State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

Financial Audit
For the Year Ended June 30, 2010

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

State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program
Financial Audit
For the Year Ended June 30, 2010

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State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

Agency Officials

Executive Director	Andrew Davis
Chief Financial Officer	John Sinsheimer
Interim Chief Financial Officer (10/16/2009 to Current)	Shoba Nandhan
General Counsel	Kim Barker Lee

Agency offices are located at:

1755 Lake Cook Road
Deerfield, IL 60015-5209

500 West Monroe
Springfield, IL 62704

100 West Randolph
Suite 3-200
Chicago, IL 60601

State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

Financial Statement Report

Summary

The audit of the accompanying financial statements of the Illinois Prepaid Tuition Program of the State of Illinois, Illinois Student Assistance Commission (Program) was performed by McGladrey &l Pullen, LLP.

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

Summary of Findings

The auditors identified matters involving the Program's internal control over financial reporting that they considered to be a material weakness. The material weakness is described in the accompanying schedule of findings listed in the table of contents as finding 10-1 (Procurement Law and Sound Business Practices Not Followed).

Exit Conference

The findings and recommendations appearing in this report were discussed with Program personnel at an exit conference on March 8, 2011. Attending were:

Illinois Student Assistance Commission	
Andrew Davis	Executive Director
Shoba Nandhan	Chief Financial Officer
Karen Salas	Interim General Counsel
Anita Geter	Director-Internal Audit
Brian Begrowicz	Deputy Chief Financial Officer
Frank Berauer	Director, Accounting and Finance-IDAPP
Anne Hunter	Assistant Comptroller
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 11, 2011.

McGladrey

Independent Auditors' Report

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

Mr. Donald J. McNeil
Honorable Chairman 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 Prepaid Tuition Program of the State of Illinois, Illinois Student Assistance Commission as of and for the year ended June 30, 2010, 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 Prepaid Tuition 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, 2010, and its 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 further discussed in Note 10, the Illinois Prepaid Tuition Program has a deficit as of June 30, 2010 of $338 million.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Illinois Prepaid Tuition Program of the State of Illinois, Illinois Student Assistance Commission, as of June 30, 2010, and the 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 Prepaid Tuition 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 14, 2011 on our consideration of the State of Illinois, Illinois Student Assistance Commission's internal control over financial reporting of the Illinois Prepaid Tuition Program and on 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.

McGladrey & Pullen, LLP

Schaumburg, Illinois
March 14, 2011

State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

Statement of Net Assets
June 30, 2010

Assets	
Current	
Cash and cash equivalents	$ 14,808,663
Receivables:	
Accrued interest on investments	1,272
Total current assets	14,809,935
Noncurrent	
Investments	971,480,836
Total assets	986,290,771
Liabilities	
Current	
Accounts payable and accrued expenses	947,238
Tuition payable	68,490,000
Accreted tuition payable	6,510,000
Due to State of Illinois component units	97,894
Compensated absences	14,898
Total current liabilities	76,060,030
Noncurrent	
Tuition payable	845,947,224
Accreted tuition payable	402,082,515
Compensated absences	89,039
Total noncurrent liabilities	1,248,118,778
Total liabilities	1,324,178,808
Net assets, unrestricted (deficit)	$ (337,888,037)

See Notes to Financial Statements.

State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

Statement of Revenues, Expenses, and Changes in Net Assets
Year Ended June 30, 2010

Operating revenues:	
Income from investment securities	$ 88,599,291
Interest revenue - other	179,032
Fees	1,470,094
Net operating revenues	90,248,417
Operating expenses:	
Salaries and employee benefits	3,347,593
Accreted tuition expenses	76,596,924
Management and professional services	2,965,427
Investment management fees	1,609,519
Investment advisory fees	1,926,058
Total operating expenses	86,445,521
Operating income	3,802,896
Transfer - out	(31,300)
Change in net assets	3,771,596
Net assets (deficit), July 1, 2009	(341,659,633)
Net assets (deficit), June 30, 2010	$ (337,888,037)

See Notes to Financial Statements.

State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

Statement of Cash Flows
Year Ended June 30, 2010

Cash flows from operating activities	
Cash receipts from prepaid tuition contracts	$ 100,007,771
Cash received from fees	1,470,094
Cash paid for refund of contracts	(10,299,863)
Cash paid for tuition and accretion	(65,129,152)
Cash payments to suppliers for goods and services	(2,631,765)
Cash payments to employees for services	(3,339,051)
Net cash provided by operating activities	20,078,034
Cash flows from noncapital financing activities	
Transfer out	(31,300)
Cash flows from investing activities	
Purchase of investment securities	(773,523,563)
Sales and maturities of investment securities	684,617,457
Cash returned for securities lending collateral transactions	(77,663,481)
Investments sold from securities lending collateral transactions	77,663,481
Interest and dividends on investments	23,946,006
Cash paid to investment managers	(1,609,519)
Net cash used in investing activities	(66,569,619)
Net decrease in cash and cash equivalents	(46,522,885)
Cash and cash equivalents, July 1, 2009	61,331,548
Cash and cash equivalents, June 30, 2010	$ 14,808,663

(Continued)

State of Illinois
Illinois Student Assistance Commission
Illinois Prepaid Tuition Program

Statement of Cash Flows (Continued)
Year Ended June 30, 2010

Reconciliation of operating income to net cash provided by operating activities:	
Operating income	$ 3,802,896
Adjustments to reconcile operating income to net cash provided by operating activities:	
Investment income and other interest income	(88,778,323)
Investment management fees	1,609,519
Investment advisory fees	1,926,058
Accreted tuition expense	76,596,924
Increase (decrease) in liabilities:	
Accounts payable and accrued expenses	309,144
Due to other State funds	(88,481)
Due to State of Illinois component units	85,063
Tuition payable	24,578,756
Compensated absences	36,478
Total adjustments	16,275,138
Net cash provided by operating activities	$ 20,078,034
Supplemental disclosure of noncash investing transactions:	
Net appreciation in fair value of investments	$ 146,485,299

See Notes to Financial Statements.

Note 1. Description of Program

The Illinois Student Assistance Commission (ISAC) administers the nonshared proprietary fund, Illinois Prepaid Tuition Program (*College Illinois!*®) 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.

Legislation authorizing ISAC to administer an Illinois Prepaid Tuition Program was passed in November 1997. The Illinois Prepaid Tuition Program is administered by ISAC with advice and counsel from an investment advisory panel consisting of seven members appointed by ISAC. The purpose of this program is to provide Illinois families with an affordable tax-advantaged method to pay for college. Illinois Prepaid Tuition contracts will allow participants to prepay the cost of tuition and mandatory fees at Illinois public universities and community colleges at current program prices, which are significantly less than projected future college costs. Benefits of the contracts can also be used at private and out-of-state colleges and universities. Contracts can be purchased in a lump sum payment or in installments.

The first contracts were offered for sale in 1998. After twelve enrollment periods, as of June 30, 2010, the Illinois Prepaid Tuition Program had 54,900 contracts in force with a purchased value of $1,566 million. As of June 30, 2010, the fund has received cash collections of $1,142 million.

The Illinois Prepaid Tuition Program Fund is a non-appropriated fund.

Note 2. Summary of Significant Accounting Policies

The financial statements of the Illinois Prepaid Tuition Program 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.

Based upon the required criteria, the Illinois Prepaid Tuition Program does not have component units, nor is it a component unit of any other entity. However, because the Illinois Prepaid Tuition Program is not legally separate from the State of Illinois, 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.

Note 2. Summary of Significant Accounting Policies - Continued

A. Reporting Entity - Continued

The financial statements present only the Illinois Prepaid Tuition Program administered by the State of Illinois, Illinois Student Assistance Commission (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, 2010, and changes in financial positions and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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 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 net assets, and statement of cash flows have been presented for the Illinois Prepaid Tuition Program administered by ISAC.

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 the Illinois Prepaid Tuition Program activities, income from investments is considered an operating activity in the Statement of Revenues, Expenses, and Changes in Net Assets. Nonoperating revenues and expenses result from non-exchange transactions or ancillary activities.

C. Basis of Accounting

The Illinois Prepaid Tuition Program 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. The fund accounts for resources received and used for financing self-supporting activities of the Illinois Prepaid Tuition Program that offers services on a user-charge basis to the general public.

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. The State also has the option of following subsequent private-sector guidance for their enterprise funds, subject to this same limitation. The State has elected not to follow subsequent private-sector guidance as it relates to the Program’s operations.

D. Cash and Cash Equivalents

Cash and cash equivalents consist principally of deposits held in the State Treasury. Cash and cash equivalents include cash on hand, cash in banks, interest bearing deposits with banks, and securities with maturities at the date of purchase of 90 days or less.

Note 2. Summary of Significant Accounting Policies - Continued

E. Investments

The Illinois Prepaid Tuition Program presents investments on its Statement of Net Assets at fair value. The net appreciation or depreciation in the fair value of investments is included in investment income in the Statement of Revenues, Expenses, and Changes in Net Assets. The investments are classified as noncurrent, as current cash flows cover payments for the program and the program has no plan to withdraw investments in the near future.

F. Interfund Transactions

The Illinois Prepaid Tuition Program 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.

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.

Transfers—flows of assets (such as cash or goods) without equivalent flow of assets in return and without a requirement for repayment. Transfers are reported after nonoperating revenues and expenses.

G. Compensated Absences

The liability for compensated absences reported in the Illinois Prepaid Tuition Program consists of unpaid, accumulated vacation and sick leave balances for Illinois Prepaid Tuition Program employees. The liability has been calculated using the vesting method in which leave amounts for both employees that 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.

Note 2. Summary of Significant Accounting Policies - Continued

H. Tuition Payable

Tuition payable in the Illinois Prepaid Tuition Program represents the net principal payments received for the 54,900 contracts held by the fund as of June 30, 2010.

I. Net Assets, Unrestricted (Deficit)

The program does not have any net assets that are restricted by outside parties or by law or through constitutional provisions or enabling legislation. As a result, all net assets are categorized as unrestricted.

J. 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.

K. Funding and Actuarial Assumptions

Program funding is derived entirely from payments received from contract purchasers and the investment income earned by the Fund. The Commission has obtained actuarial assistance in order to establish, maintain and certify assets sufficient to meet the Fund's obligations. The assets of the Fund are to be preserved, invested and expended solely pursuant to and for the purposes of the Fund and may not be loaned or otherwise transferred or used by the State of Illinois for any other purpose.

In the event the Commission, with the concurrence of the State of Illinois, determines the Illinois Prepaid Tuition Program to be financially infeasible, the Commission may discontinue, prospectively, the operation of the Illinois Prepaid Tuition Program. Any beneficiary who has been accepted by and is enrolled, or will within five years enroll, at an eligible institution shall be entitled to exercise the complete benefits of his/her contract. All other contract holders shall receive an appropriate refund of all contributions and accrued interest up to the time the Illinois Prepaid Tuition Program is discontinued.

Note 3. Deposits and Investments

A. Investment Authority and Legal Compliance

The State Treasury is the custodian of the State's cash and cash equivalents for the Illinois Prepaid Tuition Program maintained in the State Treasury. The investment authority for the State Treasury is found in the State Treasurer Act (15 ILCS 505), which authorizes the State of Illinois primary government and its component units to engage in a wide variety of investment activities. For further details please refer to the State of Illinois Comprehensive Annual Financial Report (CAFR). A copy of the CAFR can be obtained from the Illinois Office of the Comptroller at 325 West Adams, Springfield, Illinois 62704.

Note 3. Deposits and Investments - Continued

A. Investment Authority and Legal Compliance - Continued

The Illinois Prepaid Tuition Program independently manages cash and cash equivalents maintained outside the State Treasury. The Commission by statute (Illinois Prepaid Tuition Act, 110 ILCS 979) is required to appoint an investment advisory panel to offer advice and counseling regarding the investments of the Illinois Prepaid Tuition Program. The panel is required to annually review and advise the Commission on provisions of the strategic investment plan, which will specify the investment policies to be utilized by the Commission in the administration of the Illinois Prepaid Tuition Program.

The Commission may direct that assets of those Funds be placed in savings accounts or may use the same to purchase fixed or variable life insurance or annuity contracts, securities, evidence of indebtedness, or other investment products pursuant to the comprehensive investment plan and in such proportions as may be designated or approved under that plan.

Investment managers are hired who, by their record and experience have demonstrated their fiduciary responsibility, their investment expertise, their investment experience, and their capacity to undertake the mandate for which they are being considered. Investment managers retained for the Illinois Prepaid Tuition Program acknowledge in writing, a fiduciary relationship with respect to the Illinois Prepaid Tuition Program and need to be currently registered and maintain registration as an investment advisor under the Investment Advisors Act of 1940, a bank (as defined in the Act), or an insurance company qualified to perform investment management services under the law of more than one state unless otherwise approved on an exception basis. The Commission has established investment guidelines for the investment managers and conducts thorough due diligence before the appointment of all investment managers.

A qualified investment consultant, on an ongoing basis, evaluates the Illinois Prepaid Tuition Program. Written reports are provided to the Commission by the investment consultant no later than 45 days after the end of each calendar quarter. The investment consultant meets with the various investment managers on a regular basis to review the investment guidelines and analyzes the general liability structure of the Illinois Prepaid Tuition Program. They also assist the Commission and the Investment Advisory Panel with the selection of investment managers and custodians. The qualified investment consultant retained by the Commission is required to exercise discretion within the parameters set forth in the investment policy guidelines for the portfolio(s) they manage. Additionally, the program has contracted with Marquette Associates to evaluate the investment performance of the Illinois Prepaid Tuition Program on a quarterly basis.

In addition, the investment policy passed by the Commission on June 24, 2008 also authorized the Commission to make investment decisions within the bounds of financial and fiduciary prudence within asset classes that permit direct investments of Fund assets by the Commission. For direct investments the Chief Investment Officer of the agency obtains report(s), due diligence documents and a detailed analysis from an independent investment consultant or registered financial advisor, to ensure that the investments are consistent with the overall goals and objectives of the Fund.

The proposed investment is presented to and evaluated by the Investment Committee. With the approval of the Investment Committee, the Chief Investment Officer may then recommend the said investment to the Commission. The Commission is responsible for making the investment decision for the Fund.

Note 3. Deposits and Investments - Continued

A. Investment Authority and Legal Compliance - Continued

The Illinois Prepaid Tuition Program investment policy dictates certain guidelines and restrictions that apply to investments in domestic equities by the investment managers. The manager may only hold up to 5% of its portfolio in a money market and/or cash. The only exception to this rule is during trading activity, which can only be maintained for very short time periods, i.e. less than 30 days. Further, options, financial futures, private placements, restricted stock, issues related to the investment manager, or venture capital may not be purchased. The policy also prohibits the purchase of securities on margin and short selling. Also, investments cannot be made in securities not traded on a U.S. exchange or traded in U.S. dollars.

The investment policy authorizes the Commission to utilize a third party custodian 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 money market fund for re-deployment. The custodian retained by the Commission is required to exercise discretion within the parameters set forth in the investment policy guidelines for the portfolio(s) they manage on behalf of the Fund.

B. Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Illinois Prepaid Tuition Program's deposits may not be returned to it. State law (30 ILCS 230/2C) requires that all deposits of public funds be covered by FDIC insurance or eligible collateral. The Illinois Prepaid Tuition Program has no policy that would further limit the requirements under State law. As of June 30, 2010, the Illinois Prepaid Tuition Program's locally held deposits were not exposed to custodial credit risk.

The State Treasurer is the custodian of the State's cash and cash equivalents for the Illinois Prepaid Tuition Program maintained in the State Treasury. Deposits in the custody of the State Treasurer totaled $12,126,618 at June 30, 2010. These deposits are pooled and invested with other State funds in accordance with the Deposits 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 the Illinois Prepaid Tuition Program 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.

C. Investments

ISAC is required annually to adopt a comprehensive investment plan to invest the funds received through contract payments. The Commission approved the Illinois Prepaid Tuition Program's most recent revision to the investment plan in January 2010. The comprehensive investment plan specifies the investment policies to be utilized by the Commission in its administration of the Illinois Prepaid Tuition Program. The Commission may direct that assets of those funds be invested in a manner that will provide the investment return and risk level consistent with the actuarial return requirements and risk levels and cash flow demands of the Fund. The investments should be in compliance with all applicable federal and state laws and other statutes governing the investment of Illinois Prepaid Tuition Program resources.

Note 3. Deposits and Investments - Continued

C. Investments - Continued

ISAC has retained State Street Global Advisors, LSV Asset Management, Galliard Capital, Income Research Management, RhumbLine Advisors, Pugh Capital, C.S. McKee Investment, Piedmont Investment, Security Capital Research, Alinda Infrastructure, Portfolio Advisors, JP Morgan AIRRO, Morgan Stanley, Balestra Capital, Neuberger Berman, Pinnacle Natural Resource, Reynoso Asset, and DDJ Distressed Fund as investment managers to assist with the investment of the fund assets for the Illinois Prepaid Tuition Program. Approximately $75,000,000 of additional contract payments received has been invested as of the end of the fiscal year June 30, 2010. The program has contracted with Marquette Associates to evaluate the investment performance of the Program on a quarterly basis. Use of funds invested on behalf of the Illinois Prepaid Tuition Program by the investment managers is restricted to the payout of tuition and fee benefits for program beneficiaries.

As of June 30, 2010, 25% of the funds were invested in Domestic Equities, 28% in Domestic Fixed Income, 9% in International Equities, 1% in Infrastructure Funds, 14% in Hedge Funds, 7% in Private Equity Funds, 14% in Real Estate, and 2% as Cash and Equivalents. Investments of the Program, other than alternative investments and real estate, are recorded at fair value based on quoted market prices.

Investments owned are reported at fair value as follows: (1) U.S. Government and Agency, Foreign and Corporate Obligations, Convertible Bonds – prices quoted by a major dealer in such securities; (2) Common Stock and Equity Funds, Preferred Stock, Foreign Equity Securities - (a) Listed – closing prices as reported on the composite summary of national securities exchanges; (b) Over-the-counter – bid prices; (3) Money Market Instruments – average cost which approximates fair values; (4) Real Estate Investments – fair values as determined by the Program in conjunction with its investment managers and investment advisors; (5) Alternative Investments (Private Equity, Hedge Funds and Infrastructure Funds) – fair values as determined by the Program in conjunction with its investment managers and investment advisors.

Note 3. Deposits and Investments - Continued

C. Investments – Continued

The Illinois Prepaid Tuition Program's cash and investments at June 30, 2010 are presented below at fair value by investment type and by investment manager:

Investment Managers
Asset Allocation at June 30, 2010

Asset Class	Investment Manager	Fair Value	Actual Allocation
Fixed Income-Short Term	U.S. Bank (Custodian)	$ 2,374,165	0.24%
Fixed Income-Core	C.S. Mckee	67,912,508	6.89%
Fixed Income-Core	Piedmont	31,477,767	3.19%
Fixed Income-Core	Pugh Capital	39,819,711	4.04%
Fixed Income-Intermediate	Galliard Capital	63,160,984	6.40%
Fixed Income-Intermediate	Income Research Management	60,759,252	6.16%
TIPS Account	N/A	7,975,279	0.81%
Total Fixed Income Portfolio		**273,479,666**	**27.73%**
Real Estate-Debt	SCM Capital Term Income	34,191,161	3.47%
Real Estate-Debt/Equity	SCM Capital Stable Income	56,930,345	5.77%
Real Estate-Preferred	SCM Capital Preferred Growth	41,610,968	4.22%
Total Real Estate		**132,732,474**	**13.46%**
Large-Cap Core Equity	SSgA S&P 500 Index	99,111,953	10.05%
Large-Cap Core Equity	LSV Asset Management	5,652	0.00%
All-Cap Core Equity	Rhumb Line Advisors	146,160,128	14.82%
Total Domestic Equity		**245,277,733**	**24.87%**
International Core Equity	SSgA MSCI EAFE	43,519,146	4.41%
International Core Equity	LSV Asset Management	49,142,754	4.98%
Total International Equity		**92,661,900**	**9.39%**
Infrastructure	Alinda Capital II	9,526,910	0.97%
Total Infrastructure		**9,526,910**	**0.97%**
Hedge FoFs	Balestra Spectrum II	56,418,094	5.72%
Hedge FoFs	NB Diversified Arbitrage	25,338,722	2.57%
Hedge FoFs	Pinnacle Natural Resources	50,770,630	5.15%
Hedge Fund-Market Neutral	Reynoso	9,889,586	1.00%
Total Hedge Fund		**142,417,032**	**14.44%**
Private Equity FoFs Secondary	Morgan Stanley Secondary Fund	4,044,903	0.41%
Private Equity FoFs Secondary	Portfolio Advisors Secondary Fund	4,225,179	0.43%
Private Equity Distressed	DDJ Distressed Fund	49,897,808	5.06%
Private Equity Buy-Out	J.P. Morgan AIRRO Fund	10,034,530	1.01%
Total Private Equity		**68,202,420**	**6.91%**
Illiquid Securities Liquidating Trust	U.S. Bank (Custodian)	3,429,214	0.35%
Total Illiquid Securities Liquidating Trust		**3,429,214**	**0.35%**
Cash and Equivalents	N/A	3,753,487	0.38%
Investment Cash Equivalents		**3,753,487**	**0.38%**
Total Investments		**971,480,836**	**98.50%**
Cash and Equivalents	N/A	14,808,663	1.50%
Total Cash Equivalents		**14,808,663**	**1.50%**
TOTAL PORTFOLIO		**$ 986,289,499**	**100%**

Note 3. Deposits and Investments - Continued

C. Investments – Continued

The Illinois Prepaid Tuition Program's (Program) investment in real estate represents convertible debt, senior unsecured debt securities, and preferred and common equity securities. Investment strategies of private equity funds include, but are not limited to, foreign infrastructure and related resources investments, secondary funds of funds and distressed debt and special situations.

The Program's investments in infrastructure represent investments used to seek capital appreciation and current income by acquiring, holding, financing, refinancing and disposing of infrastructure investment and related assets. Infrastructure assets include various public works such as a water utility, inland barge terminals and a gas pipeline system.

The Program's investments in hedge funds include, but are not limited to, hedge funds of funds employing a broad range of arbitrage investments strategies, global commodities, and a market-neutral fund.

Investment Commitments

Private equity and infrastructure investment portfolios consist of passive interests in limited partnerships. The Program had outstanding commitments of approximately $72 million to private equity partnerships and $41 million to infrastructure funds as of June 30, 2010.

Investment Management Fees

The Program has contracted with Board-approved investment managers to make investment decisions based on investment objectives given to them by the Program investment consultant. The investment managers serve as investors for and investment advisors to the Program. The Program pays an investment management fee to each investment manager for investment management and advisory services. The investment management fee is based upon contractual agreement provisions. Investment management fees expense and investment advisory fees totaled $1,609,519 and $1,926,058 for the year ended June 30, 2010.

Management fees paid to private equity, infrastructure, hedge and real estate funds are calculated based upon the terms of each individual fund agreement and are reported in income from investment securities on the Statement of Revenues, Expenses, and Changes in Net Assets.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Illinois Prepaid Tuition Program's policy for managing interest rate risk is to ensure that the investment managers comply with its investment policy guidelines. As per the investment policy, the operational guidelines for the Fixed Income Securities Managers (excludes real estate portfolio) require that the average duration of the manager's portfolio not vary more than +/- 50% of the duration of the Barclays Intermediate Government/Credit Index and the Barclays Aggregate Index, respectively (see schedule of investments on previous page).

Note 3. Deposits and Investments - Continued

C. Investments – Continued

Interest Rate Risk - Continued

As of June 30, 2010, all portfolios are within the guidelines permitted by the investment policy. The duration of the portfolios, by Manager, for the fixed income securities (excluding real estate portfolio), compared to the benchmark index(s) is as follows:

Fixed Income Portfolio Manager	Portfolio Average Duration	BarCap Aggregate Index	BarCap Int. Government/ Credit Index
Galliard Capital	3.4 Years	N/A	3.9 Years
Income Research Management	3.7 Years	N/A	3.9 Years
C.S. McKee	3.8 Years	4.3 Years	N/A
Piedmont	4.0 Years	4.3 Years	N/A
Pugh Capital	4.3 Years	4.3 Years	N/A

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Portfolio Weighted Average Maturity

Portfolio Weighted Average

Investment Type	Fair Value	Weighted Average Maturity (in Years)
U.S. treasury notes	$ 20,487,160	5.2
U.S. treasury bonds	35,145,127	10.9
Federal agencies bonds and notes	35,712,593	10.4
U.S. agency asset-backed securities	7,094,652	3.2
Municipal debt	7,319,298	26.8
Corporate debt securities	162,357,819	3.6
Corporate asset-backed securities	7,955,541	3.4
Other debt securities	1,425,074	4.1
Corporate mortgage-backed securities (CMBS)	11,831,050	24.5
Mortgage backed securities (MBS):		
Pass through (fixed rate, adjustable rate)	30,579,335	25.7
Collateralized mortgage obligations	12,912,589	7.6
Delegated underwriting and servicing bonds and surety bonds	12,034,266	5.4
Money market mutual funds	9,127,750	0.1
Equity in public treasurer's investment pool (Illinois Funds)	1,908,727	0.1
Total Fair Value	**$ 355,890,981**	
Portfolio weighted average maturity		**8.3**

Note 3. Deposits and Investments - Continued

C. Investments – Continued

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Commission is authorized to hire competent registered professional investment managers to manage the assets of the Illinois Prepaid Tuition Program. The operational guidelines as set forth in the Illinois Prepaid Tuition Program investment policy for fixed income investments dictate that no securities with a credit rating below BBB- by Standard & Poor's or Ba3 by Moody's may be purchased. In the case of a split rating, the higher rating shall apply. Securities, which are downgraded below the policy minimum, may only be held at the manager's discretion for up to 6 months.

The following tables indicate credit ratings, as of June 30, 2010, for the Program's debt security investments (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). Ratings for debt security investments that have multiple ratings are on the following page:

Credit Ratings (Excludes Multiple-Rated Securities)
June 30, 2010

		Credit Rating*		
	Total Fair Value	Moody's	Standard & Poor's	Fitch
Other debt securities	$ 1,425,074	Aaa	AAA	AAA
Mortgage-backed securities (collateralized and delegated)	24,946,855	Aaa	AAA	AAA
Money market mutual funds	9,127,750	Aaa	AAA	NR
Illinois Funds	1,908,727	NR	AAA	NR

*NR - not rated

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Credit Risk - Continued

The following tables indicate credit ratings, as of June 30, 2010, for debt security investments that received multiple ratings:

Credit Ratings (Multiple-Rated Securities)
June 30, 2010

Rating Agency	Investment Type	Credit Rating*	Fair Value
Moody's:	Corporate debt securities	Aaa	$ 4,089,990
	Corporate debt securities	Aa	16,545,241
	Corporate debt securities	A	37,860,519
	Corporate debt securities	Baa	49,364,882
	Corporate debt securities	Ba	21,094,390
	Corporate debt securities	NR	32,911,234
	Corporate debt securities	WR	491,563
			162,357,819
Standard & Poor's:	Corporate debt securities	AAA	3,844,299
	Corporate debt securities	AA	13,157,949
	Corporate debt securities	A	42,625,103
	Corporate debt securities	BBB	51,311,705
	Corporate debt securities	BB	24,086,890
	Corporate debt securities	NR	27,331,873
			162,357,819
Fitch:	Corporate debt securities	AAA	2,386,297
	Corporate debt securities	AA	11,104,975
	Corporate debt securities	A	36,353,111
	Corporate debt securities	BBB	29,288,914
	Corporate debt securities	BB	27,480,652
	Corporate debt securities	NR	55,743,870
			162,357,819

* NR - not rated, WR - withdrawn rating

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Credit Risk - Continued

Credit Ratings (Multiple-Rated Securities), continued
June 30, 2010

Rating Agency	Investment Type	Credit Rating*	Fair Value
Moody's:	Corporate asset-backed securities	Aaa	$ 7,955,541
			7,955,541
Standard & Poor's:	Corporate asset-backed securities	AAA	6,590,059
	Corporate asset-backed securities	AA	375,440
	Corporate asset-backed securities	NR	990,042
			7,955,541
Fitch:	Corporate asset-backed securities	AAA	5,042,344
	Corporate asset-backed securities	NR	2,913,197
			7,955,541
Moody's:	Municipal Debt	Aaa	2,169,416
	Municipal Debt	Aa	3,586,811
	Municipal Debt	A	885,935
	Municipal Debt	Baa	206,717
	Municipal Debt	NR	470,419
			7,319,298
Standard & Poor's:	Municipal Debt	AAA	2,186,659
	Municipal Debt	AA	2,821,179
	Municipal Debt	A	1,092,652
	Municipal Debt	NR	1,218,808
			7,319,298
Fitch:	Municipal Debt	AAA	437,876
	Municipal Debt	AA	1,747,825
	Municipal Debt	A	885,935
	Municipal Debt	NR	2,728,995
	Municipal Debt	WR	1,518,667
			7,319,298

* NR - not rated, WR - withdrawn rating

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Credit Risk - Continued

Credit Ratings (Multiple-Rated Securities), continued
June 30, 2010

Rating Agency	Investment Type	Credit Rating*	Fair Value
Moody's:	CMBS	Aaa	$ 8,734,997
	CMBS	NR	3,096,053
			11,831,050
Standard & Poor's:	CMBS	AAA	9,347,032
	CMBS	AA	747,074
	CMBS	A	216,775
	CMBS	NR	1,520,169
			11,831,050
Fitch:	CMBS	AAA	8,341,335
	CMBS	NR	3,489,715
			11,831,050
Moody's:	MBS-Pass Through	Aaa	29,501,024
	MBS-Pass Through	Aa	390,565
	MBS-Pass Through	A	102,263
	MBS-Pass Through	Caa	585,483
			30,579,335
Standard & Poor's:	MBS-Pass Through	AAA	28,203,150
	MBS-Pass Through	AA	148,389
	MBS-Pass Through	CCC	585,483
	MBS-Pass Through	NR	1,642,313
			30,579,335
Fitch:	MBS-Pass Through	AAA	23,509,738
	MBS-Pass Through	NR	6,792,248
	MBS-Pass Through	WR	277,349
			30,579,335

* NR - not rated, WR - withdrawn rating

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Credit Risk - Continued

Credit Ratings (Multiple-Rated Securities), continued
June 30, 2010

Rating Agency	Investment Type	Credit Rating*	Fair Value
Moody's:	Federal Agencies Bonds and Notes	Aaa	$ 35,712,593
			35,712,593
Standard & Poor's:	Federal Agencies Bonds and Notes	AAA	35,712,593
			35,712,593
Fitch:	Federal Agencies Bonds and Notes	AAA	33,309,280
	Federal Agencies Bonds and Notes	NR	2,403,313
			35,712,593
Moody's:	U.S. Agency Asset Backed	Aaa	7,032,950
	U.S. Agency Asset Backed	Baa	61,702
			7,094,652
Standard & Poor's:	U.S. Agency Asset Backed	AAA	7,032,950
		NR	61,702
			7,094,652
Fitch:	U.S. Agency Asset Backed	AAA	7,094,652
			7,094,652

* NR - not rated, WR - withdrawn rating

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Securities Lending

As of June 30, 2010, the Illinois Prepaid Tuition Program had exited from its securities lending program. The value of the remaining illiquid trust at U.S. Bank was $3,429,214. U.S. Bank also held a corporate bond valued at $2,374,165 which was formerly held in the securities liquidating trust. The Illinois Prepaid Tuition Program paid $9,675,737 to exit the securities lending program. At year-end, the Illinois Prepaid Tuition Program has no credit risk exposure to borrowers.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the Illinois Prepaid Tuition Program will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The Program does not have an investment policy for custodial credit risk for investments.

As of June 30, 2010, the Program exited its securities lending program. The counterparty continues to hold investments of $5,803,379 in the Program’s name. These investments are subject to custodial credit risk.

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.

The operational guidelines as set forth in the Illinois Prepaid Tuition Program’s investment policy for fixed income investments dictate that no single security should comprise more than 10% of the portfolio’s overall allocation after accounting for price appreciation, except for any U.S. Treasury or U.S. agency security, which may comprise no more than 15% of the portfolio’s overall allocation after accounting for price appreciation. In the case of investments in domestic equities the policy states that no single security in the manager's portfolio will comprise more than 5% of its equity allocation at the time of purchase, nor will it be more than 10% of the equity allocation of the portfolio after accounting for price appreciation. Additionally, in the case of the small-cap investment managers at no point in time should the portfolio hold a security such that the investment management firm’s aggregate position in that company exceeds 20% of the fair value of the outstanding stock of the company.

There were no investments in any single issuer (other than U.S. Treasury or securities explicitly guaranteed by the U.S. government) that exceeded 5% or more of the total investment portfolio as of June 30, 2010.

Note 3. Deposits and Investments - Continued

Foreign Currency Risk

Foreign currency risk is the risk that changes in currency exchange rates will adversely affect the fair value of an investment.

The Illinois Prepaid Tuition Program's investment policy authorizes a maximum of 10% of the portfolio for investments in international equities. As of June 30, 2010, 9% is invested in international equities; however, none of these investments are denominated in foreign currencies. Certain alternative investments hold investments located outside of the United States. Fluctuations in foreign exchange rates between the U.S. dollar and other currencies could have an effect on the amounts realized in U.S. dollars involving these investments.

Note 4. Balances Due to Other State of Illinois Component Units and Transfers

As of June 30, 2010, the Illinois Prepaid Tuition Program owed $97,894 to Illinois Universities for payment of tuition and fee benefits. During the year, $31,300 was transferred to the ISAC COP Debt Service Fund for lease payments.

Note 5. Compensated Absences Payable

Changes in compensated absences for the year ended June 30, 2010, were as follows:

	Balance July 1, 2009	Additions	Deletions	Balance June 30, 2010	Amounts Due Within One Year
Compensated absences	$ 67,459	$ 104,604	$ 68,126	$ 103,937	$ 14,898

Note 6. Tuition Payable

Tuition payable activity for the year ended June 30, 2010 is as follows:

Balance July 1, 2009	$ 884,485,313
Add:	
Contributions	100,007,771
Less:	
Return of contributions	(10,299,863)
Tuition payments	(59,755,997)
Balance June 30, 2010	$ 914,437,224
Reported as:	
Current	$ 68,490,000
Noncurrent	845,947,224
	$ 914,437,224

Note 7. Accretion Payable

Accretion payable is management's estimate of the present value of the estimated tuition payment to be made in excess of principal payments received and is expected to be financed from investments of prepaid tuition contracts. The accretion expense for fiscal year 2010 is estimated as a percentage of net tuition contracts paid to date. The rate is 8.68% and is based on the average increase in tuition for Illinois colleges.

Average monthly tuition payable over the year	$ 891,366,713
Estimate of 8.68% increase of tuition payable	$ 77,370,631
Present value	$ 76,596,924
Beginning balance accretion payable as of July 1, 2009	$ 337,368,746
Accretion expense	76,596,924
Accretion payments	(5,373,155)
Ending balance accretion payable as of June 30, 2010	$ 408,592,515
Reported as:	
Current	$ 6,510,000
Noncurrent	402,082,515
	$ 408,592,515

Note 7. Accretion Payable - Continued

The accretion expense is calculated on a monthly basis on the balance in the tuition payable account. Accretion expense is reflected as an expense in the Statement of Revenues, Expenses, and Changes in Net Assets and as an increase to liabilities on the Statement of Net Assets.

Note 8. 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. The 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 the SERS for fiscal year 2010 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2010. The SERS issues a separate CAFR that may be obtained by writing to the 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 the SERS' CAFR. Also included is a discussion of employer and employee obligations to contribute and the authority under which those obligations are established.

The Commission pays employer retirement contributions for the Illinois Prepaid Tuition Program based upon an actuarially determined percentage of its payroll. For fiscal years 2010, 2009 and 2008, the employer contribution rate was 28.4%, 21.0% and 16.6%, respectively. The required and actual contribution for fiscal years 2010, 2009 and 2008 was $614,330, $268,065 and $98,701, respectively.

Note 9. Post-employment and Termination Benefits

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.

Note 9. Post-employment and Termination Benefits - Continued

Post-employment Benefits - Continued

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.

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.

Termination Benefits

During the fiscal year ended June 30, 2010, the Illinois Student Assistance Commission (ISAC) engaged in a workforce reduction, which resulted in the elimination of certain positions within the Illinois Prepaid Tuition Program (the Program). Applicable accounting standards require that a liability and expense for involuntary termination benefits (such as severance benefits) be recognized when a plan of termination has been approved by those with the authority to commit the government to the plan, the plan has been communicated to the employees and the amounts can be reasonably determined.

In relation to the workforce reduction, the Program has accrued approximately $9,000 in severance benefits, representing 60 days of salary continuation for affected employees. This amount was paid to the employees subsequent to the year ended June 30, 2010 and is included with accounts payable and accrued expenses on the Statement of Net Assets.

Note 10. Fund Deficits

A. Deficit in Net Assets

As of June 30, 2010, the Illinois Prepaid Tuition Program has a deficit in net assets of $337,888,037. The actuarial soundness of the Program and management’s plans to eliminate the deficit over time, are discussed in the paragraphs that follow.

B. Actuarial Report on Soundness - Unaudited

The estimated actuarially determined deficit for *College Illinois!®,* the State’s section 529 prepaid tuition program, as of June 30, 2010 is $341 million.

In terms of the program's actuarially determined deficit, actual investment performance is only one influencing factor. Expected future investment performance is another factor, as is the level of actual tuition and fee increases at Illinois public universities, new contracts for each <u>future</u> enrollment period, as well as <u>future</u> expectations for tuition and fee increases at those institutions.

Note 10. Fund Deficits - Continued

B. Actuarial Report on Soundness – Unaudited - Continued

Implementation of the Truth-in-Tuition law (in 2004) has impacted and will continue to impact future tuition increases for classes of new students entering the State's public universities. Another significant fact that only became evident after the law was implemented was that while tuition rates charged to students who remain enrolled for continuous academic years must remain level, public universities typically continue to increase fees annually for all students, not just new enrollees.

Tuition and fee increase assumptions were reevaluated for FY2011 and beyond. Each year when setting plan prices, the Commission reviews the assumptions that influence the actuarial deficit. The program opened on November 1, 2009 for its first year-round enrollment in the program's history. Contract prices have been recommended at a level that will provide revenue from contract sales sufficient not only to fund future contract obligations and current administrative costs, but also to improve the actuarial soundness of the program. Management believes that this provision of building a stabilization premium into contract prices provides a buffer against uncertainty associated with the annual volatility of college cost increases and performance of program investments.

Investment performance lagged the assumed return for FY2009 due to the extreme market conditions experienced during that year. Additionally, the actuarial deficit has been significantly impacted by the negative investment performance recorded during FY2009. To address these unusual conditions, the Commission approved changes to the program's investment policy in June 2008. Those changes are designed to reduce the volatility in returns and to enhance performance over time.

The Commission also approved changes to the program's investment policy in June 2009. Those changes are designed to reduce the volatility in returns and to enhance performance over time. Consistent with past Commission action, the ultimate goal is to eliminate the current actuarial deficit over time.

In September 2009, ISAC's Commissioners approved new prices for 2009-2010 which reflect ISAC's ongoing efforts to expand the *College Illinois!*® program to more people at more price points. In the fall of 2008, *College Illinois!*® introduced SmartChoice Pricing. Under SmartChoice Pricing, purchasers have, for the first time, the option of purchasing semesters at Community Colleges (Choice 1), at public universities and colleges within the State of Illinois excluding the University of Illinois at Urbana-Champaign (Choice 2), and finally, semesters at any public university and college, including the University of Illinois at Urbana-Champaign (Choice 3). This differential pricing expands the market for *College Illinois!*® contracts to a wider range of household incomes.

Management assumes that 3,500 contracts will be sold during 2010-2011 enrollment period. Starting with 2010-2011 enrollment, the program expands to partner with several brokerage firms and believes that this should greatly increase the long-term sales outlook for the program.

Other significant assumptions include an investment rate of return on a gross basis, of 9.25% in 2011, and 8.75% per annum thereafter. Investment expense is estimated to be 35 basis points. Weighted average tuition increases range from 6.5% per annum to 8.5% per annum, based on the type of contract.

Note 10. Fund Deficits - Continued

B. Actuarial Report on Soundness – Unaudited - Continued

The Actuary's Report on Soundness as of June 30, 2010 indicates that the program's cash flow is expected to remain positive through the fiscal year that ends in 2012 without reflecting expected proceeds from contracts sold after June 30, 2010 and the program's assets are projected to cover expected benefit payments through fiscal year 2020. The report also highlights a continuing business scenario based on current point estimate and future contract sales projected by the Commission. Based on this scenario, the soundness of the program would improve over time.

	Actuarial Evaluation
Market value of current assets*	$ 986,428,308
Unamortized investment gains and losses	190,396,624
Actuarial present value of future payments expected to be made by contract purchasers	173,526,170
Subtotal	1,350,351,102
Actuarial present value of future payments expected to be made by the program	1,691,226,373
Actuarial deficit as of June 30, 2010	$ (340,875,271)

* Based on unaudited financial statements provided by Commission management.

Note 11. Risk Management

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 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, 2010.

Note 12. New Governmental Accounting Standards

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

Statement No. 59, *Financial Instruments Omnibus*. The objective of this Statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools. The Illinois Prepaid Tuition Program is required to implement the provisions of this Statement for the year ending June 30, 2011.

Note 12. New Governmental Accounting Standards - Continued

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.

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.

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

Mr. Donald J. McNeil
Honorable Chairman 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 Prepaid Tuition Program of the State of Illinois, Illinois Student Assistance Commission (Commission), as of and for the year ended June 30, 2010, and have issued our report thereon dated March 14, 2011. 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

In planning and performing our audit, we considered the Commission's internal control over financial reporting of the Illinois Prepaid Tuition Program 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.

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.

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 10-1 in the accompanying schedule of findings to be a material weakness.

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 finding 10-1.

The Commission's response to the finding identified in our audit is described in the accompanying schedule of findings. We did not audit the Commission's response and, accordingly, we express no opinion on it.

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 14, 2011

Current Finding – *Government Auditing Standards*

Finding 10-1 Procurement Law and Sound Business Practices Not Followed

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

The Illinois Prepaid Tuition Program of the Illinois Student Assistance Commission (Commission) did not comply with the competitive procurement requirements of the Illinois Procurement Code and did not follow sound business practices in its selection of a vendor to provide investment due diligence services. Further, the services performed by the vendor did not match the services specified in the contract.

The Commission awarded a contract for investment due diligence services without following established procurement law, administrative rules or sound business practices. We noted the following exceptions discussed further below:

1. The Request for Proposal (RFP) issued to procure the Services was not specific to investment due diligence services, but rather was for financial advisory services pertaining to issuing or restructuring debt;
2. Only one of ten “prequalified vendors” provided pricing for the investment due diligence services and there was no effort to obtain quotes from any of the other successful respondents when it was determined that investment due diligence services were needed;
3. The performance of the work commenced prior to obtaining a signed contract;
4. The Commission could not provide documentation showing the vendor’s “due diligence” services were provided as required by the contract;
5. The fee arrangements with the selected vendor did not ensure objectivity in the performance of the work which was the subject of the contract: and
6. Management focused on only one private equity investment alternative.

<u>**Competitive Price Procurement Circumvented in the RFP Process (Exceptions #1 and #2)**</u>
On January 4, 2008, the Commission (through Central Management Services) issued an RFP titled “**To Provide Financial Advisory Services to the Illinois Student Assistance Commission #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. During the term of the contract, as ISAC has a need for financial advisory services, ISAC shall issue invitation for bids (IFB).” Responses to the RFP were due January 18, 2008.

Using this RFP, 10 vendors were prequalified to perform the services specified in the RFP. Upon review of the complete RFP, the auditors concluded the RFP was primarily issued to assist the Commission with services pertaining to the issuance/ restructuring of debt. The auditors reviewed the proposal provided by the vendor awarded investment due diligence services under this RFP. The proposal was complete and clearly demonstrated the vendor’s capabilities and experience in assisting governmental entities with debt issuance related matters, however the vendor did not present qualifications in the proposal pertaining to investment advisory services or investment due diligence services. The price proposal, however, did contain the following additional <u>unsolicited</u> fee quote that was not included in the RFP fee proposal form:

Current Finding – *Government Auditing Standards* (Continued)

Finding 10-1 Procurement Law and Sound Business Practices Not Followed (Continued)

"Other Services: Financial Advisor, investment banking and analysis services related to investment of 529 prepaid tuition plan assets in illiquid assets and/or private placement in new asset categories charges: 1.25 to 2% of invested assets."

According to the Illinois Administrative Code (44 Ill. Adm. Code 1.2035.h) RFP's 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;
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.

Based on the RFP issued, there was no clear basis for awarding a contract for investment due diligence services in a fair and competitive manner that allowed all interested parties the opportunity to participate in the procurement opportunity. Based on the fact that none of the other 9 successful (prequalified) respondents provided pricing for investment due diligence services, it is clear that the RFP was not sufficiently clear that those types of services were being solicited. There is no evidence that any of the 9 respondents were asked to provide pricing for due diligence services after the proposals were received and scored.

There may have been numerous vendors who specialize in these types of investment services who did not reply to the request for proposal because it was predominantly requesting bond issuance services. By circumventing the competitive procurement process the Commission may have paid higher fees than it otherwise might have obtained through a truly competitive process.

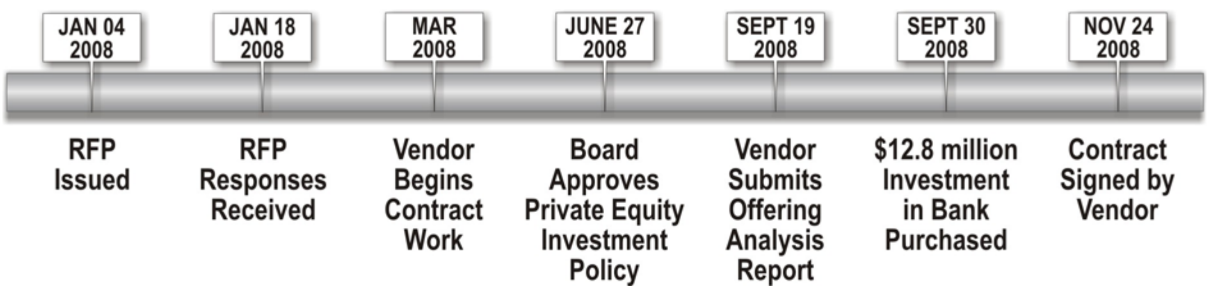
According to Commission management, the Commission believes that the RFP process complied with the Illinois Procurement Code and permitted selection of a vendor from the qualified list of financial advisors to perform the services requested. Additionally, the Commission examined the responses of the winning vendors for financial advisory services and selected the qualified vendor that provided a response and a price for these specific services.

Current Finding – *Government Auditing Standards* (Continued)

Finding 10-1 Procurement Law and Sound Business Practices Not Followed (Continued)

Contract Not Reduced to Writing and Performance of Contract Requirements not Adequately Documented (Exceptions #3 and #4)

The Vendor's investment due diligence services were limited to one recommended transaction – a private equity investment in a specific bank. According to Commission management, the Vendor began performing its due diligence work on the viability of the recommended private equity investment in the Bank around March 2008. This was prior to the Board approving changes to the investment policy on June 27, 2008 that would allow for direct private equity investments. The Vendor issued its final Offering Analysis report on September 19, 2008. The investment in the Bank was actually made on September 30, 2008. The terms of the contract with the vendor provided for services to be performed between November 24, 2008 and March 31, 2009. The contract was not signed until November 24, 2008. Thus all the work required by the contract was completed and the private equity investment was purchased prior to the date and terms of the contract beginning November 24, 2008.



The Commission lacked documentation showing that the vendor performed the same services as specified by the contract. The contract called for the vendor to "Conduct thorough due diligence of the proposed investment". Due diligence generally requires the independent verification of material facts, and in this case, Bank management representations. In the "Sources of Information Used in Our Analysis" section of the Offering Analysis, provided as the final work product of the Vendor, it states "All information concerning the Bank was provided by (Bank) management. All information received has been accepted by (the Vendor) to be accurate with no further investigation". The auditors requested but were not provided any evidence that the Vendor independently verified management's representations.

Statewide Accounting Management Systems (SAMS) Procedure 15.10.40 and sound business practices require contracts be reviewed and signed prior to the inception of the contract and prior to services being rendered to be binding and enforceable and to protect the interest of the parties involved. Sound business practices would also require the Commission to ensure that the provisions of the contract were performed prior to the payment for services.

Failure to review and sign contracts before the beginning of the contract period increases the risk of liability to the State. Failure to obtain documentation ensuring the contractor performed the due diligence provisions of the contract may have diluted the value of the contract performance received by the Commission.

Current Finding – *Government Auditing Standards* (Continued)

Finding 10-1 Procurement Law and Sound Business Practices Not Followed (Continued)

According to Commission management, the contract was not executed prior to the commencement of work because of unclear communication and an incorrect assumption that contracts were entered into with all vendors prequalified to provide financial advisory services. Commission management stated the vendor, in conjunction with the Commission's outside attorneys, reviewed financial records and reports, conducted site visits and interviews, reviewed reports of federal regulators and other corporate records and documents prior to preparing their report.

<u>Vendor Fee Arrangement Not Objective and Alternative Investments Not Considered (Exceptions #5 and #6)</u>
The terms of the agreement with the Vendor performing the due diligence services stated the Vendor would receive as payment for services, 1.25% to 2% of the invested amount. The fee paid was 2% of the amount invested, or $255,600. The vendor was asked to provide due diligence services leading to a conclusion as to the viability of one specific private equity investment. Management did not solicit from this vendor or any other vendor information on the viability of other alternate investment choices.

By paying the vendor on a commission or a contingent fee basis, the Commission may have created an incentive for the vendor to recommend the private equity investment. Specifically, there was no contractual means for the vendor to be paid under the signed contract if the investment was not made. The vendor recommended the investment in the Bank in its report issued September 19, 2008, which preceded the contract execution. The Commission did not consider other private equity investment choices for this asset allocation category.

We noted the Offering Analysis prepared by the Vendor included an analysis of the Capital Adequacy, the Asset Quality, Management, Earnings and Liquidity of the potential investment in the Bank. This type of rating is called a CAMEL rating in the report. We noted that in each category of the analysis report there were potential red flags as to the soundness of the investment.

Despite the red flags noted the vendor recommended the investment in the Bank and the Commission purchased the $12.78 million investment on September 30, 2008. By the end of fiscal year 2010, the Commission determined the entire $12.78 million value of the investment was worthless when the Bank was taken over by the FDIC.

Best practices require that vendors contracted to provide their opinion on investment purchase decisions not be compensated on a basis that is contingent upon the opinion rendered. It generally would be considered to be a prudent business practice for management to consider a variety of alternative private equity investments to allow for greater opportunity to make sound investment choices.

According to Commission management, the Commission believed the fee arrangement was appropriate and consistent with the Vendor's price proposal and contingent fee proposals from other qualified vendors in response to the RFP that were based upon the principal amount of securities offered. Commission management stated the decision to consider only the one Bank investment was a business decision.
(Finding Code No. 10-1)

Current Finding – *Government Auditing Standards* (Continued)

Finding 10-1 Procurement Law and Sound Business Practices Not Followed (Continued)

Recommendation:

We recommend the following:

- The Commission should comply with the Procurement Code and Administrative Rule in procuring professional and artistic services.
- 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 in the document. If the Commission determines at a later time that a necessary service was not fully described in the original RFP, the Commission should issue an addendum if the deadline for submission has not yet expired. If the deadline has expired, the Commission should issue a new RFP for the omitted service.
- If one RFP is being issued to solicit vendors for multiple and/or varying services, the pricing portion of the RFP should provide a detailed schedule or table specifying the manner in which pricing should be provided for the different types of services requested. Bidders should be required to use this standardized template to ensure comparable results are received.
- The Commission should process and approve all contracts in writing before the beginning of the contract period or commencement of any services.
- The Commission should ensure that the provisions of contracts are performed and documented before paying vendors for services.
- The Commission should revisit contingent fee based compensation methods when contracting for opinions on investment purchase decisions that may influence the objectivity or the perception of objectivity of the opinion rendered.
- The Commission should consider taking into account other alternate investments choices when making investment decisions.

Commission Response

We accept the recommendation.

While appropriate procurement procedures were followed, ISAC's future RFPs will have more precise descriptions of services to be solicited with clearer pricing requirements. Moreover, we have changed our procedures for RFPs that result in a large number of qualified bidders in order to ensure that services begin only after the contract is signed. We have reinforced our procedures that require review and sign-off of contract deliverables before vendor payments are processed. We will review contingent-fee compensation and consider taking into account different investment choices when making investment decisions.