

STATE OF CONNECTICUT

**AUDITORS' REPORT
CONNECTICUT HIGHER EDUCATION
SUPPLEMENTAL LOAN AUTHORITY
FOR THE FISCAL YEARS ENDED JUNE 30, 1998 AND 1999**

AUDITORS OF PUBLIC ACCOUNTS
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April 12, 2000

**AUDITORS' REPORT
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FOR THE FISCAL YEARS ENDED JUNE 30, 1998 AND 1999**

We have made an examination of the financial records of the Connecticut Higher Education Supplemental Loan Authority for the fiscal years ended June 30, 1998 and 1999.

Financial statements pertaining to the operations and activities of Connecticut Higher Education Supplemental Loan Authority for the fiscal years ended June 30, 1998 and 1999, are presented and audited on a Statewide Single Audit basis to include all State agencies and funds. We have relied on the financial and compliance audits conducted by the Corporation's independent public accountant covering the fiscal years mentioned above, after having satisfied ourselves as to the firm's professional reputation, qualification and independence, and verifying that generally accepted accounting principles and auditing standards were followed in the audits and in the preparation of the reports. Financial statements of the Authority are included in the Authority's Annual Reports for 1998 and 1999.

In addition to reviewing the audits and related working papers prepared by the independent public accountants, we reviewed State statutory compliance requirements, tested certain internal control procedures, followed up on prior audit recommendations and reviewed the minutes of the Authority's meetings. We conducted our audit in accordance with generally accepted government auditing standards for financial related audits. This report on our examination consists of the following Comments, Condition of Records and Recommendations.

COMMENTS

FOREWORD:

The Connecticut Higher Education Supplemental Loan Authority (hereafter referred to as CHESLA or the Authority) operates primarily under the provisions of Title 10a, Chapter 187b, Sections 10a-221 through 10a-246 of the Connecticut General Statutes.

Effective October 1, 1985, 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.

CHESLA is a body politic and corporate constituting a public instrumentality and political subdivision of the State and the exercise of its statutory powers is deemed and held to be the performance of an essential public and governmental function. 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 education through its Bond Funds. As of June 30, 1999, the Authority did not have any loans to institutions.

Under the Authority's Connecticut Family Education Loan Program, qualifying applicants can receive an Education Loan for each academic year as long as the loan does not exceed the student's financial need for the year. The cost of education is determined by the college or university and includes consideration of all other financial assistance.

CHESLA is defined by the General Statutes as a Quasi-Public Agency. Provisions for Quasi-Public Agencies are codified in Sections 1-120 through 1-125 of Chapter 12, and various Sections of Chapter 187b, of the General Statutes. Those Sections require CHESLA to adopt written procedures related to the following:

1. adoption and approval of an annual budget and plan of operations;
2. personnel policies, including an affirmative action policy;
3. real and personal property and personal services acquisition, including approval procedures for non-budgeted expenditures over \$5,000;
4. professional services contracts, including a requirement that CHESLA solicit proposals at least every three years for each service;
5. loan, grant and other financial assistance awards;
6. use of surplus funds; and
7. issuing and retiring bonds, notes and other obligations.

The provisions also require that an annual compliance audit be performed addressing CHESLA's compliance with the above mentioned procedures. We verified that the independent certified public accountants issued reports on CHESLA's compliance with the above requirements.

Board Members:

As authorized under Section 10a-224 of the General Statutes, the powers of CHESLA are 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 as ex-officio directors, and five directors appointed by the Governor.

As of June 30, 1999, CHESLA's board of directors was as follows:

Ex-Officio:

Denise L. Nappier, State Treasurer
Marc S. Ryan, Secretary of the Office of Policy and Management
Valerie F Lewis, Commissioner of Higher Education

Appointed by the Governor:

Term Expires July 1,

Michael E. McKeeman, Chairman	2002
Morrison H. Beach	2000
Winifred E. Coleman	2003
Frank R. A. Resnick	1999

As of June 30, 1999, there was one vacancy on CHESLA's board of directors. Michael A. Gerber served as Executive Director of CHESLA until December 31, 1997. Gloria F. Ragosta was appointed Acting Executive Director, effective January 1, 1998. On May 19, 1998 the Authority approved her appointment as Executive Director.

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 come from interest income and administrative fees.

Bond Issue Funds Outstanding as of June 30, 1999:

1996, 1994, 1993, 1992 and 1991 Series A and 1998, and 1990 Series A and B:

Debt Service Funds - These funds are comprised of the Revenue Funds and Loan Funds for each series as defined by the Revenue Bond Resolution and were funded from bond proceeds. Certain Connecticut Family Education Loan Program revenues are paid into these funds.

The Debt Service Funds are used to service the debt on the bonds, to disburse loans to students and to pay the initial and annual administrative fees and issuance costs on the bonds, and may be used to transfer amounts to the Special Capital Reserve Funds to maintain the required Special Capital Reserve Funds requirements.

Special Capital Reserve Funds - These funds, established from a portion of bond proceeds, represent a source of cash for semi-annual debt service payments to the extent that revenues

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from investments and individuals may not be adequate to do so. Interest earned in excess of the Special Capital Reserve Fund debt service requirements is transferred to the Debt Service Funds to pay principal and interest on the bonds.

1992 Series A Revenue Refunding Bonds in the amount of \$6,600,000 were for the purpose of redeeming outstanding 1985 Series Bonds.

Beginning with the 1996 Series Bonds, loan repayments in excess of the amounts needed for debt service are matched to the related bond issue to determine the amount of the special mandatory redemption of those related bonds. For the 1990-1994 Series of bonds, loan revenues will continue to be used for redemptions pro rata among those Series of bonds.

Beginning with the 1998 Series, original proceeds of the Series B Bonds can be used to effect current refunding. Those funds that were held to pay debt service become available for Education Loans. To date no such refunding has occurred.

As of June 30, 1999 the Authority had issued \$159,525,000 in Revenue Bonds and Revenue Refunding Bonds with \$98,085,000 outstanding. Currently, the aggregate amount of bonds outstanding at any given time is capped by statute at one hundred seventy million dollars.

The 1990, 1991 and 1993 Loans were made to finance an eligible student's cost of education in principal amounts between \$2,000 and \$20,000 for each year of an academic program subject to the limitation of \$100,000 aggregate principal amount of Loans. The 1994, 1996 and 1998 Loans may be made to finance educational needs in principal amounts between \$2,000 and the costs of education subject to a limitation of \$125,000 aggregate principal amount of Loans.

The Authority contracts for the following services to help it achieve its accounting objectives:

- Loan Servicer: Originates and services student loans.
- Accountant: Produces financial statements and supporting ledgers.
- Investors: Invests and accounts for bond proceeds, payments.
- Financial Advisors: Underwriting, cash flow analysis, arbitrage calculation.

Independent Audits:

An independent certified public accountant audited the books and accounts of CHESLA for each of the two fiscal years under review. In order not to duplicate that effort we have accepted the audit work performed by the firm and adjusted our audit procedures accordingly. We accepted such audit work after reviewing the reports and working papers of the firm and satisfying ourselves as to the professional reputation, qualifications and independence of the other auditor and verifying that generally accepted accounting principles and auditing standards were followed.

The independent public accountant's reports to the Authority for the fiscal year ended June 30, 1998 and 1999 contained no recommendations.

Section 1-122 of the Connecticut General Statutes requires that quasi-public agencies such as CHESLA have a compliance audit performed annually. The results of the tests performed by the independent public accountant disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

RÉSUMÉ OF OPERATIONS:

The Authority had issued twelve series of bonds as of June 30, 1999. 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 and 1998 Series A Revenue Bonds and 1998 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 Family Education Loan Program (FELP). The 1990 and 1991 Series B and 1992 Series A issues were Revenue Refunding Bonds.

The 1998 Series A and B Revenue Bonds, issued during the audited period, amounted to \$15,000,000 and \$3,560,000, respectively.

The bonds are special obligations of the Authority 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 the Authority'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, 1999 in the aggregate amount of \$8,035,600.

The Vice President of the Connecticut Conference of Independent Colleges (CCIC) served as the Executive Director of the Authority. The Executive Director was compensated by CCIC. The Authority reimbursed CCIC, pursuant to an agreement for services with CCIC. Total payments were \$90,403 and \$100,000 during the 1997-1998 and 1998-1999 fiscal years, respectively. The current contract commenced on July 1, 1999 and shall terminate on June 30, 2002.

Also, CCIC was reimbursed for a share of its office rental and other operating expenses applicable to the Authority's operation. Total payments were \$24,307 and \$21,378 during the 1997-1998 and 1998-1999 fiscal years, respectively.

Revenues credited to Bond Funds totaled \$7,598,165 and \$8,442,241 during the 1997-1998 and 1998-1999 fiscal years, respectively. These consisted primarily of interest income derived from investments and loans to individuals.

Expenditures for the Bond Funds totaled \$7,445,903 and \$8,220,312, during the 1997-1998 and 1998-1999 fiscal years and consisted primarily of debt service (interest) which totaled \$5,669,758 and \$6,001,424, respectively. The negative Bond Funds balance of (\$1,299,817) as of June 30, 1997 declined to (\$925,626) as of June 30, 1999. The negative Bond Funds balance is caused by the sale

of the bonds at a discount and the use of some bond proceeds for issuance and administrative expenses. The remaining bond proceeds are then invested in student loans and other market investments so as to earn sufficient return to eliminate the negative fund balance over the life of each series of bonds. The continual addition of newer bond series to the bond series outstanding keeps the negative Bond Funds balance from fully reversing.

Revenues credited to the Authority Operating Fund during the 1997-1998 and 1998-1999 fiscal years totaled \$749,705 and \$731,253, respectively and consisted of administrative fees, and investment income. Operating expenses paid from the Operating Fund during the same fiscal years, primarily for professional and administrative fees, and general office expenses, totaled \$427,800 and \$489,625, respectively. Operations in the Operating Fund increased the fund balance of such fund from \$1,455,269 at June 30, 1997, to \$2,018,802 at June 30, 1999.

The total number of loans made by the Authority for all Bond Funds as of June 30, 1998 and 1999 were 13,070 and 14,337 with an average loan amount of \$7,827 and \$8,017, respectively. The aggregate net loan default rate as of June 30, 1998 and 1999 for all Bond Funds was 3.82 percent and 3.52 percent, respectively.

CONDITION OF RECORDS

The Authority contracted with an independent certified public accounting firm for the fiscal years

under review. Those audits did not find any conditions requiring a separate management letter. Our review noted no condition warranting recommendation(s) under this caption. We did not perform an audit of the Authority's financial records because of our reliance on the work performed by the independent certified public accounting firm.

RECOMMENDATIONS

No recommendations were presented in our prior audit report. No recommendations are being presented as a result of this audit.

CONCLUSION

We wish to express our appreciation for the cooperation and courtesy extended our representatives by the personnel of the Connecticut Higher Education Supplemental Loan Authority during the course of this examination.

Michael R. Adelson
Associate Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts

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