STATE OF CONNECTICUT

AUDITORS' REPORT
CONNECTICUT HIGHER EDUCATION
SUPPLEMENTAL LOAN AUTHORITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

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

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December 4, 2014

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FOR THE FISCAL YEAR ENDED JUNE 30, 2012

We have audited certain operations of the Connecticut Higher Education Supplemental Loan Authority (CHESLA) in fulfillment of our duties under Sections 1-122 and 2-90 of the Connecticut General Statutes.

The objectives of our audit were to:

1. Evaluate the authority's internal controls over significant management and financial functions;

2. Evaluate the authority's compliance with policies and procedures internal to the authority or promulgated by other state agencies, as well as certain legal provisions, including but not limited to whether the Connecticut Higher Education Supplemental Loan 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, grants, and other financial assistance, as applicable; and

3. Evaluate the economy and efficiency of certain management practices and operations, including certain financial transactions.

Our methodology included reviewing written policies and procedures, financial records, minutes of meetings, and other pertinent documents; interviewing various personnel of the corporation, as well as certain external parties; and testing selected transactions. We obtained an understanding of internal controls that we deemed significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We tested certain of those controls to obtain evidence regarding the effectiveness of their design and operation. We also obtained an understanding of legal provisions that are significant within the context of the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of contracts, grant agreements, or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting instances of noncompliance significant to those provisions.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

The accompanying Résumé of Operations is presented for informational purposes. This information was obtained from the authority's management and was not subjected to the procedures applied in our audit of the authority.

For the areas audited, we identified:

1. Deficiencies in internal controls;
2. Apparent noncompliance with legal provisions; and
3. Need for improvement in management practices and procedures that we deemed to be reportable.

The State Auditors' Findings and Recommendations in the accompanying report presents the findings arising from our audit of the Connecticut Higher Education Supplemental Loan Authority. The authority was consolidated with the Connecticut Health and Educational Facilities Authority under Public Act 12-249, effective July 1, 2012. This is explained further in the Résumé of Operations section of this report.

COMMENTS

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 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.

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 the Résumé of Operations section of this report.

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 President of the Board of Regents for Higher Education, all serving as ex-officio directors, and five directors appointed by the Governor.

As of June 30, 2012, 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
Dr. Robert A. Kennedy, President of the Board of Regents for Higher Education

Appointed by the Governor:	Term Expires July 1,
Michael E. McKeeman, Chairman	2014
William J. Pizzuto	2012
Delores P. Graham	2015
Martin L. Budd	2017

There was one vacancy on the board as of June 30, 2012.

Julie B. Savino and Kathleen Woods also served as members of the board during the period covered by this examination.

Judith B. Greiman was appointed the executive director of CHESLA on January 31, 2011 and served in that position through June 30, 2012.

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 or to refinance bonds previously issued. Bond fund revenue is generated from interest earned on investments and loans outstanding.

Bond Issue Funds Outstanding as of June 30, 2012, included:

2012 Series A, 2010 Series A, 2009 Series A, 2007 Series A, 2006 Series A, 2005 Series A, 2003 Series A and B, 2000 Series B, and 1999 Series B.

During the period under review, CHESLA issued 2012 Series A Refunding Bonds in the amount of $13,085,000.

As of June 30, 2012, CHESLA had issued $454,925,000 in revenue bonds and revenue refunding bonds, with $166,065,000 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, 2012, the 1999, 2000, 2003, 2005, 2006, 2007, 2009, 2010, and 2012 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 year under review. The audit report for the fiscal year ended June 30, 2012 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 by the Auditors of Public Accounts. Such an audit should determine whether the agency complies 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 statute, we performed the compliance audit of CHESLA covering the 2011-2012 fiscal year. We noted certain weaknesses in compliance and internal control, which are discussed in the State Auditors' Findings and Recommendations section of this report.

RÉSUMÉ OF OPERATIONS

CHESLA had 26 bond issues as of June 30, 2012. 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, 2005 Series B, 2012 Series A 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.

These Series A and B Bonds are special obligations of CHESLA and are payable from the revenues and other receipts, funds or monies pledged by the authority. In accordance with Section 10a-232(b) of the General Statutes, however, the State of Connecticut is contingently liable to CHESLA for amounts needed annually to maintain debt service reserves for one year's principal and interest on these bonds in the event the authority's funds are insufficient to do so. This annual debt service reserve requirement, which is held in a special capital reserve fund, amounted to $19,395,819 as of June 30, 2012. Through June 30, 2012, the state has not been required to make any payments into this debt service reserve, as CHESLA's pledged revenues and other resources have been sufficient to cover all debt service requirements.

As noted above, the President of the Connecticut Conference of Independent Colleges (CCIC), Judith B. Greiman, served as the executive director of CHESLA through June 2012. The executive director was compensated by CCIC. 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 year ended June 30, 2012.

CHESLA has 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 year ended June 30, 2012 totaled $10,477,416. This amount consisted primarily of interest income derived from investments and loans to individuals.

Expenditures related to the bond funds for the fiscal year ended June 30, 2012 totaled $8,882,215 and consisted primarily of debt service (interest). The bond funds' balance of $8,878,694 as of June 30, 2011, increased as of June 30, 2012, to $10,473,895.

Revenues credited to the Authority Operating Fund for the fiscal year ended June 30, 2012, totaled $798,889 and consisted of administrative fees and investment income. Operating expenses paid from the operating fund during the fiscal year ended June 30, 2012, totaled $934,957. This amount consisted primarily of professional and administrative expenses and amortization of bond issuance costs. The Authority Operating Fund balance decreased from $3,963,147 at June 30, 2011, to $3,827,079 as of June 30, 2012.

The cumulative number of loans made to students by CHESLA for all bond funds as of June 30, 2012, totaled 35,586 compared to 33,477 as of June 30, 2011, amounting to 2,109 additional loans in that period. The average of the cumulative dollar amount loaned to each student as of June 30, 2012, was $9,746. 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 changed the composition of CHESLA's board of directors and provided that CHESLA appoint an employee of CHEFA as executive director. Consequently, CHESLA's relationship with CCIC was terminated. The CHESLA board has appointed Jeanette Weldon, managing director of CHEFA, as executive director.

STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

Compliance with Reporting Requirements

Criteria: Section 1-123 subsections (b) and (c) of the General Statutes requires the board of directors of the authority to submit fiscal and personnel status reports to the legislative Office of Fiscal Analysis (OFA) on a quarterly basis.

Condition: In our reviews of the submission of these reports, we noted that the reports for the quarter ended September 30, 2011, were not submitted to OFA until June 2012. We also noted that the reports for the quarter ended December 31, 2011, were not submitted until July 2014.

Effect: CHESLA was not in compliance with the requirements of Section 1-123 subsections (b) and (c) of the General Statutes.

Cause: A lack of oversight appears to be the cause for this noncompliance.

Recommendation: CHESLA should improve internal control procedures to ensure compliance with Section 1-123 subsections (b) and (c) of the General Statutes.

Agency Response: "Beginning July 1, 2012, CHESLA's compliance to subsections (b) and (c) of CGS Section 1-123 are administered under its parent company, CHEFA."

Approval of Credit Card Purchases

Criteria: The authority has implemented a procedure for reviewing and approving credit card purchases. In order to pay the credit card bill in a timely manner, the board chairman reviews the charges made by the executive director by comparing the monthly credit card statement to the documentation related to the charges. After the approval of the board chairman, the credit card bill is paid.

Condition: We reviewed a sample of credit card purchases and noted one instance in which a credit card purchase by the executive director was approved by the chairman of the board of directors after the credit card bill had been paid.

Effect: CHESLA was not in compliance with its established internal control procedures related to credit card purchases, approvals, and payments.

Cause: The authority failed to follow its internal control procedures.

Recommendation: CHESLA should follow its internal control procedures related to credit card purchases, approvals, and payments.

Agency Response: "Beginning July 1, 2012, CHESLA's credit card payments are administered under the guidelines of its parent company, CHEFA."

RECOMMENDATIONS

Status of Prior Audit Recommendations

- **The authority should strengthen internal control over personnel matters.** Our review in the current audit noted no exceptions in the area, and this finding is not being repeated.

- **The authority should improve compliance with statutorily required certification requirements.** Testing performed in the current audit noted that the authority is in compliance with these requirements. The finding is not being repeated.

- **The authority 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.** Testing performed in the current audit noted no exceptions. The finding is not being repeated.

Current Audit Recommendations

1. **CHESLA should improve internal control procedures to ensure compliance with Section 1-123 subsections (b) and (c) of the General Statutes.**

   Comment:

   These two subsections require the authority to submit fiscal and personnel status reports to the legislative Office of Fiscal Analysis on a quarterly basis. We noted that the submission of these reports for two quarters during the audited period were not made in a timely manner.

2. **CHESLA should follow its internal control procedures related to credit card purchases, approvals, and payments.**

   Comment:

   We noted an instance in which the authority's established procedures were not followed. The approval of one purchase occurred after the credit card bill had been paid.

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:

John C. Geragosian
Auditor of Public Accounts

Robert M. Ward
Auditor of Public Accounts