

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

Financial Audit  
For the Year Ended June 30, 2012

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, 2012**

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

**Agency Officials**

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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
Chief Financial Officer	Shoba Nandhan
Deputy Chief Financial Officer	Brian Begrowicz
General Counsel	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**

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**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 LLP.

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

**Summary of Findings**

The auditors identified a matter involving IDAPP's internal control over financial reporting that they considered to be a significant deficiency. The significant deficiency is described in the accompanying schedule of findings listed in the table of contents as finding 12-1 (Budget Not Properly Approved).

The auditors also identified an instance of noncompliance or other matter. The instance of noncompliance or other matter is described in the accompanying schedule of findings listed in the table of contents as finding 12-2 (Debt Covenant Violation).

**Exit Conference**

In correspondence received from Shoba Nandhan, Chief Financial Officer, on November 29, 2012 the Commission elected to waive a formal exit conference. The responses to the recommendations were provided by Shoba Nandhan in correspondence dated December 19, 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 Fund of the State of Illinois, Illinois Student Assistance Commission as of and for the year ended June 30, 2012, 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 State of Illinois, Illinois Student Assistance Commission'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, 2012, 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 Fund of the State of Illinois, Illinois Student Assistance Commission, as of June 30, 2012, 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.

As discussed in Note 9, the Commission is in default of certain conditions of its Revolving Credit Facility.

In accordance with *Government Auditing Standards*, we have also issued a report dated February 7, 2013 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 Fund and our tests of the State of Illinois, Illinois Student Assistance Commission's 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.

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America requires to be presented to supplement the fund financial statements. Such missing information, although not a required part of the fund financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the fund financial statements in an appropriate operational, economic or historical context. Our opinion on the fund financial statements is not affected by this missing information.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Illinois Designated Account Purchase Program Fund 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 fund financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the fund financial statements. The schedule of bonds outstanding has been subjected to the auditing procedures applied in the audit of the fund financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the fund financial statements or to the fund financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of bonds outstanding is fairly stated in all material respects in relation to the fund financial statements as a whole.

*McGladrey LLP*

Schaumburg, Illinois  
February 7, 2013

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

**Statement of Net Assets**  
**June 30, 2012**

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**Assets**

Current assets - unrestricted	
Cash and cash equivalents	\$ 9,356,017
Investments	6,996,631
Total current assets - unrestricted	<u>16,352,648</u>
Current assets - restricted	
Cash and cash equivalents	48,672,332
Receivables	
Student loans, net of allowance of \$5,978,437	113,317,359
Accrued interest - loans	15,208,460
Accrued interest - investments	4,046
Other	171,454
Due from other ISAC funds	180,600
Total current assets - restricted	<u>177,554,251</u>
Noncurrent assets - unrestricted	
Depreciated capital assets, net	<u>3,721</u>
Noncurrent assets - restricted	
Receivables	
Student loans, net of allowance of \$36,724,684	696,092,349
Unamortized debt issuance costs	6,014,832
Total noncurrent assets - restricted	<u>702,107,181</u>
Total assets	<u>896,017,801</u>

(Continued)

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

**Statement of Net Assets (Continued)  
June 30, 2012**

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**Liabilities**

Current liabilities

Accounts payable and accrued expenses	\$	616,565
Accrued interest payable		1,523,226
Federal special allowance and interest subsidy		2,174,257
Due to other ISAC funds		3,395,892
Compensated absences		20,270
Revolving credit line		275,956,827
Total current liabilities		<u>283,687,037</u>

Noncurrent liabilities

Compensated absences		182,430
Revenue bonds and notes payable, net		590,703,859
Total noncurrent liabilities		<u>590,886,289</u>

Total liabilities		<u>874,573,326</u>
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**Net Assets**

Invested in capital assets		3,721
Restricted for debt service		9,303,263
Unrestricted		<u>12,137,491</u>
Total net assets	\$	<u>21,444,475</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, 2012**

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Operating revenues	
Investment income	
Interest - student loans	\$ 35,201,108
Interest - investments	342,966
Fees	717,271
Total operating revenues	<u>36,261,345</u>
Operating expenses	
Interest and other student loan expenses	
Interest expense	
Student loan revenue bonds and notes	6,097,353
Amortization of loan premiums and fees	2,586,309
Other student loan fees	2,429,385
Provision for loan losses	15,475,241
Other operating expenses	
Salaries and employee benefits	1,805,715
External loan servicing	2,141,343
Legal fees	47,473
Occupancy	1,810
Management and professional services	1,522,529
Depreciation	7,438
Other	231,924
Total operating expenses	<u>32,346,520</u>
Operating income	3,914,825
Nonoperating expenses	
Federal special allowance and interest subsidy and excess interest expense (Note 5)	<u>(9,421,893)</u>
Change in net assets	(5,507,068)
Net assets, July 1, 2011	<u>26,951,543</u>
Net assets, June 30, 2012	<u><u>\$ 21,444,475</u></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, 2012**

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Cash flows from operating activities	
Cash payments to suppliers for goods and services	\$ (5,253,158)
Cash payments to employees for services	(1,826,347)
Cash receipts from other operating activities (student loans and fees)	157,575,784
Cash payments for other operating activities (student loans)	<u>(9,818,904)</u>
Net cash provided by operating activities	<u>140,677,375</u>
 Cash flows from noncapital financing activities	
Principal paid on revenue bonds and other borrowings	(147,997,000)
Interest paid on revenue bonds and other borrowings	(9,308,694)
Federal special allowance and interest subsidy	<u>(9,788,321)</u>
Net cash used for noncapital financing activities	<u>(167,094,015)</u>
 Cash flows from investing activities	
Interest received from investment securities	214,640
Purchase of investment securities	(8,000,266)
Proceeds from sale and maturities of investment securities	<u>24,857,932</u>
Net cash provided by investing activities	<u>17,072,306</u>
 Net decrease in cash and cash equivalents	(9,344,334)
 Cash and cash equivalents, July 1, 2011	<u>67,372,683</u>
 Cash and cash equivalents, June 30, 2012	<u><u>\$ 58,028,349</u></u>
 Reported as:	
Current - unrestricted	\$ 9,356,017
Current - restricted	<u>48,672,332</u>
	<u><u>\$ 58,028,349</u></u>

(Continued)

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

**Statement of Cash Flows (Continued)**  
**Year Ended June 30, 2012**

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Reconciliation of operating income to net cash provided by operating activities	
Operating income	\$ 3,914,825
Adjustments to reconcile operating income to net cash provided by operating activities	
Depreciation	7,438
Interest - investments	(342,966)
Interest expense	6,097,353
Provision for loan losses	15,475,241
Amortization of student loan premiums and fees	2,586,309
Change in assets and liabilities	
Notes receivable	
Accounts receivable	
Student loans	112,378,711
Accrued interest - loans and notes	2,000,729
Due from other ISAC funds	(179,264)
Other receivables	(171,455)
Accounts payable and accrued expenses	86,349
Due to other State funds and component units	(1,155,262)
Compensated absences	(20,633)
Net cash provided by operating activities	<u>\$ 140,677,375</u>
Supplemental disclosure of noncash transactions	
Net appreciation in fair value of investments	<u>\$ 251,284</u>

See Notes to Financial Statements.

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

**Notes to Financial Statements**

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**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 a servicer of student loans. As such, designation of the governing authority is 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 generally accepted accounting principles (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**

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**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, 2012, and changes in their 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. A proprietary fund type records 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, 2012.

**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**

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**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**

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 shown as an operating expense, 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 4.

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**

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**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 debt indentures or resolutions or are pledged as security in support of debt 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, which approximates the effective interest rate 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**

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**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. 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 debt 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.



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

**Notes to Financial Statements**

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

**C. Investments**

The State Treasurer 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. Amounts in the custody of the State Treasurer totaled \$3,273 at June 30, 2012. These funds 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. Funds held by the State Treasurer are not rated for credit risk and the interest rate risk cannot be determined because the weighted average maturity information for these amounts is not available for individual funds. Details on the nature of these deposits and investments are available within the State of Illinois' Comprehensive Annual Financial Report.

**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 documents applicable to bonds and other securities issued by ISAC. The portfolio's maturity characteristics at June 30, 2012 are as follows:

Investment Type	Fair Value	Weighted Average Maturity (Years)
Government Securities (U.S. Treasury Bills)	\$ 6,996,631	0.7

**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, 2012, 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
Money Market Funds	\$ 49,183,222	AAAm	Aaa

**State of Illinois  
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**Notes to Financial Statements**

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**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 has no investments subject to custodial credit risk at June 30, 2012.

**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, 2012, there were no investments that exceed 5% or more of IDAPP's total investment portfolio.

**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 is not exposed to foreign currency risk and, therefore, IDAPP's investment policy does not address foreign currency risk.

**State of Illinois  
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**Notes to Financial Statements**

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**Note 4. 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 is \$1,729,978 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, 2012.

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 \$262,023,582 at June 30, 2012. Of this amount, \$37,798,020 was over 120 days old.

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 \$42,703,121 as of June 30, 2012, which includes the amount collected from borrowers as an insurance fee for the Alternative Loans.

**State of Illinois  
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**Notes to Financial Statements**

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**Note 4. Student Loans Receivable (Continued)**

**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, 2012 as reported by ISAC was \$36,351,769. Restricted net assets, which includes \$30,076,325 of claims in process, was \$42,569,244. If the federal reinsurance percentage were temporarily reduced from 97% 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. 3% to 25%) of the IDAPP's net FFELP student loans receivable of \$587,448,972 at June 30, 2012 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 5. Federal Special Allowance and Interest Subsidy**

The Federal government pays IDAPP (interest subsidy) or IDAPP owes the federal government (excess interest) an interest amount 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, 2012 was \$2,174,257.

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	\$ 3,618,896
Special Allowance Payments (Interest Subsidy)	227,584
Excess Interest	<u>(13,268,373)</u>
Net Expense Incurred to ED	<u>\$ (9,421,893)</u>

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**Notes to Financial Statements**

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**Note 6. Interfund Balances and Activity**

**Balances Due from/to Other Funds**

The following balance at June 30, 2012 represents amounts due from other ISAC funds.

Fund	Amount	Description/Purpose
Illinois Prepaid Tuition Program	\$ 175,000	Expense reimbursement - collection of these funds is anticipated in fiscal year 2013.
ISAC - Student Loan Operating	5,600	Due from Student Loan Operating Fund for Know How 2 Go program expense reimbursement.
	<u>\$ 180,600</u>	

The following balance at June 30, 2012 represents amounts due to other ISAC funds.

Fund	Amount	Description/Purpose
Student Loan Operating Fund	<u>\$ 3,395,892</u>	Shared services

**Note 7. Capital Assets**

Capital asset activity for the year ended June 30, 2012 was as follows:

	Equipment	Accumulated Depreciation	Capital Assets, Net
Balance, July 1, 2011	\$ 529,194	\$ (518,035)	\$ 11,159
Additions	-	(7,438)	(7,438)
Deletions	(97,274)	97,274	-
Balance, June 30, 2012	<u>\$ 431,920</u>	<u>\$ (428,199)</u>	<u>\$ 3,721</u>

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**Notes to Financial Statements**

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**Note 8. 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 maximum rate at June 30, 2012 was 1.33%.

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. 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. The remaining balance of bonds outstanding issued under the resolutions is \$19,450,000 as of June 30, 2012.

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 all of the student loan revenues from the underlying portfolio. The total principal and interest remaining to be paid on the bonds is approximately \$27.9 million.

Interest paid for the current year was approximately \$0.2 million and total related student loan principal and interest received were approximately \$2.9 million and \$0.4 million, respectively.

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 remaining 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.

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**Notes to Financial Statements**

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**Note 8. 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. \$9,500,000 of the bonds were redeemed during the fiscal year. The remaining balance of bonds outstanding is \$40,500,000 as of June 30, 2012. 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 \$43.1 million. Interest paid for the current year was approximately \$1.6 million and total related student loan principal and interest received were approximately \$5.3 million and \$0.7 million, respectively.

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 92.9% percent of these student loan collections. The total principal and interest remaining to be paid on the bonds is approximately \$475 million. Principal and interest paid for the current year were approximately \$85.0 million and \$6.8 million, respectively. Total related student loan principal and interest received were approximately \$92.5 million and \$13.6 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 during fiscal year 2011, a deferred amount on refunding of \$70,320,074 was recorded. This amount is being amortized over the weighted average life of the LIBOR Floating Rate Notes of 16 years. The portion attributable to fiscal year 2012 is \$4,418,013. Amortization is included as a reduction of interest expense on the Statement of Revenues, Expenses, and Changes in Fund Net Assets.

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**Notes to Financial Statements**

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**Note 8. Long-Term Obligations Payable (Continued)**

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

Changes in long-term obligations payable for the year ended June 30, 2012 were as follows:

	Balance July 1, 2011	Additions	Deletions	Balance June 30, 2012	Amounts Due Within One Year
Compensated absences payable	\$ 223,333	\$ 118,681	\$ (139,314)	\$ 202,700	\$ 20,270
Revenue bonds/notes payable	644,645,000	-	(109,497,000)	535,148,000	-
Unamortized discounts	(7,367,753)	-	335,064	(7,032,689)	-
Unamortized deferred amount on refunding	67,006,561	-	(4,418,013)	62,588,548	-
	<u>\$ 704,507,141</u>	<u>\$ 118,681</u>	<u>\$ (113,719,263)</u>	<u>\$ 590,906,559</u>	<u>\$ 20,270</u>

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

IDAPP issued bonds and notes to provide funds for student loan originations and purchases. IDAPP pledges the income derived from its assets to pay debt service. The majority of IDAPP's outstanding revenue bonds and notes are comprised of variable rate debt. As such, the interest figures shown are calculated assuming the interest rate in effect on June 30, 2012. Actual interest paid in future years could be materially different.



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Notes to Financial Statements

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**Note 8. Long-Term Obligations Payable (Continued)**

Annual debt service requirements to maturity for revenue bonds and notes are as follows (amounts in thousands):

Year Ending June 30	Principal	Interest	Total
2013	\$ -	\$ 8,208	\$ 8,208
2014	40,500	8,208	48,708
2015	-	6,932	6,932
2016	-	6,932	6,932
2017	52,198	6,842	59,040
2018-2022	269,000	31,447	300,447
2023-2027	-	11,809	11,809
2028-2032	-	11,809	11,809
2033-2037	-	11,809	11,809
2038-2042	100	11,809	11,909
2043-2045	173,350	5,033	178,383
	<u>535,148</u>	<u>\$ 120,838</u>	<u>\$ 655,986</u>
Plus (minus):			
Unamortized discounts	(7,033)		
Unamortized deferred amount on refunding	<u>62,589</u>		
Net long-term principal outstanding	<u>\$ 590,704</u>		

**State of Illinois  
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**Notes to Financial Statements**

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**Note 9. 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, 2012 was 0.23875%.

On July 27, 2010, the Facility became due and payable. Due to conditions currently existing in the credit markets, ISAC has been unable to refinance this debt and is currently in default under the Facility. 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. Citibank has not exercised its remedies to date. Conversations are ongoing with Citibank to resolve the issues mentioned.

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 2012 there was approximately \$32.5 million in principal and \$8.8 million in interest collected all of which was transferred to the trust. During the same period the trust paid \$1.9 million for interest expense and other professional fees and \$2.1 million for servicing fees.

Changes in the revolving credit line is as follows:

	Balance, July 1, 2011	Borrowings	Repayments	Balance, June 30, 2012	Amounts Due Within One Year
Citibank	\$ 314,456,827	\$ -	\$ (38,500,000)	\$ 275,956,827	\$ 275,956,827

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**Notes to Financial Statements**

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**Note 10. 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 2012 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2012. 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 2012, 2011 and 2010 were \$380,338, \$474,235 and \$1,081,869, respectively. For fiscal years 2012, 2011 and 2010, the employer contribution rate was 34.2%, 28.0% and 28.4%, respectively.

**Note 11. 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.

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**Notes to Financial Statements**

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**Note 11. 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 12. 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, 2012.

**Note 13. 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. 65, *Items Previously Reported as Assets and Liabilities* establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term "deferred" in financial statement presentations. The Commission is required to implement this Statement for the year ending June 30, 2014.

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**Notes to Financial Statements**

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**Note 13. New Governmental Accounting Standards (Continued)**

Statement No. 66, *Technical Corrections – 2012 – an amendment of GASB Statements No. 10 and No. 62* was established to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This Statement amends Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type. This Statement also amends Statement 62 by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. The Commission is required to implement this Statement for the year ending June 30, 2014.

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.

**Note 14. Subsequent Event**

**Loan Sale and Bond Redemption/Defeasance**

ISAC completed a competitive bidding process to sell certain FFELP student loan portfolios and entered into loan sale agreements with Educational Services of America, Inc. and SLM Education Credit Finance Corporation on November 16, 2012. The two parties purchased loans with a principal amount of \$50,027,771 plus accrued interest of \$690,763. The average sales price of \$98.65 resulted in a discount of \$666,793. The proceeds of the sale and available cash on hand were used to redeem/defeas two outstanding bond issues. The \$40,500,000 of Student Loan Revenue Bonds, Series 2009 (state guaranteed) were redeemed on December 3, 2012 at par plus accrued interest. The \$19,450,000 of Student Loan Revenue Bonds, Series II and Series VIII and IX were defeased on December 3, 2012 with a redemption date of December 13, 2012. The bonds were redeemed at par plus accrued interest.

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**Schedule of Bonds Outstanding  
 June 30, 2012**

A summary of bonds and notes outstanding at June 30, 2012 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	(249,900,000)	(350,000,000)	(250,000,000)	(580,650,000)	(9,500,000)
Unamortized Deferred Amount on Refunding	-	-	-	-	-
Unamortized discount	(497)	-	-	(47,432)	(102,569)
Balance at June 30, 2012	\$ 99,503	\$ -	\$ -	\$ 19,302,568	\$ 40,397,431
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, 2012 variable interest rates were 1.330% for taxable auction rate securities debt and .94565%, 1.51565% and 1.36565% for the LIBOR FRN Class A-1, A-2 and A-3, 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
(128,802,000)	-	-	Principal retirements	(1,568,852,000)
18,755,840	27,874,701	15,958,007	Unamortized Deferred Amount on Refunding	62,588,548
-	-	(6,882,191)	Unamortized discount	(7,032,689)
<u>\$ 70,953,840</u>	<u>\$ 296,874,701</u>	<u>\$ 163,075,816</u>	Balance at June 30, 2012	<u>\$ 590,703,859</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>590,703,859</u>
			Total debt outstanding	<u>\$ 590,703,859</u>
Varies	Varies	Varies		
Wells Fargo Minneapolis, MN	Wells Fargo Minneapolis, MN	Wells Fargo Minneapolis, MN		
At issuance 100%	At issuance 100%	At issuance 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 Fund of the State of Illinois, Illinois Student Assistance Commission (Commission), as of and for the year ended June 30, 2012 and have issued our report thereon dated February 7, 2013. That report contains an emphasis of a matter paragraph which states "As discussed in Note 9, the Commission is in default of certain conditions of its Revolving Credit Facility." 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 Fund as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but 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.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined above. However, we identified a certain deficiency described in the accompanying schedule of findings as item 12-1 that we consider to be a significant deficiency in internal control over financial reporting. 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.



## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Illinois Designated Account Purchase Program Fund of the State of Illinois, Illinois Student Assistance 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 an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings as finding 12-2.

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 LLP*

Schaumburg, Illinois  
February 7, 2013

**Current Findings – Government Auditing Standards**

**Finding 12-1 Budget Not Properly Approved**

**(Note: This finding is also presented in the audit of the Illinois Prepaid Tuition Program and the Department-wide audit of the Illinois Student Assistance Commission)**

The Illinois Student Assistance Commission (Commission) did not approve the fiscal year 2012 budget relating to the Commission's non-appropriated funds and did not deliberate and vote on budget requests submitted to the General Assembly for appropriations relating to the appropriated funds of the Commission.

During our audit, we noted that the annual operating budgets for fiscal year 2012 for the Commission's non-appropriated funds, the Illinois Prepaid Tuition Program (IPTP) and the Illinois Designated Account Purchase Program (IDAPP), were not approved by the Board of Commissioners. In addition, budget requests that were submitted to the General Assembly for appropriation for fiscal year 2012 were not deliberated and voted on by the Board of Commissioners.

The Illinois Administrative Code (2 Ill. Adm. Code 5375.210j) requires the Board of Commissioners to deliberate and vote on the operating budgets for IPTP and IDAPP. In addition, the Illinois Administrative Code requires that budget requests for appropriations submitted to the General Assembly are deliberated and voted on by the Board of Commissioners.

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 a formal and effective budgeting process to ensure an entity's objectives and goals are met.

According to Commission management, effective July 2011, ISAC's Commission members were all newly appointed. The fiscal year 2012 budget was presented to the Commission at its meeting on July 8, 2011. Since the members were all new, the budget was treated as an information item and action was not taken to approve the budget.

The ability to budget effectively is very critical for any entity. A budget can be useful in setting standards of performance, motivating board members and employees, and providing a tool to measure results of the different operations of the Commission. Preparing, approving and monitoring budgets will better enable the Commission to monitor its operations to ensure expenditures are in accordance with the Commission's mission and purpose. (Finding Code No. 12-1)

**Recommendation**

We recommend the Commission approve the annual budget for non-appropriated funds and the budget request to be submitted to the General Assembly for appropriated funds that are prepared by management.

**Finding 12-1 Budget Not Properly Approved (Continued)**

**Commission Response**

ISAC agrees with the recommendation.

The budget for 2012 was not approved by the Commission because the Commission members were newly appointed. The budget was presented but was treated as an information item and no action was taken to approve the budget.

ISAC has already implemented the recommended corrective action. The fiscal year 2013 budget for the agency, including the budgets for IPTP and IDAPP were approved by the Commission at its meeting on June 25, 2012. The budget request to be submitted to the General Assembly for appropriation for fiscal year 2014 was presented as an information item at the November Commission Meeting and will be presented to the Board of Commissioners at the January 2013 meeting as an action item for their approval.

**Finding 12-2 Debt Covenant Violation**

**(Note: This finding is also presented 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 discovered 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, 2012 was 101.30%.

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, 2012, IDAPP's Default ratio was 8.36%, 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 \$275,956,827 at June 30, 2012.

According to Commission management, the coverage condition and default issues are 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. 12-2, 11-10, 10-6, 09-1)

**Recommendation**

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

**Finding 12-2 Debt Covenant Violation (Continued)**

**Commission Response**

ISAC agrees with the recommendation. IDAPP will continue to monitor these loan covenants and will work with our external servicers to try to bring the coverage condition and default ratios back into compliance.

This credit facility matured on July 27, 2010. Due to the tight credit markets for student loans and the performance of the portfolio, neither Citibank nor ISAC have been able to refinance the facility. ISAC management has been in regular contact with the lender and continues to explore options on the refinancing. At this time however, there are no imminent plans to refinance the facility.

### **Prior Findings Not Repeated**

**(Note: Prior findings not repeated A-E are reported in the Illinois Student Assistance Commission - Illinois Prepaid Tuition Program financial audit. Those prior findings not repeated A-E and the prior findings not repeated F-I that follow in this report are also reported in the Department-wide audit of the Illinois Student Assistance Commission.)**

### **F Competitive Procurement Requirements Not Followed**

The Illinois Student Assistance Commission (Illinois Designated Account Purchase Program) did not comply with certain competitive procurement requirements of the Illinois Procurement Code. (Finding Code No. 11-6)

The Commission has strengthened its procurement process by adding additional levels of review, as well as filled key management positions. No exceptions were noted regarding noncompliance with procurement laws during fiscal year 2012 sample audit testing.

### **G Financial Reporting Process**

The Illinois Student Assistance Commission (Illinois Designated Account Purchase Program) did not have sufficient control over financial reporting. (Finding Code Nos. 11-7, 10-2, 09-3, 08-5)

Based on our review of the draft financial statements for fiscal year 2012 provided by the Illinois Designated Account Purchase Program, we did not note any significant errors or omissions relating to reporting or disclosures in the draft financial statements.

### **H Student Loan Payments Not Processed Correctly**

The Illinois Student Assistance Commission (Illinois Designated Account Purchase Program) did not properly apply student loan payments to principal and interest. (Finding Code Nos. 11-8, 10-3)

This issue was resolved with the external service organization utilized by the Illinois Designated Account Purchase Program (IDAPP) during fiscal year 2012. The resulting adjustment was recorded by IDAPP in the current fiscal year. We noted no exceptions with the application of student loan principal and interest during fiscal year 2012 sample audit testing.

### **I Noncompliance with Write-Off Policy**

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. (Finding Code Nos. 11-9, 10-5)

No exceptions were noted in this area during fiscal year 2012 sample audit testing.