

STATE OF CONNECTICUT

**AUDITORS' REPORT
CONNECTICUT STUDENT LOAN FOUNDATION
FOR THE FISCAL YEARS ENDED
SEPTEMBER 30, 1999, SEPTEMBER 30, 2000
AND SEPTEMBER 30, 2001**

AUDITORS OF PUBLIC ACCOUNTS
KEVIN P. JOHNSTON ♦ ROBERT G. JAEKLE

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July 28, 2003

**AUDITORS' REPORT
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FOR THE FISCAL YEARS ENDED
SEPTEMBER 30, 1999, SEPTEMBER 30, 2000 AND SEPTEMBER 30, 2001**

We have examined the books, records and accounts of the Connecticut Student Loan Foundation ("CSLF" or "Foundation"), as provided in Section 2-90 of the General Statutes, for the fiscal years ended September 30, 1999, 2000 and 2001.

Scope of Audit:

We have relied on the financial and compliance audits conducted by the Foundation's independent public accountants covering the fiscal years mentioned above, after having satisfied ourselves as to the firm's professional reputation, qualifications and independence, and verifying that generally accepted accounting principles and auditing standards were followed in the audits and in the preparation of the reports. Comments in their reports are presented under the heading "Audits by Independent Public Accountants" in this report. Financial statements of the CSLF are included in the Foundation's annual reports for 1999, 2000 and 2001. In addition to reviewing the audits and related working papers prepared by the independent public accountants, we reviewed certain State statutory requirements. We conducted our audit in accordance with generally accepted government auditing standards for financial related audits. This report on our examination consists of the Comments, Condition of Records and Recommendations which follow.

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 stated mission of the corporation is to improve the post-secondary educational and vocational opportunities of persons who are attending, or plan to attend, eligible institutions by

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administering, guaranteeing and/or servicing loans to such persons to assist them in meeting their educational expenses.

Since 1980, 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. Beginning in July 1989, the Foundation became a direct participant in the secondary market for student loans whereby it has purchased and holds, in part as a revenue-producing investment, portfolios of loans originally issued by other authorized lending institutions. It is presumed that this activity provides lenders with the necessary liquidity to offer additional student loans. The Foundation's loan servicing and secondary market activities are discussed in this report under separate headings.

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 13 members, including four legislative members. Seven public members are appointed by the Governor with at least one member representing the State's private colleges. Two legislative members are from the House of Representatives, one appointed by the Speaker and the other appointed by the Minority Leader. The other two legislative members are from the Senate, one appointed by the President Pro Tempore and the other by the Minority Leader. The Chairman of the Board of Governors of Higher Education and the Commissioner of Higher Education are ex officio members of the Board. The directors receive no compensation for their services, but are reimbursed for expenses incurred in the performance of their duties.

Membership of the Board, as of September 30, 2001, is presented below:

T. Brian Condon, Chairman
William J. Lucas, Vice Chairman
William P. Hawkins, Treasurer
Stephen B. Keogh, Esq., Secretary
Gregory C. Davis, Assistant Secretary
Patrick B. O'Sullivan II
Robert C. Schatz
William A. Bevacqua, Chairman, Board of Governors of Higher Education
Valerie F. Lewis, Commissioner of Higher Education
Senator Thomas P. Gaffey
Senator Thomas J. Herlihy
Representative Claudia Powers
Vacancy

The following individuals also served as members of the Board during the period covered by this examination:

Andrew G. DeRocco, Commissioner of Higher Education

Senator Mary Ann Handley
Representative Denise Merrill
Representative Thomasina Clemons

Mr. Mark Valenti served as President of the Foundation through the audited period.

Recent State Legislation:

Section 27 of Public Act 00-220 of the February 2000 Regular Session of the General Assembly, amended Section 10a-203, subsection (b), of the General Statutes and provides that any member of the Board of Directors may designate in writing to the chairperson of the Board a representative to act in the place of the member at a meeting or meetings, with all rights and obligations at such meeting as the member represented would have had at the meeting. Section 28 of the Act, amended Section 10a-206a by adding a requirement that any borrower in default on installments of a loan made or guaranteed by the Connecticut Student Loan Foundation have the amount in default applied as reduction of any amount payable by the State to such borrower, and that the Comptroller promptly forward the amount to the Foundation. And Section 29 of the Act amended Section 10a-210, subsection (a), which changed the due date of the Foundation's annual report to on or before December 31, for the fiscal year ending September 30. The aforementioned Sections took effect July 1, 2000.

Recent Federal Legislation:

New regulations concerning "Guaranty Agency Reforms" became effective for the Federal fiscal year beginning October 1, 1998. The 1998 Amendments to the Higher Education Act of 1965 mandated significant changes to guaranty agency financial structures; in response Connecticut Student Loan Foundation management modified the accounting and reporting structure, and restated the beginning fund balances of the Federal Reserve Fund (formerly the Restricted Fund) and Unrestricted Fund by transferring items specified in the regulations to specific funds. (See Résumé of Operations section.)

RÉSUMÉ OF OPERATIONS:

The financial record keeping practices of the Connecticut Student Loan Foundation are generally governed by Section 10a-213 of the General Statutes, which specifies that there shall be two funds for the foundation, (1) unrestricted and (2) restricted.

Unrestricted Fund (formerly Operating Fund):

The Unrestricted Fund has been established to account for the administrative and general operations of the Foundation, including the secondary market investment, administration of defaulted loans, administration of the guarantee loan program, loan servicing activities, real estate activities and fixed assets purchased with non-Federal funds.

We are not presenting, as part of this report, the formal financial statements of the Fund. As previously noted, we have relied on the work done by the Foundation's independent public

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accountants who have certified such statements in conjunction with their audits. However, a summary schedule of the Fund's revenues and expenses taken from those statements for the fiscal years covered by our examination, as compared with the year ended September 30 1998, is presented below:

<u>(In Thousands)</u>	Fiscal Year Ended			
	September 30,			
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Revenues:	\$	\$	\$	\$
Defaulted loan recoveries	7,367	6,076	7,034	6,489
Loan processing and issue fees	1,619	1,167	996	1,427
Account maintenance fees	-	1,450	1,574	1,414
Servicing fees	892	1,070	965	1,065
Investment income	24,995	25,647	31,206	32,919
Rental	219	214	227	250
Kissystems income	1,460	1,225	-	1
Other	<u>2,366</u>	<u>49</u>	<u>10</u>	<u>10</u>
Total Revenues	<u>38,918</u>	<u>36,898</u>	<u>42,012</u>	<u>43,575</u>
Expenses:				
Employee comp./benefits	7,124	7,617	7,796	8,679
Equipment expenses	340	432	395	564
Collection	3,700	3,418	3,821	3,298
Communications	536	554	469	493
EDP expenses	266	291	253	356
Printing and supplies	252	219	183	181
Rental/occupancy costs	407	389	329	351
Interest on building	716	680	654	631
Interest on investments	2,606	3,647	3,516	3,514
Bond interest	15,221	14,222	20,069	19,425
Legal/professional fees	1,662	1,002	627	403
Secondary market	1,451	1,707	1,701	2,625
Depreciation	1,150	654	678	478
Other	<u>1,268</u>	<u>767</u>	<u>746</u>	<u>835</u>
Total Expenses	<u>36,699</u>	<u>35,599</u>	<u>41,237</u>	<u>41,833</u>
Other transfers to/from Unrestricted Fund	<u>-</u>	<u>1,016</u>	<u>542</u>	<u>563</u>
Excess of Revenues over Expenses	<u>\$ 2,219</u>	<u>\$ 2,315</u>	<u>\$ 1,317</u>	<u>\$ 2,305</u>

The two major sources of revenue have been defaulted loan recoveries and investment income. The Foundation maintains a collection effort on defaulted loans and is permitted to retain a specific percentage of those collections. As of October 1, 1998, retentions are limited to 24 percent plus the applicable reinsurance compliment (equal to 100 percent of the lender claim amount less the percentage reimbursed by the U. S. Department of Education).

As discussed in the "Secondary Market Lending Activity" section of this report, the Foundation has purchased portfolios of student loans to hold as an investment, using funds borrowed from the State Treasurer under a revolving loan agreement, (the September 30, 1998

balance of \$27,503,000, plus accrued interest, was repaid to the State Treasurer in July 1999), as well as using proceeds from bond issues. As presented in the above schedule, investment income accounts for a majority of the Foundation's revenues. This is offset by the interest paid to bondholders. The principal balance of the student loan portfolio investment increased from \$292,204,000 at September 30, 1998, to \$368,896,000 at September 30, 2001, due, in large part, to the increase in available funds generated by bond issues.

Employee compensation and fringe benefit costs continued to be a significant operating expense category of the Foundation. The number of filled positions fluctuated somewhat during the audited period. There were 155 filled positions as of September 30, 1998; 163 as of September 30, 1999; 159 as of September 30, 2000, and 157 as of September 30, 2001.

Restricted Funds:

The 1998 Amendments to the Higher Education Act of 1965 mandated significant changes to guaranty agency financial structures; in response, Connecticut Student Loan Foundation management modified the accounting and reporting structure, and restated the beginning fund balances of the Restricted Federal Reserve Fund (formerly the Restricted Fund) and Unrestricted Fund, as of October 1, 1998, by transferring items specified in the regulations to specific funds. Additionally, the Foundation established the Restricted Collections Fund to temporarily account for receipts of borrower payments on defaulted loans which contains both Federal Reserve Fund and Unrestricted Fund cash.

Federal Reserve Fund (formerly Restricted Fund):

The Federal Reserve Fund, formerly known as the Restricted Fund, has been established and used to account for the operations of the Foundation relative to its guarantee agency responsibilities. Included in the Fund are assets belonging to the Secretary, U. S. Department of Education; which includes the Secretary's share of default loan recoveries, reinsurance payments, federal advances, federal recall deposits and fixed assets purchased with Federal funds.

As with the Unrestricted Fund, we are not presenting, as part of this report, formal financial statements on this Fund. We have relied on the work done by the Foundation's independent public accountants who have already certified such statements. However, for informational purposes, a summary of the Fund's revenues and expenses taken from those financial statements for the fiscal periods covered by our examination, as compared with the period ended September 30 1998, is presented below:

<u>(In Thousands)</u>	Fiscal Year Ended				
		<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Revenues:	\$	\$	\$	\$	
Default loan recoveries		-	89	103	110
Investment income		172	831	1,112	1,153
Other		-	819	112	93
Total Revenues		<u>172</u>	<u>1,739</u>	<u>1,327</u>	<u>1,356</u>
Expenses:					
Unreimbursed guarantee fees		-	1,270	1,130	935
Account maintenance expense		-	-	87	188
Depreciation		-	361	299	218
Guarantee fees rebate		-	-	28	9
Other		6	6	-	1
Total Expenses		<u>6</u>	<u>1,637</u>	<u>1,544</u>	<u>1,351</u>
Other transfers to/from Restricted Fund		-	(1,016)	(486)	(563)
Excess (deficiency) of Revenues over Expenses		<u>\$ 166</u>	<u>\$(914)</u>	<u>\$(703)</u>	<u>\$(558)</u>

Although it is not reflected in the above income statement summary, the primary activity accounted for in this Fund is the Federal loan guarantee or reinsurance. The Foundation accounts for Federal reinsurance through an asset account in its balance sheet. The amount of Federal reinsurance received is discussed in the "Federal Program" section of this report.

Restricted Collections Fund:

The Restricted Collections Fund is a restricted clearing account for cash collected on borrowers' defaulted loans. The account includes recoveries payable to both the Federal Reserve Fund and Unrestricted Fund. Transfers to the Federal Reserve Fund and the Unrestricted Fund, inclusive of each Fund's respective share of interest earned, are made within 30 days of receipt. At September 30, 2001 the Fund held assets of \$841,000 and \$663,000 due to the Federal Reserve Fund and the Unrestricted Fund, respectively.

Federal Program:

CSLF serves as the guarantee agency for the Federal Family Education Loan Program (FFELP), formerly known as the Stafford or Guaranteed Student Loan Program, (CFDA # 84.032), as authorized by Title IV-B of the Higher Education Act of 1965, as amended. The objective of the program is to authorize and make available guaranteed loans for educational expenses from eligible lenders. These loans may be insured and reimbursed through a state or private nonprofit guarantee agency, such as CSLF, which has entered into basic program and supplementary agreements with the Federal agency.

During the fiscal years ended September 30, 1999, September 30, 2000 and September 30, 2001, the Foundation's statistical records presented new loan guarantees amounting to \$232,004,000, \$256,432,000 and \$231,676,000, respectively. These loan guarantees were made under provisions of the following Federally-sponsored loan programs:

Federal Stafford Student Loans:

Formerly known as the Guaranteed Student Loan Program (GSLP), now referred to as the Federal Family Education Loan Program (FFELP), this program guarantees low-interest loans made by commercial lenders to eligible students. The U.S. Department of Education pays interest to holders of subsidized loans during the in-school, grace and deferment periods. Commencement of loan and interest repayment generally begins after graduation or discontinuance of a course of study, or reduction to less than half-time study. For unsubsidized Federal Stafford Loans, the borrower is required to pay interest from the time the loan is made. Unsubsidized Federal Stafford Loans became available on October 1, 1992.

**Federal Parent Loans for Undergraduate Students (PLUS)/
Federal Supplemental Loans For Students (SLS):**

Loans guaranteed under this program are available to parents of dependent students. Loan interest is not subsidized, and the repayment of principal and interest begins immediately. The loans are made by commercial lenders at a variable interest rate set by the Federal government. A similar program, for undergraduate, graduate or professional students (SLS), was replaced by the Stafford unsubsidized loan program, as of July 1, 1994.

Consolidation Loans:

The Consolidation Loan Program was authorized by Congress in October 1986. By consolidating various student loans (i.e. Stafford, SLS, Perkins, etc.) borrowers can bring their debt to a manageable level by reducing the monthly payment. With consolidation loans, the repayment period can be extended to as long as 30 years.

The actual loans are made through authorized private lending institutions (banks, credit unions, CSLF's Susie Mae program, etc.) under regulations of the Connecticut Student Loan Foundation. The Foundation's regulations are, in turn, primarily based upon the provisions of the Higher Education Act of 1965, as amended.

As noted above, during the academic and grace periods, interest on Stafford loans is paid directly to the lender by the Federal government. In addition, a special allowance based on a Federal formula is also paid to lenders on certain low-interest loans. In the event that the borrower defaults on the loan, the Foundation, as the guarantee agency, reimburses the lender the unpaid principal and interest, and the costs are eventually reimbursed by the Federal government.

A major source of revenue arises directly or indirectly from this program. These include Federal payments received and accrued for account maintenance fees, the portion of loan recoveries retained when payments are received from defaulting borrowers, loan processing and issue fees, and investment income earned on Federal Recall funds. The Foundation also receives the default reinsurance credits, which as previously noted, has not been reflected in the Agency's financial statements as revenue. Payments for defaulted loans and the offsetting reinsurance

credits amounted to \$14,680,000, for the fiscal year ended September 30, 1999, \$15,627,000 for the fiscal year ended September 30, 2000 and \$20,129,000 for the fiscal year ended September 30, 2001.

As noted previously, under the FFEL program, the Foundation is allowed to retain 24 percent plus the applicable reinsurance compliment on collections. The balance is remitted to the Federal government. The amount retained is accounted for as "Defaulted loan recoveries" in the Unrestricted Fund.

The reinsurance credits represent reimbursements received from the Federal government or accrued during the fiscal year. In order for a guarantee agency to receive the maximum percent of reimbursement, the Agency must not exceed an annual default rate of five percent. Prior to October 1, 1993 the Federal reinsurance rate was 100 percent of claims amounts. Federal reinsurance was reduced to 98 percent for defaults on loans made after October 1, 1993 and to 95 percent for defaults on loans made after October 1, 1998. These offset the payments for defaulted loans made to lenders during the year in accordance with the guarantee agreements. Federal reinsurance transactions are accounted for in a liability account in the Restricted Federal Reserve Fund.

As previously noted, we have relied on the work done by the Foundation's independent public accountants (IPA) who have issued reports and financial statements in conjunction with their audits. Based upon our discussions with Agency personnel and IPA representatives, and our review of those statements, we noted that the Foundation remained fully insured for its defaulted loans as its default rate has remained well below five percent. A comparison of the default rate for the years under review is as follows:

	Federal Fiscal Year Ended September 30,		
	<u>1999</u>	<u>2000</u>	<u>2001</u>
Annual default percentage	1.26	1.50	2.72

During the fiscal periods under review, the Foundation received the maximum percent of reinsurance credits for the default payments it made to lenders based on the established rates at the time of loan origination. Under certain conditions however, reinsurance credits could drop. If the annual default rate climbed to five percent, then reinsurance would amount to 90 percent of defaulted loans made prior to October 1, 1993, 88 percent for loans made prior to October 1, 1998, and 85 percent for loans made after that date. If the annual default rate increased to nine percent, then reinsurance would cover 80 percent for defaulted loans with origination dates prior to October 1, 1993, 78 percent for defaulted loans with origination dates prior to October 1, 1998 and 75 percent for defaulted loans with later origination dates.

The guarantee and servicing fees are charged directly to lenders. The guarantee fee is authorized under the program (fee may not exceed one percent of the principal of the loan) and is passed on to borrowers. However, in May 1999 the Foundation elected to waive this fee for all borrowers as of June 1, 1999, until further notice. The Foundation cited industry pressures created by larger competitors. The servicing fee arises from the servicing of guaranteed loans

which will be discussed later in this report. The investment income earned on Federal funds advanced to the Foundation for paying default claims remains in the Restricted Federal Reserve Fund.

State Funded Student Loan Forgiveness Program:

Subsection (c) of Section 10a-206 of the General Statutes requires the Foundation to make a ten percent forgiveness payment to certain student borrowers who have had loans guaranteed by it. To qualify for this payment, a borrower must meet certain criteria including: the loans must have been for academic periods prior to July 1, 1979; the borrower must have been a State resident at the time of application for the loans; the student must graduate from the program the loan applied to; and full repayment of the loans must have occurred. The ten percent is calculated on the total amount repaid (principal and interest) and is paid directly to the borrower.

This program had been funded through a grant appropriation received from the Department of Higher Education. These moneys were transferred to the CSLF at the beginning of each fiscal year, as needed. However, during the audited period the unexpended balance was adequate for program expenditures and no grant appropriations were received.

A summary of program activity for the fiscal periods ended September 30, 1998, 1999, 2000 and 2001 is presented below:

Fiscal Year Ended	Actual Expenses	Unexpended Balance
September 30, 1998	\$5,804	\$111,192
September 30, 1999	4,898	106,294
September 30, 2000	185	106,109
September 30, 2001	186	105,923

The unexpended balance of forgiveness monies is invested in the State's Short Term Investment Fund (STIF), administered by the Treasurer, within a restricted account, and is reflected in the Foundation's audited financial statements as part of the Unrestricted Fund cash balance.

State Bond Authorization:

A bond authorization of \$5,000,000 is provided for under Section 10a-214 of the General Statutes. This authorization is subject to State Bond Commission approval. As of September 30, 2001, the Foundation has not made use of this bonding authority.

Office of Policy and Management Line of Credit:

In May 1999 the Foundation entered into a Revolving Loan Agreement with the State of Connecticut, Office of Policy and Management. At this time the agreement allows the Foundation to borrow up to \$8,000,000 from the General Fund of the State of Connecticut for

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the purposes of meeting its operating expenses and to make or purchase student loans. Repayment is to commence six months after the date of the first advance, principal and interest is to be repaid no less than quarterly. At September 30, 2001 the Foundation had a \$1,455,000 balance on the line of credit plus accrued interest of approximately \$8,000.

Loan Servicing:

As discussed previously, since 1980, the Foundation has been authorized to provide loan servicing to all holders of Connecticut student loans. The Foundation has established the Connecticut Assistance for Loan Servicing (CALs) to function as a semi-autonomous servicing department within the Foundation. The services offered include, for a fee, such duties as disbursing loans, providing for the collection of Federal interest subsidies, collections of principle and interest from borrowers, performing student status checks, and preparing required forms and correspondence.

During the period under review, CALs primarily serviced loans guaranteed by the Foundation under the Federal loan guarantee program that were owned by direct lenders or secondary market organizations. The exception, however, were loans which had been made by the Connecticut Higher Education Supplemental Loan Authority (CHESLA). In December 1998, the Foundation was awarded the contract to service all CHESLA loans.

A comparison of the Foundation's loan servicing volume and number of borrowers as of September 30, 1998, 1999, 2000 and 2001, taken from agency statistical reports, is presented below:

<u>Fiscal Year Ended</u>	<u>Annualized Number of Borrowers</u>	<u>Value of Loans Serviced</u>
September 30, 1998	58,041	\$355,767,506
September 30, 1999	60,841	431,678,849
September 30, 2000	60,013	437,889,799
September 30, 2001	55,201	451,192,479

Revenue generated by CALs is reflected as "Servicing fees" in the financial summary presented under the Unrestricted Fund section in this report.

Secondary Market Lending Activity:

As mentioned previously, as of July 1, 1989, the Foundation became a direct participant in the secondary market for student loans whereby it has acquired loans originally issued by authorized lending institutions. The Foundation's entry into this market came about through its acquisition of the loan portfolios held by the State Treasurer's Connecticut Student Loan Program, also known as the "Susie Mae" program.

From 1981 until 1989, CALs was the primary servicer of the "Susie Mae" loans. This program, established by the State in 1972, purchased guaranteed student loans from the original

lending institutions and was an investment in the State's Short Term Investment Fund (STIF) administered by the Treasurer.

On July 7, 1989, the Foundation entered into an agreement with the State under which it purchased the total "Susie Mae" portfolio with a value of approximately \$37,000,000 at the time of transfer. This acquisition was funded through a revolving loan made by the Treasurer from STIF. The nature of the loan agreement is such that the Foundation is allowed to purchase additional student loan portfolios from lenders as they become available. The agreement currently provides for a ceiling of up to \$100,000,000. At September 30, 2001 the Foundation had a zero balance.

During the audit period the Foundation issued the following Student Loan Revenue Bonds as Auction Rate Certificates:

<u>Date</u>	<u>Amount</u>	<u>Description</u>
July 27, 1999	\$40,000,000	Senior Series 1999A-1
July 27, 1999	35,000,000	Senior Series 1999A-2
November 30, 2000	30,000,000	Senior Series 2000A-1
November 30, 2000	30,000,000	Senior Series 2000A-2
November 30, 2000	10,000,000	Subordinate Series 2000B

The proceeds of the above bond issues were to be used for affecting the optional redemption of the 1994 bond issue, originating new student loans and to refinance part of the existing portfolio.

As of September 30, 2001, the Foundation's investment in student loan portfolios financed by Student Loan Revenue Bonds, totaled \$296,973,000.

As noted in a prior section of this report, Federal reinsurance was reduced to 95 percent for guarantors for defaults on loans made after October 1, 1998; however the lender's portion of reinsurance remained at 98 percent for the fiscal years reviewed. Since it is anticipated that defaults will occur within the "Susie Mae" loan portfolio, a liability is being accrued for the two percent uninsured by the U.S. Department of Education; this expense is reflected as "secondary market" on the summary of Unrestricted Fund revenues and expenses presented earlier in this report.

Audits by Independent Public Accountants (IPA):

The U.S. Department of Education regulations require that each "guarantee agency shall arrange for an independent financial and compliance audit of the agency's FFEL program (FFELP.)" Such audits were performed and covered the fiscal periods of our examination.

In the management letters accompanying the audits for the fiscal years ended September 30, 1999 and September 30, 2000, two findings were repeated; that the Foundation consider

sweeping account balances to a US Treasury money market account in order to maximize interest potential on excess cash and to consider establishing an allowance account to estimate potential losses on borrower accounts receivable that have lost reinsurance. In the management

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letter accompanying the audit by the IPA for the fiscal year ended September 30, 2001 no matters were reported.

Federal Audits and Reviews:

Additionally, the Foundation has been subject to Federal examinations and reviews by the U.S. Department of Education. A special audit of cash reserves was conducted during 1995. As a result of that review, the U.S. Department of Education expressed concerns over the balance available in the Federal Reserve Fund and the uses of such funds. During September 2000, the U. S. Department of Education conducted a review of the Foundation's administration of the Federal and Agency Operating Funds as required by the 1998 Amendments to the Higher Education Act of 1965. No adjustments to the Federal Fund or the Operating Fund were proposed as a result of that review. We comment further on this issue in the "Condition of Records" section of this report as an "Other Matter."

CONDITION OF RECORDS

Our examination of the records of the Connecticut Student Loan Foundation disclosed an area requiring improvement, which is discussed below.

Finding:

State Funded Student Loan Forgiveness Program:

Criteria: Pursuant to Section 10a-206, subsection (c) of the General Statutes, the Connecticut Student Loan Foundation is to rebate to students who received guaranteed student loans for academic periods prior to July 1979 ten percent of the total principal and interest paid as a forgiveness rebate. Any payments to a borrower are to be after the close of the repayment period of the contract (loan to be repaid in full), and successful completion of the program for which the loan was made.

An effective internal control system provides for the establishment of policies and procedures for accounting systems, including provisions for the retention of records, documents and other data processed through the system. Source documentation is required to support transaction analysis and subsequent verifiability of recorded data by management and interested parties.

Condition: The Connecticut Student Loan Foundation disbursed eight payments, totaling \$5,269, from the State Funded Student Loan Forgiveness Program for the audit period. Testing revealed two instances where signed Forgiveness Request forms (e.g., students' request for rebate payments), inclusive of a notarized statement that the requestor satisfactorily completed degree requirements for the program for which the guaranteed loan was made, were not on file; and two instances where the calculated forgiveness payment was in error. (In response to an inquiry from a borrower, one payment was corrected by the Foundation subsequent to the audit period).

Effect: The Connecticut Student Loan Foundation is not in compliance with Section 10a-206, subsection (c) of the General Statutes nor established Agency policy. A weakness in controls over forgiveness payments may lead to a loss of program funds.

Cause: The cause could not be determined.

Recommendation: The Connecticut Student Loan Foundation should comply with Section 10a-206, subsection (c) of the General Statutes and Agency policy in respect to rebates made from the State Funded Student Loan Forgiveness

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Program, and retain adequate documentation to support such rebates. (See Recommendation 1.)

Agency Response: "The issue is not an issue of compliance as stated. Our review indicates that rebates were, in fact, made. However, there were calculation errors made in two instances, one which was corrected prior to the audit. There was also a question of documentation in two other instances."

"As a result of the near obsolescence and inactivity of the program (eligibility for the program is only available to borrowers who had loans in the academic periods prior to July 1979) and employee turnover, the proper controls and procedures were inadvertently abandoned. Consequently, two errors were made. The Foundation is developing new written controls and procedures, which will be reviewed and approved by the President. If future changes to these new controls and procedures are necessary, it will also require written approval by the President."

Auditors' Concluding Comments:

When developing new written controls and procedures for the State Funded Student Loan Forgiveness Program, the Foundation should also include provisions for retention of the records, documents and other data processed through the accounting system that support disbursement of State funds.

Other Matter:

In our prior auditors' report we commented on a matter relative to the U.S. Department of Education's concerns over the balance available in the Federal Reserve Fund and the uses of such funds. In a December 1995 letter from the Acting Director of Guarantor and Lender Oversight for the U.S. Department of Education, the Foundation was informed that "formal action" might be taken unless it responded to certain issues raised regarding the Federal Reserve Fund and provided an accurate Federal Reserve Fund calculation. The Foundation had acknowledged that Federal reports had not been prepared on the "cash basis" of accounting, as prescribed by amended Federal regulations in their response dated January 17, 1996. In May 1996 the U.S. Department of Education restated its concerns to which the Foundation responded on July 3, 1996. To date, the U.S. Department of Education has not accepted or rejected any of the Foundation's responses. However, during September 2000, the U. S. Department of Education conducted a review of the Foundation's administration of the Federal and Agency Operating Funds as required by the 1998 Amendments to the Higher Education Act of 1965. No adjustments to the Federal Fund or the Operating Fund were proposed as a result of that review.

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- Our prior report, which covered the fiscal periods ended June 30, 1997, September 30, 1997 and September 30, 1998, did not contain any recommendations.

The following recommendation has been developed as a result of this examination.

Current Audit Recommendation:

- 1. The Connecticut Student Loan Foundation should comply with Section 10a-206, subsection (c) of the General Statutes and Agency policy in respect to rebates made from the State Funded Student Loan Forgiveness Program, and retain adequate documentation to support such rebates.**

Comment:

Our review of the State Funded Student Loan Forgiveness Program disclosed that the Foundation did not comply with provisions of Section 10a-206, subsection (c) of the General Statutes and established Agency control procedures in disbursing Program funds in some instances.

CONCLUSION

In conclusion, we wish to express our appreciation for the cooperation and courtesy extended to our representatives by the management and personnel of the Connecticut Student Loan Foundation during the course of our examination.

Michele L. Cosgrove
Associate Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts