STATE OF CONNECTICUT

AUDITORS' REPORT
CONNECTICUT HIGHER EDUCATION
SUPPLEMENTAL LOAN AUTHORITY
FOR THE FISCAL YEAR ENDED JUNE 30,2008

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

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September 9, 2009

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SUPPLEMENTAL LOAN AUTHORITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

We have examined the books, records, and accounts of the Connecticut Higher Education Supplemental Loan Authority, as provided in Section 2-90 and Section 1-122 of the General Statutes, for the fiscal year ended June 30, 2008.

SCOPE OF AUDIT:

This audit was primarily limited to performing tests of the Authority's compliance with certain provisions of laws, regulations, contracts, and grant agreements, including but not limited to a determination of whether the Authority has complied with its regulations concerning the following areas:

- Affirmative action
- Personnel practices
- Purchase of goods and services
- Use of surplus funds
- Distribution of loans, grants and other financial resources

We also considered the Authority's internal control over its financial operations and its compliance with requirements that could have a material or significant effect on its financial operations in order to determine our auditing procedures for the purpose of evaluating the Authority's financial operations and compliance with certain provisions of laws, regulations, contracts and grant agreements, and not to provide assurance on the internal control over those control objectives. Our consideration of internal control included the five areas identified above.

Our audit included a review of a representative sample of the Authority's activities during the fiscal year in the five areas identified above and a review of other such areas as we considered necessary. The financial statement audit of the Connecticut Higher Education Supplemental Loan Authority, for the fiscal year ended June 30, 2008, was conducted by the Authority's independent public accountants.

COMMENTS

FOREWORD:

The Connecticut Higher Education Supplemental Loan Authority (hereafter referred to as CHESLA) operates primarily under the provisions of Title 10a, Chapter 187b, Sections 10a-221 through 10a-246 of the Connecticut General Statutes.

Effective October 1, 1985, Section 10a-232 permits CHESLA to create and establish one or more Special Capital Reserve Funds for which the State of Connecticut has a contingent liability. The State's contingent liability is described further under "Résumé of Operations," below.

CHESLA is a quasi-public agency and political subdivision of the State. CHESLA's purpose is to assist borrowers (students, their parents or others responsible for paying the costs of education) and institutions of higher education in the financing and refinancing of the costs of higher education through its Bond Funds. During the audited period, CHESLA reported no loans to institutions.

Under CHESLA's Connecticut Family Education Loan Program, qualifying applicants can receive an Education Loan for each academic year in an amount that does not exceed the student's cost of education for the year. The cost of education is determined by the college or university in which the student is enrolled and is reduced by all other financial assistance received by the student.

CHESLA is defined by the General Statutes as a Quasi-Public Agency. Provisions for Quasi-Public Agencies are codified primarily in Sections 1-120 through 1-127 of Chapter 12 of the General Statutes. The provisions require that an annual compliance audit be performed addressing CHESLA's compliance with its regulations concerning affirmative action, personnel practices, the purchase of goods and services, the use of surplus funds, and the distribution of loans, grants and other financial assistance. Effective July 1, 2004, Section 1-122 of the General Statutes requires that the Auditors of Public Accounts perform or contract out such audits. This is our report on our audit of CHESLA's compliance with these requirements during the audited period.

Board Members:

As authorized under Section 10a-224 of the General Statutes, responsibility over the operations of the Authority is vested in an eight member board of directors, consisting of the State Treasurer, the Secretary of the Office of Policy and Management, and the Commissioner of

Higher Education, all serving as ex-officio directors, and five directors appointed by the Governor.

As of June 30, 2008, CHESLA's board of directors was as follows:

Ex-Officio:

Denise L. Nappier, State Treasurer
Robert L. Genuario, Secretary of the Office of Policy and Management
Michael P. Meotti, Commissioner of Higher Education

Appointed by the Governor:	Term Expires July 1,
Michael E. McKeeman, Chairman	2014
Kathleen Woods	2011
Julie B. Savino	2011
William J. Pizzuto	2012
Delores P. Graham	2009

Gloria F. Ragosta was appointed the Executive Director of CHESLA on May 19, 1998, and has served in that position throughout the audited period.

Accounting Policies:

CHESLA maintains financial records for its own operation and for the debt issue outstanding in accordance with the requirements of bond issue documents. Assets of the Bond Issue Funds are held by a trustee. A brief description of each fund follows:

Authority Operating Fund – Revenues and expenses applicable to the Authority's operations are accounted for within this fund. Revenues are generated from interest income and administrative fees.

Bond Funds – Proceeds of revenue bonds issued by CHESLA are used to provide loans directly to students and others to finance the cost of higher education. Bond Fund revenue is generated from interest earned on investments and loans outstanding.

Bond Issue Funds Outstanding as of June 30, 2008, included:

2007 Series A, 2006 Series A, 2005 Series A and B, 2003 Series A and B, 2001 Series A, 2000 Series A and B, 1999 Series A and B, and 1998 Series A and B.

During the period under review, CHESLA issued, in total, $41,000,000 in 2007 Series A Senior Revenue bonds.

As of June 30, 2008, CHESLA had issued $366,840,000 in Revenue Bonds and Revenue Refunding Bonds, with $153,880,000 outstanding. During the audited period, the aggregate amount of Special Capital Reserve Fund-backed (to be discussed below) bonds outstanding at any given time was limited by statute to $170,000,000. It should be noted that, effective July 1, 2008, Public Act 08-117, codified in Section 10a-232(b)(2) of the General Statutes, increased that amount to $300,000,000.

With respect to bond issues outstanding as of June 30, 2008, the 1998, 1999, 2000, 2001, 2003, 2005, 2006, and 2007 Series loans may be made to finance educational needs, under the Connecticut Family Education Loan Program (CT FELP), in principal amounts from $2,000 up to the costs of education for eligible students. Cumulative loan amounts are capped at $125,000 for each eligible student over the life of the CT FELP program.

CHESLA contracts for the following services, among others, to help it achieve its accounting objectives:

- Loan Servicer: Originates and services student loans.
- Accountant: Produces financial statements and supporting ledgers.
- Investors services: Invests and accounts for bond proceeds, payments.
- Financial Advisors: Performs underwriting, cash flow analyses, arbitrage calculations.
- Collection Agency: Pursues non-performing student loans.

Other Audit Examinations:

An independent certified public accountant audited the books and accounts of CHESLA for the fiscal year under review.

The independent public accountant's report to CHESLA for the fiscal year ended June 30, 2008, expressed an unqualified opinion on CHESLA's financial statements and reported no material weaknesses in internal control.

Section 1-122 of the Connecticut General Statutes requires that quasi-public agencies such as CHESLA have a compliance audit performed annually. Such audits should determine whether these agencies comply with their own regulations concerning affirmative action, personnel practices, the purchase of goods and services, the use of surplus funds, and the distribution of loans, grants and other financial assistance. In accordance with this statute, we performed the compliance audit of CHESLA covering the 2007-2008 fiscal year. We noted certain weaknesses in compliance and internal control, which are discussed in the "Condition of Records" and "Recommendations" sections of this report.

RÉSUMÉ OF OPERATIONS:

CHESLA had 23 bond issues as of June 30, 2008. The 1983 Series A Revenue Bonds were issued for the purpose of financing loans to Yale University, Wesleyan University, and Connecticut College in order to fund education loans to students, and parents of students, and to finance the students' attendance at such institutions. The 1985, 1990, 1991, 1993, 1994, 1996, 1998, 1999, 2000, 2001, 2003, 2005, 2006, and 2007 Series A Revenue Bonds and the 1998, 1999, and 2000 Series B Revenue Bonds were issued for the purpose of providing financial assistance directly to students in or from the State, their parents, and others responsible for the costs of students attending eligible institutions for higher education under the Family Education Loan Program (FELP). The 1990, 1991, 2000, 2003, and 2005 Series B and a portion of the 1992 and 2006 Series A issues were Revenue Refunding Bonds. Refunding bonds are new bonds issued to retire an already outstanding bond issue. The refunding of bonds is most frequently done to take advantage of more favorable interest rates and to escape from less favorable bond covenants. By this and other measures, such as restricting its administrative fees and covering bond issuance costs from its operating fund, CHESLA seeks to achieve a competitive advantage in the market place for its student loans.

The bonds are special obligations of CHESLA, which has no taxing power. The bonds shall not be deemed to constitute a debt or liability to the State or any of its political subdivisions, but shall be payable solely from the revenues and other receipts, funds or moneys pledged therefore. However, effective October 1, 1985, the State became contingently liable in that it must provide annual debt service requirements if not met by CHESLA's funds. The State's contingent liability in connection with the various Series A and B Bonds is the Special Capital Reserve Fund requirement for such Bonds, funded as of June 30, 2008, in the aggregate amount of $12,600,000. As of June 30, 2008, the State has not made, nor was it required to make, any such deposit.

The Vice President of the Connecticut Conference of Independent Colleges (CCIC), Gloria F. Ragosta, served as the Executive Director of CHESLA. The Executive Director was compensated by CCIC. The CCIC charged CHESLA for services provided by the Executive Director, pursuant to a written agreement for services with the CCIC. Such fees totaled $104,000 for the fiscal year ended June 30, 2008.

CHESLA also entered into a sublease agreement with the CCIC for the use of office space in connection with CHESLA's operation. Under the agreement, CCIC charged CHESLA a monthly fee for the use of such space.

Revenues credited to Bond Funds totaled $10,136,696 for the fiscal year ended June 30, 2008. This amount consisted primarily of interest income derived from investments and loans to individuals.

Expenditures for the Bond Funds totaled $9,014,613 for the fiscal year ended June 30, 2008. This amount consisted primarily of debt service (interest). The Bond Funds balance of $8,226,128 as of June 30, 2007, increased to $9,740,255 as of June 30, 2008.

Revenues credited to the Authority Operating Fund for the fiscal year ended June 30, 2008, totaled $1,041,652 and consisted primarily of administrative fees and investment income. Operating expenses paid from the Operating Fund during the same fiscal year totaled $736,332 and consisted primarily of professional and administrative expenses, and bond issuance costs. The Authority Operating Fund balance decreased from $3,402,895 at June 30, 2007, to $3,316,171 at June 30, 2008, primarily due to the transfer of the cost of issuance from the Bond Fund to the Operating Fund during the fiscal year ended June 30, 2008.

The cumulative number of loans made to students by CHESLA for all Bond Funds as of June 30, 2008, totaled 27,153, compared to 24,934 as of June 30, 2007, amounting to 2,219 additional loans over the audited period. The average of the cumulative dollar amount loaned to each student as of June 30, 2008, was $10,019.

CONDITION OF RECORDS

Payroll and Personnel:

Criteria:

- Sound internal control over employee leave time requires timely submission and review of Leave Time Sheets.
- The calculation of salary increases should be based on accurate data.

Condition:

- Our review of monthly Personnel Leave Time Sheets disclosed that leave time sheets were not submitted and reviewed consistently during the 2007-2008 fiscal year. Therefore, several variances between employee leave records and supervisory records were not detected and resolved.
- During a review of employee compensation for the 2007-2008 fiscal year, we noted that, for one employee, the salary increase for the 2008-2009 fiscal year was incorrect. The Board of Directors approved a 4.93 percent increase over the prior year's salary. However, the spreadsheet presented to the Board exhibiting the prior year's salary had an error in the formula, resulting in a 9.65 percent increase. The employee received a salary increase that was $2,290 higher than intended.

Effect:

- Internal control over employee leave time is weakened when Leave Time Sheets are not submitted and reviewed on a consistent basis. Leave balances were not affected by the inaccuracies in posting of leave time.
- The affected employee received a salary increase $2,290 greater than intended. The Authority plans to reduce this employee's future salary increases by that amount.

Cause: The Authority did not maintain sufficient control over personnel practices.

Recommendation: The Authority should strengthen internal control over payroll and personnel matters. Leave Time Sheets should be submitted and reviewed on a consistent basis to allow for prompt resolution of inaccuracies. (See Recommendation 1.)

Agency Response: "The staff members (2) forgot to give the executive director two of their end of month leave reports. The executive director checks the reports the day they are received against her records for staff-leave time. Since two of the reports were not received they could not be checked prior to the audit. The total vacation, sick time and personal days for the fiscal year did match the executive director's total records. In some instances the staff had marked a wrong "date" on the day they took off. The time sheets are not a requirement for the Authority. In the past, the executive director kept track of the timesheets. The state auditor had recommended that individuals also maintain a sheet to be submitted each month. With only two employees, it is not difficult to know when someone is not in the office. There were no variances on the total sick, vacation and leave time for the end of the year.

The payroll mistake was due to a formula error on an Excel sheet and will be rectified this year when the employee's salary is calculated which will probably result in no increase for FY 2010. The executive director notified the Chair of the Authority as soon as the error was brought to her attention and he agreed to make the adjustment in next year's budget."

Distribution of Student Loans:

Criteria:

- The Authority's *Family Education Loan Program Manual* states that, upon receipt of a completed loan application, the loan servicer shall:

  - verify the applicant's and co-applicant's income;
  - calculate a debt-to-income ratio; such ratio may not exceed 40 percent of the stable gross monthly income.

  CHESLA has determined that the primary income determinant, with certain exceptions, is the applicant's adjusted gross income (AGI).

- Section 10a-225(b) of the General Statutes stipulates that the Authority "shall require that Authority loans be used solely for the purpose of education loans and in an amount not to exceed the total cost of attendance, less other forms of student assistance, as defined by the Authority."

Condition:

- We performed tests of eight student loan applications to verify that the students and/or coborrowers were eligible to receive Connecticut Family Education Loans (CT FELP). During our review of the eligibility criteria included in CHESLA's Instructions/Procedures for Administering the CT FELP Program, we noted that the procedures manual used terminology related to income that varied somewhat in each section but did not clearly define income. The manual consisted partly of a collection of instructions used by Firstmark Services, the loan servicer, as well as those supplied by CHESLA in the form of instructions and instructional emails. We noted various inconsistencies related to income determination as well. Our testing disclosed that for five of the student loan applications tested, the loan servicer did not use the applicant's adjusted gross income as the primary income determinant when evaluating eligibility, as instructed by CHESLA through discussions and in emails.

- During our review of student loans, we noted that one university did not include the student's cost of attendance and other financial assistance on CHESLA's loan certification form. Such information allows the Authority to determine that the loan is used solely for the student's education costs.

Effect:

- A lack of consistent terminology in the Authority's Instruction/Procedures Manual may lead to an incorrect interpretation of what income amount should be used when determining a borrower's eligibility. Determination of an applicant's income should be based on standard criteria, as it is used to calculate the debt-to-income ratio. That ratio is a critical indicator that the applicant will be able to repay the loan. Although the loan servicer used an incorrect income figure in the instances noted, this did not result in ineligible borrowers receiving CT FELP loans.

- In the instances noted where a university failed to include the cost of attendance and other financial assistance on CHESLA's loan certification form, assurance that the student's total financial aid has not exceeded his/her cost of attendance was reduced. This, in turn, increased the risk of ineligible students being awarded CT FELP loans and the risk that eligible students would be awarded loan amounts greater than the amounts allowed.

Cause:

- The Authority's Loan Instruction/Procedures Manual included varied and inconsistent terminology and instructions related to income determination. Further, the loan servicer experienced a change in personnel which may have contributed to miscommunication between its management and the personnel responsible for loan approval.

- The Authority indicated that some universities do not wish to provide the student's cost of attendance and other financial aid on the loan certification form. CHESLA believed that acceptance of the University's certification form without that information is standard practice in the student loan industry.

Recommendation: The Authority should revise its Loan Procedures Manual in order to provide clear and consistent instructions to the parties responsible for reviewing loan applications. CHESLA should also ensure that those procedures have been communicated to the loan servicer's personnel by reviewing the servicer's written instructions and procedures. Further, the Authority should require that colleges and universities provide the requested information related to the student's cost of attendance and other financial aid to help ensure compliance with Section 10a-225(b) of the General Statutes. (See Recommendation 2.)

Agency Response: "The Authority continues to revise its Loan Procedures Manual and will act upon this recommendation.

The college who did not provide the total information on its certification was certifying its loans through ELM Resources. Here is the process we were told concerning institution X:

Cost of education is a field on the ELM processing system.

X began using ELM to certify loans and made inquiry to ELM to see if the field needed to be populated.

X was told "no" the field did not need to populated to certify a loan (this affected any loan certified by Xl, not just CHESLA).

Inquired if X has a policy/procedure barring the population of that field.

X has no policy/procedure barring the population of that field.

Inquired if X can populate that field going forward for CHESLA loans.

X will populate that field going forward for CHESLA loans (03/26/09).

CHESLA has notified Firstmark to convey this information to any institution certifying its loans through ELM Resources. This should take care of this issue."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

There were no recommendations presented in our prior audit report.

Current Audit Recommendations:

1. **The Authority should strengthen internal control over payroll and personnel matters. Leave Time Sheets should be submitted and reviewed on a consistent basis to allow for prompt resolution of inaccuracies.**

   Comment:

   Our review of monthly Personnel Leave Time Sheets disclosed that leave time sheets were not submitted and reviewed consistently during the 2007-2008 fiscal year. Therefore, several variances between employee leave records and supervisory records were not detected and resolved. Also, the Authority overpaid one of its employees by $2,290 in gross pay during the 2008-2009 fiscal year as a result of a miscalculation of the employee's annual salary increase.

2. **The Authority should revise its Loan Procedures Manual in order to provide clear and consistent instructions to the parties responsible for reviewing loan applications. CHESLA should also ensure that those procedures have been communicated to the loan servicer's personnel by reviewing the servicer's written instructions and procedures. Further, the Authority should require that colleges and universities provide the requested information related to the student's cost of attendance and other financial aid to help ensure compliance with Section 10a-225(b) of the General Statutes.**

   Comment:

   We noted that the Authority's manual for Administering the CT FELP Program used terminology that varied somewhat in each section, especially in sections related to income determination. This might have contributed to the loan servicer, at times, not using the required income determinant when evaluating eligibility. We also noted that one university did not include the student's cost of attendance and other financial assistance on CHESLA's loan certification form.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 and Section 1-122 of the General Statutes, we have conducted an audit of the Connecticut Higher Education Supplemental Loan Authority's activities for the fiscal year ended June 30, 2008. This audit was primarily limited to performing tests of the Authority's compliance with certain provisions of laws, regulations, contracts and grant agreements, including but not limited to a determination of whether the Authority has complied with its regulations concerning affirmative action, personnel practices, the purchase of goods and services, the use of surplus funds and the distribution of loans, grant agreements and other financial resources, and to understanding and evaluating the effectiveness of the Authority's internal control policies and procedures for ensuring that the provisions of certain laws, regulations, contracts and grant agreements applicable to the Authority are complied with. The financial statement audit of the Connecticut Higher Education Supplemental Loan Authority for the fiscal year indicated above was conducted by the Authority's independent public accountants.

We conducted our audit in accordance with the requirements of Section 2-90 Section 1-122 of the General Statutes. In doing so, we planned and performed the audit to obtain reasonable assurance about whether the Connecticut Higher Education Supplemental Loan Authority complied in all material respects with the provisions of certain laws, regulations, contracts and grant agreements and to obtain a sufficient understanding of the 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 Connecticut Higher Education Supplemental Loan Authority'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 Authority'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 Authority's internal control over those control objectives. Our consideration of internal control included, but was not limited to, the following areas:

- Affirmative action
- Personnel practices
- Purchase of goods and services
- Use of surplus funds
- Distribution of loans, grants and other financial resources.

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 Authority'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 Authority's internal control.

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 Authority's financial operations will not be prevented or detected by the Authority's internal control.

Our consideration of the internal control over the Authority's financial operations, and compliance with requirements would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over the Authority's financial operations and compliance with requirements that we consider to be material weaknesses, as defined above.

Compliance and Other Matters:

As part of obtaining reasonable assurance about whether the Connecticut Higher Education Supplemental Loan Authority 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 Authority's financial operations for the fiscal year ended June 30, 2008, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, including but not limited to the following areas:

- Affirmative action
- Personnel practices
- Purchase of goods and services
- Use of surplus funds
- Distribution of loans, grants and other financial resources.

Our examination included reviewing all or a representative sample of the Authority'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 Authority management in the accompanying "Condition of Records" and "Recommendations" sections of this report.

The Connecticut Higher Education Supplemental Loan Authority's response to the findings identified in our audit is described in the accompanying "Condition of Records" section of this report. We did not audit the Authority'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 Authority'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 courtesies and cooperation extended to our representatives by the personnel of the Connecticut Higher Education Supplemental Loan Authority during the course of our examination.

Cynthia A. Ostroske
Associate Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts