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INTRODUCTION
AUDITORS' REPORT
CONNECTICUT STUDENT LOAN FOUNDATION
FOR THE FISCAL YEAR ENDED
SEPTEMBER 30, 2013

We have audited certain operations of the Connecticut Student Loan Foundation in fulfillment of our duties under Section 2-90 of the Connecticut General Statutes. The scope of our audit included, but was not necessarily limited to, the year ended September 30, 2013.

The objectives of our audit were to:

1. Evaluate the foundation’s internal controls over significant management and financial functions;

2. Evaluate the foundation’s compliance with internal policies and procedures, as well as certain legal provisions; 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 representatives, 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.
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 foundation's audited financial statements and was not subjected to the procedures applied in our audit of the foundation.

For the areas audited, we identified:

1. No deficiencies in internal controls;
2. No apparent noncompliance with legal provisions; and
3. No 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 any findings arising from our audit of the Connecticut Student Loan Foundation.

COMMENTS

FOREWORD

The Connecticut Student Loan Foundation, a nonprofit corporation created in 1965, operates primarily under the provisions of Sections 10a-201 through 10a-216 of the General Statutes. The mission of the corporation is to improve educational opportunity. As mentioned later in this report, the foundation has not recently been engaged in promoting its corporate mission by either making new loans available to students or purchasing existing student loans in the secondary market. Consequently, both preceding and during the period of our audit, the foundation’s operations have primarily been limited to providing for the servicing of existing student loans.

The foundation has been authorized under the provisions of Section 10a-201 to administer (collect repayments and otherwise service) Connecticut guaranteed loans for lenders and their assignees since 1980. Beginning in July 1989, the foundation became a direct participant in the secondary market for student loans, whereby it purchases and holds, in part as a revenue-producing investment, portfolios of loans originally issued by other authorized lending institutions. It was presumed that this would provide lenders with the necessary liquidity to offer additional student loans.
Board of Directors and Administrative Officials

Under the provisions of Section 10a-203 of the General Statutes, the foundation is governed by a board of directors consisting of 14 members. Six public members are appointed by the Governor with at least one member representing an eligible institution of higher education and at least one member having a favorable reputation for skill, knowledge and experience in management of a private company or lending institution at least as large as the corporation. Another public member, having financial expertise, is appointed by the board of directors. There are also four members with knowledge of business or finance, one each appointed by the speaker of the House of Representatives, the minority leader of the House of Representatives, the president pro tempore of the Senate and the minority leader of the Senate. The State Treasurer is an ex-officio member of the board. The chairperson of the Board of Regents for Higher Education and the president of the Board of Regents for Higher Education are ex-officio members of the board. The board of directors elects a chairperson and a vice chairperson from its own membership each year. The directors receive no compensation for their services but are reimbursed for expenses incurred in the performance of their duties.

Since June 2009, the foundation’s board of directors has only consisted of its three ex-officio members. Membership of the board, as of September 30, 2013, is presented below:

Sarah K. Sanders, designee of State Treasurer Denise L. Nappier
James R. Howarth, designee of Dr. Gregory W. Gray, President of the Board of Regents for Higher Education
Craig S. Lappen, designee of Yvette Meléndez, Acting Chairperson of the Board of Regents for Higher Education

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

Subsequent Significant Legislation

Notable legislative changes, which took effect after the audited period, are presented below:

Public Act 14-217

Section 39 (a) of the act constituted the Connecticut Student Loan Foundation as a subsidiary of the Connecticut Health and Educational Facilities Authority. Section 39 (b) (1) of the act provides that the board of directors of the Connecticut Higher Education Supplemental Loan Authority shall also serve as the board of directors for the Connecticut Student Loan Foundation. The effective date for both of these provisions was July 1, 2014.
RÉSUMÉ OF OPERATIONS

Fund Structure

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

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

Financial Activities

The following summary of revenues, expenses, and changes in net position and explanation of changes for the fiscal years ended September 30, 2012 and 2013, was obtained from the foundation’s audited financial statements.

<table>
<thead>
<tr>
<th>Fiscal Year Ended September 30,</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Revenues</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Student Loan Interest</td>
<td>$17,780,929</td>
<td>$14,814,133</td>
</tr>
<tr>
<td>Servicing Income</td>
<td>62,828</td>
<td>636,153</td>
</tr>
<tr>
<td>Other Revenue</td>
<td>0</td>
<td>102,371</td>
</tr>
<tr>
<td>Total Operating Revenues</td>
<td>$17,843,757</td>
<td>$15,552,657</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bond Interest</td>
<td>$9,356,354</td>
<td>$6,735,544</td>
</tr>
<tr>
<td>Loan Administration</td>
<td>5,707,716</td>
<td>4,439,594</td>
</tr>
<tr>
<td>Contracted Services</td>
<td>700,384</td>
<td>792,335</td>
</tr>
<tr>
<td>Bad Debt Expense</td>
<td>1,400,000</td>
<td>1,500,000</td>
</tr>
<tr>
<td>Other Operating Expenses</td>
<td>72,427</td>
<td>79,514</td>
</tr>
<tr>
<td>Total Operating Expenses</td>
<td>$17,236,881</td>
<td>$13,546,987</td>
</tr>
<tr>
<td>Change in Net Position from Operations</td>
<td>606,876</td>
<td>2,005,670</td>
</tr>
<tr>
<td>Non-Operating Revenues</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grant Income</td>
<td>22,733</td>
<td>0</td>
</tr>
<tr>
<td>Investment Income</td>
<td>118,821</td>
<td>16,748</td>
</tr>
<tr>
<td>Gain on Redemption of Bonds</td>
<td>2,138,500</td>
<td>37,500</td>
</tr>
<tr>
<td>Change in Net Position from Continuing Operations</td>
<td>2,886,930</td>
<td>2,059,918</td>
</tr>
<tr>
<td>Discontinued Operations</td>
<td>4,821,143</td>
<td>4,471,414</td>
</tr>
<tr>
<td>Change in Net Position</td>
<td>7,708,073</td>
<td>6,531,332</td>
</tr>
</tbody>
</table>
Auditors of Public Accounts

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Position – Beginning of Year</td>
<td>37,632,001</td>
<td>45,340,074</td>
</tr>
<tr>
<td>Restatement – GASB 65 Adjustment (Bond Issue Costs)</td>
<td>0</td>
<td>(776,495)</td>
</tr>
<tr>
<td>Net Position – End of Year</td>
<td>$45,340,074</td>
<td>$51,094,911</td>
</tr>
</tbody>
</table>

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

In March 2013, the foundation entered into an agreement to participate in the not-for-profit servicer program established under the federal Health Care and Education Reconciliation Act (HCERA) of 2010. The USDOE approved the foundation’s participation in the program. Servicers in the program are assigned direct loans originated by USDOE for servicing. The federal government pays loan servicers fees to service the loans. As a result, the foundation recognized $636,153 in income from that program during the fiscal year.

The foundation’s largest expense is debt payments on the auction rate certificates it issued to raise money to make student loans. The interest rate on the certificates is variable and auctioned every 28 days. Investors are paid at the maximum rates defined in each issuance of Treasury Bills plus 1.2 percent to 1.5 percent. However, during the fiscal year, the credit ratings of the foundation’s subordinated bonds were upgraded, thereby lowering the foundation’s maximum borrowing margin to 1.2 percent above the applicable Treasury Bill rate. The interest expense paid to bondholders decreased in fiscal year 2013 primarily due to the aforementioned bond credit ratings upgrades and a reduction of bonds outstanding between the fiscal years.

As a result of the implementation of GASB Statement No. 65, Items Previously Reported as Assets and Liabilities, the foundation has restated its beginning net position, effectively decreasing the position as of October 1, 2012 by $776,495. The decrease results from no longer deferring and amortizing bond issuance costs.

Administration

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

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

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

Loan servicing was performed by outside service organizations retained by the foundation during the audited period. Loan portfolio assets as of September 30, 2013 and associated classifications per the foundation’s independent public accountant are summarized as follows:

<table>
<thead>
<tr>
<th></th>
<th>FFELP</th>
<th>Alternative</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>In-School</td>
<td>$4,623,900</td>
<td>$705,640</td>
<td>$5,329,540</td>
</tr>
<tr>
<td>Grace</td>
<td>4,197,529</td>
<td>342,356</td>
<td>4,539,885</td>
</tr>
<tr>
<td>Deferment</td>
<td>50,565,634</td>
<td>703,931</td>
<td>51,269,565</td>
</tr>
<tr>
<td>Forbearance</td>
<td>44,624,095</td>
<td>542,957</td>
<td>45,167,052</td>
</tr>
<tr>
<td>Repayment</td>
<td>316,724,669</td>
<td>7,142,058</td>
<td>323,866,727</td>
</tr>
<tr>
<td>Totals</td>
<td>420,735,827</td>
<td>9,436,942</td>
<td>430,172,769</td>
</tr>
<tr>
<td>Allowance</td>
<td>(1,580,186)</td>
<td>(796,154)</td>
<td>(2,376,340)</td>
</tr>
<tr>
<td></td>
<td>$419,155,641</td>
<td>$8,640,788</td>
<td>$427,796,429</td>
</tr>
</tbody>
</table>

Student loans are classified as In-School from the date the loan is made until a student graduates or leaves school. Loans are classified as being in Grace status from the time the student leaves school until repayment begins six months later. Subsequent to this period, student loans are classified as being in Repayment status. Deferment and Forbearance statuses are periods during the life of the loan in which repayment is suspended for authorized purposes.

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

Independent Public Accountants’ Audit Results

The audited financial statements of the foundation for the fiscal year ended September 30, 2013, reflect a clean audit opinion. In the management letter accompanying the audit, the
independent public accountant identified three control deficiencies that are not considered to be material weaknesses or significant deficiencies. One deficiency identified was the lack of segregation of duties over certain areas of internal controls, including financial reporting and loan receivable reconciliations, due to the size of the organization. A critical key control to mitigate those risks is the board’s oversight of the quarterly financial reporting and budget to actual analysis. Another deficiency identified was that the foundation’s administrative agents have the ability to wire money out of an account without a board member’s signature. We were informed that commencing in 2010, the administrative agent restructured the foundation’s flow of funds so that the principal and interest payments made on the loans in the bond trust would be transferred directly from the loan servicer to the bond trustee, which substantially reduced the amounts transferred through the foundation’s accounts. In addition, during the audited period, the Board of Regents for Higher Education provided its representatives with access to review the foundation’s monthly bank statements, reconciliations and transaction records. The last deficiency noted was that the foundation did not have a full complement of board members appointed as governed by the bylaws and state statute. As noted elsewhere in this report, this deficiency was subsequently resolved effective July 1, 2014 through the passage of Public Act 14-217.
STATE AUDITORS’ FINDINGS AND RECOMMENDATIONS

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

Board Membership

Criteria: Section 10a-203(a) of the General Statutes requires that the board of directors shall consist of fourteen members, as follows: the chairperson of the Board of Regents for Higher Education and the president of the Board of Regents for Higher Education; six public members appointed by the Governor, at least one of whom shall represent an eligible institution of higher education, at least one of whom shall be a person having a favorable reputation for skill, knowledge and experience in management of a private company or lending institution at least as large as the corporation and all of whom shall be electors of this state; one public member appointed by the board of directors who shall have, through education or experience, an understanding of relevant accounting principles and practices, financial statements and audit committee functions and knowledge of internal controls, who shall be an elector of this state; four members with knowledge of business or finance, one each appointed by the speaker of the House of Representatives, the minority leader of the House of Representatives, the president pro tempore of the Senate and the minority leader of the Senate; and the State Treasurer or, if so designated by the State Treasurer, the Deputy State Treasurer appointed pursuant to Section 3-12 of the General Statutes.

Condition: Our review of the board membership of the Connecticut Student Loan Foundation for the fiscal year ended September 30, 2013 revealed that the board was still operating with only its three ex-officio members, leaving eleven vacancies.

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

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

Resolution: Public Act 14-217, Section 39 (b) (1), effective July 1, 2014, provides that the board of directors of the Connecticut Higher Education Supplemental Loan Authority shall also serve as the board of directors for the Connecticut Student Loan Foundation. Consequently, the Connecticut Student Loan Foundation is no longer responsible for maintaining sufficient board membership.
RECOMMENDATIONS

Status of Prior Audit Recommendation:

The Connecticut Student Loan Foundation should seek legislation to modify the board composition requirements. Our prior audit found that the board of directors was operating with only its three ex-officio members at the end of the audited period. This recommendation will not be repeated, as the Connecticut Student Loan Foundation is no longer responsible for maintaining sufficient board membership following the passage of Public Act 14-217, Section 39 (b) (1), effective July 1, 2014.

Current Audit Recommendation:

Our current review did not reveal any areas that require comment.
CONCLUSION

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

Marc A. Amutice
Associate Auditor

Approved:

John C. Geragosian
Auditor of Public Accounts

Robert M. Ward
Auditor of Public Accounts