

# STATE OF CONNECTICUT



*AUDITORS' REPORT  
CONNECTICUT STUDENT LOAN FOUNDATION  
FOR THE FISCAL YEARS ENDED  
SEPTEMBER 30, 2009, 2010 AND 2011*

**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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November 16, 2012

**AUDITORS' REPORT  
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FOR THE FISCAL YEARS ENDED  
SEPTEMBER 30, 2009, 2010 AND 2011**

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, 2009, 2010 and 2011.

**SCOPE OF AUDIT:**

This audit included performing tests of the Foundation's compliance with certain state statutory requirements and its financial operations. Regarding the Foundation's financial operations, we considered the Foundation's internal control over those operations and compliance with requirements that could have a material or significant effect on the Foundation's financial operations in order to determine our auditing procedures for the purpose of evaluating those financial operations and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objectives.

Our audit also included a review of a representative sample of the Foundation's activities during the audited period and a review of such other areas as we considered necessary. The financial statement audits of the Foundation for the fiscal years ended September 30, 2009, 2010 and 2011, were conducted by the Foundation's independent public accountant.

This report on our examination consists of the Comments and Recommendations 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 mission of the corporation is to improve educational opportunity. Until January 2010, the Foundation also served as a guarantee agency for the Federal Family Education Loan (FFEL) Program.

The Foundation has been authorized under the provisions of Section 10a-201 to administer (collect repayments and otherwise service) Connecticut guaranteed loans for lenders and their assignees since 1980. Beginning in July 1989, the Foundation became a direct participant in the secondary market for student loans whereby it purchases and holds, in part as a revenue-producing investment, portfolios of loans originally issued by other authorized lending institutions. It is presumed that this provides lenders with the necessary liquidity to offer additional student loans. The Foundation's secondary market activities are discussed in this report under a separate heading.

### **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 (Board) consisting of 14 members. Six public members are appointed by the Governor with at least one member representing an eligible institution of higher education and at least one member having a favorable reputation for skill, knowledge and experience in management of a private company or lending institution at least as large as the corporation. Another public member, having financial expertise, is appointed by the Board. There are also four members with knowledge of business or finance, one each appointed by the speaker of the House of Representatives, the minority leader of the House of Representatives, the president pro tempore of the Senate and the minority leader of the Senate. The State Treasurer is an ex officio member of the Board. Until July 1, 2011, the Chairman of the Board of Governors of Higher Education and the Commissioner of Higher Education were ex officio members of the Board. Public Act 11-48, effective July 1, 2011, replaced the Chairman of the Board of Governors of Higher Education and the Commissioner of Higher Education with the Chairman of the Board of Regents for Higher Education and the President of the Board of Regents for Higher Education, respectively. The Board of Directors elects from its own members each year a chairperson and a vice chairperson. The directors receive no compensation for their services, but are reimbursed for expenses incurred in the performance of their duties.

The Board experienced a significant number of changes during the audited period. Membership of the Board, as of October 1, 2008, is presented below:

T. Brian Condon, Chairperson  
William J. Lucas, Vice Chairperson  
Stephen B. Keogh, Esq., Secretary

Gregory C. Davis, Esq., Assistant Secretary  
David S. Arteaga  
Representative Ryan Barry  
Senator Dan Debicella  
Michael Meotti, Commissioner of Higher Education  
Denise Nappier, State Treasurer  
Patrick B. O'Sullivan II  
Frank W. Ridley, Chairman of the Board of Governors of Higher Education  
Robert C. Schatz  
Jack Testani  
vacancy

Senator Dan Debicella resigned and was succeeded by Michael E. Hahn in February 2009. In March 2009, the following gubernatorial appointments were replaced:

T. Brian Condon  
William J. Lucas  
Stephen B. Keogh  
Gregory C. Davis  
Patrick B. O'Sullivan II  
Robert C. Schatz

The following new gubernatorial appointments were made in March 2009:

Lisa Kelly Morgan, Chairperson  
Julie M. Drouin  
Michael E. Hahn  
Walter Harrison  
William McGurk  
John Schuyler  
Pamela Partridge West

In May 2009, the following individuals resigned from the Board:

Lisa Kelly Morgan  
David S. Arteaga  
Representative Ryan Barry  
Julie M. Drouin  
Michael E. Hahn  
Walter Harrison  
William McGurk  
John Schuyler  
Jack Testani  
Pamela Partridge West

Since June 2009, the Foundation's Board has consisted solely of the Foundation's three ex-officio members. As of September 30, 2011, the members were as follows:

Michael P. Meotti, designee of Dr. Robert Kennedy, President of the CT Board of Regents for Higher Education

Sarah K. Sanders, designee of State Treasurer Denise Nappier

Lewis J. Robinson, Chairman of the CT Board of Regents for Higher Education

Mr. Mark Valenti served as President of the Foundation until he was terminated from employment with the Foundation in June 2009. R. Richard Croce was appointed Acting President effective June 2009 and served through February 2010.

### **Organizational Changes:**

Decisions were made during the audited period to streamline and consolidate the Foundation's functions, that resulted in focusing solely on its secondary market functions and eliminating the lender and guarantor functions. The Foundation ceased processing new loan applications for federal loans under the Family Federal Education Loan (FFEL) Program effective June 30, 2009. Effective January 1, 2010, the Foundation transferred all guarantor operations to an outside organization. Accordingly, the Federal Reserve Fund and all guarantor-related activity were transferred. Effective January 4, 2010, the Foundation's administrative functions were managed by an outside organization.

The Foundation reduced its workforce by forty-three employees during the fiscal year ended September 20, 2009. Between October 2009 and February 2010, the foundation terminated its remaining employees. The Foundation's facility was closed in February 2010.

### **RÉSUMÉ OF OPERATIONS:**

#### **Fund Structure:**

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

The Foundation's unrestricted fund was established to account for the administrative and general operations of the Foundation. The Foundation maintains two restricted funds, which include a fund used to account for its trust estate. This fund accounts for the assets and liabilities associated with the bond offerings as detailed in the bond indenture. The second restricted fund is used to account for the Foundation's discontinued operations and includes the annual proceeds received from the transfer of its guarantor functions to a third party. During the audited period, the Foundation also maintained a federal reserve fund, which was established and used to account for the operations of the Foundation relative to its guarantee agency responsibilities. As of January 1, 2010, the Foundation's federal reserve fund was transferred to the outside organization that took over the Foundation's guarantor functions.

A schedule of revenues, expenses and changes in net assets for the fiscal years ended September

2008, 2009, 2010 and 2011, follows. The information was obtained from the Foundation's audited financial statements.

<b>(In Thousands)</b>	<b>Fiscal Year Ended September 30,</b>			
	<b><u>2008</u></b>	<b><u>2009</u></b>	<b><u>2010</u></b>	<b><u>2011</u></b>
<b>Revenues:</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Guarantee Program Revenues	11,868	11,961	0	0
Investment Income	53,949	32,999	23,233	20,608
Other	<u>195</u>	<u>171</u>	<u>7</u>	<u>11</u>
<b>Total Revenue</b>	<b><u>66,012</u></b>	<b><u>45,131</u></b>	<b><u>23,240</u></b>	<b><u>20,619</u></b>
<b>Expenses:</b>				
Bond Interest	34,950	15,538	11,808	9,737
Secondary Market	13,933	13,560	15,117	7,416
Salaries and Benefits	8,843	7,647	444	0
Collection Costs	2,459	2,521	6	0
Building, Equipment and Software	2,052	2,912	14	0
Unreimbursed Guarantee Fee	2,106	2,357	0	0
Default Aversion Fee	405	485	0	0
Other Expenses	<u>1,997</u>	<u>1,912</u>	<u>894</u>	<u>760</u>
<b>Total Expenses</b>	<b><u>66,745</u></b>	<b><u>46,932</u></b>	<b><u>28,283</u></b>	<b><u>17,913</u></b>
 Change in Net Assets from Continuing Operations	 (733)	 (1,801)	 (5,043)	 2,706
 <b>Discontinued Operations:</b>				
Change in Net Assets from Discontinued Operation	0	0	(646)	4,018
 <b>Other Changes in Fund Balances/Net Assets</b>				
Gain on Disposal of Property and Fixed Assets	0	807	0	0
Gain on Redemption of Bonds	0	0	20,420	3,163
Gain on Dissolution of Subsidiary	0	0	175	0
Transfer of Guarantor Operations to ECMC	<u>0</u>	<u>0</u>	<u>(1,873)</u>	<u>0</u>
<b>Change in Net Assets</b>	<b><u>\$ (733)</u></b>	<b><u>\$ (994)</u></b>	<b><u>\$13,033</u></b>	<b><u>\$ 9,887</u></b>

Investment income from student loans financed with bond proceeds accounts for the majority of the Foundation's revenues. This is offset by the interest paid to bondholders. 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, lower interest rates, as well as the reduced size of the loan portfolio, resulted in decreases in investment income and interest expense during the fiscal years 2008-2009, 2009-2010 and 2010-2011.

Guarantee program revenues decreased during the 2009-2010 fiscal year. On November 5, 2009, the Foundation's Board of Directors entered into an agreement with Education Credit Management Corporation (ECMC) which transferred the Foundation's guarantor responsibilities, including the loan guarantee and collections functions to ECMC. In exchange, the Foundation received advances from ECMC to pay certain agreed upon unrestricted liabilities and related expenses. As of January 1,

2010, the Foundation's federal fund, operating fund and defaulted loan portfolio were transferred to ECMC. As part of the agreement, ECMC is required to remit to CSLF a portion of the net collection retention fees collected through December 31, 2014. These fees are reported under discontinued operations.

Employee compensation and fringe benefit costs decreased during the audited period. As mentioned previously, as of February 2010, the Foundation had terminated all of its employees. The defined benefit pension plan was frozen effective May 1, 2008. Thereafter, CSLF created a defined contribution plan. Effective February 1, 2010, the Foundation's defined benefit plan was terminated. The plan was fully funded with all benefits paid out to participants by September 30, 2010. Employee salary contributions to the defined contribution plan were discontinued upon the termination of the remaining CSLF employees during the fiscal year ended September 30, 2010. Discretionary employer contributions were discontinued in February 2009. Salary reduction contributions to the defined contribution plan during the fiscal year ended September 30, 2010 totaling \$13,008.

Secondary market expenses include expenses related to the trust estate, including servicing fees, lender fees, consolidation fees, bad debts, debt issue costs, default fees, loan origination fees and the amortization of discounts on the bonds payable.

The Foundation's greatest secondary market expense is bond interest expense. The Foundation issues variable auction rate certificates. During the 2007-2008 fiscal year, the capital markets for student loans began to experience significant disruptions, resulting in failed auctions. The failed auctions resulted in a maximum bond interest rate calculation. The cost to issuers of auction rate securities backed by student loans became much more expensive and the Foundation experienced a reduction in student loan spread and related portfolio interest income, as well as increased rates on its interest payable on bonds. During the 2008-2009 fiscal year, bond interest expense decreased as a result of improved financial market conditions, created by lower interest rates calculated for the bonds. During the 2009-2010 and 2010-2011 fiscal years, the reduction in bond interest expense was also due to a reduction of bonds outstanding.

Included in the secondary market expense in the 2009-2010 fiscal year was the write-off of loans with no guarantee due to servicing errors. This write-off and the establishment of respective reserves for future credit related losses totaled \$3.3 million. Also included in this expense were fees associated with consolidating three servicing relationships to two, which totaled \$416,000. Additional imaging costs for loan files associated with the close of the Foundation's office amounted to \$537,000.

Building, equipment and software costs decreased during the 2009-2010 fiscal year. In 2008-2009, the building and property was written off as a result of a foreclosure resulting in a net gain on disposal of \$807,000.

On January 25, 2010, the Board approved the dissolution of the Foundation's two subsidiaries, KISSystems, Inc. and First Rate Marketing Corporation.

The Foundation had assets totaling \$967,632,000, \$735,662,956 and \$677,843,238; liabilities

totaling \$954,319,000, \$709,316,362 and \$641,609,650; and net assets of \$13,313,000, \$26,346,594 and \$36,233,588 as of September 30, 2009, 2010 and 2011, respectively.

**Federal Programs:**

Until January 2010, CSLF served as a guarantee agency for the Federal Family Education Loan (FFEL) Program, 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 Foundation's principal responsibilities as a guarantee agency included making claim payments to lenders whose loans it has insured and collecting defaulted loans from borrowers. Loan guarantees were made under provisions of the following federally-sponsored loan programs: federal Stafford Student Loans (both subsidized and unsubsidized), federal Parent Loans for Undergraduate Students (PLUS), Graduate and Professional Student PLUS Loans, and Consolidation Loans. The actual loans were made through authorized private lending institutions under the provisions of the Higher Education Act of 1965, as amended.

Effective October 1, 2007, the Federal College Cost Reduction and Access Act made significant changes to the FFEL Program. Some of the key provisions impacting the Foundation included: (1) reduction of account maintenance fees from 0.10 percent to 0.06 percent of outstanding guarantees; (2) reduction of collection retentions from 23 percent to 16 percent on direct collections from borrowers; (3) increase in lender fees from 0.50 percent to 1.00 percent; and (4) reduction of special allowance revenue by 0.40 percent on Stafford and Consolidation loans and 0.70 percent on PLUS loans.

As mentioned previously, the Foundation transferred its guarantor operations to a third party guarantor. Through 2014, the Foundation has the right to a percentage of collection retention revenues in excess of operating costs and liabilities paid by the third party guarantor on behalf of the Foundation. Any funds distributed to CSLF are to be distributed on an annual basis within 60 days of the end of each federal fiscal year by the third party guarantor. Collection retention revenue for the fiscal year ended September 30, 2011 was \$4,017,667.

Collection retention revenues that are distributed to the Foundation are restricted and may only be used for those educational purposes as specified in 34 CFR 682.423(c) and for the benefit of higher educational institutions located in the State of Connecticut, and for supporting efforts in the State of Connecticut for the benefit of Connecticut students and their families for college access and completion. This restriction on the use of funds distributed to the Foundation applies regardless of whether the recipient of the Foundation funds is a guaranty agency operating in the FFEL Program. Permitted uses of said funds would include, but not be limited to, default aversion activities, financial aid awareness and related outreach activities or other student financial aid-related activities for the benefit of students, and boosting the college completion rates of low-income students.

**Private Programs:**

On October 3, 2005, the Foundation introduced its new alternative loan program named First Rate Solutions. This non-federal program offers a variable rate to borrowers who are going to

school less than half-time or half-time and greater. For loans made prior to April 2008, the variable rate is based on the prime rate plus a margin established by the lender. The rate shall not exceed ten percent and is revised quarterly. For loans made on or after April 1, 2008, the interest rate is variable and based on the prime rate. The principal amount of the loan cannot be less than \$2,500 and the maximum cumulative borrowing cannot exceed \$100,000. As of September 30, 2011, there were 1,108 loans outstanding with a balance of \$11,154,193 (\$12,136,089 net of \$981,896 in loan loss reserves). The Foundation stopped offering alternative loans in February 2009.

**Loan Servicing:**

As previously mentioned, since 1980, the Foundation has been authorized to provide loan servicing to all holders of Connecticut student loans. Effective April 2007, the Foundation outsourced all loan servicing functions.

**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 of the state's Short Term Investment Fund (STIF) administered by the State Treasurer. From 1981 until 1989, the CSLF division Connecticut Assistance for Loan Servicing (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 valued at 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 structure 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, 2011, the loan agreement had a zero balance.

The majority of the Foundation's loans were made using taxable bond proceeds, and in December 2007, the Foundation issued tax-exempt bonds. The proceeds of the bond issues were used for the financing of additional student loans and related costs of issuance and to refinance the Foundation's outstanding student loan revenue bonds under its 1995 indenture. During the audited period, the Foundation did not issue any student loan revenue bonds as auction rate certificates. Instead, in September 2009, the Foundation issued an invitation to tender bonds pursuant to which it invited bondholders to tender auction rate certificates for purchase by the Foundation at a discounted price. The Foundation completed the purchase for cancellation of certain captioned series of its student loan revenue bonds in the aggregate principal amount of \$44.22 million and continued to purchase bonds through the fiscal years ended September 30, 2010 and 2011 for a total of \$232,750,000 and \$65,550,000, respectively. The Board approved an ongoing program to purchase auction rate certificates as market conditions allow. In June 2011, the Foundation redeemed all of its tax exempt bonds.

The outstanding principal due to all bondholders as of September 30, 2011, was \$637,600,000. The Foundation's investment in student loan portfolios as of September 30, 2011, was \$603,045,967, all of which was financed by student loan revenue bonds.

**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 (FFEL) Program. Such audit was performed for the fiscal year ended September 30, 2009. Such audits were not performed subsequent to the Foundation's transfer of its guarantor functions to a third party. The IPA noted three areas where they found instances of noncompliance with federal regulations with respect to the Federal Family Education Program.

Two matters were reported in the management letter accompanying the audit for the fiscal year ended September 30, 2009. The IPA stated that the Foundation's contracting of administration may cause the segregation of duties within the Foundation to be less than ideal. The IPA also stated that as of the date of the financial statements, the Foundation was comprised of the assets supporting the secondary market, primarily the trust estate. Cash flow supporting the daily operational needs of the organization is derived from administrative fees received from the trust estate. Operating expenses of the organization are expected to be minimal as most staff and expenses have been outsourced or eliminated. It is anticipated that the administrative fees received will be adequate to cover the operating expenses not paid directly by the trust estate. Cash flow matters were not reported in the management letters accompanying the audits for the fiscal years ended September 30, 2010 and 2011.

Two matters were reported in the management letter accompanying the audit for the fiscal year ended September 30, 2010. The IPA reported that it appears the Foundation lacks segregation of duties with respect to its accounting process. The same individual reconciles bank statements and enters general ledger transactions. Ideally, these duties should remain separate. Actions have been taken by the Foundation to implement document reviews by the Board to mitigate this issue. The IPA also noted an issue with arbitrage rebate calculations. The Internal Revenue Service requires a rebate computation and payment to the federal government at least every five years, or on final redemption or maturity of tax exempt bonds. The IPA recommended that the Foundation implement procedures to compute the required rebate and monitor its impact for the future. In June 2011, the tax exempt bond was redeemed, arbitration liability was calculated, and no liability resulted from the calculation.

One matter was reported in the management letter accompanying the audit for the fiscal year ended September 30, 2011. The IPA again reported that it appears that the Foundation lacks segregation of duties with respect to its accounting process. The same individual reconciles bank statements and enters general ledger transactions. Ideally these duties should remain separate. Actions have been taken by the Foundation to implement document reviews by the Board to mitigate this issue. The process, as of September 30, 2011, is that an appointee by the Board is reviewing all bank statements and bank transactions.

The audited financial statements for the fiscal year ended September 30, 2009, reflect an unqualified opinion and noted material subsequent events. These material subsequent events include the transfer of all guarantee business to another entity, eliminating all employees of the Foundation, outsourcing all operating functions, and committing to reduce the debt of the Foundation through a tender offer program or other methods allowed by the indenture. As of the date of the financial statements, the Foundation was comprised of the assets supporting the secondary market function, primarily the trust estate. Cash flow supporting the daily operational needs of the organization is derived from administrative fees received from the trust estate. Operating expenses of the organization are expected to be minimal as most staff and expenses have been outsourced or eliminated. It is anticipated that the administrative fees received will be adequate to cover the operating expenses not paid directly by the trust.

The audited financial statements for the fiscal year ended September 30, 2010, reflect an unqualified opinion. Operations, including cash flow of the organization, were discussed in the footnotes to the financial statements, but not specifically referenced in the audit opinion. Subsequent events include completion of a bond redemption totaling \$2.2 million.

The audited financial statements for the fiscal year ended September 30, 2011, reflect an unqualified opinion. Subsequent events include the adoption of legislation, expressly the 2011-2012 fiscal year budget of the U.S. government, which includes authorization for borrowers who currently have both FFEL program loans with private holders, such as the Foundation, and certain loans originated under the Higher Education Act with the Department of Education as the lender, to choose to convert their FFEL program loans to loans with the Department of Education as the lender. The new loans would have the same terms and conditions as the converted FFEL program loans, except for a two percent reduction in principal balance owed by the borrower upon conversion. The holder of the FFEL program loan would receive a prepayment of the full outstanding principal and interest balance upon such conversion. Based on the Foundation's supporting documentation, as of June 30, 2012, CSLF received approximately \$11.9 million in aggregate principal of the FFEL program loans previously included in the trust estate as a result of the borrowers' exercise of the 2012 conversion option. Additionally, in November, 2011, the Foundation issued an invitation to tender bonds pursuant to which it invited bondholders to tender auction rate certificates for purchase by the Foundation at a discounted price. On December 9, 2011, the Foundation completed the purchase for cancellation of certain of the captioned series of its student loan revenue bonds in the aggregate principal amount of \$55.2 million. All purchased bonds were settled on December 9, 2011, pursuant to the invitation at offer prices that did not exceed the offer price ceiling of \$985 per \$1,000. Lastly, on November 18, 2011, the Foundation made an application to the U.S. Department of Education Office of Federal Student Aid for Title IV student financial aid servicing. A memorandum of understanding was executed with expected implementation in September 2013.

### **Federal Audits and Reviews:**

Additionally, the Foundation has been subject to federal examinations and reviews by the U.S. Department of Education. In August 2008, a review of the Foundation's compliance with the establishment of the Federal and Operating funds as required by the Federal Higher Education Act of

1965, as amended by the Higher Education Amendments of 1998 (enacted on October 7, 1998) was performed. This review covered the period of October 1, 1997 through September 30, 1999. It appears this review was conducted as a result of the Office of the Inspector General's recommendations for improving federal monitoring of Guaranty Agency Compliance with the establishment of the Federal and Operating Funds. In a letter dated June 21, 2010, the U.S. Department of Education notified the Foundation's successor guarantor agency that they would not be pursuing the findings noted and that the matter was considered closed.

In April 2011, a review was performed to evaluate the Foundation's compliance with federal statutes and regulations as they pertain to the retention of promissory notes. The review covered the period January 1, 2006 through June 30, 2010. In the final program review determination dated July 19, 2012, the U.S. Department of Education reported that there were no findings and the review was considered closed.

During the prior audit, two other federal reviews relating to the Foundation's guarantor functions were pending. The Foundation has not received any further communications on these matters, as its guarantor functions have been transferred and are now the responsibility of a third party.

## CONDITION OF RECORDS

Our review of the records of the Connecticut Student Loan Foundation revealed the following areas that warrant comment.

### **Board Membership:**

*Background:* During the audited period, the Foundation experienced significant organizational changes. Decisions were made to streamline and consolidate the Foundation's functions that resulted in focusing solely on its secondary market functions and eliminating the lender and guarantor functions. Effective January 2010, the Foundation transferred all guarantor operations and administrative functions to an outside organization. The Foundation terminated all of its employees by February 2010 and closed its facility.

*Criteria:* Section 10a-203(a), as amended by Public Act No. 11-48 requires that the board of directors (Board) shall consist of fourteen members, as follows: the chairperson of the Board of Regents for Higher Education and the President of the Board of Regents for Higher Education; six public members appointed by the Governor, at least one of whom shall represent an eligible institution of higher education, at least one of whom shall be a person having a favorable reputation for skill, knowledge and experience in management of a private company or lending institution at least as large as the corporation and all of whom shall be electors of this state; one public member appointed by the board of directors who shall have, through education or experience, an understanding of relevant accounting principles and practices, financial statements and audit committee functions and knowledge of internal controls, who shall be an elector of this state; four members with knowledge of business or finance, one each appointed by the speaker of the House of Representatives, the minority leader of the House of Representatives, the president pro tempore of the Senate and the minority leader of the Senate; and the State Treasurer or, if so designated by the State Treasurer, the Deputy State Treasurer appointed pursuant to section 3-12.

*Condition:* Our review of board membership for fiscal years ended September 30, 2009, 2010 and 2011 revealed that, since June 2009, the Board has had eleven member vacancies and has continued to operate with only its three ex-officio members. Elected officials have not appointed ten members to replace the resigning board members.

*Effect:* The Board did not operate in compliance with the General Statutes with regard to full membership.

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

*Recommendation:* The Foundation should seek legislation to modify the board composition requirements. (See Recommendation 1.)

*Agency Response:* “Before the majority of the Board members resigned on May 26, 2009, the Foundation proposed legislation providing that the state shall protect, save harmless and indemnify the Connecticut Student Loan Foundation and its directors. The legislation was not passed when proposed during 2009, and since May 26, 2009, none of the elected officials with the power to appoint Foundation Board members have exercised their power to appoint additional directors. The Foundation feels that the absence of such appointments does not constitute the Board's failure to operate in compliance with the General Statutes. The Board's ex officio members have continued to observe their duties under the General Statutes and do not have the authority to assure passage of legislation that would modify the Board composition requirements, nor to require public officials to make appointments to volunteer positions that have historically proven to be difficult to fill without the protection of a hold harmless and indemnification from the state.”

*Auditors' Concluding*

*Comments:* The intent of Section 10a-203(a) of the General Statutes, as amended by Public Act No. 11-48, is for the Foundation's board to consist of 14 members with varying backgrounds and experience and not for a small group of three to be responsible for overseeing the Foundation. Although the Board does not have the authority to assure the passage of legislation, the Board does have the authority to seek such legislation through the legislative process.

**Freedom of Information:**

*Background:* Both the Freedom of Information Commission and the Attorney General's Office have issued advisory opinions concluding that the Foundation is the functional equivalent of a public agency for purposes of the Freedom of Information Act, and accordingly, is subject to the Freedom of Information Act.

*Criteria:* Section 1-225 of the General Statutes requires public agencies to perform the following: (a) post meeting minutes to the public agency's website not later than seven days after such meeting; (b) file not later than January 31<sup>st</sup> of each year with the Secretary of the State a schedule of regular meetings for the ensuing year and to post such schedule on the public agency's website; (c) file not less than 24 hours before a meeting the agenda of such meeting with the Secretary of the State and to post such agenda on the public agency's website; and (d) file not less than 24 hours before a special meeting a notice

of such special meeting with the Secretary of the State and to post the special meeting notice on the public agency's website.

*Condition:* Our review of board meetings for fiscal years ended September 30, 2009, 2010 and 2011 revealed that the Foundation did not post meeting minutes, schedules of regular meetings for the ensuing year, meeting agendas, and notices of special meetings to the Foundation's website. The Foundation did not maintain written documentation that it filed with the Secretary of the State the meeting agenda for the majority of its meetings.

*Effect:* Public notice was not provided for board meetings, minutes and agendas.

*Cause:* A lack of administrative oversight contributed to the lack of public notices.

*Recommendation:* The Foundation should ensure compliance with the Freedom of Information Act. (See Recommendation 2.)

*Agency Response:* "The Foundation believes that it has been complying with the Freedom of Information Act and that, consistent with prior periods, all notices of all Foundation Board meetings, both regular and special, were timely posted with the Connecticut Secretary of the State. The Foundation has not retained proof (fax confirmations) that it sent all such notices during the first 6 months of 2009. Section 1-225 of the act requires posting of minutes, agendas, and other materials on public agency websites "if available." Since the Foundation discontinued certain lines of business and minimized its staff in 2010, it has maintained only a basic website focused on investor reporting. The act was amended in 2010 to clarify that public agencies of political subdivisions were not required to post minutes of meetings. This amendment addressed the concerns of small towns which, like the Foundation, lacked websites or web managers that could perform frequent updates. The Foundation is not actually a public agency, but was deemed to be the functional equivalent of a public agency in a 1995 opinion from the Attorney General, issued when the Foundation had scores of employees and operated separate lines of business that were issuing student loan guarantees, making student loans, and servicing student loans. The Foundation's activities have been greatly reduced since 1995, and for over two years, it has had no facilities and no employees and has dedicated its activities primarily to managing its current portfolio of loans and related debt financing with a minimal staff, while executing the Foundation's public purpose. The Foundation, as operated today, is more analogous to the small towns that sought and received explicit relief from website posting requirements. As the Foundation is currently upgrading its website, it will voluntarily comply with the website posting provisions of the act, commencing later this summer."

*Auditors' Concluding*

*Comments:*

Despite the changes that occurred to the Foundation's organizational structure during the audited period, the Foundation continued to maintain a website, and thus should have posted the required information. If the Foundation believes that they are not subject to the FOI requirements regarding the posting of minutes, meeting notices and agendas to its website, the Foundation should seek an exemption from the FOI Commission.

## RECOMMENDATIONS

### *Status of Prior Audit Recommendations:*

- The Foundation should strengthen internal controls to ensure compliance with the Foundation's travel policy, including completing detailed expense reports for all credit card transactions and retaining itemized receipts. The Foundation should also consider specifying a cap on the amount of meal charges for employees traveling out of state and the monthly invoices should be reviewed by at least two members of the Board of Directors. This recommendation has been resolved. As of February 2010, the Foundation no longer has any employees.
- The Foundation should institute internal controls to ensure only reasonable and necessary payments are made. This recommendation has been resolved. On April 21, 2009, the Board passed a motion instructing the Chief Executive Officer to discontinue all unnecessary expenses of the Foundation, including advertising, dues and subscriptions, meetings and workshops.
- The Foundation should reimburse employees for actual business mileage driven or should implement policies and procedures to ensure that gasoline cards are used only for business mileage and should give car allowances only to employees whose job duties require significant traveling and the amounts of car allowances should be reviewed and approved by the Board. This recommendation has been resolved. As of February 2010, the Foundation no longer has any employees.
- The Foundation should strengthen internal controls over payroll and personnel, including ensuring that employees are paid within approved salary ranges, or the salary ranges should be revised accordingly, maintaining written policies for all benefits received by the Foundation's employees and ensuring that all payments made to employees are supported by appropriate written documentation. The Board should have a more active role in reviewing bonuses and salary increases of non-executive staff and should communicate executive increases directly to Human Resources. The Foundation should consider ceasing paying the split dollar life insurance policies for the executives and surrendering the proceeds. This recommendation has been resolved. The Foundation ceased paying the split dollar life insurance premiums for its executives in January 2010. As of February 2010, the Foundation no longer has any employees.

### *Current Audit Recommendations:*

#### **1. The Foundation should seek legislation to modify the board composition requirements.**

##### Comment:

Our review of board membership for fiscal years ended September 30, 2009, 2010 and 2011 revealed that, since June 2009, the Board has had eleven member vacancies and has continued to operate with only its three ex-officio members.

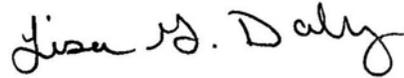
**2. Foundation should ensure compliance with the Freedom of Information Act.**

Comment:

Our review of board meetings for fiscal years ended September 30, 2009, 2010 and 2011 revealed that the Foundation did not post meeting minutes, schedules of regular meetings for the ensuing year, meeting agendas, and notices of special meetings to the Foundation's website. The Foundation did not file with the Secretary of the State the meeting agenda for the majority of its meetings.

**CONCLUSION**

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



Lisa G. Daly  
Principal Auditor

Approved:



John C. Geragosian  
Auditor of Public Accounts



Robert M. Ward  
Auditor of Public Accounts