

**State of Illinois**  
**Illinois Student Assistance Commission**  
**Illinois Designated Account Purchase Program**

Financial Audit  
For the Year Ended June 30, 2011

Performed as Special Assistant Auditors for the  
Auditor General, State of Illinois

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program  
Financial Audit  
For the Year Ended June 30, 2011**

**Table of Contents**

---

	Page
Agency Officials	1
Financial Statement Report	
Summary	2
Independent Auditors' Report	3 – 4
Financial Statements	
Statement of Net Assets	5 – 6
Statement of Revenues, Expenses, and Changes in Fund Net Assets	7
Statement of Cash Flows	8 – 9
Notes to Financial Statements	10 – 26
Supplemental Information	
Schedule of Bonds Outstanding	27 - 28
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	29 - 30
Schedule of Findings	31 - 40
Prior Finding Not Repeated	41

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Agency Officials**

---

Executive Director (through July 8, 2011)	Andrew Davis
Interim Executive Director (July 8, 2011 – February 21, 2012)	John Sinsheimer
Executive Director (February 21, 2012 - Current)	Eric Zarnikow
Interim Chief Financial Officer (July 1, 2010 – March 1, 2011)	Shoba Nandhan
Chief Financial Officer (March 1, 2011 - Current)	Shoba Nandhan
Deputy Chief Financial Officer	Brian Begrowicz
General Counsel (July 1, 2010 – February 11, 2011)	Kim Barker Lee
Interim General Counsel (February 12, 2011 – June 7, 2011)	Karen Salas
General Counsel (June 8, 2011 – Current)	Annie Pike

Agency offices are located at:

1755 Lake Cook Road  
Deerfield, IL 60015-5209  
(847) 948-8500

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Financial Statement Report**

---

**Summary**

The audit of the accompanying financial statements of the Illinois Designated Account Purchase Program of the State of Illinois, Illinois Student Assistance Commission (IDAPP) was performed by McGladrey & Pullen, LLP.

Based on their audit, the auditors expressed an unqualified opinion on IDAPP's financial statements.

**Summary of Findings**

The auditors identified matters involving IDAPP's internal control over financial reporting that they considered to be a material weakness and significant deficiencies. The material weakness is described in the accompanying schedule of findings listed in the table of contents as:

- finding 11-7 (Financial Reporting Process)

The significant deficiencies are described in the accompanying schedule of findings listed in the table of contents as:

- finding 11-6 (Competitive Procurement Requirements Not Followed)
- finding 11-8 (Student Loan Payments Not Processed Correctly)
- finding 11-9 (Noncompliance with Write-Off Policy)

The auditors also identified instances of noncompliance and other matters. The instances of noncompliance and other matters are described in the accompanying schedule of findings listed in the table of contents as finding 11-6 (Competitive Procurement Requirements Not Followed), finding 11-9 (Noncompliance with Write-Off Policy) and finding 11-10 (Debt Covenant Violation).

**Exit Conference**

The findings and recommendations appearing in this report were discussed with IDAPP personnel at an exit conference on January 23, 2012. Attending were:

**Illinois Student Assistance Commission**

John Sinsheimer	Interim Executive Director
Shoba Nandhan	Chief Financial Officer
Annie Pike (via phone)	General Counsel
Anita Geter	Director-Internal Audit
Brian Begrowicz	Deputy Chief Financial Officer
Anne Hunter	Assistant Comptroller
Wendy Funk	Director of Accounting and Finance

**McGladrey & Pullen, LLP**

Linda Abernethy	Partner
Rolake Adedara	Director

**Office of the Auditor General**

Jon Fox	Audit Manager
---------	---------------

The responses to the recommendations were provided by Shoba Nandhan in a letter dated March 16, 2012.



## Independent Auditors' Report

Honorable William G. Holland  
Auditor General  
State of Illinois, and

Ms. Kym Hubbard  
Honorable Chair of the Governing Board  
Illinois Student Assistance Commission

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the Illinois Designated Account Purchase Program of the State of Illinois, Illinois Student Assistance Commission as of and for the year ended June 30, 2011, as listed in the table of contents. These financial statements are the responsibility of the State of Illinois, Illinois Student Assistance Commission's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2, the financial statements present only the Illinois Designated Account Purchase Program, a fund of the State of Illinois, Illinois Student Assistance Commission, and do not purport to, and do not present fairly the financial position of the State of Illinois or the Illinois Student Assistance Commission as of June 30, 2011, and its changes in financial position and cash flows where applicable for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Illinois Designated Account Purchase Program of the State of Illinois, Illinois Student Assistance Commission, as of June 30, 2011, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The State of Illinois, Illinois Student Assistance Commission has not presented a management's discussion and analysis for the Illinois Designated Account Purchase Program that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the financial statements.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 27, 2012 on our consideration of the State of Illinois, Illinois Student Assistance Commission's internal control over financial reporting of the Illinois Designated Account Purchase Program and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Illinois Designated Account Purchase Program of the State of Illinois, Illinois Student Assistance Commission. The schedule of bonds outstanding, listed in the table of contents as supplemental information, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

*McGladrey & Pullen, LLP*

Schaumburg, Illinois  
March 27, 2012

**State of Illinois  
 Illinois Student Assistance Commission  
 Illinois Designated Account Purchase Program**

**Statement of Net Assets  
 June 30, 2011**

---

**Assets**

Current assets - unrestricted	
Cash and cash equivalents	\$ 10,734,785
Investments	3,997,400
Total current assets - unrestricted	<u>14,732,185</u>
Current assets - restricted	
Cash and cash equivalents	56,637,898
Investments	19,605,613
Receivables	
Student loans, net of allowance of \$3,876,663	127,702,333
Accrued interest - loans and notes	17,209,189
Accrued interest - investments	127,004
Due from other funds	1,336
Unamortized debt issuance cost	797,944
Total current assets - restricted	<u>222,081,317</u>
Noncurrent assets - unrestricted	
Depreciated capital assets, net	<u>11,159</u>
Noncurrent assets - restricted	
Receivables	
Student loans, net of allowance of \$23,813,790	812,147,636
Unamortized debt issuance costs	6,083,379
Total noncurrent assets - restricted	<u>818,231,015</u>
Total assets	<u>1,055,055,676</u>

(Continued)

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Statement of Net Assets (Continued)  
June 30, 2011**

---

**Liabilities**

Current liabilities

Accounts payable and accrued expenses	\$	530,216
Accrued interest payable		1,518,109
Federal special allowance and interest subsidy		2,540,686
Due to other ISAC funds		4,551,154
Compensated absences		22,333
Revolving credit line		314,456,827
Total current liabilities		<u>323,619,325</u>

Noncurrent liabilities

Compensated absences		201,000
Revenue bonds and notes payable, net		704,283,808
Total noncurrent liabilities		<u>704,484,808</u>

Total liabilities 1,028,104,133

**Net Assets**

Invested in capital assets		11,159
Restricted		17,512,902
Unrestricted		<u>9,427,482</u>
Total net assets	\$	<u>26,951,543</u>

See Notes to Financial Statements.



**State of Illinois**  
**Illinois Student Assistance Commission**  
**Illinois Designated Account Purchase Program**

**Statement of Revenues, Expenses, and Changes in Fund Net Assets**  
**Year Ended June 30, 2011**

<hr/>	
Operating revenues	
Investment income	
Interest - student loans	\$ 41,428,009
Interest - investments	2,725,416
Fees	1,280,830
Total operating revenues	<u>45,434,255</u>
Operating expenses	
Interest and other student loan expenses	
Interest expense	
Student loan revenue bonds and notes	9,122,681
Amortization of loan premiums and fees	2,775,406
Other student loan fees	2,623,208
Provision for loan losses	18,575,748
Other operating expenses	
Salaries and employee benefits	2,480,628
External loan servicing	4,021,950
Bond issuance and legal fees	586
Occupancy	20,861
Management and professional services	2,465,139
ISAC shared expense	2,100,000
Depreciation	13,937
Other	146,914
Total operating expenses	<u>44,347,058</u>
Operating income	1,087,197
Nonoperating expenses	
Federal special allowance and interest subsidy and excess interest expense (Note 6)	<u>(10,714,769)</u>
Change in net assets	(9,627,572)
Net assets, July 1, 2010	<u>36,579,115</u>
Net assets, June 30, 2011	<u>\$ 26,951,543</u>

See Notes to Financial Statements.

**State of Illinois**  
**Illinois Student Assistance Commission**  
**Illinois Designated Account Purchase Program**

**Statement of Cash Flows**  
**Year Ended June 30, 2011**

<hr/>	
Cash flows from operating activities	
Cash payments to suppliers for goods and services	\$ (9,708,756)
Cash payments to employees for services	(2,799,222)
Cash receipts from other operating activities (student loans and fees)	217,399,144
Cash payments for other operating activities (student loans)	(10,038,420)
Net cash provided by operating activities	<u>194,852,746</u>
 Cash flows from noncapital financing activities	
Principal paid on revenue bonds and other borrowings	(954,043,174)
Proceeds from revenue bonds and other borrowings	589,965,727
Interest paid on revenue bonds and other borrowings	(11,648,056)
Federal special allowance and interest subsidy	(10,994,085)
Net cash used for noncapital financing activities	<u>(386,719,588)</u>
 Cash flows from investing activities	
Interest received from investment securities	3,028,577
Purchase of investment securities	(189,336,239)
Proceeds from sale and maturities of investment securities	395,707,739
Net cash provided by investing activities	<u>209,400,077</u>
 Net increase in cash and cash equivalents	17,533,235
 Cash and cash equivalents, July 1, 2010	<u>49,839,448</u>
 Cash and cash equivalents, June 30, 2011	<u><u>\$ 67,372,683</u></u>
 Reported as:	
Current - unrestricted	\$ 10,734,785
Current - restricted	56,637,898
	<u><u>\$ 67,372,683</u></u>

(Continued)

**State of Illinois**  
**Illinois Student Assistance Commission**  
**Illinois Designated Account Purchase Program**

**Statement of Cash Flows (Continued)**  
**Year Ended June 30, 2011**

Reconciliation of operating income to net cash provided by operating activities	
Operating income	\$ 1,087,197
Adjustments to reconcile operating income to net cash provided by operating activities	
Depreciation	13,937
Interest - investments	(2,725,416)
Interest expense	9,122,681
Provision for loan losses	18,575,748
Amortization of student loan premiums and fees	2,775,406
Change in assets and liabilities	
Notes receivable	16,519,645
Accounts receivable	
Student loans	145,645,530
Accrued interest - loans and notes	4,068,886
Due from other funds	5,540
Accounts payable and accrued expenses	(528,650)
Due to other State funds and component units	473,600
Compensated absences	(181,358)
Net cash provided by operating activities	<u>\$ 194,852,746</u>
Supplemental disclosure of noncash transactions	
Net appreciation in fair value of investments	<u>\$ 538,058</u>

See Notes to Financial Statements.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 1. Description of Fund**

The Illinois Student Assistance Commission (ISAC) administers the nonshared proprietary fund described below. A nonshared fund is a fund in which a single State agency is responsible for administering substantially all financial transactions of the fund.

The Illinois Designated Account Purchase Program (IDAPP), a program of ISAC, was created through an Act of the State of Illinois General Assembly to increase participation of eligible lenders in ISAC's Student Loan Programs by purchasing guaranteed student loans from lenders in order to reduce the lenders' collection and administrative costs. IDAPP is also an originator and servicer of student loans. IDAPP is an integral unit of the State. As such, designation of management and governing authority are determined by the Governor of the State. The State also maintains overall accountability for IDAPP's fiscal matters. Activities of IDAPP are subject to the authority of the Office of the Governor, the State's Chief Executive Officer, and other departments of the executive branch of government (such as the Department of Central Management Services and the State Comptroller's Office) as defined by the General Assembly.

The accompanying financial statements present the financial position, results of operations, and cash flows of IDAPP. IDAPP's financial statements are an integral part of the State's overall comprehensive annual financial report. IDAPP was initially funded by a state appropriation as of July 1977 and has operated on a self-sustaining basis beginning in fiscal year 1979 through the issuance of student loan revenue bonds and notes, collection of its student loans receivable, payments from the United States Department of Education for interest and special allowance, and payments from various guarantors on defaulted loans. All IDAPP funds are held locally in various banks and financial institutions. The guaranteed student loans must be purchased from eligible lenders under the Illinois Student Assistance Law and the Federal Higher Education Act of 1965. IDAPP generally does not purchase student loans, which are more than 90 days delinquent. The reimbursement rates to lenders, such as IDAPP, in the Federal Family Education Loan Program (FFELP) are 100% for loans disbursed before October 1, 1993. For loans disbursed between October 1, 1993 and prior to July 1, 2006 the loans are reimbursed at 98%. Loans disbursed after July 1, 2006 are reimbursed at 97%.

**Note 2. Summary of Significant Accounting Policies**

The financial statements of IDAPP as administered by ISAC have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). To facilitate the understanding of data included in the financial statements, summarized below are the more significant accounting policies.

**A. Reporting Entity**

As defined by GAAP, the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable. Financial accountability is defined as:

1. Appointment of a voting majority of the component unit's board and either (a) the primary government's ability to impose its will, or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or
2. Fiscal dependency on the primary government.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 2. Summary of Significant Accounting Policies (Continued)**

**A. Reporting Entity (Continued)**

Based upon the required criteria, IDAPP has no component units, nor is it a component unit of any other entity. However, because IDAPP is not legally separate from the State of Illinois (State), it is included in the financial statements of the State as a proprietary fund. The State of Illinois' Comprehensive Annual Financial Report may be obtained by writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams Street, Springfield, Illinois 62704-1871.

The financial statements present only IDAPP as administered by the State of Illinois and ISAC, and do not purport to, and do not, present fairly the financial position of the State of Illinois or ISAC as of June 30, 2011, and changes in its financial position and cash flows, where applicable, for the year then ended in conformity with GAAP.

**B. Basis of Presentation**

In government, the basic accounting and reporting entity is a fund. A fund is defined as an independent fiscal and accounting entity with a self-balancing set of accounts recording cash and/or other resources together with all related liabilities, obligations, reserves, and equities (net assets) which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. A Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Fund Net Assets, and Statement of Cash Flows have been presented for IDAPP.

Operating revenues result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Due to the nature of IDAPP activities, income from investments and interest expense are considered operating activities in the Statement of Revenues, Expenses, and Changes in Fund Net Assets. Nonoperating revenues result from non-exchange transactions (e.g. grants (subsidy payments)) or ancillary activities.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

**C. Basis of Accounting**

IDAPP is reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flow takes place.

**D. Revenue Recognition**

Revenues from fees and the federal special allowance and interest subsidy assistance are recognized when earned. Uncollected interest income on student loans is accrued as revenue at June 30, 2011.

**E. Cash and Cash Equivalents**

Cash and cash equivalents consist principally of deposits held in banks for locally held funds and securities with maturities of less than 90 days at the date of purchase. Cash and cash equivalents also include deposits held in the State Treasury.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 2. Summary of Significant Accounting Policies (Continued)**

**F. Investments**

IDAPP presents investments in its Statement of Net Assets at fair value. The net appreciation or depreciation in the fair value of investments is included as investment income in the Statement of Revenues, Expenses, and Changes in Fund Net Assets.

**G. Student Loans Receivable/Premiums**

The interest rate charged on IDAPP's student loans receivable is considered market rate, therefore the carrying amount of student loans receivable is considered a reasonable estimate of their market value.

As a secondary lender, when IDAPP purchases loans from another lender, IDAPP may pay a premium on those loans. Premiums over \$50,000 (in the aggregate) are capitalized and amortized on a straight-line basis over the average remaining useful lives of the student loans. Premiums under \$50,000 (in the aggregate) are expensed.

**H. Allowance for Possible Loan Losses**

The allowance for possible loan losses is a reserve for estimated credit losses arising from the student loan portfolio. A provision for possible loan losses, which is a charge against operating revenue, is added to bring the allowance to a level that, in management's judgment, is adequate to absorb losses in the portfolio. Management performs a monthly assessment of the loan portfolio in order to determine the appropriate level of the allowance. The factors in this evaluation include, but are not necessarily limited to, delinquencies over 120 days, loan servicing deficiencies and the amount of unguaranteed reimbursement from the United States Department of Education as discussed in Note 5.

Management believes that the allowance for possible loan losses is adequate. While management uses available information to recognize losses on loans, future additions may be necessary based on future review of compliance with due diligence and contractual servicing requirements by IDAPP, and its outside loan servicers.

**I. Interfund Transactions**

IDAPP has the following type of interfund transactions with other funds of the State:

Loans - amounts provided with a requirement for repayment. Interfund loans are reported as interfund receivables (i.e. due from other funds) in lender funds and interfund payables (i.e. due to other funds) in borrower funds.

Services provided and used - sales and purchases of services between funds for a price approximating their external exchange value. Interfund services provided and used are reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts are reported as interfund receivables and payables in the fund Statement of Net Assets.

Reimbursements - repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. Reimbursements are reported as expenditures/expenses in the reimbursing fund and as a reduction of expenditures/expenses in the reimbursed fund.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 2. Summary of Significant Accounting Policies (Continued)**

**J. Capital Assets**

Capital assets, which include equipment, are reported at cost. Capital assets are depreciated using the straight-line method over a period of five years. IDAPP capitalizes all equipment that has a cost or value greater than or equal to \$5,000.

**K. Restricted Assets**

Restricted assets represent those assets which are required to be held by the trustee as mandated by the bond indentures or resolutions or are pledged as security in support of bond indentures or resolutions.

**L. Compensated Absences**

The liability for compensated absences consists of unpaid, accumulated vacation and sick leave balances for IDAPP employees. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments, and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary level and includes salary related costs (e.g., social security and Medicare tax).

Legislation that became effective January 1, 1998 capped the paid sick leave for all State Employees' Retirement System members at December 31, 1997. Employees continue to accrue twelve sick days per year, but will not receive monetary compensation for any additional time earned after December 31, 1997. Sick days earned between 1984 and December 31, 1997 (with a 50% cash value) would only be used after all days with no cash value are depleted. Any sick days earned and unused after December 31, 1997 will be converted to service time for purposes of calculating employee pension benefits.

**M. Debt Premiums, Discounts, Deferred Amounts on Refunding and Issuance Costs**

Revenue bonds and notes payable are stated at face value net of premiums, discounts and deferred amounts on refundings. These amounts, as well as issuance costs are deferred and amortized over the life of the debt using the straight-line method. Amortization expense is reported as a component of interest expense in the financial statements.

**N. Net Assets**

Invested in capital assets - this consists of capital assets, net of accumulated depreciation, less the outstanding balances, if any, of bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets.

Restricted - result when constraints placed on net asset use are either externally imposed by creditors or imposed by law through constitutional provisions or enabling legislation.

Unrestricted - consists of net assets that do not meet the definition of "restricted" or "invested in capital assets."

Based on bond indentures, all IDAPP assets, except for assets relating to operations, are restricted for the benefit of bondholders until the bonds are retired. IDAPP first applies restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 2. Summary of Significant Accounting Policies (Continued)**

**O. Use of Estimates**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Note 3. Deposits and Investments**

**A. Permitted Deposits and Investments**

Bond documents such as trust indentures place strict limitations on the type of investments that can be made by IDAPP. These limitations are set by the rating agencies and by the institutions providing third party guarantees, such as bond insurance or bank letters of credit. The limitations vary slightly from issue to issue, but in general they restrict investments to direct obligations of the federal government and government agencies, investment agreements, repurchase agreements, bank certificates of deposit, money market funds and highly rated commercial paper and municipal bonds.

The Public Funds Investment Act (Act) also restricts the investment of funds under the control of IDAPP. These restrictions apply to any funds, which are not restricted by the terms of a bond document. Permitted deposits and investments under the Act include (subject to various restrictions and limitations) direct federal obligations of the United States of America, federal guaranteed obligations, participation interests in federal obligations, federal affiliated institutions, certificates of deposit, time deposits, and other bank deposits which are fully insured by the Federal Deposit Insurance Corporation or similar federal agency or which are fully collateralized, money market funds, repurchase agreements, investment agreements with financial institutions, commercial paper, state or municipal bonds, and bankers' acceptances. IDAPP's Investment Policy, which applies to all investments, is more restrictive than the Act in that investments in money market mutual funds are restricted to those with portfolio holdings of United States obligations including bonds, notes, certificates of indebtedness, treasury bills or other securities, which are guaranteed by the full faith and credit of the United States of America as to principal and interest, and direct United States obligations (bonds, notes, debentures or other similar obligations of the United States of America or its agencies).

**B. Deposits – Custodial Credit Risk**

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. State law (30 ILCS 230/26) requires that all deposits of public funds be covered by FDIC insurance or eligible collateral. IDAPP has no policy that would further limit the requirements under the law.

The State Treasury is the custodian of the State's cash and cash equivalents for IDAPP maintained in the State Treasury. IDAPP independently manages cash and cash equivalents maintained outside the State Treasury. Deposits in the custody of the State Treasurer totaled \$219 at June 30, 2011. These deposits are pooled and invested with other State funds in accordance with the Deposit of State Moneys Act of the Illinois Compiled Statutes (15 ILCS 520/11). Funds held by the State Treasurer have not been addressed as to custodial credit risk because IDAPP does not own individual securities. Details on the nature of these deposits and investments are available within the State of Illinois' Comprehensive Annual Financial Report. As of June 30, 2011, IDAPP's locally held deposits were not exposed to custodial credit risk.



**State of Illinois  
 Illinois Student Assistance Commission  
 Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 3. Deposits and Investments (Continued)**

**C. Investments**

**Interest Rate Risk**

IDAPP invests its funds in a manner that meets its cash flow needs while conforming to state statutes governing the investment of funds, including without limitation the Investment Act and all requirements/limitations of the various bond documents applicable to bonds and other securities issued by ISAC. The portfolio's maturity characteristics at June 30, 2011 are as follows:

Investment Type	Fair Value	Weighted Average Maturity (Years)
Federal Agencies	\$ 19,605,613	4.8
Government Securities (U.S. Treasury Notes and Bonds)	<u>3,997,400</u>	<u>0.6</u>
Total	<u><u>\$ 23,603,013</u></u>	
Portfolio weighted average maturity		<u><u>4.0</u></u>

**Credit Risk**

IDAPP's investment policy limits the following types of investments to the top two ratings issued by nationally recognized credit rating organizations: commercial paper, state or municipal bonds, and bankers' acceptances. The investment policy places no further limitations on investment credit quality.

As of June 30, 2011, IDAPP's investments were subject to credit risk (other than obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government which are not considered to have credit risk) as follows:

Investment Type	Fair Value	Rating	
		Standard & Poor's	Moody's
Federal Agencies	\$ 19,605,613	AAA	Aaa
Money Market Securities	55,708,707	AAAm	Aaa

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 3. Deposits and Investments (Continued)**

**C. Investments (Continued)**

**Custodial Credit Risk**

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, IDAPP will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

The investment policy authorizes IDAPP to utilize a third party custodian (Trustee) to safe-keep the assets of the fund and to provide reports on a monthly basis to all necessary parties. The custodian is responsible for sweeping all interest and dividend payments and any other un-invested cash into a short-term government money market fund

IDAPP's investments total \$79,311,720 of which \$75,314,320 is held by the various trustees in the trust's name.

**Concentration of Credit Risk**

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. IDAPP's investment policy requires IDAPP to diversify its investments by security type and institution. With the exception of the obligations set forth in the investment policy (direct federal obligations, federal guaranteed obligations, and federal affiliated institutions) or investments fully collateralized by these obligations, no more than 5% of IDAPP's total investment portfolio will be invested in the obligations of a single issuer.

As of June 30, 2011, the following investments (other than U.S. Treasury or securities explicitly guaranteed by the U.S. government) exceed 5% or more of IDAPP's total investment portfolio:

<u>Issuer</u>	<u>Fair Value</u>	<u>Percentage of Portfolio</u>
Federal Farm Credit Bank	\$ 13,756,900	17.35%

**Foreign Currency Risk**

Foreign currency risk is the risk that changes in currency exchange rates will adversely affect the fair value of an investment. IDAPP's investment policy does not address foreign currency risk and IDAPP is not exposed to foreign currency risk.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 4. Notes Receivable**

Previously IDAPP made loans to institutions of higher education for the purpose of funding loans by such institutions to students or parents of students attending such institutions to finance the students' attendance at such institutions of higher education. In such case, the student loans made with the proceeds were pledged by the borrowing institution to IDAPP to secure such institution's obligation to IDAPP. The institutions were contractually committed to selling such loans to IDAPP after the loans reach a certain aging status. All such loans were purchased by IDAPP in early fiscal year 2011.

**Note 5. Student Loans Receivable**

IDAPP's student loans receivable balance is comprised of two types of student loans: loans that were originated or purchased as part of the Federal Family Education Loan Program (FFELP) and loans that are originated as part of IDAPP's Alternative Loan Program. The FFEL Program was eliminated as of June 30, 2010 and as such IDAPP no longer originates FFELP loans.

All FFELP loans originated or purchased by IDAPP prior to October 1, 1993 are guaranteed at 100% by Guarantors in accordance with the Higher Education Act. For loans disbursed between October 1, 1993 and prior to July 1, 2006 the loans are guaranteed at 98%. Loans disbursed after July 1, 2006 are guaranteed at 97%. All guaranteed loans are reinsured by the United States Department of Education (ED). ED has issued detailed loan servicing requirements, which, if not strictly adhered to, may result in the loss of the loan guaranty. The United States Department of Education has also issued specific guidelines to provide for the cure of such servicing deficiencies and the reinstatement of the guaranty. For servicing contracts established with outside vendors, contractual provisions require the contractors to indemnify IDAPP for losses due to their negligence in loan servicing. Such recoveries will be recognized as income when received. There are \$2,010,975 of student loans receivable that IDAPP has classified as defaulted loans under the FFEL Program. These loans have been submitted to, but have not been reimbursed by, the guarantee agencies as of June 30, 2011.

Alternative Loans are not guaranteed by Guarantors and are not eligible for reinsurance by ED. Alternative Loans are credit-based and a provision for loan loss is set aside for the full amount of the loan when a loan becomes 120 days delinquent. The total amount of Alternative Loans outstanding was \$287,090,409 at June 30, 2011.

Included in the student loans receivable balance are premiums and other acquisition fees paid on the origination and purchase of certain student loans. These premiums and other acquisition fees are being amortized over the average life of the related loans. Premiums and other acquisition fees totaling less than \$50,000 paid to a particular party during a fiscal year are expensed. Other acquisition fees typically represent lender fees and insurance fees and are also being amortized over the average life of the related loans.

Management has identified loans that may not be reimbursed by the guarantor or collected from the student. Accordingly, management has established an allowance for possible loan losses totaling \$27,690,453 as of June 30, 2011, which includes the amount collected from borrowers as an insurance fee for the Alternative Loans.

**State of Illinois  
 Illinois Student Assistance Commission  
 Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 5. Student Loans Receivable (Continued)**

During fiscal year 2011, IDAPP sold \$43,874,733 of loans to ED under ED's loan purchase (PUT) program. Reflected in the Statement of Revenues, Expenses, and Changes in Fund Net Assets is \$1,280,830 of fees received from ED. The fee is comprised of \$439,030 of lender fee reimbursement and \$841,800 of purchase fees, calculated as \$75 for each loan purchased.

**Federal Student Loan Fund**

ISAC's Federal Student Loan Program maintains a fund that is on deposit with the State Treasurer, known as the Illinois Student Assistance Commission Federal Student Loan Fund. This fund is used to pay defaulted loan claims. Receipts for this fund include reinsurance receipts from the DOE.

The cash balance in this fund as of June 30, 2011 as reported by ISAC was \$34,944,672. Restricted net assets, which includes \$33,031,487 of claims in process, was \$46,543,971. If the federal reinsurance percentage were temporarily reduced from 95% to either 85% or 75% (for loans disbursed after October 1, 1998) due to excessive default claims and if the State's pledge of full faith and credit were found to be ineffective, then the full collectibility of the non-federal reinsurance amount (i.e. 5% to 25%) of the IDAPP's net student loans receivable of \$939,849,969 at June 30, 2011 is subject to the adequacy of the annual appropriation from the Illinois Student Assistance Commission Federal Student Loan Fund and the reserve funds of the other Guarantors to pay defaulted loan claims. However, based on past loan default experience, management believes that material losses will not be incurred.

**Note 6. Federal Special Allowance and Interest Subsidy**

The Federal government pays IDAPP or IDAPP owes the federal government an interest subsidy on certain student loans during the time that the student is enrolled in an eligible educational institution or qualifies for deferment status. The federal interest payable at June 30, 2011 was \$2,540,686.

IDAPP is also eligible to receive special allowance payments from the federal government that are paid to adjust for the low yield on student loans in comparison to other investment sources. In addition IDAPP owes the federal government excess interest on the portfolio.

Federal Interest Benefits	\$ 4,951,737
Special Allowance Payments	184,203
Excess Interest	<u>(15,850,709)</u>
Net Amount Paid to ED	<u><u>\$ (10,714,769)</u></u>

**State of Illinois  
 Illinois Student Assistance Commission  
 Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 7. Interfund Balances and Activity**

**Balances Due from/to Other Funds**

The following balance at June 30, 2011 represents amounts due from other ISAC funds.

Fund	Amount	Description/Purpose
Federal Student Loan Fund	<u>\$ 1,336</u>	Claim payments - collection of these funds is anticipated in fiscal year 2011.

The following balance at June 30, 2011 represents amounts due to other ISAC funds.

Fund	Amount	Description/Purpose
Student Loan Operating Fund	<u>\$ 4,551,154</u>	Shared services

**Note 8. Capital Assets**

Capital asset activity for the year ended June 30, 2011 was as follows:

	Equipment	Accumulated Depreciation	Capital Assets, Net
Balance, July 1, 2010	\$ 543,929	\$ (518,833)	\$ 25,096
Additions	-	(13,937)	(13,937)
Deletions	(14,735)	14,735	-
Balance, June 30, 2011	<u>\$ 529,194</u>	<u>\$ (518,035)</u>	<u>\$ 11,159</u>

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 9. Long-Term Obligations Payable**

**A. Revenue Bonds and Notes Payable and Pledged Revenues**

On July 29, 2002, ISAC adopted a general resolution and adopted supplemental resolutions on July 29, 2002, September 19, 2003, April 2, 2004, and June 24, 2005 authorizing the issuance of Student Loan Revenue Bonds, Series I and II, Series III, IV and V, Series VI and VII, and Series VIII and IX, respectively. All bonds are at a variable rate of interest. Any subsequent bonds issued under this resolution are issued on parity and the assets acquired and revenues generated under these bond issues serve as collateral for all of these issues.

The general resolution bonds are auction rate certificates and are taxable. The variable interest rate for the debt is reset every 28 days, based on the one-month LIBOR rate. Starting in August 2007, the bond markets experienced severe disruption. As a result, an auction held on February 13, 2008 for \$70 million of bonds issued under the 2002 Resolution failed to attract enough bidders. All subsequent auctions also failed and continue to do so. A "failed auction" results in the bonds being priced at the "maximum auction rate" which, as defined in the Resolution, can be no more than the lesser of the rolling twelve-month 90 day U.S. Treasury rate plus 1.2% (for "AAA" rated bonds), 1.5% (for "A" rated bonds), 1.75% (for bonds rated below the lowest category of "A") and one-month LIBOR plus 1.5%. The average maximum rate at June 30, 2011 was .98%.

In connection with the issuance of the LIBOR Floating Rate Notes (LIBOR FRN) in October 2010 (described below) and by using existing cash in the trust \$849,950,000 of the Student Loan Revenue Bonds were redeemed. The remaining balance of bonds outstanding issued under the resolutions is \$34,450,000 as of June 30, 2011.

IDAPP has pledged future student loan revenues, net of specified operating expenses, to repay the outstanding principal for these student loan revenue bonds. The bonds are payable solely from principal and interest revenues under the related student loans and are payable through the final maturity of the bonds in 2045. Annual principal and interest payments on the bonds are expected to require approximately 92 percent of these student loan revenues. The total principal and interest remaining to be paid on the bonds is approximately \$45.6 million.

Interest paid for the current year was approximately \$4.8 million and total related student loan principal and interest received were approximately \$32.3 million and \$5.4 million, respectively. These figures reflect the higher amount of bonds outstanding from July 2010 to October 2010.

On May 19, 2009, ISAC entered into a Bond Purchase Agreement with a group of underwriters to sell \$50,000,000 Student Loan Revenue Bonds, Series 2009 (State Guaranteed). The bonds mature on May 1, 2014 and bear interest at the rate of 3.15% per annum. The interest on the bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended. The proceeds of the bonds were used to (a) fund eligible loans to the extent permitted under the indenture, (b) fund, together with certain funds provided by ISAC, a debt service reserve fund and (c) pay bond issuance costs.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 9. Long-Term Obligations Payable (Continued)**

**A. Revenue Bonds and Notes Payable and Pledged Revenues (Continued)**

IDAPP has pledged future student loan revenues, net of specified operating expenses, to repay the outstanding principal for these Student Loan Revenue Bonds, Series 2009 (State Guaranteed). The bonds are payable solely from principal and interest revenues under the related student loans and are payable through the final maturity of the bonds in 2014. Annual principal and interest payments on the bonds are expected to require most of these student loan revenues. The total principal and interest remaining to be paid on the bonds is approximately \$54.7 million. Interest paid for the current year was approximately \$1.6 million and total related student loan principal and interest received were approximately \$8.3 million and \$.8 million, respectively.

On August 12, 2009 ISAC entered into a Bond Purchase Agreement with a group of Illinois Credit Unions to sell Taxable Student Loan Revenue Bonds (Series 2009A, Series 2009B, and Series 2009C). Funds from the bond sales were used to support FFELP student loans for the 2009/2010 school year. On August 12, 2009 ISAC sold the first in the series of bonds and received \$44,175,000. The Series 2009B bonds were sold for \$44,175,000 on December 15, 2009. The Series 2009C bonds were not sold due to a lack of demand. Interest on the bonds was set at "AA" Financial Commercial Paper Rate plus 80 basis points. The principal of \$88,350,000 and interest of \$783,650 was paid-off on August 10, 2010.

On October 27, 2010, ISAC entered into a Bond Purchase Agreement with a group of underwriters to sell \$604,000,000 Student Loan Asset Backed Notes, Series 2010-1 (LIBOR Floating Rate Notes). The Notes were issued in three tranches. The Class A-1 tranche is \$181,000,000 maturing April 25, 2017 with a rate of 3-Month LIBOR plus 0.48%, The Class A-2 tranche is \$269,000,000 maturing April 25, 2022 with a rate of 3-Month LIBOR plus 1.05% and the Class A-3 tranche is \$154,000,000 maturing July 25, 2045 with a rate of 3-Month LIBOR plus 0.90%. The variable interest rate for the debt is reset every quarter. The proceeds from the sale of the Notes were used to make the initial deposits to the Capitalized Interest Fund, the Reserve Fund, a portion of the initial deposit to the Loan Fund, and to pay acquisition costs. The remaining proceeds were transferred to the 2002 Resolution Trust (described above) and were used with cash from the Trust to purchase and cancel certain bonds outstanding thereunder. The FFELP loans released from the 2002 Resolution Trust were deposited into the Loan Fund. Annual principal and interest payments on the bonds are expected to require approximately 61% percent of these student loan revenues. The total principal and interest remaining to be paid on the bonds is approximately \$664.5 million. Interest paid for the current year was approximately \$3.4 million and total related student loan principal and interest received were approximately \$69.3 million and \$10.2 million, respectively.

As a result of the issuance of the LIBOR Floating Rate Notes and the purchase and cancellation of certain of the 2002 bonds, a deferred amount (gain) on refunding of \$70,320,074 was recorded. This gain will be amortized over the weighted average life of the LIBOR Floating Rate Notes of nearly 16 years. The portion attributable to fiscal year 2011 is \$3,313,512 and the annual amount of amortization recognized in future years will be \$4,418,015. Amortization of the gain is included as a reduction of interest expense on the Statement of Revenues, Expenses, and Changes in Fund Net Assets.

The current refunding allowed the Commission to reduce its total debt service payments over the next 34 years by \$303,797,090, and resulted in an economic loss (difference between the present values of the debt service payments on the old and the new debt) of \$78,648,720.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

**Note 9. Long-Term Obligations Payable (Continued)**

**B. Changes in Long-Term Obligations Payable**

Changes in long-term obligations payable for the year ended June 30, 2011 were as follows:

	Balance July 1, 2010	Additions	Deletions	Balance June 30, 2011	Amounts Due Within One Year
Compensated absences payable	\$ 404,690	\$ 121,525	\$ (302,882)	\$ 223,333	\$ 22,333
Revenue bonds/notes payable	1,022,750,000	604,000,000	(982,105,000)	644,645,000	-
Unamortized discounts	(3,049,192)	(7,230,916)	2,912,355	(7,367,753)	-
Unamortized deferred amount on refunding	-	70,320,074	(3,313,512)	67,006,561	-
	<u>\$ 1,020,105,498</u>	<u>\$ 667,210,683</u>	<u>\$ (982,809,039)</u>	<u>\$ 704,507,141</u>	<u>\$ 22,333</u>

**C. Future Maturities of Revenue Bonds and Notes Payable**

IDAPP issues bonds and notes to provide funds for student loan originations and purchases. IDAPP pledges the income derived from its assets to pay debt service. Annual debt service requirements to maturity for revenue bonds and notes are as follows (amounts in thousands):

Year Ending June 30	Principal	Interest	Total
2012	\$ -	\$ 8,315	\$ 8,315
2013	-	8,315	8,315
2014	50,000	8,315	58,315
2015	-	6,740	6,740
2016	-	6,740	6,740
2017-2021	137,195	29,375	166,570
2022-2026	269,000	13,634	282,634
2027-2031	-	10,726	10,726
2032-2036	-	10,726	10,726
2037-2041	-	10,726	10,726
2042-2045	188,450	6,586	195,036
	<u>644,645</u>	<u>\$ 120,198</u>	<u>\$ 764,843</u>
Plus (minus):			
Unamortized discounts	(7,368)		
Unamortized deferred amount on refunding	<u>67,007</u>		
Net long-term principal outstanding	<u>\$ 704,284</u>		



**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 9. Long-Term Obligations Payable (Continued)**

The majority of IDAPP's outstanding revenue bonds and notes are comprised of variable rate debt. As such, the interest figures shown above are calculated assuming the interest rate in effect on June 30, 2011. Actual interest paid in future years could be materially different.

**Note 10. Mid-Term Credit Facility and Short Term Revolving Credit Line and Pledged Revenues**

On July 27, 2007, ISAC entered into a Three-Year Asset Backed Revolving Credit Facility (the "Facility") through an affiliate of Citibank (the "Lender") pursuant to which ISAC has borrowed funds for the purpose of purchasing certain student loans. Advances made under the Facility are secured by a portfolio of student loans, which loans were largely financed with proceeds of the advances (the "Collateral"). Amounts due under the Facility constitute limited obligations of ISAC, payable solely and only from the Collateral and the revenues derived therefrom. The costs of borrowing under the Program will not exceed Citibank's commercial paper rate. The rate at June 30, 2011 was .19103%. On July 27, 2010, the final maturity date under the Facility, approximately \$355 million remaining outstanding under the Facility became due and payable. Due in part to conditions currently existing in the credit markets, ISAC has been unable to refinance this debt and is currently in payment default under the Facility. ISAC has reached an agreement with the Lender pursuant to which, subject to certain conditions, the Lenders will refrain from exercising their rights to require payment in full of amounts due under the Facility until July 27, 2011 or such later date as may be negotiated. Negotiations are under way with the Lender to extend the date to July 27, 2012. In addition, IDAPP is in breach of the coverage condition and default ratios, as defined in the indenture. The breaches qualify as an Event of Termination under which Citibank would be eligible for remedies under the indenture. The agreement extending the date until July 27, 2011 with the lender discussed above also extends to the breach of the ratios.

Under the terms of the agreement all revenues generated by the underlying student loan portfolio are transferred to a trust. The trust pays all expenses related to the debt service and student loan servicing costs (capped at 65 basis points of the outstanding average balance in the portfolio). During fiscal year 2011 there was \$34,728,628 in principal and \$9,646,185 in interest collected. The total amount transferred to the trust was \$44,391,214. During the same period the trust paid \$2,365,506 for interest expense and other professional fees and \$2,650,222 for servicing fees.

On December 22, 2008 ISAC/IDAPP executed a \$7,000,000 credit and security agreement with ShoreBank. The revolving credit line was used for the purchase or origination of student loans under the Capstone Program established in 2007. The agreement was amended on November 12, 2009 and reduced to \$4,717,675. The credit and security agreement was paid in full on March 28, 2011.

Changes in the revolving credit lines are as follows:

	Balance, July 1, 2010	Borrowings	Repayments	Balance, June 30, 2011	Amounts Due Within One Year
Citibank	\$ 355,456,827	\$ -	\$ (41,000,000)	\$ 314,456,827	\$ 314,456,827
ShoreBank	4,717,675	-	(4,717,675)	-	-
<b>Total</b>	<b>\$ 360,174,502</b>	<b>\$ -</b>	<b>\$ (45,717,675)</b>	<b>\$ 314,456,827</b>	<b>\$ 314,456,827</b>

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 11. Pension Plan**

Substantially all of ISAC's full-time employees who are not eligible for participation in another state-sponsored retirement plan participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity. SERS is a single-employer defined benefit public employee retirement system (PERS) in which State employees participate, except those covered by the State Universities, Teachers', General Assembly, and Judges' Retirement Systems. The financial position and results of operations of SERS for fiscal year 2011 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2011. SERS issues a separate CAFR that may be obtained by writing to SERS, 2101 South Veterans Parkway, Springfield, Illinois 62794-9255.

A summary of SERS benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of SERS' CAFR. Also included is a discussion of employer and employee obligations to contribute and the authority under which those obligations are established.

IDAPP pays employer retirement contributions based upon an actuarially determined percentage of their payrolls. IDAPP's required and actual contributions for fiscal years 2011, 2010 and 2009 were \$474,235, \$1,081,869 and \$828,291, respectively. For fiscal years 2011, 2010 and 2009, the employer contribution rate was 28.0%, 28.4% and 21.0%, respectively.

**Note 12. Post-Employment Benefits**

The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by the Department of Healthcare and Family Services along with the Department of Central Management Services. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State sponsored pension plans. Health, dental, and vision benefits include basic benefits for annuitants and dependents under the State's self-insurance plan and insurance contracts currently in force. Annuitants may be required to contribute towards health, dental, and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in the State Employees' Retirement System do not contribute towards health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with twenty or more years of credited service to not have to contribute towards health, dental, and vision benefits. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefit becomes \$5,000.

The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including post-employment health, dental, vision, and life insurance benefits, is recognized as an expenditure by the State in the Illinois Comprehensive Annual Financial Report. The State finances the costs on a pay-as-you-go basis.

The total costs incurred for health, dental, vision, and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 12. Post-Employment Benefits (Continued)**

A summary of post-employment benefit provisions, changes in benefit provisions, employee eligibility requirements, including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the financial statements of the Department of Healthcare and Family Services. A copy of the financial statements of the Department of Healthcare and Family Services may be obtained by writing to the Department of Healthcare and Family Services, 201 South Grand Ave., Springfield, Illinois 62763-3838.

**Note 13. Risk Management**

IDAPP, through the Commission, is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; workers compensation and natural disasters. The State retains the risk of loss (i.e., self insured) for these risks except for insurance purchased by the Commission for the building and EDP equipment. There has been no reduction in insurance coverage from coverage in the prior year. Settlement amounts have not exceeded coverage for the current or prior two fiscal years. The Commission's risk management activities for workers compensation are financed through appropriations to the Illinois Department of Central Management Services and are accounted for in the general fund of the State. The claims are not considered to be a liability of the Commission and, accordingly, have not been reported in the Commission's financial statements for the year ended June 30, 2011.

**Note 14. New Governmental Accounting Standards**

The Governmental Accounting Standards Board (GASB) has issued the following statements:

Statement No. 62 – *Codification of Accounting and Financial Reporting Guidance contained in pre-November 1989 FASB and AICPA Pronouncements*, was established to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in certain FASB and AICPA pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. The Commission is required to implement this Statement for the year ending June 30, 2013.

Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*, was established to improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. It alleviates uncertainty about reporting those financial statement elements by providing guidance where none previously existed. The Commission is required to implement this Statement for the year ending June 30, 2013.

Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions – An Amendment to GASB Statement No. 53*, was established to enhance comparability and improve financial reporting by clarifying the circumstances in which hedge accounting should continue when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The Commission is required to implement this Statement for the year ending June 30, 2012.

Management has not yet completed its assessment of these Statements; however, they are not expected to have a material effect on the overall financial statement presentation.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Notes to Financial Statements**

---

**Note 15. Subsequent Event**

As a condition of the rating agency confirmation in connection with the purchase and cancellation of certain bonds issued under the 2002 resolution, IDAPP was required to retire \$11 million of the outstanding bonds at par plus accrued interest in November 2011. In addition IDAPP retired an additional \$4 million of the outstanding bonds at par plus accrued interest in November 2011.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Designated Account Purchase Program**

**Schedule of Bonds Outstanding  
June 30, 2011**

A summary of bonds and notes outstanding at June 30, 2011 is presented as follows:

	Series 2002 I and Series 2002 II	Series 2003 III 2003 IV and 2003 V	Series 2004 VI and 2004 VII	Series 2005 VIII and 2005 IX	Series 2009
Original amount	\$ 250,000,000	\$ 350,000,000	\$ 250,000,000	\$ 600,000,000	\$ 50,000,000
Principal retirements	(247,900,000)	(347,700,000)	(241,000,000)	(578,950,000)	-
Unamortized Deferred Amount on Refunding	-	-	-	-	-
Unamortized discount	(10,047)	(10,312)	(7,441)	(53,251)	(195,961)
Balance at June 30, 2011	\$ 2,089,953	\$ 2,289,688	\$ 8,992,559	\$ 20,996,749	\$ 49,804,039
Effective interest rate (1)	Variable	Variable	Variable	Variable	Fixed
Date of bonds/notes	8/20/02	10/2/03	4/21/04	7/19/05 12/08/05	05/28/09
Interest dates	Varies	Varies	Varies	Varies	November 1 and May 1
Paying agents	Bank of New York New York, NY	Bank of New York New York, NY	Bank of New York New York, NY	Bank of New York New York, NY	Wells Fargo Minneapolis, MN
Optional call feature beginning:	At issuance 100%	At issuance 100%	At issuance 100%	At issuance 100%	05/01/10 100%
Taxable/Tax-exempt	Taxable	Taxable	Taxable	Taxable	Tax-exempt

(1) As of June 30, 2011 variable interest rates were .98% for taxable auction rate securities debt and .75375%, 1.32375% and 1.17375% for the 2010 LIBOR FRN respectively.

LIBOR FRN - 2010					
Class A-1	Class A-2	Class A-3			Total
\$ 181,000,000	\$ 269,000,000	\$ 154,000,000	Original amount		\$ 2,104,000,000
(43,805,000)	-	-	Principal retirements		(1,459,355,000)
20,079,781	29,842,326	17,084,455	Unamortized Deferred		
-	-	(7,090,742)	Amount on Refunding		67,006,562
			Unamortized discount		(7,367,754)
<u>\$ 157,274,781</u>	<u>\$ 298,842,326</u>	<u>\$ 163,993,713</u>	Balance at June 30, 2011		<u>\$ 704,283,808</u>
Variable	Variable	Variable	<u>Debt outstanding per Statement of Net Assets</u>		
10/26/10	10/26/10	10/26/10	Current portion of :		
			Revenue bonds payable	\$	-
			Long-term revenue		
			bonds/notes payable, net		<u>704,283,808</u>
			Total debt outstanding	\$	<u><u>704,283,808</u></u>
Varies	Varies	Varies			
Wells Fargo	Wells Fargo	Wells Fargo			
Minneapolis, MN	Minneapolis, MN	Minneapolis, MN			
At issuance	At issuance	At issuance			
100%	100%	100%			
Taxable	Taxable	Taxable			



**Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards**

Honorable William G. Holland  
Auditor General  
State of Illinois, and

Ms. Kym Hubbard  
Honorable Chair of the Governing Board  
Illinois Student Assistance Commission

As Special Assistant Auditors for the Auditor General, we have audited the financial statements of the Illinois Designated Account Purchase Program of the State of Illinois, Illinois Student Assistance Commission (Commission), as of and for the year ended June 30, 2011 and have issued our report thereon dated March 27, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Commission is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Commission's internal control over financial reporting of the Illinois Designated Account Purchase Program as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements and not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the Commission's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency described in finding 11-7 in the accompanying schedule of findings to be a material weakness.

A *significant deficiency* is a deficiency or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in findings 11-6, 11-8 and 11-9 in the accompanying schedule of findings to be significant deficiencies.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings as findings 11-6, 11-9 and 11-10.

The Commission's responses to the findings identified in our audit are described in the accompanying Schedule of Findings. We did not audit the Commission's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, Commission management, and the Commission Board and is not intended to be and should not be used by anyone other than these specified parties.

*McGladrey & Pullen, LLP*

Schaumburg, Illinois  
March 27, 2012



**Current Findings – Government Auditing Standards**

**(Note: Findings 11-1 to 11-5 are reported in the Illinois Student Assistance Commission – Illinois Prepaid Tuition Program financial audit. They are also reported in the Department-wide audit of the Illinois Student Assistance Commission).**

**Finding 11-6 Competitive Procurement Requirements Not Followed**

**(Note: This finding is also reported in the Department-wide audit of the Illinois Student Assistance Commission)**

The Illinois Student Assistance Commission (Illinois Designated Account Purchase Program) did not comply with certain competitive procurement requirements of the Illinois Procurement Code.

The Commission awarded a vendor contract for assistance in analyzing account balance issues pertaining to one of Illinois Designated Account Purchase Program's (IDAPP) third party loan servicers (loan processing services). Pricing for the loan processing services noted above was not requested in the Commission's request for proposal, and was not included in the vendor's proposal. Pricing for this service was negotiated at a later date, outside the competitive procurement process.

On January 4, 2008, the Illinois Student Assistance Commission (through Central Management Services) issued an RFP titled "**to provide Financial Advisory services to the Illinois Student Assistance Commission RFP#IDAPP200710**". Within the RFP, Page 8, Section 4.1. "**Need For Services**" it stated "The Illinois Student Assistance Commission (ISAC) is requesting proposals for financial advisory services to ISAC in connection with (i) structuring and placing new debt, (ii) restructuring its current debt structure and (iii) swaps or other derivative transactions. ISAC will enter into contracts with several financial advisory firms and (iv) general financial advice in connection with improving ISAC's operational and financial functions".

Using this RFP, approximately 10 vendors were prequalified to perform the services specified in the RFP. Upon review of the complete RFP, the auditors concluded the RFP was issued primarily to assist the Commission with services pertaining to the issuance/ restructuring of debt.

The proposal submitted by the vendor who was awarded a fiscal year 2011 contract to review loan processing issues at IDAPP's external service provider did not include proposed fees for this type of service in the proposal submitted. Prequalified vendors were not asked to provide written fee quotes for this service. These fees were negotiated at a later date with only this vendor. The vendor was awarded a contract for \$450,000 to review the student loans processed by an external service provider. The external service provider managed a portfolio of \$287 million in student loans. The vendor has been paid \$222,398 as of the date of this report.

According to the Illinois Administrative Code (44 Ill. Adm. Code 1.2035.h), RFPs shall include the following information:

- A. The type of services required;
- B. A description of the work involved;
- C. An estimate of when and for how long the services will be required;
- D. The type of contract to be used;
- E. A date by which proposals for the performance of the services shall be submitted;

**Current Findings – Government Auditing Standards**

**Finding 11-6 Competitive Procurement Requirements Not Followed (Continued)**

- F. A statement of the minimum information that the proposal shall contain, which may, by way of example, include: (i) the name of the offeror, the location of the offeror's principal place of business and, if different, the place of performance of the proposed contract; (ii) if deemed relevant by the Procurement Officer, the age of the offeror's business and average number of employees over a previous period of time, as specified in the Request for Proposals; (iii) the abilities, qualifications, and experience of all persons who would be assigned to provide the required services; (iv) a listing of other contracts under which services similar in scope, size, or discipline to the required services were performed or undertaken within a previous period of time, as specified in the Request for Proposals; (v) a plan, giving as much detail as is practical, explaining how the services will be performed;
- G. Price ( to be submitted in a separate envelope in the proposal package and not mentioned elsewhere in the proposal package); and
- H. The factors to be used in the evaluation and selection process and their relative importance.

The Illinois Procurement Code (30 ILCS 500/35-30 and 35-35) requires that all professional and artistic services greater than \$20,000 shall be awarded using competitive request for proposal.

The Commission did not provide sufficient oversight over the procurement process which resulted in the above noted departure from the procurement law.

Based on the RFP issued, there was not a clear request for loan processing related services which would have resulted in a fair and competitive process that allowed all interested parties the opportunity to participate in the procurement opportunity, including competitive pricing. There may have been numerous vendors who specialize in the above mentioned types of services who did not reply to the requests for proposal because they did not appropriately describe the services needed. Under the process used, the Commission may have paid higher fees than it otherwise might have obtained through a truly competitive process. (Finding Code No. 11-6)

**Recommendation**

We recommend the following:

1. The Commission should comply with the requirements set forth in the Illinois Procurement Code and Administrative Rules in procuring professional and artistic services.
2. The Commission should establish policies whereby RFP's are thoroughly reviewed before issuance to ensure that all aspects of the needed services are thoroughly described. If the Commission determines at a later time that a necessary service is needed and was not initially included in the original RFP, the Commission should issue an addendum to the services needed provided that the RFP response submission deadline has not expired. In the event that the RFP deadline has expired, the Commission should issue a new RFP describing the new service needed.

**Current Findings – *Government Auditing Standards***

**Finding 11-6 Competitive Procurement Requirements Not Followed (Continued)**

**Commission Response**

We accept the recommendation.

IDAPP's future RFPs will have more precise descriptions of services to be solicited with clearer requirements.

**Current Findings – Government Auditing Standards**

**Finding 11-7 Financial Reporting Process**

**(Note: This finding is also reported in the Department-wide audit of the Illinois Student Assistance Commission)**

The Illinois Student Assistance Commission (Illinois Designated Account Purchase Program) does not have sufficient control over financial reporting.

During our review of the draft financial statements of the Illinois Designated Account Purchase Program (IDAPP) provided to the auditors, several errors and omissions relating to the draft financial statements and note disclosures were identified and corrected. Some of the more significant items noted were as follows:

- On October 27, 2010, ISAC entered into a Bond Purchase Agreement with a group of underwriters to sell \$604,000,000 Student Loan Asset Backed Notes, Series 2010-1 (LIBOR Floating Rate Notes). As a result of the issuance of the LIBOR Floating Rate Notes and the purchase and cancellation of certain of the 2002 bonds, a deferred amount (gain) of approximately \$70 million was recorded. IDAPP erroneously recognized this gain on the Statement of Changes in Net Assets, rather than recording it as a component of the debt liability and amortizing it over the weighted average life of the LIBOR Floating Rate Notes of approximately 16 years resulting in an overstatement of assets and the increase in net assets of \$67 million.
- In relation to the issuance of the LIBOR Floating Rate Notes and refunding of the 2002 bonds noted above, IDAPP did not perform a calculation of or disclose the economic loss resulting from the transaction of \$78,648,720, or the reduction in debt service of \$303,797,090 over 34 years, as required by applicable accounting standards.
- The student loan receivable balance was not properly classified between the current and non-current portions on the Statement of Net Assets. \$3.9 million was reclassified from current student loans receivable to noncurrent student loans receivable.

Governmental Accounting Standard Board Statement No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*, states that “for current refundings and advance refundings resulting in defeasance of debt reported by proprietary activities, the difference between the reacquisition price and the net carrying amount of the old debt be deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.”

In addition, Governmental Accounting Standard Board Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt*, states “governmental entities that defease debt through an advance refunding should provide a general description of the transaction in the notes to financial statements in the year of the refunding. At a minimum, the disclosures should include (a) the difference between the cash flows required to service the old debt and the cash flows required to service the new debt and complete the refunding and (b) the economic gain or loss resulting from the transaction.”

**Current Findings – Government Auditing Standards**

**Finding 11-7 Financial Reporting Process (Continued)**

Further, the Fiscal Control and Internal Auditing Act, 30 ILCS 10/3001 requires all State agencies to establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources.

According to IDAPP management, IDAPP did not initially regard the bond transaction as a refunding because it was not performed to reduce its annual debt service payments as discussed in the accounting standard. The current/non-current classification issue for the student loan receivable was due to IDAPP not having the latest draft of the report template from last year as the change was made outside of IDAPP.

Submitting incomplete and inaccurate draft financial statements delays completion of the audit process and the timely release of IDAPP's and the Commission's financial reports to users. Also, insufficient and/or ineffective controls over financial reporting could lead to significant reporting inaccuracies in the financial statements and notes to the financial statements. (Finding Code Nos. 11-7, 10-2, 09-3, 08-5)

**Recommendation**

We recommend the Commission improve controls over financial reporting to ensure accurate presentation and disclosure of IDAPP's annual financial statements. The Commission should take a comprehensive look at the entire financial reporting process and make changes needed to timely release financial reports to users and to auditors presented in accordance with generally accepted accounting principles.

**Commission Response**

We accept the recommendation.

IDAPP is reviewing its policies and procedures regarding the preparation of the financial statements. Quality control checks will be put in place to ensure the submission of accurate financial statements.

**Current Findings – Government Auditing Standards**

**Finding 11-8 Student Loan Payments Not Processed Correctly**

**(Note: This finding is also reported in the Department-wide audit of the Illinois Student Assistance Commission)**

The Illinois Student Assistance Commission (Illinois Designated Account Purchase Program) did not properly apply student loan payments to principal and interest.

The Illinois Designated Account Purchase Program (IDAPP) utilizes several external service organizations to manage and monitor its student loan portfolio. IDAPP management indicated it was aware of a system problem relating to the processing of payments at one of its service organizations. Subsequent to IDAPP's fiscal year ended June 30, 2011, the service provider performed a retrospective review calculation for propriety. In addition, the Commission hired an independent third party to review the service provider's retrospective calculation. Based on the review, misapplied payments as of June 30, 2011 totaled approximately \$638,773, resulting in an overstatement of IDAPP's student loan receivable balance by the same amount. This amount was deemed immaterial and was not recorded at year-end.

The Fiscal Control and Internal Auditing Act, 30 ILCS 10/3001 requires all State agencies to establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources.

A good internal control environment includes checks and balances to ensure accounting transactions are recorded accurately. This extends to those transactions processed by third parties such as service organizations.

According to IDAPP management, this is the result of issues with the vendor's loan servicing software package in which certain transactions did not get processed correctly.

The service provider in question manages approximately \$287 million of IDAPP's student loan portfolio as of June 30, 2011. This represents approximately 31% of the student loan receivable balance of \$940 million at the fiscal year ended June 30, 2011. Misapplication of student loan payments between interest and principal could result in IDAPP's student loan receivable and operating revenue being misstated. Additionally, misapplication of payments could lead to certain borrowers "paying off their loan" when a balance actually remains, or over paying the remaining loan balance. Although individual payments misapplied during the year ended June 30, 2011 appear to be insignificant, these amounts can accumulate throughout the years to a more significant amount. (Finding Code Nos. 11-8, 10-3)

**Recommendation**

Since this issue has been ongoing for over a year, we recommend IDAPP management find a resolution to this situation as soon as possible. We recommend IDAPP management closely monitor each service organization used to manage its student loan portfolio. This should include reviews of the service organization's "Reports on controls at a service organization" prepared and issued by independent auditors in accordance with the Statement on Standards for Attestation Engagements No. 16. Any noted variances in application of borrower payments should be investigated and corrected in a timely manner.

**Current Findings – *Government Auditing Standards***

**Finding 11-8 Student Loan Payments Not Processed Correctly (Continued)**

**Commission Response**

We accept the recommendation.

A systematic solution which will correct borrower balances has been developed and is awaiting Commission approval. The balances should be properly stated before the end of the state fiscal year 2012. Additionally, we have an RFP in process to replace the servicer of our Private Loan portfolio which should lead to better processing and control.

IDAPP also has a process where it reviews the SAS 70/SSAE-16 reports of all the outside service providers and follows up on any findings that are deemed material weaknesses.

**Current Findings – Government Auditing Standards**

**Finding 11-9 Noncompliance with Write-Off Policy**

**(Note: This finding is also reported in the Department-wide audit of the Illinois Student Assistance Commission)**

The Illinois Student Assistance Commission (Illinois Designated Account Purchase Program) was not in compliance with its non-cash write-off policy regarding the student loan receivable balances.

During our analysis of the Illinois Designated Account Purchase Program's (IDAPP) student loan receivable balance, we noted that IDAPP's current write-off policy requires the Loan Accounting department to write-off the loan balance within three business days of receiving the completed and approved write-off form. Three out of the three selections reviewed (100%) were not written-off within three business days, as required by the policy. They were written off 23 days from the date of receiving the completed and approved write-off form.

The Fiscal Control and Internal Auditing Act, 30 ILCS 10/3001 requires all State agencies to establish and maintain a system, or systems, of internal fiscal and administrative controls, which shall provide assurance that revenues, expenditures, and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the State's resources. Good internal controls include checks and balances to ensure policies established by management are followed.

According to IDAPP management, timeliness of the write-offs was the result of reductions in the workforce occurring within IDAPP.

Not posting the write-off within the required time period of three days could result in interest being inaccurately accrued on outstanding balances. Although individual write-off amounts were immaterial (an average of \$250), these amounts can accumulate throughout the year to a more significant amount. (Finding Code Nos. 11-9, 10-5)

**Recommendation**

We recommend that IDAPP improve its controls to ensure that accounting staff complies with current policy and procedures in place regarding the timing of the write-offs of student loan receivables.

**Commission Response**

We accept the recommendation.

IDAPP is reviewing its policies and procedures regarding the write-off of student loans. The policies and procedures will take into account the outsourcing of the loan servicing operations and the current number of employees.

Additionally, the agency's credit agreement with Citi Bank does not allow us to write off loans. IDAPP recognizes an allowance for uncollectible loans in its balance sheet instead of writing off student loans. This should not be a problem going forward.



**Current Findings – Government Auditing Standards**

**Finding 11-10 Debt Covenant Violation**

**(Note: This finding is also reported in the Department-wide audit of the Illinois Student Assistance Commission)**

The Illinois Student Assistance Commission (Illinois Designated Account Purchase Program) was not in compliance with two of the covenants relating to the Agency's revolving line of credit agreement.

During the audit of the Agency's June 30, 2009 financial statements, the Illinois Designated Account Purchase Program (IDAPP) management brought to our attention that they had potentially violated one of the covenants relating to the agency's revolving credit line (loan) agreement with a bank. The noncompliance pertained to the "Coverage condition ratio" covenant. According to the line of credit agreement with the bank, the "Forbearance Excess Amount", defined as the aggregate value of all eligible student loans that are subject to forbearance, is to be used in the calculation of the Coverage condition ratio covenant. When IDAPP completed the report created by the bank, and as instructed by the bank, the report produced an inaccurate calculation of the amount for the loans in forbearance. Once the error was discovered and the Coverage condition ratio was recalculated, it resulted in noncompliance with the Coverage condition ratio by IDAPP. The minimum Coverage condition ratio required by the line of credit agreement is 104% and the current ratio as of June 30, 2011 was 102%.

During our audits of the Agency's June 30, 2010 and 2011 financial statements, we noted that IDAPP was in violation of the same covenant noted above. In addition, the Agency was in violation of another covenant, the "Default ratio." According to the line of credit agreement with the bank, the Default ratio is defined as "the annualized percentage of the aggregate principal balance of all student loans which have become defaulted pledged student loans during the settlement period divided by the weighted average principal balance of all pledged student loans during such settlement period." IDAPP is required to maintain a maximum Default ratio of 6.25%. As of June 30, 2011, IDAPP's Default ratio was 13.39%, resulting in noncompliance with the Default ratio by IDAPP.

As a result of the violation, the bank has certain remedies available to it under the terms of the loan agreement, principal of which would be rights to call the loan and take possession of the collateral (the underlying student loan portfolio). The bank has been made aware of the event of default and has not communicated to IDAPP any intent to exercise the remedies available to it under the terms of the loan agreement. Management believes the bank would have little incentive to call the line of credit and begin servicing the student loans itself, particularly because IDAPP has made all of its required payments in a timely fashion. The balance of the line of credit with the bank was \$314,456,827 at June 30, 2011.

According to IDAPP management, the noncompliance with the Coverage condition ratio and the Default ratio is due to the increased level of delinquent accounts in the portfolio. The level has increased due to the poor global economic conditions.

Failure to comply with debt covenants could result in the debt becoming due and payable in advance of scheduled retirement dates. As a result of the violation, the bank may have certain remedies under the terms of the loan agreements, principal of which would be the right to call the loan and take possession of the collateral (the underlying student loan portfolio of IDAPP). (Finding Code Nos. 11-10, 10-6, 09-1)

**Current Findings – *Government Auditing Standards***

**Finding 11-10 Debt Covenant Violation (Continued)**

**Recommendation**

We recommend that IDAPP continue to monitor the loan covenant violations and continue seeking remedies from the lender involved.

**Commission Response**

We accept the recommendation.

IDAPP will continue to monitor these loan covenants. Commission management has been in constant communication with the lender and is working with them to resolve the violations and to refinance the facility.

**Prior Finding Not Repeated**

**A. Noncompliance with Investment Policy**

**(Note: This prior finding not repeated is also reported in the Department-wide audit of the Illinois Student Assistance Commission.)**

The Illinois Student Assistance Commission (Illinois Designated Account Purchase Program) invested in a money market mutual fund with holdings in securities not permitted by its investment policy. (Finding Code No. 10-4)

The non-compliant investment was sold and the funds moved into a compliant investment on December 16, 2010. No noncompliant investments were noted during fiscal year 2011 audit testing.