AUDITORS' REPORT
CONNECTICUT HIGHER EDUCATION SUPPLEMENTAL LOAN AUTHORITY
FOR THE FISCAL YEARS ENDED JUNE 30, 2010 and 2011

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN  ROBERT M. WARD
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FOR THE FISCAL YEARS ENDED JUNE 30, 2010 and 2011

We have examined the books, records, and accounts of the Connecticut Higher Education Supplemental Loan Authority (CHESLA), as provided in Section 2-90 and Section 1-122 of the General Statutes, for the fiscal years ended June 30, 2010 and 2011.

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 CHESLA's internal control over its operations and its compliance with requirements that could have a material or significant effect on its operations in order to determine our auditing procedures for the purpose of evaluating the authority’s 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 CHESLA operations during the aforementioned fiscal years in the five areas identified above and a review of such other areas as we considered necessary. The financial statement audits of the Connecticut Higher Education Supplemental Loan Authority, for the fiscal years ended June 30, 2010 and 2011, were conducted by the authority’s independent public accountants.
FOREWORD:

The Connecticut Higher Education Supplemental Loan Authority operates primarily under the provisions of Title 10a, Chapter 187b, Sections 10a-221 through 10a-246 of the Connecticut General Statutes. CHESLA is a quasi-public agency and political subdivision of the state. Provisions for quasi-public agencies are codified primarily in Sections 1-120 through 1-127 of Chapter 12 of the General Statutes.

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 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 that 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.

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.

Board Members:

As authorized under Section 10a-224 of the General Statutes, responsibility over the operations of CHESLA 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, 2011, CHESLA’s board of directors was as follows:

Ex-Officio:

Denise L. Nappier, State Treasurer
Benjamin Barnes, 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
Robert L. Genuario and Brenda Sisco, former Secretaries of the Office of Policy and Management, also served as members of the board during the period covered by this examination.

Gloria F. Ragosta was appointed the executive director of CHESLA on May 19, 1998, and served in that position through January 2011. Judith B. Greiman was appointed executive director effective January 31, 2011.

**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 of CHESLA 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 outstanding loans.

Bond issue funds outstanding as of June 30, 2011, included:


During the period under review, CHESLA issued 2009 and 2010 Series A revenue bonds in the amounts of $30,000,000 and $45,000,000, respectively.

As of June 30, 2011, CHESLA had issued $441,840,000 in revenue bonds and revenue refunding bonds, with $184,250,000 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, 2011, the 1998, 1999, 2000, 2001, 2003, 2005, 2006, 2007, 2009 and 2010 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.
- **Trustee Services:** Invests and accounts for bond proceeds, payments.
- **Underwriters and Financial Advisors:** Perform 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 years under review. The audit reports for the fiscal years ended June 30, 2010 and June 30, 2011, expressed unqualified opinions 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 by the Auditors of Public Accounts. Effective July 1, 2010, Public Act 10-172 changed the requirement for an annual compliance audit to a biennial audit. The audit should determine whether the agency complied with its 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 the act, we performed the compliance audit of CHESLA covering the 2009-2010 and 2010-2011 fiscal years. 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 25 bond issues as of June 30, 2011. 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, 2007, 2009 and 2010 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 marketplace 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, 2011, in the aggregate amount of $19,395,819. As of June 30, 2011, the state has not made, nor was it required to make, any such deposit.

As noted above, the vice president of the Connecticut Conference of Independent Colleges (CCIC), Gloria F. Ragosta, served as the executive director of CHESLA through January 2011. Effective January 31, 2011, Judith B. Greiman, president of the CCIC, assumed responsibility as 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. Annual fees totaled $106,000 for the fiscal years ended June 30, 2010 and 2011.

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 for the fiscal years ended June 30, 2010 and 2011, totaled $9,326,299 and $8,921,871, respectively. Those amounts consisted primarily of interest income derived from investments and loans to individuals.

Expenses related to the Bond Funds for the fiscal years ended June 30, 2010 and 2011, totaled $10,365,500 and $9,425,491, respectively. Those amounts consisted primarily of debt
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service, namely interest. The Bond Funds balance of $10,421,515 as of June 30, 2009, decreased to $9,382,314 as of June 30, 2010, and further decreased, as of June 30, 2011, to $8,878,694.

Revenues credited to the Authority Operating Fund for the fiscal years ended June 30, 2010 and 2011, totaled $1,055,665 and $990,534, respectively. Those amounts consisted of administrative fees and investment income. Operating expenses paid from the Operating Fund during the fiscal years ended June 30, 2010 and 2011, totaled $819,682 and $798,397, respectively. Those amounts consisted primarily of professional and administrative expenses and amortization of bond issuance costs. The Authority Operating Fund balance increased from $3,535,027 at June 30, 2009, to $3,771,010 at June 30, 2010, and further increased, as of June 30, 2011, to $3,963,147.

The cumulative number of loans made to students by CHESLA for all bond funds as of June 30, 2010, totaled 31,750, compared to 29,664 as of June 30, 2009, amounting to 2,086 additional loans in that period. The average of the cumulative dollar amount loaned to each student as of June 30, 2010, was $9,836. The cumulative number of loans made to students as of June 30, 2011, totaled 33,477, amounting to 1,727 additional loans in that period. The average of the cumulative dollar amount loaned to each student as of June 30, 2011, was $9,784.

Subsequent Events:

Effective July 1, 2012, Public Act 12-149, An Act Concerning the Connecticut Health and Educational Facilities Authority (CHEFA), consolidated CHEFA with CHESLA by making CHESLA a subsidiary of CHEFA. CHESLA retains authority to issue loans and bonds and hire its own employees. The act also changes the composition of CHESLA’s board of directors and provides that CHESLA appoint an employee of CHEFA as executive director. Consequently, CHESLA’s relationship with the CCIC was terminated. The CHESLA board has appointed Jeanette Weldon, managing director of CHEFA, as executive director.
CONDITION OF RECORDS

Payroll and Personnel – Vacation Leave Carryover:

Criteria: The CHESLA vacation policy, effective March 23, 2010, states: “Staff members will be allowed to carry-over up to a maximum of ten vacation days from one fiscal year to the next. Carry-over vacation days are to be used first within three months in the next fiscal year.”

Condition: Due to an audit finding related to vacation carryover reported in our audit of fiscal year ended June 30, 2009, CHESLA revised its vacation policy. We performed testing to determine whether CHESLA complied with the revised policy. We noted that vacation leave carried over into the next fiscal year by both CHESLA employees was not used within the first three months of the next fiscal year. For one employee, only one-half day of the 9.5 days of vacation leave carried over from fiscal year 2010 to 2011 was used within the first three months of fiscal year 2011. For the other employee, only three days of the eight days carried forward from fiscal year 2010 to 2011 were used within the first three months of fiscal year 2011.

Effect: CHESLA did not follow its vacation policy requirements. Vacation days earned in fiscal year 2010 were carried over into fiscal year 2011 but were not used within the first three months of that year.

Cause: The vacation policy had been revised by CHESLA in March of 2010. A change to the proposed policy was made by the board of directors, and CHESLA personnel were not aware that vacation days carried over into the next fiscal year must be used within the first three months of that fiscal year.

Recommendation: CHESLA should strengthen internal control over personnel matters.

Agency Response: “The Authority agrees with this finding but disagrees with the overly broad recommendation. This was a one-time error that occurred soon after the carry-over policy changed. It was corrected in the subsequent year. Additionally, in the subsequent year, the Authority devoted considerable staff and board time to a review of personnel policies along with job functions and titles. This resulted in the development of an extensive personnel manual, new job descriptions and salary structures. Great attention has and will continue to be paid to personnel matters and this one-time issue does not reflect the broad concern raised by the language of the recommendation.”
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Auditors’ Concluding Comments: We acknowledge that CHESLA has taken steps to review and revise personnel policies. However, either a lack of communication with personnel or attention to those policies resulted in the error continuing beyond the audited period into fiscal year 2012. It was upon notification by the Auditors of Public Accounts that both management and personnel became aware of the restriction on the carryover. The error was then corrected by management.

Certifications Required by Legislation

Criteria: Section 4-252, subsection (b), of the Connecticut General Statutes and Governor Rell’s Executive Order No. 7C require that the agency official who is authorized to execute a contract with a value of $50,000 or more shall certify that the selection of the most qualified or highest ranked person, firm or corporation was not the result of collusion, the giving of a gift or the promise of a gift, compensation, fraud or inappropriate influence from any person.

Condition: During our review of expenditures, we performed tests of CHESLA's compliance with statutory requirements for obtaining agency and vendor affidavits and certifications. We found that the authority did not complete the certification required by Section 4-252, subsection (b), for three of its contracts valued at $50,000 or more.

Effect: CHESLA was not in compliance with certification requirements.

Cause: CHESLA was not aware that it must complete the certification required by Section 4-252, subsection (b), of the General Statutes.

Recommendation: CHESLA should take steps to ensure that the required certifications are completed.

Agency Response: “The Authority disagrees with this finding. The Authority’s actions were consistent with the explicit language and with its counsel’s interpretation of the statute and Executive Order No. 7C. As a result, the Authority and its counsel believed that it was in full compliance with statutory requirements. In light of this finding, the Authority has put in place the policies and procedures necessary to comply with the Auditor’s interpretation of the statute and of Executive Order No. 7C, and the three additional forms have been signed and filed with the contracts.”

Auditors’ Concluding Comments: In order to confirm our interpretation of the statutes and Executive Order No. 7C, we consulted with legal counsel at the Office of Policy and Management during our audit. The OPM legal counsel confirmed that the
certification is required for quasi-public agencies, and CHESLA was made aware that OPM supported our position and that it was not solely auditor interpretation. In addition, it should also be noted that prior audits indicated that the authority has historically completed the required certification.

Distribution of Student Loans:

**Background:** CHESLA outsources servicing of its student loans to a loan servicer. The servicer evaluates and approves loan applications using documentation provided by the applicant(s), the student’s school, and instructions provided by the authority. The evaluation includes a review of the student’s cost of attendance as determined by the school, as well as financial aid received from other sources. Such information allows the authority to determine that the loan is used solely for the student’s education costs.

**Criteria:** Section 10a-225, subsection (b), of the Connecticut General Statutes stipulates that CHESLA “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 co-borrowers were eligible to receive CHESLA student loans. Our compliance testing disclosed that one student received a loan that was greater than the student’s cost of attendance (COA) less other financial aid received. The loan certification form provided by the student’s school indicated that the estimated cost of attendance was $34,630 and other financial aid was $40,500. The loan amount requested was $36,500. Therefore, the total possible excess award was $42,370. Despite internal control procedures adopted by CHESLA’s loan servicer to detect such a situation, the loan was disbursed to the student. It should be noted that the COA and other financial aid had been recorded incorrectly on the certification form, and the student did not receive a loan in excess of the student’s financial need. The student’s school subsequently verified a COA of $51,230 and estimated other financial aid of $4,000.

**Effect:** The student’s loan was disbursed despite evidence contained on the submitted forms that the loan amount exceeded the cost of attendance less other financial aid.

**Cause:** Human error by the loan servicer’s personnel during the loan approval process and the quality control review resulted in the discrepancy going unnoticed.
Recommendation: CHESLA should take steps to ensure that the student loan servicer establishes procedures that enable compliance with Section 10a-225, subsection (b), of the General Statutes.

Agency Response: “The Authority agrees with this finding. Steps have been taken to reiterate and ensure that the student loan servicer is utilizing established procedures that require compliance with Section 10a-225, subsection (b), of the General Statutes. It should be noted that it was through other established procedures and automated system reports that the error was discovered by the servicer. This enabled the servicer to contact the school regarding the discrepancy and allowed the school to correct its error regarding the COA that it had certified incorrectly. The Authority will continue to monitor servicer compliance with this and all statutes and procedures.”
RECOMMENDATIONS

Status of Prior Audit Recommendations:

- The authority should comply with its vacation policy and obtain board approval for the carryover of unused vacation leave. The board revised the vacation leave carryover policy; however, the authority was not in compliance with the new policy. Therefore, the recommendation is being restated and repeated. (See Recommendation 1.)

- Salary overpayments to an authority employee totaling $2,290 should be recovered in a clear manner. CHESLA has received restitution of the overpayments. Therefore, the recommendation will not be repeated.

- Credit card expenses incurred by the executive director should be reviewed and approved by the CHESLA board. CHESLA implemented a procedure whereby the board chairman would approve the monthly credit card statements with all of the attached receipts. Current testing indicated compliance with that procedure. Therefore, this recommendation is not being repeated.

Current Audit Recommendations:

1. CHESLA should strengthen internal control over personnel matters.

   Comment:

   CHESLA implemented a new vacation policy effective March 23, 2010. We noted that vacation leave carried over into the next fiscal year by both CHESLA employees was not used within the first three months of the next fiscal year, as stipulated by the policy.

2. CHESLA should take steps to ensure that the required certifications are completed.

   Comment:

   Testing disclosed that the authority did not complete the certification required by Section 4-252, subsection (b), of the General Statutes and Governor Rell’s Executive Order No. 7C for three of its contracts valued at $50,000 or more.
3. **CHESLA should take steps to ensure that the student loan servicer establishes procedures that enable compliance with Section 10a-225, subsection (b), of the General Statutes.**

Comment:

Our compliance testing disclosed that one student received a loan that was greater than the amount that the school had erroneously certified as the student’s cost of attendance less other financial aid received. The loan servicer’s records indicated a total possible excess award of $42,370. Despite internal control procedures adopted by the servicer to detect such a situation, the loan was disbursed to the student. It should be noted that the loan servicer subsequently resolved the errors in the student’s records, which resulted in a determination that the student did not receive a loan in excess of the student’s financial need.
INDEPENDENT AUDITORS’ CERTIFICATION

As required by Section 2-90, Section 1-122, and Section 10a-240 of the General Statutes, we have conducted an audit of the Connecticut Higher Education Supplemental Loan Authority’s operations for the fiscal years ended June 30, 2010 and 2011. 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 audits of the Connecticut Higher Education Supplemental Loan Authority, for the fiscal years indicated above, were 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 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 Compliance:

Management of the Connecticut Higher Education Supplemental Loan Authority is responsible for establishing and maintaining effective internal control over its operations. In planning and performing our audit, we considered the Connecticut Higher Education Supplemental Loan Authority’s internal control over its operations as a basis for designing our auditing procedures for the purpose of evaluating the authority’s operations and compliance with certain provisions of laws, regulations, contracts and grant agreements, but not for the purpose of expressing an opinion on the effectiveness of the authority’s internal control over operations and compliance. Accordingly, we do not express an opinion.

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 deficiency in internal control 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
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prevent, or detect and correct, unauthorized, illegal, or irregular transactions on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control that adversely affects the authority’s ability to properly initiate, authorize, record, process, or report data reliably consistent with management’s direction, and/or comply with certain provisions of laws, regulations, contracts, and grant agreements such that there is a reasonable possibility that material noncompliance with laws, regulations, contracts and grant agreements will not be prevented or detected and corrected on a timely basis.

Our consideration of the internal control over the authority’s operations was for the limited purpose described previously and was not designed to identify all deficiencies in the internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined previously.

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 operations for the fiscal years ended June 30, 2010 and 2011, 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 operations 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 and use of authority management, 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 Ostroske
Associate Auditor

Approved:

John C. Geragosian  Robert M. Ward
Auditor of Public Accounts  Auditor of Public Accounts