

# STATE OF CONNECTICUT



*AUDITORS' REPORT  
CONNECTICUT HEALTH AND EDUCATIONAL FACILITIES AUTHORITY  
FOR THE FISCAL YEARS ENDED JUNE 30, 2012 AND 2013  
AND  
CONNECTICUT HIGHER EDUCATION SUPPLEMENTAL LOAN AUTHORITY  
FOR THE FISCAL YEAR ENDED JUNE 30, 2013*

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

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# STATE OF CONNECTICUT



## AUDITORS OF PUBLIC ACCOUNTS

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December 10, 2015

### **AUDITORS' REPORT CONNECTICUT HEALTH AND EDUCATIONAL FACILITIES AUTHORITY FOR THE FISCAL YEARS ENDED JUNE 30, 2012 AND 2013 AND CONNECTICUT HIGHER EDUCATION SUPPLEMENTAL LOAN AUTHORITY FOR THE FISCAL YEARS ENDED JUNE 30, 2013**

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

Throughout this auditor's report, CHEFA and CHESLA are referred to as the authority on a consolidated basis.

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 authorities or promulgated by other state agencies, as well as certain legal provisions, including but not limited to whether the Connecticut Health and Educational Facilities Authority and Connecticut Higher Education Supplemental Loan Authority have complied with 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 authority personnel, 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 authority 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 Health and Educational Facilities Authority (CHEFA) and Connecticut Higher Education Supplemental Loan Authority (CHESLA). Effective July 1, 2012, the Connecticut Higher Education Supplemental Loan Authority was statutorily consolidated as a subsidiary of the Connecticut Health and Educational Facilities Authority. The results of operations of CHESLA for the fiscal year ended June 30, 2012 were presented separately in our audit report issued December 4, 2014.

## COMMENTS

### FOREWORD

#### **Connecticut Health and Educational Facilities Authority**

Pursuant to Chapter 12 of the General Statutes, CHEFA is classified as a quasi-public agency which operates primarily under the provisions of Chapter 187, Sections 10a-176 through 10a-198 of the General Statutes. Pursuant to Section 10a-179, CHEFA is constituted as a public instrumentality and political subdivision of the state. As a quasi-public agency, CHEFA's financial information is included as a component unit in the State of Connecticut's Comprehensive Annual Financial Report.

CHEFA was established to assist certain healthcare, higher education, and qualified not-for-profit institutions in the financing and refinancing of projects undertaken in relation to programs of such institutions.

CHEFA generates revenue from fees on its portfolio of bonds, as well as investment income which is used to pay operating expenses. As a result, CHEFA operations do not rely upon any state appropriation either from the General Fund or from bond funds. CHEFA is empowered to issue its own bonds, bond anticipation notes and any other obligations for any of its corporate purposes and to fund and refund the same. Interest on bonds issued by CHEFA is generally exempt from federal income tax to the bondholder. CHEFA's outstanding bond portfolio consists of special obligation bonds for which payments of principal and interest are the responsibility of the institutions and are not a debt of CHEFA or the State of Connecticut.

#### **Connecticut Higher Education Supplemental Loan Authority**

Pursuant to Chapter 12 of the General Statutes, CHESLA is classified as a quasi-public agency which operates primarily under the provisions of Chapter 187b, Sections 10a-221 through 10a-246 of the General Statutes. Pursuant to Section 10a-179a, CHESLA is constituted as a subsidiary of the Connecticut Health and Educational Facilities Authority. Public Act 12-149, effective July 1, 2012, statutorily consolidated CHESLA as a subsidiary of CHEFA. As a subsidiary of CHEFA, CHESLA retains its legal identity as a separate quasi-public authority and has no recourse to the general funds, revenues, resources or other assets of CHEFA or the State of Connecticut.

CHESLA was established 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.

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.

During fiscal year 2012-2013, certain functions which were previously outsourced were transitioned to CHEFA staff, including accounting and general counsel services. In addition, CHEFA now provides management services, administrative support, and office space to CHESLA. Administrative service costs totaled \$216,000 and \$232,000 in fiscal years 2011-2012 and 2012-2013, respectively. In order to facilitate a smooth transition during fiscal year 2012-2013, there was some overlap of services between outside providers and CHEFA staff. Administrative services costs paid to CHEFA by CHESLA for fiscal year 2013-2014 amounted to approximately \$143,000, which reflects cost savings achieved as part of the consolidation of services.

## **BOARDS OF DIRECTORS AND ADMINISTRATIVE OFFICIALS**

### **CHEFA Board of Directors**

Pursuant to Section 10a-179(a) of the General Statutes, CHEFA operates under a ten person board of directors. The board consists of the State Treasurer and the Secretary of the Office of Policy and Management as ex-officio members and eight residents of the state who are appointed by the Governor. Not more than four of the eight appointed members can be of the same political party. In addition, three appointed members shall be trustees, directors, officers, or employees of institutions for higher education, two appointed members shall be trustees, directors, officers or employees of healthcare institutions and one shall be a person having a favorable reputation for skill, knowledge, and experience in state and municipal finance.

As of June 30, 2013, CHEFA's board of directors was composed as follows:

#### **Ex-Officio Members:**

Denise L. Nappier	State Treasurer
Benjamin B. Barnes	Secretary, Office of Policy and Management

#### **Appointed Members:**

Barbara Rubin	Chair
Patrick A. Colangelo	Vice-Chair
John M. Biancamano	
Dr. Peter W. Lisi	
Barbara B. Lindsay, Esq.	
Dr. Estela R. Lopez	
Paul Mutone	
1 Vacancy	

The vacancy occurred when one member retired in December, 2012, and was filled subsequent to the audit period in May 2015.

**CHESLA Board of Directors**

Pursuant to Section 10a-179(b) of the General Statutes, as amended by Public Act 12-149 effective July 1, 2012, CHESLA operates under a nine person board of directors. The board consists of the State Treasurer, Secretary of the Office of Policy and Management, and the president of the Board of Regents for Higher Education as ex-officio members, the chairperson of the CHEFA board of directors, the executive director of CHEFA, and four residents of the state who are appointed by the board. In addition, two appointed members shall be CHEFA board members who are an active or retired trustee, director, officer or employee of a Connecticut institution for higher education, one member shall have a favorable reputation for skill, knowledge and experience in the higher education loan field, and one member shall have a favorable reputation for skill, knowledge and experience in either the higher education loan field or state and municipal finance. Of the four appointed members, not more than two may be members of the same political party. Pursuant to Section 10a-179(c) of the General Statutes, the chairperson of the CHEFA board of directors shall serve as the chairperson of the CHESLA board of directors.

As of June 30, 2013, CHESLA’s board of directors was composed as follows:

**Ex-Officio Members:**

Denise L. Nappier	State Treasurer
Benjamin B. Barnes	Secretary, Office of Policy and Management
Phillip E. Austin	Interim President, Board of Regents for Higher Education

**Appointed Members:**

Barbara Rubin	Chair
Julie B. Savino	Vice-Chair
Jeffrey A. Asher	Executive Director, CHEFA
Martin L. Budd	
Dr. Peter W. Lisi	
Paul Mutone	

**Administrative Officials**

In accordance with the provisions of Public Act 12-149, the CHESLA board of directors appointed a CHEFA employee, Jeanette Weldon, as its executive director at its meeting on June 5, 2012. Jeffrey A. Asher served as executive director of CHEFA throughout the audit period. Subsequent to the audit period, Mr. Asher retired effective June 30, 2015. Jeanette Weldon was chosen to succeed Mr. Asher as executive director of CHEFA at the April 22, 2015 meeting of the CHEFA Board of Directors, effective July 1, 2015.

## **SIGNIFICANT STATE LEGISLATION**

Public Act 10-75, effective January 1, 2012, required the transfer of \$3,000,000 from CHEFA to the General Fund to fund a program established by the same act, which provides loan reimbursements and grants to Connecticut students seeking jobs in alternative energy technology and other related fields.

Public Act 12-149, effective July 1, 2012, statutorily consolidated CHESLA as a subsidiary of CHEFA. As a subsidiary of CHEFA, CHESLA remains constituted as a quasi-public agency for the purposes of Chapter 12 of the General Statutes and retains its legal identity as a separate quasi-public authority, with no recourse to the general funds, revenues, resources or other assets of CHEFA or the State of Connecticut. As part of the consolidation, the CHESLA board of directors was reconstituted to comply with the provisions of Public Act 12-149, as discussed previously under CHESLA Board of Directors.

## **AUTHORITY PROGRAMS**

### **CHEFA Programs**

#### **Nonprofit and Client Grant Programs**

The Nonprofit and Client Grant programs are funded by the annual servicing fee charged to CHEFA clients. Grants under these programs are awarded to non-profit organizations for programs focusing on essential health, educational, cultural, and childcare services to residents of targeted geographic areas of Connecticut. Nonprofit grants may also be awarded for programs focusing on food insecurity. During the audited period, grant awards from the Nonprofit Program were awarded for essential services such as food, healthcare, and shelter only, in response to the recent recession. Individual grants range from \$5,000 to \$75,000 for both programs. Grant awards for the Client Grant Program totaled \$938,582 and \$1,034,469 in fiscal years 2011-2012 and 2012-2013, respectively. Grant awards for the Nonprofit Grant Program totaled \$1,000,000 and \$1,197,783 in fiscal years 2011-2012 and 2012-2013, respectively.

#### **Targeted Investment Program**

The Targeted Investment Program is funded by the annual servicing fee charged to CHEFA clients. During the audit period, Targeted Investment Program grants were awarded strictly on a case-by-case basis. For fiscal year 2014-2015, formalized guidelines were adopted aiming to fund activities which have a substantial and measurable impact on a wide scale basis in addressing a demonstrated need. Grants are awarded for projects which impact the areas of childcare, cultural, educational and healthcare facilities and programs and generally range from \$100,000 to \$500,000. Grant disbursements totaled \$515,100 and \$230,000 for the fiscal years 2011-2012 and 2012-2013, respectively.



### **Child Care Facilities Loan Fund**

Public Act 97-259 established three separate programs to finance the construction, expansion and renovation of childcare facilities. Under the Tax-Exempt Financing Program loans are provided to not-for-profit entities or municipalities serving children with school readiness or Department of Social Services contract funds. A portion of loan payments due under the Tax-Exempt Financing Program are made from funds allocated by the state legislature. The Guaranteed Loan Program provides loans to experienced childcare providers serving lower income children and/or children 0-4 years old. The Small Direct Loan Program serves experienced and new childcare businesses and provides funding for pre-development, minor renovations, equipment, or start-up costs of home-based care.

### **Special Capital Reserve Program**

Under the Special Capital Reserve Program, debt is guaranteed by the state under Section 10a-186a of the General Statutes, which provides for such funds to be used for the payment of principal and interest on authority bonds to finance projects at participating nursing homes and public institutions of higher education. The state is contingently liable to provide annual debt service requirements for such bonds if CHEFA's funds are not sufficient to meet minimum reserve requirements for the special capital reserve fund. The state's contingent liability related to these guarantees totaled \$271,550,000 as of June 30, 2012 and \$292,130,000 as of June 30, 2013.

### **CHESLA Programs**

#### **Student Loan Program**

Under the CHESLA Student Loan Program, qualifying applicants can receive an education loan for each academic year up to the student's total cost of education for the year, with a cumulative maximum of \$125,000. 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. Loans are given at fixed interest rates, determined in connection with the series of bonds used to finance the loan. While in school and for a six-month grace period after leaving school, undergraduates must make interest-only payments while graduate students may choose to defer interest. After this period, interest and principal payments commence.

## **RÉSUMÉ OF OPERATIONS**

The financial position of CHEFA as of June 30, 2013 and 2012 per its audited financial statements is presented below (amounts expressed in thousands):

<b>Assets</b>	<b>June 30</b>	
	<b>2013</b>	<b>2012</b>
Current Unrestricted Assets:		
Cash	\$ 227	\$ 276
Accounts Receivable	195	379
Board Designated Investments	10,638	7,941
Prepaid Expenses and Other Assets	91	123
Total Current Unrestricted Assets	11,151	8,719
Current Restricted Assets:		
Cash	57	81
Fund Investments	507,721	571,323
Total Current Restricted Assets	507,778	571,404
Non-current Assets:		
Restricted Investments	7,167	7,257
Capital Assets, net	178	158
<b>Total Assets</b>	<b>\$ 526,274</b>	<b>\$ 587,538</b>
<b>Liabilities</b>		
Current Liabilities	\$ 509,451	\$ 572,061
Non-current Liabilities	2,182	2,191
Total Liabilities	511,633	574,252
Net Position		
Invested in Capital Assets	178	158
Restricted	4,985	5,066
Unrestricted	9,478	8,062
Total Net Position	14,641	13,286
<b>Total Liabilities and Net Position</b>	<b>\$ 526,274</b>	<b>\$ 587,538</b>

The decrease in total assets in the 2012-2013 fiscal year was mainly attributable to a decrease in restricted fund investments. Restricted fund investments consist of construction funds managed and held by CHEFA on behalf of its client institutions. As a result, balances are

dependent on new financing and subsequent expenditure of construction funds by client institutions.

The revenues, expenses, and changes in net position of CHEFA as of June 30, 2013 and 2012 per its audited financial statements are presented below (amounts expressed in thousands):

	<b>June 30</b>	
	<b>2013</b>	<b>2012</b>
Operating Revenues:		
Administrative Fees	\$ 7,110	\$ 6,956
Investment Income	14	12
Bond Issuance Fees	158	101
Other Revenue	241	22
Total Operating Revenues	<u>7,523</u>	<u>7,091</u>
Operating Expenses:		
Salaries and Related Expenses	2,844	2,795
General and Administrative	1,057	1,135
Total Operating Expenses	<u>3,901</u>	<u>3,930</u>
Total Operating Income	3,622	3,161
Non-operating Activity		
Grant Expense	<u>(2,267)</u>	<u>(2,004)</u>
<b>Change in Net Position</b>	<b><u>\$ 1,355</u></b>	<b><u>\$ 1,157</u></b>

CHEFA generates revenue from fees on its portfolio of bonds, as well as investment income and does not rely on any state appropriation. Revenues generated from annual administrative fees during the audit period were based on the board approved rate of 9 basis points (or .0009) on the outstanding balance for most issues. Special Capital Reserve Fund long-term care bond issues carry an annual fee of 14 basis points (or .0014). Fee revenue increased two percent in fiscal year 2012-2013, and four percent in fiscal year 2011-2012, from \$6,687,000 in fiscal year 2010-2011, reflecting an increase in new issues and the par amount of bonds outstanding.

The consolidating financial position of CHEFA and CHESLA as of June 30, 2013 per its audited financial statements is presented below (*amounts expressed in thousands*):

<b>Assets</b>	<b>June 30, 2013</b>		
	<b>CHEFA</b>	<b>CHESLA</b>	<b>Total</b>
Current Assets:			
Unrestricted Assets:			
Cash	\$ 227	\$ 50	\$ 277
Investments		1,180	1,180
Current Portion of Loans Receivable			
Net of Loss Allowance of \$2,321		18,652	18,652
Accounts Receivable			
Net of Allowance of \$86	195		195
Interest Receivable on Investments		150	150
Interest Receivable on Loans Receivable		519	519
Board-designated Investments	10,638	1,000	11,638
Prepaid Expenses and Other Assets	91	15	106
Total Unrestricted Assets	<u>11,151</u>	<u>21,566</u>	<u>32,717</u>
			-
Restricted Assets:			
Cash	57		57
Fund Investments	507,721	37,509	545,230
Total Restricted Assets	<u>507,778</u>	<u>37,509</u>	<u>545,287</u>
Total Current Assets	<u>518,929</u>	<u>59,075</u>	<u>578,004</u>
Non-current Assets:			
Restricted Investments	7,167	22,036	29,203
Loans Receivable, Net of Current Portion		102,743	102,743
Prepaid Bond Insurance Premiums		248	248
Capital Assets, Net	178		178
Total Non-current Assets	<u>7,345</u>	<u>125,027</u>	<u>132,372</u>
<b>Total Assets</b>	<b><u>\$ 526,274</u></b>	<b><u>\$ 184,102</u></b>	<b><u>\$ 710,376</u></b>
<b>Liabilities and Net Position</b>			
Current Liabilities:			
Accounts Payable and Accrued Expenses	\$ 1,673	\$ 36	\$ 1,709
Current Portion of Bonds Payable		10,275	10,275
Accrued Interest Payable		761	761
Amounts Held for Institutions	507,778		507,778
Total Current Liabilities	<u>509,451</u>	<u>11,072</u>	<u>520,523</u>

	June 30, 2013		
	CHEFA	CHESLA	Total
Non-current liabilities:			
Bonds Payable, Net of Current Portion		158,225	158,225
Amount Held on Behalf of the State of CT	2,182		2,182
Total Non-current Liabilities	2,182	158,225	160,407
Total Liabilities	511,633	169,297	680,930
Net Position:			
Invested in Capital Assets	178		178
Restricted	4,985	59,545	64,530
Unrestricted	9,478	(44,740)	(35,262)
Total Net Position	14,641	14,805	29,446
<b>Total Liabilities and Net Position</b>	<b>\$ 526,274</b>	<b>\$ 184,102</b>	<b>\$ 710,376</b>

### Changes in CHESLA Bonds Payable

Changes in CHESLA bonds payable for the fiscal year 2012-2013 per its audited financial statements is presented below (*amounts expressed in thousands*):

	Balance at 7/1/2012	Increases	Decreases	Balance at 6/30/2013	Due Within One Year
Bonds Payable - Principal	\$ 166,065	\$ 25,000	\$ (23,405)	\$ 167,660	\$ 10,275
Discount	(620)		69	(551)	
Premium	1,361	104	(74)	1,391	
	\$ 166,806	\$ 25,104	\$ (23,410)	\$ 168,500	\$ 10,275

### CHEFA Bonds Issued

Bonds issued by CHEFA during fiscal years 2012-2013, 2011-2012, and 2010-2011 per its audited financial statements are presented below (*amounts expressed in thousands*):

	2012-2013		2011-2012		2010-2011	
	# of Issues	Par Amount	# of Issues	Par Amount	# of Issues	Par Amount
Healthcare	4	\$ 207,145	9	\$ 890,440	10	\$ 321,963
Higher Education	2	46,060	5	167,620	7	145,345
Private Secondary Schools	10	103,609	7	88,963		
Long-term Care	2	44,454			1	21,000
Child Care			1	28,840		
Other	1	20,000	2	39,460	1	12,020
	19	\$ 421,268	24	\$ 1,215,323	19	\$ 500,328

Bonds issued in fiscal year 2011-2012 represented a 143% increase in the par amount issued over fiscal year 2010-2011 levels. This large increase in dollar volume was due in large part to refinancing transactions totaling \$631,280,000 as a result of a low interest rate environment. Total issuances in fiscal year 2011-2012 represented the second highest annual dollar volume in CHEFA's history.

### **Reserve Funds**

	June 30,	
	2013	2012
Restricted Reserves		
School Readiness and Child Daycare		
Guaranteed Loan Fund Program	\$ 4,320	\$ 4,320
Held for the State of Connecticut	2,182	2,191
Connecticut Credit Union Student		
Loan Guarantee Program	665	746
	<u>\$ 7,167</u>	<u>\$ 7,257</u>

Reserves for the School Readiness and Child Daycare Guaranteed Loan Fund Program were established by CHEFA pursuant to Public Act 97-259. Reserves held for the State of Connecticut consist of the balance of reserve funds contributed by the state after expenses for administration costs and defaults. At inception, the state deposited \$1,500,000 for the Guaranteed Loan Fund Program established under Section 17b-749g of the General Statutes and \$750,000 for the Small Direct Revolving Loan Program established under Section 17b-749h of the General Statutes. The Connecticut Credit Union Student Loan Guarantee Program is not currently accepting new loans. Reserve amounts equal the authority's exposure under the program at the respective reporting dates.

In accordance with Section 10a-232(b) of the General Statutes, the State of Connecticut is contingently liable to CHESLA for amounts needed to maintain debt service reserves for one year's principal and interest on outstanding bonds. Required reserves are held in a special capital reserve fund, and amounted to approximately \$19.4 million as of June 30, 2012 and \$22 million as of June 30, 2013. Required reserves were \$19.4 million as of February, 2013. To date, the state has not made or been required to make any payments into the reserve fund.

### **Staffing Levels**

CHEFA employed 22 and 21 employees as of June 30, 2012 and 2013, respectively. CHESLA employed an additional two employees as of June 30, 2013. CHESLA's executive director is also a CHEFA employee, and is only included in the CHEFA employee count.

### **Other Examinations**

Independent public accountants audited the authority's consolidated financial statements for the fiscal year ended June 30, 2013, CHESLA financial statements for the fiscal year ended June 30, 2012, and CHEFA financial statements for the fiscal year ended June 30, 2012. Those audits attested that the financial statements presented fairly, in all material respects, the financial position of the authority as of the respective fiscal year end dates, and the respective changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

As an integral part of their financial statement audits, the independent public accountants also provided reports on compliance and internal control over financial reporting for each of the three audits noted above. These reports disclosed no instances of noncompliance concerning these requirements. The reports on internal control indicated that no material weaknesses in internal control over financial reporting were identified.

### **Subsequent Events**

Public Act 14-217, effective July 1, 2014, constituted the Connecticut Student Loan Foundation (CSLF) as a subsidiary of CHEFA and a quasi-public agency. The act also appoints the board of directors of CHESLA as the board of directors of CSLF, and the chairperson of the board of directors of CHESLA as the chairperson of the board of directors of CSLF. In accordance with the act, the CSLF board of directors appointed a CHEFA employee, Jeanette Weldon, as its executive director.

## STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

### MONITORING OF OUTSIDE SERVICE AGENCY

- Background:* CHESLA has contracted with an outside service organization to originate and service student loans made by the authority. Service organizations may engage independent auditors to issue Service Organization Controls Reports on the services they provide, which assist users in assessing and addressing risks associated with the outside service.
- As of June 30, 2013, CHESLA had approximately \$121 million in total loans receivable that were being serviced by the firm.
- Criteria:* Authority management is responsible for establishing and implementing sound internal controls to ensure the safeguarding of authority assets. When critical components of authority operations are delegated to an outside service organization, adequate monitoring of such service organization is necessary to ensure the safeguarding of authority assets.
- Condition:* We reviewed the independent auditor's reports on the service organization's description of the loan origination and loan servicing system and the suitability of the design and operating effectiveness of its controls covering calendar years 2013 and 2014. We found that in both instances, the independent auditor had issued a qualified opinion citing the same weakness in internal controls for both periods. While our review noted considerable other monitoring of the outside service organization, discussion with authority personnel indicated that they were unaware of the qualified opinion and underlying internal control weakness prior to it being brought to their attention by our review.
- Effect:* Not including reviews of Service Organization Controls Reports in monitoring of the outside service organization increases the risk of misappropriation of CHESLA assets.
- Cause:* Procedures for the monitoring of outside service organizations providing services to the authority did not include reviews of Service Organization Controls Reports.
- Recommendation:* The Connecticut Higher Education Supplemental Loan Authority should strengthen procedures to ensure adequate monitoring of outside service organizations. (See Recommendation 1.)



*Agency Response:*

“Management believes that it is important to clarify that the loan originator/servicer’s independent auditor’s report on the service organization’s Loan Origination and Loan Servicing System and the Suitability of the Design and Operating Effectiveness of Its Controls for the period from January 1, 2013 to December 31, 2013 (the “SSAE 16 Report”) renders a qualified opinion in connection with a very specific information systems related issue. The originator/servicer’s independent auditor’s report for the prior period, January 1, 2012 to December 31, 2012, did not contain this qualification.

The SSAE 16 Report identifies complementary user entity controls (“CUECs”) which users should have in place to confirm the completeness and accuracy of the processing provided by the service organization. Management believes that CHESLA has the proper complementary controls in place. CHESLA and CHEFA accounting staff routinely monitor the performance and reconcile the records of the loan originator/servicer.

On a regular basis, CHESLA staff performs the following activities:

1. Review of weekly disbursement rosters from the loan originator/servicer to ensure accuracy and compliance with all CHESLA requirements such as 501(c)(3) status of school, Connecticut nexus, and minimum disbursement amount. Staff also verifies that the bond ID matches the pool of funds identified. Staff also reconciles disbursement rosters monthly to trustee statements and to disbursements shown on the loan originator/servicer’s Accrual Summary Report;
2. Monthly review of the loan originator/servicer’s Roster Balancing Sheet;
3. Monthly reconciliation of the ending balance in the current loan pool to trustee bank statements;
4. Use as needed of a dedicated in-office terminal from the loan originator/servicer. This is used to follow-up on accounts through the Service History and ensure that the loan originator/servicer is servicing the program according to CHESLA guidelines;
5. Regular and routine telephonic communication with the loan originator/servicer’s service representatives regarding all aspects of CHESLA’s account administration; and
6. Maintenance of ongoing communication with all school representatives.

In addition to the above activities performed by CHESLA staff, the Accounting Department reviews the following and compares against

CHESLA internal accounting records and account statements from the Trustee:

1. The loan originator/servicer’s Accrual Summary sheet, which shows the total amount of dollars collected per Loan pool for the month;
2. The daily A CH Funds Transfer request sheets from the loan originator/servicer, which show the day’s collections and the dollar amount being sent to the trustee;
3. The trustee statements to verify the loan originator/servicer’s daily reports of loan payments made;
4. The amount of new loans to be disbursed according to the loan originator/servicer and loans cancelled according to originator/servicer’s Accrual Summary sheet; and
5. Disbursement rosters.

Going forward, we will augment the above list of activities with a careful review of the SSAE16 Report.”

**STATUTORY REPORTING**

*Criteria:* Section 1-123 subsections (b) and (c) of the General Statutes require 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:* Of the eight reports required of CHEFA and four required of CHESLA during the respective periods under review, we noted late submissions of quarterly reports as shown in the table below:

Reporting Entity	Reporting Period Ending	Submission Date	Months from Quarter End to Submission
<b>CHEFA</b>			
	9/30/2011	1/25/2012	4
	12/31/2011	8/14/2012	7
	3/31/2012	8/14/2012	4
	3/31/2013	11/21/2013	8
	6/30/2013	11/21/2013	5
<b>CHESLA</b>			
	9/30/2012	5/21/2014	20
	12/31/2012	5/21/2014	17
	3/31/2013	5/21/2014	14
	6/30/2013	5/21/2014	11

- Effect:* The authority is not in compliance with Section 1-123 subsections (b) and (c) of the General Statutes. The value of quarterly data is diminished when not submitted timely.
- Cause:* The authority has not prioritized the timely submission of quarterly reports to the OFA.
- Recommendation:* CHEFA and CHESLA should strengthen internal controls to ensure that quarterly reports are provided to the Office of Fiscal Analysis in a timely manner. (See Recommendation 2.)
- Agency Response:* “The authority has submitted all reports as required by Section 1-123 (b) and (c) of the General Statutes. The statutory provision does not identify a time period within which such reports must be filed. The statute provides that it is the obligation of “the board of directors of each quasi-public agency” to file such reports. Going forward, management will endeavor to file the reports required by Sections 1-123 (b) and (c) within 45 days following the date of the Board of Directors meeting at which such quarterly results are presented.”

## **LEAVE TIME APPROVAL**

- Criteria:* The authority’s personnel policies and procedures manual requires that an employee obtain prior supervisory approval for vacation time usage through the use of a vacation request form. CHEFA relies upon vacation request forms being provided to the administration manager in order to track employee vacation accrual records.
- Condition:* A review of 6 instances of vacation time used found that in 3 cases, supervisory approval was not requested until after the pay period had ended and employees had been paid for the time taken.
- Effect:* Lack of prior approval increases the risk that employees may charge vacation time that they have not earned. Delays in the processing of vacation request forms increases the risk of leave time not being posted to accrual records.
- Cause:* There appears to be inadequate management oversight of the vacation time request and approval process.
- Recommendation:* CHEFA and CHESLA should comply with their policies and procedures to ensure that supervisory approval is granted in advance of the requested leave time. (See Recommendation 3.)

*Agency Response:*

“Management is revising its vacation request policy to make it clear that employees must obtain written approval of vacation time from their supervisor on a timely basis. Verbal approval in advance will be required, with written documentation of approval provided as timely as possible thereafter. We will continue our practice of having the manager responsible for accrual time records provide bi-monthly to each manager a report of each employee’s accrued vacation time. This enables each manager to determine availability of vacation time, when the employee notifies the manager of requested time off. The manager responsible for the authority’s records will also continue to notify the controller, responsible for payroll processing, when any employee reaches a level of 2 remaining vacation days available.”

## RECOMMENDATIONS

### *Status of Prior Audit Recommendations:*

#### CHEFA

- **The Connecticut Health and Educational Facilities Authority should strengthen its internal controls to ensure that a valid application is obtained and on file for every bond issuance.** The current review noted improvements in internal controls and no further instances of a lack of a valid application on file. As a result, the recommendation will not be repeated.

#### CHESLA

- **CHESLA should improve internal control procedures to ensure compliance with Section 1-123 subsections (b) and (c) of the General Statutes.** Section 1-123, subsections (b) and (c) of the General Statutes require the board of directors of the authority to submit fiscal and personnel status reports to the legislative Office of Fiscal Analysis on a quarterly basis. The current review noted instances of untimely filing of these reports. As a result, the recommendation will be repeated in modified form. (See Recommendation 2.)
- **CHESLA should follow its internal control procedures related to credit card purchases, approvals, and payments.** The prior review noted credit card purchases which were approved subsequent to payment, inconsistent with CHESLA procedures. The current review noted improvements in controls due to the merger with CHEFA, and no further instances of a lack of approval prior to payment. As a result, the recommendation will not be repeated.

### *Current Audit Recommendations:*

1. **The Connecticut Higher Education Supplemental Loan Authority should strengthen procedures to ensure adequate monitoring of outside service organizations.**

#### Comment:

A review of authority monitoring of the outside service organization responsible for significant portions of CHESLA operations noted the outside service organization was not properly monitored by CHESLA.

- 2. CHEFA and CHESLA should strengthen internal controls to ensure that quarterly reports are provided to the Office of Fiscal Analysis in a timely manner.**

Comment:

A review of the eight reports required of CHEFA and four required of CHESLA, during the respective periods under review, noted nine instances in which reports were submitted subsequent to the end of the succeeding quarter.

- 3. CHEFA and CHESLA should comply with their policies and procedures to ensure that supervisory approval is granted in advance of the requested leave time.**

Comment:

A review of vacation time use noted that authority procedures for the approval of leave time were not followed in three of the six instances tested.

**CONCLUSION**

In conclusion, we wish to express our appreciation for the cooperation and courtesies extended to our representatives by the staff of the Connecticut Health and Educational Facilities Authority and Connecticut Higher Education Supplemental Loan Authority during the course of our examination.



Douglas Stratoudakis  
Associate Auditor

Approved:



John C. Geragosian  
Auditor of Public Accounts



Robert M. Ward  
Auditor of Public Accounts