Office of the Washington State Auditor

Pat McCarthy

Accountability Audit Report

Guaranteed Education Tuition Program

For the period July 1, 2016 through December 31, 2017

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Office of the Washington State Auditor
Pat McCarthy

June 7, 2018

Michael Meotti, Executive Director
Washington Student Achievement Council
Olympia, WA

Thank you for requesting our assistance in reviewing Washington's Guaranteed Education Tuition program (GET). In August 2017, a former GET employee contacted our Office and asserted the program grossly mismanaged administrative fees charged to those who purchased the college-tuition units. For example, the complaint asserted GET had improperly used the fees to create a reserve to cover closing costs in the event the program was shut down.

The Washington Student Achievement Council, GET's administrative agency, also asked us to investigate the complaint. The Office determined the matter would be best addressed with an accountability audit. These audits assess whether governments have adequate internal controls to protect public resources and comply with the relevant laws and rules and their own policies.

After reviewing the issues, the audit team determined GET administrators had not grossly mismanaged the program or failed to comply with applicable state laws or their own policies. With regard to the reserve fund for potential program shutdown costs, the Office of the State Actuary gave an opinion that this is a valid operating expense.

The audit does note areas in which GET could be more transparent and operate more efficiently, and provided that information to management. Given the significant public interest in this audit, those results and recommendations are included in this report.

I hope the information will benefit the program and policy makers, as well as the tens of thousands of people who purchase tuition units through GET. When public agencies embrace the independent accountability an audit provides, they increase public trust in government. I would like to thank the staff of the GET program, the Washington Student Achievement Council and the Office of the State Actuary for their professionalism and assistance during this audit.

Sincerely,

Pat McCarthy

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Executive Summary

The Guaranteed Education Tuition Program (Program) is Washington's 529 prepaid college tuition plan that helps families save for future higher education expenses. The state guarantees the value of customer accounts will keep pace with the cost of college tuition, no matter how much it changes in the future. The Program is staffed by the Washington Student Achievement Council (WSAC) and administered by the Guaranteed Education Tuition Committee (Committee), a five-member panel that meets quarterly to set policies, pricing and investments.

Since the Program's inception in 1998, more than 100,000 Washington families have opened accounts and more than 50,000 students have used over $1 billion in Program benefits to help pay for qualified higher education expenses at colleges, universities and technical schools nationwide.

The Office of the Washington State Auditor received a whistleblower complaint in August 2017, asserting the Program grossly mismanaged its responsibilities in how it collects, accounts for and spends administrative funds. These funds are provided through the expense component of each Program credit. The whistleblower's concerns included that the Program was using these funds to create a reserve to cover expenses in the event of a shutdown, and to fund development of DreamAhead, a separate 529 college savings plan. WSAC also contacted our Office to request an investigation of the issues raised in the whistleblower complaint.

The complaint asserted the Program had acted contrary to state law in several areas with regard to administrative fees. We determined the complaint did not meet the criteria for a whistleblower investigation, because the issues related to Program governance rather than the actions of specific people. Therefore, we conducted an accountability audit to determine whether the Program had followed applicable laws and rules and policies. The scope of work is detailed in this report.

The Program did not grossly mismanage its responsibilities. The audit did identify areas in which the Program could more accurately calculate a unit's cost and account for its administrative funds.

Specifically, we recommend the Program and GET Committee consider:

- Changing how it computes the expense component of a unit by including *all* administrative revenues in its calculation. The Program should also consider including an estimate of shutdown costs in the expense component and describe how those costs are calculated.
- Implementing a retrospective review process that compares the actual amounts collected from the expense component of unit sales to actual administrative expenses. The GET Committee should consider using this information to make subsequent adjustments to the expense component when establishing the price of a unit.
- Discretely accounting for the different administrative fees collected from the sale of units.

The Program should also follow through with its plan to ensure proper accounting adjustments are made for costs related to the state's new DreamAhead 529 college savings plan by June 30, 2018.

Our recommendations are detailed in this report and in a letter issued to management dated May 21, 2018.

Audit Results and Recommendations

This accountability audit is the result of a whistleblower asserting gross mismanagement in the Guaranteed Education Tuition program (Program). The Washington Student Achievement Council also asked the Office of the Washington State Auditor to investigate. In addition to concerns about how the Program accounted for and spent administrative fees provided by the expense component of tuition credits, the whistleblower asserted improper handling of some customer accounts and specific contracts with outside vendors. Based on the issues identified in the complaint and others raised by stakeholders, this audit answered the following questions:

1. *Program unit expense component*

   - What is the expense component of a unit?
   - How is the expense component amount calculated and what are the proceeds used for?
   - How much has the Program collected through the expense component of unit sales?
   - Have amounts collected been set aside to cover the cost of a potential future Program shutdown?

2. *Administrative fees*

   - How are the fees set and accounted for, and how are the fee proceeds spent?
   - Is revenue from administrative fees included in the calculation of the expense component of a unit?

3. *529 college savings plan expenses*

   - Are Program funds being used to pay for Washington's new 529 college savings plan?

4. *Customer accounts*

   - How are customer accounts assigned to and managed by Program staff?
   - Are accounts for legislators, or any other customers, flagged and given special consideration or priority in service?
   - Are program staff violating privacy rights?

5. *Contracts*

   - Were contracts properly procured and public funds paid to vendors properly spent and accounted for?

1. Program unit expense component

Program account values are measured in "units," where 100 units equals the cost of one year of resident, undergraduate tuition and state-mandated fees at Washington's highest priced public university. Individual units are valued at 1/100th of that cost.

The GET Committee is responsible for setting the unit price. It does so considering advice from the State Actuary and after considering risks such as projected tuition increases, expected investment returns, customer behaviors and legislative actions.

What is the expense component of a unit?

The current price of a unit includes the following components:

Unit price components	Amount
Expected Costs Covers the expected present value of the cost of future tuition and state-mandated fees	$94.34
Expenses Covers the Program's annual administrative expenses	$4.18
Reserve Covers unexpected future costs, such as higher than expected tuition growth	$14.78
Amortization Covers unexpected past costs from significant Program or policy changes	Not applicable
Total unit price (sum of components, rounded down to a whole dollar)	**$113**

Source: GET Program Details Booklet, 2017-2018 Enrollment Year

How is the expense component amount calculated, and what are the proceeds used for?

The expense component's cost is calculated by dividing the Program's administrative budget, less estimated expected revenues for new account enrollment fees, by estimated unit sales for the coming enrollment period.

(Budget – Expected Revenues) / Estimated Unit Sales

The purpose of the expense component is to collect enough revenue to cover the Program's ***annual*** administrative expenses, such as payroll, travel, goods and services, lease payments and other costs necessary for program operation.

State law (RCW 28B.95.060) says the Program can spend proceeds from unit sales on administrative expenses. The law does not restrict the Program from spending only proceeds from the expense component on administrative expenses. The Program deposits proceeds from all components of unit sales into the same account and does not separately track what amounts were collected from the expense component. Therefore, we could not verify if the proceeds were used to pay only for administrative expenses.

Because the law is not restrictive, we determined the Program complied with state law.

How much has the Program collected through the expense component of unit sales?

Using data from the 1999-2000 enrollment period through the 2016-2017 period, we compared actual expenses with estimated revenues collected from the expense component and other administrative fees. Detailed revenue information was not available in the state's general ledger accounting system, the Agency Financial Reporting System (AFRS). To obtain the information, we asked Program staff to query the Program's Banner system, which it uses to manage customer accounts. The information provided was a "**best estimate**" because it does not include the effect of refunded fees.

Since the 1999-2000 Program year, revenues collected from the expense component and fees have exceeded actual Program administrative expenses by about $38 million. If the estimated present value of shutdown costs (the administrative cost to maintain the program for at least 10 years until units are redeemed, in the event of the Legislature shutting down the Program), are considered, the money collected from the expense component and fees from participants exceeded actual administrative expenses by $22.7 million.

Program year	Actual Program administrative expenses	Estimated fees and expense component collected	Estimated fees and expense component collected in excess of actual expenses
1999-2000	$928,160	$1,183,165	$255,005
2000-2001	$1,416,413	$1,356,955	($59,458)
2001-2002	$1,851,706	$3,635,036	$1,783,330
2002-2003	$2,559,473	$9,725,839	$7,166,366
2003-2004	$2,862,897	$4,548,820	$1,685,923
2004-2005	$2,543,580	$6,248,190	$3,704,610
2005-2006	$2,893,105	$6,076,287	$3,183,182
2006-2007	$3,262,428	$6,451,171	$3,188,743
2007-2008	$3,874,302	$6,130,381	$2,256,079
2008-2009	$3,822,173	$10,459,202	$6,637,029
2009-2010	$3,986,616	$8,670,625	$4,684,009
2010-2011	$3,881,040	$9,690,823	$5,809,783
2011-2012	$4,212,759	$7,310,356	$3,097,597
2012-2013	$4,419,116	$6,285,433	$1,866,317
2013-2014	$4,983,024	$5,737,131	$754,107
2014-2015	$5,373,589	$5,325,070	($48,519)
2015-2016	$4,818,526	$664,695	($4,153,831)
2016-2017	$4,601,664	$752,478	($3,849,186)
Totals	**$62,290,571**	**$100,251,658**	**$37,961,087**
Less: Present value of estimated shutdown costs			$15,247,070
Estimated fees collected in excess of actual expenses			**$22,714,017**

According to the Program, approximately $426 million in non-penalty contribution refunds have been made to customers since 2015. A portion of these refunds included the expense component of unit sales.

Revenue collected from the expense component and fees in excess of actual administrative expenses is deposited in the Program's operating fund and contributes to the fund's overall balance. A higher funded status and higher reserve results in a more secure Program. For example, the State Actuary estimates that if this excess were $25 million at June 30, 2017, that amount would contribute 1.4 percentage points to the Program's funded status of 132.8 percent.

The Program has not established an annual formal process that compares revenues collected from the expense component of unit sales with actual Program administrative expenses.

The Office of the State Actuary reported it cannot offer advice whether participants were over or under charged for the units they purchased.

The Actuary also said that more detailed accounting information on the administrative fee fund balance would benefit his office and other decision makers.

A full statement from the State Actuary responding to our questions is attached in **Appendix A** of this report.

Recommendation

We recommend the Program implement a retrospective review process that compares the actual amounts collected from the expense component of unit sales to actual administrative expenses. The GET Committee should consider this information to make subsequent adjustments to the expense component of a unit.

We also recommend the Program consider implementing modifications to its Banner system that would allow it to account for more detailed revenue sources, so information can be recorded in AFRS and available to management and the Committee.

Have amounts collected been set aside to cover the cost of a potential future Program shutdown?

The Program does not consider shutdown costs when calculating the expense component for the coming enrollment period. The accuracy of this expense component calculation would improve if these additional costs were considered.

If the Legislature decided to discontinue the Program, customers could no longer purchase new units. State law would allow customers to redeem purchased units for up to 10 years from the date the Program was discontinued. During this 10-year period, the Program would continue to incur costs without a revenue source to support administrative expenses. The Office of the State Actuary, which prepares actuarial valuations of the Program, considers shutdown costs to be a valid operating expense. In its 2017 valuation of the Program, the Office of the State Actuary estimated the present value of future shutdown costs to be $15.2 million.

Recommendation

We recommend the Program consider including an estimate of shutdown costs in the expense component of the unit cost and clarify how those costs accumulate.

2. Administrative fees

In addition to the unit cost's expense component, the Program also collects administrative fees and charges for certain transactions. The fees provide additional revenue for the Program.

What administrative fees does the Program collect?

2017-2018 Program Fees

Type of Fee	Amount
Account Fees	
Paper Enrollment Form Fee *(non-refundable)* Effective November 1, 2017, we only charge this fee for mailed paper enrollment forms. Additionally, if you open more than two Accounts for Students living at the same home address, we will waive all future enrollment fees for Students living at that address (accounts that have been refunded, canceled, or rolled over to another 529 plan are not included as eligible Accounts).	Paper Enrollment Form: $50 Online Enrollment Form: N/A
Late Payment Fee For Custom Monthly Plans, all payments are due on the 15th day of each month. We will post a late fee to your Account if we do not receive your monthly payment by the 10th day following the due date.	$10
Dishonored Payment Fee (Automatic withdrawal, electronic payments, and checks)	$25 or actual fee charged by the bank, whichever is greater
Refund Fees	
Program Refund Penalty For all Refunds except in the event of death, disability, Scholarship, attendance at a U.S. service academy, or graduation/completion of a degree or certificate.	10% of earnings or $100, whichever is greater
Account Cancellation Fee *(assessed on Refunds only)*	$10
Account Maintenance Fee *(assessed on Refunds only)*	$1.70 per month that the account was open and active
For Organizations	
Scholarship Set-up Fee *(non-refundable)*	$100 per master account
Student Account Transfer Fee Assessed each time the Organization transfers Units from the master Account to a named Student Account (per Student Account).	$25

Source: GET Program Details Booklet, 2017-2018 Enrollment Year

How are the fees set and accounted for, and how are the fee proceeds spent?

State law (RCW 28B.95.030(9)(c)) authorizes the Program to impose and collect administrative fees. Since the Program's inception, the Committee has periodically reviewed and updated the fees. Program management said fees are not exclusively set to recover the cost associated with a particular transaction. In some cases, fees are set to act as a deterrent, such as to discourage late payment, for example.

Another state law (RCW 28B.95.060) directs that Program administration costs shall include, but not be limited to, salaries and expenses of the Program personnel including lease payments, travel, and goods and services necessary for Program operation; contracts for Program promotion and advertisement, audits, and account management; and other general costs of conducting the Program's business.

The Program did not maintain detailed accounting records that tracked the revenue generated from each type of fee. Instead, the fees were commingled with all other revenues in the Program's operating fund. Because of this, the accounting records did not show what activities the Program pays for using the fees.

Recommendation

We recommend the Program discretely account for the different administrative fees collected from the sale of units.

Is revenue from administrative fees included in the calculation of the expense component of a unit?

When calculating the expense component of a unit, the Program does not include revenues from administrative fees in the calculation. State law authorizes the Program to assess these fees but does not restrict how the proceeds can be used.

Recommendation

We recommend the Program include administrative fees when it calculates the expense component of a unit.

3. 529 college savings plan expenses

Are Program funds being used to pay for Washington's new 529 college savings plan?

Some program funds have been used to pay for Washington's new college savings plan.

In 2001, the Legislature authorized the Washington Student Achievement Council (WSAC), which administers the Program to borrow up to $200,000 of administrative fees collected from Program participants to fund the development and startup of a college savings program. State law requires the loan to be repaid, with interest, before the conclusion of the biennium following the biennium in which the Committee draws funds for this purpose from the Program's operating account.

In June 2015, the Legislature directed the Committee to review the feasibility of and explore options for establishing a new college savings plan to operate in addition to the Program. The Legislature did not appropriate funds for this exploratory work, so Program funds were used to pay for it.

In March 2016, the Legislature approved the creation of the Washington College Savings Plan (DreamAhead) and appropriated $25,000 from the state's General Fund to partially pay for startup costs. Legislation established a new account for DreamAhead and authorized the account to maintain a cash deficit for no more than five fiscal years to defray initial administration costs. In November 2016, the Committee presented a preliminary report to the Legislature.

From July 1, 2015, through June 30, 2017, WSAC spent $251,665 to study the feasibility of and develop the new plan. Of this amount, $25,000 was charged to the General Fund, and the remaining $226,665 was paid for with Program funds. WSAC management said they did not record the

Program funds WSAC used as a loan, nor did WSAC deficit spend in the newly created DreamAhead account. Management believed the Legislature's intent was for Program funds to be used for the feasibility and development of the new plan because the Legislature:

- Directed the Committee to study a college savings program;
- Did not appropriate funding apart from Program funds for this purpose; and
- Explicitly granted additional expenditure authority from Program funds for this purpose in response to a specific request from WSAC for this purpose.

As of July 1, 2017, when management said it began to implement the new plan, WSAC believes deficit spending in the new account is appropriate to fund operations.

From July 1, 2017, through December 31, 2017, the Program incurred an additional $120,037 in costs for DreamAhead implementation. At the direction of the Office of Financial Management, the Program charged those costs to the General Fund. WSAC management said these costs would be transferred to the DreamAhead account by June 30, 2018.

We found no evidence that the Program failed to comply with state law regarding how Program funds were used to pay for the state's new college savings program.

Recommendation

We recommend WSAC follow through with its plan to transfer the implementation costs for the DreamAhead plan from the General Fund to the new account by June 30, 2018.

4. Customer accounts

How are customer accounts assigned to and managed by Program staff?

The Program has a customer service center (Center) that answers questions and assists customers with issues regarding their Program accounts. The Center is staffed by six customer service specialists and a manager. Program customer accounts are not assigned to a specific employee. The Center uses an off-the-shelf automated call distributor to assign incoming calls to staff; calls are answered as received.

Are accounts for legislators, or any other customers, flagged and given special consideration or priority in service?

The Program's Banner system allows Center staff to flag customer accounts. The Center's supervisor said flags typically are assigned when customers share information that might help staff manage accounts more effectively in the future. A customer's account may be flagged with a code for reasons such as difficult experiences with a customer (DIF), customers who allow the Program to use their experiences for marketing purposes (MED), blocked accounts that prevent access by the student (BLK), a government official (GOV) or very important persons (VIP).

Of the 92,224 active accounts in the Banner system, 1,166 (1.2 percent) had a code assigned. We found no evidence to indicate that accounts of legislators or any other customer received special consideration or priority in service. The Center's supervisor said it is typical practice within the customer service industry to assign flags to customer accounts.

Are program staff violating privacy rights?

Center staff are trained to manage private, confidential and sensitive information. Staff sign confidentiality agreements and acknowledge that they have read Program policies and received required training. We found no evidence that Program Staff violated any customer's privacy rights.

However, we found three instances when signed confidentiality agreements were not on file and one instance when a signed acknowledgement form of Program policies was not on file. The Center manager provided us with evidence that these forms were completed while the audit was ongoing.

5. Contracts

Were contracts properly procured and public funds paid to vendors properly spent and accounted for?

As part of the audit, we examined the procurement of two contracts and corresponding vendor payments.

The first contract was with a vendor that provides media-related services for the Program. We found the contract was competitively bid and procured following state law. We examined supporting documentation for the payments to the vendor and determined the program properly spent and accounted for public funds.

The second contract was for specialized legal services to support the establishment of the DreamAhead plan. This contract was procured as sole source by the Attorney General's Office – not the Program. Because it was procured as sole source, the contract did not need to be competitively bid. The contract's procurement followed state law.

In examining the supporting documentation for payments to the vendor, we identified instances when the vendor provided services related to the Program – not the DreamAhead plan. Work related to the Program was not contained in the contract's scope of services. From July 1, 2016, to December 31, 2017, the vendor was paid $76,496 by WSAC. Of this, $9,975 were for services related to the Program – not to the DreamAhead plan.

WSAC management and the Attorney General's Office both said Program staff believed that all services provided by the vendor were covered in the contract. Both parties said they are in the process of correcting this oversight.

Recommendation

We recommend the Program work with the Attorney General's Office to improve the Program's contract oversight to prevent paying a vendor for services provided outside the scope of the contract.

Concluding remarks

The Program did not grossly mismanage its responsibilities and complied with state laws and its own policies.

The Program could improve the process used to calculate the expense component of a unit, as defined in the Program's Details Booklet, to more accurately reflect the annual cost of administering the program.

We appreciate the Program's assistance and cooperation during the audit, and will follow up on our recommendations in a future audit.

Agency Response

The Washington Student Achievement Council (WSAC) thanks the Auditor and staff for reviewing, at our request, several assertions made by a former employee. In brief, the employee's allegations are that the GET Program's internal accounting for expenses is deficient and that this affects GET account owners in a negative way. The SAO's accountability audit report dispels these unfounded allegations, which rest on a misunderstanding of the GET Program's "promise" to account holders and the GET Committee's statutory duty to administer the GET Program in an "actuarially sound" manner. This includes the responsibility to price tuition units appropriately in order to guard against the State having to appropriate funds to "make good" on its promise to account owners, which is a guarantee that a specific number of GET units is guaranteed to pay for a specific amount of tuition and eligible fees charged by Washington's highest cost public institution of higher education.

The scope of this audit was relatively narrow, and while WSAC appreciates and agrees with many of the SAO's conclusions and recommendations, we respectfully disagree with some. Therefore, we are providing some context and information that helps to explain our position.

Background

The GET Committee (officially the Committee on Advanced Tuition Payment and College Savings) is comprised of the Washington State Treasurer, the Director of the Office of Financial Management, the Executive Director of WSAC, and two citizen members appointed by the Governor. Setting the unit price falls squarely within the authority and discretion of the GET Committee, and WSAC has no authority to direct GET how to do so. The GET Committee is statutorily required to administer the GET Program in an "actuarially sound" manner, which means it has the responsibility to price units appropriately in order to guard against the State having to appropriate funds to "make good" on its guarantee. As a consequence, its statutory duty to the State co-exists with its contractual duties to GET account owners. The GET Committee – with input from staff, the State Investment Board, and the State Actuary – considers a range of factors in setting a unit price, which prospective account owners are free to accept or reject. This calculation is a function of investment returns (past and projected), tuition costs (projected), reserves, and consideration of several other risk factors not considered by SAO.

WSAC agrees that considering additional detail with respect to revenue and fees is a good idea. In fact, it has been developing this additional detail for analysis since 2014. But the added detail is not needed for reasons recommended by SAO and will not lead to outcomes this audit report suggests, i.e., the GET Committee being able to calculate a unit price more accurately.

1. **Program Unit Expense Component**

   SAO recommends that actual amounts collected and attributable to the expense component of all units sold each year be compared to actual administrative expenses, and that this information be used to make subsequent adjustments to the expense component of future unit prices. SAO also recommends that administrative fees be used in calculating the expense component. The audit suggests these steps will result in a more accurately calculated expense component (and presumably that fewer fees will be collected in excess of actual expenses).

While this approach seems logical, and while additional detail may help the GET Committee and WSAC in other ways, it will not bring expense component collections in line with administrative expenses. SAO's recommended method does not consider several factors that would substantially affect any such calculation.

1. *The effect of subsequent refunds and conversions on the actual revenue collected.*

Refunds and conversions can occur months or years following a purchase, and result in retrospective changes to the revenues attributable to a given fiscal year. In fiscal year 2016 there were 2,650 such conversions.

2. *Unit sales fluctuations have a much greater influence on expense component revenue variability.*

Reducing variability is generally limited by the least predicable variable. Projecting unit sales is inherently inexact and depends on customer behavior, influenced by tuition costs, market activity, and myriad other factors. The effect of the difference in actual vs projected unit sales dwarfs the effect of changes to the expense component using the method recommended by SAO.

3. *Recent refunds erase much of the putative "excess."*

The SAO suggests that $22,714,017 in estimated fees were collected in excess of actual expenses. Individual unit components do not separately accumulate from year-to-year as suggested by this estimate. The audit correctly states that "The law does not restrict the Program from spending only proceeds from the expense component on administrative expenses." Accordingly, any component variance inures each year to the bottom line of the GET account rather than to a component sub-account. In other words, the expense component calculation begins from zero each year, any "excess" or "deficit" goes to the overall account balance.

If it was appropriate to maintain a separate balance for the expense component, it would also be appropriate to account for instances when there was a reduction in that expense component balance. Since 2015, and as a result of legislative changes, the GET Program has issued $436 million in non-penalty contribution refunds to customer. Assuming an average expense component of 3.7% of contributions, the Program has refunded $16.1 million of expense component payments to customers. Accounting for this reduces the amount of fees collected in excess of expenses to $6.6 million.

4. *Shutdown costs are appropriately considered in the Actuary's present value of future expenses.*

The SAO states that shutdown costs are not considered when calculating the expense component. While this is true, the present value of future shutdown costs are considered by the Actuary and included in the annual valuation report that informs the Committee's unit price analysis.

2. Administrative Fees

Administrative fees represent a small fraction of administrative revenues and are accounted for but not used for budget planning or determining the expense component. Since 2014, the Program has maintained detailed accounting records that track the revenue generated from each type of fee. In fiscal year 2017, administrative fees represented 1.38% of total administrative expenses. The effect of these small amounts on administrative revenue collected each year is dwarfed by the variability injected by differences in actual unit sales over projected.

3. 529 College Savings Plan Expenses

After consulting with counsel and OFM, WSAC is comfortable regarding the proper timing and method of paying for studying and then implementing the new DreamAhead program. The plan to transfer implementation costs for DreamAhead to the new account in fiscal year 2018 and thereafter has been in place from the beginning.

4. Customer Accounts

We appreciate the SAO looking into this allegation and verifying that Program Staff did not violate customer privacy rights.

5. Contracts

The WSAC will work with the Attorney General's Office to help ensure that necessary services are covered by the scope of work in contracts with special assistant attorneys general.

Conclusion

Again, we appreciate the assistance of the SAO in reviewing and putting to rest the allegations of a former employee. And while we may not completely agree with the SAO's approach and certain conclusions inferred from its report, WSAC appreciates the SAO's work and dedication, and will share the recommended changes with the GET Committee and the Attorney General's Office.

February 1, 2018

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SUBJECT: RESPONSE TO GET AUDIT QUESTIONS

Steve,

In this letter, I provide written responses to the questions you asked during our meeting on January 24, 2018. For your reference, I provide the question (in italics) and my response below the question.

Background

Under the program's current practices, accounting practices, and commingling of all program assets in a single fund, any fee revenue collected in excess of the program's operating expenses, including shutdown expenses, would contribute to the program's overall reserve. With that background in mind, I address your questions below.

Questions and Responses

1. *Based on information provided by the program, the fees collected from participants have exceeded the costs to administer the program in most years. What effect, if any, has this had on GET participants? Have participants been overcharged for the units they purchase and entitled to a refund?*

   Note: We have considered program fees to include the expense component of unit cost and transaction fees such as enrollment, late payment, NSF, refund penalty, account cancellation, account maintenance, set up, transfer and processing fees. We have considered the program administrative costs to include the present value of estimated shutdown costs.

   Based on the *June 30, 2017, GET Actuarial Valuation Report* (GAVR), if the program's collection of fees exceeded the cost to administer the program, that would result in the program having a higher funded status and reserve. For example, if this excess were $25 million at June 30, 2017, that amount would contribute 1.4 percentage points to the program's funded status of 132.8 percent and $25 million of the $570 million reserve at June 30, 2017. A higher funded status and higher reserve results in a more secure program than a program with a lower funded status and lower reserve.

In theory, to determine whether participants over or under paid for their units, the program would need to separately account for all units, separately account for their associated fee revenue and expenses, and determine the actual total cost of unit redemption after the redemption of all units. The actual total cost of a unit, if the program closed, would be based on actual shutdown costs instead of the current estimated costs. The actual cost of a program shutdown may vary from current estimates. The GET Committee or Legislature may also need to change the terms and purpose of the program to make a valid assessment of whether participants over or under paid for their units.

Under the current terms and purpose of the program, the program provides a guaranteed, defined benefit and assumes the risk of providing that guaranteed benefit. By assuming this risk, the program provides a form of insurance for the purchaser. For example, the program provides insurance against above expected tuition growth or below expected investment returns the purchaser would experience if they were to invest in a traditional college savings plan. Returning a portion of the cost of that insurance if the risk does not materialize, could change the terms and purpose of the program.

Because the program does not separately account for all units, does not separately account for their associated fee revenue and expenses, does not determine or track the actual total cost of unit redemption, and because not all outstanding units have been redeemed, I cannot determine, at this time, whether account holders have over or under paid for their units. Additionally, if such a determination could be made, providing a refund if account holders over paid (or requiring an additional payment if they under paid) could be inconsistent with the current terms and purpose of the program.

2. *Would OSA and other decision makers benefit if more detailed accounting information was available that would track an administrative fee fund balance? (fees collected less program administrative expenses)*

   Yes. With that information, the program could more easily respond to questions about program expenses, increase understanding of the amount and purpose of program expenses, and create the accounting infrastructure to un-commingle program expenses from other program assets if deemed necessary.

   I note, however, that the Legislature or GET Committee may need to make other program changes if they determine the program intends to track the actual total cost of each unit and provide refunds for a portion of the cost of a unit in the future.

3. *Is the present value of future shutdown administrative expenses a valid cost to consider when valuing units and, if so, which component would it be included in?*

In my opinion, the present value of future shutdown expenses is a valid operating expense for the program and we include an estimate of the program's shutdown costs in the GAVR each year. The program does not currently include shutdown expenses in the price purchasers pay for a unit.

Under the program's current practices, it may not be clear how the program accumulates funds to provide for shutdown expenses. Under these current practices, any fee revenue collected in excess of the program's actual operating expenses would fund the program's shutdown expenses. As noted above, any fee revenue collected in excess of actual operating expenses and estimated shutdown expenses would contribute to the program's overall reserve.

The program could close indefinitely instead of terminate in the future. If the program closed indefinitely, we would expect the shutdown costs under that scenario to exceed the termination costs included in the GAVR.

4. *It appears some GET program funds (account 788) [have] been used to partially fund the implementation of the new College Savings Program. What effect, if any, does this have on GET program participants who own units or will be buying units in the future?*

   The effect will depend on the amount of funds used and whether the funds are returned with interest. For example, if $200,000 were used and ultimately not returned, that amount would reduce the program's funded status by 0.01 percentage points measured at June 30, 2017. That amount would not significantly impact the program's funded status and would not impact the unit price paid by future purchasers.

   Larger and on-going amounts could significantly impact the program's funded status and potentially increase the cost of future units depending on future actions of the GET Committee when adopting a unit price. We would need to perform additional analysis with known amounts before we could reach a final determination.

I hope you find my responses helpful. Please do not hesitate to contact our office if you have further questions or need additional information.

Sincerely,

Matthew M. Smith, FCA, EA, MAAA
State Actuary

cc: Michael Harbour, ASA, MAAA
Senior Actuarial Analyst
Jim Brownell
Audit Manager, Office of the Washington State Auditor

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Appendix B: Criteria

RCW 28B.95.030 - Washington advanced college tuition payment program, states in part:

(8) The governing body shall promote, advertise, and publicize the Washington advanced college tuition payment program. Materials and online publications advertising the Washington advanced college tuition payment program shall include a disclaimer that the Washington advanced college tuition payment program's guarantee is that one hundred tuition units will equal one year of full-time, resident, undergraduate tuition at the most expensive state institution of higher education, and that if resident, undergraduate tuition is reduced, a tuition unit may lose monetary value.

(9) In addition to any other powers conferred by this chapter, the governing body may:

(c) Impose and collect administrative fees and charges in connection with any transaction under this chapter;

RCW 28B.95.060

Washington advanced college tuition payment program account

(1) The Washington advanced college tuition payment program account is created in the custody of the state treasurer. The account shall be a discrete nontreasury account retaining its interest earnings in accordance with RCW 43.79A.040.

(2)(a) Except as provided in (b) of this subsection, the governing body shall deposit in the account all money received for the program. The account shall be self-sustaining and consist of payments received from purchasers of tuition units and funds received from other sources, public or private. With the exception of investment and operating costs associated with the investment of money by the investment board paid under RCW 43.33A.160 and 43.84.160, the account shall be credited with all investment income earned by the account.

Disbursements from the account are exempt from appropriations and the allotment provisions of chapter 43.88 RCW. Money used for program administration is subject to the allotment of all expenditures. However, an appropriation is not required for such expenditures. Program administration shall include, but not be limited to: The salaries and expenses of the program personnel including lease payments, travel, and goods and services necessary for program operation; contracts for program promotion and advertisement, audits, and account management; and other general costs of conducting the business of the program.

(b) All money received by the program from the office for the GET ready for math and science scholarship program shall be deposited in the GET ready for math and science scholarship account created in RCW 28B.105.110.

(3) The assets of the account may be spent without appropriation for the purpose of making payments to institutions of higher education on behalf of the qualified beneficiaries, making refunds, transfers, or direct payments upon the termination of the Washington advanced

college tuition payment program. Disbursements from the account shall be made only on the authorization of the governing body.

(4) With regard to the assets of the account, the state acts in a fiduciary, not ownership, capacity. Therefore the assets of the program are not considered state money, common cash, or revenue to the state.

RCW 42.40.020, states in part

Definitions.

As used in this chapter, the terms defined in this section shall have the meanings indicated unless the context clearly requires otherwise.

(4) "Gross mismanagement" means the exercise of management responsibilities in a manner grossly deviating from the standard of care or competence that a reasonable person would observe in the same situation.