and Reimbursement Policy (effective July 2008). Business meals are defined as the cost of food and beverages, including tips (up to a maximum of 20%) and taxes, incurred while conducting MEFA-related business. The location, attendees and business purpose must be documented on the reimbursement form.