STATE OF CONNECTICUT

AUDITORS' REPORT
CONNECTICUT STUDENT LOAN FOUNDATION
FOR THE FISCAL YEARS ENDED
SEPTEMBER 30, 2006, 2007 AND 2008

AUDITORS OF PUBLIC ACCOUNTS
KEVIN P. JOHNSTON ❖ ROBERT G. JAEKLE

Table of Contents

December 11, 2009

AUDITORS' REPORT
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FOR THE FISCAL YEARS ENDED
SEPTEMBER 30, 2006, 2007 AND 2008

We have examined the books, records and accounts of the Connecticut Student Loan Foundation ("CSLF" or "Foundation"), as provided in Section 2-90 of the General Statutes, for the fiscal years ended September 30, 2006, 2007 and 2008.

SCOPE OF AUDIT:

This audit included performing tests of the Foundation's compliance with certain State statutory requirements and of its financial operations. In regard to its financial operations, we considered the Foundation's internal control over its financial operations and its compliance with requirements that could have a material or significant effect on the Foundation's financial operations in order to determine our auditing procedures for the purpose of evaluating the Foundation's financial operations and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objectives.

Our audit also included a review of a representative sample of the Foundation's activities during the audit period and a review of such other areas as we considered necessary. The financial statement audits of the Foundation for the fiscal years ended September 30, 2006 and 2007, were conducted by the Foundation's independent public accountant. The financial statement audit for the fiscal year ended September 30, 2008, had not been completed by the Foundation's independent public accountants at the time of our review.

This report on our examination consists of the Comments, Recommendations and Certification that follow.

COMMENTS

FOREWORD:

Connecticut Student Loan Foundation, a nonprofit corporation created in 1965, operates primarily under the provisions of Sections 10a-201 through 10a-216 of the General Statutes. The mission of the corporation is to improve the educational and vocational opportunities of persons who are attending, or plan to attend, eligible institutions by administering, guaranteeing and/or financing loans to such persons to assist them in meeting their educational expenses. The Foundation also serves as a guarantee agency for the Federal Family Education Loan Program (FFELP).

The Foundation has been authorized under the provisions of Section 10a-201 to administer (collect repayments and otherwise service) Connecticut guaranteed loans for lenders and their assignees since 1980. Beginning in July 1989, the Foundation became a direct participant in the secondary market for student loans whereby it has purchased and holds, in part as a revenue-producing investment, portfolios of loans originally issued by other authorized lending institutions. It is presumed that this activity provides lenders with the necessary liquidity to offer additional student loans. The Foundation's loan servicing and secondary market activities are discussed in this report under separate headings.

Board of Directors and Administrative Officials:

Under the provisions of Section 10a-203 of the General Statutes, as amended by Section 6 of Public Act 07-109, effective July 1, 2007, and Public Act 08-149, effective July 1, 2008, the Foundation is governed by a Board of Directors consisting of 14 members. Six public members are appointed by the Governor with at least one member representing an eligible institution of higher education and at least one member having a favorable reputation for skill, knowledge and experience in management of a private company or lending institution at least as large as the corporation. Another public member, having financial expertise, is appointed by the Board. There are also four members with knowledge of business or finance, one each appointed by the speaker of the House of Representatives, the minority leader of the House of Representatives, the president pro tempore of the Senate and the minority leader of the Senate. The Chairman of the Board of Governors of Higher Education, the Commissioner of Higher Education, and the State Treasurer are ex officio members of the Board. The Board of Directors elects from its own members each year a chairperson and a vice chairperson. The directors receive no compensation for their services, but are reimbursed for expenses incurred in the performance of their duties.

Membership of the Board, as of September 30, 2008, is presented below:

T. Brian Condon, Chairperson
William J. Lucas, Vice Chairperson
Stephen B. Keogh, Esq., Secretary
Gregory C. Davis, Esq., Assistant Secretary
David S. Artega
Ryan Barry

Dan Debicella
Michael Meotti, Commissioner of Higher Education
Denise Nappier, State Treasurer
Patrick B. O'Sullivan II
Frank W. Ridley, Chairman of the Board of Governors of Higher Education
Robert C. Schatz
Jack Testani
vacancy

Senator Anthony Guglielmo, Senator John A. Kissel, Senator Bob Duff, William P. Hawkins, Representative DebraLee Hovey, Valerie Lewis, Commissioner of Higher Education and Harry H. Penner, Jr., Chairman of the Board of Governors of Higher Education, also served as members of the Board during the period covered by this examination.

The Board experienced a significant number of changes after September 30, 2008. Senator Dan Debicella resigned and was succeeded by Michael E. Hahn in February 2009. In March 2009 the following gubernatorial appointments were replaced:

T. Brian Condon
William J. Lucas
Stephen B. Keough
Gregory C. Davis
Patrick B. O'Sullivan II
Robert C. Schatz

The following new gubernatorial appointments were made in March 2009:

Lisa Kelly Morgan, Chairperson
Julie M. Drouin
Michael E. Hahn
Walter Harrison
William McGurk
John Schuyler
Pamela Partridge West

In May 2009, the following individuals resigned from the Board:

Lisa Kelly Morgan
David S. Artega
Ryan Barry
Julie M. Drouin
Michael E. Hahn
Walter Harrison
William McGurk
John Schuyler
Jack Testani
Pamela Partridge West

As of June 2009, the Foundation's Board consisted solely of the Foundation's three ex-officio members as follows: Michael Meotti, Chairperson; Howard Rifkin, Vice Chairperson; and Frank Ridley, Secretary. Mr. Mark Valenti served as President of the Foundation throughout the audit period and until he was terminated from employment with the Foundation in June 2009. R. Richard Croce was appointed Acting President effective June 2009.

Recent State Legislation:

An Act Concerning the Connecticut Student Loan Foundation - Public Act 07-109, effective July 1, 2007, extends the Foundation's bonding authority to a nonprofit subsidiary of the Foundation. The Act (1) authorizes the Foundation or its subsidiary to issue Federal tax-exempt bonds, notes, or other obligations, subject to the private activity bond cap and (2) requires CSLF or its subsidiary to fund borrower benefits with the savings it achieves by issuing these bonds. It also exempts any bonds issued by the Foundation or its subsidiaries and any transfer of or income generated by the bonds, from any State and local taxes, except for State estate and succession taxes. The Act adds the State Treasurer, or the Deputy State Treasurer if designated by the Treasurer, to the Foundation's Board of Directors. The Act explicitly allows the Foundation to make, guarantee, and acquire loans not governed by Federal law (i.e. alternative loans) as well as Federal loans. The Act also makes various technical and conforming changes.

An Act Concerning Borrower Repayment and the Connecticut Student Loan Foundation - Public Act No. 08-177, effective June 12, 2008, authorizes the Foundation to repay certain borrowers 10 percent of their Federal student loans made or guaranteed by the Foundation. Eligible borrowers must be State residents when they apply for repayment, meet any applicable income limitations and criteria for subsidized Federal student loans under the 1965 Higher Education Act, have successfully completed the program for which the loan was made, and have applied for repayment between July 1, 2005 and December 31, 2008. The loans must be for an academic period prior to July 1, 1979. The Act also requires that on May 15, 2009, the Foundation must refund the Department of Higher Education (DHE) any unspent appropriations for the repayment program that DHE originally transferred to the Foundation. This program had previously been authorized under Section 10-206, subsection (c), of the General Statutes and had been repealed by Public Act 05-184, Section 6, effective July 1, 2005.

RÉSUMÉ OF OPERATIONS:

Fund Structure:

The financial record keeping practices of the Connecticut Student Loan Foundation are generally governed by Section 10a-213 of the General Statutes, which specifies that there shall be two funds for the Foundation, (1) unrestricted and (2) restricted. The 1998 Amendments to the Higher Education Act of 1965 mandated significant changes to guaranty agency financial structures; in response, Connecticut Student Loan Foundation management modified the accounting and reporting structure, and restated the beginning fund balances of the Restricted Federal Reserve Fund (formerly the Restricted Fund) and the Unrestricted Fund, as of October 1, 1998, by transferring items specified in the regulations to specific funds. Additionally, the Foundation established the Restricted

Collections Fund to temporarily account for receipts of borrower payments on defaulted loans. It contains both Federal Reserve Fund and Unrestricted Fund cash. Although the Foundation maintains this Fund structure, effective with the fiscal year ended September 30, 2003, its audited financial statements do not present the Funds separately. This change was made to comply with the reporting requirements of the Governmental Accounting Standards Board Statements No. 34, 37 and 38. For informational purposes the financial statement footnotes include a summary of the financial position and the changes in net assets as of each fiscal year-end for each of the Funds.

Unrestricted Fund:

The Unrestricted Fund was established to account for the administrative and general operations of the Foundation, including the secondary market investment, administration of defaulted loans, administration of the guarantee loan program, loan servicing activities, real estate activities, and fixed assets purchased with non-Federal funds.

We are not presenting, as part of this report, the formal financial statements of the Fund. Presented below is a summary of the schedule of the Fund's revenues and expenses presented in the footnotes to the financial statement audited by the Foundation's Independent Public Accountant for the fiscal years ended September 30, 2006 and 2007, as compared with the fiscal year ended September 30, 2005. The figures for the fiscal year ended September 30, 2008, were obtained from the Foundation's internal financial statements. It should be noted that certain 2004-2005 and 2005-2006 amounts have been reclassified to be consistent with the 2006-2007 presentation.

	Fiscal Year Ended September 30,			
(In Thousands)	**2005**	**2006**	**2007**	**2008**
Revenues:	**$**	**$**	**$**	**$**
Guarantee Program Revenues	9,359	10,771	10,041	9,192
Investment Income	28,612	41,729	58,323	53,542
Other	498	220	251	388
Total Revenue	38,469	52,720	68,615	63,122
Expenses:				
Interest	17,271	28,806	41,471	34,957
Secondary Market	8,595	5,676	10,426	12,962
Salaries and benefits	10,011	11,643	10,170	8,861
Collection costs	2,271	2,431	2,504	2,459
Building, Equipment and software	878	2,165	3,507	2,051
Other expenses	2,687	2,658	2,989	2,957
Total Expenses	41,713	53,379	71,067	64,247
Other changes in Fund Balances/Net Assets	608	0	0	0
Excess of Revenues over Expenses	**$ (2,636)**	**$ (659)**	**$(2,452)**	**$ (1,125)**

Investment income from student loans financed with bond proceeds accounts for the majority of the Foundation's revenues. This is offset by the interest paid to bondholders. Because of the variable interest rates associated with the Foundation's investments and related debt, investment income and interest expense is directly related to market conditions. Accordingly, higher interest rates during fiscal years 2005-2006 and 2006-2007 resulted in significant increases in investment income and interest expense.

The two major sources of guarantee program revenues are defaulted loan recoveries and account maintenance fees. The Foundation maintains a collection effort on defaulted loans and is permitted to retain a specific percentage of those collections, while the bulk of them are paid to the Federal government. Guarantee program revenues decreased during the 2006-2007 fiscal year due to a decrease in defaulted loan recoveries. Guarantee program revenues decreased during the 2007-2008 fiscal year due to a decrease in account maintenance fees due to changes in Federal legislation, effective October 1, 2007, that reduced the account maintenance fees from .10% to .06% of outstanding guarantees.

Other revenue decreased by $278,000 from the 2005-2006 fiscal year to the 2006-2007 fiscal year primarily due to a decline in loan servicing revenue. The Foundation ceased loan servicing activities for other organizations and outsourced its portfolio to other servicers during the 2006-2007 fiscal year.

Employee compensation and fringe benefit costs continued to be a significant operating expense of the Foundation. The fiscal year 2005-2006 expenses increased approximately $1,632,000 primarily due to a pension adjustment that included an early retirement offer. The fiscal year 2006-2007 expenses decreased by $1,472,000 due to layoffs and early-retirements due to the closing of the Servicing Department. The fiscal year 2007-2008 expenses decreased by $1,227,000 due to additional employee layoffs and due to changes in the Foundation's pension plan. Effective May 1, 2008, the Foundation froze its defined benefit plan and created a defined contribution plan. The number of filled positions decreased during the audited period from 162 as of September 30, 2005 and 2006, to 126 and 96 as of September 30, 2007 and 2008, respectively.

The Foundation's greatest secondary market expense is bond interest expense. The Foundation issues variable auction rate certificates. During the 2007-2008 fiscal year, the capital markets for student loans began to experience significant disruptions, resulting in decreased margins on loans. The cost to issuers of subordinate auction rate securities backed by student loans became much more expensive. The Foundation has experienced a reduction in student loan spread and related portfolio interest income, as well as increased rates on its interest payable for bonds.

Building, equipment and software costs increased during the 2006-2007 fiscal year due to an adjustment to reduce capitalized software costs in the amount of $1.2 million, as a result of entering into an agreement with an outside organization that allows CSLF to have access to a guarantee and collection system.

The Unrestricted Fund had assets totaling $709,210,000, $874,134,000 and $962,035,000, liabilities totaling $695,736,000, $863,112,000 and $952,235,000, and net assets of $13,474,000, $11,022,000 and $9,800,000, as of September 30, 2006, 2007 and 2008, respectively.

Restricted Funds:
Federal Reserve Fund:

The Federal Reserve Fund has been established and is used to account for the operations of the Foundation relative to its guarantee agency responsibilities. Included in the Fund are assets belonging to the Secretary, U. S. Department of Education; which includes the reinsurance compliment portion of default loan recoveries, reinsurance payments, Federal advances, Federal recall deposits and fixed assets purchased with Federal funds.

As with the Unrestricted Fund, we are not presenting, as part of this report, the formal financial statements of the Fund. Presented below is a summary of the schedule of the Fund's revenues and expenses presented in the footnotes to the financial statement audited by the Foundation's Independent Public Accountant for the fiscal years ended September 30, 2006 and 2007, as compared with the fiscal year ended September 30, 2005. The figures for the fiscal year ended September 30, 2008 were obtained from the Foundation's internal financial statements. It should be noted that certain 2004-2005 and 2005-2006 amounts have been reclassified to be consistent with the 2006-2007 presentation.

	Fiscal Year Ended September 30,			
(In Thousands)	**2005**	**2006**	**2007**	**2008**
Revenues:	$	$	$	$
Guarantee Program Revenues	345	1,179	2,689	3,078
Investment Income	267	347	376	234
Other	31	29	28	2
Total Revenue	643	1,555	3,093	3,314
Expenses:				
Building, Equipment and software	35	32	32	5
Other expenses	1,970	2,331	1,565	2,913
Total Expenses	2,005	2,363	1,597	2,918
Other changes in Fund Balances/Net Assets	(739)	1,559	0	0
Excess of Revenues over Expenses	**$ (2,101)**	**$ 751**	**$1,496**	**$ 396**

The primary activity accounted for in this Fund is the Federal loan guarantee or reinsurance. Under the Federal program, the Federal government reimburses the Foundation a certain percentage of the amount the Foundation pays to lenders on defaulted loans. The Foundation accounts for these transactions through an asset account on its balance sheet; therefore, the related transaction information is not presented above. The Foundation's payments to lenders were $29,529,000, $35,592,000 and $44,901,000, for the fiscal years ended September 30, 2006, 2007 and 2008, respectively, while the reimbursements received and accrued from the U.S. Department of Education were $28,366,000, $34,134,000 and $42,876,000, respectively. Federal reinsurance is discussed further in the "Federal Program" section of this report. Prior to July 1, 2006, there was an optional guarantee, or insurance fee, that was authorized under the program that could be charged directly to the lenders and passed on to borrowers. The Foundation elected to waive this fee for all borrowers for loans guaranteed on or after June 1, 1999, citing industry pressures created by larger competitors as the reason for that decision. As previously noted, effective July 1, 2006, Federal law replaced the optional guarantee fee with a mandatory one percent Federal default fee. The Foundation deposits this fee into the Federal Reserve fund as required. The Foundation's greatest expense in this fund is for unreimbursed guarantee fees.

The Federal Reserve Fund had assets totaling $8,968,000, $9,199,000 and $9,759,628, liabilities totaling $6,446,000, $5,181,000 and $5,345,067, and net assets of $2,522,000, $4,018,000 and $4,414,561, as of September 30, 2006, 2007 and 2008, respectively.

Restricted Collections Fund:

The Restricted Collections Fund is a restricted clearing account for cash collected on borrowers' defaulted loans. The account includes recoveries payable to both the Federal Reserve Fund and Unrestricted Fund, as well as to the U.S. Department of Education. Transfers to the Federal Reserve Fund and the Unrestricted Fund, inclusive of each Fund's respective share of interest earned, are made within 30 days of receipt. The Fund had assets of $3,114,000, $1,966,000 and $1,866,403 as of September 30, 2006, 2007 and 2008, respectively. These assets included $2,057,000, $1,289,000 and $1,284,356 that were due to the U.S. Department of Education for the same years, respectively.

Federal Programs:

CSLF serves as a guarantee agency for the Federal Family Education Loan Program (FFELP), formerly known as the Stafford or Guaranteed Student Loan Program, (CFDA #84.032), as authorized by Title IV-B of the Higher Education Act of 1965, as amended. The objective of the program is to authorize and make available guaranteed loans for educational expenses from eligible lenders. These loans may be insured and reimbursed through a state or private nonprofit guarantee agency, such as CSLF, which has entered into basic program and supplementary agreements with the Federal agency.

New loan guarantees made during the fiscal years ended September 30, 2006, 2007 and 2008, totaled $549,066,586, $326,588,529 and $197,223,890, respectively. These loan guarantees were made under provisions of the following Federally-sponsored loan programs:

Federal Stafford Student Loans:
Formerly known as the Guaranteed Student Loan Program (GSLP), now referred to as the Federal Family Education Loan Program (FFELP), this program guarantees low-interest loans made by commercial lenders to eligible students. The U.S. Department of Education pays interest to holders of subsidized loans during the in-school, grace and deferment periods. Commencement of loan and interest repayment generally begins after graduation or discontinuance of a course of study, or reduction to less than half-time study. For unsubsidized Federal Stafford Loans, the borrower is required to pay interest from the time the loan is made. Unsubsidized Federal Stafford Loans became available on October 1, 1992.

Federal Parent Loans for Undergraduate Students (PLUS):
Loans guaranteed under this program are available to parents of dependent students. Loan interest is not subsidized, and the repayment of principal and interest begins within sixty days after the loan has been fully disbursed. Commercial lenders make the loans at a variable interest rate set by the Federal government. Loans that originated after July 1, 2006, have a fixed interest rate.

Graduate and Professional Student PLUS Loans:
Beginning July 1, 2006, loans guaranteed under the PLUS program became available to graduate and professional students. These loans have a fixed interest rate and repayment begins within sixty days after the loan has been fully disbursed.

Consolidation Loans:
Congress authorized the Consolidation Loan Program in October 1986. By consolidating various student loans, borrowers can bring their debt to a manageable level by reducing the monthly payment. With consolidation loans, the repayment period can be extended to as long as 30 years. The Foundation stopped offering consolidation loans as of January 2008.

The actual loans are made through authorized private lending institutions under the provisions of the Higher Education Act of 1965, as amended.

A major source of revenue arises directly or indirectly from this program. These include Federal payments received and accrued for account maintenance fees, the portion of loan recoveries retained when payments are received from defaulting borrowers, loan processing and issue fees, and investment income earned on Federal Recall funds. The Foundation also receives default reinsurance payments, which as previously noted, are accounted for in the Restricted Federal Reserve Fund, through an asset account. In the event that the borrower defaults on a loan, the Foundation, as the guarantee agency, reimburses the lender the unpaid principal and interest, and the Federal government subsequently reimburses the Foundation. The reinsurance payments represent the reimbursements received or accrued during the fiscal year. Prior to October 1, 1993, the Federal reinsurance rate was 100 percent of claims amounts. Federal reinsurance was reduced to 98 percent for defaults on loans made after October 1, 1993, and to 95 percent for defaults on loans made after October 1, 1998. In order for a guarantee agency to receive the maximum percent of reimbursement, the Agency must not exceed an annual default rate of five percent. At the time of our review the default rate for the 2007-2008 was unavailable. A comparison of the default rate for the 2005-2006 and 2006-2007 fiscal years as compared to the 2004-2005 fiscal year is as follows:

	Federal Fiscal Year Ended September 30,		
	2005	**2006**	**2007**
Annual default percentage	3.12	2.33	2.58

During the fiscal years ended September 30, 2006 and 2007, the Foundation received the maximum percent of reinsurance payments for the default payments it made to lenders. However, if the annual default rate climbed to five percent, reinsurance payments would drop in accordance with a set of formulas that are used to calculate the payments. Should the Foundation subsequently recover any monies from the borrowers of defaulted loans, it is permitted to retain a percentage of those monies that varies in accordance with applicable regulations, plus the applicable reinsurance compliment. The reinsurance compliment is equal to 100 percent of the lender claim amount less the percentage reimbursed by the U. S. Department of Education. The remainder is paid to the Federal government. Defaulted loan recoveries, excluding the reinsurance compliment, are reported as revenue in the Unrestricted Fund. The reinsurance compliment is reported as revenue in the Restricted Federal Reserve Fund. As of September 30, 2008, the principal balance of defaulted loans in repayment was $31,056,370

Prior to July 1, 2006, there was an optional guarantee, or insurance fee, that was authorized under the program that could be charged directly to the lenders and passed on to borrowers. The Foundation elected to waive this fee for all borrowers for loans guaranteed on or after June 1, 1999, citing industry pressures created by larger competitors as the reason for that decision. As previously noted, effective July 1, 2006, Federal law replaced the optional guarantee fee with a mandatory one percent Federal default fee. The Foundation deposits this fee into the Federal Reserve fund as required.

Effective October 1, 2007, the Federal College Cost Reduction and Access Act made significant changes to the FFEL program. Some of the key provisions impacting the Foundation include: (1) reduction of account maintenance fees from .10% to .06% of outstanding guarantees; (2) reduction of collection retentions from 23% to 16% on direct collections from borrowers; (3) increase in lender fees from .50% to 1.00%; and (4) reduction of special allowance revenue by .40% on Stafford and Consolidation loans and .70% on PLUS loans.

The Foundation has terminated its participation as a lender in the Federal Family Education Loan Program effective for the 2009-2010 academic year.

Private Programs:

On October 3, 2005, the Foundation introduced its new alternative loan program named “First Rate Solutions.” This non-Federal program offers a variable rate to borrowers who are going to school less than half time or half time and greater. For loans made prior to April 2008, the variable rate is based on the prime rate plus a margin established by the lender. The rate shall not exceed ten percent and is revised quarterly. For loans made on or after April 1, 2008, the interest rate is variable and based on the prime rate. The principal amount of the loan cannot be less than $2,500 and the maximum cumulative borrowing can not exceed $100,000. As of September 30, 2008, there were 1,219 loans outstanding with a principal balance of $12,547,425. The Foundation stopped offering alternative loans in February 2009.

Loan Servicing:

As previously mentioned, since 1980 the Foundation has been authorized to provide loan servicing to all holders of Connecticut student loans. The Foundation has established the Connecticut Assistance for Loan Servicing (CALS) to function as a semi-autonomous servicing department within the Foundation. The services offered include, for a fee, such duties as disbursing loans, providing for the collection of Federal interest subsidies, collections of principal and interest from borrowers, performing student status checks, and preparing required forms and correspondence.

During the fiscal year ended September 30, 2005, CALS primarily serviced loans guaranteed by the Foundation under the Federal loan guarantee program that were owned by direct lenders or secondary market organizations. As mentioned previously, during the audit period, the foundation ceased loan servicing for other organizations and also began outsourcing its own portfolio to other servicers. Effective April 2007, the entire portfolio was outsourced and all loan servicing functions were eliminated.

Secondary Market Lending Activity:

As of July 1, 1989, the Foundation became a direct participant in the secondary market for student loans whereby it has acquired loans originally issued by authorized lending institutions. The Foundation's entry into this market came about through its acquisition of the loan portfolios held by the State Treasurer's Connecticut Student Loan Program, also known as the "Susie Mae" program. This program, established by the State in 1972, purchased guaranteed student loans from the original lending institutions and was an investment in the State's Short Term Investment Fund (STIF) administered by the State Treasurer. From 1981 until 1989, CALS was the primary servicer of the "Susie Mae" loans.

On July 7, 1989, the Foundation entered into an agreement with the State under which it purchased the total "Susie Mae" portfolio with a value of approximately $37,000,000 at the time of transfer. This acquisition was funded through a revolving loan made by the State Treasurer from STIF. The nature of the loan agreement is such that the Foundation is allowed to purchase additional student loan portfolios from lenders as they become available. The agreement currently provides for a ceiling of up to $100,000,000. The loan agreement was not used during the period under review and as of September 30, 2007, the loan agreement had a zero balance.

The majority of the Foundation's loans are made using taxable bond proceeds. During the audited period the Foundation issued the following taxable Student Loan Revenue Bonds as Auction Rate Certificates:

Date	Amount	Description
July 2006	$80,000,000	Senior Series 2006-A-1
July 2006	$20,000,000	Subordinate Series 2006B
December 2006	$100,000,000	Senior Series 2006A-2
July 2007	$60,000,000	Senior Series 2007A-1
July 2007	$20,000,000	Subordinate Series 2007B
December 2007	$50,000,000	Senior Series 2007A-3

In December 2007, the Foundation issued tax exempt bonds for the first time. The Foundation issued $36,900,000 in Subordinate Series 2007 B-2 Tax Exempt Student Loan Revenue Bonds.

The proceeds of the above bond issues were used for the financing of additional student loans and related costs of issuance and to refinance the Foundation's outstanding Student Loan revenue

Bonds under its 1995 indenture.

The outstanding principal due to all bondholders as of September 30, 2008, was $935,900,000. The Foundation's investment in student loan portfolios as of September 30, 2008, was $757,896,510, all of which was financed by Student Loan Revenue Bonds

State Funded Student Loan Forgiveness Program:

Prior to July 1, 2005, Section 10a-206, subsection (c), of the General Statutes required the Foundation to make a ten percent forgiveness payment to certain student borrowers who have had loans guaranteed by it. To qualify for this payment, a borrower must meet certain criteria including: the loans must have been for academic periods prior to July 1, 1979; the borrower must have been a State resident at the time of application; the student must graduate from the program the loans applied to; and full repayment of the loans must have occurred. The ten percent is calculated on the total amount repaid (principal and interest) and is paid directly to the borrower. Effective July 1, 2005, Public Act 05-184, Section 6, removed subsection (c) of Section 10a-206 of the General Statutes. The forgiveness program was subsequently reinstated with the passage of Public Act 08-177, effective June 12, 2008.

A summary of program activity for the fiscal years ended September 30, 2005, 2006, 2007 and 2008 is presented below:

Fiscal Year Ended	Payments	Unexpended Balance
September 30, 2005	7,496	94,976
September 30, 2006	1,867	93,109
September 30, 2007	0	93,109
September 30, 2008	1,207	92,904

The unexpended balance of the forgiveness program appropriation is invested in a separate STIF account and is included as part of the Unrestricted Fund cash balance. Effective May 15, 2009, the program was closed in accordance with Public Act 08-177 and the unexpended balance was returned to the State Department of Higher Education.

Audits by Independent Public Accountants (IPA):

The U.S. Department of Education regulations require that each "guarantee agency shall arrange for an independent financial and compliance audit of the agency's Federal Family Education Loan Program (FFELP.)" As mentioned previously, such audits were performed for the fiscal years ended September 30, 2006 and 2007. At the time of our review the audit covering the fiscal year ended September 30, 2008 had not been completed.

Four matters were reported in the management letter accompanying the audit for the fiscal year ended September 30, 2006. The IPA cited negative cash flow from operations to be approximately $2,400,000. Significant changes to the way the Foundation services its loans were implemented during the fiscal year ended September 30, 2006. The IPA recommended that these changes be evaluated to ensure a positive impact on the Foundation's cash flow and operations and management should continue to implement plans to improve cash flows and surpluses from operations. The IPA also noted that there were two policies in place for expense reimbursements and recommended that the Board review the policy adopted by the Board in 1983, update it and formally act upon a current policy and recommended that expense policies should be in compliance with IRS Guidelines. Lastly, the IPA recommended that the Foundation's employee manual, which was last updated in 2000, be revisited at a minimum every 5 years to verify its ongoing applicability and to take into consideration applicable changes inside and outside the Foundation. We noted that the manual was subsequently revised in June 2007. The IPA also noted three areas where they found instances of noncompliance with Federal regulations with respect to the Federal Family Education Program.

Two matters were reported in the management letter accompanying the audit for the fiscal year ended September 30, 2007. The IPA cited negative cash flow from operations of approximately $8,800,000 during the fiscal year ended September 30, 2007. The overall projection is that cash flows from operations continues to be negative. The IPA noted that the Audit and Finance Committee has been addressing the overall issues of cash flow for the Foundation. The IPA also noted that "going" concern refers to a company's ability to continue functioning as a business entity. If the Foundation continues to incur losses, this issue will need to be revisited in future periods.

At the time of our review, a management letter had not been issued for the fiscal year ended September 30, 2008.

Federal Audits and Reviews:

Additionally, the Foundation has been subject to Federal examinations and reviews by the U.S. Department of Education. A review was conducted in July 2007, in accordance with the Improper Payments information Act of 2002 (IPIA). The purpose of the review was to determine whether payments made to Lenders and Guaranty Agencies were proper and appropriate, and to determine an error rate in accordance with the IPIA. Two payments made to the Foundation and a statistically valid sample of loans were selected for review. As of the date or our review, the resolution of this review was pending. In August 2008, a review of the Foundation's compliance with the establishment of the Federal and Operating Funds as required by the Federal Higher Education Act of 1965, as amended by the Higher Education Amendments of 1998 (enacted on October 7, 1998) was performed. This review covered the period October 1, 1997 through September 30, 1999. It appears this review was conducted as a result of the Office of the Inspector General's recommendations for improving Federal monitoring of Guaranty Agency Compliance with the establishment of the Federal and Operating Funds. As of the date of our review, the resolution of this review was pending. In May 2009, a review of the Foundation's future reserve ratios and guarantor solvency was performed. As of the date of our review, the resolution of this review was pending.

EVENTS PRECEDING PUBLICATION OF THE AUDIT REPORT:

As mentioned previously, there were significant changes to the composition of the Board of Directors subsequent to the audit period. In March 2009, Governor M. Jodi Rell replaced six members of the Board of Directors and in May 2009, all but three members of the Board resigned. At the time our audit was completed, the sole remaining members of the Board were the three ex-officio members.

Upon completion of our field work in June 2009, we sought an Agency response to the audit findings from the Board. We received a response to the audit findings from the President of the Foundation. The President's response was not approved or researched for accuracy by the Board. Within days of receipt of that response, and prior to the publication of our report, the President was terminated from his employment with the Foundation and we were unable to contact him regarding the response provided. Our standard Office policy, which was explained in our memo requesting a response from the Foundation referred to above, is that our Office reserves the right to provide additional comments following the auditee's response if we believe that their responses are incorrect or misleading. We believe that the responses provided by the former President were in fact misleading. Therefore, concluding comments were drafted and included in this report. In light of the President's departure, we contacted the Foundation's current three-member Board for guidance on whether to proceed with the presentation of the former President's response or whether they preferred to provide a statement from the Board to be incorporated into our report. We were provided with the following official response from Michael Meotti, Chairman of the Board and Commissioner of the Department of Higher Education:

> ***"On behalf of my fellow members of the Board of Directors of the Connecticut Student Loan Foundation (Deputy Treasurer Howard Rifkin and Chair of the Board of Governors of Higher Education Frank Ridley), I would like to respond to the Draft of Preliminary Audit Findings for the Connecticut Student Loan Foundation (CSLF) dated June 1, 2009.***
>
> ***The Board shares your concerns about the practices described, especially given the public nature of the entity and its ongoing financial difficulties. We will be taking immediate steps to assure that any continuing inappropriate compensation and fringe benefit practices are stopped.***
>
> ***We will keep your office advised as we move forward on these matters of mutual concern."***

We included the former President's response in the following Condition of Records section of this report immediately following each recommendation. We noted that the response received was not in the format required for inclusion in our audit report. For presentation purposes, attachments were omitted, references to attachments were modified and individual headings within the responses were removed. The Auditors' Concluding comments follow each response provided by the former President.

CONDITION OF RECORDS

Our review of the records of the Connecticut Student Loan Foundation revealed the following areas that warrant comment. As mentioned previously in the section of this report entitled Events Preceding Publication of the Audit Report, we received a response to the findings from the former President of the Foundation. Subsequent to his departure, we also received a separate official response from the current Board of Directors of the Foundation, which appears at the end of this section. Immediately following each recommendation is the response provided by the former President of the Foundation. The Auditors Concluding Comments presented below are in response to the comments received from the former President of the Foundation.

Credit Card Bills:

Background: The Foundation permits certain employees to use a Foundation-owned credit card for Foundation business. During the audit period, credit cards were assigned and used by the Foundation's four executives and nine employees at various times.

During the 2007 and 2008 fiscal years, the Foundation's operating expenses exceeded its operating revenues by $956,000 and $728,000, respectively, per the Foundation's audited financial statements for the 2007 fiscal year and internal financial statements for the 2008 fiscal year. We were informed that there is doubt about the Foundation's ability to continue as a going concern.

Criteria: The Foundation does not have a separate written policy governing the use of Foundation credit cards. We were informed that the Travel Expense Reimbursement Policy is followed.

The Foundation's Travel Expense Reimbursement Policy states that employees will be reimbursed for all reasonable, actual expenses incurred while they are on official business.

The policy states that a reasonable cost means a cost that, in its nature and amount, does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. Consideration must be given to:

(A) Whether the cost is of a type generally recognized as ordinary and necessary for the proper and efficient performance and administration of the Foundation's responsibilities;
(B) The restraints or requirements imposed by factors such as sound business practices, arms-length bargaining, Federal, State and other laws and regulations; and
(C) Market prices of comparable goods or services in the particular geographic area.

Travel expenses are the reasonable expenses of traveling away from home on official Foundation business. To be considered travel away from home the following criteria must be met:

(A) Your duties require you to be away from home substantially longer than an ordinary day's work, and
(B) You need to get sleep or rest to meet the demands of your work while away from home.

Employees must submit requests for travel expense reimbursements on Foundation expense report forms. Expense reports should be completed in enough detail as to be understandable by auditors.

Condition: Our review of 12 monthly credit card bills totaling $161,134 for the fiscal years ended September 30, 2007 and 2008, disclosed the following:

- We noted numerous charges for business lunches and dinners that were unreasonable in amount. We noted one charge for $311 for three of the Foundation's executives and one business associate and a charge of $440 for four executives and two business associates. We noted six restaurant charges for business meetings between the Foundation's executives and one or more former Board members in which the charges were more than $50 per person.

- We noted several expenses for meals while employees were traveling out-of state that were not reasonable in amount. We noted nine instances in which dinner charges for employees were more than $50 per person and three instances in which lunch charges were $30 or more per person. We also noted sixteen instances in which employees used the credit cards to purchase lunch while making day trips to various organizations, which did not appear to meet the requirements of the travel policy, as there was no documentation that the employees traveled away from home for substantially more than an ordinary day's work.

- We noted instances in which receipts were missing. We also noted numerous charges at restaurants in which the receipts were not itemized and we were unable to determine the number of individuals participating in business lunches/dinners and what was purchased. We also noted several charges for business lunches/dinners for which there were no detailed explanations for the purpose of the meeting and/or whom the meetings were with. We also noted numerous business lunches and dinners among only CSLF executives and/or staff, for which the business purpose was not documented.

Effect: The Foundation is paying for unreasonable, unnecessary and unsupported expenses and is not in compliance with its travel policies. The incurrence of unreasonable expenses exacerbates the Foundation's going concern problem.

Cause: There appears to be a lack of oversight by the Board of Directors. We noted that only 2 of 24 invoices were reviewed and signed by the former Chairman of the Board.

Recommendation: The Foundation should strengthen internal controls to ensure compliance with the Foundation's travel policy, including completing detailed expense reports for all credit card transactions and retaining itemized receipts. The Foundation should also consider specifying a cap on the amount of meal charges for employees traveling out of state and the monthly invoices should be reviewed by at least two members of the Board of Directors. (See Recommendation 1.)

Former Foundation President Response:

"CSLF no longer has outstanding credit cards. The Auditors of Public Accounts make repeated references to a going concern issue. To date, independent auditors have never included a going concern disclaimer in an audit opinion. However, the College Cost Reduction and Access Act (CCRAA), which became effective October 1, 2007, the collapse of the capital markets and other legislative, political and market developments since that time have been among the most challenging and detrimental to CSLF since its inception. CCRAA increased expenses to guarantors and lenders and decreased revenues to guarantors and lenders. These changes have had a devastating impact on CSLF's business model and have rendered CSLF's business potentially unsustainable.

CSLF does have a written policy that governs the use of its credit cards. A copy of the written policy which is provided to employees who had CSLF credit cards…[was furnished to the Auditors along with this response].

Specific items listed under "Condition" are not unreasonable, unnecessary or unsupported expenses. CSLF is in a competitive business which requires sales, marketing and other business related expenditures. CSLF receives no funding from the State of Connecticut and is not a State or quasi-public agency. CSLF functions within the regulations of the Federal program in which it participates and is not required to follow governmental meal allowances. A Federal review in May 2009 indicated no findings related to the expenditures noted.

CSLF's travel policy is not intended to provide guidance for day trips. This policy cannot be applied to these expenses. It has been a long standing CSLF policy that lunch would be covered if an employee was caused to be away from the office for the entire day. Sufficient documentation is required for expenditures. In addition to documentation, credit card bills with accompanying notations provide appropriate documentation.

CSLF requests receipts for all transactions. It does not require that an itemized list of food or number of participants be on receipts for restaurant charges. In cases where an employee misplaces a receipt, expenses are approved at the discretion of the appropriate manager or executive. In all cases CSLF requires enough information about the transaction to substantiate the expenditure and allocate the expense appropriately.

Signed copies of the credit card bills from January 2007 through June 2008…[were provided to the Auditors along with this response]. Bills for July 2008 through September 2008 are pending approval. They have not been approved to date due to the illness of the past Chairman of the Board who was out of state and undergoing medical care for a significant period of time. In addition, since his replacement in March 2009, CSLF's Board has been in a constant state of flux…

Pursuant to its credit card policy CSLF requires that its credit cards be used within the parameters of its travel and purchasing policies. Completing expense reports for credit card usage is not necessary. Expense reports are used to reimburse employees for expenses the employee incurs out of pocket. The purpose of corporate credit cards is to allow CSLF to be billed directly and eliminate the employee's need to incur out of pocket expenses. It also provides ease of reference. This is a common business practice.

Use and review of credit card invoices by the President or his designee are activities within the normal course of conducting business. CSLF does have a procedure which requires all credit card transactions of the President to be reviewed by the Chairman of the Board. As previously stated, CSLF no longer uses company credit cards."

Auditors' Concluding Comments:

The essence of the former Foundation President's response is that the Foundation can spend the Foundation's money as they desire subject only to the specific disapproval of the Board of Directors. While this is legally accurate, it misses the point of the finding, which is that the expenses cited appear to be unnecessary and ultimately have contributed to the Foundation operating in a deficit position. Operating at a deficit has led to questions regarding whether the Foundation will be able to continue operations.

The policy governing the use of credit cards that the former Foundation

President has referenced is a series of emails from the Foundation's Executive Manager to the credit card holders asking that they keep certain things in mind. These emails do not constitute a policy.

In the instances reported in which we could not determine the purpose of the business lunches or dinner, there were no notations on the credit card bills. In addition, without requiring itemized receipts, the Foundation is unable to identify inappropriate purchases such as purchases of alcohol, which is contrary to the Foundation's policies.

We were informed by the U.S. Department of Education that a review of expense transactions was not within the scope of the review they conducted at the Foundation in May 2009. They performed an assessment of the Foundation's future reserve ratios and guarantor solvency in order to assess the Foundation's administration of the Federal Family Education Loan program. A report on this review has not yet been issued.

At the time of our review, the credit card bills that were provided to us by the Accounting Department did not include the former chairman's signature on them.

Unreasonable/Unnecessary Expenses:

Background: During the 2007 and 2008 fiscal years, the Foundation's operating expenses exceeded its operating revenues by $956,000 and $728,000, respectively, per the Foundation's audited financial statements for the 2007 fiscal year and internal financial statements for the 2008 fiscal year. We were informed that there is doubt about the Foundation's ability to continue as a going concern.

Criteria: Sound business practices dictate that expenses incurred by non-profit organizations should be necessary and reasonable in nature and amount.

Condition: Controlling unnecessary expenses is particularly critical when there is a going concern issue. Our review of expenses for the fiscal years ended September 30, 2007 and 2008, disclosed the following expenses that we question as being unnecessary or unreasonable:

- $660 for four tickets to the Big East Basketball Tournament held in March 2007.
- A donation in the amount of $1,000 paid in July 2007 to the Basketball Hall of Fame for the UCONN women's basketball coach's Court of Honor plaque.
- $980 for four club seats for the 2008 University of Connecticut football season and $5,600 for the required donation to purchase the tickets.

- $1,100 paid in March 2007 to a golf open for a foursome sponsorship.
- Two monthly payments to a golf club during the fiscal year ended September 30, 2008, in the amounts of $2,467 and $946, respectively. Included in both of these amounts were monthly dues of $525. Also included in the $2,467 payment were golf and pub charges totaling $780 that appear to be expenses incurred by a former Board member and his party, based on the notations on the invoice. Also included were charges totaling $292 for fees incurred by the President while golfing on a weekend and on a vacation day that were reimbursed by the President based on the approval of the President himself.
- The Foundation contributed toward the cost of a retirement party held in March 2007 for the Financial Aid Director of a State university. The restaurant cost was $2,410, of which the Foundation paid $1,265, with the remaining amount of $1,145 collected from others attending the function. The Foundation also paid $385 for a band hired to play at the party, $451 for invitations and postage and $97 for a plaque.
- The Foundation paid $4,459 in restaurant charges for a holiday party held in December 2006 for the Board of Directors, executive and management level staff and their guests for a total of 62 individuals. We also noted a payment of $1,884 for three stretch limousines and one sedan to provide transportation to this party for certain Board members, Foundation staff, and guests. We also noted the President was reimbursed for a $50 tip to one of the limousine drivers, although the tip was already included in the bill, and a $40 tip for musicians playing at the party. We noted that this party was in addition to the holiday party held the next day for employees of the Foundation. We also noted purchases totaling $2,427 and $1,628, respectively, for prizes for the employee holiday luncheons held in December 2006 and 2007. We were informed that a separate party for the Board and executives was not held in December 2007.

Effect: The incurrence of unnecessary, unreasonable expenses exacerbates the Foundation's going concern problem.

Cause: It appears that the Foundation staff believe such expenses are necessary as part of the Foundation's marketing and advertising efforts.

Recommendation: The Foundation should institute internal controls to ensure only reasonable and necessary payments are made. (See Recommendation 2.)

Former Foundation President Response:

"Expenses incurred have been necessary and reasonable given both their nature and the competition within the industry. In this highly competitive business environment, which also includes for-profit entities, it is necessary to incur marketing, sales and advertising expenses to maintain and increase business. These expenditures, among other things, allow customers and potential customers to develop a relationship with individuals within the organization. Developing good relationships with customers within this industry is essential to creating a level of confidence and trust that is needed when providing CSLF's products and services. The levels of advertising, sales and marketing that have been employed by CSLF are far from unreasonable. Examining similar expenditures of competitors within the industry would indicate that CSLF has been more than reasonable.

The student loan industry has been a highly competitive market in which not for-profit entities such as CSLF have had to compete with for-profit entities such as Sallie Mae, Bank of America and NelNet. These for-profit competitors have provided to clients' schools everything from trips and expensive dinners to opportunity funds worth millions of dollars to be used at the discretion of educational institutions' financial aid offices to make loans to students not eligible for Federal loans. These types of expenses have been eliminated due to changes in the Higher Education Act and codes of conduct promulgated by various attorneys general.

In light of the foregoing illustrations of the competition it faced, expenses incurred by CSLF for advertising, sales and marketing were reasonable and necessary at the time they were incurred. Control over unnecessary expenses is a regular CSLF practice.

During 2006 and 2007 CSLF did not have a going concern issue. In 2008 CSLF continued to promote itself in order to maintain and increase volume. It is not appropriate to examine expenses incurred in 2006 through 2008 based on a going concern issue and without knowledge of the activities that were necessary to compete and retain business.

The impact of the CCRAA, as well as legislative, political and market developments, have been detrimental to CSLF. These changes, in combination with the collapse of the capital markets, have created a potentially unsustainable business model for CSLF.

The Auditors of Public Accounts' letter dated March 5, 2009, was provided to and reviewed by a United States Department of Education (ED) review team. The team was on site in May 2009 reviewing CSLF's policies and procedures relevant to its participation in the Federal Family Education Loan Program. The ED review team had no findings or concerns related to any of the issues that the State Auditors raised in that letter."

Auditors' Concluding Comments:

The essence of the former Foundation President's response is that the Foundation can spend the Foundation's money as they desire subject only to the specific disapproval of the Board of Directors. While this is legally accurate, it misses the point of the finding, which is that the expenses cited appear to be unnecessary and ultimately have contributed to the Foundation operating in a deficit position. Operating at a deficit has led to questions regarding whether the Foundation will be able to continue operations.

The expenses reported above were incurred during the 2007 and 2008 fiscal years. During the 2007 year, the Foundation's expenses exceeded its revenues. In addition, in a management letter the Foundation's IPA cited negative cash flow from operations during the fiscal year ended September 30, 2007, and reported that the overall projection was that cash flows from operations would continue to be negative. The IPA also reported that if the Foundation continued to incur losses, the Foundation's ability to continue functioning as a business entity would need to be revisited in future periods.

The letter referenced in the former Foundation President's response was an informational letter sent to one of the Foundation's Board members that did not include the formal findings. We were informed by the U.S. Department of Education that a review of expense transactions was not within the scope of their May 2009 review at the Foundation. They performed an assessment of the Foundation's future reserve ratios and guarantor solvency in order to assess the Foundation's administration of the Federal Family Education Loan program. A report on this review has not yet been issued.

Automobile Related Benefits:

Background: The Foundation's Employee Handbook states that if employees are required to use their own car to conduct CSLF business, they will be reimbursed for mileage at the applicable Federal rate. The Foundation's Travel Expense Reimbursement Policy states that employees will be reimbursed at the standard IRS mileage rate when using their personal vehicles for business. Actual mileage should be used when calculating mileage reimbursement. Employees are required to document the date, location and purpose of their travel on the expense report. If employees drive from their home directly to a work related destination other than the office, the mileage from their home to the office must be deducted from the mileage between their home and the work related destination to determine the mileage eligible for reimbursement.

Criteria: Sound business practices dictate that gasoline cards be used for business related mileage and that car allowances be paid only to employees who require a significant amount of travel as part of their routine job duties.

Condition: Our review disclosed the following:

- During the 2006, 2007, and 2008 calendar years, the Foundation paid car allowances to 15, 16 and 17 employees, respectively, totaling $32,250, $50,730, and $51,978, respectively. Our review also disclosed that during the 2006, 2007, and 2008 calendar years, 13, 14, and 16 employees, respectively, made gasoline purchases using assigned gasoline cards totaling $25,382 $36,564, $37,713, respectively. Of the numbers reported above, 9, 11, and 13 employees, respectively, received both a car allowance and a gasoline card and 3 employees who used a gas card were also assigned Foundation-owned cars. We also noted the Foundation has no written procedures specifically governing the use of Foundation cars. One car was provided in accordance with the terms of the employee's employment contract.

- During the 2006, 2007 and 2008 calendar years, 6, 7, and 6 employees, respectively, who received either a car allowance or used a gasoline card (or both) did not maintain records of their business mileage. Therefore, we were unable to determine whether the employees had any business mileage. For those employees who did track their mileage, we noted several instances in which business mileage was not recorded in detail as required by the Foundation's travel policy. In many instances mileage was simply a total for the month communicated via email. It appears that mileage was tracked solely for the purpose of determining the taxable portion of the employees' car-related benefits for these employees.

- Of those employees who had use of a gasoline card, the Foundation's executives were among the top 5 highest purchasers of gasoline in all three years. We noted that amounts purchased by the executives were higher than those in positions that required significant traveling. We noted patterns followed by all four executives that included making multiple purchases of gasoline while on vacations and purchasing gasoline both before and after weekends and holidays. We also noted that there did not appear to be a direct correlation between the amount of travel required by the employee's job duties and the dollar amount of the car allowance. Three of the Foundation's executives were among the employees who received the highest car allowance amounts. The executive who did not receive a car allowance, was assigned a Foundation car. Following is a summary of the employees who received the largest car-related benefits for the 2008 calendar year.

Position Type	Car Allowance Amount	Dollar Amount of Gas Card Purchases	Total of Car Allowance and Gas Card Purchases	Business Miles Reported
Executive	$6,600	$4,038	$10,638	378
Executive	$6,600	$4,017	$10,617	Not tracked
Executive	$6,600	$3,463	$10,063	Not tracked
Non-management	$6,600	$2,164	$8,764	6,374
Director	$4,800	$3,189	$7,989	1,672
Manager	$4,800	$1,521	$6,321	3,043
Manager	$2,100	$4,035	$6,135	936
Manager	$3,000	$2,956	$5,956	2,134
Director	$4,800	$1,115	$5,915	1,194
Manager	$3,600	$1,651	$5,251	1,244
Executive	n/a *	$4,100	$4,100	10,205
Non-management	n/a *	$2,656	$2,656	5,754

* These employees were provided with cars owned by the Foundation.

As illustrated above, the executive with an assigned Foundation car had the greatest dollar amount of gas card purchases for the year. For this individual, we noted that the business miles reported were supported only by monthly emails documenting the beginning and ending odometer readings and the total business miles for the month, as required by the employee's employment contract. Since detailed records including the dates of business travel and where the employee traveled were not maintained, we were unable to verify the accuracy of the miles reported.

- We also noted that one Manager, not reported above, received a car allowance and gas card benefits totaling $5,315, $5,568 and $1,033 during the 2006, 2007 and 2008 calendar years, respectively, and reported zero, 240, and zero business miles respectively. It should be noted that the employee's benefits decreased during the 2008 calendar year only as a result of her being laid off in February 2008. This manager was the third highest user of gasoline during the 2006 year, despite reporting that she had no business miles.

Effect: If the Foundation had followed for all employees its travel policy of reimbursing employees for business miles driven in the employee's car rather than paying car allowances and providing gas cards, it would have saved

$39,325, $62,523, and $71,860 for the 2006, 2007 and 2008 calendar years, respectively, for the employees who tracked their mileage. Car allowances and gasoline cards are being used as a means to increase the income of executives and managers.

Although the employees were taxed on a portion of the gas card purchases they made, since the Foundation is exempt from paying Federal excise taxes, by charging personal amounts to the gas cards, employees also saved on the Federal excise taxes.

Cause: There appears to be lack of oversight by the Board of Directors. The Foundation has no written policies governing car allowances or the use of the gas cards and has no procedures in place to monitor the usage of the gasoline cards. We were informed that car allowance amounts are determined by the executives and approved by the President.

Recommendation: The Foundation should reimburse employees for actual business mileage driven or should implement policies and procedures to ensure that gasoline cards are used only for business mileage and should give car allowances only to employees whose job duties require significant traveling and the amounts of car allowances should be reviewed and approved by the Board. (See Recommendation 3.)

Former Foundation President Response:

"The concept of sound business practices is subjective and is clearly an opinion. CSLF operates in a highly competitive industry with for-profit entities. Attracting individuals with the background and knowledge required to perform specific functions requires reasonable flexibility in providing competitive compensation packages. CSLF does have a mileage reimbursement policy that is sound and is appropriately based on business mileage. Many individuals at CSLF have been required to do a significant amount of driving to provide services to schools, lenders and families. Some individuals have been provided with automobiles or allowances as part of their compensation packages. CSLF allowed the residual benefits of having gas cards and car allowances as part of compensation packages for executives and specific managers. In addition, the tracking of non-business mileage is difficult, if not impossible, to accurately verify. All employees had taxes deducted appropriately for these benefits.

Setting compensation packages for non-executive employees is an activity in the normal course of conducting business. The Board of Directors approved all benefits awarded to executives."

Auditor's Concluding Comments:

Again, the essence of the former Foundation President's response is that the Foundation can spend the Foundation's money as they desire subject only to the specific disapproval of the Board of Directors. While this is legally accurate, it misses the point of the finding, which is that the expenses cited appear to be unnecessary and ultimately have contributed to the Foundation operating in a deficit position. Operating at a deficit has led to questions regarding whether the Foundation will be able to continue operations.

Although the Foundation does have a business mileage reimbursement policy, the Foundation chose not to follow this policy for 15, 16 and 17 employees during the 2006, 2007 and 2008 calendar years, respectively.

The Foundation has used gas cards and car allowances as a means to increase the salaries of executives and managers. There was no discussion or approval documented in the minutes of the Board of Directors meetings for the increases in executive car allowances that occurred during the audit period.

Payroll and Personnel:

Background: During the audit period, the Foundation used an outside organization to process its payroll. Employee salary information, hours of work, and other payment information were entered into the payroll system by the Foundation's Human Resources Unit. The outside organization processed and delivered the payroll checks to the Foundation. Effective May 1, 2008, the Foundation changed the outside organization it used to process its payroll.

During the 2007 and 2008 fiscal years the Foundation's operating expenses exceeded its operating revenues by $956,000 and $728,000, respectively, per the Foundation's audited financial statements for the 2007 fiscal year and internal financial statements for the 2008 fiscal year. We were informed that there is doubt about the Foundation's ability to continue as a going concern.

Criteria: Good internal controls require that human resources policies and procedures be in writing, all compensation paid to employees be adequately supported and approved, employee salaries be within approved salary ranges, employees be compensated for hours worked, amounts be reviewed for accuracy and proper supporting documentation prior to payment, payroll earnings and deductions be properly coded, and salary increases approved by the Board be communicated directly by the Board to the Human Resources Unit.

The Foundation maintains an Employee Handbook that specifies the human resources policies of the Foundation.

Condition: Our review of the Foundation's payroll and personnel disclosed that the Foundation's policies and procedures should be more formal and as a non-profit organization with doubt about its ability to continue as a going concern, the Foundation should have been much more conservative in limiting its personnel expenses. Following are examples of such:

- During calendar years 2007 and 2008, thirteen and fourteen employees, respectively, were paid above the maximum salary ranges for their positions. Our review disclosed that in one of these instances, an employee received a 10 percent salary increase at the time of her annual review. One month later, the employee reduced her hours from 40 to 35 hours without any reduction in pay putting her over the salary range. The employee's hourly pay rate was increased to preserve her annual salary.

- Although the Board of Directors approved salary increases, bonuses and tax sheltered annuity contributions for the Foundation's four executives, no documentation from the Board was provided directly to the Human Resources Unit. The only supporting documentation maintained by the Human Resources Unit were letters from the President of the Foundation notifying Human Resources of the salary related changes, including his own. Our review disclosed that the executives were paid salary and bonus amounts as approved by the Board of Directors per the minutes. However, we noted that when executive salary increases were approved at the June 2007 Board meeting, the continuation of the tax sheltered annuity contributions was not explicitly stated in the minutes.

- Effective February 1, 2008, the Foundation implemented an employee incentive program in lieu of annual raises, in which employees received a 3 percent lump sum bonus, of which 50 percent was paid at the time of the employee's annual review and the remaining 50 percent was paid six months later. The only supporting documentation on hand for this change in policy was an email from the Human Resources Manager to employees explaining the change. The email also stated that incentive payments would not be added to employees' base pay. However, we noted that these payments were not identified as incentive payments in the Foundation's payroll system and were instead coded as regular earnings in the same manner that annual increases are coded.

- The Foundation has no formal written policies on bonuses and non-executive bonuses are paid at the discretion of the President. Non-executive bonuses in the amounts of at least $52,700, $30,450 and $15,000 were paid during calendar years 2006, 2007 and 2008, respectively. For two employee bonuses in the amount of $1,000 each, there was no documentation of the President's approval. We also noted there was no written documentation to support the purpose of a $10,000 bonus to one employee and $400 bonuses paid to 93 non-union employees in December 2006, and 28 former union employees after de-certification of the union in January 2007. We were informed that the $400 bonuses were announced by the President in staff meetings.

- The Foundation provided benefits to managers and executives for which there were no written policies. The Foundation reimbursed interested executives and managers 50 percent of health club fees to a maximum of $200 per year. Although the Foundation has a tuition reimbursement policy in the Employee Handbook that states employees are reimbursed after proof of a passing grade at either 50 percent with no cap or 100 percent with a $3,000 maximum per fiscal year, tuition reimbursement was paid in advance for managers and executives at a rate of 100 percent with no limit.

- The Foundation paid $18,000 per calendar year for the split-dollar life insurance premiums for the Foundation's four executives, collectively. Split dollar policies are policies in which the proceeds are split between the employer and employee. Although the Foundation did not have a copy of the insurance policies, we were informed that the executives are the sole beneficiaries of the policies. We were informed that the split dollar life insurance agreements were first dated in December 2000 and began as 20 percent executive 80 percent CSLF interest split with CSLF relinquishing ownership at the rate of 20 percent each year. For most split dollar life insurance policies, upon the employee's death, the business is usually entitled to receive from the death benefit the total of the premiums it has paid. The cost to the employer is the loss of the use of the funds while the policy is in effect, which is particularly unfavorable when an entity is in a tenuous financial position. We also noted that the split-dollar life insurance policies are in addition to the life insurance policies provided by the Foundation to all employees with a benefit of three-times the employee's salary to a maximum of $500,000.

- Prior to May 2008, the Foundation maintained a defined benefit plan and permitted employees to participate in a 403(b) tax sheltered annuity program. During the 2006, 2007 and 2008 calendar years, the Foundation's four executives received a contribution from the Foundation in the amount of 5 percent of their salaries that they elected to contribute to their tax sheltered annuity plans. Total contributions were $28,607, $31,738, and $34,150 collectively, for the calendar years 2006, 2007 and 2008, respectively. These contributions were made exclusively for the four executives and were made during times in which the Foundation's defined benefit plan was underfunded. Effective April 30, 2008, the Foundation froze its defined benefit plan and effective May 1, 2008, instituted a defined contribution plan as a cost savings measure. Beginning in May 2008, the Foundation contributed 2 percent of salaries to the defined contribution plan for all employees. The executives continued to receive the 5 percent contributions made exclusively for the four executives, in addition to the 2 percent contributions made on behalf of all employees through the end of calendar year 2008.

- One employee who was laid off received the Foundation-owned car that he used while working at the Foundation as part of his severance even though it was not included in the employee's severance agreement. Although the Foundation had the book value of the car listed as zero, the fair market value of the car was approximately $4,320 and was not reported by the Foundation as taxable income to the employee.

- During the audit period, the Foundation had a commissions program for Call Center Representatives. Commissions totaling $260,860, $94,037 and $6,525 were paid during calendar years 2006, 2007 and 2008, respectively. Our review disclosed that the Human Resources Unit paid commissions without obtaining the written Commission Plan and without reviewing supporting documentation. Our review also disclosed that the Foundation paid commissions for activities that were not specified in the Foundation's Commission Plan totaling $1,960 for one employee. In addition, Commission payments totaling $4,600 and $10,830 for calendar years 2006 and 2007, respectively, were not supported by adequate detailed documentation as required by the Plan and there was no evidence of managerial review as required by the Plan.

- During the audit period, the Foundation had an incentive compensation program for School Representatives. Incentive payments of $5,561 and $21,697 were paid during calendar years 2007 and 2008, respectively. Our review disclosed that although the amounts were correctly calculated by the Executive overseeing Academic Services, the written incentive plan also required the approval of Human Resources. We noted that Human Resources did not have a copy of the written plan and paid the amounts without any knowledge of the commission structure.

- We noted that meaningful year to date payroll figures by specific earnings codes were not available in 2008. In February 2008 the Foundation processed an off-cycle payroll period for group layoffs.

We noted that severance payments of $370,203 did not accumulate to a specifically identified payroll cumulative earnings code. Instead, they were included in the general category of gross earnings year to date. In addition, we noted that when the Foundation changed payroll processors in May 2008, the payroll cumulative earnings per specific earnings code did not transfer correctly; instead, all earnings were aggregated to regular earnings. Appropriate reports were not prepared by the Human Resources Unit to reconcile for these variances.

Effect: Without written documentation provided directly from the Board to the Human Resources Manager, there is risk that executives may not be paid the amounts as approved by the Board.

When payments are not adequately approved and supported, they could be processed for incorrect or questionable amounts.

When payments and related benefits are provided to employees without having formal written policies or without complying with written policies, abuse of Foundation assets could occur.

The Foundation is paying for split-dollar life insurance policies for which the Foundation is currently receiving no benefit.

When incentive payments are coded as regular earning and are not separately identified, there is risk that they will be included in the employee's base salary when subsequent calculations are made.

When cumulative earnings and corresponding codes are not properly maintained and reconciled, payroll data becomes worthless for comparative analysis and potentially misleading for users, such as management, auditors, and the Board of Directors.

Cause: There is a control environment in which decisions are made by the President without adequate oversight by the Board of Directors.

Recommendation: The Foundation should strengthen internal controls over payroll and personnel, including ensuring that employees are paid within approved salary ranges, or the salary ranges should be revised accordingly, maintaining written policies for all benefits received by the Foundation's employees and ensuring that all payments made to employees are supported by appropriate written documentation. The Board should have a more active role in reviewing bonuses and salary increases of non-executive staff and should communicate executive increases directly to Human Resources. The Foundation should consider ceasing paying the split dollar life insurance policies for the executives and surrendering the proceeds. (See

Recommendation 4.)

Former Foundation President Response:

"CSLF is not a State agency or quasi-public agency. CSLF receives no State funding and participates in a highly competitive student loan program. During CSLF's fiscal years 2007 and 2008, CSLF provided borrower benefits in excess of $2,000,000. These borrower benefits of fee waivers and interest rate reductions were savings provided to borrowers that were absorbed by CSLF. CSLF's consolidated financial statements of 2007 and 2008 show expenses that exceeded revenues by $956,000 and $728,000, respectively. These figures include the impact of the benefits provided to borrowers during those years.

CSLF maintains strong internal controls over its compensation and benefits for executive and nonexecutive personnel. This information would have been shared with the auditors had they inquired. The auditors did correctly find that CSLF did not appropriately withhold taxes for an individual cited by the auditors as being for the value of an asset.

CSLF prepared a salary range chart based on a thirty-five hour work week, which is standard for the majority of CSLF employees. All but one of the employees outside the salary range were all employees who, by necessity, were working a forty hour work week. The auditors did not make an adjustment for the additional hours worked by these individuals.

CSLF's independent auditors, Whittlesey and Hadley, as a matter of practice, prepare a comparison of the Board of Director's minutes documenting executive increases to actual payroll records as part of their annual audit procedures.

Incentive payments are not required to be coded differently in payroll records. These payments are easily traced in CSLF's records. The payments were required to be taxed and were in fact taxed.

Health club fees and tuition reimbursement for managers are supported by written policies. These policies … [were provided to the Auditors along with this response].

The Split dollar life insurance policies were provided to the executives by the Board of Directors as a retention incentive and became part of the executive compensation package. The terms and conditions of the policies were discussed by the Board and approved by the Board without the executives present.

The 403(b) tax shelter contribution was awarded to the executives by the

Board of Directors as part of their compensation package. This was discussed and approved by the Board.

School Representative incentive compensation was prepared by one senior manager and reviewed by another senior manager prior to any payment.

There is no requirement to process earnings under separate payroll earnings codes. All payroll transactions have supporting documentation. In May 2008, when CSLF changed payroll processors, a decision was made not to carry forward accumulators, which saved on conversion costs. Detailed amounts are easily calculated by using the final payroll from the prior provider and the new payroll processors accumulators. These items have an easily traceable audit trail.

Raises and bonuses of non-executive staff are under the purview of day to day operations. These items have not historically required Board of Directors' oversight."

Auditors' Concluding Comments:

Although this finding stresses many procedural deficiencies, a number of the expenses cited appear to be unnecessary and ultimately have contributed to the Foundation operating in a deficit position. Operating at a deficit has led to questions regarding whether the Foundation will be able to continue operations.

Auditors met with the Foundation's Human Resources Unit for a series of ten interviews during January and February 2009 to obtain a comprehensive understanding of the Foundation's internal controls. In addition, the Auditors contacted the Human Resources Unit for follow-up questions through May 2009.

In determining whether employees were paid above the Foundation's salary range we made adjustments to the salary range to reflect each employee's respective hours worked per week. After salary range adjustments, employees were paid up to 32% or $20,238 above the salary range.

The Foundation cannot rely on procedures performed by its Independent Public Accountant as part of its internal controls.

The incentive payments are not easily traced to CSLF's records, as they are not separately identified. We did not question whether they were taxed. We were informed that the intent of the incentive payments was that they would not be added to the employee's salary base, as they were issued in lieu of annual raises. By coding them as regular earnings, this raises the risk that the incentive payments will be incorrectly included in the employee's base salary when subsequent calculations are made, such as paying incentive payments or cost of living adjustments in following years.

The health club fees and tuition reimbursement policies provided to us were emails dated in 1998 and 2000 that were sent to certain employees. These policies have never been incorporated into the Foundation's Employee Handbook, which has been revised on four occasions since the emails were issued.

The school representative incentive compensation was reviewed by a manager who did not have a copy of the plan and had no knowledge of the commission structure.

The Foundation was unable to provide us with meaningful year to date payroll figures for 2008 that included a break down of costs such as bonuses, vacation payouts, incentive payments, etc.

When raises or bonuses for non-executive staff are not reviewed by the Board, it is even more important to have formal policies on bonuses in place.

OFFICIAL RESPONSE RECEIVED FROM THE BOARD OF DIRECTORS

The following response to the audit findings was received from Michael Meotti, Chairman of the Board of Directors and Commissioner of the Department of Higher Education:

> ***"On behalf of my fellow members of the Board of Directors of the Connecticut Student Loan Foundation (Deputy Treasurer Howard Rifkin and Chair of the Board of Governors of Higher Education Frank Ridley), I would like to respond to the Draft of Preliminary Audit Findings for the Connecticut Student Loan Foundation (CSLF) dated June 1, 2009.***
>
> ***The Board shares your concerns about the practices described, especially given the public nature of the entity and its ongoing financial difficulties. We will be taking immediate steps to assure that any continuing inappropriate compensation and fringe benefit practices are stopped.***
>
> ***We will keep your office advised as we move forward on these matters of mutual concern."***

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- The Foundation should seek legal clarification from the Office of the Attorney General to determine the validity of future claims to the loan forgiveness program and how the remaining program funds should be handled. This recommendation has been resolved due to the passage of Public Act 08-177.

Current Audit Recommendations (See also Events Preceding Publication of the Audit Report on Page14*):*

1. **The Foundation should strengthen internal controls to ensure compliance with the Foundation's travel policy, including completing detailed expense reports for all credit card transactions and retaining itemized receipts. The Foundation should also consider specifying a cap on the amount of meal charges for employees traveling out of state and the monthly invoices should be reviewed by at least two members of the Board of Directors.**

   Comment:

   We noted numerous credit card charges for business lunches, business dinners, and meals for employees traveling out of state that were unreasonable in amount, instances in which employees used credit cards to purchase lunch while making day trips to various organizations, and instances in which receipts were missing or were not itemized.

2. **The Foundation should institute internal controls to ensure only reasonable and necessary payments are made.**

   Comment:

   Our review disclosed several expenses that we question as being unnecessary or unreasonable including expenses for sporting events, a golf membership, and costs related to parties.

3. **The Foundation should reimburse employees for actual business mileage driven or should implement policies and procedures to ensure that gasoline cards are used only for business mileage and should give car allowances only to employees whose job duties require significant traveling and the amounts of car allowances should be reviewed and approved by the Board.**

   Comment:

   Our review disclosed that although the Foundation's written policy states that employees will be reimbursed for actual mileage driven, car allowances and gas cards were provided to employees. The Foundation's executives received the highest car allowances and were among the highest purchases of gasoline.

4. **The Foundation should strengthen internal controls over payroll and personnel, including ensuring that employees are paid within approved salary ranges, or the salary ranges should be revised accordingly, maintaining written policies for all benefits received by the Foundation's employees and ensuring that all payments made to employees are supported by appropriate written documentation. The Board should have a more active role in reviewing bonuses and salary increases of non-executive staff and should communicate executive increases directly to Human Resources. The Foundation should consider ceasing paying the split dollar life insurance policies for the executives and surrendering the proceeds.**

   Comment:

   Our review of the Foundation's payroll and personnel disclosed that the Foundation's policies and procedures should be more formal and, as a non-profit organization with doubt about its ability to continue as a going concern, the Foundation should have been much more conservative in limiting its personnel expenses.

INDEPENDENT AUDITORS' CERTIFICATION

This audit included performing tests of the Connecticut Student Loan Foundation's compliance with certain State statutory requirements and of its financial operations. In regard to its financial operations, we considered the Foundation's internal control over its financial operations and its compliance with requirements that could have a material or significant effect on the Foundation's financial operations in order to determine our auditing procedures for the purpose of evaluating the Foundation's financial operations and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objects. Our audit also included a review of a representative sample of the Foundation's activities during the audit period and a review of such other areas as we considered necessary. The financial statement audits of the Foundation for the fiscal years ended September 30, 2006 and 2007 were conducted by the Foundation's independent public accountant. The financial statement audit for the fiscal year ended September 30, 2008 had not been completed by the Foundation's independent public accountants at the time of our review.

We conducted our audit in accordance with the requirements of Section 2-90 of the General Statutes. In doing so, we planned and performed the audit to obtain reasonable assurance about whether the Connecticut Student Loan Foundation complied in all material respects with the provisions of certain laws, regulations, contracts and grant agreements and to obtain a sufficient understanding of internal control to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

Internal Control over Financial Operations and Compliance:

In planning and performing our audit, we considered the Foundation's internal control over its financial operations and its compliance with requirements as a basis for designing our auditing procedures for the purpose of evaluating the Foundation's financial operations and compliance with certain provisions of laws, regulations, contracts and grant agreements, but not for the purpose of providing assurance on the effectiveness of the Foundation's internal control over those control objectives.

Our consideration of the internal control over the Foundation's financial operations and over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial operations and compliance with requirements that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial operations and compliance with requirements that we consider to be significant deficiencies.

A *control deficie*ncy exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis unauthorized, illegal, or irregular transactions. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the Foundation's ability to properly initiate, authorize, record, process, or report financial data reliably consistent with management's direction, and/or comply with certain provisions of laws, regulations, contracts, and grant agreements such that there is more than a remote likelihood that noncompliance with laws, regulations, contracts and grant agreements that is more than inconsequential will not be prevented or detected by the Foundation's internal control. We consider the following deficiencies, described in detail in the accompanying "Condition of Records" and "Recommendations" sections of this report to be significant deficiencies in internal control over financial operations and compliance with requirements: Recommendation 4 - payroll and personnel.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions and/or material noncompliance with certain provisions of laws, regulations, contracts, and grant agreements that would be material in relation to the Foundation's financial operations will not be prevented or detected by the Foundation's internal control.

Our consideration of the internal control over the Foundation's financial operations and compliance with requirements was for the limited purpose described in the first paragraph of this section and would not necessarily disclose all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters:

As part of obtaining reasonable assurance about whether the Foundation complied with laws, regulations, contracts and grant agreements, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Foundation's financial operations for the fiscal years ended September 30, 2006, 2007 and 2008 we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements.

Our examination included reviewing all or a representative sample of the Foundation's activities in those areas and performing such other procedures as we considered necessary in the circumstances.

The results of our tests disclosed no material or significant instances of noncompliance. However, we noted certain matters which we reported to the Foundation's management in the accompanying "Condition of Records" and "Recommendations" sections of this report.

The Foundation's response to the findings identified in our audit is described in the accompanying "Condition of Records" and "Events Preceding Publication of the Audit Report" sections of this report. We did not audit the Foundation's response and, accordingly, we express no opinion on it.

This report is intended for the information of the Governor, the State Comptroller, the Appropriations Committee of the General Assembly and the Legislative Committee on Program

Review and Investigations. However, this report is a matter of public record and its distribution is not limited. Users of this report should be aware that our audit does not provide a legal determination of the Foundation's compliance with the provisions of the laws, regulations, contracts and grant agreements included within the scope of this audit.

CONCLUSION

We wish to express our appreciation for the cooperation and courtesies extended to our representatives by the personnel of the Connecticut Student Loan Foundation during our examination.

Lisa G. Daly
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts