STATE OF CONNECTICUT

AUDITORS' REPORT
CONNECTICUT STUDENT LOAN FOUNDATION
FOR THE FISCAL YEAR ENDED
SEPTEMBER 30, 2012

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN ❖ ROBERT M. WARD

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October 2, 2013

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We have examined the records of the Connecticut Student Loan Foundation, as provided in Section 2-90 of the General Statutes, for the fiscal year ended September 30, 2012.

SCOPE OF AUDIT:

This audit included performing tests of the foundation’s compliance with certain state statutory requirements. When determining our auditing procedures, we considered the foundation’s internal control over its operations that could have a significant effect on the foundation’s operations and for the purpose of evaluating compliance with certain provisions of laws, regulations, contracts and grants. However, the purpose of this examination was not to provide assurance on the internal control over those operations and compliance.

Information relating to the foundation’s financial operations as reported by its independent public accountant for the fiscal year ended September 30, 2012 is included for informational purposes only.

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

COMMENTS

FOREWORD:

The 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 educational opportunity. Until January 2010, the foundation also served 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 purchases and holds, in part as a revenue-producing investment, portfolios of loans originally issued by other authorized lending institutions. It is presumed that this provides lenders with the necessary liquidity to offer additional student loans.

Board of Directors and Administrative Officials:

Under the provisions of Section 10a-203 of the General Statutes, 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 State Treasurer is an ex-officio member of the board. The chairperson of the Board of Regents for Higher Education and the president of the Board of Regents for Higher Education 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.

Since June 2009, the foundation's board of directors has only consisted of its three ex-officio members. Membership of the board, as of September 30, 2012, is presented below:

Michael P. Meotti, designee of Dr. Robert Kennedy, President of the Board of Regents for Higher Education
Lewis J. Robinson, Chairperson of the Board of Regents for Higher Education
Sarah K. Sanders, designee of State Treasurer Denise Nappier

Michael P. Meotti served as chairperson of the board until October 2012 when he resigned from the Board of Regents for Higher Education. Sarah K. Sanders has been serving as chairperson of the board since January 2013.

RÉSUMÉ OF OPERATIONS:

Fund Structure:

The financial record keeping practices of the Connecticut Student Loan Foundation are governed by Section 10a-205 of the General Statutes, which specifies that the foundation shall maintain its funds in accordance with the requirements set forth in Title IV Part B of the federal Higher Education Act of 1965. The foundation maintains restricted and unrestricted funds.

The foundation's unrestricted fund was established to account for the administrative and general operations of the foundation. The foundation maintains two restricted funds. One fund is used for the foundation's trust estate and accounts for the assets and liabilities associated with bond offerings. The second restricted fund is used to account for the foundation's discontinued operations and includes the annual proceeds received from the transfer of its guarantor functions to a third party.

Financial Activities:

The following schedule of revenues, expenses and changes in net assets and explanation of changes for the fiscal years ended September 30, 2011 and 2012 was obtained from the foundation's audited financial statements.

	Fiscal Year Ended September 30,	
	(As restated)	
Operating Revenues:	**2011**	**2012**
Student Loan Interest	$ 20,524,713	$ 17,780,929
Other Revenue	10,896	62,828
Total Operating Revenue	20,535,609	17,843,757
Operating Expenses:		
Bond Interest	10,728,700	9,356,354
Loan Administration	6,424,315	5,707,716
Contracted Services	691,368	700,384
Bad Debt Expense	0	1,400,000
Other Operating Expenses	68,174	72,427
Total Operating Expenses	17,912,557	17,236,881
Change in Net Assets from Operations	2,623,052	606,876
Non-Operating Revenue:		
Grant Income	0	22,733
Investment Income	83,275	118,821
Gain on Redemption of Bonds	3,163,000	2,138,500
Total Non-Operating Revenue	3,246,275	2,280,054
Change in Net Assets from Continuing Operations	5,869,327	2,886,930
Discontinued Operations	4,017,667	4,821,143
Change in Net Assets	$ 9,886,994	$ 7,708,073

Interest income represents the largest operating revenue component. The foundation earns interest income, interest subsidies and a special allowance on student loans. All of these revenue sources are variable in nature and are a direct function of market conditions. Interest rates for new student loan borrowers have been fixed, though the net interest to loan holders remains variable and subject to market conditions. Lender yields are limited and vary as Congress and market conditions dictate. Loan interest revenue calculated to be in excess of congressionally established levels is paid back to the United States Department of Education (USDOE).

The foundation's largest expense is debt payments on the auction rate certificates it issued to raise money to make student loans. The interest rate on the certificates is variable and auctioned every seven to 28 days. Investors are paid at the maximum rates defined in each issuance of Treasury Bills plus 1.2 percent to 1.5 percent. The interest expense paid to bondholders decreased in fiscal year 2012 due to the reduction of bonds outstanding between the fiscal years.

Administration:

Since February 2010, the foundation has not had any employees or office locations. The foundation stopped processing new loan applications for all of its programs as of June 30, 2009. In January 2010, the foundation transferred its guarantor obligations to a third-party guarantor. In the same month, the foundation contracted with another outside service organization to manage its administrative functions.

Loan Portfolio:

The foundation's loan portfolio consists of loans that originated from FFELP and the Solutions Alternative loan program. FFELP loans are student loans financed by state bond issues and insured by USDOE and are repaid by borrowers on a monthly basis for a term of up to 30 years. The interest rate on these loans varies and ranges from approximately one percent to 12 percent. The federal Health Care and Education Reconciliation Act (HCERA) of 2010 eliminated new lending under FFELP as of June 30, 2010.

Alternative loans are student loans financed by state bond issues that are not insured by the USDOE. Alternative loans are repaid monthly over a period of time ranging from 10 to 30 years. The interest rate on these loans varies. The foundation stopped offering alternative loans in February 2009.

Loan servicing was performed by outside service organizations retained by the foundation during the audited period. Loan portfolio assets as of September 30, 2012 and associated classifications per the foundation's independent public accountant are summarized as follows:

	FFELP	**Alternative**	**Total**
In-School	$ 11,747,706	$ 589,688	$ 12,337,394
Grace	9,070,466	757,920	9,828,386
Deferment	60,078,704	768,414	60,847,118
Forbearance	61,541,587	719,017	62,260,604
Repayment	342,946,331	7,576,495	350,522,826
Total	485,384,794	10,411,534	495,796,328
Allowance	(1,467,728)	(359,551)	(1,827,279)
	$483,917,066	$10,051,983	$493,969,049

Student loans are classified as in-school from the date the loan is made until a student graduates or leaves school. Loans are classified as being in grace status from the time the student leaves school until repayment begins six months later. Subsequent to this period, student loans are classified as being in repayment status. Deferral and forbearance status are periods during the life of the loan where repayment is suspended for authorized purposes.

As noted earlier in this report, the foundation was the state guarantor for FFELP until January 2010 at which time it transferred its guarantor obligations to a third party. Through 2014, the foundation has a right to 50 percent of collection retention revenues in excess of operating costs and liabilities paid by the third-party guarantor on behalf of the foundation.

Subsequent Events:

During fiscal year 2013, the foundation entered into an agreement to participate in the not-for-profit servicer program established under HCERA. The USDOE approved the foundation's participation in the program. Servicers in the program are assigned direct loans originated by USDOE for servicing. The federal government pays loan servicers fees to service the loans.

Independent Public Accountants' (IPA) Audit Results:

The audited financial statements of the foundation for the fiscal year ended September 30, 2012, reflect an unqualified opinion. In the management letter accompanying the audit, the IPA identified three control deficiencies that are not considered to be material weaknesses or significant deficiencies. One deficiency identified was the lack of segregation of duties over certain areas of internal controls, including financial reporting and loan receivable reconciliations, due to the size of the organization. A critical key control to mitigate those risks is the board's oversight of the quarterly financial reporting and budget to actual analysis. Another deficiency identified was that the foundation's administrative agents have the ability to wire money out of an account without a board member's signature. We were informed that commencing in 2010, the administrative agent restructured the foundation's flow of funds so that the principal and interest payments made on the loans in the bond trust would be transferred directly from the loan servicer to the bond trustee which substantially reduced the amounts transferred through the foundation's accounts. In addition, during the audited period, the Board of Regents for Higher Education provided its representatives with access to review the foundation's monthly bank statements, reconciliations and transaction records. The last deficiency noted was that the foundation does not have a full complement of board members appointed as governed by the bylaws and state statute. A finding relating to the foundation's board membership is presented in the Condition of Records section of this report.

CONDITION OF RECORDS

Our review of the records of the Connecticut Student Loan Foundation revealed the following area that warrants comment.

Board Membership:

Criteria: Section 10a-203(a) requires that the board of directors shall consist of fourteen members, as follows: the chairperson of the Board of Regents for Higher Education and the president of the Board of Regents for Higher Education; six public members appointed by the Governor, at least one of whom shall represent an eligible institution of higher education, at least one of whom shall be a person 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 and all of whom shall be electors of this state; one public member appointed by the board of directors who shall have, through education or experience, an understanding of relevant accounting principles and practices, financial statements and audit committee functions and knowledge of internal controls, who shall be an elector of this state; 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; and the State Treasurer or, if so designated by the State Treasurer, the Deputy State Treasurer appointed pursuant to Section 3-12.

Condition: Our review of the board membership of the Connecticut Student Loan Foundation for the fiscal year ended September 30, 2012 revealed that the board is still operating with only its three ex-officio members leaving eleven vacancies.

Effect: The board did not have sufficient membership to be in compliance with the General Statutes.

Cause: The majority of board members resigned on May 26, 2009, purportedly because board members serving as appointees of the Governor or legislators do not have indemnity to protect them from legal action.

Recommendation: The Connecticut Student Loan Foundation should seek legislation to modify the board composition requirements. (See Recommendation 1.)

Agency Response: "The board acknowledges that the current board is still operating with only its three ex-officio members. The board is currently reviewing strategic options for the future of the foundation, which may include its termination and dissolution, which may require a legislative finding. The board plans to complete that strategic review before making any decisions – whether to seek legislation to modify the board composition, or to actively seek the appointment of additional board members, or to seek legislative assistance in its dissolution."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- The foundation should seek legislation to modify the board composition requirements. Our prior audit found that the board of directors was operating with only its three ex-officio members at the end of the audited period. Our current review found that the board still consists of only its three ex-officio members. Therefore, this recommendation will be repeated.

- The foundation should ensure compliance with the Freedom of Information Act. We previously reported that all information relating to the board of directors meetings was not posted to the foundation's website and that the foundation did not maintain written documentation that it filed all meeting agendas with the Secretary of the State. Our current review found that the foundation now posts all information relating to the board meetings on its website and maintains appropriate support that the required information was filed with the Secretary of the State. This finding is considered resolved.

Current Audit Recommendation:

1. **The Connecticut Student Loan Foundation should seek legislation to modify the board composition requirements.**

   Comment:

   Our review of the membership of the foundation's board of directors for the fiscal year ended September 30, 2012 revealed that the board still only consists of its three ex-officio members.

CONCLUSION

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

Jill A. Schiavo
Associate Auditor

Approved:

John C. Geragosian
Auditor of Public Accounts

Robert M. Ward
Auditor of Public Accounts