A Report
to the
Montana
Legislature

Financial Audit

Montana Guaranteed Student Loan Program

For the Fiscal Year Ended June 30, 2011

December 2011

Legislative Audit Division

11-06A

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LEGISLATIVE AUDIT DIVISION

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Deputy Legislative Auditors
Cindy Jorgenson
Angie Grove

December 2011

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the fiscal year 2010-11 financial audit of the office of the Commissioner of Higher Education's Montana Guaranteed Student Loan Program. As a result of our review of the program's operations and compliance with selected federal regulations, we issued an unqualified opinion on the program's financial statements. This report contains three recommendations related to an internal control deficiency, an accounting error, and noncompliance with the Montana Constitution and state law.

We thank the Office of the Commissioner of Higher Education, the Director of the Montana Guaranteed Student Loan Program, and their staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

Tori Hunthausen, CPA
Legislative Auditor

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Table of Contents

Figures and Tables ii
Appointed and Administrative Officials iii
Report Summary S-1

CHAPTER I – INTRODUCTION 1
Introduction 1
Background 2

CHAPTER II – FINDINGS AND RECOMMENDATIONS 3
Teacher Loan Forgiveness 3
Internal Control Over Financial Statement Preparation 4
Cost of Loan Collections 5

INDEPENDENT AUDITOR'S REPORT AND PROGRAM FINANCIAL STATEMENTS
Independent Auditor's Report A-1
Federal Special Revenue Fund Balance Sheet as of June 30, 2011 .... A-3
Federal Special Revenue Fund Statement of Revenues, Expenditures, and Changes in Fund Balance-Budget and Actual for the Fiscal Year Ended June 30, 2011 .... A-4
Federal Special Revenue Fund Notes to the Financial Statements for the Fiscal Year Ended June 30, 2011 .... A-5

PROGRAM RESPONSE
Montana Guaranteed Student Loan Program B-1

Figures and Tables

Tables

Table 1 Summary of Deficiencies in Internal Control 1

Appointed and Administrative Officials

Office of the Commissioner of Higher Education	Sheila M. Stearns, Ed.D., Commissioner of Higher Education
	Sylvia Moore, Deputy Commissioner, Academic, Research and Student Affairs
	John E. Cech, Deputy Commissioner of Two-Year Education and Community College Education
	Mick Robinson, Deputy Commissioner for Fiscal Affairs/Chief of Staff
	Frieda Houser, Director of Accounting and Budgeting
Montana Guaranteed Student Loan Program	Bruce Marks, Director
	Ron Muffick, Associate Director
	Robin Graham, Chief Financial Officer

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Montana Legislative Audit Division

Financial Audit
Montana Guaranteed Student Loan Program
For the Fiscal Year Ended June 30, 2011

December 2011 11-06A Report Summary

In accordance with Federal Family Education Loan Program regulations, the Montana Guaranteed Student Loan Program (GSL) guarantees loans to eligible students for post-secondary education. At June 30, 2011, GSL's original principal balance of loans guaranteed was $1,756,727,435. This is a drop of $296 million from the previous fiscal year. GSL ceased guaranteeing any new loans in fiscal year 2011 because Congress changed the Federal Family Education Loan Program effective July 1, 2010. Therefore, GSL's original principal balance of guaranteed loans will decrease until it has no more outstanding loans.

Context

In fiscal year 2011, GSL purchased over $28 million of student loans from institutions, due to the borrower defaulting on a loan, filing bankruptcy, becoming disabled or dying. This is an increase of $7 million from fiscal year 2010.

During the current fiscal year GSL collected $8 million from borrowers on loans purchased in the current and previous years. In accordance with Federal Family Education Loan Program regulations, GSL remitted $5.8 million of that amount to the U.S. Department of Education.

GSL's current default rate is 2.8 percent.

Results

We issued an unqualified opinion on GSL's financial statements. This report contains three recommendations regarding noncompliance with the Montana Constitution and state law, an accounting error, and a financial statement preparation control deficiency. The previous report had no recommendations.

Recommendation Concurrence	
Concur	3
Partially Concur	0
Do Not Concur	0
Source: Agency audit response included in final report.	

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Call toll-free 1-800-222-4446, or e-mail lad@mt.gov.

Chapter I – Introduction

Introduction

We performed a financial audit of the Commissioner of Higher Education's Montana Guaranteed Student Loan Program (GSL) for the fiscal year ended June 30, 2011. The objectives of our audit were to:

1. Determine if GSL's financial statements present fairly the financial position and results of operations for the fiscal year ended June 30, 2011.
2. Obtain an understanding of GSL's control systems to the extent necessary to support our audit of GSL's financial statements and, if appropriate, make recommendations for improvements in management and internal controls.
3. Determine whether GSL complied with selected federal laws and regulations.

Auditing standards require us to communicate, in writing, deficiencies in internal control we identified as a result of audit objective #2 above and considered to be significant or material. A deficiency in internal control exists when the design or operation of a control does not allow management or employees to prevent or detect and correct misstatements on a timely basis. A material weakness is one or more deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is one or more deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Table 1 below outlines the status of significant deficiencies and material weaknesses we identified during this audit.

Table 1
Summary of Deficiencies in Internal Control

Subject	Significant Deficiency	Material Weakness	Page
Financial Statement Preparation	Yes	No	4

This report contains three recommendations. In accordance with §5-13-307, MCA, we analyzed and disclosed, if significant, the costs of implementing the recommendations made in the report.

Background

GSL is part of the Office of the Commissioner of Higher Education. Working under the guidance of the Montana Board of Regents, GSL's primary goal is to improve access to postsecondary education in Montana. This goal is accomplished by working collaboratively with schools, colleges, lenders and other trading partners who believe that an investment in education is an investment in Montana.

Created in 1979 by the Montana Legislature, and guaranteeing their first loans in 1981, the program has been the designated guarantor of the Federal Family Education Loan Program in Montana. For more than 25 years, GSL has been a full service guarantee agency providing schools and lenders with a central loan origination and disbursement service. It provides a variety of guarantee support services including streamlined application processing, single point of contact for schools, lenders and borrowers, on-site technical expertise, and in-house default prevention and collections.

Through efficient management of the Federal Family Education Loan Program, the Montana Guaranteed Student Loan Program has been able to administer a variety of state and federal grant and scholarship programs, such as:

- The Montana University System Honor Scholarship, a renewable merit scholarship that covers the cost of tuition at qualifying Montana colleges
- The Governor's Postsecondary Scholarship Program
- The Montana Family Education Savings Program

From early awareness programs like Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) to financial management courses taught by staff, GSL delivers the information students and families need to succeed after high school.

As of June 30, 2011, the original principal balance of guaranteed loans outstanding was $1,756,727,435, with a current default rate of 2.8 percent. Given the current default rate, the federal government will reimburse the program for defaulted loans at the following rates: 98 to 100 percent for loans issued prior to October 1, 1998, and 95 percent for loans issued on or after October 1, 1998.

Chapter II – Findings and Recommendations

Teacher Loan Forgiveness

In fiscal year 2011, the Montana Guaranteed Student Loan Program released funds from the treasury without the use of an appropriation, not complying with the Montana Constitution and state law.

Section 17-1-102(4), MCA, and state policy require GSL to record all activity on its accounting records in accordance with generally accepted accounting principles (GAAP). State accounting policy and GAAP require GSL to recognize revenue when it is realizable, measurable, available, and all eligibility requirements are met and recognize expenditures when payment is due. Additionally, Article VIII Section 14 of the Montana Constitution states that except for interest on the public debt, no money shall be paid out of the treasury unless upon an appropriation made by law.

GSL forgives portions of teacher's student loans after ensuring the individual meets specific federal eligibility criteria. GSL pays the lender the portion of the loan that is forgiven and seeks reimbursement from the federal government.

To account for these transactions on the state's accounting records, GSL uses an asset account to record the payments to the lenders and the reimbursement from the federal government rather than recording revenues and expenditures. State accounting policy requires GSL to record revenue and expenditure activity on the state's accounting records. GSL staff believed they did not have a revenue or expenditure activity since GSL did not actually purchase the loans.

Since GSL uses an asset account instead of revenues and expenditures to reflect the payments to teachers, GSL disbursed $543,455 of funds from the treasury without using an appropriation. This practice violates the Montana Constitution and understated GSL's revenues and expenditures on the state's accounting records by $543,455 in fiscal year 2011. GSL adjusted its financial statements for this error and the revenues and expenditures on the Statement of Revenues, Expenditures, and Changes in Fund Balance-Budget and Actual included on page A-4 are not understated.

Recommendation #1

We recommend the Montana Guaranteed Student Loan Program:

A. *Record revenues and expenditures associated with the teacher loan forgiveness in accordance with state law and policy.*

B. *Only disburse funds from the treasury with an appropriation in accordance with the Montana Constitution.*

Internal Control Over Financial Statement Preparation

The Montana Guaranteed Student Loan Program's internal control over financial statement preparation did not identify errors in its financial statements.

State accounting policy requires GSL to develop appropriate internal control procedures based upon their business processes. One of GSL's business processes is creating its financial statements. GSL management has a review process to make sure the financial statements are appropriately presented. However, when we reviewed the financial statements, we identified a variety of errors including:

- GSL staff adjusted the financial statements for a $700,000 error on the accounting records. However the staff made the adjustment to an incorrect account on the Balance Sheet.
- GSL has investments which require specific asset and liability classification on its Balance Sheet. GSL listed the liability but not the asset on its Balance Sheet as of June 30, 2011. Rather, GSL combined the investment asset with Cash in Treasury, overstating total Cash in Treasury by $181,643 on its Balance Sheet.
- On the Statement of Revenues, Expenditures, and Changes in Fund Balance-Budget and Actual, GSL used an incorrect fund balance as of June 30, 2010, for the Essay Scholarship Fund. This resulted in an incorrect ending fund balance in the Essay Scholarship Fund on that statement.

GSL's Management stated that when they reviewed the financial statements they looked at the bottom line of each of the statements and made sure that they appeared reasonable for the big picture. They also stated that the Essay Scholarship Fund is immaterial compared to the rest of their funds, and they did not review that fund in as much detail.

GSL management's review of the financial statements should be more detailed to ensure the financial statements appropriately reflect the activity for which GSL is accountable. The agency adjusted the Balance Sheet and the Statement of Revenues, Expenditures, and Changes in Fund Balance-Budget and Actual included on pages A-3 and A-4 for these errors. Therefore the financial statements do not include the misstatements listed above.

Recommendation #2

We recommend the Montana Guaranteed Student Loan Program implement effective internal controls to prevent or detect errors in its financial statement preparation process.

Cost of Loan Collections

In fiscal year 2011, GSL recorded $5.8 million of inflows and outflows associated with its Federal Student Loan Reserve Fund's Cost of Loan Collections in its Agency Fund rather than its Federal Student Loan Reserve Fund on the state's accounting records.

Federal regulations require GSL to have two funds; the Agency Operating Fund (operating account) and the Federal Student Loan Reserve Fund (federal account). In accordance with federal regulations GSL deposits and pays for certain activities in each account. The state's accounting system allows GSL to use separate accounting entities in the Federal Special Revenue Fund to comply with these legal requirements.

Section 17-1-102(4), MCA, requires GSL to record all activity on its accounting records in accordance with GAAP. State accounting policy and GAAP require GSL to record:

- all transactions and events that affect each account's current financial resources on its operating statement
- all assets, liabilities, revenues, expenditures, and transfers that affect an account, in that account

GSL deposits a portion of its loan collections in each account. The portion of loan collections deposited in the federal account is remitted to the U.S. Department of Education. GSL records these deposits and remittances by increasing and decreasing a liability in the federal account rather than recording revenues, expenditures or transfers.

During fiscal year 2011, GSL's federal account received $5.8 million of deposits associated with loan collections and paid $5.8 million to the federal government without any operating activity reported in the federal account. Since GSL's operating fund is charged with all loan collection activities GSL staff recorded the loan collection revenues in its operating account. To show the operating fund's net loan collections, GSL recorded the expenditure for the payment to federal government in the operating account.

GSL's practice of not recording any inflows or outflows in its federal account for these collections and remittances is not done in accordance with state accounting policy and GAAP. GSL should record the federal account's operating activity in the federal account. GSL staff adjusted the financial statements by recording a $5.8 million transfer-out in the operating account. In the federal account GSL recorded a $5.8 million transfer-in and a Cost of Loans Collections expenditure. Therefore, on the Statement of Revenues, Expenditures, and Changes in Fund Balance-Budget and Actual on page A-4, the federal account includes its operating activity for the receipt of cash and its payments to the federal government.

Recommendation #3

We recommend Montana Guaranteed Student Loan Program record the Federal Student Loan Reserve Fund operating activity in the Federal Student Loan Reserve Fund on the state's accounting records in accordance with state law, state accounting policy, and generally accepted accounting principles.

Independent Auditor's Report and Program Financial Statements

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Deborah F. Butler, Legal Counsel

Deputy Legislative Auditors
Cindy Jorgenson
Angie Grove

Independent Auditor's Report

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Balance Sheet of the Montana Guaranteed Student Loan Program as of June 30, 2011, and the related Statement of Revenues, Expenditures, and Changes in Fund Balance-Budget and Actual for the fiscal year then ended. The information contained in these financial statements is the responsibility of the program'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. 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 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 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.

The financial statements of the Montana Guaranteed Student Loan Program present the financial position and the changes in financial position of only that portion of the reporting entity of the state of Montana that is attributable to the transactions of the program. They do not purport to, and do not, present fairly the financial position of the state of Montana as of June 30, 2011, or the changes in financial position for the fiscal 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 Montana Guaranteed Student Loan Program as of June 30, 2011, and its changes in fund balance for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the financial statements, the Montana Guaranteed Student Loan Program changed the fund in which it recorded expenditures associated with the Cost of Loan Collections.

Respectfully submitted,

Cindy Jorgenson, CPA
Deputy Legislative Auditor

November 9, 2011

Commissioner of Higher Education
Montana Guaranteed Student Loan Program
Federal Special Revenue Fund
Balance Sheet
As of June 30, 2011

	Agency Operating Fund	Federal Student Loan Reserve Fund	Essay Scholarship Fund
Assets			
Cash in Treasury	$ 409,570	$ 873,795	$ -
Cash Collateral - SI	106,696	74,948	2,386
Short Term Investments (Note 3)	7,881,713	5,536,459	176,245
Long Term Investments (Note 3)	136,130	95,624	3,044
Accounts Receivable	34,865	835	36
Due From Federal Government (Note 3)	264,866	3,472,230	-
Prepaid Expense	-	-	-
Total Assets	$ 8,833,840	$ 10,053,891	$ 181,711

	Agency Operating Fund	Federal Student Loan Reserve Fund	Essay Scholarship Fund
Liabilities and Fund Balance			
Liabilities			
Accounts Payable	$ 132,573	$ 759,562	$ -
Deferred Revenue	2,987	-	-
Property Held in Trust	583	-	-
Liab. Under Securities Lend	106,696	74,948	2,386
Due to Federal Government (Note 5)	-	1,419,986	-
Total Liabilities	$ 242,838	$ 2,254,496	$ 2,386
Total Fund Balance	8,591,002	7,799,395	179,325
Total Liabilities and Fund Balance	$ 8,833,840	$ 10,053,891	$ 181,711

The accompanying notes are an integral part of this financial statement.

Commissioner of Higher Education
Montana Guaranteed Student Loan Program
Federal Special Revenue Fund
Statement of Revenues, Expenditures, and Changes in Fund Balance
Budget and Actual
For the Fiscal Year Ended June 30, 2011

	Agency Operating Fund			Federal Student Loan Reserve Fund			Essay Scholarship Fund		
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance
Revenue									
Guarantee Fee Income (Note 6)	$ -	$ -	$ -	$ -	$ (3,646)	$ (3,646)	$ -	$ -	$ -
Loan Processing and Issuance Fee (Note 7)	-	(21,029)	(21,029)	-	31,998	$ 31,998	-	-	-
Account Maintenance Fees (Note 8)	1,059,899	1,080,493	20,594	-	-	-	-	-	-
Default Aversion Fees (Note 9)	800,000	632,438	(167,562)	300,000	238,875	(61,125)	-	-	-
Collection Recoveries (Note 10)	2,100,000	2,181,981	81,981	-	-	-	-	-	-
Loan Rehabilitations (Note 10)	5,200,000	5,240,766	40,766	-	-	-	-	-	-
FDSLP Consolidation Collection Fees (Note 10)	850,000	923,372	73,372	-	-	-	-	-	-
Reinsurance from Department of Education (Note 11)	-	-	-	21,948,863	28,831,863	6,883,000	-	-	-
Non-Reinsured Loan Recoveries (Note 13)	-	-	-	200,000	253,176	53,176	-	-	-
Disbursement Service Fees	-	66	66	-	-	-	-	-	-
Investment Earnings (Note 3)	10,500	21,814	11,314	20,000	17,433	(2,567)	-	481	481
STIP Security Lending Gross Earnings	3,500	4,008	508	3,000	3,365	365	-	90	90
Miscellaneous	4,000	15,900	11,900	-	298	298	-	-	-
Total Revenue	10,027,899	10,079,809	51,910	22,471,863	29,373,362	6,901,499	-	571	571
Expenditures									
Administrative Costs	$ 4,581,550	$ 4,083,654	497,896	$ -	$ -	$ -	$ -	$ -	$ -
Cost of Loan Collections (Note 10)	-	-	-	5,809,000	5,803,469	5,531	-	-	-
Claims Paid to Lenders (Note 11)	-	-	-	26,000,000	28,809,085	(2,809,085)	-	-	-
Claims Paid to Lenders -uninsured	-	-	-	611,004	964,820	(353,816)	-	-	-
Default Aversion Fees (Note 9)	300,000	238,875	61,125	800,000	632,438	167,562	-	-	-
STIP Security Lending Expense	-	848	(848)	-	712	(712)	-	19	19
Scholarships	-	-	-	-	-	-	-	6,601	6,601
Total Expenditures	4,881,550	4,323,377	558,173	33,220,004	36,210,524	(2,990,520)	-	6,620	(6,620)
Excess (Deficiency) of Revenues Over Expenditures	5,146,349	5,756,432	610,083	(10,748,141)	(6,837,162)	3,910,979	-	(6,049)	(6,049)
Other Financing Sources/(Uses)									
Transfer In (Note 2)	-	-	-	5,809,000	5,803,469	(5,531)	-	-	-
Transfer Out (Note 2)	(5,809,000)	(5,803,469)	5,531	-	-	-	-	-	-
Net Change in Fund Balance	(662,651)	(47,037)	615,614	(4,939,141)	(1,033,693)	3,905,448	-	(6,049)	(6,049)
Fund Balance 06/30/10	8,638,039	8,638,039	-	8,833,088	8,833,088	-	185,374	185,374	-
Fund Balance 06/30/11	$ 7,975,388	$ 8,591,002	$ 615,614	$ 3,893,947	$ 7,799,395	$ 3,905,448	$ 185,374	$ 179,325	$ (6,049)

The accompanying notes are an integral part of this financial statement.

Commissioner of Higher Education
Montana Guaranteed Student Loan Program
Federal Special Revenue Fund
Notes to the Financial Statements
For the Fiscal Year Ended June 30, 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Program

The State of Montana's Guaranteed Student Loan Program (MGSLP) is located in the Office of the Commissioner of Higher Education. MGSLP was established by the Office of the Commissioner of Higher Education in fiscal year 1981 to coordinate and administer the federally insured student loans issued by various lending institutions. Montana's Federal Family Education Loan Program (FFELP) operates in compliance with and pursuant to agreements between the Montana Board of Regents and the U.S. Department of Education (DE), pursuant to Section 428 of the Higher Education Act of 1965, as amended. On February 8, 2006, President Bush signed the Higher Education Reconciliation Act of 2005 (the "HERA"), PUB. L. 109-171, which made changes to the Higher Education Act of 1965, as amended. These changes became effective during the fiscal year ended June 30, 2008.

B. Basis of Accounting

The financial statements were prepared using the modified accrual basis of accounting, and are presented in a budget to actual format, which does not significantly differ from a GAAP presentation. Under the modified accrual basis of accounting, revenues are recognized when they are realizable, measurable, earned and available. They are considered realizable and measurable if the transaction has been completed or there is enough information to reasonably estimate the revenue to be received. The revenue is considered earned when the services have taken place. Available means that the revenue is collectable within the current accounting period or will be received within sixty days after the end of the fiscal year. The expenditures are recorded when the department incurs the related liability and it is measurable.

C. Descriptions of Federal Special Revenue Funds

As a Federal Special Revenue Fund, MGSLP accounts for the proceeds of revenue sources that are legally restricted to expenditures for specified purposes. Pursuant to the Higher Education Act of 1965, as amended, MGSLP accounts for its operations in two separate funds: the Federal Student Loan Reserve Fund (FSLRF) and the Agency Operating Fund (AOF). Use of the FSLRF is limited to payment of lender claims and payment of default aversion fees or other DE fee payments as directed. MGSLP is required to deposit claim reimbursements from DE into the FSLRF, as well as the following: DE's equitable share of defaulted loan recoveries, the portion of default recoveries that equals the complement of the reinsurance rate which is not reimbursed to MGSLP by DE, and student loan insurance premiums (guarantee fees). The AOF is the property of MGSLP and is used for a variety of FFELP activities and for other student aid related activities as selected by the agency. Payments received by MGSLP for loan processing and issuance, account maintenance, default aversion activities, and MGSLP's share of defaulted loan collections is all deposited into the AOF. MGSLP also maintains a fund to account for funds held in trust for recipients of MGSLP's essay scholarship contest. Funds are invested in the Montana Short Term Investment Pool (STIP).

2. ACCOUNTING CHANGE

A change in accounting for loan recoveries and consolidations was made for the fiscal year ended June 30, 2011. The change redirects the reporting of the federal share of collections on defaulted loans from the Agency Operating Fund into the Federal Student Loan Reserve Fund as a transfer-in and expenditure of cost of loan collections. This is based on the interpretation of federal regulations requiring MGSLP to directly remit the portion of recoveries to the U.S. Department of Education. In the current financial statements, the net revenue retained by MGSLP of $2,542,650 is reported in the Agency Operating Fund. The federal share remitted directly to the U.S. Department of Education of $5,803,469 is now reported in the Federal Student Loan Reserve Fund as a transfer-in with corresponding expenditures of $5,803,469 (See Note 10). Prior to June 30, 2011, the revenues and expenditures related to the federal share remitted directly to the U.S. Secretary of Education were reported in the Agency Operating Fund. The change has no overall effect on the financial statements and does not change the amount of defaulted loans collected or the amount of funds retained by the federal government. The administration expenses incurred by MGSLP in the collection of the defaulted loans remains in the Agency Operating Fund. The related budget has been moved to reflect the change in accounting.

3. INVESTMENTS

Short and Long Term investments are units purchased in the State of Montana's Short Term Investment Pool (STIP) and are recorded at a unit cost of $1. All securities in STIP are held in the name of the Montana Board of Investments or were registered in the nominee name for the Montana Board of Investments and held by the Board's custodial bank. STIP credit quality is not rated. The Board of investments employs the "Prudent Expert Rule" in managing the State's investment portfolio. At June 30, 2011, MGSLP owned 13,829,215 units valued at $13,829,215. MGSLP does not have a formal policy for credit risk. As directed by the Department of Administration, MGSLP classified $ 234,798 of STIP as Long Term Investments to reflect MGSLP pro rata share of STIP Investments that were non-liquid at June 30, 2011.

4. DUE FROM FEDERAL GOVERNMENT

MGSLP pays individual lending institutions for any loans that have defaulted or are unpaid due to the death, permanent disability, or bankruptcy of the borrower. The agency then seeks reimbursement from the DE in accordance with reinsurance agreements between the agency and DE. Claim payments and subsequent reinsurance payments are paid from and deposited into the Federal Student Loan Reserve Fund. MGSLP's claims for reinsurance payments not received as of June 30, 2011, are included here. In addition, the receivable Due From Federal Government includes amounts MGSLP had not yet received for Account Maintenance Fee (Note 8) for the last quarter of fiscal year 2011. The extent of the outstanding reinsurance activity and other pending reimbursements from DE as of June 30, 2011, is shown below.

Reinsurance Claims	$3,352,723	Federal Student Loan Reserve Fund
Teacher Loan Forgiveness	$ 119,507	Federal Student Loan Reserve Fund
Account Maintenance Fee	$264,964	Agency Operating Fund
IRS Overpayment	$(96)	Agency Operating Fund
Total Due From Federal Government	$3,737,096	

5. DUE TO FEDERAL GOVERNMENT

After assignment to the guaranty agency, MGSLP seeks collection of student loans that have defaulted. A portion of the recoveries of loans reinsured by the Department of Education (DE) is owed back to DE (Note 10). At June 30, 2011, the amount owed to DE was $1,419,986.

6. GUARANTEE FEE INCOME

The default fee was paid by the borrowers or by any other non-federal source. As of July 1, 2010 all Federal student loans are made through the Federal Direct Student Loan Program (FDSLP). MGSLP will no longer be receiving Guarantee Fee income.

Guarantee fee revenue for fiscal year 2011 was $(3,646) in the Federal Student Loan Reserve Fund (FSLRF). Guarantee fee revenue was negative because of loan guaranteed before and cancelled after July 1, 2010.

7. LOAN PROCESSING AND ISSUANCE FEE

The Higher Education Amendments of 1998 authorized payment of a Loan Processing and Issuance Fee beginning October 1, 1998. Under this Act, each guaranty agency is paid a loan processing and issuance fee (LPIF), to be deposited into the Agency Operating Fund As of July 1, 2010 all Federal student loans are made through the Federal Direct Student Loan Program (FDSLP). MGSLP will no longer be receiving a Loan Processing and Issuance Fee from the U.S. Department of Education.

During fiscal year 2011, the U.S. Department of Education made an adjustment to current and prior year Loan Processing and Issuance Fee revenue totaling $31,998.

8. ACCOUNT MAINTENANCE FEE

The Higher Education Amendments of 1998 authorized the payment of an Account Maintenance Fee beginning October 1, 1998. Under this Act, each guaranty agency is paid an account maintenance fee, to be deposited into the Agency Operating Fund. For federal fiscal years beginning 2007, the fee is .06% of the original principal balance of guaranteed loans outstanding during the year. During fiscal year 2011, Account Maintenance Fee revenue totaled $1,080,493 which includes $264,964 accrued for reimbursements that were not received until after June 30, 2011.

9. DEFAULT AVERSION FEE

The Higher Education Amendments of 1998 authorized the payment of a Default Aversion Fee beginning October 1, 1998. Upon receipt of a completed lender request for assistance (LRA) not earlier than the 60th day of delinquency, a guaranty agency must engage in default aversion activities designed to prevent a default by the borrower. Department of Education regulations provide for payment of a fee equal to 1% of the loan balance at the time an LRA is submitted, regardless of whether or not the loan is brought current. The default aversion fees are to be transferred from the Federal Student Loan Reserve Fund (FSLRF) to the Agency Operating Fund (AOF) no more frequently than monthly. If the agency receives a default aversion fee and the account later defaults, the agency must rebate 1% of the claim amount to the FSLRF. The fee may be paid only once on any loan. During fiscal year 2011, the Default Aversion Fee paid to the Operating Fund was $632,438 and $238,875 was reimbursed back to the Federal Reserve Fund.

10. COLLECTION COSTS RETAINED

MGSLP pursues collection, from the borrower or other responsible party, of defaulted loans held by the agency. The U.S. Secretary of Education is entitled to an equitable share of any recoveries, as determined by the rate of reinsurance on the defaulted loans less an allowance for collection cost reimbursement. Beginning October 1, 2003, the Higher Education Amendments (HEA) of 1998 authorize guaranty agencies to deposit an amount equal to 23% of the payments made by or on behalf of a defaulted borrower into its Agency Operating Fund. Beginning October 2007, this changed to 16%. The HEA also stipulates that the agency shall remit 81.5% of the total outstanding principal collected on rehabilitated loans to the Secretary and the agency shall deposit 18.5% of the principal, 100 % accrued interest and18.5 % of the outstanding balance. In addition, the Secretary provides the agency with collection costs amounting to 18.5% of the outstanding balance of any defaulted loan held by the agency which is consolidated by the borrower into a Federal Consolidation Loan through either Federal Family Education Loan Program (FFELP) consolidation or Federal Direct Student Loan Program (FDSLP) consolidation. HERA requires that on or after October 1, 2006, the guaranty agency shall remit directly to the Secretary that portion of the collection charge equal to 8.5 % of the outstanding balance of the defaulted loan. During fiscal year 2011, MGSLP retained $2,542,650 in net collection costs from loan recoveries and consolidations, as follows.

	Revenues	Expenses	Net
Collection Recoveries	$2,181,981	$1,832,927	$ 349,054
Rehabilitations	$5,240,766	$3,544,175	$ 1,696,591
FDSLP Consolidations	$ 923,372	$ 426,367	$ 497,005
Total	$8,346,119	$5,803,469	$ 2,542,650

11. CLAIMS PAID TO LENDERS AND REINSURANCE FROM DEPARTMENT OF EDUCATION

MGSLP records amounts paid to lenders for claims and subsequent amounts received from the Department of Education (DE) as expenses and revenues respectively. For fiscal year 2011, MGSLP paid claims totaling $28,809,085 and received reinsurance from DE totaling $28,831,863.

12. ESSAY SCHOLARSHIP FUNDS

MGSLP sponsored an essay competition from 1999 to 2008 which was open to students in GEAR UP schools. The recipients were awarded scholarships worth $150 - $250. MGSLP will hold the scholarship in the recipient's name until he or she enters an eligible postsecondary education institution or until the eligibility to use the scholarship run out. If the student doesn't enroll in the time frame allotted, the funds will revert back to MGSLP.

13. CONTINGENCIES

The original principal balance of guaranteed loans outstanding held by MGSLP as of June 30, 2011 was approximately $1,756,727,435 This amount excludes bad debt, death, disability, and bankruptcy claims which have been previously purchased by the agency. MGSLP has entered into agreements with the Department of Education (DE), dated June 13, 1980, for reinsurance and supplemental reinsurance of loans, in accordance with the Higher Education Act of 1965, as amended. These agreements allow for 100% reimbursement by DE for claims due to the death, disability, or bankruptcy of the borrower. Claims paid due to defaulted loans may be reimbursed by DE for up to 100%. The percent of reimbursement on defaulted loans payable to the agency is dependent upon MGSLP's annual default rate and date of the loan’s first disbursement. Annual default rates are calculated as the ratio of year-to-date default purchases divided by the original guaranteed amount of loans in repayment status at the beginning of the federal fiscal year.

The following schedule reflects the federal reinsurance rates on defaulted student loans. In the event of extreme future adverse loss experience, MGSLP could be liable for up to 25% of the outstanding loan volume. Since its inception, MGSLP has paid $6,760,686 in claims, or portions of claim eligible loans, which were not reinsured by DE. During fiscal year 2011, MGSLP recovered $253,176 of the total outstanding balance of non-reinsured claims held by the agency.

RATE OF ANNUAL DEFAULTS	**FEDERAL REINSURANCE On loans made prior to 10/01/93**	**FEDERAL REINSURANCE On loans made on or after 10/01/93 and prior to 10/01/98**	**FEDERAL REINSURANCE On loans made after 10/01/98**
Less than 5%	100%	98%	95%
5% or greater but less than 9%	90% of claims 5% or greater but less than 9%	88% of claims 5% or greater but less than 9%	85% of claims 5% or greater but less than 9%
9% or greater	80% of claims 9% or greater	78% of claims 9% or greater	75% of claims 9% or greater

14. COMMITMENTS

MGSLP is bound by Guarantee Reserve Agreements with the lending institutions participating in the Federal Family Education Loan Program in Montana. These agreements require MGSLP to maintain an amount in the guarantee reserve fund equal to at least 0.25% of the unpaid principal balance of all outstanding loans guaranteed by the agency.

The Guarantee Reserve Agreement ensures that MGSLP will have sufficient cash available to carry out its reasonably expected obligations on guaranteed claim eligible student loans. As of June 30, 2011, MGSLP was in compliance with all Guarantee Reserve Agreements.

15. RELATED PARTY TRANSACTIONS

The Montana Board of Regents, which governs MGSLP, guarantees loans owned by the Montana Higher Education Student Assistance Corporation (MHESAC). Approximately 77.59% of MGSLP's outstanding loan volume is held by MHESAC.

MGSLP also has an agreement with Student Assistance Foundation of Montana (SAF) to share certain costs for the lease of computer equipment; computer and software maintenance costs; and personnel costs for employees of SAF who perform services that are of direct benefit to MGSLP. Certain SAF personnel are authorized to purchase computer equipment for use by both MGSLP and SAF. Costs for these purchases are covered under an agreement for services between the two entities. During fiscal year 2011, MGSLP's portion of shared costs reimbursed to SAF was $414,854.

16. GOING CONCERN

As of July 1, 2010 all new Federal student loans are made through the Federal Direct Student Loan Program (FDSLP). MGSLP will no longer receive income from LPIF (see Note 7), Disbursement Service, or Guarantee Fees.

17. EMPLOYEES' RETIREMENT SYSTEM

MGSLP classified employees participate in the Montana Public Employees' Retirement System (PERS). Professional employees under contract with the Board of Regents are covered by the Optional Retirement Program (ORP), which is available through the Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF).

Defined Benefit Plans

Established in 1945 and governed by Title 19, chapter 3, MCA, PERS participants are eligible to retire at age 60 with at least five years of service; at age 65 regardless of length of service; or at 30 years of service regardless of age. A reduced retirement benefit may be taken with 25 years of service or at age 50 with a minimum of five years of service. Effective January 1, 1989, monthly retirement benefits are calculated by taking 1/56 times the years of service times the final average salary. Vesting occurs once membership service totals five years.

Defined Contribution Plan

ORP was established in 1988 and is underwritten by the Teacher's Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF). The ORP is a defined-contribution plan. Until July 1, 2002, only faculty and staff with contracts under the authority of the Board of Regents were eligible to participate. The plan was changed, effective July 1, 2003, to allow all staff to participate in the ORP. Contribution rates for the plan are required and determined by State law. MGSLP's contributions were equal to the required contribution. The benefits at retirement depend upon the amount of contributions, amounts of investment gains and losses, and the employee's life expectancy at retirement. Under the ORP, each employee enters into an individual contract with TIAA-CREF. MGSLP records employee/employer contributions and remits monies to TIAA-CREF. Individuals vest immediately in the employer portion of retirement contributions. Annual reports that include financial statements and required supplemental information on the plan are available directly from TIAA-CREF.

According to state law, MGSLP also remits additional employer contributions to the PERS and TRS to amortize past service unfunded liability.

Retirement plan information for MGSLP as of June 30, 2011, is as follows.

	PERS	ORP Professional	ORP Staff
Covered Payroll	$714,997	$93,312	$124,057
Employer Contributions	$ 39,486	$5,558	$ 5,573
Percent of Covered Payroll	5.523%	5.956%	4.449%
Employee Contribution	$ 50,079	$6,573	$8,560
Percent of Covered Payroll	7.004%	7.044%	6.900%

Montana Guaranteed Student Loan Program

Program Response

Montana Guaranteed Student Loan Program
2500 Broadway P.O. Box 203101
Helena, MT 59620-3101
Phone: (406) 444-6594 Fax: (406) 444-1869
Customer Assistance: (800) 537-7508
mgslpcustserv@montana.edu www.mgslp.org

December 16, 2011

Tori Hunthausen, Legislative Auditor
Legislative Audit Division
State Capital Building, Room 160
Helena, MT 59620

Dear Ms. Hunthausen

We appreciate the opportunity to respond to the financial statement audit report of the Montana Guaranteed Student Loan Program for the year ended June 30, 2011. The recommendations presented in the report improve the financial reporting and have all been implemented.

RECOMMENDATION #1
We recommend the Montana Guaranteed Student Loan Program:

A. Record revenues and expenditures associated with teacher loan forgiveness in accordance with state law and policy.
B. Only disburse funds from the treasury with an appropriation in accordance with the Montana Constitution.

AGENCY RESPONSE: Concur
The Montana Guaranteed Student Loan Program has implemented the recommended change. The adjustment to record teacher loan forgiveness transactions as revenues and expenses to reflect the payments to teachers are included in the financial statements. The recommendation did not change the amount spent on teacher loan forgiveness.

RECOMMENDATION #2
We recommend the Montana Guaranteed Student Loan Program implement effective internal controls to prevent and detect errors in its financial statement preparation process.

AGENCY RESPONSE: Concur
The Montana Guaranteed Student Loan Program agrees that the internal controls policy in place did not specifically address the annual preparation of the financial statements. Written procedures, to prevent

and detect financial statement preparation errors, have been incorporated into the agency's established internal controls policy.

RECOMMENDATION #3

We recommend Montana Guaranteed Student Loan Program record the Federal Student loan Reserve Fund operating activity in the Federal Student Loan Reserve fund on the state's accounting records in accordance with the state law, state accounting policy, and generally accepted accounting principles.

AGENCY RESPONSE: Concur

Based on the interpretation of 34 C.F.R. §682.419(b)(6) which states that all funds received by the guaranty agency from any source on FFEL Program loans on which a claim has been paid, within 48 hours of receipt of the funds, minus the portion the agency is authorized to deposit in its operating fund and the application of state law, state accounting policy, and GAAP, the agency made the recommended accounting adjustment. The adjustment was made to the financial statements to reflect transfer-in/transfer-out activity for loan collections as explained in Note 2 and did not change the amounts retained by the program and or returned to the U.S. Department of Education.

In closing, we would like to thank you and your staff for their valuable suggestions and appreciate the opportunity to work with Ms. Toeckes. She is very knowledgeable and professional and represented your office well.

Sincerely,

Bruce Marks

Bruce Marks
Director, Montana Guaranteed Student Loan Program