Pennsylvania Higher Education Assistance Agency

A Special Performance Audit for the Period of
July 1, 2004, through June 30, 2007

With updates through August 12, 2008

August 2008

Jack Wagner, Auditor General

Pennsylvania Department of the Auditor General
Bureau of Special Performance Audits

August 19, 2008

The Honorable William F. Adolph, Jr., Chair
The Honorable Sean Logan, Vice Chair
Board of Directors
Pennsylvania Higher Education Assistance Agency
1200 North Seventh Street
Harrisburg, Pennsylvania 17102

Dear Chairman Adolph and Vice Chairman Logan:

Enclosed is the report of our special performance audit of the Pennsylvania Higher Education Assistance Agency for the period of July 1, 2004, through June 30, 2007, with updates through August 12, 2008.

We conducted our audit under generally accepted government auditing standards, and we began our work with the broad objective of evaluating PHEAA's performance in improving access to higher education for Pennsylvania students. Our objectives, scope, and methodology are further explained in Appendix A of the report; our audit authority is discussed on page 6.

As the result of our audit work, we have developed 6 findings and 20 recommendations, and we present sufficient and appropriate evidence to support our work. In addition, we have formulated an overall conclusion based on the 6 findings.

> **Specifically, we have concluded that PHEAA was governed and managed within a culture that sometimes allowed self-reward to supersede fiscal prudence. In those instances, PHEAA failed its mission by not using all available resources to benefit Pennsylvania students.**

Our overall conclusion has led to an overall recommendation, one that calls for an immediate restructuring of the 20-member board to expand and diversify its professional base, provide stronger oversight, and ensure that PHEAA is governed and managed to achieve the goals of accountability, exemplary leadership, and transparency.

> **Accordingly, we call on you and the entire General Assembly to decrease the number of board seats held by legislators from 16 to 8; retain the 3 appointees of the Governor and add a fourth who is a full-time post-secondary student; retain the seat of the Pennsylvania Secretary of Education; add one seat each for the secretaries of the Pennsylvania**

> **Department of Banking and the Pennsylvania Department of Community and Economic Development; and add 5 seats for representatives of higher education—including the Chancellor of the Pennsylvania State System of Higher Education, a member from a state-related university, a member from an independent college or university, a member from a community college, and a member from a post-secondary vocational or trade school.**

We thank you for your recent review of the report, and we have carefully studied the written response from PHEAA management on your behalf. A copy of the full response is appended to this report.

Regarding our evaluation of your response, we acknowledge and appreciate your agreement with the majority of our recommendations. On the other hand, we take strong exception to PHEAA's negative reaction to our overall recommendation to restructure the board. Your response does not demonstrate a full commitment to reform and, additionally, is flawed in the following ways:

- First, there is scant support for the position that PHEAA would lose its tax-exempt status without 16 legislators on the board. Our review of the documents provided by PHEAA last week shows that neither the application for federal tax-exempt status nor the federal approval emphasized the fact that 16 board members are legislators. Instead, the application emphasized that, for many reasons, the Commonwealth has control over PHEAA; that the agency was created by legislation; that board members are appointed by the Governor, the President Pro Tempore of the Senate, or the Speaker of the House; and that a majority of the board members are "state government officials." Not one of these points would change under our recommendation to restructure the seats on the board.

- Second, the response is flawed to suggest that bipartisanship can result only by having 16 legislators on the board (i.e., 8 from each party), or that only legislators can transcend partisanship.

- Third, the response is flawed to suggest a contradiction in our calling for a new board structure after our specific citation (on page 18 of the report) of the existing structure to demonstrate PHEAA's status as a state agency. Our citation is one of 12 such reasons contributing to PHEAA's "state agency" status; moreover, a restructuring will not affect that status. Rather, the state agency will be enhanced by the added professional diversity.

- Fourth, the response is flawed to suggest that representatives of higher education are unsuitable members of the PHEAA board because of potential conflicts of interest. The flaw in this response occurs because there would be only one member from any particular type of institution, and therefore only one vote. At the same time, the board needs the *collective* knowledge and experience from these education sectors just as it needs our recommended representatives from banking and finance—hence the secretaries of Banking and Community and Economic Development. Furthermore, any concern for conflict of interest would have been better placed in your response to our recommendations following Finding Six, which discusses how PHEAA enabled its affiliated Pennsylvania Higher Education Foundation to underperform its fundraising and development roles. It is there where independent thinking may have been conflicted based on the fact that some PHEAA board members hold dual roles as Foundation board members.

- Finally, the response does not contain any evidence pointing to a potential exodus among investors and other entities that contract with PHEAA. Again, as previously explained, while we believe that our proposed restructuring of the board will significantly improve the agency, it will not fundamentally change PHEAA's status as a state agency. Therefore, it is difficult to conceive of any material negative impact on current or future contracts.

Once again, I appreciate your acceptance of the majority of our recommendations; I also appreciate the professionalism and courtesy extended to our audit team by PHEAA's management and staff over the course of our audit work. As provided by government auditing standards under which this audit was conducted, we will follow up on our findings and recommendations to determine whether they are being addressed. Accordingly, we will contact PHEAA management within the next 12 to 24 months.

In the meantime, please feel free to contact me directly with additional questions or concerns. Although we may disagree on certain specific issues, I believe our goal is the same: to improve higher education opportunities for Pennsylvania students and their families.

Sincerely,

JACK WAGNER
Auditor General

Enclosure

cc: The Honorable Edward G. Rendell, Governor of Pennsylvania
Members, Board of Directors, Pennsylvania Higher Education Assistance Agency
James L. Preston, President and CEO, Pennsylvania Higher Education Assistance Agency

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Overall, based on our findings, we can logically conclude that PHEAA's management and governance were flawed. That conclusion leads to our overall recommendation that PHEAA's board must be restructured by reducing the number of its legislators from 16 to 8 and by adding members with expertise in higher education and finance.

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A Special Performance Audit

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Results in Brief

Our special performance audit of the Pennsylvania Higher Education Assistance Agency, known as PHEAA, resulted in six findings from our audit period of July 1, 2004, through June 30, 2007, along with updated information through August 12, 2008. The findings and 20 accompanying recommendations are detailed in the narrative of this report.

We also found that, in conjunction with our audit work, PHEAA initiated some significant steps to reform itself, including the elimination of various expenditures and perks and the closing of out-of-state offices. These steps are commendable. Still, **the agency needs to continue and expand its reforms** to be fully accountable to Pennsylvania taxpayers while serving Pennsylvania students.

We call for an immediate overhaul of PHEAA's governing board.

We address this continuing need by calling for an immediate overhaul of PHEAA's governing board through the reassignment of seats to decrease the number of legislators while adding board members with expertise in education and finance. This restructuring would provide stronger oversight and greater diversity. *(pp. 1-5)*

Our call for this change results from the overall conclusion that **PHEAA was governed and managed within a culture that sometimes allowed self-reward to supersede fiscal prudence.** In those instances, PHEAA failed its mission by not using all available resources to benefit Pennsylvania students. *(pp. 1-2)*

PHEAA's questionable use of resources, plus its weaknesses in internal control, include these examples:

- An executive compensation package that included excess salaries and bonuses not typical of a prudent state agency *(pp. 21-26)*

  Improvements needed: PHEAA should modify its management compensation plan and eliminate management bonuses permanently.

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- Excessive spending in areas such as employee perks, service contracts, and advertising *(pp. 27-40)*

  Improvements needed: PHEAA should continually review its spending and eliminate all unnecessary expenditures.

- Misclassification of operating expenditures totaling almost $2 million *(pp. 41-44)*

  Improvements needed: PHEAA should conduct routine audits of its accounting records and take immediate action to ensure that every expenditure is classified correctly.

- Inadequate reporting of vehicle usage and allowing employees to drive vehicles for personal use *(pp. 45-50)*

  Improvements needed: PHEAA should revise and clarify its vehicle policy, prohibit personal travel in the vehicles, require uniform reporting, and implement tighter internal controls.

- Contributing 90 percent of the funding to PHEAA's related organization, the Pennsylvania Higher Education Foundation, thereby enabling the Foundation to under-perform in raising contributions on its own *(pp. 74-79)*

  Improvements needed: PHEAA must insist that the Foundation raise more private funding; that such efforts are led only by someone with proven success as a development director; and that Foundation board members who are also PHEAA board members do not allow their Foundation interests to compromise their PHEAA interests.

We also found some examples that represent more positive aspects of PHEAA's operations, but we caution that greater improvements are needed nonetheless:

- A state grant validation process that worked for 100 percent of the 150 higher-risk applications we sampled *(pp. 53-56)*

  Improvement still needed: PHEAA should validate at least a sample of the larger population of grant applications.

- Attempts to increase the purchasing power of state grant awards, even though those attempts could not be fully successful because of the escalating costs of post-secondary education *(pp. 57-66)*

  Improvements still needed: PHEAA should conduct annual audits of the grant program to determine how the program can benefit from closer and more exhaustive examination; PHEAA also should look for ways to cut its overall operating costs further, as previously noted, so that it can direct more revenue to the grant program.

- Improvements to the agency travel policy in response to public criticism *(pp. 67-73)*

  Improvements still needed: PHEAA should make further revisions as necessary and also clarify any policy areas that are vague; PHEAA should conduct its own internal audit of 2008 travel expenses and report the results publicly.

Our introduction and background section *(pp. 6-20)* provides information so that readers can understand the nature and profile of PHEAA. Here, in our Results in Brief, we can summarize that information by noting that PHEAA is an agency of state government, that it administers state taxpayer-funded student grants totaling $407 million for the 2008-09 fiscal year, that the grant appropriations go entirely to benefit students and their families, and that PHEAA's operating expenses are paid not with tax appropriations but instead with PHEAA's own revenues derived from servicing and guaranteeing student loans nationwide.

At present, all but 4 members of PHEAA's 20-member governing board are state senators and representatives as mandated by PHEAA's enabling legislation. The remaining 4 members include the state Secretary of Education and 3 appointees of the Governor. This audit report will show why our recommended restructuring of the board is necessary.

Overall audit conclusion based on our six findings

Our overall conclusion that we have drawn from our audit findings is this:

PHEAA's governing board must be restructured to include more diversity—specifically, members from the fields of higher education and finance—who will make tough decisions to keep the agency focused on its mission.

Overall, based on our findings, we can logically conclude that PHEAA's management and governance were flawed. That conclusion leads to our overall recommendation that PHEAA's board must be restructured by reducing the number of its legislators from 16 to 8 and by adding members with expertise in higher education and finance.

This change is necessary because PHEAA was governed and managed within a culture that sometimes allowed self-reward to supersede fiscal prudence. In those instances, PHEAA failed its mission by not using all available resources to benefit Pennsylvania students.

Discussion

Our audit resulted in six findings, most of which reflect negatively on the way that PHEAA was governed and managed. PHEAA's governing board, comprised primarily of state legislators, had the power and the duty to make changes. But the majority of board members may not have had the technical backgrounds necessary to question some of the operational decisions made by PHEAA management.

Historically, we can see that the less prudent side of PHEAA's culture developed as the agency grew and prospered. In 1983, for example, the *Philadelphia Inquirer* referred to PHEAA as a "little known state agency" with 670 employees and an executive director making $55,000 annually. The *Inquirer* went on to say that the agency was "generally regarded as one of the more efficient in state government" and that it generated annual gross revenues of $6.4 million from servicing loans.[1]

[1] "Pa. Official to Retire with his Job," by Frederick Cusick, *Philadelphia Inquirer*, May 15, 1983.

Contrast that 1983 description with the less flattering descriptions published by news outlets nationwide beginning primarily in March 2007 after The Patriot-News in Harrisburg, WTAE-TV in Pittsburgh, and The Associated Press successfully sued PHEAA for access to records detailing approximately $900,000 in expenses for board retreats and travel several years earlier. PHEAA had more than 2,600 employees in 2007, operating revenues totaling more than $429 million, and top management officials who received six-figure salaries and bonuses.

It was clear from the media coverage that PHEAA was no longer a little-known state agency generally regarded as one of the most efficient agencies of state government. In fact, *The Patriot-News* titled its series of front-page stories, "PHEAA Spending: Play Money."[2]

At some point between the 1983 story in the *Inquirer* and the uncomplimentary coverage in 2007, PHEAA appears to have been emboldened by its lending successes and earnings. We can reasonably conclude that this boldness was also enabled because PHEAA's management had direct access to, and the ear of, 16 state lawmakers on the PHEAA board. In addition, although PHEAA has noted that it undergoes more than 40 audits annually of its various programs, those audits are primarily compliance audits that by nature would not probe the same topics as would a special performance audit. All the preceding factors show how PHEAA's less positive culture might have become ingrained, and how management might have become distracted by the rewards of being PHEAA "executives" rather than public servants for the Commonwealth of Pennsylvania.

Over the course of this audit, PHEAA has notably begun taking corrective action in various areas. Still, PHEAA will have to prove over time that it is accountable to taxpayers, that its

[2] Under the title of "PHEAA Spending: Play Money," *The Patriot-News* published the following on March 13, 2007: "Facials, cigars, cooking classes - Student-loan agency's records reveal array of recreational expenses," by Jan Murphy; and "Why couldn't room and board be enough?" (commentary) by Nancy Eshelman.

leaders are exemplary, and that its actions are open and transparent.

Overall recommendation→

Accordingly, the following action is necessary:

Overall recommendation - To ensure that PHEAA is governed to achieve the goals of accountability, exemplary leadership, and transparency, and based on the overall conclusion drawn from our audit findings, we call on the General Assembly to act immediately to restructure and diversify PHEAA's board of directors.

Specifically, a diversified 20-member PHEAA board should consist of the following:

- **Four appointees by the Governor, including one full-time post-secondary student**
- **The Secretary of the Pennsylvania Department of Education**
- **The Secretary of the Pennsylvania Department of Banking**
- **The Secretary of the Pennsylvania Department of Community and Economic Development**
- **Eight members of the General Assembly (four from the Senate appointed by the Senate President Pro Tempore, four from the House of Representatives appointed by the Speaker of the House), evenly divided between the majority and minority parties**
- **Five representatives of higher education as follows:**
  - ✓ **The Chancellor of the Pennsylvania State System of Higher Education, to represent state-owned universities**
  - ✓ **One member to represent the state-related universities (i.e., University of Pittsburgh, Pennsylvania State University, Temple University, Lincoln University); confirmed by the Senate**

- ✓ **One member to represent independent colleges and universities; nominated by the Association of Independent Colleges and Universities of Pennsylvania and confirmed by the Senate**

- ✓ **One member to represent community colleges; nominated by the Pennsylvania Commission for Community Colleges and confirmed by the Senate**

- ✓ **One member to represent post-secondary vocational or trade schools, confirmed by the Senate**

Pennsylvania appears to be the only state in which the board of an agency like PHEAA is so heavily weighted with legislators. A more diversified board would include members from the fields of higher education and finance, both of which are relevant to PHEAA's users.

Discussion

Not only is the preceding recommendation necessary and overdue, but it serves as the foundation to support all the other recommendations in this report. It is also a recommendation that brings PHEAA's governing structure more in line with that of higher education assistance agencies in other states.

At the time of this report, according to our audit team's research, Pennsylvania is the only state whose higher education assistance agency's board structure is so heavily weighted with legislators.[3] We found only two other states that require legislators on their boards: Alaska (2 of 14 board members are legislators); and Vermont (2 of 11 board members are legislators).

Also based on the audit team's research, we found that the higher education assistance agencies in 22 states are governed by boards with members who include representatives of institutions of higher education, such as colleges/universities and trade or vocational schools.

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[3] We conducted research to compare the boards of directors of the primary higher education assistance agencies for all 50 states. A list of these agencies can be found on the U.S. Department of Education's Web site at http://wdcrobcolp01.ed.gov/Programs/EROD/org_list.cfm?category_ID=SHE.

Finally, we found 34 states where the boards include at least one member from banking, finance, or private industry, and 20 states that include one or more students as voting members.

Because PHEAA's board has such little diversity with regard to the positions, backgrounds, and expertise of board members, it is important that the board makeup be changed so that members represent post-secondary institutions as well as the fields of banking or finance. In that way, not only will the board have the checks and balances that diversity provides, but board members also will have the relevant experience and expertise necessary to oversee an agency whose work is most related to those fields.

On the PHEAA board, with the exception of the Pennsylvania Secretary of Education who serves by virtue of holding that office, there is no obligation that board members have experience in banking, finance, or higher education. By amending state law to ensure such representation as we have recommended, the General Assembly will ensure that the board makeup is more relevant to PHEAA's activities and that the governing body is better prepared to carry out its leadership responsibility.

Introduction and background to findings –

Understanding the nature and profile of PHEAA

The Department of the Auditor General began this special performance audit of the Pennsylvania Higher Education Assistance Agency, known as PHEAA, in April 2007. Our overall objective was to evaluate PHEAA's performance in improving access to higher education for Pennsylvania residents. Appendix A discusses our objectives and methodology further.

The audit is our first special performance audit of PHEAA in its 45-year history; the audit period is July 1, 2004, through June 30, 2007, unless otherwise indicated.

We have conducted this audit under the authority of The Fiscal Code (72 P.S. §§ 402, 403) and PHEAA's own enabling act (24 P.S. §§ 5104(1.1), 5108), and in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States.

PHEAA's purpose: To create or improve access to higher education

PHEAA is a Pennsylvania government agency. According to its Web site, PHEAA has "devoted its energy, resources and imagination to creating affordable access to higher education for students and their families."[4] PHEAA has stated that its mission is both "to create access to education"[5] and "to improve higher education opportunities for Pennsylvanians."[6]

The agency was first authorized to guarantee student loans for Pennsylvania residents following its creation in 1963. In 1966,

[4] www.pheaa.org/about/index.shtml
[5] www.pheaa.org/community/index.shtml
[6] PHEAA's annual financial report, June 30, 2007 and 2006. This financial report and those of other years are available at http://www.pheaa.org/about/financial_reports.shtml.

PHEAA was also authorized by the General Assembly to award grants through the Pennsylvania State Grant Program.[7]

PHEAA has traditionally provided financial aid in the form of loans, grants, and work-study opportunities through state and federal aid programs. However, in March 2008, PHEAA temporarily suspended using its own cash to make loans. "Issues in the markets related to the sub-prime mortgage mess everyone is talking about have made it difficult for PHEAA to raise the cash it needs to fund student loans," said PHEAA.[8]

In this audit report, we are critical of the way in which PHEAA was governed and managed in its traditional day-to-day operations. However, at the same time, we should recognize PHEAA's public service initiatives during our audit period. For example, in addition to PHEAA's past supplements to the state's grant program discussed in Finding Four, PHEAA also offered loan-forgiveness programs for military service men and women, early childhood educators, and nurses; and served non-traditional students by offering merit-based scholarships and aid programs. In addition, PHEAA continues to pay the one-percent federal guaranty fee that borrowers would otherwise pay themselves on certain loans; and underwrites portions of up-front fees in cooperation with other lenders. Finally, PHEAA continues to provide useful information on various Web sites, such as financial aid information at www.PHEAA.org, college- and career-planning information at www.EducationPlanner.org, and after-college financial wellness information at www.YouCanDealWithIt.com.

Overall, PHEAA has said that over the past ten years it used more than $1 billion of its own revenues—i.e., not General Fund appropriations—to make the preceding services available to the public.

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[7] In 1966, the Pennsylvania Higher Education Assistance Act established the Pennsylvania State Grant Program as a broad-scale "State scholarship program." *See* 24 P.S. § 5151 *et seq.*, enacted through the Act of January 25, 1966 (P.L. 1546, No. 541).
[8] *[PHEAA] Student Aid News – Update on Student Loans*, accessed July 22, 2008, online at http://www.pheaa.org/studentaidnews/index.shtml?s=H3.

PHEAA's staffing and governance: 2,600+ employees and 20 board members, mostly legislators

PHEAA is headquartered in Harrisburg, Pennsylvania. The agency also staffs a call center in nearby Mechanicsburg, Cumberland County. In addition, PHEAA has six in-state regional offices at the following locations: Philadelphia, Pittsburgh, Wilkes-Barre, Williamsport, and on the college campuses of Penn State University in Shenango and Dickinson College in Carlisle.

In locations other than Pennsylvania, PHEAA does business as American Education Services, or AES. During the audit period, PHEAA had offices in Sacramento, CA; Magnolia, DE; Wilmington, DE; Deltona, FL; North Canton, OH; Charleston, WV; and Carolina, Puerto Rico. However, in 2008 between March and June, following the suspension of PHEAA's student lending activity, PHEAA closed those out-of-state offices.[9] PHEAA told us it would realize annual savings of approximately $1 million in salaries and overhead expenses associated with those offices.[10]

In 2007, there were approximately 2,600 employees on the staff of PHEAA.[11] It is governed by a 20-member board of directors, including the following:

- Three members appointed by the Governor
- The Pennsylvania Secretary of Education[12]
- Sixteen state legislators

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[9] PHEAA is the federally designated guarantor for Delaware and West Virginia, but the closure of offices in those states does not affect that designation.

[10] Included in that $1 million figure is the following: $885,935 in total salaries and benefits, comprising an average salary of about $91,095 each for 8 employees, plus average benefits of $19,647 for each employee, including health, group life, retirement, Social Security, Medicare, and long-term disability, but not vehicle benefits or reimbursements; also $136,541 in leases for some of the offices, parking, phone lines, and other office expenses.

[11] Between October 2007 and August 2008, PHEAA's staff level decreased to about 2,100 because of attrition and unfilled vacancies, and also because of PHEAA's voluntary workforce reduction program announced in April 2008 that resulted in the voluntary departure of more than 260 employees.

[12] The Pennsylvania Secretary of Education is an ex-officio member, meaning that the state's Secretary of Education sits on the board by virtue of his or her position. *See* 24 P.S. § 5103(a).

- ⇒ Eight members of the Senate appointed by the Senate President Pro Tempore, four of the majority party and four of the minority party
- ⇒ Eight members of the House of Representatives appointed by the Speaker of the House, four of the majority party and four of the minority party[13]

All PHEAA board members must be of "full age,"[14] citizens of the United States, and residents of Pennsylvania, and shall serve for terms of six years each.[15] Members of the board do not receive any compensation, but they are eligible for the reimbursement of the expenses "actually and necessarily" incurred by them in the performance of their duties.[16]

The PHEAA board may appoint the agency's managing officers and employees as it deems advisable, fix the compensation of the officers and non-union employees,[17] and prescribe their duties. Further, the PHEAA board may elect an executive committee to conduct any business of the agency as the board may authorize.

Since 1988, PHEAA paid its operating expenses with revenues from its lending activities

Since PHEAA was created in 1963, it has received annual allocations of taxpayer dollars from the state's General Fund to fund a variety of financial aid programs. For many years, PHEAA used the allocations to pay for the operating costs to administer these programs as well. However, beginning in 1988, the General Assembly no longer appropriated taxpayer dollars for PHEAA to pay salaries and other operating expenses. Instead, PHEAA paid

[13] *Id*.
[14] The term "full age" is not defined by the Statutory Construction Act of 1972, 1 Pa.C.S. § 1991. However, *Black's Law Dictionary*, 7th Ed. (2000), defines the term to mean "[t]he age of legal majority; legal age," which equates to 18 years of age, at which time a person attains full legal rights.
[15] 24 P.S. § 5103(a).
[16] *Id*.
[17] The compensation for union employees is determined by contract negotiations.

these expenses using money that it generated mostly from making and servicing loans.

For the fiscal year ended June 30, 2007, PHEAA's operating expenses totaled $286.6 million, including salaries, benefits, bonuses, travel, advertising, professional services, and contracts. The $286.6 million represents an increase of nearly ten percent over the prior year's expenditures.

Again, the operating expenses beginning in 1988 have not been paid with taxpayer allocations. Nonetheless, PHEAA remained a state agency with the same obligations as before. The table on page 12 shows what taxpayer allocations did pay for during the three years of our audit period.

Each of the programs named in the table is described below:

Pennsylvania State Grant Program. This program funds grants for students who attend post-secondary institutions. Based on certain criteria, such as financial need and costs of tuition, these grants do not need to be repaid; they are "free" money that students use toward the cost of educational expenses. For the 2007-08 academic year, the maximum grant award amount per student was $4,700. (Please see Finding Four for more information on the grant program.)

Institutional Assistance Grants. This program provides grants to independent post-secondary institutions. The institutions must be non-profit and non-denominational, and they must not receive any direct appropriation from the state. During our audit period, between 83 and 85 private post-secondary schools received Institutional Assistance Grant awards each year.

Matching Payments for Student Aid Funds. According to PHEAA, the Matching Funds Program is designed to use both public and private funds to make education more affordable and consists of three employment programs and one scholarship program. It is supported by an appropriation from the General Assembly.

New Economy Technology Scholarship. This program is sometimes referred to as the SciTech and Technology Scholarships Program, and it provides scholarships to eligible Pennsylvania students who are enrolled in an approved post-secondary science or technology curriculum.

Cheyney University Keystone Academy. The monies for this program are used to recruit gifted students for enrollment at Cheyney University.

Horace Mann Bond-Leslie Pinckney Hill Scholarship. This program provides grants to graduates of Lincoln University and Cheyney University of Pennsylvania who enter the professional programs of law, medicine, or dentistry at Temple University, the Pennsylvania State University, or the University of Pittsburgh.

PA Internship Program Grants. This program provides internship opportunities for academic credit in Pennsylvania institutions through a partnership with the Washington Center for Internships and Academic Seminars, a non-profit independent educational organization. Participants in the program spend a semester in Washington, D.C., to develop their professional skills, further their academic knowledge, and experience the professional world on a first-hand basis.[18]

Agricultural Education Loan Forgiveness. Monies for this program are used by PHEAA to provide loan forgiveness for graduates with agriculture degrees who work on family-owned farms, for veterinarians whose practices include the treatment of farm animals, and teachers of agriculture.

[18] This program was in effect during our audit period but did not receive an appropriation in fiscal years 2007-08 and 2008-09.

PHEAA-administered programs: $1.3 billion in General Fund appropriations for fiscal years ended June 30, 2005, through June 30, 2007

Program	FY 2004-05	FY 2005-06	FY 2006-07
Pennsylvania State Grant Program	$359,218,000	$368,198,000	$386,198,000
Institutional Assistance Grants	39,398,000	40,186,000	41,392,000
Matching Payments for Student Aid Funds	14,122,000	14,122,000	14,122,000
New Economy Technology Scholarship	3,100,000	3,100,000	6,800,000
Cheyney University Keystone Academy	2,000,000	2,000,000	2,000,000
Horace Mann Bond-Leslie Pinckney Hill Scholarship	750,000	750,000	750,000
PA Internship Program Grants	300,000	300,000	300,000
Agricultural Education Loan Forgiveness	85,000	85,000	85,000
Technology Work Experience Internship Program	500,000	0	0
Total General Fund Appropriation	**$419,473,000**	**$428,741,000**	**$451,647,000**
	Overall total = $1.3 billion		

Source: Office of the Budget, *Status of Appropriations*, July 1, 2004, July 1, 2005, and July 1, 2006.
Note: All appropriations pass through to the students and are not used by PHEAA to pay its employee salaries and its other operating expenses to carry out these programs.

Technology Work Experience Internship Program. This program reimburses emerging technology companies for a portion of wages paid to student interns. It provides practical work experience along with wages for the student. It is not a scholarship.

For the first fiscal year after our audit period ended, or the fiscal year ended June 30, 2008, General Fund appropriations to PHEAA amounted to $452.0 million. For the fiscal year that will end June 30, 2009, as presented in the Governor's Executive Budget dated February 5, 2008, the Governor recommended a funding level of $463.6 million from the General Fund. However, the actual funding level approved by the General Assembly and enacted into law was higher, at $472.9 million. All appropriated funds are used to benefit students and are not used by PHEAA to administer the program.

Evolution of PHEAA's student lending activities

In addition to administering its grant program, PHEAA administers a loan program. As American Education Services, PHEAA administers the Federal Family Education Loan Program (also known as FFELP) nationwide. More specifically, PHEAA is authorized to operate in all 50 states and the District of Columbia; it is also registered as a corporation in Puerto Rico.

PHEAA is considered a "full-service" student loan agency because it provides all services associated with student financial aid, including guaranteeing student loans, servicing student loans for itself and other lenders, and making student loans. However, in March 2008, as we noted earlier, PHEAA temporarily suspended its activities relating to its role as a lender for education loans that are part of the Federal Family Education Loan Program.

PHEAA as loan guarantor. PHEAA first began to guarantee federal loans for lenders in 1964. In this capacity, PHEAA's primary function is to guarantee repayment of loan balances to lending institutions if the applicable student loan borrowers default, die, or become totally and permanently disabled. PHEAA also functions as the direct link to the U.S. Department of Education, maintaining and monitoring the status of these loans regardless of what organization is holding and/or servicing them at any given time.

PHEAA as loan servicer. With the passage of Act 357 of 1974, PHEAA became authorized to service loans. As servicer, PHEAA performs payment processing, customer service and collections activities—including default prevention—for federally and non-federally guaranteed loans while the borrower is in school, during any grace period granted, and during the repayment period of the loan. In 1975, PHEAA began to service loans for national lenders.

PHEAA as lender. With the passage of Act 330 of 1982, PHEAA began to raise money by selling bonds to fund its own student loans. Until March 2008, PHEAA was a lender in the Federal Family Education Loan Program; in addition, PHEAA made some non-federally guaranteed loans known as private or alternative loans, just like the non-federally guaranteed loans offered by commercial banks.

The identity question: Is PHEAA a state agency using taxpayer dollars to award grants? Or is PHEAA a private entity supporting itself with earnings from its lending activities?

PHEAA has identified itself over the years in various ways. At times, it identifies itself as a state agency, such as in various news releases and in several places on its Web site. In other cases, it avoids the term “state agency” or “agency” altogether, such as in its 2005 annual report that eliminates any such terminology, not even spelling out “Pennsylvania Higher

Education Assistance Agency" a single time in place of the PHEAA acronym.[19]

PHEAA often identifies itself as one of the largest full-service financial aid organizations in the nation.[20] It sometimes denotes its status as a not-for-profit entity, but it also calls itself a commercial enterprise and publicly compares itself to private for-profit lenders such as Sallie Mae and Citibank.

PHEAA uses its name interchangeably with American Education Services, or AES, although sometimes it opts to call itself one or the other. PHEAA has both a PHEAA Web site, titled "PHEAA powered by AES" at http://www.pheaa.org/, and an AES Web site, titled "AES – American Education Services" at http://www.aessuccess.org/. Both Web sites include the same links for annual financial reports from 2002 to 2007, but the reports themselves carry different identities: "Pennsylvania Higher Education Assistance Agency" in 2002 and 2003, "AES/PHEAA" in 2004 and 2005; and "PHEAA powered by AES" in 2006 and 2007.[21]

PHEAA generally defines AES as the name used to conduct loan operations in other states. But sometimes PHEAA refers to AES as a "division of PHEAA," such as in various documents on both Web sites. Other times, PHEAA states clearly that AES is simply a "doing-business-as" designation and nothing more. For example, in November 2007, PHEAA responded in writing as follows when we asked about the AES terminology:

> The idea of creating AES was first considered in 1983. "American Education Services" or "AES" was created as a d/b/a designation at that time. The name, which has national appeal, was intended to promote business outside of Pennsylvania. The expansion first occurred in

[19] http://www.pheaa.org/about/pdf/ANNUALREPORT.pdf.
[20] *About PHEAA,* http://www.pheaa.org/about/index.shtml. Accessed July 15, 2008.
[21] http://www.pheaa.org/about/financial_reports.shtml.

California for the purpose of originating loans for Great Western Bank, who was seeking a company to perform originations in their home state. AES was never organized as a subsidiary nonprofit corporation in Pennsylvania, or elsewhere.

Viewed from a public perspective overall, we found that PHEAA provided little consistency and offered no clear explanation about which of PHEAA's identities to use when. Even so, the mixed identities may not seem important; for example, to how many people in the general public does it really matter what PHEAA calls itself at any given time?[22] However, in other ways, the mixed identities are quite significant, particularly if they enable PHEAA to blur its message and thus depart from its core mission of serving Pennsylvania students first. Explained in our findings, we found such a departure as evidenced by PHEAA's excessive spending, including the salaries, bonuses, and perks that PHEAA gave to its top officials.

The identity answer:
PHEAA is a state agency accountable to Pennsylvania taxpayers for using all available resources responsibly

There is no question that PHEAA is a state agency whose governing body, management, and staff should be accountable to Pennsylvania taxpayers. Regardless of the fact that PHEAA used its lending activity profits to supplement the tax dollars appropriated for the awarding of grants, its accountability—including transparency in operations—should not change or diminish.

Again, PHEAA is without question a state government agency serving the public interest. But because PHEAA has allowed

[22] Please also note that, as discussed, PHEAA's varied facades do not in any way change its core mission of assisting state residents with meeting their higher education expenses as envisioned by the General Assembly in 1963 (S*ee* 24 P.S. § 5102).

its public servant identity to become blurred with its "corporate" identity, we have set forth below the facts that demonstrate PHEAA's status as a government agency:

- Act 290 of 1963 created PHEAA as "a body corporate and politic constituting a public corporation and government instrumentality."[23]

- Section 2 of this same act, as amended,[24] provides that PHEAA was established for the sole purpose of helping Pennsylvania residents who may not otherwise have the opportunity to attend an institution of higher education to be able to obtain a college education.

In further support of PHEAA as a state agency are various other facts about PHEAA that are common to other state government agencies:

- Upon the dissolution of PHEAA or the cessation of its activities, all the property and monies of such corporation in excess of its obligations shall become the property of the Commonwealth of Pennsylvania.[25]

- PHEAA was created in 1963 with tax dollars from the state's General Fund and continues to receive General Fund monies each year.

- PHEAA's employees participate in the State Employees' Retirement System and receive health care benefits under the Pennsylvania Employees Benefit Trust Fund.[26]

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[23] 24 P.S. § 5101.
[24] 24 P.S. § 5102.
[25] 24 P.S. § 5109.
[26] Please note that there are no statutory provisions related directly to the ability of employees of PHEAA to participate in the State Employees' Retirement System (SERS) or in the Pennsylvania Employees Benefit Trust Fund. However, it is well settled that PHEAA is an agency of the Commonwealth of Pennsylvania and, as such, has the same privileges and obligations as any other state agency. *See Richmond v. Pennsylvania Higher Education Assistance Agency*, 6 Pa. Cmwlth. 612, 297 A.2d 544 (1972). It is also evident that SERS has jurisdiction over the pensions of PHEAA's employees as shown in *Beardsley v. State Employees' Retirement Bd.*, 691 A.2d 1016 (Pa. Cmwlth., 1997).

- PHEAA uses the state Treasury Department's investment pool for some of its investments and pays its expenditures through Treasury accounts.

- PHEAA has the option to procure products and/or services from the list of state contract-approved vendors at the agreed-to state agency rates, or negotiating with such vendors to obtain better pricing.[27]

- PHEAA follows the accounting guidance issued by the Governmental Accounting Standards Board, not that of the Financial Accounting Standards Board used by non-governmental entities.

- PHEAA's financial information is presented in the financial statements of the Commonwealth of Pennsylvania as a discretely presented component unit of the commonwealth (meaning that the financial information of PHEAA is included in the Commonwealth's financial statements but that PHEAA is not considered part of the primary government).[28]

- Sixteen of the twenty PHEAA board members are members of the General Assembly; three of the twenty members are appointed by the Governor; the remaining member is the Secretary of Education, an ex-officio member, meaning that he or she serves as a board member simply by being the Secretary of Education.

- PHEAA's union employees (approximately 1,500 of PHEAA's total 2,600 employees[29]) are members of AFSCME, the American Federation of State, County and Municipal Employees, the labor union representing most state government employees.

[27] PHEAA's Policy/Procedure 603.0, Bidding Types and Processes, dated June 27, 2006.
[28] The Pennsylvania Turnpike Commission and the Pennsylvania State System of Higher Education are two other examples of agencies that are "discretely presented component units."
[29] As discussed in a previous footnote, PHEAA's staff level decreased to about 2,100 as of August 2008.

- PHEAA does not file a tax return as it would be required to do if it were a private entity. When we asked PHEAA about its status as a tax-exempt entity, it replied, "PHEAA is an integral part of the Commonwealth of Pennsylvania for federal tax purposes. Accordingly, PHEAA shares the Commonwealth's status for federal tax purposes and is exempt to the same extent as the Commonwealth."[30]

Since the start of this audit, PHEAA has begun to reform itself by re-claiming its identity as an agency of state government

Since the start of our audit, PHEAA has taken notable corrective actions to address some of its shortcomings. By continuing such actions and implementing other recommendations from this audit, PHEAA will sharpen its focus and regain public respect.

It is important to note that PHEAA began to implement numerous changes since we started this audit in April 2007. For example, PHEAA adopted new travel policies and procedures more in line with those of other government agencies. It established a more rigorous ethics policy. It modified many of its excessive spending habits. Overall, PHEAA began behaving less like a for-profit corporation and more like a state agency.

On October 4, 2007, we presented PHEAA with an interim audit report that detailed some of the more significant problems and called for immediate corrective action, specifically the extent of PHEAA's employee bonus program and the generous funding of an employee outing just after PHEAA announced it would eliminate unnecessary expenditures. Soon thereafter, PHEAA's president and CEO resigned and was replaced by an interim president from in-house. On March 20, 2008, after a nationwide search, PHEAA's board named the interim president as the new president and CEO.

PHEAA should be commended for the corrective actions that it has initiated since the start of this audit, and we report on those actions accordingly. Still, it is our responsibility to report on

[30] PHEAA's written response to questions submitted by the Department of the Auditor General, November 29, 2007.

PHEAA's actions during our three-year audit period of July 1, 2004, through June 30, 2007. It is our goal that this reporting of past practices will enable the public to benchmark PHEAA's progress at reforming itself, bring greater transparency to PHEAA's future actions, and make PHEAA fully accountable for the use of its resources.

Ultimately, if PHEAA remains serious about implementing our recommendations and continuing its corrective actions, we are confident that it can restore public confidence, regain public respect, and focus exclusively on its mission to serve Pennsylvania students and their families.

As stated in our overall conclusion developed as the result of our six findings, we are convinced that the most important action that must be taken with regard to PHEAA as a public agency serving the taxpayers of Commonwealth of Pennsylvania is the restructuring of the board of directors. PHEAA can no longer have a governing board with 80 percent of the board members from the General Assembly, and with PHEAA's top management having minimal oversight and guidance. Diversity on the board will expand the professional base and allow for much stronger oversight. As a result, there can be greater public confidence that PHEAA is meeting its core mission—to create access to higher education and to improve higher education opportunities for Pennsylvanians.

Finding One

PHEAA spent excessively on employee compensation and perks, service contracts, and advertising.

As a state agency, PHEAA is responsible not only for the appropriate use of General Fund monies, but also for fiscal responsibility with regard to the use of the money it earns from its loan servicing and other lending activities. Yet PHEAA lost sight of its responsibilities as a state agency, instead treating its management staff as elite employees and spending excessively in many areas. This finding expands on the information we transmitted to PHEAA in our interim report of October 4, 2007.

Finding 1.a

Finding 1.a – PHEAA created an elite compensation package for its executive staff that included excessive salaries and incentive payments not typical of a prudent state agency.

We found that PHEAA had two salary pay scales for its permanent employees: "Commonwealth Pay Scale" and "Management Pay Scale." The Commonwealth Pay Scale included all union-eligible (AFSCME) positions as well as non-union entry-level professional and supervisory roles. For those employees paid under PHEAA's Commonwealth Pay Scale, the pay grade and salary ranges were identical to those for employees of other commonwealth agencies in the same job positions.

The Management Pay Scale was broken down into three different salary plans: one for the president and CEO and the executive vice presidents, a second for vice presidents and other executive staff, and a third for mid-level management employees. **These pay plans were unique to PHEAA; they did not align with other state government agency pay plans.** For the three years of our audit, PHEAA paid $120.8 million in salaries for management staff. Broken down by year, the $120.8 million includes $33.1 million for fiscal year 2004-05,

$40.4 million for fiscal year 2005-06, and $47.3 million for fiscal year 2006-07.

Following are more detailed descriptions of the three salary plans within the management pay scale:

1. Executive Salaries. PHEAA maintained a separate salary pay plan for its president and chief executive officer and its four executive vice presidents. For fiscal year 2006-07, the salary for the president and CEO was $289,118; the salary for three of the executive vice presidents was $217,757 each; and the salary for the remaining executive vice president was $201,178.

2. Vice Presidents and Other Executive Staff. A total of 30 executive job titles were included in this salary plan. Each of six pay grades contained 20 steps, with each step representing a salary increase of approximately two percent. During 2007, the salary ranges were $70,782 to $107,016 for employees in the first pay grade, and $135,970 to $205,608 for employees in the top pay grade of this salary plan.

3. Mid-Level Management. This salary plan encompassed 73 different job positions classified as mid-level managers, assistant vice presidents, and other professionals. Again, each of five grades contained 20 steps, with each step representing a salary increase of approximately two percent. During 2007, the salary ranges were $51,032 to $77,147 for an employee in the first pay grade and from $86,008 to $130,062 for employees in the top pay grade of this salary plan.

Compensation philosophy and assessments

On August 25, 2004, the executive committee of the PHEAA board of directors passed a resolution on the development and administration of PHEAA's compensation plan. The resolution states that the compensation plan will do the following:

> . . . compensate officers, executives, and staff for their successful contributions to the

> Agency's mission, and ensure the competitiveness of pay levels of AES/PHEAA in order to attract and retain qualified individuals from industry who can grow and sustain the business and mission driven public service initiatives.

In addition to establishing a compensation philosophy, PHEAA contracted with two human resource consultants as part of a comprehensive compensation assessment.[31] With the exception of the assessment of union positions,[32] all other job positions were compared to those in the financial services market, specifically a blend of banks and insurance companies, rather than to public service positions.

As a result, as discussed earlier, management salaries, especially those of the top executives, were set at a higher rate than those of other commonwealth employees. When we asked PHEAA about its practice of basing salaries on those paid in the financial services industry rather than on those paid in government and public service, it responded as follows:

> Based on our recruiting activities, it was determined in conjunction with our consulting advisors…that the most appropriate comparisons were in the Financial Services Industry, rather than Commonwealth agencies. [The consultants] established each position in the context of a "P-50" level (at the 50th percentile or Market Value) for each position's salary. Competitors' executives are paid much more than PHEAA's executives, but PHEAA executives are here because they believe in the public service mission of PHEAA.[33]

[31] Five reports were released by The Hay Group from June 2005 through February 2007. One report was released by Mercer Human Resource Consulting in February 2007.
[32] Union positions were compared to Commonwealth of Pennsylvania union classifications.
[33] PHEAA's written response to the Department of the Auditor General's submission of notes from a June 20, 2007, meeting held with PHEAA, August 8, 2007.

The majority of Pennsylvania taxpayers would clearly question the sincerity of government officials who, on one hand, publicize their strong belief in public service but, on the other hand, will enter public service only at a salary commensurate with private employment. The assertion is simply not consistent with the action.

As of July 2006, PHEAA's president and CEO and the executive vice presidents all earned *base* salaries higher than the Pennsylvania governor's salary of $164,500. We emphasize the term "base" salary because these same public officials also received more than 50 percent of their base salaries in the form of bonuses in that year—bonuses that also increased their future pension payouts far beyond the base salaries.

Bonuses at PHEAA

As we discussed in our interim audit report of October 2007, PHEAA paid out $6,411,785 in bonuses during the three-year audit period. The bonuses were paid through different incentive programs to PHEAA's top officials (of which there were 23 in the last year of our audit period), other management staff, and certain union employees. However, regarding the union employees, we found their bonuses to be minimal in contrast to the other bonuses—just 2.4 percent of the total $6.4 million, or $152,195. Furthermore, as part of the negotiated union contract, the union employee bonuses resulted from an incentive program that recognized call center representatives for collecting or preventing bad debts; over the past two years, the average bonus was $650 quarterly for debt collection and $520 quarterly for debt prevention. PHEAA noted that the union bonuses would continue under the negotiated contract.

The table on the next page shows the distribution by employee group for each of the three years.

PHEAA bonuses based on category of employee, by fiscal year				
Employee Group	FY 2004-05	FY 2005-06	FY 2006-07	**3-year total**
Executive Group	$1,322,105.00 *(35 executives)*	$1,196,555.00 *(22 executives)*	$1,456,990.48 *(23 executives)*	**$3,975,650.48**
Other Management	498,295.59 *(165 employees)*	817,402.15 *(209 employees)*	968,242.54 *(227 employees)*	**2,283,940.28**
Union Employees	13,525.00 *(±20 employees)*	48,450.45 *(±45 employees)*	90,218.79 *(±75 employees)*	**152,194.24**
Total	**$1,833,925.59** ***(±220 employees)***	**$2,062,407.60** ***(±276 employees)***	**$2,515,451.81** ***(±325 employees)***	**$6,411,785.00**
Source: Developed by the Department of the Auditor General staff based on information obtained from PHEAA.				

Not included in the table is PHEAA's subsequent payment of $1.1 million more in bonuses to its 23 top officials in September 2007.

PHEAA is not the only state agency to provide employee bonuses, and we are exploring that issue apart from this audit. However, we are particularly troubled by PHEAA's system because not only were the incentive amounts excessive—the highest-ranking officials received 62 percent of the total bonus amount awarded agency-wide over three years—but the bonuses were added to the already-excessive base salaries to significantly increase the officials' future monthly pension payouts upon retirement.

As noted previously, for fiscal year 2006-07, after adding the bonus amounts to the employees' base salaries, we found that 12 PHEAA officials—all public employees—each earned more than the Governor of Pennsylvania was paid to govern the entire commonwealth.

In our interim audit report, we recommended to PHEAA that it immediately, permanently, and completely discontinue all incentive/bonus programs for its top management officials. Furthermore, we recommended that, at the same time, PHEAA should not raise its top salaries as a way to compensate for the discontinued bonuses.

PHEAA responded affirmatively only in part, saying that no further incentives would be paid to employees for their performance in fiscal year 2006-07. That discontinuance resulted in immediate savings of approximately $1 million, PHEAA noted. PHEAA further said that it would pay no incentives to the top officials for their performance in the following year (2007-08). However, PHEAA did not commit to eliminating bonuses permanently and completely.

Further, PHEAA did not confirm its position on raising executive and management pay to compensate for the loss of bonuses. Rather, PHEAA said its board of directors has "historically relied upon the expertise of outside objective leading national consultants regarding the compensation of PHEAA employees," and that "PHEAA intends to continue to rely on industry expertise to assist the executive committee of the PHEAA board of directors in determining appropriate action with regard to compensation."

Recommendations

1. PHEAA should modify its management compensation package to be more in line with the compensation of other state agency executives.

2. PHEAA should permanently eliminate its incentive programs for its executive and management employees.

Finding 1.b

Finding 1.b – PHEAA spent excessively in many areas, including employee perks, service contracts, and advertising.

PHEAA lost sight of its responsibilities as a state agency by spending excessively in numerous other areas besides salaries and bonuses. Such expenditures include the following:

- **More than $80,000 to buy tickets to Hersheypark for PHEAA employees and their guests for an "appreciation event" on April 22, 2007.**

  PHEAA called this day-long outing the "2007 Annual Appreciation Event." The announcement to employees and others noted that all full- and part-time permanent employees could receive two free tickets to include admission and meals, additional discounted admission and meal tickets were available for purchase by employees and contractors, and parking was free because the semi-private event was being held outside the park's regular summer season.

  We first discussed this issue in our interim audit report to PHEAA officials in October 2007. At that time, we reported that PHEAA spent $108,000 on the event, which was the amount that PHEAA itself reported to us in writing. However, after the issuance of our interim report, PHEAA clarified that it had actually spent less than it initially reported. Specifically, PHEAA provided us with documentation to show that more than 350 employees had reimbursed the agency $28,281.50 for additional admission and meal tickets.

  After subtracting the $28,281.50 reimbursement amount and then adding $1,237.50 because PHEAA returned that amount to employees who paid for tickets but instead were required to report to work on the day of the outing, we found that the total cost of the 2007 Hersheypark event was $80,309.75.

Regardless of how much PHEAA spent, the point is this: a top PHEAA official had signed the contract for this event just one day after PHEAA had publicly declared it would tighten its belt with regard to travel and other expenses.

The 2007 employee outing was not the first such event that PHEAA had hosted. In fact, this type of event and expenditure had become a part of PHEAA's culture. For example, PHEAA paid at least that same amount of $80,000 for similar events (before any reimbursements by employees) in each of the three years from 2004 to 2006.

After we released our interim report, PHEAA's board chairman and vice chairman immediately announced that the board was directing management to suspend all such expenditures going forward.

- **PHEAA paid more than $900,000 to two human resources consulting firms for services which included a study of the executive compensation program, including bonuses.**

  PHEAA paid $906,233 to the consultants over our three-year audit period. This expenditure is questionable based on the fact that PHEAA's internal human resources staff should itself be able to analyze the agency's compensation system. PHEAA should not imply that, on one hand, it hires and recruits better-than-average public employees but that, on the other hand, it cannot rely on those employees to perform their jobs without spending hundreds of thousands of dollars on external consultants.

- **More than $30 million in advertising expenses, including extravagant expenses for unnecessary items, between July 1, 2004, and June 30, 2007.**

  Specifically, PHEAA spent $9,002,210 in fiscal year 2004-05, $9,492,705 in fiscal year 2005-06, and $11,945,299 in fiscal year 2006-07 for these advertising expenses.

PHEAA provided us with a comprehensive list of its advertising expenditures over the three-year period, totaling more than 10,000 accounting transactions. Many items could be considered general advertising expenses, including media, billboard, television, radio, and newspaper announcements.

Other expenditures appeared atypical for a state agency, including business dinners costing several thousand dollars each, golf outings, and various gifts. We selected a sample of 101 of these expenses for analysis to determine whether they were relevant business expenses. In addition, because many of these expenses occurred prior to PHEAA's adoption of its new travel expense policy, we wanted to determine the extent to which PHEAA's new travel policy was addressing PHEAA's spending practices.

The process we undertook to conduct our analysis included challenges of its own. First, it took almost three months for PHEAA to respond to our request for documents to support the 101 expenditures in our sample. Second, when PHEAA did respond, the response was inadequate. Specifically, PHEAA provided a spreadsheet that included data about each expense, such as the date the expense was recorded, what PHEAA called a "detailed description" of the expenses, and the name of the employee who approved the expense. However, we received no supporting documentation that would allow us to verify the accuracy of the information with which we were provided. In fact, even PHEAA's details on the spreadsheet lacked important information. Using a business dinner as an example, PHEAA did not provide the name of the restaurant, the specific business that was discussed, or the number of people that attended the dinner. We were, therefore, unable to determine whether a $3,000 dinner was attended by 10 people, which would have been extravagant and unnecessary, or 100 people, which would have been more reasonable.

We then contacted PHEAA and requested that we be able to review the supporting documentation directly, and we again made it clear that we were seeking copies of receipts and the documents submitted by the person who incurred the expense.

PHEAA complied with this subsequent request immediately and thoroughly, explaining that the original response had been unintentionally incomplete. We were then able to review the documentation and identify the following expenses that are atypical for a state government agency. Examples follow:

- $66,640 in total to buy 2,380 Hershey's "Holiday Splendor Select Towers" at $28 each. PHEAA said these gifts were sent to clients during the holidays in recognition of valued partnerships.

- $26,116 to buy 4,000 "rally" towels, which PHEAA said were used as promotional items at two Penn State football games.

- $11,500 to buy 5,000 screwdriver tool sets, which PHEAA said were used at various conferences as promotional items to attract attendees to PHEAA's exhibit booth.

- $10,024 to buy iPod Nanos, which PHEAA said were used as prizes for a sweepstakes being held on one of the agency's Web sites.

- $5,300 to pay for a business dinner for 20 people, of which six were PHEAA employees. The cost per person was therefore $265. The restaurant, in Scottsdale, AZ, describes itself online as "an unparalleled experience" and an "ultra high-end Coastal version of the Steakhouse, [offering] the best in upscale seafood dining in a clubby, avant-garde atmosphere, featuring live entertainment nightly in the 'O' Bar."[34]

- $4,373 to pay for a holiday luncheon, which PHEAA said was "to celebrate the success of the past year," for senior management held in December 2005. A similar holiday reception for management staff was held in December 2006, costing $1,057.

- $3,000 for four PHEAA employees to participate in a golf tournament hosted by a school client.

- $1,082 for retirement celebrations for three PHEAA executives.

As part of its response to our request for documentation, PHEAA explained that it had since taken corrective action to address the expenditures, meaning that many of the spending practices reflected in our sample were no longer occurring. Specifically, PHEAA officials stated:

> Of the 101 items selected, 75 of these items are no longer taking place in accordance with the Education Lending Code of Ethics and the Travel Expense Policy and Procedures, while 21 have been significantly modified.[35]

Along those lines, PHEAA's internal audit department reviewed certain agency expenses in late 2007 in order to determine whether agency spending was in compliance with PHEAA's new travel policy and procedures and the code of ethics.[36] The audit covered all expenses between April 1 and October 31, 2007, and found that agency

[34] http://www.mastrossteakhouse.com/
[35] PHEAA's written response to questions submitted by the Department of the Auditor General, January 24, 2008.
[36] *Internal Audit Report, Expense Audit with Management Response,* December 11, 2007, PHEAA.

spending was generally in compliance with agency policies, although the review did find several exceptions. Examples of two exceptions include an instance of reimbursing an employee for expenses such as meal costs for a personal guest, and an instance in which another expense exceeded the per diem amount established by the Internal Revenue Service.

PHEAA's internal audit team also identified spending for certain items that are not covered under any spending policies. These expenses include mileage reimbursement for those who work in home offices; catering for new hire orientation; catered lunches; purchasing candy for booths; staff meetings catered or held in restaurants; purchases of non-branded prizes for employees, schools, and students; gifts for employees; personal guests of clients; snacks and meals for employees working unusual shifts; rental car upgrades; and corsages for special events. The internal audit department recommended that management make a decision regarding spending for such items and incorporate these decisions into policy. Management responded in part as follows:

> . . . the effort to provide direction on "ordinary and necessary" expenses has generated some discussion at the executive level on the best way in which to communicate expectations. Currently, a recommendation is being developed for executive review to modify some existing related policies/procedures to create a more cohesive, useable document that provides staff with meaningful guidelines.

- **At least $62.5 million in professional service fees, including $12.4 million in legal fees and $2.1 million for lobbying services.**

At our request, PHEAA provided us with a list of its operating expenses for the audit period. After reviewing the list, we calculated that PHEAA spent more than $62 million on professional services, as shown on the table below. In some cases, it is reasonable to think that PHEAA would have had in-house professionals available so that outside contractors should not have been necessary.

Professional services paid for by PHEAA
FY 2004-05 through 2006-07

Expense Category	FY 2004-05	FY 2005-06	FY 2006-07	Total
Contractor Fees	$15,931,059	$12,939,137	$8,831,874	$37,702,070
Consulting Fees	2,039,462	3,204,170	1,743,594	6,987,226
Legal Fees	3,456,662	4,446,592	4,493,888	12,397,142
Other Professional Services	1,913,184	1,925,274	1,598,205	5,436,663
Total	**$23,340,367**	**$22,515,173**	**$16,667,561**	**$62,523,101**

Source: Developed by the Department of the Auditor General staff from information obtained from PHEAA on September 7, 2007.

Each of the four expense categories in the table is explained in more detail below.

Important note: We must qualify that we cannot be sure that $62.5 million is the actual total that PHEAA spent in these areas. As we discuss in Finding Two, we found that PHEAA did not always classify its expenditures accurately in its accounting records.

Contractor fees

As the table shows, PHEAA spent $15.9 million on what it categorized as “contractor fees” in fiscal year 2004-05; $12.9 million in fiscal year 2005-06; and $8.8 million in fiscal year 2006-07. Therefore, the total that PHEAA paid in contractors’ fees totaled $37.7 million over the three years.

While PHEAA had a filled complement of 330 employees in its Information Technology division (or 13 percent of

PHEAA's total employee complement overall), "IT development" expenses accounted for more than 90 percent of all contractor fees for the three-year audit period. When we asked PHEAA officials what IT development services comprised, the officials explained that "the consultant augments existing staff in performing application development level work or IT support, on a temporary basis."[37] Examples of such work include network security, client support, and Web development.

For each of the three fiscal years in our audit period, we also found that the same six vendors accounted for approximately 85 percent of total IT development costs. When we asked PHEAA if these six contractors were selected through a bidding process or a sole source process, PHEAA officials explained that each of the six contractors was selected on a sole source basis.[38] "We did not bid each consultant agreement but do request services as needed from the pool of consultants," said PHEAA. "We add additional consulting firms as needed to obtain specialized skills."

Consulting fees

The expenses that PHEAA categorized as consulting fees amounted to $2,039,462 during fiscal year 2004-05; $3,204,170 during fiscal year 2005-06; and $1,743,594 during fiscal year 2006-07. PHEAA paid consultants for advertising and branding services, Web site development (in other cases Web development was considered to be a contractor fee, as noted in our discussion about IT contractors), and human resources, which we discussed earlier in this finding.

We also found that PHEAA paid more than $2 million to ten separate lobbying firms or lobbyists. Interestingly,

[37] PHEAA's written response to questions submitted by the Department of the Auditor General, August 13, 2007.
[38] PHEAA is exempt from the Commonwealth Procurement Code. Therefore, PHEAA developed its own policies which outline when contracts should be bid. *See* 62 Pa.C.S. § 102(d).

PHEAA did not label the fees that it paid as "lobbying fees" but instead said that the firms provided "specialized industry knowledge."

Payments for this "specialized industry knowledge" totaled $595,764 to seven firms in fiscal year 2004-05; $891,889 to seven firms in fiscal year 2005-06; and $565,260 to eight firms in fiscal year 2006-07.

During our compilation of this information, we found that PHEAA paid a $64,551 ***bonus*** to a single lobbyist. When we asked PHEAA its reason for awarding the bonus payment, which was termed "Merit Bonus for April 2004 through January 2005," PHEAA noted simply that the payment was made pursuant to PHEAA's contract with the lobbyist.

In response to our further questioning, PHEAA later provided a copy of that lobbyist's contract. We reviewed the contract and found that PHEAA also agreed to pay this lobbyist for the following: administrative assistance, office rental, office furniture, computer equipment, fax machine, office telephone with charges paid, cellular telephone with charges paid, television with cable charges paid, association dues, and conference registration fees.

Additionally, PHEAA agreed to pay the lobbyist's business travel expenses, excluding the following: local travel; travel between Washington, D.C., and Harrisburg; and travel to regularly scheduled industry-sponsored events.

With regard to the provision of administrative assistance by PHEAA for this lobbyist, the contract states that the "consultant will have access to administrative staff at Client headquarters to assist in the production and distribution of documents and materials that are relevant to carrying out his responsibilities under this Agreement."

PHEAA staff told us that all its lobbying consultants were acquired through a sole source basis, rather than through a bidding process.[39] PHEAA also stated that "these firms benefited PHEAA because of their unique and high-level contacts within the U.S. Congress and the executive branch that supplemented PHEAA's federal government relations efforts."[40] PHEAA officials went on to state that, with the exception of one contract, "the lobbying contracts have been re-evaluated under the new management and that contracts have either been terminated, are in the process of being terminated, or have been restructured in terms of fees."[41]

Subsequently, on February 15, 2008, PHEAA provided information to us stating that the lobbying contracts for six of the eight firms or lobbyists used in fiscal year 2006-07 had been terminated. Even more recently, as of August 6, 2008, PHEAA told us that only one contract for lobbying services remained in effect, and even that contract is now assessed routinely to ensure that the contracted services continue to benefit the organization.

Legal services

While PHEAA had an authorized complement of 21 regular full-time positions for the legal department, of which 17 positions were filled, including 8 attorneys, (according to the June 25, 2007, complement report), PHEAA continued to utilize the services of outside counsel. For the three-year audit period, PHEAA spent approximately $12.4 million on outside legal counsel.[42]

PHEAA officials stated that the agency hired outside legal counsel for two purposes: "matters in which in-house

[39] *Id.*
[40] PHEAA's written response to questions submitted by the Department of the Auditor General, November 29, 2007.
[41] Ibid.
[42] This is the minimum amount spent by PHEAA staff on legal services for the three-year period. PHEAA staff stated that they misclassified some legal costs in the line item of "consulting fees." Accordingly, we do not have an accurate figure of total expenditures for outside legal counsel.

counsel are unable to appear on behalf of PHEAA, or matters in which it would not be cost effective for in-house counsel to appear and represent PHEAA."[43]

PHEAA elaborated on its response as follows:

> PHEAA engages local or outside counsel in litigation matters filed outside of Pennsylvania in jurisdictions where PHEAA's in-house attorneys are not admitted to practice law, making it cost prohibitive for the matter to be handled in-house. When local counsel is engaged to handle such matters, as much work as possible is handled in-house, and in house attorneys work closely with local counsel to manage the matters/cases in order to ensure the best representation of PHEAA and to minimize costs. PHEAA also engages outside counsel for complex matters that would not be most effectively and efficiently managed by in-house counsel due to the complexity of the issues involved and/or the resources and time required.[44]

We found that more than two-thirds of PHEAA's legal expenses were paid to one law firm. PHEAA first contracted with that firm in May 1996. In fiscal year 2004-05, PHEAA paid the firm $2,392,414; in fiscal year 2005-06, $3,262,510; and, in fiscal year 2006-07, $2,626,074. In total, then, PHEAA paid $8.3 million to this one firm for legal services over the three years.

PHEAA officials stated that, from "2004 through 2007, this law firm served as the outside counsel to the PHEAA Board of Directors and management on issues such as

[43] PHEAA's written response to questions submitted by the Department of the Auditor General, June 29, 2007.
[44] PHEAA's written response to questions submitted by the Department of the Auditor General, November 29, 2007.

human resources, finance and litigation."[45] PHEAA further stated that, based on certain criteria, the firm was selected to serve as general counsel for the agency.

We note that the same firm also serves as legal counsel to PHEAA's related organization, the Pennsylvania Higher Education Foundation, and that PHEAA told us that it paid for those legal services on behalf of the Foundation. (See Finding Six for more information on the Pennsylvania Higher Education Foundation.)

Other professional services

PHEAA spent $1.9 million in the area of "other professional services" in each of the fiscal years 2004-05 and 2005-06. This line item amounted to $1.6 million in fiscal year 2006-07.

An analysis of these expenditures shows that a variety of expenditures made up this expense item each year. For example, during the audit review period, there were expenditures for the following: education and support services, desktop and laptop integration, default aversion services for student loans, educational and informational videos, and a space plan study.

There were also expenses that were erroneously charged to this line item. For example, during fiscal year 2004-05, "contractor services" were erroneously charged to this expense line item; in addition, for fiscal year 2006-07, renovation expenses were recorded in this category rather than the expense category labeled "renovation expenses." (This issue of misclassifying expenses is further addressed in Finding Two).

[45] PHEAA's written response to questions submitted by the Department of the Auditor General, June 29, 2007.

Summary

The public places its trust in PHEAA officials, as managers of a state government agency, to spend agency funds appropriately, and only for items that are necessary for PHEAA to meet its public mission of providing higher education opportunities for Pennsylvania students. Yet PHEAA established many spending practices that are not typical for a state agency. These spending practices include excessive expenditures for management salaries, bonus payments, annual employee events, extensive service contracts, and certain advertising expenses that appear to be more frivolous than necessary. For every expenditure that PHEAA eliminates or reduces, additional monies could be allocated for direct student aid to Pennsylvania students.

Recommendations

3. PHEAA should permanently eliminate activities such as the annual Hersheypark event. However, if PHEAA wants to sponsor an "employee day" event, it should schedule such an event and request that employees pay for their attendance and that of guests, albeit at a discounted rate negotiated by PHEAA.

4. PHEAA should evaluate on an ongoing basis the level of professional services for which it contracts, and determine which contracts can be eliminated or renegotiated. In particular, professional services should not be a duplication of in-house professional expertise.

5. In cases where outside contractors must be used, PHEAA should choose such contractors in a fiscally responsible way, and by using a competitive bidding process where possible.

6. Also in cases where outside contractors must be used, PHEAA should not include bonuses in its contracts, nor

should it include frivolous payments such as cell phones, office furniture, association dues, and other such items.

7. PHEAA should continue its review of all its operating expenses and continue to identify areas where costs can be brought in line with those of a typical state agency.

Finding Two

PHEAA misclassified almost $2 million in operating expenditures when it accounted for them. Such errors raise questions about the overall accuracy of expenditure totals and also weaken PHEAA's ability to monitor its expenses.

While looking at the propriety of various expenses over the course of our audit work, we also identified almost $2 million in expenditures that PHEAA did not record accurately in its accounting records during fiscal years 2004-05 through 2006-07. For each of the following expenses, we saw more appropriate and exacting classifications under which these expenses should have been recorded. These more appropriate classifications are based on a PHEAA-provided list of categories and definitions for recording each type of expense.

Several examples follow:

- Deposit for Hersheypark employee event recorded in “other professional fees” ($20,000) when previous Hersheypark event fees were recorded in “employee awards and recognition”

- Conference fee for a board of directors retreat recorded in “promotion of business and affairs” ($8,000) under the aggregate advertising expense totals

- Travel expenses recorded with “contractors expense” ($2,420)

- Advertising expenses recorded in both “contractors expense” and “consulting fees” ($47,500)

- Intermingling of “consulting fees,” “contractors expense,” “information technology,” “legal,” and “other professional fees” ($1,855,621)

When we asked PHEAA officials about such expenditures and the classifications, the officials acknowledged that some misclassifications occurred but noted that—regardless of the classification—the expenses were still accounted for overall.

> We … recognized that some misclassifications occurred. … From a financial reporting standpoint, the misclassifications have no effect since all of these expenses are rolled up into a single line item, Operating Expenses. We found that the errors in coding occurred due to misunderstanding about the nature and purpose of the accounts by both business units who perform the initial coding and by Accounts Payable staff who verify the coding. Reorganizations that occurred within Financial Management during the year could have contributed to the miscoding of expenses. We made the decision to not reclassify any of the expenses in the year ended June 30, 2007; however, communication is occurring so that these types of errors are avoided in the current fiscal year.[46]

Although we agree with PHEAA that expenses are all "rolled up" into single line items and are therefore accounted for, and although PHEAA undergoes an annual financial audit for which an independent accounting firm reviews the *total* figure for "operating expenses," it is still important for PHEAA to be clear when it classifies the individual transactions that make up the total.

PHEAA also explained that some of its expenses could not fit precisely into a single category. For example, we also questioned the following two classifications that PHEAA believes it classified correctly:

[46] PHEAA's written response to questions submitted by the Department of the Auditor General, August 13, 2007.

- Private airplane charter fee recorded in "promotion of business and affairs" ($45,888) under the aggregate advertising expense totals. PHEAA officials said that the flight was chartered to visit out-of-state client companies to address technology issues raised by those clients.

- Renovation expenses recorded in "other professional fees" ($272,833) when there was an expenditure category called "renovation expenses." PHEAA said this amount was the total paid to three architectural firms for the redesign of several offices to maximize space usage and to ensure compliance with safety codes.

Again, we identified the misclassifications and the potential misclassifications over the course of audit work in which we were determining the *propriety* of questionable and/or high-dollar expenses. In other words, we did not start out with the purpose of reviewing the *classifications* but, as we saw potential classification errors, we noted them. As such, the items we have noted are not intended to be all-inclusive.

It is imperative that PHEAA record every one of its expenditures accurately in its accounting records. Misclassifications can negatively affect the budget process and result in inaccurate and inconsistent presentation of financial activity. As such, we are not able to state with certainty the exact amount of money spent by PHEAA in any expense category because expenditures were inaccurately recorded in the accounting records.

Such misclassifications can also impact PHEAA's ability or efforts to monitor certain types of expenditures, and the same misclassifications can also raise questions about whether the misclassifications are by accident, as in employees making an unintentional mistake, or whether the misclassifications are by design, as in employees intentionally misclassifying the expense to avoid audit or public scrutiny.

At a meeting conducted on December 4, 2007, PHEAA officials acknowledged that there have been problems with misclassifications in the past, and that some expense items are difficult to classify. They also acknowledged that classifications have not always been consistent. However, they stated that PHEAA has internal controls in place to try to prevent misclassifications of expenditures and that they are currently working to improve those controls. It is critical that PHEAA conduct more testing of its internal controls in this area so that it can provide greater assurance that all expenses are recorded accurately. This accuracy is fundamental to PHEAA's responsibility to be open and transparent in its activities.

Recommendation

8. PHEAA's internal and IT audit department should conduct periodic audits of the accounting records and tests of the internal controls and take appropriate action to ensure that all expenses are recorded properly in the accounting records. As problems are identified, PHEAA should take appropriate corrective actions. It is imperative that PHEAA record every one of its expenditures accurately in its accounting records.

Finding Three

PHEAA did not require some employees to report vehicle usage as they should have done; PHEAA also did not require enough usage detail to provide for openness and transparency in vehicle operations.

As of June 30, 2007, PHEAA's vehicle fleet consisted of 73 vehicles.[47] Of those, PHEAA identified 30 as pool cars, which PHEAA said can be temporarily assigned to employees for pre-approved, business-related travel only. The remaining 43 vehicles were permanently assigned to PHEAA employees.

PHEAA said that all the agency's vehicles were purchased using PHEAA funds and are the property of the agency. PHEAA pays for all costs to operate and maintain its vehicles, including fuel, and maintains policies for both the temporary and permanent assignment of the vehicles.

Unless stated otherwise, we have focused this finding on the use of permanently assigned vehicles. PHEAA's policy in this regard contains mostly the same information as the commonwealth's management directives for the operation of, and responsibility for, assigned vehicles. However, we found two differences worthy of note.

- First, PHEAA's policy for permanently assigned vehicles permits the spouse of the employee who is assigned a vehicle to operate that vehicle, as long as the assignee is riding in the vehicle at that time. It is important for PHEAA to consider whether Pennsylvania taxpayers would find that provision acceptable and appropriate; it is doubtful that the public would agree with PHEAA that a person who is not a PHEAA employee should be driving a state agency car.

- Second, PHEAA's policy allows certain employees, whom the policy identifies by salary level, business needs, or department, to use their assigned vehicles for personal use.

[47] In February 2008, PHEAA said that its vehicle fleet had been consolidated to 58 vehicles.

PHEAA defines "personal use" of its vehicles as follows:

> All mileage that is not for business purposes as defined in [U.S.] Treasury Regulation Section 1.61-21(f) is considered to be "personal use," and is taxed accordingly.[48]

In tax year 2007, of the 43 employees with permanently assigned vehicles, there were 13 employees who reported using those vehicles for personal use.

Not all employees reported mileage adequately. In addition, PHEAA did not retain all related documentation.

PHEAA's policy on the permanent assignment of agency vehicles requires certain employees[49] to submit a monthly breakdown of business and personal miles to PHEAA's vehicle management office. Specifically, the employees are required to complete a "Permanent Assignment Monthly Automotive form" that lists their starting and ending mileage for every day the car is in use, whether the miles driven were for business or personal purposes, and destination information. Appendix D includes a copy of this form.

We initially asked to see the completed monthly forms that had been submitted by employees who were permitted to use their permanently assigned cars for personal reasons during the three years of our audit period—July 1, 2004, through June 30, 2007.

In response to our request, we found that PHEAA had discarded either most or all of the actual forms submitted

[48] PHEAA's written response to questions submitted by the Department of the Auditor General, February 15, 2008.
[49] PHEAA's policy refers to these employees as "Control Employees." Control employees are those whose compensation exceeds a certain amount, which was $136,200 in 2007.

through the end of 2006.[50] (In February 2008, during our audit work, PHEAA officials said they had had implemented a new practice to scan and retain the monthly automotive forms electronically.)

Nevertheless, PHEAA did have its forms for the first six months of 2007, which were the most recent forms at the time we made our request.

Accordingly, we were able to review information as follows:

1. **January through June 2007.** Any and all monthly forms that PHEAA had for the period of January 1, 2007, through June 30, 2007, including forms submitted by employees who did not have the personal-use option. (Altogether, PHEAA supplied us with the monthly forms submitted by more than 30 employees for that time period.)

2. **November 2003 through December 2006.** Only spreadsheets that PHEAA had maintained for each of its 2004, 2005, and 2006 tax years (November through October), and also for November and December of 2006. These spreadsheets included mileage information only for those employees for whom PHEAA recorded personal mileage.

   - For tax year 2004, the information summarized the mileage traveled by 13 employees in their vehicles.

   - For tax years 2005 and 2006, the information summarized the mileage traveled by 15 employees.

   - For November and December of 2006, the information summarized the mileage traveled by 13 employees.[51]

[50]PHEAA responded that "the [monthly automotive forms] are maintained only until the tax year computation is completed. Once the adjustments to income are made, ***the individual records are discarded***." Letter from PHEAA to the Department of the Auditor General dated February 28, 2008. [Emphasis added.]

[51] For the most part, the core of 13 to 15 employees comprised the same individuals, but not always.

Results of our review and analysis of the spreadsheets and the automotive forms

- We found a fundamental recordkeeping flaw in that most of the core 13-15 employees reported their monthly mileage only by using beginning and ending odometer readings—even though the automotive form clearly provided for day-by-day reporting. Thus, although the employees were also required to break down the total mileage by business-versus-personal use, we saw no documentation to support that breakdown.

- We also found that, despite not being able to produce the documentation in support of this breakdown, PHEAA calculated that, between November 2003 and December 2006, its 13-15 applicable employees used their permanently assigned cars to drive a total of 315,572 personal miles and 481,970 business miles. Those numbers show that, based on the overall total of 797,542 miles, the employees drove their assigned cars for personal use 40 percent of the time during that period.

- During the time period of January 1 through June 30, 2007, we found that employees (for whom we received forms) at the level of senior vice president and above reported driving their permanently assigned vehicles 70 percent of the time for personal use and 30 percent of the time for business use.

- Under PHEAA's policy, employees who use their vehicles for both business and personal mileage are required to pay taxes according to Internal Revenue Service rules that take both business and personal mileage into consideration. While it was not our objective to test any such tax methodology or calculations of PHEAA's, and while we therefore have no reason to believe that PHEAA used an incorrect methodology, PHEAA could not have known if the totals of employee-reported personal and business miles were accurate and true without seeing a day-by-day breakdown. The potential risk is that employees could have driven their cars for no official use but reported otherwise.

- Based on the standard mileage reimbursement in effect at the various times, we determined that it would have cost PHEAA $131,451 to provide the vehicles to the applicable employees—including gasoline, insurance, and maintenance—for the 315,572 personal miles.

- Because PHEAA also provided us with the mileage forms from January through June 2007 for employees who were not permitted to drive their cars for personal use, we were able to determine that PHEAA did not use a uniform reporting form. In fact, we found that PHEAA used seven variations of the initial form that PHEAA had provided to us.[52] The forms were similar, but some did not contain the field for recoding personal mileage, and others contained a field for tracking maintenance expenses. Even if it means that employees who do not have cars for personal use have to fill in "0" to record they drove no personal miles, it makes sense for PHEAA to require that type of uniform reporting for comparative and documentary purposes.

- In the case of two out-of-state employees who each had a permanently assigned Pennsylvania state-owned vehicle, neither employee provided the actual mileage form and instead submitted e-mails with their mileage totals.

- There were no automotive forms for one employee, even though that employee had a permanently assigned vehicle.

Gasoline purchases overall

During our review of PHEAA's expense detail for vehicle maintenance and repairs (not the review of the individual mileage spreadsheets), we found that expenditures listed as gasoline purchases totaled at least $245,816 between July 1,

[52] See Appendix D.

2004, and June 30, 2007. There is no doubt that PHEAA, by its very nature, has reason to be a mobile agency, but it should take greater care to support that mobility by openly reporting the use of its vehicles, including the details of mileage, fuel, and other vehicle expenses.

Summary

We found that vehicle reporting requirements were not always followed, that automotive reporting forms lacked uniformity, and that documentation to support many of the reports had been discarded. Overall, these issues point to a problem with internal controls, lead to a lack of transparency and openness, and show that PHEAA could be doing still more to demonstrate fiscal prudence. Every way in which PHEAA can be more efficient and every dollar that PHEAA can save will enhance its financial condition, thereby helping the agency to meet its core mission of providing financial assistance to Pennsylvania students.

Recommendations

9. PHEAA should revise its vehicle policy so that employees use permanently assigned cars for business purposes only.

10. PHEAA should prohibit non-employees (e.g., spouses of employees) from driving state-owned cars.

11. PHEAA should retain its automotive forms and supporting documentation for a minimum of four years in accordance with Commonwealth records-retention policy.

12. PHEAA should distribute and use an official and uniform version of the monthly automotive form to ensure that all employees are using the same form. Daily mileage, including destination information, should be recorded.

Finding Four

PHEAA was successful in validating the accuracy of state taxpayer-funded grant awards when looking at higher-risk applications. PHEAA was less successful in keeping pace with rising education costs. Overall, regardless of its degrees of success, PHEAA should audit all aspects of its state grant program on a continuing basis.

In this finding, which we divide into Finding 4.a and 4.b, we discuss the importance of the state taxpayer-funded grant program. Since its inception, the program has provided Pennsylvania residents with $6 billion in financial aid that does not need to be repaid. However, over the past ten years, the percentage of students who have received these grants—as compared to those who have applied—has decreased.[53] (See page 90 of the Question and Answer section in Appendix B.)

The Pennsylvania State Grant Program was established in 1966 as a broad-scale "State scholarship program" under the Pennsylvania Higher Education Assistance Act.[54] Because the program is funded with taxpayer dollars appropriated by the General Assembly, and because the appropriations would have to be virtually unlimited for every eligible post-secondary student to receive a grant, it is critical for the program to undergo continuous monitoring to ensure that grant amounts are awarded fairly and that—as much as possible—they keep pace with rising education costs.

[53] PHEAA said that, while there has been a decrease in the percentage of awards compared to the number of applications filed, the number of applications overall has increased for several reasons. One reason is an increase in outreach activities that have made students more aware of the need to complete a FAFSA. Another reason is that the FAFSA no longer contains a check-off box (as it did in the late 1990s) whereby students could indicate they were not interested in applying for aid through their state's financial aid agency. Therefore, all FAFSA applications are now automatically sent to the agency. Finally, some families complete the FAFSA realizing they are not eligible for a grant but knowing that a FAFSA must nonetheless be completed to apply for a federal Stafford Loan.

[54] *See* 24 P.S. § 5151. Regulations governing the Pennsylvania State Grant Program are found at 22 Pa. Code § 121.41 *et seq*.

Again, since the grant program's inception, PHEAA has awarded more than $6 billion to Pennsylvania residents, primarily from General Fund appropriations. As impressive as that amount appears to be, it is still not high enough to help with the cost of education for every Pennsylvania student who needs financial assistance in order to attend a post-secondary institution.

State grants are awarded based on financial need. PHEAA uses a formula to determine the amount of each grant, taking into consideration family resources, as well as the cost of tuition, fees, room, board, and books. PHEAA reviews this formula on an annual basis and, in fact, has established a state grant advisory committee, which is made up of representatives from the Pennsylvania Association of Student Financial Aid Administrators, selected post-secondary schools, and secondary and technical schools. The advisory committee meets several times a year to review the status of the state grant program with respect to the distribution of funds, minimum and maximum awards, and purchasing power. This committee also is involved in the development of the annual grant formula.

In order to receive a state grant, students must be enrolled in an approved school at least on a part-time basis[55] and be a resident of Pennsylvania, among other criteria. Pennsylvania residents who choose to go to an out-of-state school may still be eligible for a state grant, but at a lower amount.

Pennsylvania State Grant Program Awards - Academic Years 2004-05 through 2006-07

Academic Year *	Total of grants awarded	Number of grants awarded	Average grant amount**	Maximum grant amount
2004-05	$361,343,406	167,947	$2,621	$3,300
2005-06	$400,008,328	175,144	$2,809	$3,500
2006-07	$452,927,929	178,594	$3,135	$4,500

Source: "1995-96 to 2006-07 Year by Year Summary Statistic Report," PHEAA.
**The amounts of state grant program awards differ from the General Fund appropriation amounts shown in the table on page 12 due to differences in the fiscal year versus the academic year, and also due to supplementary contributions that PHEAA made to the grants from its earnings.*
***The average grant amount is based on academic year only; the total of grants awarded and the number of grants awarded are based on academic and summer year.*

[55] Part-time basis is defined as at least 6 credits but less than 12 credits per semester.

Finding 4.a

Finding 4.a – PHEAA confirmed that it awarded state grant amounts accurately by validating applications that it considered to be error-prone. However, it did not validate the larger population of applications, which are those not considered to be error-prone.

In this finding, we discuss our audit test in which we found that PHEAA's state grant validation process worked for 100 percent of 150 applications that we sampled. PHEAA's validation process is used to review selected state grant application information to ascertain its accuracy and to ensure that students who receive grant funds meet both financial and non-financial eligibility criteria.

PHEAA completed approximately 18,000 validations from a total population of 290,194 grant applications in academic year 2006-07.[56] The 18,000 validations represent six percent of the total population of applications, specifically those that PHEAA identified as being at risk for errors. PHEAA explained that, to identify the 18,000 applications at risk for errors, it first shared data from approximately 130,000 applications with the state's Department of Revenue in order to compare information from tax filings with the information on the grant applications.

When a student completes and submits a Free Application for Federal Student Aid (FAFSA), that application also serves as the primary application for the state grant program. PHEAA determines state grant eligibility and grant award amounts using information from the FAFSA.[57]

The error-prone grant applications that PHEAA validates typically are those for which PHEAA has questions regarding a

[56] PHEAA's written response to the Department of the Auditor General's submission of notes from a July 17, 2007, meeting held with PHEAA, August 8, 2007.
[57] PHEAA also collects a small number of supplemental data items from students once the FAFSA results are received. Initial grant award amounts may be increased, decreased, or cancelled following PHEAA's validation process.

significant change in family income from prior years,[58] the exclusion of retirement and deferred compensation contributions,[59] out-of-state address, out-of-state driver's license, or out-of-state high school graduation. PHEAA staff members also review student grant application files in order to validate items such as family size and number in college, family assets, veteran status, and other items not necessarily contained in tax returns.

Once the error-prone grant application files have been identified, PHEAA sends written notices to the students/families requiring them to submit additional information to PHEAA. The type of information requested depends on the type of potential error identified. Examples of information requested include copies of federal income tax returns, documents related to untaxed income, and proof of high school graduation. PHEAA may also require students/families to complete questionnaires in order to gain more detailed information related to areas such as Pennsylvania residency or veteran status.

PHEAA officials stated that, according to state grant program requirements, grant funds may not be disbursed to a student until validation of the selected files is completed, including receipt of the documents that PHEAA requested.[60]

When the validation process is completed, a student's preliminary grant award amount will either remain unchanged, or it will be recalculated according to the student's newly corrected eligibility status.

To test the impact of PHEAA's validation process on state grant award amounts, we reviewed a random sample of 150

[58] As explained on the previous page, PHEAA finds looks for such inconsistencies by sharing information with the Pennsylvania Department of Revenue.
[59] The Pennsylvania State Grant program and federal financial aid programs require that families report all current sources of untaxed income, including tax sheltered contributions to retirement plans or deferred annuity contributions, whether they are voluntary or involuntary.
[60] PHEAA's written response to the Department of the Auditor General's submission of notes from a July 17, 2007, meeting held with PHEAA, August 8, 2007.

state grant case files, consisting of 50 case files from each of the three academic years 2004-05 through 2006-07.[61] The most frequent type of validation performed in our sample was income validation, accounting for 44 percent of the cases we reviewed. The second most frequent type of validation was for Pennsylvania residency, accounting for 26 percent of the cases we reviewed. Other types of validation performed in our sample were:

- Estimated income validation[62]
- High school diploma validation
- Validation of veteran status
- Dividends/interest validation
- Special consideration verification[63]

We found the following upon review of the 150 case files:

- In 59 of the cases (39 percent), the student/family did not return the required information to PHEAA; consequently, no disbursement of grant funds was made.
- In 48 of the cases (32 percent), the grants were awarded following the validation process with no changes made to the preliminary award amounts.
- In 29 of the cases (19 percent), the grant awards were recalculated and reduced to $0 after PHEAA received and processed the requested information. In other words, in

[61] PHEAA used generally accepted auditing methods to select the random sample as requested by the Department of the Auditor General. The files were accessed and reviewed by the Department of the Auditor General at PHEAA's headquarters on October 2, 2007.
[62] If a student's or family's income tax information was not available when the FAFSA was completed, an estimate of income was used to determine the preliminary grant amount. Subsequently, a validation request is made for tax returns, W-2s, etc.
[63] Special consideration verification is a review of a student's or family's request for reconsideration due to unforeseen circumstances, such as unemployment, disability, or death of a parent or spouse.

each of these cases, the student/family did not meet at least one of the eligibility requirements for a state grant award.

- In 12 of the cases (8 percent), grants were still awarded following the validation process, but the award amounts were recalculated and reduced.[64]
- Preliminary grant award amounts were recalculated and increased in two cases following the validation process.[65]

Overall, in the 150 cases that we reviewed, we found that PHEAA's validation process worked—either because PHEAA confirmed that the original intended award amount was correct (in 48 cases) or because PHEAA determined that the award needed to be changed (in 102 cases).

What is still unknown, however, is whether *all* grants—specifically those that PHEAA does not validate because they are not considered to be error-prone—are awarded properly. Because the error-prone applications make up such a small percentage of the total (e.g., only 6 percent in award year 2006-07), it is important for PHEAA to expand its validations to include more cases from the entire population of applications.

Recommendation

13. PHEAA should expand its validation process to include a random sample of records that are not error-prone to provide greater assurance that all grant funds are awarded properly.

[64] Eleven of the twelve cases in which this occurred were income validation cases, where the student's or family's income (as determined for state grant purposes) was found to be higher than originally calculated. The remaining case in which the preliminary grant award amount was reduced was a dividends/interest validation case.
[65] Both of these cases were categorized as "special consideration/October verification." Each case involved parental unemployment issues resulting in the family's income being lower than initially reported on the FAFSA.

Finding 4.b

Finding 4.b – PHEAA tried to make the state's grant awards keep pace with rising education costs but has been unable to do so as those costs continue to escalate.

What was the purchasing power of state grants?

As the table on page 52 shows, the average grant award amount increased for each of the three years under review. However, during that same time period, the costs for tuition and other higher education expenses also increased. Therefore, it is necessary to look at the percentage of educational expenses that are covered by the average grant amount to determine the "meaningfulness" of state grants. This measure is also referred to as "purchasing power." [66]

While PHEAA took action as the grant program administrator to improve the purchasing power of the state's grant awards as discussed later in this finding, we found that PHEAA's actions did not result in grant awards that kept pace with students' needs.

- PHEAA officials estimated that the average state grant award covered only 23 percent of the tuition and fees for Pennsylvania students[67] during academic year 2006-07. This estimated purchasing power amount increased from 21 percent in the prior year. However, this figure does not include costs for room, board, and other costs that are incurred when attending a post-secondary institution. If such costs were considered when calculating purchasing power, the average grant award amount would become nominal when compared to total educational expenses.

- In academic year 2006-07, only 56 percent of those students who met program requirements received a grant

[66] Purchasing power is defined as the percentage of tuition and fees covered by the average state grant award. See more information in the Question and Answer Section of Appendix A.
[67] "Pennsylvania students" includes Pennsylvania residents attending both in-state and out-of-state post-secondary schools.

award. The remaining 44 percent of students were not awarded a state grant because the PHEAA-administered grant formula deemed these students ineligible for the grant, generally because applicants' expected family contributions exceeded program eligibility parameters. The percentage of students being served by the state grant program decreased over the past ten years.

- The average grant award amount for academic year 2006-07 amounted to $3,135. The maximum grant allowed in that school year was $4,500. These amounts contrast with $16,263, the annual average costs to attend a public four-year institution in Pennsylvania, and with $33,953, the annual average costs to attend a private four-year school in the same year.[68]

- The 4.4 percent increase in the maximum grant award for 2007-08 (up to $4,700 from $4,500 in the prior year) is smaller than the increase in tuition costs for several Pennsylvania schools. For example, the University of Pittsburgh imposed a 6.5 percent increase in tuition for 2007-08, while Pennsylvania State University's tuition increased 5.5 percent, and that of the Pennsylvania School of Technology increased 6 percent in 2007-08. With tuition increasing at a faster rate than that of grant award amounts, the grant award becomes less meaningful with each rise in tuition costs.

What did PHEAA do during our audit period to make grant award amounts more significant for students?

PHEAA took several measures in an effort to provide higher grant awards that would be more helpful to students.

[68] U.S. Department of Education, National Center for Education Statistics, 2005-06 and 2006-07 Integrated Post-secondary Education Data System (IPEDS), July 2007. Costs include tuition, fees, room, and board charged for full-time students in degree granting institutions. As of July 22, 2008, it could be accessed on the Internet at http://nces.ed.gov/programs/digest/d07/tables/dt07_321.asp.

State Grant Task Force. PHEAA's board of directors created the State Grant Task Force[69] in June 2004 to study the effectiveness of the state grant program and to evaluate the formula by which state grants are awarded. According to PHEAA, the task force examined all aspects of the state grant program awarding formula, including the distribution of funds among students by income, financial need, and school selection; as well as the purchasing power of the state grant awards.[70] PHEAA noted that some members of this task force are also members of the state grant advisory committee, which meets on a regular basis to provide guidance to PHEAA on matters related to the annual grant formula and award recommendations.

On June 16, 2005, the task force proposed a new state grant awarding formula, which the board of directors accepted. The new formula became effective in academic year 2006-07. With the acceptance of the new state grant formula, the task force was disbanded.

Change to Grant Award Formula. When we asked PHEAA officials why they changed the grant award formula, they stated the following:

> The primary reason for changing the State Grant formula was to ensure that limited financial resources were targeted to the students from families with the least ability to pay for higher education. Making the formula simpler and easier to understand was also a goal but not as significant as providing higher grant awards to students.[71]

[69] The State Grant Task Force consisted of 22 members, 5 PHEAA staff participants, and 2 consultants. The members included state legislators, financial aid administrators, and representatives from higher education organizations and agencies.
[70] PHEAA's written response to questions submitted by the Department of the Auditor General, June 13, 2007.
[71] PHEAA's written response to the Department of the Auditor General's submission of notes from a July 17, 2007, meeting held with PHEAA, August 8, 2007.

Some of the major changes to the grant formula include the following:

- The new formula relies on the Expected Family Contribution, or EFC, as calculated from the Free Application for Federal Student Aid (FAFSA). This change resulted in aligning the state grant program with federal student aid programs. Prior to the change, PHEAA officials made a longhand internal calculation to arrive at the family's contribution amount.

- The new formula created tiers for the expected family contribution amounts. This practice allows those with lower expected family contributions to receive larger grant amounts, and those with higher expected family contributions to receive smaller grant amounts.[72] The old formula used a flat percentage in calculating award amounts.

- The new formula deducts 100 percent of the amount of a student's Federal Pell Grant award in calculating a student's need, whereas the original formula deducted only 65 percent.[73] PHEAA officials stated that the reason for this change was so that federal resources are considered before any state dollars are committed to the educational costs of the student.

- The new formula places a cap on educational costs in determining state grant eligibility. Prior to this change, no such caps existed.[74]

[72] In award year 2006-07, a student in the lowest EFC range ($0 - $4,000) had 45 percent of need met by a state grant award, up to the maximum award and after any Pell grant was considered. A student in the highest EFC range ($12,001 and above) had three percent of need met by a state grant award.
[73] There are two categories of state grant applicants whose eligibility is determined without regard to the Federal Pell Grant: (1) students who have recently suffered the death or disability of a parent or spouse, and (2) veterans of the U.S. Armed Services.
[74] The cap for educational costs for award year 2006-07 was $25,000, and for award year 2007-08 was $26,000. Under the original formula, state grant awards were limited to the lesser of 80 percent of tuition and fees or the state grant maximum award established for that particular year.

In addition to these changes, PHEAA committed approximately $35 million in funds to cover the costs of "grandfathering" renewal students in award years 2006-07 and 2007-08.

GIFTS Initiative. Until fiscal year 2005-06, PHEAA used the taxpayer-funded General Fund appropriations to make all state grant awards.[75] The General Fund appropriations to PHEAA for the state grant program since fiscal year 1995-96 are shown below.

General Fund Appropriations made to PHEAA
for the Pennsylvania State Grant Program
FY 1995-96 through FY 2008-09

Fiscal year	Appropriation amount	Percent increase over prior year
1995-96	$233,091,000	N/A
1996-97	$233,091,000	0.0%
1997-98	$249,407,000	7.0%
1998-99	$266,866,000	7.0%
1999-00	$285,547,000	7.0%
2000-01	$314,102,000	10.0%
2001-02	$336,089,000	7.0%
2002-03	$347,911,000	3.5%
2003-04	$347,911,000	0.0%
2004-05	$359,218,000	3.3%
2005-06	$368,198,000	2.5%
2006-07	$386,198,000	4.9%
2007-08	$386,198,000	0.0%
2008-09	$407,413,000	5.5%

Source: "1995-96 to 2006-07 Year by Year Summary Statistic Report," PHEAA; the 2007-08 Governor's Executive Budget; the July 31, 2007, General Fund Status of Appropriations; and the General Appropriations Act of 2008, Act 38A of 2008.

[75] In addition to the state appropriations, PHEAA continues to receive some federal funding for the state grant program. These federal funds are not included in the table above but range from $1.1 million to $4.9 million annually between 1995-96 and 2008-09.

PHEAA officials told us that, in early 2004, PHEAA's board chairman and its president and CEO met with legislative leaders regarding funding for the state grant program, including the possibility that PHEAA would provide supplemental funding to the program.[76] According to PHEAA officials, before taking such action, it needed a commitment from these legislative leaders that the General Fund would continue to provide funding for the state grant program, and that PHEAA's funds would "supplement, not supplant" state funds.[77]

PHEAA officials said that the legislative leaders made such a commitment in spring 2004. Subsequently, on February 2, 2005, PHEAA announced that it would supplement the annual General Fund appropriation for the state grant program through a program it called the Grants and Infrastructure for Tomorrow's Students, or GIFTS, Initiative.

PHEAA based the amount of its initial GIFTS supplement on the agency's financial performance as of the year ended June 30, 2004.[78] Funding for the GIFTS Initiative increased until 2007-08 as shown in the table at right.

PHEAA initially projected that it would continue to fund the GIFTS Initiative through fiscal year 2011-12.[79] However, on April 24, 2008, the PHEAA board voted not to supplement the General Fund appropriation for academic year 2008-09. PHEAA indicated that it eliminated the supplement as the result of PHEAA's financial condition that followed the disruption of the capital markets and the sub-prime mortgage crisis.

Future supplemental funding amounts for the state grant program will be decided by PHEAA in subsequent years. We

[76] PHEAA's written response to the Department of the Auditor General's submission of notes from a July 17, 2007, meeting held with PHEAA, August 8, 2007.
[77] Ibid.
[78] PHEAA's written response to questions submitted by the Department of the Auditor General, June 13, 2007.
[79] PHEAA's contributions to the GIFTS Initiative have been projected through fiscal year 2011-12; PHEAA could not state with certainty that the program will continue beyond that time frame.

prepared the table below using information that PHEAA provided to us in June 2007, and we updated that information as new information became available.

PHEAA's supplement to state grant appropriations through its GIFTS Initiative
FY 2005-06 through FY 2011-12

Fiscal Year	2005-06 *actual*	2006-07 *actual*	2007-08 *projected*	2008-09 *projected*	2009-10 *projected*	2010-11 *projected*	2011-12 *projected*
Total annual supplement	$25 million	$52.5[a/] million	$60 million[a/]	$0 now; originally $67.5 million	$0 now; originally $75 million	$0 now; originally $82.5; million	$0 now; originally $90 million

[a/] These figures do not include $35 million in funds committed by PHEAA to cover the costs of "grandfathering" renewal students in 2006-07 and 2007-08. These are the students who would have received a higher award under the original award formula as opposed to the new award formula. PHEAA committed $20 million in fiscal year 2006-07 and $15 million for fiscal year 2007-08 to hold these students harmless in the transition to the new formula.

Source: Information initially provided by PHEAA in response to a written request submitted by the Department of the Auditor General, June 13, 2007. We have updated the information based on actions announced by the PHEAA board of directors in April 2008.

We asked PHEAA officials to explain why more monies were not allocated toward supplementing the state grant program in academic years 2005-06 through 2007-08 and received the following response:

> The GIFTS Initiative and other public service contributions are funded through the business earnings of American Education Services, our student loan commercial enterprise. Revenue generation from [our commercial activities] is impacted by many factors including federal legislation, interest rates, and economic markets. Since these areas are subject to change with sometimes little notice, it is more prudent to

> project funding through a five year period rather than indefinitely into the future.[80]

It appears that PHEAA could have contributed more money to the state's appropriations for grants during fiscal years 2004-05 through 2007-08, based on the fact that PHEAA spent excessively in other areas—including salaries, bonuses, employee outings, advertising, and the hiring of contractors—as we have noted in our first finding of this report.

More specifically, as generous as PHEAA was in contributing to the state grant program in previous years, that generosity should not camouflage PHEAA's lack of fiscal prudence elsewhere during the times when the agency publicized its substantial earnings. If PHEAA had planned for greater fluctuations in economic conditions, and if it had more wisely set aside the monies it spent to reward itself, it could have given more to supplement the grant appropriations. Even if the amounts of its spending excesses do not make up a great proportion of PHEAA's total spending, every dollar spent elsewhere by PHEAA was a dollar that could have been spent to benefit Pennsylvania students and their families.

Audit of state grant program needed to ensure grants are meaningful

In light of the recent changes made to the state grant program, we examined the extent to which the state grant program was audited, either internally or externally. We also wanted to assess if any audit concluded on the effectiveness of these program changes in providing more meaningful grant awards to Pennsylvania students.

As the result of our examination, we found that the state grant program has not been recently audited by either internal or external auditors. That information was surprising given the

[80] PHEAA's written response to the Department of the Auditor General's submission of notes from a meeting with PHEAA officials on July 17, 2007, August 8, 2007.

fact that PHEAA provided us with a list showing that 44 external audits are annually conducted on its operations.[81] However, none of these audits cover the state grant program. Instead, the yearly external audits generally relate to PHEAA's information technology systems, service level agreements with lenders, and compliance with various aspects of the federal student loan program. Furthermore, while an independent auditor conducts annual audits of PHEAA's financial statements, these audits do not include an examination of the state grant program.

PHEAA also provided a listing of all internal audit projects conducted from July 1, 2004, through May 9, 2007.[82] This listing did not include any internal audits conducted of the state grant program.

We asked PHEAA when it plans to begin an audit of the state grant program; PHEAA's response was that such an audit "is not scheduled at this time." We find this response to contradict PHEAA's own risk-based internal audit plan approved by its audit review committee on January 24, 2007. This plan classifies the various PHEAA operations into risk categories, which in turn establish the frequency for which internal audits will be conducted.[83] "State Grant Processing and Program Maintenance" is listed as a "high" risk area, which means that this area is to be audited once each year.

Based on our own review of the grant program, we found that several components could benefit from a closer examination. Unlike this audit, which looked at the larger picture, such an examination would have to be a separate and intensive audit in itself, focused entirely on the mechanics and performance of the grant program only. Specific audit targets could include,

[81] Pennsylvania Higher Education Assistance Agency/American Education Services, Scope of Agency Audits, May 18, 2007.
[82] PHEAA provided the internal audit information on May 25, 2007.
[83] PHEAA operations are broken down into "high," "medium," and "low" risk categories. Those items that are classified as high-risk are to be audited once in 12-month period; those items that are medium-risk are to be audited once in a 24-month period; and those items that are low-risk are to be audited once in a 36-month period.

for example, the formula used to determine individual grant awards; the process used to determine the maximum grant award, including the use of projection models; and the validation process used on error-prone grant applications, among others. Any such audits should ascertain that processes are in place to ensure that state grant awards are properly awarded and that they are keeping pace as much as possible with the increasing costs of post-secondary education.

Recommendations

14. PHEAA should follow its risk-based internal audit plan and conduct annual audits of the state grant program.

15. PHEAA should ensure that all its expenditures are fiscally prudent and, in so doing, determine how it can continue supplementing the taxpayer-funded state grant appropriations.

16. PHEAA should continue the use of its state grant advisory committee and enhance the committee's role as necessary to ensure the effectiveness of grant awards.

Finding Five

PHEAA made numerous improvements to its travel policy and procedures in response to criticism of its expenditures but can do still more.

Of PHEAA's 2,600 employees, approximately 500 travel on agency business at least once per year.[84] PHEAA said that, in fiscal year 2006-07, 119 of the 500 employees were classified as "frequent travelers," or employees who travel more than six times in a fiscal year.[85] From our discussions with PHEAA officials, we learned that frequent travelers are typically employees within PHEAA's client relations and educational services groups, who travel for the primary purpose of increasing business for the agency. In total, frequent travelers represent approximately five percent of PHEAA's employees.

PHEAA's total travel expenses in fiscal year 2006-07 amounted to $1.1 million. PHEAA seeks to control its employees' travel expenses through its travel expense policy and accompanying procedures. PHEAA revised its travel expense policy and procedures after several newspaper articles—particularly a series in *The Patriot-News*, Harrisburg—were published in March 2007 that detailed more than $800,000 in expenses spent by members of PHEAA's board of directors at retreats between 2000 and 2005.[86] The board approved the new policy on March 22, 2007, and issued a press release on the same day.

One day after PHEAA adopted its new travel policy, an article printed in the *Pittsburgh Post-Gazette* quoted the Governor's policy director as saying that "PHEAA's new travel policy does not go far enough, because it does not include limits on

[84] PHEAA's written response to the Department of the Auditor General's submission of notes from a June 6, 2007, meeting held with PHEAA, July 31, 2007.
[85] PHEAA's written response to questions submitted by the Department of the Auditor General, June 13, 2007.
[86] *The Patriot-News*, Harrisburg, and the *Pittsburgh Post-Gazette* each released a series of articles in March 2007 that detailed their analyses of the expense records they obtained from PHEAA.

PHEAA's use of state planes."[87] PHEAA subsequently addressed state plane use in its travel expense procedures. Those procedures, which PHEAA approved on April 18, 2007, and officially implemented on May 3, 2007,[88] expand upon the travel policy to provide detailed guidance for employees on what travel arrangements are appropriate.

New travel policy sometimes vague

Despite the numerous improvements to the new travel policy as discussed in the next section, we found some vagueness that could lead to PHEAA's misuse of travel. We make this statement because, over time as PHEAA's previously publicized travel abuses fade from public memory, there is the potential for employees—particularly top management officers by virtue of their positions of authority—to migrate gradually and almost unnoticeably back to past practices.

For example, despite all the details in the new travel policy, it does not contain direct language to prohibit PHEAA-sponsored retreats and PHEAA-hosted seminars at exclusive resorts, either out of state or in state.

The policy also does not contain direct language limiting the number of events that any one person may attend. Although the new policy does contain language that all expenses should be reasonable and necessary for the benefit of PHEAA, we are concerned that past abusive practices must be addressed with greater specificity.

Within other organizations, we are aware of instances whereby specific past abuses have resulted in actually naming that particular abuse as a prohibition. Overall, PHEAA should provide more specific definitions of "reasonableness" and

[87] Mauriello, Tracie, "College loan agency tightens travel policy," *Pittsburgh Post-Gazette*, March 23, 2007. The Pennsylvania Department of Transportation is responsible for operating state-owned aircraft that are used by elected officials and state employees.
[88] PHEAA's written response to questions submitted by the Department of the Auditor General, July 20, 2007.

accompanying guidelines, as well as examples of abuses, in its travel policy or in a supplement to the policy. Again, this added specificity is necessary to demonstrate visibly to the public that PHEAA has truly redirected itself.

Travel policy improvements

We reviewed a copy of PHEAA's previous travel policy, which was dated February 9, 2006, in addition to its new travel expense policy and procedures. By comparing the two policies, and also during discussions with PHEAA officials, we found that PHEAA made several improvements to its travel policy and procedures:

- PHEAA's new policy divides employee travel into three different types: standard, conference-related, and business development. The 2006 policy referred only to general business travel. Standard travel applies for all travel-related costs except for when employees are attending a conference or for the specific time frame during which business is being conducted with clients and customers.[89]

- PHEAA reduced the amount for which receipts are required from $35.00 to $25.00 per expenditure. Furthermore, PHEAA's new policy states that the receipts provided must itemize the detail of the transaction. For business development travel only, employees are required to submit receipts for all expenses, regardless of amount, in order to be reimbursed.

- PHEAA included a detailed list of items that are ineligible for reimbursement. Some of these items include fees or dues for airline VIP clubs, laundry and dry cleaning charges, airline upgrades, room service orders, room mini-bar charges, personal entertainment and costs for personal

[89] PHEAA officials explained that PHEAA competes in a national marketplace and therefore must have interactions—which may involve entertainment, such as dinners—with its clients. These interactions comprise "business development" travel.

guests, among many others. The 2006 policy only prohibited the reimbursement of costs for shoe shine, dry cleaning, movie rental, and other hotel amenities.

- PHEAA developed more detailed restrictions on lodging costs and use of rental cars. Procedures were also developed for expenses related to air travel and parking, which were not covered in the 2006 policy.

- Unlike the prior policy, PHEAA's new policy states that board members are now subject to the same requirements as PHEAA employees. The previous policy covered all employees, including top officials, but it did not apply to board members. PHEAA later explained that, prior to the adoption of the new policy, the board had not approved policies related to board member travel.[90]

- PHEAA now reimburses employees based upon their ***actual*** expenses per day up to the daily per diem rate. The per diem rate is the maximum amount of money that PHEAA allows its employee and board members to spend for meals while traveling on business. PHEAA's standard per diem rate is $36.00 per day, except in specific areas where costs are typically higher.[91] In its previous travel policy, PHEAA reimbursed employees based solely on the per diem amount for the travel destination. In other words, PHEAA would simply reimburse an employee $36.00 per day, or more, depending upon location, without regard to what the employee actually spent.

- Employees must provide more documentation for their expenses under the new policy. PHEAA created a new travel expense form on which employees must document the individual costs of each meal and also any incidental expenses, such as tips given to hotel staff. Employees

[90] PHEAA's written response to the Department of the Auditor General's submission of notes from a June 6, 2007, meeting held with PHEAA, July 31, 2007.
[91] PHEAA's written response to questions submitted by the Department of the Auditor General, July 20, 2007.

must also list the names of other PHEAA employees and the names of clients attending the same meeting or conference. The two forms that PHEAA used under its old policy, a general invoice for pre-paid expenses, such as conference registration fees, and a travel expense voucher for other costs incurred during the trip, did not require such detailed information. PHEAA said that the expense report replaces the general invoice and travel expense voucher and that it would be formally distributed to all employees by the end of July 2007.

As mentioned previously, PHEAA addressed employees' state plane usage in the new travel expense procedures. Specifically, the procedures state that PHEAA has imposed a moratorium, or suspension, on the use of state planes. The procedures go on to state that, if the suspension is lifted, "state plane usage should only be permitted when cost of travel of all passengers in the delegation who are traveling for official business is lower on the state plane than it would be for an advance and effectively made reservation on a commercial carrier." The Pennsylvania Department of Transportation maintains flight logs for its aircraft and posts those logs on its Web site.[92] We obtained and reviewed the flight logs posted through June 2008 to see if PHEAA was listed as having used the state plane. We found no listing of PHEAA since September 18, 2006.

Our analysis of a sample

To determine whether employees were complying with the new policy, we analyzed travel expense payments for the period April 1, 2007, through June 7, 2007. We found that PHEAA made 546 reimbursements to employees—none of whom were board members—for travel expenses totaling $195,021. We also noted that $160,153 was for out-of-state travel.

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[92] As of July 22, 2008, the flight logs could be accessed at www.dot.state.pa.us by clicking on the "Aviation & Rail Freight" link and then on the link for "State Flight Logs."

To further examine the specifics of the travel, we selected a sample of 30 of the 546 payments and reviewed all supporting expense documentation. In those 30 travel expense payments, we found that the employees had complied with the new policy.

Specifically, we noted that employees provided appropriate documentation to support the expenses for which reimbursement was requested. Documentation included hotel bills, credit card statements, airline ticket confirmations and itineraries, and various receipts for such expenses as rental cars, taxis, and meals.

Overall, we found that every employee in our sample had provided receipts for expenses greater that $25 as required by the new policy. We also noted that PHEAA had denied reimbursement in a case for which the expenses were not adequately supported.

As the result of our review of the sample, we concluded that PHEAA's review and approval process had been strengthened. We note, however, that our review took place soon after the travel policy was put into place and that, accordingly, PHEAA should itself conduct a review of 2008 travel expenses and report publicly on that review in the first quarter of the new year.

Recommendations

17. PHEAA should add more specific language to its travel policy to prohibit, for example, PHEAA-sponsored seminars and PHEAA-sponsored retreats at extravagant locations both in-state and out-of-state. Furthermore, all PHEAA travel should be fiscally conservative, limited only to necessary travel, and be in-state as much as possible.

18. PHEAA should continue to review its internal policies and procedures as it has done with the travel policy and make further revisions where appropriate to ensure accountability

to the public; along those lines, PHEAA should itself conduct a review of 2008 travel expenses and report publicly on that review in the first quarter of 2009.

Finding Six

PHEAA provided 90 percent of the funding for its affiliated Pennsylvania Higher Education Foundation, thereby enabling the Foundation to fall short of raising private contributions as it was created to do.

Although PHEAA can legally solicit and receive private donations itself,[93] PHEAA officials stated that "many private donors are reluctant to donate funds to a government agency."[94] Therefore, one of the main reasons that PHEAA created the Pennsylvania Higher Education Foundation was to allow the Foundation to solicit and receive private donations.[95]

A primary role of the Foundation's president and CEO, who received a salary of $150,000 in fiscal year 2006-07, has been to obtain these private donations. In addition to the fundraising efforts of the president and CEO, the Foundation has also paid a total of $280,000 for a private fundraising consultant since fiscal year 2002-03.

Nevertheless, we found that only **11.4 percent** of total contributions to the Foundation through June 2007 were from private donors. The total of **all** contributions was **$97.8 million**. [96]

The Foundation might have had better fundraising success—and saved on its costs—by substituting an experienced development director for its fundraising consultant

Typically, experienced development directors are used by charitable organizations to solicit funds. The Pennsylvania

[93] 24 P.S. § 5104(8); 24 P.S. § 5106.
[94] PHEAA's written response to questions submitted by the Department of the Auditor General, September 14, 2007.
[95] PHEAA also created another foundation in 2001, the Higher Education Foundation (HEF). We found no significant financial activities or program activities since HEF's creation.
[96] The total amount of cash and donated services is as of June 30, 2007.

Higher Education Foundation, however, has had one employee since its inception, the current president and CEO. Formerly, he served as the president and CEO of PHEAA itself.

PHEAA officials cited that background of the Foundation's president and CEO as critical to making the Foundation a success, saying that his "vast experience as [a former president and CEO] of PHEAA…has given him the experience and contacts that have made him invaluable to [the Foundation's] success."[97]

In reality, however, it is PHEAA that has shored up the Foundation by providing it with more than $86 million in cash and donated services between its inception in 2001 and June 21, 2007. PHEAA's donated services totaled $10 million of the $86 million, of which $3.4 million, or more than one-third of total donated services, was for legal expenses.

By contrast, the amount of private donations raised by the Foundation itself was $11.1 million through June 1, 2001, and May 31, 2007, according to our calculations that resulted in the table on the next page.[98]

Breaking down the $11.1 million in private donations, we found that the Foundation received no private donations in fiscal years 2001-02 and 2002-03, and only $229,915 in fiscal year 2003-04. This record stands in stark contrast to the record of contributions by PHEAA, which in the same three fiscal years were $13 million, $13.5 million, and $10.8 million, as shown in the table that follows:

[97] PHEAA's written response to questions submitted by the Department of the Auditor General, September 14, 2007.

[98] PHEAA's written response of September 14, 2007, puts the total amount of donations from contributors other than PHEAA at $8.7 million since the Foundation's inception, plus commitments of $7.1 million to be paid in the future, for a total of $15.8 million. However, without donor lists (the Foundation would not provide them because it "strives to protect the confidentiality of each donor"), we could not verify commitments; therefore, we developed the table on the next page using available sources.

Contributions to the Pennsylvania Higher Education Foundation
PHEAA vs. Private Donors
FY 2001-02 through FY 2006-07

Total contributions to the Foundation by fiscal year[a]			Contributions made by PHEAA only		Contributions made by private donors only	
			Amount[b]	*% of total*	*Amount*	*% of total*
2001-02	=	$13,024,850	$13,024,850	100.0%	$0	0.0%
2002-03	=	13,474,589	13,474,589	100.0%	0	0.0%
2003-04	=	11,010,924	10,781,009	97.9%	229,915	2.1%
2004-05	=	14,248,013	12,426,854	87.2%	1,821,159	12.8%
2005-06	=	19,438,955	14,200,291	73.1%	5,238,664	26.9%
2006-07	=	16,562,362	12,705,361	76.7%	3,857,001	23.3%
on 6/21/07	=	10,000,000	10,000,000	100.0%	n/a	n/a
Totals	**=**	**$97,759,693**	**$86,612,954**	**88.6%**	**$11,146,739**	**11.4%**

[a] Pennsylvania Higher Education Foundation's fiscal year is June 1 to May 31.
[b] PHEAA's contributions include cash, donated services, office furnishings, and equipment.

Sources: Pennsylvania Higher Education Foundation's Consolidated Annual Financial Reports, FY 2002-03 through FY 2006-07; PHEAA's Annual Financial Report, June 30, 2007; and IRS Forms 990 filed by the Pennsylvania Higher Education Foundation from June 1, 2002, through May 31, 2007.

The preceding table shows that the Foundation raised its greatest amounts of private contributions between fiscal years 2004-05 through 2006-07. Our review of Foundation board meeting minutes for those years shows that several of the private donations might actually have been the result of efforts by Foundation board members rather than the efforts of the Foundation's president and CEO or its fundraising consultant. For example, at the Foundation's board meeting on June 3, 2005, the Foundation's president indicated that a multi-year funding commitment of $250,000 each year had been secured through the assistance of a Foundation board member.

Regarding the fundraising consultant, we interviewed two PHEAA employees for whom PHEAA donated 100 percent and 75 percent of their time in fiscal year 2006-07 to the Foundation. The employees noted that, in their opinions, the fundraising consultant has been very valuable. According to the two donated employees, the fundraising consultant looks for new avenues to solicit funds, gives ideas for federal grants and for funding through other foundations, and for "networking and strategizing." Furthermore, both employees noted that the Foundation's president and CEO relied heavily on the fundraising consultant.

What is the mission of the Pennsylvania Higher Education Foundation?

The Pennsylvania Higher Education Foundation, Inc., is a non-profit corporation that filed its articles of incorporation with the Corporation Bureau of the Pennsylvania Department of State on June 22, 2001.[99] The Foundation is also registered as a charitable organization with the Department of State's Bureau of Charitable Organizations.[100]

The Foundation's primary mission is "to improve or enhance post-secondary educational opportunities for students in Pennsylvania and elsewhere."[101] Since 2002, the Foundation has elected to meet that mission by focusing on addressing the nursing shortage in Pennsylvania. Accordingly, the Foundation has disbursed more than $40 million in grant funds, the majority of which have been provided directly to Pennsylvania public and private schools of nursing through a variety of programs under the umbrella of the Foundation's Nursing Initiative.[102]

In fiscal year 2004-05, PHEAA committed to giving the Foundation $50 million over a five-year period **through June**

[99] The Foundation's articles of incorporation, which were accessed on July 2, 2008, at http://www.corporations.state.pa.us/corp/soskb/Corp.asp?1914050.
[100] Accessed on July 2, 2008, at http://web.dos.state.pa.us/cgi-bin/Charities/creport.cgi?charid=29015&orgtype=CO; the Foundation is exempt from taxation under Sections 501(a) and 501(c)(3) of the Internal Revenue Code, and it is classified as a publicly funded charity under Section 509(a)(1) of the Internal Revenue Code.
[101] The Foundation's articles of incorporation, as accessed on July 22, 2008, at http://www.higheredfoundation.org/about/pdf/PHEF_ArticlesofIncorporation.pdf.
[102] The $40 million in disbursements was obtained through the Foundation's IRS Forms 990 for the fiscal years 2002-03 through 2006-07, as accessed July 22, 2008, on the Foundation's Web site, www.higheredfoundation.org/about/financial_info.shtml.

30, 2009.[103] As of April 2008, PHEAA had given the Foundation $30 million of that $50 million commitment. However, PHEAA's ability to fulfill the remainder of its commitment (i.e., the remaining $20 million) is uncertain in light of its current financial condition. In fact, at a PHEAA board meeting attended by our audit team on January 24, 2008, the board announced that it had voted to limit donated services to the Foundation to $300,000 per year. Furthermore, on April 24, 2008, the PHEAA Board decided to eliminate the $10 million cash donation to the Foundation for fiscal year 2008-09.

Helping to alleviate the nursing shortage is a laudable purpose, but PHEAA should make the Foundation do its part

Given the current nursing shortage in Pennsylvania and elsewhere, there is no question that the monies given by the Foundation to nursing schools for educational purposes has been not only laudable but also critical. Therefore, contributing directly to that purpose cannot be considered wasteful.

The problem, however, is this: PHEAA has expressed its financial inability to continue its previous levels of funding—which thus far was $86.6 million through June 2007—to the Foundation and its Nursing Initiative. Without an in-depth performance audit of the Foundation itself, we simply cannot determine whether its reliance on PHEAA caused the Foundation to become complacent in its private fundraising efforts, or why the Foundation's president/CEO and the fundraising consultant should have performed the role of a development director, or if the well of potential contributors simply did not exist.

[103] PHEAA stated in its annual financial statements that this commitment "is not an obligation and has not been accrued in our financial statements."

Regardless of the cause, PHEAA should never have continued enabling the Foundation to underperform as that performance relates to the Foundation's overall funding. PHEAA also should have questioned why the critical role of a development director was filled instead by a president or consultant.

Stated another way, at some point before today, PHEAA should have insisted that the Foundation carry at least as much financial weight as PHEAA did. This insistence should have come as much from PHEAA's board of directors as from PHEAA's management. However, because the Foundation's board was made up of many of the same members as the PHEAA board during our audit period, and because the Foundation's sole employee had close ties to PHEAA, it is reasonable to suggest that independent thinking may have been compromised.

Recommendations

19. PHEAA should insist on superior fundraising performance from any foundation or charitable organization to which PHEAA makes significant contributions, including the Pennsylvania Higher Education Foundation, and should not allow the critical role of a development director to be filled by a president or consultant.

20. PHEAA's board of directors should ensure that the board members it shares with the Pennsylvania Higher Education Foundation require the Foundation to focus more on its fundraising responsibilities so that it does not continue to underperform at raising private donations.

Appendix A

Objectives, Scope, and Methodology

The Department of the Auditor General conducted this special performance audit in order to provide an independent assessment of PHEAA's performance in improving access to higher education for Pennsylvania residents. We conducted this performance audit in accordance with generally accepted government auditing standards. These 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.

Objectives

We began the audit with the broad objective of evaluating PHEAA's performance in improving access to higher education for Pennsylvania residents. We later refined that objective to focus on PHEAA's compensation, benefits, expenses, state grant program, and PHEAA's support of the Foundation. Therefore, our audit objectives can be thought of as the following questions:

1. What was the compensation package received by executive staff and what other perks did they receive?

2. To what extent were incentives awarded to PHEAA employees?

3. What was the level of spending on advertising, and what percentage of this spending was for business promotional items?

4. To what extent did PHEAA hire outside contractors for legal, lobbying, information technology, consulting, and other services?

5. To what extent did PHEAA adhere to its policies in recording expense transactions in the accounting records?

6. What was PHEAA's vehicle policy and to what extent was it followed by employees using an agency-owned vehicle?

7. How meaningful were the state grant awards; what level of funding did PHEAA provide toward the state grant program; to what extent has the state grant program been audited; and what procedures did PHEAA have in place to ensure the grants are awarded correctly?

8. How effective were PHEAA's recently-revised travel policy and procedures?

9. To what extent has PHEAA supported the Pennsylvania Higher Education Foundation?

Scope

Our audit covered PHEAA's operations and activities for the period July 1, 2004, to June 30, 2007, unless otherwise indicated.

Methodology

To address our audit objectives, we performed the following procedures:

- Conducted interviews with key PHEAA staff members.
- Reviewed and analyzed pertinent laws, regulations, policies, and procedures.
- Analyzed certain financial documents.
- Reviewed independent audits of PHEAA.
- Toured PHEAA's office locations in Harrisburg and Mechanicsburg.
- Reviewed 30 travel expense vouchers.

- Reviewed PHEAA's documentation for 60 advancement account transactions.
- Reviewed PHEAA's documentation for 60 incentive payments covering four separate incentive plans.
- Reviewed 150 state grant applications to test the grant validation process.
- Sampled 101 expenses related to advertising for fiscal years 2004-05 through 2006-07, including obtaining supporting documents to account for and justify the expense.
- Sampled 82 expense items for fiscal years 2006-07 and 2007-08 (through December 31, 2007), including obtaining supporting documents to account for and justify the expense.
- Reviewed service provider contracts, including one for a lobbyist and one for an advertising consultant.
- Reviewed monthly automotive forms submitted by employees for January through June 2007.
- Researched operations and governance of higher education agencies in all other states.

Prior to completing our audit, we issued an interim report on October 4, 2007. We subsequently completed our audit work, including most follow-up questions, by March 31, 2008, and then continued with research and report-writing until providing a draft report to PHEAA on July 31, 2008. We met with PHEAA officials on August 5, 6, and 7, 2008, to make minor edits to the draft report, and we received PHEAA's written response on August 14, 2008. That written response is included in this report.

Assessment of audit risk

Audit risk is the possibility that our findings, conclusions, recommendations, or assurances may be improper or incomplete as a result of factors such as insufficient evidence, inappropriate evidence, an inadequate audit process, or intentional omissions or misleading information due to misrepresentation or fraud. As required by generally accepted government auditing standards, we assessed audit risk, as well as its significance within the context of our audit objectives, by gaining an understanding of the nature and profile of PHEAA and its programs, the needs of potential users of this report, PHEAA's internal controls as related to our objectives, and PHEAA's history. We could not consider the results of previous special performance audits of PHEAA because this current audit was the first such special performance audit in PHEAA's history.

On February 27, 2008, in the process of conducting this audit, we did communicate with PHEAA that we were increasing our assessment of audit risk based on PHEAA's initial incomplete or inadequate responses to some of our information requests. Subsequent to that communication, PHEAA did provide more complete information as requested and also explained that the responses in question had not been intentionally incomplete or inadequate.

Findings and Recommendations

We developed **6 findings** during our review of PHEAA's performance for the audit period, and we present **20 recommendations** to address the issues we identified. We did not include specific time frames for the implementation of our recommendations, because every one of them should be addressed or begun immediately. We will follow up within the next 12 to 24 months to determine the status of the findings and recommendations.

Overall audit conclusion

On pages 1 – 3 of this report, we have reported our overall audit conclusion based on our audit objectives and findings. Standard 8.27 of *Government Auditing Standards*, July 2007

Revision, defines report conclusions as "logical inferences about the program based on the auditors' findings, not merely a summary of the findings." That same standard also notes that "Conclusions are stronger if they lead to the auditors' recommendations and convince the knowledgeable user of the report that action is necessary." Accordingly, on page 3, we have also included our overall recommendation resulting from our conclusion.

Appendix B

Questions and answers about PHEAA's operations.

The following is information that we obtained during the course of our audit. Although some of the answers may contain unaudited information because certain questions did not fall directly within our audit objectives, the information is helpful to understanding how PHEAA operates and also serves to raise questions that may be looked at in future audits.

Q. What services did PHEAA's in-state and out-of-state offices provide during our audit period?

A. PHEAA's six in-state regional offices provided the following during our audit period:

- Financial aid information and materials to parents and students via telephone, e-mail, or in person
- Financial aid presentations in high schools or community locations, as well as FAFSA completion sessions for families
- Financial aid training workshops for counselors and community staff and early awareness workshops for counselors and teachers
- Materials and information at college, career, and community fairs.

PHEAA continues to operate these in-state offices as of August 2008.

PHEAA had seven out-of-state offices during our audit period, as follows:

1. **Western Region - California**. *Closed June 30, 2008.*
2. **Southeastern Region - Florida**. Southeastern Region. *Closed May 9, 2008.*
3. **Mid-Atlantic Region - Delaware**. *Office relocated to Baltimore, Maryland, in September 2007; the Baltimore office closed on May 9, 2008.*
4. **Mid-West Region - Ohio.** *Closed May 9, 2008.*

5. **Caribbean Region - Puerto Rico**. *Closed June 30, 2008.*

   The California office, which was established in 1983, employed two national school account executives. The other four offices, which were established in 2001, each employed one national school account executive.

   Employees at these officers were primarily responsible for promoting AES products and services to schools, in addition to participating in industry related organizations and associations in the west coast region. Staff addressed any school issues that were brought to its attention and acted as the liaison between the school and the Harrisburg headquarters.

   The Caribbean region covered schools in Puerto Rico, the Dominican Republic, Costa Rica, and Nicaragua. PHEAA stated that since 2001, AES loan volume in this region increased from approximately $30 million a year to more than $170 million for fiscal year 2006-07.

6. **AES Delaware**. *Closed June 27, 2008.*
7. **AES West Virginia**. *Closed May 31, 2008, after which the operation was moved to a home office.*

   The AES Delaware office, which had one employee, was established in 1996. The AES West Virginia office, which had two employees, was established in 1991.

   The employees served as respective liaisons to the Delaware Higher Education Commission, the Delaware Department of Education, and the West Virginia Higher Education Policy Commission. The employees also conducted marketing and training visits to post-secondary institutions; provided early awareness materials and programs to elementary, middle, and secondary students, parents, teachers, and counselors; provided information and publications to student and parent visitors and callers on college financing; extended customer problem resolution support to post-secondary institutions and borrowers; and provided financial aid information at high school financial aid nights and college nights. Additionally, the offices supported national, regional, and state financial aid associations through volunteerism.

The employees who worked at all seven out-of-state offices were considered Commonwealth of Pennsylvania employees and received the same benefits available to the other PHEAA employees, including benefits administered by the Pennsylvania Employees Benefit Trust Fund (PEBTF) and the State Employees' Retirement System (SERS). PHEAA officials stated that some of the out-of-state employees received a PHEAA badge so they could access PHEAA headquarters in order to attend meetings and perform other administrative tasks.

As noted, PHEAA closed its out-of-state offices between March and June 2008. PHEAA has said that, since the closures, "The activities in **Delaware** for college planning and operational support and training to post-secondary schools are being provided by school services representatives in Pennsylvania. The **West Virginia** representative now works from a home office and "provides support to secondary schools and students and families on college planning and to postsecondary schools on products and services." Regarding the former offices in **California**, **Puerto Rico**, **Ohio**, **Florida**, and **Maryland**, students, parents, and schools in those regions now "have access to informative websites and dedicated staff [at Harrisburg's PHEAA headquarters] providing information, system and operational support."

Q. How does PHEAA pay its operating expenses?

A. PHEAA pays its expenses from its operating revenues, not from its General Fund appropriations. General Fund monies are reserved for the state grant program and other special scholarship and loan forgiveness programs.

Operating revenues are placed into PHEAA's Treasury account. PHEAA pays operating expenses from both its Treasury account and an advancement account it has with a commercial bank. PHEAA officials said that, for the fiscal year ended June 30, 2007, the three largest expenses paid out of its Treasury account were claims on defaulted loans (the largest expense), student state grant awards, and payroll. The advancement account, which has an expense limit of $100,000, is used to pay smaller expenses, such as reimbursements to employees for travel expenses, one-time bills, and sponsorships for group events.

PHEAA's total operating expenses for fiscal year 2006-07 were $286.6 million.

Q. What role does the FAFSA play in applying for the Pennsylvania State Grant Program?

A. A person must complete the Free Application for Federal Student Aid (FAFSA)[104] in order to apply for the Pennsylvania State Grant Program. After a student completes the FAFSA and sends it to the U.S. Department of Education for consideration, the U.S. Department of Education in turn forwards the FAFSA to PHEAA.

In academic year 2006-07, the U.S. Department of Education forwarded 503,861 FAFSA applications to Pennsylvania. Once PHEAA receives the FAFSA

[104] Students must also complete the FAFSA in order to be considered for most of the major forms of federal, state, and institutional aid, including both grants and loans.

applications from the U.S. Department of Education, it eliminates the applicants who are not eligible for a state grant based on program requirements[105] and then it applies its grant formula to the remaining applicants.

Q. What percentage of persons that complete a FAFSA are awarded a state grant?

A. For academic year 2006-07, 56.0 percent of those persons who completed a FAFSA were awarded a state grant. For that year, of the 503,861 FAFSA applications forwarded to PHEAA from the U.S. Department of Education, the agency considered 290,194 eligible for the state grant program. Once PHEAA applied the grant formula to those applicants, it determined that 162,502 applicants, or 56.0 percent of total FAFSA applicants, were eligible for a state grant. Of those who did not qualify for a state grant, PHEAA stated that generally it was because the applicants' expected family contributions exceeded program eligibility parameters. In some instances, the expected family contribution was within the program eligibility parameters but the resulting calculated award amount was lower than the minimum award limit.

[105] As of July 22, 2008, Pennsylvania State Grant Program basic eligibility requirements could be found at http://www.pheaa.org/stategrants/index.shtml, and include items such as state residency and school attendance requirements.

Applications to the State Grant Program
Academic Years 1996-97 through 2006-07[a/]

Academic Year	Applications Received[b/]	Applications Processed[c/]	Awards	Percent Aided
1996-97	365,292	228,670	142,232	62.2%
1997-98	368,943	216,465	141,146	65.2%
1998-99	373,286	204,456	140,123	68.5%
1999-00	390,032	214,276	138,342	64.6%
2000-01	395,672	226,352	151,887	67.1%
2001-02	416,182	228,987	150,152	65.6%
2002-03	442,374	246,611	152,223	61.7%
2003-04	468,795	255,482	159,627	62.5%
2004-05	484,080	251,626	152,003	60.4%
2005-06	495,236	262,473	159,168	60.6%
2006-07	503,861	290,194	162,502	56.0%

[a/]Excludes summer school.
[b/]Refers to all FAFSA applications.
[c/]Refers to those applicants who met the basic state grant program eligibility requirements.

Source: "1996-97 to 2006-07 Year by Year Summary Statistic Report," PHEAA.

Q. Does PHEAA conduct any FAFSA outreach activities?

A. PHEAA officials stated that the agency conducts a variety of outreach activities to encourage all prospective students and their families to complete the annual FAFSA. These activities include providing free financial aid and FAFSA brochures and guidebooks to students, conducting FAFSA completion workshops, presenting financial aid awareness events, and providing links to the FAFSA on the PHEAA and AES Web sites.

PHEAA conducted the following specific activities from December 2006 to April 2007 to encourage students to complete the 2007-08 FAFSA:[106]

- Direct mailings to every high school senior who took the SAT/ACT test during his/her junior year. This mailing includes information on financial aid along with a "FAFSA on the Web" worksheet for the student's use.
- Advertisement placed in 80 Pennsylvania newspapers on March 19, 2007, directing students to complete the FAFSA on PHEAA's Web site.
- Display of billboards throughout the state directing people to the PHEAA Web site for completion of the FAFSA.
- E-mail campaign to those students receiving a state grant renewal award who had not yet completed a FAFSA.
- Tele-FAFSA project to encourage people to complete the FAFSA via telephone if Web site completion was not possible.
- Participated in "FAFSA Completion Day" sessions at 121 sites throughout Pennsylvania.

Q. How many Pennsylvania state grants has PHEAA awarded in the last ten years, and what has been the total dollar value of these grants?

A. PHEAA has awarded more than 1.9 million Pennsylvania state grants at a total value of over $3.8 billion from award year[107] 1995-96 to 2006-07. Since award year 1995-96, the number of state grants awarded has grown by more than 17 percent through award year 2006-07, and the total value of these awards has increased by over 95 percent for the same time period. As shown in the

[106] PHEAA's written response to questions submitted by the Department of the Auditor General, August 10, 2007.
[107] The term "award year" refers to an entire academic year and summer session(s).

table below, PHEAA awarded 178,594 grants in award year 2006-07, at a value of over $452 million.

Number and Value of Awards from the Pennsylvania State Grant Program Award Years 1995-96 through 2006-07				
Award Year	Number of Awards[a/]	Percentage Change	Value of Awards	Percentage Change
1995-96	152,312	N/A	$232,018,905	N/A
1996-97	150,836	(.97%)	240,458,265	3.64%
1997-98	150,202	(.42%)	251,548,575	4.61%
1998-99	152,244	1.36%	270,722,739	7.62%
1999-00	151,098	(.75%)	280,401,189	3.58%
2000-01	164,213	8.68%	325,234,021	15.99%
2001-02	163,342	(.53%)	337,013,506	3.62%
2002-03	166,257	1.78%	346,774,770	2.90%
2003-04	175,162	5.36%	357,966,207	3.23%
2004-05	167,947	(4.12%)	361,343,406	.94%
2005-06[b/]	175,144	4.29%	400,008,328	10.70%
2006-07	178,594	1.97%	452,927,929	13.22%
Total	**1,947,351**		**$3,856,417,840**	
Percent Change from Award Years 1995-96 to 2006-07		**17.26%**		**95.21%**

[a/]Represents both the academic year and summer session.
[b/]This is the first year that the General Fund appropriation to the state grant program was supplemented by PHEAA.

Source: "1995-96 to 2005-06 Year by Year Summary Statistic Report," PHEAA.

NOTE: The values of state grant program awards differ from the General Fund appropriation amounts shown in the table on page 12 due to differences in the fiscal year versus the academic year, and also due to supplementary contributions that PHEAA made to the grants from its earnings.

Q. What is the maximum grant amount that can be awarded and how is it determined?

A. PHEAA set the maximum state grant award amount for academic year 2007-08 at $4,700. This maximum award amount is a 78.6 percent increase from the academic year 1995-96 level of $2,632. To date, the largest award increase in a single year occurred between academic years 2005-06 and 2006-07, when the maximum award increased 28.6 percent from $3,500 to $4,500. Fiscal year 2005-06 was the first year that PHEAA supplemented the grant program's General Fund appropriation with its operating revenues.

Maximum and Average State Grant Award Amounts
Academic Years 1995-96 through 2007-08

Academic Year	Maximum Award	Average Award	Average Award as a Percentage of Maximum Award
1995-96	$2,632	$1,862	70.7%
1996-97	$2,632	$1,895	72.0%
1997-98	$2,700	$1,970	73.0%
1998-99	$2,900	$2,098	72.3%
1999-00	$3,100	$2,199	70.9%
2000-01	$3,200	$2,346	73.3%
2001-02	$3,300	$2,463	74.6%
2002-03	$3,300	$2,496	75.6%
2003-04	$3,300	$2,484	75.3%
2004-05	$3,300	$2,621	79.4%
2005-06[a/]	$3,500	$2,809	80.3%
2006-07	$4,500	$3,135	69.7%
2007-08	$4,700	[b/]	n/a

[a/]This is the first year that the General Fund appropriation was supplemented by PHEAA through the GIFTS Initiative.
[b/]Academic year 2007-08 information for the average grant award amount will not be available until early in calendar year 2009.

Source: "1995-96 to 2006-07 Year by Year Summary Statistic Report," PHEAA, and "State Higher Education Grant Program Manual," 2006-07 and 2007-08, PHEAA.

Each April, the PHEAA board of directors sets the maximum state grant award for the upcoming academic year based upon recommendations from the board's committee on need analysis and aid coordination. This committee receives three options from the state grant advisory committee,[108] which is the committee with primary responsibility for analyzing various aspects of the state grant program, including the grant award formula, maximum grant limits, grant purchasing power, and the distribution of grant funds.

PHEAA's research and policy analysis department develops several projection models that allow for simulation of changes in the state grant formula. These projection models consider such factors as total available program funds, the number of anticipated grant applicants, increases in costs of school attendance, and factors related to family income. Once the state grant advisory committee reviews and analyzes these projection models, it selects the aforementioned three options that are forwarded to the committee on need analysis and aid coordination for consideration.

Q. What percentage of tuition and fees is covered by the average state grant?

A. PHEAA uses the term "purchasing power" to describe the percentage of tuition and fees covered by the average grant award amount. In academic year 2006-07, purchasing power ranged from 15.8 to 47.8 percent. For example, the average state grant for the state-related universities amounted to 31.0 percent of the cost for tuition and fees during 2006-07.

In its calculation of purchasing power, PHEAA includes the cost for fees that are typically mandatory for students,

[108] This committee is comprised of representatives from the Pennsylvania Association of Financial Aid Administrators, the Association of Independent Colleges & Universities of Pennsylvania, the Pennsylvania Association of Private School Administrators, Pennsylvania Commission for Community Colleges, and financial aid officers from post-secondary institutions.

such as student activity fees, recreation fees, academic enhancement fees, and student health fees. PHEAA does not include room and board costs when calculating purchasing power because these costs can vary dramatically by student living situation.

The purchasing power of the average state grant award varies greatly depending on the type of institution attended. Further, the purchasing power of tuition and fees at out-of-state institutions is significantly lower, averaging 2.9 percent from academic years 2000-01 through 2006-07, due to program limitations on awarding state grants to students attending out-of-state institutions. In academic year 2006-07, awards for out-of-state institutions were limited to $400 to $600, depending upon the state in which the institution is located.

Purchasing Power
Percentage of Tuition and Fees Met by the Average State Grant Award
FY 2000-01 through FY 2006-07[a/]

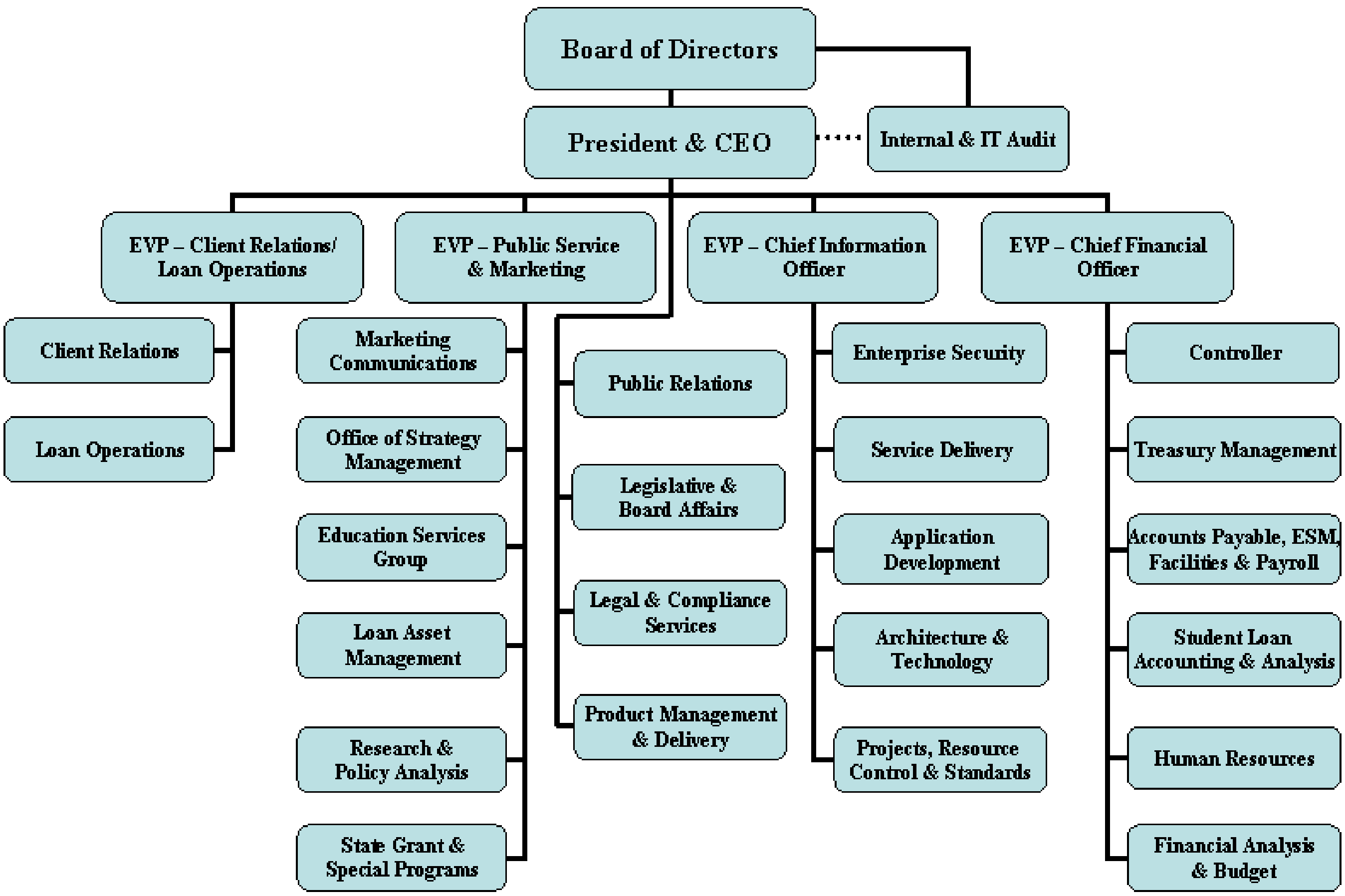
Type of Institution	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06[b/]	2006-07
In-State Institution:							
Independent	17.5%	17.1%	16.0%	15.1%	14.6%	14.6%	15.8%
State System	42.6%	42.6%	40.2%	38.3%	40.2%	42.3%	47.8%
State Related	36.2%	36.0%	33.2%	30.3%	29.6%	29.8%	31.0%
Junior College	30.6%	30.0%	26.0%	26.3%	27.1%	27.8%	30.2%
Community College	50.6%	50.5%	48.3%	45.6%	49.1%	51.1%	50.2%
Nursing School	34.3%	35.3%	32.4%	30.7%	30.5%	31.9%	35.1%
Bus/Trade/Tech School	35.1%	34.4%	32.7%	31.1%	29.7%	30.6%	33.2%
Average In-State	26.2%	25.9%	24.5%	23.2%	22.9%	23.4%	25.5%
Out-of-State	3.5%	3.3%	3.1%	2.8%	2.8%	2.7%	2.3%

[a/]For each of the years presented, the information is as of June 30. The exception is 2006-07, which is according to a year end projection based on information available as of April 27, 2007.
[b/]This was the first year that included PHEAA's contributions to the state grant program under the GIFTS Initiative.

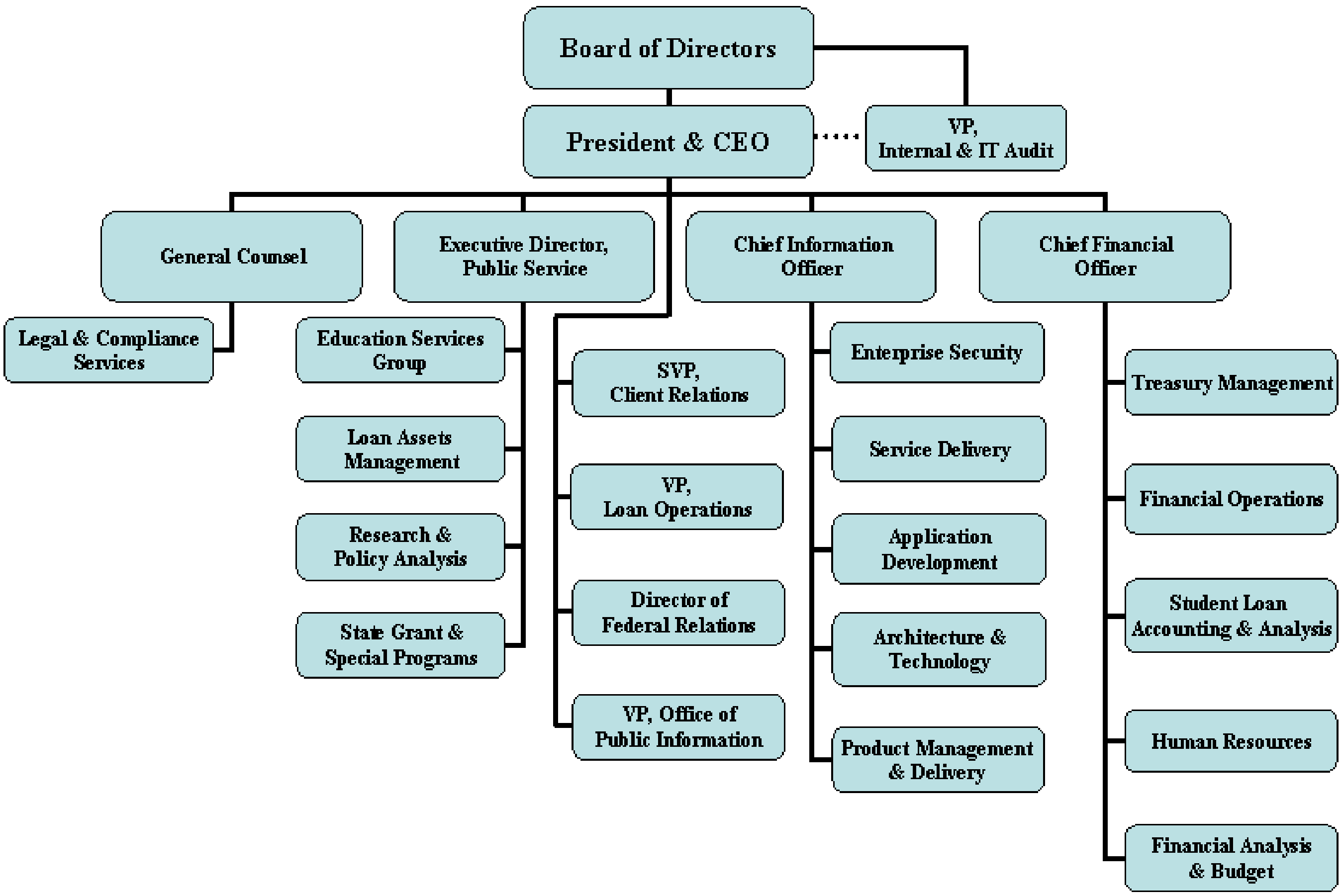
Source: PHEAA's written response to questions submitted by the Department of the Auditor General, June 13, 2007.

Appendix C PHEAA Organization Charts

Pennsylvania Higher Education Assistance Agency
Organization as of April 2008



Pennsylvania Higher Education Assistance Agency
Revised *- Organization as of August 2008*



Appendix D — Monthly Automotive Report Form

PHEaa POWERED BY aes

Monthly Automotive Report

VEHICLE ASSIGNED TO:			NAME			MONTH / YEAR:
YEAR:	MAKE:	MODEL:	VEHICLE NO.		COLOR	LICENSE NUMBER:
DAY	Mileage Start	Mileage Stop	Personal Miles	Business Miles	Total Miles	Destination/Comments
1						
2						
3						
4						
5						
6						
7						
8						
9						
10						
11						
12						
13						
14						
15						
16						
17						
18						
19						
20						
21						
22						
23						
24						
25						
26						
27						
28						
29						
30						
31						
		Total Miles	0		0	

Indiv Drivers

This form is the monthly automotive report as submitted by PHEAA to the Department of the Auditor General, as discussed on page 49.

Response from PHEAA

The Pennsylvania Higher Education Assistance Agency's letter of response to this audit report is reproduced on the following pages. In its response, PHEAA has acknowledged each of the audit recommendations directly.

The Department of the Auditor General thanks the Pennsylvania Higher Education Assistance Agency for its cooperation during this audit process.

PHEAA POWERED BY aes

Office of the President and Chief Executive Officer
Phone: (717) 720-2575 • Fax: (717) 720-3902

August 15, 2008

The Honorable Jack Wagner
Auditor General
Department of the Auditor General
229 Finance Building
Harrisburg, PA 17102

Re: Special Performance Audit of PHEAA

Dear Mr. Wagner:

I am writing in response to the final report of the Auditor General's Special Performance Audit of the Pennsylvania Higher Education Assistance Agency (PHEAA). The following comprises PHEAA's responses (in italics) to the 6 findings and 20 recommendations set forth in the report. I would like to note that I am responding on behalf of the Agency as the newly appointed CEO. Where appropriate I responded on behalf of the PHEAA Board of Directors based on my discussions with them.

I would like to emphasize that the period covered by this audit report is generally July 1, 2004 through June 30, 2007, and the Auditor General first notified us of the audit on April 17, 2007. Before the Auditor General began the audit, in February 2007, the new Board of Directors under the new leadership of Representative Adolph and Senator Logan, instituted far-reaching reforms that required a greater transparency and more accountability in business expense reporting and appropriate use of operating revenues - realizing savings of more than $74 million from the authorized budget amounts.

The new leadership of the Board and the newly appointed CEO made numerous reforms some of which include:

- Adopting a new travel and expense policy stricter than those policies used by other Commonwealth agencies and the Internal Revenue Service (March 2007);
- Adopting an industry-leading Code of Ethics (April 2007);
- Instituting an annual internal audit of expenses;
- Eliminating bonuses and incentives for executives and senior management;
- Initiating a Workforce Optimization Program;
- Reducing attendance at conferences and events; and
- Eliminating numerous nonessential capital improvement projects, advertising, sponsorships, and consultant / professional services.

PHEAA's bipartisan Board has pro-actively implemented these major reforms because they are elected officials, representing the citizens of the Commonwealth of Pennsylvania.

Auditor General's Overall conclusion – Board Restructure

PHEAA's Response:

As the PHEAA Board leaders discussed with you personally and our Board Counsel discussed with your staff, there are inherent consequences that are of concern if PHEAA's governing authority is restructured to reflect the changes that you have outlined in your overall recommendation.

Specifically, PHEAA's current bipartisan Board structure is necessary to both maintain PHEAA's tax-exempt status and to ensure that independently elected *officials chosen in a strictly bipartisan matter, vote on the distribution of hundreds of millions of dollars in state grant funds. Furthermore, because of the help of the 16 legislators on the Board, the State Grant Program received an additional $20 million for the grant program the 2008-09 year.*

On page 18 of the Auditor General's report, the Auditor General cites the current Board structure to support the argument that PHEAA is accountable to Pennsylvania taxpayers. Yet, the Auditor General then discards this argument and proceeds to recommend a radical restructuring of the Board that would dilute oversight from the General Assembly. The current Board structure is a key factor in the determination that PHEAA is an integral part of the Commonwealth's governmental structure. Being an integral part of the Commonwealth is critical for maintaining PHEAA's tax-exempt status, the loss of which could reduce PHEAA's ability to provide future public service programs.

We would like to note that it has become increasingly important that the General Assembly as the appointing authority designate people with the right backgrounds. The PHEAA Board is already diverse with backgrounds that include law, finance, business, and higher education.

Also, the Board makeup you propose in your report forces the representatives of the various higher education sectors to vote directly on the state grant formulas and as a result would pose a serious conflict of interest for them as Board members.

The Federal government, bond investors, servicing customers, and schools have entered into contracts and or other agreements under the current governance structure that could be put at risk threatening future revenues of PHEAA. Bond insurers and the rating agencies would also be in a position to question their previous favorable evaluation of PHEAA's bipartisan governance structure.

Auditor General's Recommendation #1 – Compensation Package

PHEAA's Response

PHEAA agrees with this recommendation and action has already taken action. On December 11, 2007, the Executive Committee of the PHEAA Board of Directors, in the capacity of the Compensation Committee, suspended the Executive Management Incentive Program and suspended all automatic cost-of-living increases and step increases for non-union employees including those on the management pay scale.

PHEAA Management made an announcement as part of the Workforce Optimization plan, that future increases to compensation for any non-union member will be based on the Agency's profitability, individual performance and current compensation relative to market value.

Auditor General's Recommendation #2 – Incentive Program

PHEAA's Response

PHEAA agrees with this recommendation and has already taken action. On December 11, 2007, the Executive Committee of the PHEAA Board of Directors suspended the Executive Management Incentive Program, which provided bonuses to executive and management employees.

Auditor General's Recommendation #3 – Employee Appreciation Day

PHEAA's Response

PHEAA agrees with this recommendation and has already taken action. Under the direction of Chairman William Adolph and Vice-Chairman Sean Logan of the PHEAA Board of Directors given in October 2007, I as the new interim CEO, stopped all employee appreciation events including the annual employee day at Hersheypark.

Auditor General's Recommendation #4 – Professional Services and Contracts

PHEAA's Response

PHEAA agrees with this recommendation and has already taken action. Beginning in October 2007 as the new CEO, many contracts for professional services were reviewed and many were eliminated or renegotiated. Other contracts for professional services are being evaluated and will only be continued if it is deemed that they are essential to the current mission of the Agency.

Where possible, I am requiring staff to renegotiate the fee structure with contractors for professional services and this will be continued on an on-going basis as contracts are renewed.

I eliminated all of the consultants that were hired for the purpose of lobbying the PA General Assembly. In addition, all of the consultants except for one have been eliminated in Washington, D.C. The remaining consultant's contract is reviewed every six months.

PHEAA will continue to monitor all contracts with outside professional services and limit agreements to those that are deemed essential to the mission of the Agency. Each potential service will be reviewed to determine whether or not the services requested could be performed by internal resources.

Auditor General's Recommendation #5 – Bidding Process for Contractors

PHEAA's Response

PHEAA agrees with this recommendation and has already taken action. As the new CEO, I am requiring strict compliance with the existing procurement procedures and policies. In addition, I requested the Internal Audit department to add a compliance audit of the procurement process to their audit plan.

Auditor General's Recommendation #6 - Contractors and Incentive Provisions

PHEAA's Response

PHEAA agrees with this recommendation and has already taken action. PHEAA discontinued payment of bonuses to the contractor cited in the finding on page 35 of the report. Effective June 16, 2008, the contractor was hired as a PHEAA employee.

PHEAA would like to note that in certain circumstances, as a general practice, performance clauses may be negotiated with companies who deliver critical services within specified guidelines.

Furthermore, miscellaneous expenses are only paid consistent with our travel policy. Additionally, there are no contracts with individuals that include requirements to reimburse contractors for miscellaneous expenses such as cell phones.

Auditor General's Recommendation #7 – Operating Expenses

PHEAA's Response

PHEAA agrees with this recommendation and has already taken action. In October 2007, in accordance with the Board's direction, I implemented procedures to stop all unnecessary spending on items that are not consistent with the overall mission of the Agency. Many of the expense items mentioned in the report are now prohibited under the travel procedures due to industry changes and an internal reviews of acceptable practices.

Auditor General's Recommendation #8 – Internal Audit of Expense Accounting

PHEAA's Response

PHEAA agrees with this recommendation and has already taken action. On February 13, 2008, the PHEAA Audit Review Committee revised its charter to include the following provision, "On at least an annual basis, or more frequently, in response to requests by the Board of Directors or the VP Internal and IT Audit, review activity in certain expense accounts for compliance with policy and procedures, including a review of the approval process, as needed."

Since the Auditor General commenced its Performance Audit, additional reviews have been implemented to validate coding during processing and account code descriptions have been updated to more specifically define the activities assigned to that code. In addition, monthly quality assurance reviews are performed within Financial Management to ensure appropriate classification of expenses.

Auditor General's Recommendation #9 – Vehicle Policy, Business Use

PHEAA's Response

PHEAA agrees with this recommendation and has already taken action. At the April 24, 2008, meeting of the PHEAA Board of Directors, I stated that Executive Vice Presidents and Senior Management who were permitted to use the car for *personal use would be required to turn in their vehicle. By May 9, 2008, all of the affected employees had turned in their Agency-owned vehicles.*

PHEAA would like to note that it has reduced its vehicle fleet from 73 cars to 43 as of August 2008. Of the 43 vehicles remaining, 25 of them are assigned to regional and compliance staff that travel daily. These individuals have been directed to use the vehicles for only business purposes.

*PHEAA's vehicle policy is currently being reviewed to mirror the Governor's Management Directive 615.8 entitled "Use of State Automobiles."
We expect to institute our new vehicle policy by December 31, 2008.*

Auditor General's Recommendation #10 – Vehicle Policy, Non-Employee Use

PHEAA's Response

The vehicle policy referred to in our response to recommendation #9 would exclude non-employees from operating any Agency-owned vehicle.

Auditor General's Recommendation #11 – Vehicle Policy, Supporting Documentation Retention

PHEAA's Response

PHEAA agrees with this recommendation and has already taken action. PHEAA instituted a standard electronic form for mileage records, which will be stored by PHEAA to meet the recommended record retention periods. This process will be reflected in PHEAA's new vehicle policy referred to in our response to recommendation #9.

Auditor General's Recommendation #12 – Vehicle Policy, Uniform Documentation

PHEAA's Response

PHEAA agrees with this recommendation and has already taken action. Effective July 1, 2008, PHEAA standardized its mileage forms, which include the daily mileage and destination information, and these forms are filled out and filed electronically. PHEAA Facilities personnel ensures that the documents are collected every month and that the documents are complete, showing a daily record of use.

Auditor General's Recommendation #13 – Grants, Random Validation of Records

PHEAA's Response

PHEAA agrees with this recommendation and in the next grant award year PHEAA will expand its validation process to include a random sample of records that are not considered to be error-prone. In addition, PHEAA will continue to assess the current validation process with the goal of ensuring that taxpayer dollars are awarded properly, while also evaluating the process so that it does not become *complicated to the degree that students who need financial assistance are discouraged by excessive documentation requirements.*

Auditor General's Recommendation #14 – Grants, Internal Audit's Risk Based Audit Plan

PHEAA's Response

PHEAA agrees with this recommendation and has already taken action. At its February 13, 2008 meeting, the PHEAA Audit Review Committee received a report from PHEAA's Internal Audit department, which reported on progress made with regard to the risk-based audit plan. The written report noted that the 2007 audit of "State Grant Processing and Program Maintenance" was complete and included the footnote, "The PA Auditor General Special Performance Audit included an audit of the State Grant Program." This is consistent with the practice whereby the work of outside auditors is considered when planning the scope of audit work. Going forward, PHEAA will perform audits of the State Grant Program in accordance with Internal Audit's risk-based audit plan. The next audit is expected to commence in 2008.

Auditor General's Recommendation #15 - Expenses

PHEAA's Response

PHEAA agrees with this recommendation. PHEAA continues to evaluate all expenses incurred to ensure that it is acting in the most fiscally prudent manner and I have stated that PHEAA will continue to direct excess revenues to public service programs.

Auditor General's Recommendation #16. – State Grants, Advisory Committee

PHEAA's Response

PHEAA agrees with this recommendation. The State Grant Advisory Committee has been a source of invaluable guidance and direction for the State Grant Program. Their consultative role will continue in the future.

Auditor General's Recommendation #17. – Travel Policy

PHEAA's Response

PHEAA agrees with this recommendation and has already taken action. On a quarterly basis, PHEAA reports to the PHEAA Board of Directors the expenditures made under the Travel Expense Policy adopted in March 2007. PHEAA management further refined and strengthened its Board-approved travel policy by adopting travel expense procedures which further outline allowable and prohibited expenses that may be incurred when traveling on behalf of the Agency.

PHEAA has limited its travel in-state and out-of-state to the extent possible without impacting our ability to fulfill our mission and generate revenues. Travel is only conducted to the extent where we are supporting our status as designated guarantor in PA, WV and DE; participation in regional and national organization *and association meetings and in instances where we are expanding business with existing partners or acquiring new customers/partners. As a point of information, when comparing 2006-07 expenses incurred for travel and business development to 2007-08, PHEAA reduced its expenditures by more than 50 percent or $977,000. For these same periods, PHEAA also reduced its conference expenses by 81 percent or $237,000.*

PHEAA continues to evaluate its travel policy to ensure that the policy is consistent with other state agencies, and that all expenditures under the policy are limited to ordinary and necessary business expenses.

Auditor General's Recommendation #18. – Travel Policy

PHEAA's Response

PHEAA is committed to continuing to monitor activity. As mentioned in PHEAA's response to the Auditor General's recommendation #8, monthly quality assurance reviews are performed within PHEAA's Financial Management department to ensure appropriate classification of all expenses and to confirm that expenses are consistent with established policies. When the Internal Audit department conducts this year's review of certain expenses, as referred to in PHEAA's response under Recommendation #8, it will include travel expenses in its scope.

Auditor General's Recommendation #19 – Pennsylvania Higher Education Foundation

PHEAA's Response

At the October 2007 Board of Directors meeting, the PHEAA Board of Directors voted to stop the major direct contributions to the Pennsylvania Higher Education Foundation. At the January 24, 2008 PHEAA Board of Directors meeting, the Board voted to limit donated services to the Foundation to $300,000 per year with other soft costs as authorized by the PHEAA CEO.

Direct donations from PHEAA to the Foundation did not require that the Foundation seek private donations to match its contribution. If PHEAA finds itself in the position to make future contributions to the Foundation, it will take the Auditor General's recommendation under consideration to encourage the Foundation to match.

It should be noted that the Foundation, since inception, shows $16,376,450 in commitments from sources other than PHEAA. Thirty-five thousand (35,000) undergraduate and graduate nursing scholarships have been awarded during that time frame at 127 Pennsylvania schools of nursing worth over $66 million. More than 6,000 of these awards were made possible by donations other than PHEAA's.

PHEAA, insofar as the PHEAA Board resolutions permit, will continue to work with the Foundation to provide assistance to secure additional private donations to fulfill the purpose and mission of the Foundation.

Auditor General's Recommendation #20 – Pennsylvania Higher Education Foundation

PHEAA's Response

PHEAA, insofar as the PHEAA Board resolutions permit, will continue to work with the Foundation to provide assistance to secure additional private donations to fulfill the purpose and mission of the Foundation.

Mr. Wagner, I would like to thank you for the opportunity to respond and appreciate you and your staff's time as we finalized work on this audit. If you have any questions about the information provided in this response, please contact me at (717) 720-2202.

Sincerely,

James L. Preston

James L. Preston
President and Chief Executive Officer

cc: PHEAA Board of Directors

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** The board of directors is a 20-member board, but only 19 members are listed here because, at the time this report was released, there was a vacancy on the board.*