STATE OF CONNECTICUT

AUDITORS' REPORT
CONNECTICUT HIGHER EDUCATION
SUPPLEMENTAL LOAN AUTHORITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

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

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May 14, 2010

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SUPPLEMENTAL LOAN AUTHORITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

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, 2009.

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, 2009, 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.

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.

Under the Authority's CHESLA 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, 2009, 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	2015

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, 2009, 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 did not issue any additional bonds.

As of June 30, 2009, CHESLA had issued $366,840,000 in Revenue Bonds and Revenue Refunding Bonds, with $138,710,000 outstanding. During the audited period, the aggregate amount of Special Capital Reserve Fund-backed bonds outstanding at any given time was limited by statute to $300,000,000.

With respect to bond issues outstanding as of June 30, 2009, the 1998, 1999, 2000, 2001, 2003, 2005, 2006, and 2007 Series loans may be made to finance educational needs, under the CHESLA Loan Program, 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 CHESLA Loan 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, 2009, 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 2008-2009 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, 2009. 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 CHESLA Loan Program. 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, 2009, in the aggregate amount of $12,600,000. As of June 30, 2009, 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, 2009.

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 $9,082,330 for the fiscal year ended June 30, 2009. This amount consisted primarily of interest income derived from investments and loans to individuals.

Expenditures for the Bond Funds totaled $8,401,070 for the fiscal year ended June 30, 2009. This amount consisted primarily of debt service (interest). The Bond Funds balance of $9,740,255 as of June 30, 2008, increased to $10,421,515 as of June 30, 2009.

Revenues credited to the Authority Operating Fund for the fiscal year ended June 30, 2009, totaled $1,041,804 and consisted of administrative fees and investment income. Operating expenses paid from the Operating Fund during the same fiscal year totaled $822,948 and consisted primarily of professional and administrative expenses, and amortization of bond issuance costs. The Authority Operating Fund balance increased from $3,316,171 at June 30, 2008, to $3,535,027 at June 30, 2009.

The cumulative number of loans made to students by CHESLA for all Bond Funds as of June 30, 2009, totaled 29,664, compared to 27,153 as of June 30, 2008, amounting to 2,511 additional loans over the audited period. The average of the cumulative dollar amount loaned to each student as of June 30, 2009, was $9,910.

CONDITION OF RECORDS

Payroll and Personnel – Vacation Leave Carryover:

Criteria: The Authority's Vacation Policy states, "Staff members will be allowed to carry-over up to a maximum of five vacation days from one fiscal year to the next." The Policy further states, "Any exceptions are subject to the approval of the Executive Director based on staffing needs and will be brought to the CHESLA Board for approval."

Condition: We noted an instance in which an employee was permitted to carry over 11.5 days of vacation leave in to the fiscal year ended June 30, 2010. The carryover was based on the approval of the Executive Director; there was no evidence of Board approval for this carryover.

Effect: A carryover of vacation leave was not brought to the Board for approval.

Cause: Due to a staffing shortage, an employee was permitted to carry over unused vacation leave in to the fiscal year ended June 30, 2010.

Recommendation: The Authority should comply with its Vacation Policy and obtain Board approval for the carryover of unused vacation leave.

Agency Response: "In regard to the issue about carryover vacation days. The Chair and executive director's interpretation has been that bullet I. of the CHESLA vacation policy ("vacations are to be scheduled at times mutually convenient to the staff member and to the operation of CHESLA. The executive director of CHESLA is charged with making reasonable vacation periods available for the staff, and for enforcing the taking of vacation") gave the executive director the authority for the carry forward. Since there are only two staff members and one was out for the entire summer on medical leave, it would have been unfair not to let the only other staff member carry forward additional vacation days due to the circumstances. The CHESLA staff/board plan to clean up this language at the next board meeting to avoid any confusion in the future."

Payroll and Personnel – Recovery of Salary Overpayments:

Criteria: Sound internal control requires that salary overpayments be recovered from the employee in a timely manner.

Condition: In our previous audit, we noted that an error in a salary increase spreadsheet resulted in an employee receiving salary overpayments totaling $2,290 in the fiscal year ended June 30, 2009. We recommended that the Authority strengthen internal control over payroll and personnel matters.

The Authority agreed that a mistake had occurred and responded that the error would be rectified by the employee not receiving a salary increase for the fiscal year ended June 30, 2010.

As part of our current audit, we followed up on the Authority's response to the findings in the previous audit. We noted that the affected employee did not receive a salary increase for the fiscal year ended June 30, 2010. However, we also noted that the Authority's other employee did not receive a salary increase for the same period. In discussions with the Executive Director, we learned that the Authority did not increase the salaries of its employees due to economic factors. Therefore, the salary overpayments noted in our previous audit have not been recovered.

Effect: Salary overpayments totaling $2,290 to an employee have not been recovered.

Cause: The Authority's method of recovering the overpayments was vague and subject to interpretation.

Recommendation: Salary overpayments to an Authority employee totaling $2,290 should be recovered in a clear manner.

Agency Response: "The CHESLA Compensation Committee reviewed this error and the proposed budget for FY 2010. It was decided that the employee would not receive a raise in FY 10 to rectify the error. The Committee did freeze both employees' salaries for the year due to the economy and in coordination with State agency salary freezes. A letter confirming this was provided to the auditors and signed by the Chair of CHESLA. This compensation as presented to the CHESLA board was approved unanimously. In FY 2011, the employee's base salary will be reduced by $2,290."

Purchase of Goods and Services – Approval of Credit Card Expenses:

Criteria: Adequate internal control over credit card expenses requires that the expenses be specifically reviewed and approved by someone in a position of authority over the person who incurred the expenses.

Condition: In our review of purchases, we noted there is no evidence that credit card expenses incurred by the Executive Director are subject to the specific review and approval of the CHESLA Board of Directors.

Effect: The lack of a review increases the risk that inappropriate credit card charges may occur and not be detected by management.

Cause: The Executive Director's credit card expenses are all related to meetings and trips related to Authority business matters. The Executive Director provides details to the Board on the significant matters that occurred at these meetings and trips, but there is no evidence of the specific review and approval of the credit card expenses by the Board.

Recommendation: Credit card expenses incurred by the Executive Director should be reviewed and approved by the CHESLA Board.

Agency Response: "This is a new recommendation for CHESLA. The expenses are within the approved budget. Credit card expenditures have to be paid monthly in a timely manner. It would be difficult to get "Board approval" since the CHESLA board meets quarterly. It is timelier for the executive director to have the Board Chair approve the monthly credit card statement with all the attached receipts, which are currently in place. The policy for the Chair to approve the expenses has already been implemented for FY 2010 as a result of this recommendation."

Distribution of Student Loans:

Criteria:

- The Authority's *Family Education Loan Program Manual* that was in effect during the audited period stated, 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 nine student loan applications to determine that the students and/or co-borrowers were eligible to receive CHESLA Loans. During our review of the eligibility criteria included in CHESLA's Instructions/Procedures Manual for Administering the Loan Program, we noted that six students and/or co-borrowers were determined eligible for loans using incorrect measures of income. Our testing disclosed that for those six student loan applications tested, the loan servicer did not use the applicant's AGI as the primary income determinant when evaluating eligibility.

- During our review of student loans, we noted that three universities did not include the student's cost of attendance and other financial assistance on CHESLA's certification form. Such information allows the Authority to determine that the loan is used solely for the student's education costs as required by Section 10a-225(b) of the General Statutes.

Effect:

- A lack of consistent terminology in the Authority's Instructions/Procedures Manual may lead to an incorrect interpretation of the calculated income that 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. The ratio is a critical indicator that evaluates whether the applicant will be able to repay the loan. In the instances noted, the borrowers did qualify for the CHESLA Loans despite using the incorrect income determinant.

- There is no assurance that the student's total financial aid has not exceeded his/her cost of attendance.

Cause:

- The Authority's Loan Instruction/Procedures Manual in effect during the period of our testing included varied and inconsistent terminology and instructions related to income determination.

- The Authority indicated that some universities do not wish to provide the student's cost of attendance and other financial aid on the certification form.

Resolution:

- CHESLA issued a new Loan Procedures Manual in October 2009. This manual makes it clear that AGI is the primary income determinant for evaluating eligibility.

- CHESLA implemented a procedure to ensure compliance with maximum borrowing limits for loans which have a start date subsequent to the audited period.

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- 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. This recommendation is being restated and repeated. (See Recommendations 1 and 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 ensure compliance with Section 10a-225(b) of the General Statutes.

  CHESLA issued a new Loan Procedures Manual in October 2009, which clearly states that Adjusted Gross Income is the primary income determinant for evaluating eligibility. In addition, as a result of our previous recommendation, the Authority implemented a procedure to ensure that colleges and universities are providing the information related to the student's cost of attendance and other financial aid. Based on these two actions taken by CHESLA, this recommendation is not being repeated.

Current Audit Recommendations:

1. **The Authority should comply with its Vacation Policy and obtain Board approval for the carryover of unused vacation leave.**

   Comment:

   We noted an instance in which an employee was permitted to carry over 11.5 vacation leave days in to the next fiscal year. There was no evidence of the approval of the CHESLA Board for this transaction.

2. **Salary overpayments to an Authority employee totaling $2,290 should be recovered in a clear manner.**

   Comment:

   In our previous audit, we noted that an administrative error resulted in an employee receiving salary overpayments totaling $2,290 in the fiscal year ended June 30, 2009, which has not been recovered to date.

3. Credit card expenses incurred by the Executive Director should be reviewed and approved by the CHESLA Board.

Comment:

During our review of purchases, we noted that there is no evidence that credit card expenses incurred by the Executive Director are subject to review and approval of the CHESLA Board of Directors.

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, 2009. 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 and 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, 2009, 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.

Timothy M. LePore
Principal Auditor

Approved:

Kevin P. Johnston Auditor of Public Accounts	Robert G. Jaekle Auditor of Public Accounts