

State of New Jersey
Office of the Inspector General
Mary Jane Cooper, Inspector General



**Higher Education Student
Assistance Authority**

May 18, 2010



State of New Jersey
OFFICE OF THE INSPECTOR GENERAL
PO Box 208
TRENTON NJ 08625-0208

CHRIS CHRISTIE
Governor

KIM GUADAGNO
Lt. Governor

MARY JANE COOPER
Inspector General

May 18, 2010

Honorable Chris Christie
Governor, State of New Jersey
State House
PO Box 001
Trenton, NJ 08625

Re: Office of the Inspector General Report on
Higher Education Student Assistance Authority


Dear Governor Christie:

Enclosed is a copy of the report the Office of the Inspector General (OIG) has prepared concerning its review of the internal controls and compliance with State regulations and executive orders by the Higher Education Student Assistance Authority.

The report is being provided as required by OIG's statute and is available on OIG's website.

I am available to discuss this report at any time.

Very truly yours,


Mary Jane Cooper
Inspector General of New Jersey

Enclosure

cc: Kim Guadagno, Lieutenant Governor, State of New Jersey
Stephen Sweeney, Senate President, New Jersey State Senate
Sheila Oliver, Assembly Speaker, New Jersey State Assembly
Jeffrey Chiesa, Chief Counsel to the Governor
Deborah Gramiccioni, Director, Governor's Authorities Unit
Kathleen Wiechnik, Executive Director, State Ethics Commission
Michael Angulo, Executive Director, Higher Education Student Assistance Authority

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I. INTRODUCTION

A. Scope of Review

Executive Order No. 41 (Governor Richard J. Codey 2005) directed the Office of the Inspector General (OIG) to “assess the internal controls that are in place at every authority and to make recommendations concerning what uniform practices and procedures should be established for all State authorities.” OIG responded by commencing reviews of the internal controls in place at the State’s authorities, including Higher Education Student Assistance Authority (HESAA) in order to identify reportable conditions that could facilitate or lead to fraud, waste or abuse of state funds, as well as conditions that could inhibit the organization from accomplishing its mission.

In performing this assessment, OIG reviewed contracts, policies and procedures manuals, internal and external reports and proprietary documents and conducted interviews of personnel and members of the Board. OIG’s review commenced in January 2006, and during OIG’s ongoing review, OIG’s concerns were discussed with management and staff and appropriate corrective actions were also discussed. In 2007, OIG learned that the Office of the Attorney General of the State of New Jersey, Division of Consumer Affairs, Office of Consumer Protection, was conducting an investigation into certain HESAA marketing practices. OIG interrupted its review so as to not interfere with those efforts. On February 6, 2008, the Attorney General and HESAA entered into an agreement, Assurance of Voluntary Compliance, concluding the Attorney General’s

ongoing investigation.¹ OIG then recommenced its review of HESAA's internal controls, including assessing policies and procedures that HESAA had implemented in response to OIG's initial inquiries.

A final draft of OIG's report was provided to HESAA management for review and comment in the summer of 2009. They were provided an opportunity to discuss their responses with OIG staff and their responses were then incorporated into in this final report as appropriate, or otherwise noted. As OIG was preparing to issue its final report, HESAA's former Director of Legal and Governmental Affairs contacted OIG and provided additional information to OIG. OIG investigated the information and to the extent the new information was relevant and substantiated, OIG incorporated the information into this report. Therefore, HESAA's Executive Director was provided a

¹ In February 2008, the Office of the Attorney General, through the Division of Consumer Affairs, Office of Consumer Protection, and HESAA, reached an agreement resolving the issues in controversy and concluding the matter without the need for further action. The agreement was memorialized in an Assurance of Voluntary Compliance (AVC) signed by the Executive Director on behalf of HESAA.

According to the AVC, beginning in 2001, HESAA had entered into "Marketing and Service" agreements with lending institutions whereby the lending institutions agreed to pay HESAA a fee equaling a percentage of the value of student loan applications originating from certain colleges participating in the agency's "HESAA as FFELP Sponsor" program. In exchange for the payments, HESAA marketed lending institutions to colleges participating in the HESAA as FFELP Sponsor program. HESAA made available to these colleges, as well as other colleges in the State, certain benefits, including staffing assistance. HESAA voluntarily cooperated with the Attorney General's investigation and consented to the AVC without admitting any violation of law.

According to the AVC, HESAA informed the Attorney General's office that it ended the Marketing and Service agreements in April 2007; HESAA agreed to further effectuate changes in its business practices, including the adoption of a Code of Conduct eliminating conflicts of interest and the appearance of impropriety that may arise from certain relationships with lending institutions and preserving borrowers' right to choose a student loan lender; agreed to use the remaining revenue from the HESAA as FFELP Sponsor program only for the direct benefit of student loan borrowers; is prohibited from soliciting or accepting anything of value from a lending institution that may provide the institution with an advantage or prejudice borrowers; is prohibited from offering to provide gifts to colleges or college employees; is prohibited from engaging in revenue sharing with lending institutions or colleges; was required to appoint a Chief Compliance Officer responsible for ensuring compliance with all applicable State and Federal laws, regulations, guidelines, and industry best practices; and HESAA's compliance with the AVC was to be under the scrutiny of an independent monitor for a year.

copy of the amended report for comment, and as appropriate, his comments are included herein.² OIG also provided the former Director of Legal and Governmental Affairs the portions of the report that affected her for her review and comment. She provided comments and to the extent her comments were relevant and appropriate, they also are included in this report.

B. Higher Education Student Assistance Authority

1. Organization

HESAA, an instrumentality of the State that is in but not of the Department of State, was granted authority status in 1999.³ It is charged with providing and facilitating financial assistance to higher education students by way of grants, scholarships, and loans and by guaranteeing loans.

HESAA is governed by an 18 member board with the following statutorily required members: State Treasurer, Chair of the Commission on Higher Education, Chair of the Board of Directors of the Educational Opportunity Fund, five representatives from eligible institutions in the State (including one from Rutgers, the State University; one from the New Jersey Institute of Technology or the University of Medicine and Dentistry of New Jersey; one from a County college; one from a State college; and one from an

² In his comments submitted to this draft of the report, the Executive Director made several comments for the first time concerning portions of the report with which he had previously agreed and in some instances he offered comments that are inconsistent with his earlier comments. Where appropriate, OIG notes this in the report.

³ HESAA is the successor to the New Jersey Higher Education Assistance Authority.

independent institution of higher education in the State), two college level students, seven state residents as public members, and the Executive Director of HESAA, who serves in an ex-officio capacity.⁴

In 2009, HESAA's Executive Director represented to OIG that HESAA had 225 staff positions but currently had only 184 employees, having 46 unfilled positions. He told OIG that some of the vacancies resulted from several employees taking advantage of early retirement programs offered by the State, and other staff vacancies were the result of attrition and an inability to hire staff due to the State government hiring freeze. The Chief Financial Officer and the Chief Operating Officer, who had both been with HESAA for some time, could not recall staffing ever being at more than 210 employees, and said that it had not been at that level in many years.

At the time of OIG's review, members of HESAA's staff were paid through the State payroll system and were enrolled in either the Public Employees Retirement System or Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF). Most of the staff works out of the main HESAA headquarters.

According to a December 2009 HESAA document, HESAA's top management at the time consisted of:

Executive Director – Michael Angulo holds degrees in law and financial management. He was originally appointed by Governor James E. McGreevey in July 2004. As

⁴ N.J.S.A. 18A:71A-4.

HESAA's Executive Director, he oversees and directs all managerial, administrative, operational, financial, legal, and governmental affairs of the Authority.

Chief Operating Officer – Francine Andrea joined HESAA in October 1995. Her functional responsibilities include administration of State grants and scholarship programs, NJCLASS and FFELP loans, client services, and research and financial aid services.

Chief Financial Officer – Eugene Hutchins joined HESAA at its creation in 1994 and serves as the head of finance and budgeting, accounting and procurement, and information technology and systems areas. He holds degrees in Economics and Accounting.

Controller – Robert J. Clark joined HESAA in July 2001. He is responsible for HESAA's financial reporting, systems development, staff supervision, and managerial oversight for the Authority's loan programs. He is a Certified Public Accountant, and holds degrees in business administration and accounting.

Director of Legal and Governmental Affairs – Robin Johnson was appointed in May 2006 and served until the end of 2009.⁵ She was responsible for providing legal analysis, advice, and opinions on all issues affecting the Authority, monitoring State and federal legislation impacting the Authority, and assuring regulatory compliance, including

⁵ OIG is not aware that the position was filled as of the time this report was issued.

FFELP and NJCLASS regulations. She holds an undergraduate degree and a degree in law.

Chief Compliance Officer – Joel S. Mayer was appointed in December 2007. He is responsible for ensuring the Authority's strict compliance with applicable Federal and State regulations, statutes, directives, and other associated Authority guidelines, rules and regulations. He designed and implemented HESAA's compliance program and is responsible for its day-to-day supervision including providing guidance, advice and directives regarding the interpretation of applicable laws and regulations including but not limited to FFELP. He conducts training sessions for Authority staff on the Authority's Code of Conduct, Best Practices Guide, and compliance program. He holds degrees in law, political science, and psychology and is designated a Certified Compliance and Ethics Professional.

In addition to administering the financial assistance programs described below, HESAA management is responsible for developing financial controls, establishing and maintaining effective internal controls, and assuring compliance with requirements of laws, executive orders, regulations, grants and contracts applicable to both state and federal programs. HESAA conducts program reviews, reviews of collection firms, lender reviews, and management reviews to ensure compliance with both program and governmental regulations.

2. Operating Funds

HESAA's operating funds come through servicing and application fees, retention of a percentage of collected delinquent loans, and revenue generated as a result of the investment of these funds. Since the inception of the guarantee student loan program in 1965 through the end of fiscal year 2006-2007, HESAA, in compliance with the Authority's agreement with the U.S. Department of Education (USDOE) and as federal guarantor, has paid over \$1.2 billion in federally reinsured claims out of the Authority's Federal Student Loan Reserve Trust Fund to lenders.⁶ These claims were the result of borrowers' defaults, bankruptcies, disabilities, and/or deaths.

In fiscal year 2006-2007, HESAA collected \$39.7 million in defaulted federal loans on behalf of the federal government. Of that amount, HESAA retained \$10.6 million, the guaranty agency's authorized retention. The remaining \$29.1 million was remitted to USDOE.

HESAA's 2006-2007 Biannual Report discloses that the Authority engaged in 261,100 transactions totaling approximately \$1.3 billion in the form of grants, scholarships and loans during fiscal year 2006-2007. As of June 30, 2007, HESAA's total assets were approximately \$3.7 billion (comprised mainly of investments and loans); total liabilities were \$1.6 billion (comprised mainly of bonds payable); total revenues were approximately \$1.3 billion (comprised mainly of appropriations, grants, fees and

⁶ The financial information in this and the next section of this report is taken from HESAA's 2006-2007 Biannual Report, the most recent HESAA annual report that appeared on HESAA's website at the time of this report.

investment earnings); and total expenditures for 2006-2007 were \$632 million. HESAA's loan program bond trust estates had positive cash flow of approximately \$48 million as of June 30, 2007. During discussions of OIG's draft report, HESAA management reported reserves of approximately \$6 million dollars.

3. Financial Assistance Programs Administered By HESAA

There are three major sources of financial assistance administered by HESAA:

FFELP - The Federal Family Education Loan Program, administered by USDOE, encourages private lenders⁷ to make loans to students and their parents to help pay for the cost of postsecondary education. HESAA acts as the New Jersey administrator and Guaranty Agency, the guarantor, of the FFELP loans on behalf of the federal government.⁸ Since its creation, HESAA has guaranteed over \$10 billion in FFELP loans. HESAA is reinsured under a participation agreement with USDOE. HESAA, through the FFELP program, earns a servicing fee and retains an application fee.

NJCLASS – This State loan program is issued and serviced by HESAA and provides both fixed and variable rate loans to all eligible New Jersey students who attend college in-state or out-of state. The program is generally viewed as a supplemental source of funding after all other financial sources have been exhausted. The program is funded by HESAA through the issuance of tax-exempt bonds. HESAA charges a low interest rate

⁷ As of this writing, the federal government has indicated that it will no longer use private lenders to make these loans.

⁸ HESAA's participation in FFELP is governed by a 662 page Common Manual. Failure of a program participant to comply with FFELP statutory and regulatory requirements, or a guarantor's policies, practices or procedures may result in denial of claims or other adverse action.

for the NJCLASS loan during school and for the first 48 monthly payments. This is intended to reduce the cost of the loan for borrowers at the early stages of the repayment period and results in a lower overall cost to the borrower. During the fiscal year that ended June 30, 2007, HESAA issued 19,600 NJCLASS loans, totaling \$237.3 million, to New Jersey students. HESAA charges an application fee for these loans that is retained from the loan amount and is used to generate revenue that supports the administration and cost of the program.

TAG - HESAA is the designated State authority that administers the New Jersey Tuition Assistance Grant program. These grants are awarded to all eligible New Jersey residents attending approved degree granting, postsecondary institutions in New Jersey. HESAA receives direct State services funding to administer the TAG program. For fiscal year 2006-2007, HESAA received \$269 million in aid grants, mainly comprised of the State's approximately \$231 million appropriations for TAG. HESAA received \$1.9 million in direct State services funding.

In addition, HESAA administers numerous other higher education funding programs, including but not limited to the NJ STARS, Federal Consolidation Loans, NJ World Trade Center Scholarship Program, and Dana Christmas Scholarship for Heroism. HESAA has also formed multiple partnerships to enhance its services. As an example, HESAA has partnered with Franklin Templeton Investments to administer the State's Educational Savings Trust (NJBEST). Other partnerships include but are not limited to: Governor's Teaching Scholarship Program, Law Enforcement Officer Memorial

Scholarships Program, and the Primary Care Physician/Dentist Loan Redemption Program.

HESAA performs additional functions including those intended to facilitate students' access to loans and grants, *i.e.*, participating in numerous financial aid workshops, distributing brochures and applications to students, their families and financial aid counselors; and those intended to assist borrowers in avoiding loan delinquency and defaults, *i.e.*, holding money management sessions and providing credit and financial counseling.

II. ASSESSMENT OF INTERNAL CONTROLS

During its review, OIG identified areas of concern with respect to HESAA's internal controls, including oversight by its Board and Audit Committee; its compliance with numerous executive orders and best practices guidance found in the Sarbanes-Oxley Act; the membership and adherence to procedures governing its Audit Committee; its audit processes and oversight of the collection process for delinquent accounts; its interpretation of the "Pay to Play" law; potential ethics violations; and other elements of its operations.⁹ These concerns are discussed below.

A. Financial Management Processes

1. Audit Committee Membership

Executive Order No. 122 (McGreevey 2004) requires that each Authority Board of Directors create an Audit Committee of no less than three members to assist in the oversight of the financial reporting and audit processes of the Authority. At least two of the Audit Committee members are required to be members of the Board but an Authority staff person may not serve on the Audit Committee. At least one member of the Authority Audit Committee "shall have accounting or related financial expertise," and all Audit Committee members "should have knowledge of the Authority's governmental

⁹ In conducting this assessment, OIG was guided by an internal control review framework established by the Committee of Sponsoring Organization of the Treadway Commission (COSO). The framework identified components of an entity's operational structure that must be examined: its control environment, risk assessment, control activities, information and communications systems, and self-monitoring.

functions, and sufficient time to accomplish the responsibilities” of the Committee.¹⁰ Executive Order No. 122 further provides that, “in the event the Board does not have sufficient members qualified or available to serve on the Audit Committee, or wishes to broaden the expertise on the Audit Committee, the Board may request that the State Treasurer recommend one or more qualified individuals to sit on the Committee.”

The Sarbanes-Oxley Act directed that the Securities and Exchange Committee (SEC) define “financial expert.” The Act provided the SEC with the following guidance in crafting the definition: “In defining the term ‘financial expert’...the Commission shall consider whether a person has ... (1) an understanding of generally accepted accounting principles and financial statements; (2) experience in (A) the preparation or auditing of financial statements of generally comparable issuers; and (B) the application of such principles in connection with the accounting for estimates, accruals, and reserves; (3) experience with internal accounting controls; and (4) an understanding of audit committee functions.”¹¹

The Sarbanes-Oxley Act requires that an Audit Committee shall be responsible for the “resolution of disagreements between management and the auditor regarding financial reporting[.]” Other functions of an Audit Committee shall include ensuring that any deficiencies identified by management letters are promptly addressed, reviewing

¹⁰ Executive Order No. 41 (Codey 2005) requires that all Audit Committee members be trained in the requirements of Sarbanes-Oxley Act as related to duties as Authority Members. This training is to be provided by the Governor’s Authorities Unit. The Sarbanes-Oxley Act does not apply directly to State government entities, but provides a standard for establishing best practices in conjunction with existing State standards.

¹¹ 15 U.S.C. §7265.

annual statements, reviewing the annual internal audit plan, reviewing the results of external audits and ensuring compliance with the outside auditor's independence requirements. To facilitate the exercise of these functions, audit committees shall, pursuant to the Act, also have authority to "engage independent counsel and other advisers."¹²

When OIG began its review of HESAA, OIG representatives attempted to attend an Audit Committee meeting.¹³ As the meeting was about to begin, OIG observed that a member of HESAA's staff, the Chief Financial Officer, was serving as the Audit Committee's financial expert. It was explained to OIG that a Member of HESAA's Board of Director's with financial expertise had served on the Audit Committee until his resignation from the HESAA Board in October 2005. The Chief Financial Officer with financial expertise was assisting the Audit Committee until another person with financial expertise was appointed to the HESAA Board by the Governor. OIG pointed out that having a member of staff serve in this capacity with the Audit Committee appeared to be

¹² Id.

¹³ This is one of the portions of the earlier draft report that OIG staff had reviewed with the HESAA Executive Director and the HESAA Chief Financial Officer at a meeting with OIG in the summer of 2009 and that the Executive Director has now submitted comments that are inconsistent with those discussions.

At no time, including in the written materials that HESAA submitted in advance of the summer 2009 meeting with OIG and at that meeting, did HESAA's Executive Director or HESAA's Chief Financial Officer allege that the meeting discussed in this paragraph was not an Audit Committee meeting but some other committee meeting. If they had, it would have been an important fact, that if correct, requiring changes to the report. Instead, the summer 2009 discussion was consistent with the discussion in the above paragraph – the meeting was an Audit Committee meeting – requiring no changes of note.

Now, in the Executive Director's May 4, 2010 comments to the final draft of this report, he asserts for the first time that this paragraph is "not accurate and should be amended" because the OIG staff did not attend an Audit Committee meeting but a Program Review and Quality Control Committee meeting. OIG has reviewed its original investigative notes as well as the Executive Director submissions and notes of the discussions in the summer of 2009. They are clear that OIG representatives attempted to attend the scheduled Audit Committee meeting that was adjourned because OIG staff intervened as described above.

a violation of E.O. No. 122. HESAA management and the remaining members of the Audit Committee agreed with OIG's understanding of the executive order, and they adjourned the Audit Committee meeting.

The Treasurer was contacted and his designee was appointed to serve on the Audit Committee as the Board member with financial expertise. During its review, OIG observed that neither HESAA's Audit Committee nor its Board included a public member who qualified as a "financial expert" since the time the public member who had qualified as a financial expert had resigned in October 2005. Therefore, since 2006, the Treasurer's designee has been serving on the Board and the Audit Committee, as allowed by E.O. No. 122. HESAA advised OIG that in 2008, a public member with financial expertise had been appointed to the Board.

2. State Requirements and Best Practices

Beginning at least in 2004, New Jersey Governors began emphasizing the role of Board Audit Committees in establishing and maintaining the financial integrity of independent Authorities and of the significance of independently audited financial statements as important tools in demonstrating financial integrity. The importance was communicated by way of requirements in executive orders.

Executive Order No. 122 (McGreevey 2004), requires that each State Authority, using criteria established by its Audit Committee, retain an independent auditor for the

performance of an audit of the Authority's financial statements.¹⁴ "Audit" is defined in the Executive Order as "an examination of the financial statements of [the] Authority by a certified public accounting firm in compliance with the generally accepted government auditing standards (GAGAS), issued by the Comptroller General of the United States[.]"

E.O. No. 122 charges an Authority's Audit Committee with assisting the Board in overseeing "(i) the integrity and quality of the Authority's financial statements; (ii) the Authority's compliance with legal, regulatory, and ethical requirements; (iii) the auditor's performance and ability to perform; and (iv) the performance of the Authority's own internal audit and internal control functions." Other Audit Committee functions include reviewing the annual management letter with the independent auditor and reviewing and discussing the audited financial statements and interim statements with management and internal auditors.

Since E.O. No. 122 was issued, Governors have imposed additional requirements on Authority Boards, and particularly Audit Committees, and have continued to stress the importance of an Authority's independently audited financial statements. In 2005, Governor Richard J. Codey issued Executive Order No. 41, requiring that all Authority members receive training concerning "government ethics and, where appropriate, proper fiscal practices, including specific training in the requirements of the Federal Sarbanes-Oxley Act,¹⁵ as related to their duties as authorities members. Such training will include

¹⁴ The Executive Order further requires that the outside auditor must be selected by way of a search process detailed in the Order.

¹⁵ 15 U.S.C. §§7201 et seq.

the responsibility of authority members in the employment of authority staff, oversight of procurement and fiscal operations and approval of contracts.” Sarbanes-Oxley Act’s requirements for publicly traded entities include:

- A public accounting firm shall perform an audit of the entity, and the entity’s Audit Committee shall appoint and oversee the accounting firm.
- The firm shall prepare an audit report to be submitted to the Audit Committee.
- The firm shall also report directly to the Audit Committee.
- The Audit Committee members must be outside members of the entity’s Board.
- The Audit Committee’s oversight responsibilities include, but are not limited to, resolving disagreements between management and the auditing firm concerning financial reporting.

As E.O. No. 41 recognizes, Sarbanes-Oxley is not binding on government entities; and not all of its provisions are readily translatable into requirements for government entities. Those listed above, at a minimum, should be seen as best practices and desirable goals for government entities fiscal and structural operations.

Governor Jon S. Corzine amended E.O. No. 122 (McGreevey 2004) by Executive Order No. 37 (Corzine 2006), imposing the following additional requirements concerning the independent audit of an authority’s financial statements:

- The required audit shall be conducted annually.
- The audit shall be submitted to the governing Board for its review and approval.
- The audit shall be accompanied by a written certification from both the chief executive officer and the chief financial officer that the financial information provided to the auditor in connection with the audit is, to the best of their

knowledge, accurate and that it fairly represents the financial condition and operational results of the Authority for the year in question.

- The final independent audit shall be posted on the authority's website and submitted to the State Treasurer and the Governor's Authorities Unit.

3. Limited Scope of HESAA's Independent Audits

As of fall 2009, HESAA's Audit Committee did not require its external auditor to render an opinion on its financial statements in accordance with GAGAS as required by E.O. No. 122 (McGreevey 2004) and the subsequent Executive Orders referenced above.¹⁶ An external auditor examines only a portion of HESAA's accounts: HESAA's off-line accounts (those accounts not required to be reported to the New Jersey Comprehensive Financial System) are subjected to an independent audit performed by an external certified public accounting firm. However, HESAA's on-line accounts (those required to be reported to the State's Comprehensive Financial System)¹⁷ are reviewed solely by the State Auditor. The financial data from these two different efforts are combined by HESAA staff and subsequently presented to the Office of Management and Budget within the Department of the Treasury (Treasury) for review. According to HESAA's Chief Financial Officer, the reviewed balances are presented in HESAA's annual report.¹⁸

¹⁶ GAGAS provides a framework for conducting audits of government entities. U.S. Government Auditing Standards, <http://www.gao.gov/govaud/govaudhtml/index.html>.

¹⁷ Although not relevant to the point OIG is making here, OIG grants HESAA's request to include the following: "HESAA's on-line accounts (those fully maintained on the State's Comprehensive Financial System) are subject to the Treasury system of internal controls, continuous monitoring by the Office of Management and Budget, and subject to an annual audit by the State Auditor as part of the State Governmental Operations which fall under a separate section of the State CAFR than the Authority's off system of non-State or fiduciary account."

¹⁸ As discussed *supra*, HESAA has not issued an annual report since its 2006 – 2007 Biannual Report.

OIG was advised by HESAA's Chief Financial Officer that subsequent to the issuance of E.O. No. 122 (McGreevey 2004), HESAA consulted with the New Jersey Office of the Attorney General to determine if the process HESAA had been using comported with E.O. No. 122 or if HESAA was required to change its practice. HESAA's Chief Financial Officer told OIG that HESAA was advised that HESAA's process satisfied the requirements of E.O. No. 122 as there was audit coverage for all of HESAA's accounts.¹⁹ When discussing OIG's draft report with HESAA management, OIG asked HESAA's Chief Financial Officer why HESAA had sought approval of a methodology that had the effect of avoiding full compliance with the Executive Order. He explained that some of the programs that HESAA administered had investment managers and the program's own audits; and it would have been expensive and time consuming to obtain and then merge those results with HESAA's audit results. HESAA management believed that the process HESAA used was in compliance with the spirit of the law, if not the letter, and would result in saving HESAA funds. HESAA had not revisited the concept after that initial decision.

HESAA's current methodology does not meet the requirement of E.O. No. 122, since the financial statements in their final form are not audited as a whole by an outside CPA firm. OIG recommended that going forward, in order to provide full notice of the nature of HESAA's audit opinions, HESAA include standard language in its financial statements that the audit opinion is not an opinion of the financial position of HESAA

¹⁹ OIG verified that HESAA had in fact received that advice from a Deputy Attorney General, who acknowledged to OIG that he did not have a financial or accounting degree or background and had not consulted with anyone with a financial and/or accounting background in providing the advice.

taken as a whole in accord with generally accepted government auditing standards.²⁰ Alternatively, if in the future, HESAA determines to consolidate all reports and submit the consolidated report to an outside independent auditor, the resulting opinion could accordingly be expressed with respect to the financial position of the Authority as a whole. HESAA's Chief Financial Officer told OIG that he agreed with OIG's recommendations, and in the future would include language providing notice as recommended by OIG.

4. No Internal Audit Report Produced

Although E.O. No. 122 (McGreevey) does not require an Authority to have an internal auditor on staff, both best practices concerning internal controls and E.O. No. 122 highlight the importance of an internal auditor and a complete internal audit.²¹ Best practices would dictate that an independent Authority as large as HESAA, responsible for the proper administration, distribution, and collection of a substantial amount of public funds, including its own substantial cash flow and reserves, should annually conduct an internal audit of its books and records to be submitted to its Audit Committee for review and analysis.

²⁰ An example of standard language includes:

The financial statements present only the business – type activities of the NJCLASS and FFELP of HESAA and do not purport to, and do not, present fairly the financial position of HESAA as of _(date)____ and its changes in financial position and its cash flows for the years then ended in conformity with (accounting standard)_____.

²¹ E.O. No. 122 provides that if the Authority does have an internal auditor, the Audit Committee shall meet regularly with the internal auditor, and the internal auditor shall regularly make reports to the Audit Committee. More particularly, E.O. No. 122 requires an Authority Audit Committee to assist the Board to oversee the “performance of the Authority’s own internal audit and internal control functions” and to “review actions taken as a result of internal audit findings” if the entity has an internal auditor.

HESAA's Executive Director and Chief Financial Officer acknowledged that HESAA does not have an internal auditor and more notably, does not perform an internal audit. Thus, HESAA's Audit Committee is not provided with an internal audit report; and the E.O. No. 122 Audit Committee review and oversight of the Authority's internal control functions is substantially limited.

OIG recommends that HESAA have an internal audit function. During discussions of OIG's draft report, HESAA management accepted this recommendation and informed OIG that in 2006, in response to OIG's concerns, HESAA had requested approval to fill a vacant auditor position that would be responsible for internal audits as well as external audit functions. Thus, HESAA, perhaps accurately, appeared not to consider the internal audit position to be a full-time position. HESAA was not able to fill the position because of the State-wide hiring freeze and commitment to a reduction of force.

OIG recommends that HESAA explore other avenues to accomplish the internal audit function. For instance, OIG recommends that HESAA conduct a management/organizational/performance review of its current structure and staff assignments for efficiency and optimum use of staff's capabilities. HESAA may have on its existing staff a full- or part-time employee capable of taking on the job of full-time Internal Auditor reporting to the Audit Committee of the Board. HESAA may also be able to use a certified public accounting firm to conduct its internal audit and report to the Audit Committee. HESAA reports that it has reserves available that could be used for

this purpose and has agreed to implement these recommendations. OIG will exercise its authority to observe the results of these corrective actions.

In addition, OIG has recommended that there reside in some existing Executive Branch agency – Treasury, the Office of the State Comptroller – a small group of auditors whose responsibility it is to provide the internal audit function to authorities that do not have an independent internal audit function because they do not have enough work to support a full-time internal auditor. Having the internal audit function performed by such a group would assure that the function is independent of management. The auditors would report to the Audit Committee of the authority and meet with and provide information to them.

5. Limited Self-Evaluation of Internal Controls

During the period of OIG’s initial review, HESAA was attempting to fill the gap in the review of its internal control functions by utilizing an evaluation methodology that Treasury provides to State entities within the Executive Branch. Circular Letter 03-08-OMB, issued by Treasury, requires that all Executive Branch agencies conduct an “annual self-assessment of internal controls” completing the Internal Control Assessment questionnaire in conjunction with an annual performance evaluation.²²

²² HESAA mistakenly reported to OIG that HESAA’s use of the assessment was voluntary, but the language in the circular letter does not appear to make its use discretionary for Executive Branch agencies.

Beginning in 1997, HESAA management began requiring its management personnel to complete this internal control questionnaire. From 1997 through 2003, HESAA did not evaluate the completed questionnaires, but simply forwarded them to Treasury. As of 2003, HESAA management began evaluating the questionnaires, but there was no record of corrective actions being taken on recurring conditions noted until 2006 after OIG commenced its review of HESAA.

After OIG commenced its review of HESAA's internal controls in 2006, HESAA began selectively testing its managers' completed questionnaires in order to determine if the managers had responded indicating that there were conditions at the Authority that represented internal control deficiencies. OIG was told by HESAA management that as of 2006, any conditions uncovered through this process were addressed as necessary. In 2005 and 2006, HESAA's responses to the internal control questionnaires indicated that certain problems had remained unresolved for a number of years. These problems included staffing shortages and the resultant need for overtime as well as the need for upgrades in technology.²³ HESAA management told OIG that HESAA has had unfilled positions for a number of years, and produced documentation demonstrating that they had been unable to fill vacancies going back at least as far as 2003. Thus, the HESAA

²³ During the discussion of OIG's draft report, HESAA management told OIG that HESAA was understaffed in several areas because of these unfilled positions, but that management is most interested in filling twenty or more "critical" vacancies. Since 2003, these positions have included: financial administrators, Directors and Assistant Directors, customer service representatives, student loan investigators, auditors, information technology specialists, student loan technical support, collectors, and bi-lingual collectors.

Although OIG is aware of a State-wide hiring freeze, OIG did not investigate the validity of the assertions about the basis for the vacancies, HESAA's inability to hire, HESAA's need for the staffing, or HESAA's source of funds for the positions. OIG does offer HESAA management alternate suggestions for consideration in filling the positions, *supra*.

Executive Director claimed that while loan volume and scholarship applications have increased significantly, HESAA has utilized temporary workers and required staff to work overtime to get the Authority's work done. As to the technology concerns, HESAA management claims to have implemented ongoing processes to enhance outdated software and information technology upgrades.

The HESAA Executive Director represented to OIG that for several years, HESAA has not been granted approval to hire full-time employees to fill "critical vacancies" due to the State wide hiring freeze. OIG suggested that in view of State government's commitment to a reduction of force and HESAA's inability to convince administrations going back to 2003 that some of its vacant positions were "critical", HESAA consider using its reserve funds to conduct a management/performance review of its current organizational structure and staff assignments for efficiency and optimum use of staff's capabilities. Some revenue producing authorities are required by enabling statute to conduct this type of review on a periodic basis to assure they are best utilizing their resources. HESAA may be able to accomplish its goals without adding new full-time employees by re-defining positions and re-assigning current employees.²⁴ HESAA may also be able to use the services of the State's Office of Information Technology or retain highly skilled technical consultants to update its information technology systems foregoing the need to bring on permanent staff.

²⁴ HESAA management said that there are limitations to its ability to re-define positions and re-assign staff since a large percentage of its staff holds classified positions with negotiated job descriptions that may not be flexible. Nonetheless, working within these constraints, this should be an opportunity for HESAA to become more efficient and productive. In his May 4, 2010, response to the draft of this report, HESAA's Executive Director asserted that to the extent possible, the Authority has attempted to redefine and reassign personnel, and reallocate staff cross departmentally as necessary to address emergent as well as routine needs. OIG has not attempted to verify this assertion that he had not made to OIG in the past.

HESAA management agreed to consider these alternative possibilities, and OIG will assist their retention of consultants and implementation of recommendations. HESAA submitted a draft RFP to OIG and the former Governor's Authorities Unit for review. OIG will consult with HESAA and representatives of the current Governor's Authorities Unit to move forward on this process.

6. Misinterpretation of "Pay to Play" Requirements

N.J.S.A. 19:44A-20.13 – 20.24, effective October 15, 2004, codified and superseded Executive Order No. 134 (McGreevey 2004), imposing barriers in the way of those who would attempt to use political contributions to influence their ability to obtain contracts with State government entities. The statute requires that as part of the State procurement process, a business entity is required to report (in a manner determined by the Treasurer and Election Law Enforcement Commission (ELEC)) all contributions the business entity made during the preceding four years to any political organization organized under §527 of the Internal Revenue Code that is also a "continuing political committee". The business entity's report is subject to review by the Treasurer to determine whether there exists a conflict of interest that disqualifies the entity from bidding on or being awarded the particular contract.²⁵

The law further prohibits a State entity, including an Authority, from entering a procurement contract valued in excess of \$17,500 with a business entity that has solicited

²⁵ N.J.S.A. 19:44A-20.18.

or made contributions to any of enumerated recipients within defined time periods.²⁶ Prior to the award of a procurement contract under this provision, the statute requires the business entity to provide a written certification that it has made no contribution that would bar a contract with the State under this statute. The business entity has a continuing obligation to report any contributions it makes after the certification and during the term of the contract for after the fact evaluation that could void the contract.²⁷

In 2006, during its initial review, OIG examined agreements between HESAA and its outside law firms that were put in place during the effective date of the Statute. The language in the agreements regarding reporting of campaign contributions did not accurately convey statutory requirements. It read in pertinent part:

... all persons and/or entities contracting with HESAA for sums exceeding \$17,500 must disclose campaign contributions and other relevant information. You must complete and submit form DPPc51-C&D (enclosed) upon your acceptance of this agreement.

The contracts appeared to ignore the statutory requirement for business entities to report all contributions made during the preceding four years to any political organization organized under §527 of the IRS code.

Members of HESAA's legal staff at the time told OIG that HESAA understood that the requirement for business entities to report §527 political contributions also applied only when the contract at issue exceeded \$17,500, and thus, as in the contracts OIG reviewed, the language in HESAA's contracts with outside law firms required

²⁶ N.J.S.A. 19:44A-20.15.

²⁷ N.J.S.A. 19:44A-20.19.

reporting only when it was anticipated that the contracts between HESAA and the law firms would exceed \$17,500. Not only was the contract language inadequate, but it appeared that HESAA's legal staff at the time also appeared to lack a full understanding of the reporting requirements of N.J.S.A. 19:44A-20.20.18.

OIG informed HESAA's Executive Director that HESAA's interpretation of the statutory requirements, as incorporated into contractual documents, appeared to be incorrect, particularly since it appeared to ignore the statutory provision requiring reporting by business entities contributions made during the preceding four years to any political organization organized under §527 of the IRS Code. (As noted, all campaign contributions within the last four years to political action committees must be disclosed without qualification related to the size of the contract sought with the government authority.)

After OIG resumed its review of HESAA in 2008, OIG revisited this issue. OIG was provided a document identified as "Attachment A Terms and Conditions" that has been implemented by HESAA's current legal staff for use for all HESAA contracts. The Attachment largely follows the reporting language of the statute and appears to properly convey the requirements of the statute. Section 5.6 "Requirements of N.J.S.A.19:44A-20.13-25...", mimicking the statute, requires the vendor to certify that no contribution prohibited by the legislation have been made by the entity (those that would prohibit the entity from bidding on a contract over \$17,500); to report all contributions the business entity made during the preceding four years to any political organization organized under

§527 of the IRS Code that also meets the definition of a “continuing political committee”; and to report these contributions on a continuing basis during the term of the contract.

7. Swap Agreements

As of OIG’s initial review in 2006, HESAA had entered into 16 floating-to-fixed interest rate swap agreements and two interest rate caps, but OIG was recently advised that HESAA had permanently discontinued the use of swap agreements. HESAA had engaged in swap agreements with the goal of diminishing its interest based risk as well as locking in fixed interest payments.²⁸ These floating-to-fixed rate swap agreements are designed to enable the Authority to properly match the fixed rate private loan program with its debt service requirements. HESAA, by the use of these agreements, sought to evenly match the interest it pays on its bonds, with the interest it receives from student loan payments. These financial instruments are complicated and carry a great deal of financial risk if utilized improperly. OIG made the following observations concerning HESAA’s handling of swap agreements:

- HESAA did not have written policies and procedures governing its use of swap agreements. (OIG is advised that Treasury has prepared but not yet implemented a policy governing swaps. If Treasury issues a policy, and HESAA reverses its decision not to use swap agreements in the future, HESAA should consider Treasury’s policy for guidance in implementing its own policy.)

²⁸ A swap agreement is an agreement between two parties to exchange some of the obligations associated with debts they owe. By way of example, one entity may have a fixed rate loan while a second entity may have a variable rate loan with a shorter loan period. If the entities determine that they would benefit from the terms and conditions of the other’s loan, they can agree to exchange (swap) the interest rates of their respective loans. They would make payments to each other as necessary to effectuate the terms of their agreement. OIG is advised that HESAA, by way of swap agreements, converts variable interest rate obligations to fixed rate obligations.

- OIG was concerned that Board members were not given full information regarding the extent of the potential risks associated with swap agreements, information that could have helped Board members make independent determinations regarding the desirability of HESAA's participation in these financial instruments. Although HESAA's Executive Director and Chief Financial Officer told OIG that they believed Board members had been provided full disclosure in "layman's" language and were aware of the risks, OIG was not provided sufficient documentation to support Management's position.²⁹ Further, members of HESAA's Board interviewed by OIG said that they found the swap agreements extremely complicated, that the explanations were not particularly helpful, and that they relied on the recommendations made to them by management.³⁰
- HESAA Executive Director and Chief Financial Officer advised OIG that it made all required disclosures regarding these agreements. However, the amounts of these transactions are not recorded in actual financial statements, but only in the footnotes to the financial statements.³¹

²⁹ In response to this concern expressed in OIG's draft report, HESAA's Chief Financial Officer and Executive Director provided OIG with a flip chart that had been used by the broker selling the instruments during the broker's presentation to the Board as evidence that the Board was fully informed of the risks involved in the use of swap agreements. HESAA's Executive Director also asserted that Board members were provided "memos and resolutions in advance of the meeting explaining what a swap agreement was and related risks." However, there was insufficient evidence for OIG to reach a conclusion on the effectiveness of the presentation explaining the risk associated with the use of swap agreements.

When asked if HESAA has lost money as a result of recent developments in the market and HESAA's use of swap agreements, HESAA's Chief Financial Officer explained that HESAA was currently paying a higher interest rate than what the market was offering because the swap agreements were not trading. However, it should be noted that this had no effect on the underlying bond debt.

³⁰ In response to a statement in the draft report, HESAA's Executive Director wrote: "the Chief Financial Officer, Senior Underwriter, Financial Advisor, and bond counsel were available to answer any questions the Board members might have." This misses the point, that is, to ask meaningful questions requires a basic understanding. The Executive Director continued, "A Board member's decision not to ask questions, and/or inability to recollect the specifics are not reasonable basis to conclude that full information was not provided." The Executive Director further stated about his Board's concerns, "A Board member's decision to rely on the recommendations of management where the underlying transaction remains unclear is a reflection on that particular Board member, not necessarily an Authority deficiency."

The Executive Director's comments about his Board appear to reflect a less than supportive attitude toward achieving a fully informed Board. He does not allege that his Board is incapable of understanding swaps but appears to allege that members who have expressed the concern may have decided not to make the effort to be informed. If so, he fails to hear their concern and recognize that it might be that management has failed in its responsibility to assure that the complicated information was provided in a clear and timely fashion so that Board members do understand.

³¹ In his comments to the draft report, HESAA's Executive Director replied that providing this information in footnotes was all that HESAA was required to do. Thus, HESAA was in minimum compliance. The Executive Director noted, however, that as of fiscal year 2010 financial statements, "the mark to market valuation of terminating swap agreements will be reflected in the balance sheets of the NJCLASS program

- The Office of Public Finance within Treasury currently monitors swap agreements in which State Departments and Agencies are involved but does not monitor swap agreements for State Authorities. Although HESAA consults with an advisor that HESAA considers sophisticated and seasoned in the use of swap agreements, HESAA may benefit from consultation with the Office of Public Finance within Treasury.

OIG recommends that if HESAA engages in the use of swaps in the future:

- HESAA create policies and procedures governing swap agreements coordinating with the Office of Public Finance in order to benefit from its expertise in this highly sophisticated and volatile market.
- Any swap agreement policies should address: conditions for use; credit criteria for the other parties that enter into swap agreements with HESAA; and the overall management of swap agreements.
- The extent of HESAA's involvement with these instruments be separately disclosed to the Board and adequately explained.
- The Board should be provided with annual performance updates regarding swap agreements and their associated risks.
- Documents, including HESAA's annual reports, should disclose and explain the risks involved and the potential negative exposure, should HESAA resume the use of swap agreements.³²

8. Off System Bank Account

During a review of the period 2002 through 2004, the State Auditor identified a Commerce Bank account that was being used by HESAA to make disbursements that the

as required under new Government Accounting Standards Board (GASB) guidance.” Thus, minimum compliance now requires more than providing the information in footnotes.

³² In its June 2009 response to OIG's draft report, HESAA management advised that going forward, it has discontinued its use of swap agreements, and thus, that policies and procedures are unnecessary. OIG suggests that if HESAA intends to prohibit the use of swap agreements, it should promulgate a policy establishing this.

State Auditor believed should not have been made from the account.³³ The Auditor recommended that “the authority reconsider the need for this bank account.” When OIG commenced its review of HESAA, this account was still open. HESAA’s Executive Director and Chief Financial Officer explained to OIG that the account had been kept open because HESAA had plans to stop using the State payroll system sometime in the future. OIG was told that at that time, the account would be used as HESAA’s payroll account if the State could not process payroll, e.g., in the event of a government shutdown. OIG informed HESAA that based on the State Auditor’s findings, HESAA would be well advised to close the account, as there were too many risks for inappropriate expenditures associated with it. OIG also recommended opening a new account for payroll when and if necessary. In response, HESAA advised OIG, that as of 2006, the account had been closed.

B. Limited Compliance with Executive Orders

1. Failure to Issue E.O. No. 37 Annual Reports

Executive Order No. 37 (Corzine September 26, 2006) requires all authorities to prepare a comprehensive report on an annual basis concerning the authorities operations. The report is to set forth any significant actions of the previous year, including a discussion of the degree of success the authority had in promoting the State’s economic

³³ The State Auditor wrote, “A balance of approximately \$30,000 is maintained to serve as an alternate means of payment for expenses incurred for general purposes. Between December 20, 2001 and July 30, 2004, the authority expended over \$199,000. The authority uses the state accounting system to process their expenditures. [The Office of the State Auditor] found no compelling reason to have these expenditures paid out of this bank account because they could have been processed through the state accounting system.” Office of the State Auditor: Higher Education Student Assistance Authority Administrative Expenditures, July 1, 2002 to September 30, 2004, at 4.

growth strategies and other policies. In addition, the report shall include the authority's financial statements and identify internal financial controls at the authority that govern expenditures, financial reporting, procurement, and other financial matters and transactions.

The report is to contain a certification by the appropriate senior staff person or persons that during the preceding year the authority has followed the authority's standards, procedures, and internal controls, or where not followed, a description of the corrective actions to be taken by the authority. The report is to be approved by the authority's Board, then submitted to the Governor's Authorities Unit, and then posted on the authority's website.

The evidence gathered during OIG's review indicates that prior to the issuance of E.O. No. 37, HESAA had been issuing and posting on its website an annual report. HESAA's Executive Director distinguished this type of annual report from the E.O. No. 37 annual report describing it as "not exclusively financial in nature but also intended for marketing and outreach purposes." The Executive Director told OIG that the various components of the traditional annual report were assigned to different staff within the authority, but the evidence indicates that it was the responsibility of the Senior Director of Client Services, who reported to the Chief Operating Officer, to issue this report. After he left, it was the responsibility of the Director of Communications. The last one of these was issued for the fiscal years 2006 and 2007 – respectively ending on June 30,

2006 and June 30, 2007 – and thus was called the 2006-2007 Biannual Report.³⁴ The 2006-2007 Biannual Report included the financial status of HESAA (information that would have been obtained from the Chief Financial Officer and the Controller); the number of students attending institutions of higher education with the assistance of student loans or other assistance; information about current Board members (information that would likely have come from the Chief Operating Officer); and a statement from the Executive Director.

The 2006-2007 Biannual Report did not meet all of the requirements of E.O. No. 37. For instance, it did not address HESAA's compliance with its standards, procedures, and internal controls; and neither HESAA's Executive Director, Chief Financial Officer, nor any other senior HESAA staff person certified to the best of his or her knowledge, that HESAA had either followed all of HESAA's standards, procedures, and internal controls, or that corrective actions were being taken where HESAA fell short. Moreover, no HESAA E.O. No. 37 compliant annual report was issued in 2008, 2009, and as of the date of this OIG report. Indeed, no HESAA annual report E.O. No. 37 compliant or otherwise was issued since 2007.

OIG attempted to determine the reason why no E.O. No. 37 compliant annual report had been issued. According to the Executive Director, between May 2006 and December 2009, it was the responsibility of HESAA's then Director of Legal and Governmental Affairs to assure compliance with executive orders, including assuring that

³⁴ The report does not bear a publication date. The former Director of Legal and Governmental Affairs told OIG that prior to her employment at HESAA, a decision had been made by HESAA management to issue a biannual instead of an annual report to conserve funds.

HESAA met the requirement to issue an E.O. No. 37 compliant annual report. The former Director of Legal and Governmental Affairs acknowledged to OIG that during her employment at HESAA, May 2006 through December 2009, tracking compliance with executive orders, including E.O. No. 37 that had many other requirements in addition to the annual report requirement, was her responsibility. However, she told OIG that she was not responsible for *issuing* either the pre-E.O. No. 37 annual reports or the E.O. No. 37 compliant annual reports.

HESAA's Executive Director told OIG that upon the issuance of E.O. No. 37 (September 26, 2006), it was the responsibility of the then Director of Legal and Governmental Affairs to inform executive management of the new and enhanced requirements for the annual report. The Executive Director told OIG that the former Director of Legal and Governmental Affairs never did this. The former Director of Legal and Governmental Affairs disputed the Executive Director's assertion. She told OIG that she told senior management about requirements for the annual report laid out in E.O. No. 37. The documentary evidence indicates that the then Director of Legal and Governmental Affairs did inform executive management of the requirements at least once and likely more than once.

The former Director of Legal and Governmental Affairs told OIG that shortly after the issuance of E.O. No. 37, she and her assistant prepared a presentation with documents for the HESAA Board detailing various requirements of E.O. No. 37. This presentation explicitly detailed the new annual report requirements. The former Director

of Legal and Governmental Affairs said that nothing would have been presented to the Board without the approval of the Chief Operating Officer as well as the Executive Director, and therefore she is certain that she showed the documents for the presentation to both the Chief Operating Officer and the Executive Director before the meeting and may have even had conversations with them about it. Thus, it is likely that the Executive Director and the Chief Operating Officer saw the requirements prior to the Board meeting on October 17, 2006.

The presentation was made to the HESAA Board at the October 17, 2006 Board meeting, and the minutes of that meeting indicate that the Executive Director, the Chief Financial Officer, the Chief Operating Officer, and the Senior Director of Client Services (who reported to the Chief Operating Officer and was responsible for issuing the soon to be published 2006-2007 Biannual Report) were all present. The Executive Director, who was there for the presentation, told OIG that he witnessed the Director of Legal and Governmental Affairs make the entire presentation to the Board at the meeting, and the meeting minutes confirm that she alone made the presentation.³⁵

OIG obtained the documents that were used to support the Director of Legal and Governmental Affairs' presentation and that were handed out to the attendees. In addition to a copy of E.O. No. 37, there were copies of the slides (with a place for notes next to each slide). Two of the slides, both the on-screen version and the version handed

³⁵ The Executive Director made this assertion correcting OIG's observation that the documents reflected that the presentation had both the Director of Legal and Governmental Affairs' and her assistant's names and that the assistant may have participated in the presentation.

out to the attendees with a place for note-taking, include in detail the requirements for the new annual report. More particularly, the slides indicate that E.O. No. 37 annual report requires:

- HESAA's significant actions from the previous year, regarding the degree of success the Authority had in promoting the State's economic growth strategies and other policies;
- HESAA's financial statements;
- internal controls at HESAA that govern expenditures, financial reporting, procurement, and other financial matters and transactions;
- a certification of HESAA's Executive Director and Chief Financial Officer that during the preceding year, HESAA has followed its associated standards, procedures and internal controls; and
- the corrective actions to be taken to address any deficiencies.³⁶

Thus, the evidence corroborates the Director of Legal and Governmental Affairs' assertion that executive management was fully informed of the new requirements of the E.O. No. 37 annual report.

³⁶ The Executive Director asserts in one of his May 4, 2010 comments to the draft report that the then Director of Legal and Governmental Affairs never performed her responsibility to inform executive management of "the new and enhanced requirements of the [E.O. No. 37] annual report." However, in writing this comment, he reveals that he was aware of the explicit detail of her presentation to the Board since in another May 4, 2010 comment to this same draft, he asserts that "the E.O. 37 presentation made by former Director of Legal and Governmental Affairs to the HESAA Board did not mention the requirements related to the annual report *and, specifically did not mention Board review and approval of the annual report prior to submission to the Governor's Authorities Unit and subsequent publication.*" He points to the only omission from her description of the new annual report requirements not in the presentation. This is not a requirement for what the report must contain, but a requirement for what must be done with the report after it is completed. It is noteworthy that the executive order including the paragraph from which the requirements were taken was given to everyone at the meeting.

In view of the Executive Director's knowledge that the Director of Legal and Governmental Affairs' presentation had written out the internal requirements of the E.O. No. 37 annual report and attached a copy of the executive order to the presentation, it is misleading for the Executive Director to state that the Director of Legal and Governmental Affairs did not inform executive management of the requirements for an E.O. No. 37 annual report in her presentation simply because she did not state what to do with the report after it was completed. Without a doubt, they were aware of all of those requirements at that time. However, in the unlikely event that they had a question about what to do with the report after it was put together, they could have asked the Director of Legal and Governmental Affairs.

Noteworthy is that E.O. No. 37 does not identify those at the authorities who should certify to compliance in the annual report beyond designating them as “the appropriate senior staff members(s)”. The fact that the Director of Legal and Governmental Affairs’ presentation specifically identified the two HESAA officers who would be certifying to compliance as the Executive Director and the Chief Financial Officer indicates that the then new (five-months on-the-job) Director of Legal and Governmental Affairs had discussed the matter with the Executive Director and the Chief Financial Officer before preparing the presentation to understand that they would be the appropriate officers to certify in the E.O. No. 37 compliant annual report.

OIG also obtained the minutes of the Board meeting. They indicate under a heading for “Executive Order 37 Briefing”, that the former Director of Legal and Governmental Affairs made a presentation on E.O. No. 37. Among the topics were:

Reporting Requirements

* * *

Annual Reports

HESAA will be required to prepare an annual report setting forth the significant actions of the authority from the previous year, regarding the degree of success the authority had in promoting the State’s economic growth strategies and other policies.

The Annual Report shall also contain HESAA’s financial statements and identify internal controls at HESAA that govern expenditures, financial reporting, procurement, and other financial, matters and transactions.

The report shall contain certification by HESAA's Executive Director and Chief Financial Officer that during the preceding year HESAA has followed its associated standards, procedures and internal controls, and the corrective actions to be taken to address any deficiencies.

The minutes were provided to the Board after the meeting. The former Director of Legal and Governmental Affairs said that the Chief Operating Officer, the Executive Director, and the Chief Financial Officer reviewed Board minutes before they were sent to the Board members. Thus, this was yet another opportunity for executive management to become familiar with the requirements of an E.O. No. 37 annual report.

Although when the former Director of Legal and Governmental Affairs told OIG that shortly after E.O. No. 37 was issued, she had informed HESAA executive management of the new requirements of the executive order's annual report, she may have been referring to yet another particular conversation that she had with them, the documentary evidence demonstrates that at least on October 17, 2006, -- and likely on other occasions -- she advised executive management of the executive order's requirements for an annual report. The documentary evidence thus refutes the Executive Director's assertion that the then Director of Legal and Governmental Affairs never advised him or other senior management of the new requirements of E.O. No. 37 for an annual report.

The former Director of Legal and Governmental Affairs told OIG that after she advised HESAA executive management about the E.O. No. 37 annual report requirements, she was told by the Executive Director, the Chief Financial Officer, and the

Chief Operating Officer that HESAA's Biannual Report that was about to be issued met all of the new requirements. The former Director of Legal and Governmental Affairs' statement is plausible since within several months³⁷ of being informed of the E.O. No. 37 annual report requirements, HESAA management issued the 2006-2007 Annual Report. The evidence does not indicate that it was altered to conform to E.O. No. 37. The explanation for the absence of amendment to meet E.O. No. 37 requirements could have been either that change was not needed (something that management legitimately could have believed at the time) or that there was insufficient time to change the report that had already been planned (an excuse that would be difficult to support since the report was apparently not to be published for some time.). No one at HESAA has offered the latter explanation.³⁸ So it is plausible that management told the Director of Legal and Governmental Affairs, as she reported to OIG, that the planned report met the requirements of E.O. No. 37.

The then recently appointed Director of Legal and Governmental Affairs told OIG that at the time HESAA executive managers made those statements to her, she had no basis to question their representations. She believed, based on their historical knowledge and experience with the authority, that what they were saying was correct, and she had reason to believe that they would comply with the requirements. Indeed, much of the

³⁷ The evidence gathered during OIG's investigation indicates that HESAA management was prepared to issue its 2008 Annual Report in early June 2008, supporting a conclusion that the 2006-2007 Biannual Report was issued one year earlier in June 2007.

³⁸ The Executive Director's defense to HESAA's failure to publish E.O. No. 37 Annual Reports was that HESAA management was never advised by the then Director of Legal and Governmental Affairs of the requirement to do so. While the evidence demonstrates that he was wrong about this, his error should not then allow him to belatedly assert other excuses, that include knowledge of the requirements, that he did not raise in the first instance.

information that could comply with the E.O. No. 37 requirements had been discussed at the October 17, 2006 Board meeting, including that HESAA's fiscal year 2006 financial report had been prepared and that HESAA staff had been working with Governor representatives to accomplish the State's goals.

It is undisputed that the then Director of Legal and Governmental Affairs had nothing to do with publishing the HESAA 2006-2007 Biannual Report. The former Director of Legal and Governmental Affairs told OIG that the person who was responsible for issuing that 2006-2007 Annual Report was the Senior Director of Client Services who reported to the Chief Operating Officer. Notably, neither HESAA's records nor records provided by the former Director of Legal and Governmental Affairs revealed that the 2007 Governor's Authorities Unit had been critical of HESAA's 2006-2007 Biannual Report as not meeting the requirements of E.O. No. 37 although the executive order required the E.O. No. 37 annual report to be submitted to the Governor's Authorities Unit.³⁹ In addition, the former Director of Legal and Governmental Affairs' December 2009 research purportedly revealed that several authorities combined their E.O. No. 37 annual report with their traditional annual report and that this had been an acceptable format.

As described above, despite the representations that may have been made to the then Director of Legal and Governmental Affairs by HESAA executive management, when published, as stated above, the 2006-2007 Biannual Report was not compliant with

³⁹ This was brought up in 2009 when HESAA management became aware that there had been no E.O. No. 37 compliant HESAA Annual Reports.

E.O. No. 37. There were significant omissions, including the absence of certifications by the Executive Director and/or the Chief Financial Officer that during the preceding year, HESAA had followed all of its standards, procedures, and internal controls, or where such certification was not warranted, a description of the corrective actions taken by HESAA.

According to the former Director of Legal and Governmental Affairs, the Senior Director of Client Services left HESAA in January 2007. The Executive Director replaced him in 2008 with a Director of Communications, whose responsibilities included preparing an annual report.

The former Director of Legal and Governmental Affairs told OIG that after E.O. No. 37 was issued, HESAA's focus, including her own, was on the new procurement requirements of the executive order. She was not aware of any internal discussions, meetings, or a strategy developed regarding fulfilling the requirement of an E.O. No. 37 annual report (until December 2009). As far as she knew, if senior management at HESAA had considered issuing an E.O. No. 37 compliant annual report that was different from the traditional annual report HESAA had been issuing, management had not involved her in the discussion. That may have been because the then Director of Legal and Governmental Affairs was not responsible for issuing the report, or because for any number of possible reasons⁴⁰, there simply was no intent to change the report.

⁴⁰ One likely explanation is that the responsible manager for the former annual report, the Chief Operating Officer, or the new Director of Communications, had either lost sight of the E.O. No. 37 requirements or never took ownership of them as part of her responsibility. The record does not reveal that the requirement

A review of a June 5, 2008 e-mail from the Executive Director to the Chief Operating Officer, the Chief Financial Officer, and the then Director of Legal and Governmental Affairs⁴¹ (the officers were addressed in this order in the e-mail, perhaps showing some indication of their importance to this issue) indicates that HESAA had been planning to issue another “Annual Report” in June 2008 but decided to wait until after July 1, 2008.⁴² The substance of the e-mail was that the Executive Director was asking his three executives whether they saw any problem with holding off “sending out” the annual report until after July 1, 2008. This would appear to indicate that the annual report was ready or near ready to be issued before July 1, 2008. Otherwise, he would have no reason to ask the question.

The Executive Director explained to his staff that he was asking the question of them because he wanted to hold off issuing the annual report until after the State budget was finalized. The Director of Legal and Governmental Affairs responded that he should “hold things off stay under the radar [sic]”. The former Director of Legal and Governmental Affairs told OIG that she had no responsibility for publishing the annual report, but she understood that she was asked this question by the Executive Director in her capacity as head of HESAA’s Governmental Affairs Department. Her response to the

to publish a separate E.O. No. 37 annual report was assigned to anyone until December 2009 when it was assigned to the Director of Legal and Governmental Affairs.

⁴¹ Although the Director of Legal and Governmental Affairs had provided OIG access to her e-mail files, OIG was given access to this e-mail by the Chief Compliance Officer at the direction of the Executive Director.

⁴² HESAA has carried a substantial reserve each year. The e-mail indicates that the Executive Director was concerned that if he published an Annual Report before July 1, 2008, the date the annual budget was finalized, showing HESAA’s substantial reserves, it might attract attention of the Legislature and the Governor’s Office, and they might “mistakenly assume that HESAA [could] contribute funds to balance the budget.”

Executive Director was that delaying the report would not cause problems from that perspective.

It may have been reasonable for the then Director of Legal and Governmental Affairs to assume that HESAA was about to issue a 2008 Annual Report. However, as stated above, the Director of Communications did not issue an annual report – E.O. No. 37 compliant or otherwise – that year or the next year, and neither did anyone else at HESAA.

In late 2009, HESAA’s Executive Director appeared to be unaware that no annual reports, E.O. No. 37 compliant or otherwise, had been issued since the 2006-2007 Biannual Report. In December 2009, he was asked to provide the incoming Governor’s Transition Team with copies of E.O. No. 37 annual reports for 2006, 2007, 2008, and 2009, among other documents. The Executive Director appeared to believe that there were E.O. No. 37 annual reports, and he assigned the Chief Financial Officer the job of providing him with copies of those E.O. No. 37 annual reports.

Instead of telling the Executive Director that there were no E.O. No. 37 annual reports ever produced or in fact no other annual reports produced since 2007, the Chief Financial Officer did something confounding. He responded to the Executive Director in a December 7, 2009 e-mail saying, “EO 37 reports went through Legal even though they worked with [the Controller] and I.” From the evidence available to OIG, his response

appears to be completely baseless and misleading on several levels:

- (1) HESAA had never issued an E.O. No. 37 annual report.
- (2) Therefore, none “went through Legal”.
- (3) If by “they” he meant Legal, the Chief Financial Officer had to be aware that Legal had not worked on any annual reports with the Chief Financial Officer.
- (4) HESAA had not issued *any* annual report since the 2006-2007 Biannual Report. The Chief Financial Officer had provided financial information to the Director of Client Services for the 2006-2007 Biannual Report, but that report had not been issued “through Legal”. He may have provided financial information to the Communications Officer for the almost issued 2008 Annual Report, but that report also did not go through Legal and indeed was never issued.

If the Chief Financial Officer did not know any or all of this information at the time he wrote to the Executive Director, it would have been a simple matter for him to inquire of the Chief Operating Officer, the Chief Communications Officer, or the then Director of Legal and Governmental Affairs in the hours before he responded. Instead he responded in a way that led the Executive Director to understand that (1) HESAA had been issuing E.O. No. 37 compliant annual reports; (2) that the Chief Financial Officer was aware of them because he worked on them; and, (3) that somehow Legal had issued them when OIG has uncovered no evidence that Legal was responsible for issuing the reports.

When asked by OIG about this e-mail, the Chief Financial Officer offered no rational explanation for sending it. The Chief Financial Officer acknowledged to OIG that no E.O. No. 37 compliant reports had been issued. He told OIG that in the past, he had worked on significant parts of the pre-E.O. No. 37 annual reports. That does not explain his statement to the Executive Director that the reports went through Legal, since those annual reports had nothing to do with and did not “go through” Legal. The Chief Financial Officer then told OIG that if E.O. No. 37 annual reports had been issued by HESAA, they *would have been issued* through the Legal Department, but he offered no support for this assertion.

OIG asked the Chief Financial Officer why he did not provide the Director of Legal and Governmental Affairs a copy of this e-mail when he sent it to the Executive Director. He told OIG that it was not his habit to copy other staff on his communications to the Executive Director even when the staff person was mentioned in the e-mail. It is difficult to believe that he would routinely discuss other top managers with the Executive Director in e-mails and not copy those managers in the e-mail especially on documents as simple as this e-mail was – if its contents were true.

The Executive Director read the Chief Financial Officer’s e-mail to mean that there had been E.O. No. 37 compliant annual reports issued by HESAA and that they had been issued by or through the Legal Department. He asked the then Director of Legal and Governmental Affairs for the reports. The now former Director of Legal and Governmental Affairs was asked what occurred after the Chief Financial Officer’s

December 7, 2009 e-mail to the Executive Director indicating that E.O. No. 37 reports “went through Legal”. The now former Director of Legal and Governmental Affairs told OIG that when the Chief Financial Officer sent his e-mail and the Executive Director made his initial request that she provide the reports, she had been out of the office attending a one-day training and then the next day she was home sick. She came into the office for an hour the second day to begin to prepare a response to the Executive Director’s requests for documents for the Governor’s Transition Team, of which the requests for annual reports was only one. She saw that no annual reports had been prepared since the 2006-2007 Biannual Report.

In her initial responding e-mail to the Executive Director, the then Director of Legal and Governmental Affairs wrote, “EO 37 refers to annual reports. As I recall, annual reports were [the Chief Operating Officer]’s responsibility until [the Communications Officer] joined the executive staff.” In a follow-up e-mail less than an hour later, the then Director of Legal and Governmental Affairs provided the Executive Director with the paragraph of E.O. No. 37 pertaining to annual reports; told him that the most recent annual report was for 2006-2007; that she understood that there had been a decision to publish biannual reports for cost savings; and that HESAA could and still had time to publish a 2008-2009 Annual Report because information was available.

The Executive Director apparently believed the Chief Financial Officer and e-mailed the then Director of Legal and Governmental Affairs asking if Legal had ever provided an annual report in the past. He further wrote that he was unaware of the E.O.

No. 37 requirements for an annual report. The then Director of Legal and Governmental Affairs responded by e-mail from home that she had made a presentation to the full Board on the executive order; and but that subsequently, HESAA's focus was on the procurement procedures and guidelines that she worked on with the Chief Financial Officer. She said that she had nothing to do with the decision to issue biannual reports, but that the Governor's Authorities Unit had accepted HESAA's submission of the 2006-2007 Biannual Report without comment. In an e-mail, the Executive Director asked the then Director of Legal and Governmental Affairs to compile documents that would meet the requirements of the E.O. No. 37 annual report, and she began doing so immediately.

The former Director of Legal and Governmental Affairs told OIG that when she returned to the office, the next day, the Chief Financial Officer appeared to her to be realizing for the first time that HESAA had not been issuing annual reports of any kind for several years. He appeared to be sincerely apologizing to her for getting her involved in the discussion about the production of annual reports when she had had no responsibility for them.

The Executive Director provided OIG with copies of the documents the then Director of Legal and Governmental Affairs supplied to him to form the basis of a 2008-2009 Annual Report. They included a description of HESAA's contribution toward New Jersey's economic growth through grants, scholarships, and students loans in 2008; HESAA's annual internal control self-assessments (discussed earlier in this report); and the financial audits prepared by HESAA's external auditor. The Executive Director

assigned the Chief Compliance Officer to prepare a summary of the information in lieu of an annual report.

It was at this point that the Executive Director provided an analysis of the requirement of the annual reports to the Director of Communications, the Chief Operating Officer, the Chief Compliance officer, the Chief Financial Officer, and the then Director of Legal and Governmental Affairs. He told them that going forward on an annual basis, HESAA would provide the traditional annual report for which the Director of Communications would be responsible, and the E.O. No. 37 annual report, for which the then Director of Legal and Governmental Affairs would be responsible. The analysis pointed out the differences in the two annual reports. The evidence gathered by OIG indicates that this was the first time that the Executive Director assigned distinct responsibility to a member of his staff for the E.O. No. 37 annual report. Prior to this point, if the responsibility resided anywhere, it was with those responsible for the traditional annual report. However, the Executive Director had failed to make that assignment clear.

The evidence gathered during OIG's investigation indicates that several top managers bear responsibility for the failure of HESAA to issue an E.O. No. 37 compliant annual report. Initially responsible were the Chief Operating Officer and the Director of Client Services, who were advised of the additional requirements of the annual report under E.O. No. 37, and did not incorporate them into the 2006-2007 Biannual Report.

The Chief Operating Officer and the Communications Officer were responsible in that they did not assure that there was a subsequent annual report or biannual report, let alone a report that was E.O. No. 37 compliant. Both the Executive Director and the Chief Financial Officer were made aware of the requirement that they certify to certain compliance matters in the annual report, and both of them were responsible for failing to assure that an annual report was issued containing those certifications.

The Executive Director, the Chief Operating Officer, and the Chief Financial Officer were made aware in June 2008 that HESAA had an annual report that appeared to be ready to be published but apparently did not go out. Both the Executive Director and the Chief Financial Officer would have had a significant role in the production of that report: the Executive Director making a “Statement” as well as certifying to compliance with procedures (if the report was E.O. No. 37 compliant) and the Chief Financial Officer providing financial information and certifying to compliance with procedures (if the report was E.O. No. 37 compliant). Neither of them assured that the report was published. Neither the Chief Operating Officer nor the Communications Officer, both of whom appeared to have a responsibility for annual reports, assured that a 2008 or 2009 annual report was published.

The Executive Director has ultimate responsibility for the failure of HESAA to assure that the 2006-2007 Biannual Report was E.O. No. 37 compliant or to provide a 2008 or 2009 E.O. No. 37 compliant report. He had been made aware of the E.O. No. 37 requirements for an annual report on several occasions, and he never took steps until

December 2009 to put processes in place to assure those requirements were met. It was his decision to hold off the 2008 Annual Report to protect his reserves, but he did not assure that the report was published thereafter.

At some point, the then Director of Legal and Governmental Affairs bore responsibility for the failure of HESAA to issue E.O. No. 37 compliant annual reports. She had no responsibility for the traditional annual reports, and she met her responsibility to inform executive management of the requirements of the E.O. No. 37 annual report. The evidence indicates that she was assured by executive management in 2006 that the 2006-2007 Biannual Report would be E.O. No. 37 compliant. Although it was not, she could have reasonably relied on the promises of management and the lack of negative reaction from the Governor's Authorities Unit at the time to conclude that it was either compliant or that there was leeway in the time allowed to bring the annual reports up to the executive order requirements.

In 2008, the then Director of Legal and Governmental Affairs was provided with a basis to believe that HESAA was about to issue a 2008 Annual Report. Since it was her responsibility to assure compliance with executive orders, this would have been a good time for her to intervene to assure that the upcoming annual report was E.O. No. 37 compliant, especially since there was a new Communications Officer. In addition, it should also have come to her attention that the report was not issued. She did not assure that an E.O. No. 37 compliant annual report was issued by HESAA in either 2008 or 2009.

2. Limited Compliance with E.O. No. 41 Certifications

Executive Order No. 41 (Governor Richard J. Codey 2005) requires each Executive Director to annually certify in writing to the Director of the Governor's Authorities Unit that the authority has met the requirements of several specified earlier issued executive orders and that each member of the authority has met required initial and follow-up training in ethics, proper fiscal practices, responsibility of authority members in the employment of authority staff, oversight of procurement and fiscal operations, and approval of contracts. The previously issued executive orders with which E.O. No. 41 required the Executive Director to certify compliance are E.O. No. 10 (McGreevey 2002); E.O. No. 122 (McGreevey 2002); and E.O. No. 134 (McGreevey 2004), each described in detail below. E.O. No. 41 also states that failure of the member, officer, or employee to comply with the certification requirements of the E.O. No. 41 "shall constitute good cause for his or her removal from office or employment." As described below, the evidence gathered by OIG, indicates that HESAA's Executive Director only partially complied with the certification requirements of E.O. No. 41 and the former Director of Legal and Governmental Affairs failed to assure the Executive Director's full compliance with E.O. No. 41 certification requirements.⁴³

⁴³ The Executive Director of HESAA told OIG that he did not maintain copies of the certifications and that they were maintained in the Legal Department. He believed that the former Director of Legal and Governmental Affairs may have removed documents from the Legal Department when she left HESAA.

The former Director of Legal and Governmental Affairs gave OIG access to her electronic files and provided additional documents to OIG as well. It was in her best interest to provide as much evidence of compliance with the certification requirement as she could since it was her admitted responsibility to assure compliance. She told OIG that she had provided OIG with all of the certification letters she could find.

a. Certifications of Compliance with Ethics Training Requirements

Paragraph 2 of E.O. No. 41 requires:

The Governor's Authorities Unit, in conjunction with the Executive Commission on Ethical Standards⁴⁴ and the Inspector General, shall hold several training sessions for members of all State authorities in government ethics and, where appropriate, proper fiscal practices, including specific training in the requirements of the Federal Sarbanes Oxley Act, as related to their duties as authority members. Such training will include the responsibility of authority members in the employment of authority staff, oversight of procurement and fiscal operations and approval of contracts. As of January 1, 2006 and annually thereafter, the Executive Director of each authority shall certify in writing to the Director of the Governor's Authorities Unit that each member of the authority has completed such training. Such training will be updated annually at the direction of the Director of the Governor's Authorities Unit to include such Federal mandates as directed by Congress and such State mandates as directed by the Office of the Inspector General.

OIG reviewed a letter in HESAA's files from the HESAA Executive Director to the then Director of the Governor's Authorities Unit dated June 29, 2005, stating: "HESAA will forward a certification regarding section 2 of E.O. 41 once each member of HESAA has completed training in government ethics and proper fiscal practices." In November 2005, the Governor's Authorities Unit, the Executive Commission on Ethical Standards, and OIG provided Ethics and Fiscal Controls Training as required by E.O. No. 41. On December 13, 2005, the then Director of the Governor's Authorities Unit wrote to HESAA's Executive Director advising him that Governor's Authorities Unit records showed that he and seven HESAA Board members had attended the training and

⁴⁴ The Executive Commission on Ethical Standards has been renamed the State Ethics Commission. N.J.S.A. 52:13D-21.

reminded him that he, as HESAA's Executive Director, must send the required written certification no later than January 1, 2006 that each Board Member has completed the required training.

OIG found a December 15, 2005 letter in HESAA's files from the Executive Director to the then Director of the Governor's Authorities Unit certifying that the Executive Director and all but five HESAA Board members had attended the mandatory ethics and fiscal controls training provided in November 2005. The letter explains that three of the HESAA Board members were unable to attend the training because of unavoidable scheduling conflicts but wanted to attend a makeup training in order to remain on HESAA's Board. The other two Board members did not attend because they would no longer be serving on HESAA's Board.

The letter in HESAA's file is on HESAA letterhead and has a handwritten notation on it (perhaps indicating that it required re-issuing). It does not bear a copy of the Executive Director's signature. Therefore, the evidence is not conclusive that the certification was finalized and provided to the Governor's Authorities Unit as required by E.O. No. 41. A review of HESAA's files did not reveal further evidence that either the Executive Director or HESAA's Legal Department, which at the time was led by a predecessor of the former Director of Legal and Governmental Affairs, made certain that the three remaining Board members completed makeup mandatory ethics or fiscal control training or that a completed certification was sent.

HESAA's former Director of Legal and Governmental Affairs provided OIG with additional evidence in the form of copies of letters to the Governor's Authorities Unit containing the Executive Director's certification that Board members had completed ethics training. In a letter dated November 12, 2008, the HESAA Executive Director certified that Board members had attended training in May 2007 and completed on-line training. In that same letter, he certified that three Board members who had not attended the May 2007 in-person training had attended an in-person training in October 2008. In a letter dated November 19, 2009, the HESAA Executive Director subsequently certified that all Board members had completed on-line training for 2009.⁴⁵

During OIG's review of HESAA, the Executive Director and then current Director of the Legal Department told OIG that HESAA's Legal Department ensured that after the initial training required by E.O. No. 41, all Board members and employees receive annual ethics training as required by E.O. No. 41. Therefore, the evidence indicates that from at least January 1, 2006 and through 2009, the HESAA Executive Director was in compliance with this E.O. No. 41 Paragraph 2 certification requirement.

⁴⁵ OIG made numerous requests of both HESAA management and HESAA's former Director of Legal and Governmental Affairs, who served from May 2006 through December 2009, for certifications demonstrating compliance with the Executive Order. As noted *supra*, some documents were provided by HESAA management and HESAA's former Director of Legal and Governmental Affairs during OIG's review. A few more were supplied by HESAA's former Director of Legal and Governmental Affairs after OIG had supplied her with a copy of OIG's draft report indicating that she had failed to assure compliance with executive orders, one of her admitted duties. Apparently, she made an additional search of her files and found a few more documents. She told OIG that she could find no further documents relevant to the E.O. No. 41 certification requirement.

b. Certifications of Compliance with requirements of E.O. No.10

Paragraph 5 of E.O. No. 41 requires:

Within 30 days of the date of this Executive Order and annually as of May 15 thereafter, the Executive Director of an authority shall certify in writing to the Director of the Governor's Authorities Unit that all authority members have met the requirements of Executive Order No. 10.

Executive Order No. 10 (McGreevey 2002) required that the executive or administrative head and assistant heads of any independent authority annually file sworn and notarized financial disclosure statements that they do not retain an interest in a closely held corporation, partnership, sole proprietorship, or similar business entity doing business with any federal, state, interstate, or local government entity, and that they have completed an annual review of the New Jersey Conflicts of Interest Law and the Codes of Ethics.

On June 29, 2005, HESAA's Executive Director forwarded his certification to the then Director of the Governor's Authorities Unit that he had filed his sworn and certified financial disclosure statement indicating that he did not have an ownership in a privately held business and that he had attended an annual training session regarding the requirements of the Conflicts of Interests Law and the Code of Ethics.

Executive Order No. 1 (Corzine 2006) expanded E.O. No. 10 to include members of the authority boards, including HESAA's Board. On May 18, 2006, HESAA's Executive Director forwarded a letter certifying to the Governor's Authorities Unit that

he and all members of the HESAA Board had filed their Financial Disclosure Statements. It appears that as of May 2006, the HESAA Executive Director was in compliance with Paragraph 5 of E.O. No. 41.⁴⁶

The former Director of HESAA's Department of Legal and Government Affairs told OIG that each year, HESAA's Department of Legal and Governmental Affairs submitted the list of HESAA required financial disclosure statement filers to the State Ethics Commission and those financial disclosure statements were completed and filed on line. Based upon OIG's review of HESAA's financial disclosure statements, it appears that the Executive Director filed for 2006 through 2009 as did the required Board members and employees.

However, OIG's review of HESAA's files did not reveal evidence that after May 2006, HESAA's Executive Director complied with the E.O. No. 41 Paragraph 5 requirement that he certify to the Governor's Authorities Unit by May 15 of each year that the required HESAA filers had complied with the annual requirements. Neither the Executive Director nor the former HESAA Director of Legal and Governmental Affairs could provide OIG with proof of any of those certifications having been made to the Governor's Authorities Unit as of May 15, 2007 through May 15, 2009. Therefore, the evidence indicates that the HESAA Executive Director was not in compliance with the certification requirement of Paragraph 10 of E.O. No. 41 between 2007 and 2009.

⁴⁶ This letter was provided to OIG by HESAA's former Director of Legal and Governmental Affairs.

c. Certifications of Compliance with requirements of E.O. No. 122

Paragraph 6 of E.O. No. 41 requires that:

Within 45 days of the date of this Executive Order and annually as of January 1 thereafter, each Executive Director shall certify in writing to the Director of the Governor's Authorities Unit that the authority has met the requirements of Executive Order No. 122, which includes the requirement that every authority covered by that Executive Order have an Audit Committee that serves independently of the management of the authority in soliciting, procuring and overseeing the function of the independent auditor and ensuring that the relationship with such auditor is the function of the Board and not the management of the authority.

On June 29, 2005, HESAA's Executive Director sent a letter to the then Governor's Authorities Unit certifying that HESAA has met the requirements of E.O. No. 122 (McGreevey 2002). In the letter, he certified that HESAA has an Audit Committee that serves independently of HESAA management in soliciting, procuring, and overseeing the function of the independent auditor, and ensuring that the relationship with the auditor is with HESAA's Board and not HESAA management.

OIG's review of HESAA indicated that HESAA did maintain an Audit Committee although, as indicated earlier in this report, there was a period of time that HESAA's Chief Financial Officer was attending Audit Committee meetings and providing it financial expertise since no public member of the Board had financial expertise. HESAA has been partially audited by outside certified public accounting firms and conducts a yearly review of internal controls using the Treasury self-assessment process as described above, and that process has been improved recently as well.

Furthermore, HESAA management signs a financial representation letter provided to the outside auditors.

OIG's review of HESAA's file did not reveal that after the initial certification in June 2005 through January 2008, HESAA's Executive Director certified to the Governor's Authorities Unit that HESAA had met the requirements of E.O. No. 122. OIG did find an e-mail from the Governor's Authorities Unit dated January 29, 2009, to the HESAA Executive Director reminding him that certifications that were due on January 1, 2009 had not been submitted. The Executive Director copied the e-mail to the then Director of Legal and Governmental Affairs inquiring whether the required certifications had been sent. In response, the then Director of Legal and Governmental Affairs provided the Executive Director with a draft letter dated January 30, 2009 for his approval and certification for his signature to the Governor's Authorities Unit that E.O. No. 122 requirements had been met. The former Director of Legal and Governmental Affairs provided OIG with a signed copy of the document.

Neither the Executive Director nor the former Director of Legal and Governmental Affairs have supplied OIG with additional certifications of compliance with Executive Order No. 122 required by paragraph 6 of E.O. No. 41. Thus, the evidence gathered during OIG's review indicates that the HESAA's Executive Director was not in compliance with the certification requirements of Paragraph 6 of E.O. No. 41 at least from January 2006 through January 2008.⁴⁷

⁴⁷ At the time of OIG's review, the January 1, 2010 certification was overdue and OIG did not find evidence that it had been filed. However, the Executive Director could have filed it after OIG's review.

d. Certification of Compliance with E.O. No. 134

Paragraph 7 of Executive Order No. 41 requires:

Within 60 days of this Executive Order and annually as of January 1 thereafter, each Executive Director shall certify in writing to the Director of the Governor's Authorities Unit that the authority has met the requirements of Executive Order No. 134, which includes the requirement that every authority comply with procedures designed to limit or ban campaign contributions by vendors doing business with the State or the authority.

In his June 29, 2005 correspondence to the Governor's Authorities Unit, HESAA's Executive Director certified that HESAA had met the requirements of E.O. No. 134 and that HESAA was in compliance with State procedures designed to limit or ban campaign contributions by vendors doing business with HESAA. Therefore, as of June 2005, the Executive Director was in compliance with the certification requirements of Paragraph 7 of E.O. No. 41.

HESAA has included "Pay to Play" language in their contracts, and as described above, after OIG had pointed out the deficiencies in HESAA's contract language, HESAA's Legal Department corrected its contracts to accurately represent the law. However, OIG did not find evidence that after the June 2005 letter through 2008, the Executive Director met the certification requirements of Paragraph 7 of E.O. No. 41.

As described above, the January 29, 2009 e-mail correspondence from the Governor's Authorities Unit to the HESAA Executive Director reminded him that his January 1, 2009 certifications, of which this was one, were overdue. He communicated with his then Director of Legal and Governmental Affairs, she prepared a draft letter including this certification for his signature that he approved, and the former Director of Legal and Governmental Affairs provided OIG with a copy of the signed letter indicating that it had been forwarded to the Governor's Authorities Unit.

Neither the Executive Director nor the former Director of Legal and Governmental Affairs provided OIG with evidence that the required certifications for other years were provided to the Governor's Authorities Unit. Therefore, the evidence indicates that HESAA's Executive Director was not in compliance with the certification requirements of Paragraph 7 of E.O. No. 41 between 2006 and through 2008.⁴⁸

C. Oversight of External Relationships

HESAA's Audit and Quality Assurance Department (AQAD) is charged with conducting performance reviews of the various external entities with whom HESAA has relationships. These entities include conduits for HESAA loan distributions, scholastic institutions, collection law firms that HESAA uses to assist in collecting delinquent loans, and lenders.

⁴⁸ At the time of OIG's review, OIG did not find evidence that the Executive Director had filed the January 1, 2010 certification, but the Executive Director could have filed the certification after OIG's review.

1. TAG Management Non-Compliance Discovered

HESAA has uncovered inappropriate conduct by those with whom it has relationships. While conducting a manual review of records of a New Jersey institution of higher education, it was discovered that the institution had improperly obtained TAG grants for some of its students. In order to obtain and continue to be eligible for a grant, a student must remain enrolled in school, and the school must certify to the student's enrollment for the required period. In this case, it was determined that the school had certified to an incorrect roster that contained the names of students who were no longer enrolled at the institution.

By extrapolation from a sample of relevant data, AQAD concluded that HESAA was owed \$1.2 million by the institution for a two year period. When HESAA notified the institution of its findings, the institution returned \$1.2 million to HESAA without objection.

HESAA told OIG that after its original finding, it monitored the institution with respect to the TAG grant program, and provided TAG grants for this institution on a "reimbursement only" basis, requiring documents verifying enrollment for the full term be provided to HESAA before Grant money was paid to the institution. According to HESAA management, this institution will be monitored in this way until the institution satisfactorily demonstrates that appropriate corrective actions concerning the award of TAG grants have been implemented and were being correctly applied. HESAA advised

OIG that this was the only institution of higher education in New Jersey for which a “reimbursement only” process had been established.

AQAD should be complimented for uncovering the institution’s improper acquisition of HESAA funds through false grant certifications. On the other hand, OIG concludes that AQAD missed an opportunity by acting on its own and taking too narrow a view of the scope of the institution’s conduct. AQAD could have reached a more definitive understanding of the institution’s conduct both in terms of the amount of funds improperly obtained; the period of time the institution had been operating in this fashion; and in placing accountability on individuals at the institution who may have acted intentionally or merely negligently, but in either case should be prevented from acting in improperly in this program or other programs in the future. Finally, AQAD could have deterred potential wrongdoers at all of HESAA’s 55 institutions having far more impact than requiring estimated restitution from the institution.

AQAD noted in its report to the Board that this particular incident could have had a potentially adverse impact on student financial aid programs. While HESAA subsequently reviewed other similarly situated institutions, and in doing so obtained reimbursements owed by the institutions, it did not fully expand its review of the institution at issue to examine its activities during other years.

Although HESAA has authority to review up to three years’ of the institutions transactions, it reviewed data for only two years, citing limitations due to staff shortages.

In addition, AQAD used only partial data and estimated the amount of improperly obtained grants rather than understanding the actual amount of those grants. If AQAD had sought help from a criminal or civil investigating agency, it could have added more years to the look back period. Given the severity of the findings, the better course would have been to complete audits for all available years to determine whether the improper practice of obtaining aid for ineligible students or other wrongdoing or errors that could have resulted in undue and improper funding to the institution had occurred during those years, and to use actual data rather than an estimate. After reviewing OIG's draft report, HESAA provided documentation to OIG demonstrating that the institution continued the pattern of conduct even during the "reimbursement only" years.

In response to OIG's suggestion that HESAA seek the expertise of other State entities in reviewing matters of this magnitude to determine whether further action was warranted, for example the Division of Criminal Justice in the Attorney General's Office, HESAA's management said that it was not necessary because AQAD staff would recognize signs of fraud and take appropriate steps, such as referral to the Division of Criminal Justice. However, in this case, AQAD staff did not view the size of the estimated overpayment caused by the institution's conduct; the institution's pattern of conduct over at least two years; the institution's apparent financial difficulties (providing a potential motivation for deliberate over-calculation of students eligible for grants); and the failure of the institution to offer any resistance to HESAA's estimated payback requirement (that could have indicated that the actual over-calculation by the institution was much more than the estimate) as signs of potential intentional fraudulent activity by

the institution. Therefore, AQAD did not request the assistance of other State entities such as the Division of Criminal Justice, to assure that problems detected at this institution were fully investigated and resolved. In response to OIG's concerns that AQAD had missed an opportunity, HESAA management assured OIG that its new Compliance Officer, a former prosecutor, would provide more internal guidance about when audits signal that further inquiry is required.

2. Review of Collection Law Firms

When a student loan recipient defaults or is delinquent in making payments on a FFELP or NJCLASS loan, HESAA attempts to collect the overdue payments. If and when HESAA determines that its efforts are unlikely to be successful (passage of time, borrower has relocated from New Jersey), HESAA contracts with one of several pre-qualified law firms specializing in debt collection. The firms are asked to locate property of the delinquent borrower; if possible, to place a lien on the property; and to continue to pursue the delinquent account. According to the contract between HESAA and the law firm, the firm is paid a percentage of the amount collected. As of the time of OIG's most recent review, the firms were pursuing approximately 17,000 delinquent or defaulted accounts on HESAA's behalf.

AQAD had conducted compliance reviews of the law firms for the years 2001 through 2003, and found several deficiencies including that several law firms had incorrectly calculated the interest due on delinquent or defaulted loans. As a consequence, those firms had either incorrectly reported to HESAA the amount of

interest owed by the borrower on a delinquent or defaulted loan or had collected the wrong amount of interest owed when collecting defaulted or delinquent loans. These errors were brought to the attention of the law firms. However, neither HESAA nor AQAD verified other account information supplied by these and other collection firms, such as account balances and interest owed on other loans.

AQAD did conduct a second round of compliance reviews of all the collection law firms, primarily for the years 2004 and 2005. HESAA management told OIG that this review revealed no systemic compliance issues. However, many problems that were found during the first round of law firm reviews (for the years 2001-2003), including inaccurate payment records and reports, lack of notification regarding account changes, and untimely collection activity were found.

After reviewing OIG's draft report suggesting that the law firms were either not properly performing under the contracts or not responsive to HESAA's corrective action requests, HESAA management explained to OIG that some of the problems may have continued because HESAA had not published its written report of findings before conducting the second round of compliance reviews. HESAA acknowledged that it did have an exit interview with each of the firms during which the findings were discussed with the firms. HESAA further acknowledged that the firms should have corrected the deficiencies going forward before the second review to the extent that the errors were not dependent upon past errors. However, the auditors at the exit interviews may not have had sufficient detail regarding how many years back the errors were made and the

different interest rates applied during those years that the firms would be required to correct. Thus, HESAA management conceded that it may not have been the fault of the firms but the timeliness of HESAA's audit reports that resulted in the additional similar findings.

Other observations resulting from OIG's review in HESAA's processes for control and oversight of collection law firms were discussed with HESAA management. HESAA management explained that it would be difficult to eliminate the use of collection firms. Many delinquent borrowers no longer reside in New Jersey requiring HESAA to retain out of State law firms to work on those cases. Rather than hire more staff attorneys, HESAA management believes that the better course is for HESAA to better manage the firms. In that regard, HESAA had implemented controls such as site visits and annual meetings with the firms, along with performance reviews to try to eliminate the recurring problems. In addition, HESAA management prefers that the law firms keep the administrative records associated with the debt collection, since this would add a substantial amount of record keeping to HESAA's responsibility.

HESAA management advised OIG that use of outside collection firms does not result in a loss to HESAA since HESAA is guaranteed payment, and that ultimately, HESAA receives what it is owed on these loans. However, HESAA management represented to OIG that since OIG's review, HESAA no longer permits the law firms to retain fees out of the overdue payments and defaulted loan funds they collect before turning over the funds collected to HESAA. The law firms are now required to submit

all of the collected funds to HESAA; fee calculations are verified; and fees are then remitted to the firms. This process provides HESAA an opportunity to correct the incorrect interest calculations and other deficiencies in the law firms' performance before the firms are paid.

HESAA advised OIG that it is not uncommon for overdue accounts transferred to collection firms to remain in control of these firms but uncollected for a number of years. HESAA's contracts with collection firms do not limit the time the firms may hold an account without completing a collection before return of the files to HESAA. OIG expressed to HESAA that the contracts did not appear to contain incentives for the law firms to resolve older accounts. HESAA management responded that it could recall an account from a law firm at any time, but the older accounts were more difficult to collect and therefore, HESAA often chose to let them remain with the law firms. HESAA also believed that there was the added incentive for the firms to look at older accounts because often a former student's earning potential and thus, the collectability of the loan, increases proportionately as the number of years out of school increases.

The procedure for the deposit of funds collected by law firms may be modified to remove opportunities for loss. Law firms receive the funds, book them in their records, and then deposit them in a "lockbox" account established and controlled by HESAA. This process allows a step between the debtor and HESAA, and presents an opportunity for a badly motivated person at the law firm to access the funds. If the loan payments are mailed directly to the HESAA lockbox, HESAA can be assured of the amounts received,

book the amounts, notify the law firms of payments made on their accounts, and of the amounts due to the firms, even photocopying the checks before cashing.

In response to OIG's draft report, HESAA advised that it does agree that direct deposit of these funds would ideally be preferable; however, it suggested that implementation may be impracticable given the complexities associated with attorneys' receipt of funds from county sheriffs, which may include multiple debtors unrelated to HESAA. HESAA noted that attorneys must deposit these co-mingled funds into their trust accounts and separate those funds that are to be directed to HESAA once the funds have cleared. HESAA management also noted that OIG's suggestion would also shift additional record keeping from the law firms to HESAA. The small added benefit is not warranted by the additional burden this would impose on HESAA.

The performance clause in a contract between HESAA and a collection law firm resulted in significant litigation fees. OIG recommended that the contract language be examined by the Attorney General to determine if this clause and other clauses, including a clause limiting the length of time a firm may hold a file without any collection activity or collection of past due amounts, may need re-writing to avoid future disputes. In response to OIG's draft report, HESAA advised that the initial contract was prepared in consultation with the Attorney General but that subsequent to OIG's initial review, HESAA's contracts with law firms were revised by HESAA to eliminate future attorney lien contests. The Attorney General reviewed the revised contracts.

3. Limited Audits of Schools' Grants and Scholarships

There are currently about 55 institutions of higher education that provide student aid utilizing funds supplied by HESAA. Although at the time of OIG's review, HESAA's plan was to complete three or four reviews of the handling of HESAA funds by these institutions each year, only four or five of these reviews had been completed in the four years encompassing OIG's initial review of HESAA. Moreover, HESAA told OIG that in the two-and-one-half years between the start of OIG's initial review of HESAA and OIG's follow-up review, HESAA had begun only two reviews. One had been completed resulting in a minimal recovery of funds, and the second review was still ongoing. Even if the planned rate of three or four reviews a year was fully completed in a timely manner, it would take well over 10 years to complete reviews of all the schools that receive State student aid through HESAA.

OIG had recommended that HESAA implement programmatic methods to accomplish wider results. HESAA's management told OIG that HESAA recognized that HESAA should complete timelier reviews of the institutions' use of funds to ensure the recovery of any ineligible awards.

In response to OIG's draft report, HESAA advised that from March 2003 through May 2009, AQAD had conducted 15 management reviews of postsecondary institutions and Outstanding Scholar Recruitment Program (OSRP) reviews at all 15 participating institutions. It also advised that, during this same period, it conducted two rounds of reviews of eight collection law firms. HESAA further advised that since 2003, the

AQAD audits of TAG and OSRP resulted in recoveries totaling over \$3.8 million.

In addition to these methodologies, OIG recommended that HESAA consider a risk assessment, and first schedule reviews of institutions known to HESAA as having high noncompliance rates. HESAA Management agreed and advised in response to OIG's draft report that, for at least the last eight years, it has consistently utilized procedures to identify institutions that do not comply with applicable regulations or program procedures as primary selection criteria for institutional review. OIG recommends that, in addition, HESAA should consider recommending that institutions that have been found in non-compliance hire an independent auditor to specifically monitor compliance with state grants and aid programs to report to HESAA.

HESAA management told OIG that HESAA has insufficient audit staff to conduct the number of external reviews it should. HESAA management recently told OIG that its audit staffing has remained largely static due solely to the State hiring freeze, since HESAA has a large reserve fund that could be used to hire auditors. Going back through at least 2003, AQAD staff consisted of four auditors responsible for external audits and reviews of the entities. In 2006, HESAA had requested from State authorities an exception to the hiring freeze to allow HESAA to fill a vacant auditor position.⁴⁹ HESAA management told OIG that its request was denied because of the commitment of administrations to reduce the number of government employees.

⁴⁹ At the time, HESAA represented that the position would be 100% federally funded out of federal operating revenue including payroll, pension costs, and/or fringe benefits and would operate as part of a team that "would locate improperly disbursed State funds for utilizations towards State grants and scholarship programs. HESAA management has requested to fill two auditor positions in 2009, that it considers "critical vacancies".

In discussing the hiring freeze, HESAA recognized that the hiring freeze is in force State wide and is not likely to be lifted for some time to come. OIG recommended that HESAA consider utilizing its reserve funds to retain expert consultants to conduct the audits, particularly since HESAA believes that the audits will result in the return of improperly awarded funds. OIG also recommends that HESAA consider using its reserve funds to conduct a management/performance review of its current organizational structure and staff assignments for efficiency and optimum use of staff's capabilities. HESAA may be able to accomplish its goals without adding new full-time employees by re-defining positions and re-assigning current employees.

4. Automated Management Controls

In addition to its reviews of outside entities, HESAA has several management controls to identify potential problem areas. For instance, HESAA manually tracks and monitors financial data regarding schools' financial aid activity. This tracking mechanism is manually updated on a periodic basis and is designed to identify aberrations in the data reported by the schools.

HESAA told OIG that it relies upon the skills and experience of its staff that conducts these manual reviews to flag abnormalities. Although this system brought the \$1.2 million TAG grant problem to the surface, it has inherent limitations, particularly as time passes. Because this monitoring was being manually performed by staff, changes in personnel could disrupt its continuity and the process was naturally subject to human

error. OIG recommended that it would be more efficient and secure if the process were automated to facilitate use by future staff.

In response to OIG's Draft Report, HESAA management reported that the practices and procedures for selecting the institutions for review and the review process had been memorialized in writing. However, this information is not yet electronically recorded.

D. Board Oversight

OIG found that HESAA's Board was not provided potentially significant information regarding HESAA's business. For instance, HESAA Board members interviewed by OIG were not aware of the Attorney General's investigation of HESAA (see footnote 1, *supra*), nor were they provided explanations for the former Executive Director's departure. HESAA's Board meets quarterly and occasionally more frequently (sometimes telephonically) to address measures that must be addressed before the next scheduled Board meeting. With only four regular meetings each year, it is difficult for the Board to play a meaningful oversight role for the entity. Many authority Boards with which OIG is familiar meet monthly. HESAA may want to consider increasing the number of Board meetings.

Especially with so few meetings, it is important that the Board members be provided as much information as possible before their meetings. OIG's review of HESAA Board meeting minutes and other documents revealed that although the Board

was usually provided a Board package of documents a week in advance of the scheduled meetings and had time to review the documents, the Board may not have been provided all of the information it needs to make informed decisions and to perform all of its duties.

As an example, Board members told OIG that although the HESAA Executive Director reads his remarks to the Board at their meetings, they were not provided a written copy of those remarks to the Board until well after the meeting. Therefore, Board members do not have an opportunity to provide thoughtful questions at the meeting, and they can only question him about matters he addresses that come immediately to mind. Board members OIG interviewed thought that it would be a better practice to receive his remarks even a short time in advance of the meeting so that they may give the remarks consideration before the meeting. If the Executive Director decided that he wanted to add to or change his remarks between the time he provided them to the Board and his actual presentation of the remarks, he could still do so. Providing the Board with the areas he intends to address and bullet points would give the Board members the opportunity to think about the matters in advance.

Traditionally, Boards are responsible for some degree of oversight of management. HESAA Board members interviewed said that they believed that their primary responsibility as Board members was to make certain that the student loans and grants went to the appropriate students. They claimed to be unaware or at least unsure of the degree of their responsibility for oversight of HESAA's management.

Executive Order No. 37 (Corzine 2006), Paragraph 4 provides:

“The boards of directors at State authorities shall have the following responsibilities, among others, which are designed to ensure that each authority operates in an efficient, transparent, and ethical manner: a. Exercise direct oversight over the chief executive officer, chief financial officer, and other senior management at the authority.”

OIG was told by HESAA’s former Director of Legal and Governmental Affairs that shortly after E.O. No. 37 was issued, she and her assistant made a presentation to the HESAA Board about its requirements. Her documents indicate that although the executive order was provided to the Board as a part of a package of documents, she did not describe the requirement that the Board provide oversight of authority executive and senior management. Board members interviewed by OIG said that they were not familiar with this portion of the executive order. Moreover, it would be difficult for them to provide that oversight since they meet with management only four times per year.

In addition, many written and verbal reports that were provided to the Board were only summary reports. From the information available to OIG, these summary reports are generally outcomes rather than revealing the processes used to arrive at those outcomes, and thus, the reports do not generally allow the Board the opportunity to suggest improvements.

1. Significant Performance Reviews Summarized for Board

As described above, HESAA's Audit and Quality Assurance Department (AQAD) conducts performance reviews of outside entities with which HESAA interacts. AQAD has often identified significant concerns that required corrective action and remedial measures that were ultimately taken as a result of the findings contained in AQAD reports.

OIG's review revealed that Board members were not provided and did not request copies of AQAD's full reports. Rather, results of AQAD reviews were summarized for the Board by management during Board meetings. Without all relevant information, the Board may not be in a position to determine whether the corrective actions were appropriate and sufficient to remedy problems uncovered by AQAD. While Boards are permitted to rely on management, they have a duty to exercise appropriate oversight and to not merely accept management's representations.⁵⁰

In at least one case where the Board may have benefitted from a fuller knowledge of the matter,⁵¹ management's summary of a final report issued in December 2004, advised the Board that an educational institution had improperly obtained grant funds and that the institution thereafter reimbursed \$1.2 million to HESAA. AQAD personnel

⁵⁰ In response to OIG's draft report, HESAA's Executive Director told OIG that, since the Board is comprised of, among others, college representatives, management redacts the names of audited institutions in order to protect their identities and avoid embarrassment. OIG does not comment on this practice, but redaction of the name of the institution would not preclude a more thorough knowledge of what had occurred. On the other hand, HESAA might consider recusal of Board members from voting on matters involving their institutions.

⁵¹ This case is discussed more fully in another context elsewhere in this report.

outlined the scope of the matter for the Board, but did not provide the Board an analysis of the issues, the methodology by which the refund amount was determine (an estimate rather an actual accounting), nor a copy of the report containing that information. Had the Board been aware of the nature and an analysis of the improper conduct or the manner in which the \$1.2 million repayment was determined, the Board may have asked questions and had discussions leading to independent decisions concerning whether \$1.2 million was a sufficient amount for the institution to pay under the circumstances; whether it was appropriate to estimate the amount of the reimbursement under these circumstances; and whether under these circumstances, other State agencies should have been involved in the final resolution of a matter of this significance.

Another matter that might have benefitted from Board interjection resulting from its more thorough knowledge of the matter had to do with deficiencies identified by AQAD in the performance by law firms used by HESAA to collect overdue accounts.⁵² These are reported to the Board through a management summary, and the Board is not provided with copies of AQAD reports listing specific deficiencies (*e.g.*, 8 years without collection activity; failure to post all payments to a borrowers account; miscalculation of the interest owed). The matter was only summarized for the Board, but the problematic conduct had continued for several years, and management had not been able to correct it. If the Board had been thoroughly apprised of the conduct, it could have offered solutions including whether to continue use of the firms. The Board should be aware of the specific deficiencies and have the opportunity to decide when to intervene and initiate

⁵² This subject is also discussed in another context elsewhere in this report.

more immediate or aggressive corrective action to improve a firm's performance or discontinue a relationship with a firm.

Providing Board members with copies of these full reports would put the members in a better position to make independent informed determinations concerning the weight given to AQAD findings and to assess management's handling of problems and corrective actions. Moreover, it would seem prudent to distribute to all Board members all reports assessing an organization, its programs, or significant financial matters in order to facilitate the members' ability to make meaningful, independent decisions.

Further, OIG recommends that HESAA's Board seek advice from the Attorney General's Office in implementing a written policy indicating whether and when it is appropriate for the Board to make the final determination of the amount owed to HESAA from outside entities by utilizing a representative sample, as in the matter discussed above, instead of complete data. That policy should also indicate whether, in situations involving government funds, HESAA should consult with appropriate State officials, such as the Attorney General, State Auditor, or Treasurer, before assessments are made.

2. Confidential Reporting Requirement

The Sarbanes-Oxley Act requires that all publicly traded entities establish a procedure for reporting concerns anonymously to the entity's Audit Committee regarding

the entity's financial management processes as well as suspected fraud or other illegal activities. As noted, Sarbanes-Oxley does not apply directly to governmental entities and only provides guidance for best practices.

When OIG began its review in 2006, HESAA had a process for handling employees concerns, but that process did not include a confidential process for reporting concerns directly to the Audit Committee. During OIG's review, HESAA hired a Chief Compliance Officer (CCO). When recently hired in 2008, the CCO told OIG that HESAA employees were currently able to report any problems to him, and that shortly, he would be implementing a procedure for confidential and/or anonymous reports to the Audit Committee. In a response to OIG's draft report, HESAA management advised that the CCO had established a web-based complaint reporting system that allows for anonymous complaints; that HESAA's Compliance Department consults with relevant HESAA departments, including Legal, Audit, and Client Services, as necessary to address complaints; and that the CCO has implemented the process for confidential and/or anonymous reports to the Audit Committee.

E. Potential Violation of Conflicts of Interest Law and Executive Order

1. Conflicts of Interest Law

Pursuant to the Conflicts of Interest Law, State officers and employees are prohibited from acting on matters that conflict with their responsibilities to the State.⁵³

The New Jersey Conflicts of Interest Law indicates that:

No State officer or employee ... should accept any ... thing of value under circumstances from which it might be reasonably inferred that such ... thing of value was given or offered for the purpose of influencing him in the discharge of his official duties.” N.J.S.A. 52:13D-23(e)(6).

In addition, N.J.S.A. 52:13D-24(a) states that:

No State officer or employee, special State officer or employee or member of the Legislature shall solicit, receive or agree to receive whether directly or indirectly, any compensation, reward, employment, gift, honorarium, out of State travel or subsistence expense or other thing of value from any source other than the State of New Jersey, for any service, advice, assistance, appearance, speech or the matter related to the officer, employee, or member’s official duties, except as authorized in this section.

A personal benefit to the state employee is not required in finding a violation of N.J.S.A. 52:13D-23(e)(6).⁵⁴ Furthermore, N.J.S.A. 52:13D-23(e)(7) also states in relevant part, that:

⁵³ N.J.S.A. 52:13D-12(a) provides that “it is essential that the conduct of public officials and employees shall hold the respect and confidence of the people. Public officials must ... avoid conduct which is in violation of their public trust or which creates a justifiable impression among the public that such trust is being violated...”

No state officer or employee or special State officer or employee should knowingly act in any way that might reasonably be expected to create an impression or suspicion among the public having knowledge of his acts that he may be engaged in conduct violative of his trust as a State officer or employee or special State officer or employee.

During its review of HESAA, OIG identified conduct by a then HESAA employee that may have violated the Conflict of Interest Law or at least created the justifiable impression among the public that the conduct violated the Conflict of Interest Law.⁵⁵ The evidence indicates that while a HESAA employee, the individual solicited a donation from a representative of a company with whom HESAA did business, an investment firm, for a fundraising event for a not for profit with which the then HESAA employee was associated. The then HESAA employee worked with the firm representative during the course of employment at HESAA and in perception, if not in reality, had some control over the firm's work.

In an interview and in e-mail, the former HESAA employee acknowledged having successfully solicited a donation from the investment firm for the fundraising event for the not for profit in 2009 while a HESAA employee. The former HESAA employee acknowledged having suggested to the investment firm representative that the firm might want to participate in the fundraising event because the not for profit had wealthy

⁵⁴ In the Matter of Howard & Paporozzi, 93 N.J.A.R. 2d (ETH) 1 (1993) (Although a State vendor's payment for the transportation cost of State employee benefitted the State, Final Agency Decision of the Executive Commission of Ethical Standards found that statute did not require personal gain).

⁵⁵ The individual is no longer employed at HESAA. OIG is not identifying the individual employee as the conduct was self-reported, and the one time occurrence is being referred to the State Ethics Commission for its determination of whether the conduct is violative of any of the ethics provisions based upon the employee's interaction with the vendor.

supporters and that the firm's presence might present business opportunities for the firm. The former HESAA employee said that the vendor's decision to participate and level of participation had been at the vendor's discretion.

The evidence uncovered during OIG's review revealed that the vendor was listed as a "bronze" sponsor in the program for the fundraising event indicating that the firm had donated \$1,100 in 2009. The evidence indicated that this level of sponsorship provided two tickets to the event and a table named for the firm. The former HESAA employee told OIG that the then HESAA employee and spouse sat at the firm's table but had purchased their own two tickets for \$150 each and received nothing gratuitous from the vendor. The former HESAA employee was listed as a volunteer in the program.

OIG interviewed vendor representatives including the individual whom the then HESAA employee approached for the donation. He confirmed that the then HESAA employee had called him regarding the fundraising event during the first quarter in 2009. The then HESAA employee told him that the vendor might want to consider being listed as a sponsor in the fundraising event program for the not for profit because of the wealthy people that supported it. The then HESAA employee also told him about the HESAA employee's personal connection to the not for profit.

The firm representatives told OIG that about six weeks after the original solicitation by the then HESAA employee, the investment firm received a letter from the not for profit regarding the potential fundraising event sponsorship. The firm

representatives confirmed that the investment firm was a bronze sponsor at \$1,100 and for that it received a half page advertisement in the event program and two tickets to the event. The firm representative also said that at the event there was a display area where the firm was able to display promotional items and advocate its investment product. The firm representatives also stated that after the initial solicitation, there was no other communication or correspondence with the then HESAA employee about this event.

The former HESAA employee told OIG that in March 2010, the not for profit had asked the now former HESAA employee to again contact the investment firm to ask for support for the not for profit's 2010 fundraising event. Both the former HESAA employee and the investment firm representatives told OIG that the former HESAA employee did not contact the investment firm representatives to solicit a donation for the 2010 event. The investment firm representatives told OIG that the not for profit contacted the firm directly requesting support for the 2010 event. As of the time of OIG's interview, the firm had not made a decision about whether to participate in the 2010 event.

The former HESAA employee's conduct appears to implicate the conflict of interest laws. It appears that while employed, the employee solicited and accepted indirectly something of value from a HESAA vendor with whom the then HESAA employee had contact while performing HESAA duties. This conduct could at least give the appearance that the benefit was provided to influence the then HESAA employee's official responsibilities.

Pursuant to the Conflicts of Interest Law,⁵⁶ the State Ethics Commission (SEC) established the Uniform Code of Ethics in 2006 mandating that State officers and employees may not engage in outside activity or employment when that activity or employment may impair the employee's ability to properly perform the employee's official duties. To this end, a State officer or employee must obtain the approval of the employing entity's Ethics Liaison Officer before engaging in the requested outside activity or employment. Based upon OIG's review, the former HESAA employee never submitted an outside activity request form for approval to engage in fundraising activities on behalf of the not for profit. This may be a matter the SEC will want to consider.

2. Executive Order No. 189

Executive Order No. 189 (Governor Thomas H. Kean 1988) supplements certain regulations that provide the grounds and procedures applicable to the suspension and disqualification of State vendors and to encompass appropriate standards prohibiting conflicts of interest on the part of present and prospective State vendors. Specifically, the executive order provides:

... it is essential that all persons supplying goods or services to the State of New Jersey, or performing contracts or otherwise executing public works with the assistance of and subject to the approval of the State, must meet a standard of responsibility which assures the State and its citizens that such persons will both compete and perform honestly in their dealings with the State and avoid conflicts of interest; and

⁵⁶ N.J.S.A. 52:13D-23 directed the State Ethics Commission to promulgate a uniform ethics code to govern and guide State officers and employees in the Executive Branch with regard to their compliance with the Conflicts of Interest Law.

... the New Jersey Conflicts of Interest Law prohibits State officers or employees... from having any interest or engaging in any activity that is in substantial conflict with the proper discharge of their duties in the public interest or from undertaking any employment or service which might reasonably be expected to impair their objectivity or independence of judgment; and

...the New Jersey Conflicts of Interest Law prohibits State officers or employees ... from acting in their official capacity in any matter wherein they have a direct or indirect personal financial interest which might reasonably be expected to impair their objectivity or independence of judgment; and

... N.J.S.A. 52:34-19 provides that it shall be a misdemeanor to pay any fee, commission, compensation, gift or gratuity of any kind, directly or indirectly, to any person employed by the Department of the Treasury or to any other person in the employ of the State having any duties or responsibilities in connection with the purchase or acquisition of any property or services by the State or any agency or instrumentality thereof by or on behalf of any seller or supplier of such goods or services or other party to a contract with the State...

This executive order also includes the following prohibitions on vendor activities, the violation of which shall render said vendor liable to debarment in the public interest by any Executive department or agency. These prohibitions include:

... No vendor shall pay, offer to pay, or agree to pay, either directly or indirectly, any fee, commission, compensation, gift, gratuity, or other thing of value of any kind to any State officer or employee or special State officer or employee, as defined by N.J.S.A. 52:13D-13b. and e., in the Department of the Treasury or any other agency with which such vendor transacts or offers or proposes to transact business, or to any member of the immediate family, as defined by N.J.S.A. 52:13D-13i., of any such officer or employee, or any partnership, firm, or corporation with which they are employed or associated, or in which such officer or employee has an interest within the meaning of N.J.S.A. 52:13D-13g.

... The solicitation of any fee, commission, compensation, gift, gratuity or other thing of value by any State officer or employee or special State officer or employee from any State vendor shall be reported in writing forthwith by the vendor to the Attorney General and the Executive Commission on Ethical Standards...

... No vendor shall influence, or attempt to influence or cause to be influenced, any State officer or employee or special State officer or employee in his official capacity in any manner which might tend to impair the objectivity or independence of judgment of said officer or employee.

... No vendor shall cause or influence, or attempt to cause or influence, any State officer or employee ... to use, or attempt to use, his official position to secure unwarranted privileges or advantages for the vendor or any other person.

During OIG's interview, the investment firm representatives defended the contribution to the fundraising event at the request of the HESAA employee. They told OIG that the vendor is contractually obligated with HESAA to support and market HESAA's product. They claimed that the vendor's obligation includes promoting HESAA's products (loans) through grassroots efforts and finding a variety of events and opportunities to "grow the product."

In addition, HESAA has a marketing department for solicitations, and the employee's request and the vendor's response could have been made through the appropriate channels at HESAA, reducing the likelihood that the contribution would have the appearance that it was made to influence the then HESAA employee who made the request for a donation to a not for profit with which the then HESAA employee had a connection. The solicitation of any compensation, gift, or other thing of value by a State

employee from a vendor should have been reported to the Attorney General and the State Ethics Commission. OIG refers this matter to the State Ethics Commission for its determination of whether any violations of E.O. No. 189 have occurred and what should be the appropriate resolution.

III. REFERRAL

The evidence gathered during OIG's investigation indicates that violations of State ethics provisions may have occurred. The solicitation of a donation from a vendor of the authority by an employee may be in violation of the Conflicts of Interest Law, or at least may present the appearance of impropriety. Further, no request to engage in outside activity was submitted to the employee's immediate supervisor, director/agency head or ethics liaison officer for approval. Therefore, OIG is referring this report to the State Ethics Commission for its analysis and any appropriate action.

HESAA management represents that all HESAA employees, management and Board members, including the former employee in question received annual ethics training. OIG is familiar with the training presented by the State Ethics Commission and is aware that it includes a prohibition against receipt of or solicitation of indirect gifts. OIG recommends that HESAA's Ethics Liaison Officer provide a reminder to HESAA employees that solicitation on behalf of their favorite charities from HESAA vendors is forbidden with specific examples of the kind of conduct that would be prohibited. OIG also recommends that the HESAA employees be reminded of the necessity to request permission to fundraise for an employee's favorite not for profit entity as well as relevant statutes, codes, and executive orders to prevent the improper conduct that appears to have occurred here. The reminder should include the penalties associated with violations. OIG recommends that any reminders be issued with the approval of the State Ethics Commission.

IV. RECOMMENDATIONS

A. Strengthen Internal and External Control Oversight Functions

HESAA does not have an internal auditor. According to HESAA management, AQAD's staff is not large enough to perform both internal and external audits, program reviews, and conduct follow-up actions that management deems necessary. Given the amount of funds for which HESAA is accountable, it is recommended that HESAA have adequate internal/external audit control functions.

OIG recommends that HESAA add an independent internal auditor function to its staff. The internal auditor should produce an audit report, should report its results directly to the Board's Audit Committee, and should assess whether internal controls established by management are effective. To ensure full compliance with controlling executive orders, HESAA should attempt to find an individual having experience with Generally Accepted Accounting Procedures and Generally Accepted Government Auditing Standards and how they relate to financial statements to fulfill this function. This individual must be familiar with those internal controls that are required for the proper and efficient operation of HESAA. Further, although not necessarily required, Audit Committee experience is desirable. These qualifications would aid the organization in properly complying with the policies, procedures and processes that are intended to promote its effectiveness, efficiency, financial reporting and compliance with laws and regulations.

Although during OIG's review and in response to OIG's draft report, AQAD demonstrated its ability to increase the number and scope of its audits, HESAA management, nonetheless, reported to OIG a necessity to increase the number of AQAD staff responsible for oversight of external entities receiving funds from HESAA. Management is convinced that an increased number of audits will result in an increased return of improperly awarded funds to HESAA.

According to HESAA management, it has been advised that the State-wide hiring freeze will likely restrict the addition of full time staff for the near future. Since HESAA is restricted in its ability to add staff, it is recommended that HESAA consider other options to fill both internal and external audit functions. OIG recommends that HESAA conduct a management performance review to determine whether a current staff member is qualified and interested in becoming HESAA's internal independent auditor or in joining AQAD. Another option is to retain an external accounting firm to perform HESAA's internal audits. In addition, institutions that receive HESAA funds and that have been found in non-compliance in the past may be required to hire independent auditors to audit their accounts on behalf of HESAA. Also, HESAA may consider retaining outside firms to monitor the institutions that it is unable to audit on a frequent basis. HESAA could modify its existing annual plan to address the full range of its responsibilities to expand the number and frequency of program reviews to help ensure and confirm proper awards of State funds as well as encourage institutions to bolster their internal controls where necessary.

B. Automated Monitoring Systems

HESAA should automate its monitoring of financial data regarding schools' financial aid activity. Automation of this function would allow the relevant data to be provided to more than one person within HESAA on a periodic basis in the form of MIS reports. This would improve internal controls as it would allow for simultaneous reviews by management. Automation could also prevent human error that may occur by way of incorrect manual calculations. Further, automation of these HESAA functions and tasks would help ensure that certain checks and balances would be routinely and automatically performed.

C. Strengthen Oversight of Collection Firms

OIG recommends the following measures to help strengthen procedures governing collection law firms:

- HESAA should independently confirm payments made in satisfaction of debts by sending confirmation reports to debtors.
- Collection firms should be required to reimburse HESAA for losses associated with firms' errors.
- Contracts with collection firms should limit the time allowed for firms to complete collections. If collections are not completed within the time designated, the account should be transferred to another firm or referred back to HESAA.
- The Audit Committee and Board should be provided with copies of complete reports of reviews undertaken by AQAD concerning problems with collections and collection firms so that informed decisions can be made regarding the continued use of the services of each firm.

- All payments should be made directly to the lockbox facility and procedures should be established to reduce or eliminate the number of entities that come into possession of loan payments prior to their deposit.

D. Monitor Compliance with Executive orders

Responsibility for compliance with executive orders should be established in one office in HESAA, the Legal Department or the Compliance Department. The responsible Office should review all executive orders to determine those that apply to HESAA, establish a matrix of those executive orders and requirements, and establish a mechanism to trigger HESAA's compliance with those that require some action. HESAA should institute procedures that ensure compliance with other executive orders including an annual review of executive orders to determine whether there has been compliance with requirements. HESAA's process should require a quarterly report to the Executive Director and the Board of compliance requirements; what has been done to meet those requirements; and corrective actions taken if necessary.

E. Board Oversight and Additional Recommendations

OIG recommends the following measures to help strengthen procedures for internal control and external oversight functions:

- Board should not accept summaries of reports and should require unedited copies of reports produced by and about HESAA.
- HESAA Board should consider more frequent meetings.
- HESAA Board should request additional training on its E.O. No. 37 oversight responsibilities and how it can best fulfill these responsibilities.

- HESAA should establish an internal audit function independent of management with an independent reporting relationship to the Board.
- HESAA should make clear the reporting standards it uses on financial statements.
- HESAA should establish policies for use or non-use of financial derivatives.