

STATE OF CONNECTICUT



***AUDITORS' REPORT
CONNECTICUT STUDENT LOAN FOUNDATION
FOR THE FISCAL YEARS ENDED
SEPTEMBER 30, 2004 and 2005***

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

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STATE OF CONNECTICUT



AUDITORS OF PUBLIC ACCOUNTS

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March 21, 2007

AUDITORS' REPORT CONNECTICUT STUDENT LOAN FOUNDATION FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 2004 and 2005

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, 2004 and 2005.

Scope of Audit:

Our audit was limited to a review of certain State statutory requirements. The Foundation contracts with an independent certified public accountant firm to perform financial and compliance audits. We have relied on those audits, done for 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. We have included certain financial information in the "Résumé of Operations" section in this report that we obtained from their reports and certain Foundation 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, submitted in accordance with Section 10a-210 of the General Statutes. We conducted our audit in accordance with generally accepted government auditing standards for financial audits. This report on our examination consists of the Comments, Condition of Records, and Recommendation that 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

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stated mission of the corporation is to improve the educational and vocational opportunities of persons who are attending, or plan to attend, eligible institutions by administering, guaranteeing and/or servicing loans to such persons to assist them in meeting their educational expenses. The Foundation also serves as the guarantee agency for the Federal Family Education Loan Program (FFELP).

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 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 14 members, including four legislative members. Seven public members are appointed by the Governor with at least one member representing the State's private colleges. Another public member, having financial expertise, is appointed by the Board. 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, 2005, is presented below:

T. Brian Condon, Chairman
William J. Lucas, Vice Chairman
Stephen B. Keogh, Esq., Secretary
Gregory C. Davis, Esq., Assistant Secretary
William P. Hawkins
Ryan Barry
Anthony Guglielmo
DebraLee Hovey
Patrick B. O'Sullivan II
Robert C. Schatz
Harry H. Penner, Jr., Chairman of the Board of Governors of Higher Education
Valerie F. Lewis, Commissioner of Higher Education
Two Vacancies

Senator Louis Fasano and Senator Thomas P. Gaffey also served as members of the Board during the period covered by this examination.

Mr. Mark Valenti served as President of the Foundation throughout the period and continues

to serve in that capacity.

Review of the Minutes of the Board of Directors Meetings:

Our review of the minutes of the meetings of the Board of Directors disclosed that the statutorily required meetings were held and statutory requirements governing certain matters to be discussed at such meetings were met.

Recent State Legislation:

Public Act 04-225, effective July 1, 2004, broadens the Foundation's authority by allowing it to grant loans to anyone for elementary, secondary, or higher education expenses, regardless of whether they attend school in, or reside in, Connecticut.

Public Act 05-184, effective July 1, 2005, made numerous changes to the Foundation's operations and authority. It increases the maximum term of its bonds from 30 to 40 years and reduces the rating of the financial institutions which it can contract with from "AA" to "A", and allows the Foundation's board to adopt rules governing loans the Foundation finances and services; in addition to those it makes and guarantees. The Act increases the Board of Directors' membership from thirteen to fourteen. The new member, who shall be appointed by the Board, shall be knowledgeable in accounting and considered a financial expert. It allows the Foundation to contract with financial institutions that are not governed by Federal Higher Education laws; facilitates the implementation of an alternative loan program; and provides that no law terminating the corporate existence of the Foundation shall take effect so long as the Foundation shall have bonds, notes or other obligations outstanding. In addition, Public Act 05-184 repealed laws that (1) authorized the State to issue up to \$5 million in State bonds to capitalize a fund to support the Foundation's loan guarantees, (2) required the Foundation to maintain a separate restricted fund to back any State-supported loan guarantees and the authorization to borrow from the State's General Fund, if necessary, to meet those obligations, and (3) allowed borrowers, who met certain criteria, a ten percent repayment on loans that had been applied for prior to July 1, 1979.

RÉSUMÉ OF OPERATIONS:

Fund Structure:

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. 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 the 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. It contains both Federal Reserve Fund and Unrestricted Fund cash. Although the Foundation maintains this Fund structure, effective with the fiscal year ended September 30, 2003, its audited financial statements do not present the

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Funds separately. This change was made to comply with the reporting requirements of the Governmental Accounting Standards Board Statements No. 34, 37 and 38. For informational purposes the financial statement footnotes include a summary of the financial position and the changes in net assets as of each fiscal year-end for each of the Funds.

Unrestricted Fund:

The Unrestricted Fund was 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 accountants who have certified such statements in conjunction with their audits. Presented below is a summary schedule of the Fund's revenues and expenses presented in the footnotes to those financial statements for the fiscal years covered by our examination, as compared with the fiscal year ended September 30, 2003:

<u>(In Thousands)</u>	Fiscal Year Ended		
	September 30,		
	<u>2003</u>	<u>2004</u>	<u>2005</u>
Revenues:	\$	\$	\$
Defaulted loan recoveries	5,528	5,447	5,875
Loan processing and issue fee	1,503	1,249	1,064
Account maintenance fees	1,369	1,402	1,778
Servicing fees	665	639	353
Investment income	18,122	18,553	28,612
Rental	117	91	142
Kissystems income	116	-	-
Other	<u>1,135</u>	<u>731</u>	<u>645</u>
Total Revenue	<u>28,555</u>	<u>28,112</u>	<u>38,469</u>
Expenses:			
Employee compensation /benefits	9,532	10,473	10,011
Equipment expenses	155	161	169
Collection	2,155	2,063	2,271
Communications	533	533	428
Contractual Services	1,473	611	681
Printing and supplies	226	180	168
Rental/occupancy costs	361	354	341
Interest	7,652	8,019	17,271
Legal/professional fees	481	742	525
Secondary market	3,055	3,558	8,595
Depreciation	536	442	368
Other	<u>1,034</u>	<u>765</u>	<u>885</u>
Total Expenses	<u>27,193</u>	<u>27,901</u>	<u>41,713</u>
Other changes in Fund Balances/Net Assets	<u>512</u>	<u>-</u>	<u>608</u>
Excess of Revenues over Expenses	<u>\$ 1,874</u>	<u>\$ 211</u>	<u>\$ (2,636)</u>

The two major sources of revenue in the Unrestricted Fund have been defaulted loan recoveries and investment income. The Foundation maintained a collection effort on defaulted loans and is permitted to retain a specific percentage of those collections, while the bulk of them are paid to the Federal government. Investment income, mainly from student loans financed with taxable bond proceeds, accounts for the majority of the Foundation's revenues. This is offset by the interest paid to bondholders. The Foundation also has a revolving loan agreement with the State Treasurer that it can use to enhance its investment income. The revolving loan agreement was not used during the audited period. Because of the variable interest rates associated with the Foundation's investments and related debt, investment income and interest expense is directly related to market conditions. Accordingly, higher interest rates during fiscal year 2004-2005 resulted in significant increases in Investment Income and Interest Expense.

Employee compensation and fringe benefit costs continued to be a significant operating expense of the Foundation. The number of filled positions decreased during the audited period from 172 as of September 30, 2003, to 168 and 162 as of September 30, 2004 and 2005, respectively.

The Unrestricted Fund had assets totaling \$619,267,000 and \$595,669,000, liabilities totaling \$602,498,000 and \$581,536,000, and net assets of \$16,769,000 and \$14,133,000, as of September 30, 2004 and 2005, respectively.

Restricted Funds:

Federal Reserve Fund:

The Federal Reserve Fund has been established and is 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 reinsurance compliment portion 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. For informational purposes, a summary of the Fund's revenues and expenses presented in the footnotes to those financial statements for the fiscal years covered by our examination, as compared with the fiscal year ended September 30, 2003, is being presented below:

	Fiscal Year Ended		
	September 30,		
<u>(In Thousands)</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>

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	\$	\$	\$
Revenues:			
Default loan recoveries	214	282	345
Investment income	175	139	267
Other	<u>34</u>	<u>31</u>	<u>31</u>
Total Revenues	<u>423</u>	<u>452</u>	<u>643</u>
Expenses:			
Unreimbursed guarantee fees	666	464	1,432
Default Aversion	474	405	538
Account maintenance expense	194	-	-
Depreciation	79	36	35
Other	<u>-</u>	<u>-</u>	<u>-</u>
Total Expenses	<u>1,413</u>	<u>905</u>	<u>2,005</u>
Excess (deficiency) of Revenues over Expenses before other changes in Fund Balances/Net Assets	<u>(990)</u>	<u>(453)</u>	<u>(1,362)</u>
Other Changes in Fund Balances/Net Assets	<u>(590)</u>	<u>(686)</u>	<u>(739)</u>
Excess (deficiency) of Revenues over Expenses	<u>\$(1,580)</u>	<u>\$(1,139)</u>	<u>\$(2,101)</u>

The primary activity accounted for in this Fund is the Federal loan guarantee or reinsurance. Under the Federal program, the Federal government reimburses the Foundation a certain percentage of the amount the Foundation pays to lenders on defaulted loans. The Foundation accounts for these transactions through an asset account on its balance sheet; therefore, the related transaction information is not presented above. As presented in the footnotes to its financial statements, the Foundation's payments to lenders were \$19,934,000 and \$23,639,000, for the fiscal years ended September 30, 2004 and 2005, respectively, while the reimbursements received and accrued from the U.S. Department of Education were \$19,282,000 and \$22,768,000, respectively. Federal reinsurance is discussed further in the "Federal Program" section of this report. The losses in this Fund are caused by the Foundation continuing its policy not to charge an insurance fee, a policy that benefited student and parent borrowers. The Foundation adopted the policy effective June 1, 1999, as a result of industry pressures created by larger competitors. At the March 15, 2004 meeting, the CSLF Board authorized the President to reinstate the fee at such time that he deems it appropriate to do so. The insurance fee was not reinstated during the period reviewed; however, it was reinstated on July 1, 2006, as mandated by federal law.

As presented in the footnotes to its financial statements, the Federal Reserve Fund had assets totaling \$12,906,000 and \$11,633,000, liabilities totaling \$9,034,000 and \$9,862,000, and net assets of \$3,872,000 and \$1,771,000, as of September 30, 2004 and 2005, respectively.

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, as well as to the U.S. Department of Education. 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. The Foundation's audited financial statements' footnotes state that the Fund had assets of \$1,668,000 and \$1,476,000, as of

September 30, 2004 and 2005, respectively. These assets included \$1,116,000 and \$991,000 that were due to the U.S. Department of Education for the same years, respectively.

Federal Programs:

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.

New loan guarantees made during the fiscal years ended September 30, 2004 and 2005, totaled \$350,600,000 and \$831,511,000, 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):

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. Commercial lenders make the loans at a variable interest rate set by the Federal government.

Consolidation Loans:

Congress authorized the Consolidation Loan Program in October 1986. By consolidating various student loans, 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 under the provisions of the Higher Education Act of 1965, as amended.

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

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default reinsurance payments, which as previously noted, are accounted for in the Restricted Federal Reserve Fund, through an asset account. In the event that the borrower defaults on a loan, the Foundation, as the guarantee agency, reimburses the lender the unpaid principal and interest, and the Federal government subsequently reimburses the Foundation. The reinsurance payments represent the reimbursements received or accrued during the fiscal year. 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. 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. As previously noted, we have relied on the work done by the Foundation's independent public accountants who have issued reports and financial statements in conjunction with their audits. Based on our review of those statements, we noted that the Foundation remained fully insured for its defaulted loans. A comparison of the default rate for the years under review is as follows:

	Federal Fiscal Year Ended September 30,		
	<u>2003</u>	<u>2004</u>	<u>2005</u>
Annual default percentage	2.63	2.58	3.12

During the fiscal years under review, the Foundation received the maximum percent of reinsurance payments for the default payments it made to lenders. However, if the annual default rate climbed to five percent, reinsurance payments would drop in accordance with a set of formulas that are used to calculate the payments. Should the Foundation subsequently recover any monies from the borrowers of defaulted loans, it is permitted to retain approximately 24 percent of those monies, plus the applicable reinsurance compliment. The reinsurance compliment is equal to 100 percent of the lender claim amount less the percentage reimbursed by the U. S. Department of Education. The remainder is paid to the Federal government. Defaulted loan recoveries, excluding the reinsurance compliment, are reported as revenue in the Unrestricted Fund. The reinsurance compliment is reported as revenue in the Restricted Federal Reserve Fund. As of September 30, 2005, there were approximately 3,700 defaulted loans in repayment, with principal balances totaling approximately \$26,530,000.

There is a guarantee, or insurance fee, that is authorized under the program. It can be charged directly to the lenders and passed on to borrowers. The Foundation elected to waive this fee for all borrowers for loans guaranteed on or after June 1, 1999, until further notice, citing industry pressures created by larger competitors as the reason for that decision. As previously noted, the Foundation reinstated this fee effective July 1, 2006, as mandated by Federal law.

Loan Servicing:

As previously mentioned, 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 principal 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. CALS also serviced loans made by the Connecticut Higher Education Supplemental Loan Authority (CHESLA) after being awarded a contract to service all CHESLA loans in the beginning of December 1998. As of January 2005, the Foundation no longer had a contract to service CHESLA loans. CHESLA loans are now serviced by a small servicing company in the Midwest.

A comparison of the Foundation's loan servicing volume and number of borrowers as of September 30, 2003, 2004, and 2005, taken from Foundation statistical reports, is presented below:

Fiscal Year Ended	Annualized Number of Borrowers	Value of Loans Serviced
September 30, 2003	50,052	\$446,303,146
September 30, 2004	52,935	500,340,920
September 30, 2005	49,131	456,193,140

CALS transactions are accounted for in the Unrestricted Fund. Servicing fee revenue for the fiscal years ended September 30, 2003, 2004, and 2005, was \$665,000, \$639,000 and \$353,000 respectively, as presented in the financial summary in the "Unrestricted Fund" section in this report. The decrease in revenues during the 2004-2005 fiscal year is associated with the Foundation's intention to primarily focus on servicing its own portfolio.

Secondary Market Lending Activity:

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. 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 State Treasurer. From 1981 until 1989, CALS was the primary servicer of the "Susie Mae" loans.

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 State 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. The loan agreement was not used during the period under review and as of September 30, 2005, the loan agreement had a zero balance.

The majority of the Foundation's loans are made using taxable bond proceeds. During the audited period the Foundation issued the following taxable Student Loan Revenue Bonds as Auction Rate Certificates:

<u>Date</u>	<u>Amount</u>	<u>Description</u>
October 2004	\$75,000,000	Senior Series 2004A-1
October 2004	\$75,000,000	Senior Series 2004A-2
October 2004	\$75,000,000	Senior Series 2004A-3
October 2004	\$75,000,000	Senior Series 2004A-4
October 2004	\$75,000,000	Senior Series 2004A-5
October 2004	\$71,100,000	Senior Series 2004A-6
January 2005	\$60,000,000	Senior Series 2004A-7
October 2004	\$62,900,000	Subordinate Series 2004B

Most of the proceeds of the above bond issues were used to refinance the Foundation's outstanding Student Loan Revenue Bonds under its 1995 Indenture. The remaining proceeds were used to finance new loans.

The outstanding principal due to all bondholders as of September 30, 2005, was \$569,000,000. The Foundation's investment in student loan portfolios as of September 30, 2005, was \$499,537,000 and includes \$498,949,000 financed by taxable Student Loan Revenue Bonds, and \$588,000 financed by the Foundation.

State Funded Student Loan Forgiveness Program:

Section 10a-206, subsection (c), 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; the student must graduate from the program the loans 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.

Effective July 1, 2005, Public Act 05-184, Section 6, removed subsection (c) of Section 10a-206 of the General Statutes. As a result of this legislation, several issues have arisen concerning the present status of this program. Further comments can be found in the "Condition of Records" and "Recommendation" sections of this report

A summary of program activity for the fiscal years ended September 30, 2003, 2004, and 2005, is presented below:

<u>Fiscal Year</u> <u>Ended</u>	<u>Payments</u>	<u>Unexpended</u> <u>Balance</u>
September 30, 2003	\$ -	\$104,826
September 30, 2004	2,354	102,472
September 30, 2005	7,496	94,976

The \$2,354 paid during the 2004 fiscal year consisted of eight payments while the \$7,496 paid during the 2005 fiscal year consisted of 18 payments. The unexpended balance of the forgiveness program appropriation is invested in a separate STIF account and is included as part of the Unrestricted Fund cash balance. (See the “Condition of Records” and “Recommendation” Sections of this report for additional comments.)

State Bond Authorization:

A bond authorization of \$5,000,000 was provided for under Section 10a-214 of the General Statutes and authorized the State to issue State bonds to capitalize a fund to support the Foundation’s loan guarantees and was subject to State Bond Commission approval. The Foundation did not make use of this bond authorization during the examination period. Effective July 1, 2005, Public Act 05-184, Section 9, repealed Section 10a-214 of the General Statutes and eliminated this bond authorization.

Office of Policy and Management Loan:

In May 1999, the Foundation entered into a Loan Agreement with the State of Connecticut, Office of Policy and Management, that allowed the Foundation to borrow up to \$8,000,000 from the General Fund of the State of Connecticut for the purposes of meeting its operating expenses and to make or purchase student loans. There was no activity relating to this loan agreement during the period under review. As of September 30, 2005, the loan balance was zero.

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 Federal Family Education Loan Program (FFELP.)” Such audits were performed and covered the fiscal years of our examination.

Three matters were reported in the management letter accompanying the audit for the fiscal year ended September 30, 2004. The IPA cited negative cash flow from operations (all activities except secondary market) to be approximately \$9,100,000 and recommended that the Audit Committee continue monitoring, and exploring opportunities to improved overall cash flows. The IPA also noted that there were two policies in place for expense reimbursements and recommended that the Board review the policy adopted by the Board in 1983, update it and formally act upon a current policy. Lastly, it was noted that the Foundation had taken steps to comply with some aspects of the Sarbanes-Oxley legislation and the IPA encouraged the Foundation to continue to strengthen its internal controls. The management letter for fiscal year ended September 30, 2005, reported one matter. The IPA cited the negative cash flow from operations (all activities except secondary market) to be approximately \$ 3,300,000. It was noted that the Foundation’s Audit and Finance Committee has been addressing the overall issues of cash flow and recommended that the Foundation continue to explore opportunities and options to improve the overall cash flow.

Federal Audits and Reviews:

Additionally, the Foundation has been subject to Federal examinations and reviews by the

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U.S. Department of Education. A comprehensive review was conducted in January 2005, which included an examination of the management, financial structure, and guaranty operations of the Connecticut Student Loan Foundation with a concentration on financial reporting and data integrity. The findings from that review were resolved and the U. S. Department of Education, in a letter to the Foundation President dated February 21, 2006, indicates that it considers the review closed.

Subsequent Events:

In July 2006, the Foundation issued taxable Student Loan Revenue Bond Senior Series 2006A-1 in the amount of \$80,000,000, and Subordinate Series 2006B in the amount of \$20,000,000, due on June 1, 2046. The main use of the bond proceeds is for the financing of additional student loans and related costs of issuance.

On October 3, 2005, the Foundation introduced its new alternative loan program named "First Rate Solutions." The program offers a variable rate to borrowers who are going to school less than half time or half time and greater. The variable rate is based on the prime rate plus a margin established by the lender. The rate shall not exceed ten percent and will be revised quarterly. The principal amount of the loan can not be less than \$2,500 and the maximum cumulative borrowing can not exceed \$100,000. We were informed that as of July 31, 2006, there were 79 loans, with a principal balance of \$465,490, made under this new alternative loan program.

CONDITION OF RECORDS

Our review of the records of the Connecticut Student Loan Foundation disclosed a matter of concern, as discussed below.

State Funded Student Loan Forgiveness Program

Criteria: Section 10a-206, subsection (c), of the General Statutes established the State Funded Student Loan Forgiveness Program. Pursuant to this program, the Connecticut Student Loan Foundation is required to make a ten percent loan forgiveness payment back to certain borrowers who have had loans guaranteed by the Foundation and have met specific criteria. The criteria includes that the loan must have been related to an academic period beginning before July 1, 1979, in order to be eligible for a payment. The program had been funded by annual grant appropriations transferred from Connecticut's Department of Higher Education to the Connecticut Student Loan Foundation to administer the Program. Effective July 1, 2005, Public Act 05-184, Section 6, deleted Section 10a-206, subsection (c), reasoning that the loan forgiveness program was an obsolete program.

Condition: Eight payments totaling \$2,354 and 18 payments totaling \$7,496 relating to the program were processed and returned to borrowers during the fiscal years ended September 30, 2004 and 2005, respectively. Foundation staff administering the program continues to look for and contact potential borrowers that meet the loan forgiveness program criteria and could be eligible for forgiveness payments. The staff that is directly involved with processing the forgiveness payments considers the program active until funds are no longer available. The Foundation can not locate an agreement with the Department of Higher Education regarding this program and what its responsibilities would be when the program is ended.

During our review, we noted that two loan forgiveness payments, totaling \$856, were sent to eligible borrowers for loans that had been applied for prior to July 1, 1979, however; the payments were processed after July 1, 2005, which was the effective date of the deletion of subsection (c) of Section 10a-206.

The Foundation has not received any new funding for the program from the Department of Higher Education since the 1994-1995 fiscal year. As of September 30, 2005, the balance of the remaining appropriation being held in the State Treasurer's Short Term Investment Fund (STIF) account and used for the loan forgiveness program was \$94,976. Although the Foundation does have a list of potential borrowers that could still apply for the forgiveness payments; it is not feasible to estimate how many borrowers would meet all the program requirements and be eligible for an actual payment. However, it would appear doubtful, based on the small dollar amounts of prior payments

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that future eligible payments would approach the \$94,976 being held in the STIF account.

Public Act 05-184, Section 6, was silent as to an ending date by which any remaining forgiveness loan requests must be filed by a borrower. Therefore, additional forgiveness requests could still be received at any time in the future.

Cause: The cause was not determined.

Effect: Reference to the loan forgiveness program was deleted from the General Statutes but the program continues to be administered. It is unclear whether State funds totaling \$94,976 need to be returned to the Department of Higher Education and whether continued payments can be made to borrowers who meet the forgiveness program criteria.

Recommendation: The Foundation should seek legal clarification from the Office of the Attorney General to determine the validity of future claims to the loan forgiveness program and how the remaining program funds should be handled.

Agency Response: “The Connecticut Student Loan Foundation cannot locate an agreement with the Department of Higher Education because, to the best of our knowledge and belief, there was no such agreement. The Forgiveness Funding was an appropriation from the State of Connecticut to the Connecticut Student Loan Foundation, although at times this may have appeared as an item in the Department of Higher Education Budget.

Public Act 05-184 did, in fact, delete this Program. Connecticut Student Loan Foundation will discontinue making payments and seek legal clarification from the Attorney General on future requests for payment as recommended.”

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- There were no recommendations presented in our prior audit report.

Current Audit Recommendations:

- 1. The Foundation should seek legal clarification from the Office of the Attorney General to determine the validity of future claims to the loan forgiveness program and how the remaining program funds should be handled.**

Comments:

Our review noted that the reference to the loan forgiveness program was deleted from the General Statutes, effective July 1, 2005, however; the Foundation continues to administer the program and make payments back to borrowers. It is unclear whether the any future claims should still be processed and how the remaining \$94,976 of State funds used for the program should be handled.

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.

Virginia A. Spencer
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts