

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

Financial Audit  
For the Year Ended June 30, 2011

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

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program  
Financial Audit  
For the Year Ended June 30, 2011**

**Table of Contents**

---

	Page
Agency Officials	1
Financial Statement Report	
Summary	2
Independent Auditors' Report	3 - 4
Financial Statements	
Statement of Net Assets	5
Statement of Revenues, Expenses, and Changes in Net Assets	6
Statement of Cash Flows	7 - 8
Notes to Financial Statements	9 - 31
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	32 - 33
Schedule of Findings	34 - 44

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Agency Officials**

---

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

Agency offices are located at:

1755 Lake Cook Road  
Deerfield, IL 60015-5209

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 & 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 material weaknesses and significant deficiencies. The material weaknesses are described in the accompanying schedule of findings listed in the table of contents as:

- finding 11-1 (Procurement Law Not Followed)
- finding 11-2 (Noncompliance with Investment Policy)
- finding 11-3 (Financial Statement Preparation)
- finding 11-4 (Alternative Investment Oversight and Manager Fees)

The significant deficiency is described in the accompanying schedule of findings listed in the table of contents as finding 11-5 (Timeliness of Actuarial Valuation Report).

**Exit Conference**

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

Illinois Student Assistance Commission

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

McGladrey & Pullen, LLP

Linda Abernethy	Partner
Rolake Adedara	Director

Office of the Auditor General

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

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



## Independent Auditors' Report

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

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

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

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

As discussed in Note 2, the financial statements present only the Illinois 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, 2011, 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, 2011 of \$262 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, 2011, 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 27, 2012 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 27, 2012

**State of Illinois  
 Illinois Student Assistance Commission  
 Illinois Prepaid Tuition Program**

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

<b>Assets</b>	
Current	
Cash and cash equivalents	\$ 7,833,004
Receivables:	
Accrued interest on investments	240
Total current assets	<u>7,833,244</u>
Noncurrent	
Investments	<u>1,124,442,364</u>
Total assets	<u>1,132,275,608</u>
<b>Liabilities</b>	
Current	
Accounts payable and accrued expenses	1,872,354
Tuition payable	78,276,500
Accreted tuition payable	6,897,500
Due to State of Illinois component units	114,628
Compensated absences	24,683
Total current liabilities	<u>87,185,665</u>
Noncurrent	
Tuition payable	828,374,376
Accreted tuition payable	478,780,812
Compensated absences	66,134
Total noncurrent liabilities	<u>1,307,221,322</u>
Total liabilities	<u>1,394,406,987</u>
<b>Net assets, unrestricted (deficit)</b>	<u><u>\$ (262,131,379)</u></u>

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, 2011**

Operating revenues:	
Income from investment securities	\$ 168,273,035
Interest revenue - other	621,003
Fees	1,356,011
Net operating revenues	<u>170,250,049</u>
Operating expenses:	
Salaries and employee benefits	3,276,558
Accreted tuition expense	83,916,121
Management and professional services	3,607,339
Investment management fees	1,683,812
Investment advisory fees	1,921,561
Total operating expenses	<u>94,405,391</u>
Operating income	75,844,658
Transfer - out	<u>(88,000)</u>
Change in net assets	75,756,658
Net assets (deficit), July 1, 2010	<u>(337,888,037)</u>
Net assets (deficit), June 30, 2011	<u><u>\$ (262,131,379)</u></u>

See Notes to Financial Statements.

**State of Illinois**  
**Illinois Student Assistance Commission**  
**Illinois Prepaid Tuition Program**

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

<hr/>	
Cash flows from operating activities	
Cash receipts from prepaid tuition contracts	\$ 89,028,604
Cash received from fees	1,356,011
Cash paid for refund of contracts	(24,954,903)
Cash paid for tuition and accretion	(78,690,373)
Cash payments to suppliers for goods and services	(2,656,948)
Cash payments to employees for services	(3,298,220)
Net cash used in operating activities	<u>(19,215,829)</u>
Cash flows from noncapital financing activities	
Transfer out	<u>(88,000)</u>
Cash flows from investing activities	
Purchase of investment securities	(556,615,935)
Sales and maturities of investment securities	546,784,804
Interest and dividends on investments	23,843,113
Cash paid to investment managers	(1,683,812)
Net cash provided by investing activities	<u>12,328,170</u>
Net decrease in cash and cash equivalents	<u>(6,975,659)</u>
Cash and cash equivalents, July 1, 2010	<u>14,808,663</u>
Cash and cash equivalents, June 30, 2011	<u>\$ 7,833,004</u>

(Continued)

**State of Illinois**  
**Illinois Student Assistance Commission**  
**Illinois Prepaid Tuition Program**

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

---

Reconciliation of operating income to net cash used in operating activities:

Operating income	<u>\$ 75,844,658</u>
Adjustments to reconcile operating income to net cash used in operating activities:	
Investment income and other interest income	(168,894,038)
Investment management fees	1,683,812
Investment advisory fees	1,921,561
Accreted tuition expense	83,916,121
Increase (decrease) in liabilities:	
Accounts payable and accrued expenses	925,115
Due to State of Illinois component units	16,734
Tuition payable	(14,616,672)
Compensated absences	(13,120)
Total adjustments	<u>(95,060,487)</u>
Net cash used in operating activities	<u><u>\$ (19,215,829)</u></u>
Supplemental disclosure of noncash investing transactions:	
Net appreciation in fair value of investments	<u><u>\$ 143,928,607</u></u>

See Notes to Financial Statements.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**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!*® or Program) 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. 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 thirteen enrollment periods, as of June 30, 2011, the Illinois Prepaid Tuition Program had 53,644 contracts in force with a purchased value of \$1,644 million. As of June 30, 2011, the fund has received cash collections of \$1,209 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.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**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, 2011, 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.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**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.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**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 53,644 contracts held by the fund as of June 30, 2011.

**I. Net Assets (Deficit)**

Net assets at year end (when positive) are restricted by the provisions of the tuition contracts, for tuition payments for beneficiaries of the contract owners. Net deficits however 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.

**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.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**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.

The Commission may direct that assets of the Program's 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. Unless otherwise exempt from registration, investment managers 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 reviews the asset/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. Additionally, the Program has contracted with Marquette Associates to evaluate the investment performance of the Illinois Prepaid Tuition Program on an ongoing basis.

In addition, the investment policy authorizes 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's Board. The Commission's Board is responsible for making the investment decision for the Fund.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**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 each approved asset class. Such restrictions may include certain prohibited transactions, as well as restrictions on portfolio composition.

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, 2011, 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 \$7,557,256 at June 30, 2011. 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.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**Note 3. Deposits and Investments - Continued**

**C. Investments - Continued**

ISAC has retained State Street Global Advisors, LSV Asset Management, 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, Ativo, MacKay Shields, Harris/Pyrford, Camelot Secondary, Kennedy Wilson, Lyrical-Antheus, Mesirov Value, and DDJ Distressed Fund as investment managers to assist with the investment of the fund assets for the Illinois Prepaid Tuition Program. 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, 2011, 23.9% of the funds were invested in Domestic Equities, 21.6% in Domestic Fixed Income, 9.8% in International Equities, 1.7% in Infrastructure Funds, 14.1% in Hedge Funds, 11.5% in Private Equity Funds, 15.3% in Real Estate, .3% in illiquid securities and 1.8% in 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.

State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program

Notes to Financial Statements

Note 3. Deposits and Investments - Continued

C. Investments – Continued

The Illinois Prepaid Tuition Program's cash and investments at June 30, 2011 are presented below at fair value by investment type and by investment manager:

<b>Investment Managers</b>			
<b>Asset Allocation at June 30, 2011</b>			
<b>Asset Class</b>	<b>Investment Manager</b>	<b>Fair Value</b>	<b>Actual Allocation</b>
Fixed Income-Core	C.S. McKee	\$ 71,260,146	6.29%
Fixed Income-Core	Piedmont	33,302,421	2.94%
Fixed Income-Core	Pugh Capital	42,094,968	3.72%
Fixed Income-Intermediate	Income Research Management	64,298,463	5.68%
TIPS Account	N/A	33,713,698	2.98%
<b>Total Fixed Income Portfolio</b>		<b>244,669,696</b>	<b>21.61%</b>
Real Estate-Debt	SCM Capital Term Income	7	0.00%
Real Estate-Debt/Equity	SCM Capital Stable Income	60,086,463	5.31%
Real Estate-Preferred	SCM Capital Preferred Growth	47,713,616	4.21%
Real Estate-Value Added	Kennedy Wilson Property III	23,391,895	2.07%
Real Estate-Value Added	Kennedy Wilson Property IV	19,074,475	1.68%
Real Estate-Opportunistic	Lyrical-Antheus Realty III	18,280,011	1.61%
Real Estate-Value Added	Mesirow Value	4,294,674	0.38%
<b>Total Real Estate</b>		<b>172,841,141</b>	<b>15.26%</b>
Large-Cap Core Equity	SSgA S&P 500 Index	77,616,201	6.86%
All-Cap Core Equity	Rhumblin Advisers	193,072,870	17.05%
<b>Total Domestic Equity</b>		<b>270,689,071</b>	<b>23.91%</b>
International Large-Cap Equity	Ativo	31,935,974	2.82%
International Large-Cap Equity	MacKay Shields	30,134,319	2.66%
International Large-Cap Equity	Harris/Pyrford	32,296,819	2.85%
International Core Equity	SSgA MSCI EAFE	16,150,009	1.43%
International Core Equity	LSV Asset Management	6,617	0.00%
<b>Total International Equity</b>		<b>110,523,738</b>	<b>9.76%</b>
Infrastructure	Alinda Capital II	19,634,489	1.73%
<b>Total Infrastructure</b>		<b>19,634,489</b>	<b>1.73%</b>
Hedge FoFs	Balestra Spectrum II	55,224,272	4.88%
Hedge FoFs	NB Diversified Arbitrage	27,167,572	2.40%
Hedge FoFs	Pinnacle Natural Resources	56,101,825	4.96%
Hedge Fund-Market Neutral	Reynoso	21,677,813	1.91%
<b>Total Hedge Fund</b>		<b>160,171,482</b>	<b>14.15%</b>
Private Equity FoFs Secondary	Camelot Secondary Fund	14,965,390	1.32%
Private Equity Co-Invst	Camelot Co-Investment	18,732,381	1.66%
Private Equity FoFs Secondary	Morgan Stanley Secondary Fund	10,921,734	0.97%
Private Equity FoFs Secondary	Portfolio Advisors Secondary Fund	10,456,346	0.92%
Private Equity Distressed	DDJ Distressed Fund	57,392,526	5.07%
Private Equity Buy-Out	J.P. Morgan AIRRO Fund	17,237,131	1.52%
<b>Total Private Equity</b>		<b>129,705,508</b>	<b>11.46%</b>
Illiquid Securities Liquidating Trust	U.S. Bank (Custodian)	3,402,447	0.30%
<b>Total Illiquid Securities Liquidating Trust</b>		<b>3,402,447</b>	<b>0.30%</b>
Cash and Equivalents	N/A	12,804,792	1.13%
<b>Investment Cash Equivalents</b>		<b>12,804,792</b>	<b>1.13%</b>
<b>Total Investments</b>		<b>1,124,442,364</b>	<b>99.31%</b>
Cash and Equivalents	N/A	7,833,004	0.69%
<b>Total Cash Equivalents</b>		<b>7,833,004</b>	<b>0.69%</b>
<b>TOTAL PORTFOLIO</b>		<b>\$ 1,132,275,368</b>	<b>100%</b>

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**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, real estate and infrastructure investment portfolios consist of passive interests in non-publicly traded companies. The Program had outstanding unfunded commitments of approximately \$43 million to private equity partnerships, \$67 million to real estate and \$32 million to infrastructure funds as of June 30, 2011.

**Investment Management Fees**

The Program has contracted with Commission-approved investment managers to manage the assets of the Program. The investment managers serve as investors and investment advisors to the Program.

For investment managers who invest moneys in publicly held securities the Program pays an investment management fee for investment management services. The investment management fee is based upon contractually agreed upon conditions and provisions. Investment management fees expense for investments in publicly held securities amounted to \$1,683,812 for the year ended June 30, 2011 and is accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets.

For certain investment managers of private equity and real estate funds, the Program pays an investment advisory fee. The investment advisory fees are calculated based upon the terms and conditions agreed upon with each individual contractual agreement. The investment advisory fee expense for private equity and real estate funds amounted to \$1,921,561 for the year ended June 30, 2011 and is accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets.

In addition for administration of the private equity, infrastructure, hedge and real estate funds the Program also incurs additional fees such as investment management fees, syndication fees and other costs. These expenses are netted out of the unrealized gain on the market value of the investments. For the fiscal year ending June 30, 2011, these expenses amounted to approximately \$7.6 million and are accounted for as a part of the income from investment securities in the Statement of Revenues, Expenses, and Changes in Net Assets and the market value of investments on the Statement of Net Assets.

**State of Illinois  
 Illinois Student Assistance Commission  
 Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**Note 3. Deposits and Investments - Continued**

**C. Investments – Continued**

**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. Per the investment policy, the average duration of the portfolio for actively-managed bond managers is not to vary more than +/-50% of the duration of the BarCap Intermediate Government/Credit Index and the BarCap Aggregate Index.

As of June 30, 2011, 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
Income Research Management	3.7 Years	N/A	3.9 Years
C.S. McKee	4.6 Years	5.2 Years	N/A
Piedmont	5.0 Years	5.2 Years	N/A
Pugh Capital	5.1 Years	5.2 Years	N/A

State of Illinois  
 Illinois Student Assistance Commission  
 Illinois Prepaid Tuition Program

Notes to Financial Statements

---

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Portfolio Weighted Average Maturity

Investment Type	Portfolio Weighted Average	
	Fair Value	Weighted Average Maturity (in Years)
U.S. treasury bills	\$ 555,984	0.2
U.S. treasury notes	25,576,244	6.1
U.S. treasury bonds	3,640,082	19.0
U.S. Agency obligations	27,289,861	11.3
Index linked government bonds (U.S. Treasuries)	46,604,802	24.8
Municipal/Provincial Bonds	5,498,241	16.5
Corporate debt securities	104,869,828	6.4
U.S. agency asset-backed securities	4,169,785	17.1
Guaranteed fixed income	1,475,853	0.8
Corporate convertible bonds	4,935,638	7.1
Corporate asset-backed securities	5,280,378	4.4
Mortgage backed securities (MBS):		
Government agencies	30,553,477	22.8
Commercial	15,408,586	31.1
<b>Total Fair Value</b>	<b><u><u>\$ 275,858,759</u></u></b>	
Portfolio weighted average maturity		<b><u><u>13.6</u></u></b>

**State of Illinois  
 Illinois Student Assistance Commission  
 Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**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 operational guidelines for actively-managed bond managers set forth in the Illinois Prepaid Tuition Program investment policy state that securities rated below investment grade by at least two of the three rating agencies (Standard & Poor's, Fitch or Moody's) may not be purchased. If a security is downgraded to below investment grade status by at least two of the three rating agencies the Investment Manager must notify the Chief Investment Officer and the Investment Consultant in writing of the downgrade and their recommended action. Furthermore, the Investment Manager may hold up to 20% of the portfolio in securities rated below investment grade by at least two of the three rating agencies only if the securities are downgraded to below investment grade while the Investment Manager held the security in the portfolio.

The following tables indicate credit ratings, as of June 30, 2011, 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, 2011**

	Total Fair Value	Credit Rating*		
		Moody's	Standard & Poor's	Fitch
Money market mutual funds	\$ 22,434,805	NR	AAA	NR
Illinois Funds	78,513	NR	AAA	NR
Guaranteed fixed income	1,475,853	Aaa	AAA	AAA
Mortgage backed securities - government agencies	30,553,477	NR	NR	NR

\*NR - not rated

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**Note 3. Deposits and Investments - Continued**

**C. Investments - Continued**

**Credit Risk - Continued**

The following tables indicate credit ratings, as of June 30, 2011, for debt security investments that received multiple ratings:

**Credit Ratings (Multiple-Rated Securities), continued  
June 30, 2011**

<b>Rating Agency</b>	<b>Investment Type</b>	<b>Credit Rating*</b>	<b>Fair Value</b>
Moody's:	Corporate Debt Securities	Aaa	\$ 1,471,048
	Corporate Debt Securities	Aa	14,777,228
	Corporate Debt Securities	A	25,885,729
	Corporate Debt Securities	Baa	31,497,215
	Corporate Debt Securities	Ba	22,897,251
	Corporate Debt Securities	NR	8,341,357
			<u>104,869,828</u>
Standard & Poor's:	Corporate Debt Securities	AAA	1,471,049
	Corporate Debt Securities	AA	10,598,436
	Corporate Debt Securities	A	33,643,885
	Corporate Debt Securities	BBB	40,440,741
	Corporate Debt Securities	BB	14,871,570
	Corporate Debt Securities	NR	3,844,147
			<u>104,869,828</u>
Fitch:	Corporate Debt Securities	AAA	1,289,569
	Corporate Debt Securities	AA	6,214,061
	Corporate Debt Securities	A	28,487,325
	Corporate Debt Securities	BBB	18,606,897
	Corporate Debt Securities	BB	29,674,951
	Corporate Debt Securities	NR	20,597,025
			<u>104,869,828</u>

\* NR - not rated

State of Illinois  
 Illinois Student Assistance Commission  
 Illinois Prepaid Tuition Program

Notes to Financial Statements

---

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Credit Risk - Continued

Credit Ratings (Multiple-Rated Securities), continued  
 June 30, 2011

Rating Agency	Investment Type	Credit Rating*	Fair Value
Moody's:	Corporate Asset Backed Securities	Aaa	\$ 4,366,046
	Corporate Asset Backed Securities	NR	914,332
			<u>5,280,378</u>
Standard & Poor's:	Corporate Asset Backed Securities	AAA	3,889,346
	Corporate Asset Backed Securities	A	200,421
	Corporate Asset Backed Securities	NR	1,190,611
			<u>5,280,378</u>
Fitch:	Corporate Asset Backed Securities	AAA	4,211,526
	Corporate Asset Backed Securities	NR	1,068,852
			<u>5,280,378</u>
Moody's:	Municipal/Provincial Bonds	Aaa	959,274
	Municipal/Provincial Bonds	Aa	3,216,303
	Municipal/Provincial Bonds	A	842,301
	Municipal/Provincial Bonds	NR	480,363
			<u>5,498,241</u>
Standard & Poor's:	Municipal/Provincial Bonds	AAA	959,273
	Municipal/Provincial Bonds	AA	2,441,413
	Municipal/Provincial Bonds	A	2,097,555
			<u>5,498,241</u>
Fitch:	Municipal/Provincial Bonds	AAA	354,634
	Municipal/Provincial Bonds	AA	3,289,531
	Municipal/Provincial Bonds	A	428,252
	Municipal/Provincial Bonds	NR	1,425,824
			<u>5,498,241</u>

\* NR - not rated

State of Illinois  
 Illinois Student Assistance Commission  
 Illinois Prepaid Tuition Program

Notes to Financial Statements

---

Note 3. Deposits and Investments - Continued

C. Investments - Continued

Credit Risk - Continued

Credit Ratings (Multiple-Rated Securities), continued  
 June 30, 2011

Rating Agency	Investment Type	Credit Rating*	Fair Value
Moody's:	Commercial Mortgage-Backed	Aaa	\$ 11,152,291
	Commercial Mortgage-Backed	Aa	325,049
	Commercial Mortgage-Backed	A	601,855
	Commercial Mortgage-Backed	NR	3,329,391
			<u>15,408,586</u>
Standard & Poor's:	Commercial Mortgage-Backed	AAA	7,837,518
	Commercial Mortgage-Backed	AA	1,228,675
	Commercial Mortgage-Backed	A	2,154,022
	Commercial Mortgage-Backed	BBB	1,375,281
	Commercial Mortgage-Backed	NR	2,813,090
			<u>15,408,586</u>
Fitch:	Commercial Mortgage-Backed	AAA	9,984,405
	Commercial Mortgage-Backed	NR	5,424,181
			<u>15,408,586</u>
Moody's:	Corporate Convertible Bonds	Baa	1,367,645
	Corporate Convertible Bonds	NR	3,567,993
			<u>4,935,638</u>
Standard & Poor's:	Corporate Convertible Bonds	A	597,326
	Corporate Convertible Bonds	BBB	1,367,645
	Corporate Convertible Bonds	NR	2,970,667
			<u>4,935,638</u>
Fitch:	Corporate Convertible Bonds	BBB	1,278,362
	Corporate Convertible Bonds	NR	3,657,276
			<u>4,935,638</u>

\* NR - not rated

**State of Illinois  
 Illinois Student Assistance Commission  
 Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**Note 3. Deposits and Investments - Continued**

**C. Investments - Continued**

**Credit Risk - Continued**

**Credit Ratings (Multiple-Rated Securities), continued  
 June 30, 2011**

<b>Rating Agency</b>	<b>Investment Type</b>	<b>Credit Rating*</b>	<b>Fair Value</b>
Moody's:	U.S. Agency obligations	Aaa	\$ 23,346,169
	U.S. Agency obligations	A	1,091,535
	U.S. Agency obligations	NR	2,852,157
			<u>27,289,861</u>
Standard & Poor's:	U.S. Agency obligations	AAA	24,522,438
	U.S. Agency obligations	AA	2,767,423
			<u>27,289,861</u>
Fitch:	U.S. Agency obligations	AAA	9,210,156
	U.S. Agency obligations	NR	18,079,705
			<u>27,289,861</u>
Moody's:	U.S. Agency Asset Backed	Aaa	3,662,751
	U.S. Agency Asset Backed	NR	507,034
			<u>4,169,785</u>
Standard & Poor's:	U.S. Agency Asset Backed	AAA	3,662,751
	U.S. Agency Asset Backed	AA	507,034
			<u>4,169,785</u>
Fitch:	U.S. Agency Asset Backed	AAA	4,169,785
			<u>4,169,785</u>

\* NR - not rated

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**Note 3. Deposits and Investments - Continued**

**C. Investments - Continued**

**Illiquid Trust**

During fiscal year June 30, 2010, the Illinois Prepaid Tuition Program exited from its securities lending program. As of June 30, 2011, the value of the remaining illiquid trust at U.S. Bank was \$3,402,447. 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.

During fiscal year June 30, 2010, the Program exited its securities lending program. The counterparty continues to hold investments of \$3,402,447 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 actively managed bond managers 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 active U.S. equity managers and non-U.S. equity managers, the policy states that no single security in the manager's portfolio will comprise more than 10% of its equity allocation at the time of purchase, nor will it be more than 15% of the equity allocation of the portfolio after accounting for price appreciation.

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, 2011.

**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 12% of the portfolio for investments in international equities. As of June 30, 2011, 9.8% is invested in international equities. 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. The Program has the following investments denominated in foreign currency.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

**Note 3. Deposits and Investments - Continued**

**C. Investments - Continued**

**Investments in Foreign Currency  
June 30, 2011**

Deposit or Investment Type	Foreign Currency Denomination	Fair Value in U.S. Dollars
Equities, cash and cash equivalents	Australian dollar	\$ 3,629,287
Equities, cash and cash equivalents	British pound sterling	15,559,086
Equities, cash and cash equivalents	Canadian dollar	4,174,469
Equities, recoverable taxes, cash and cash equivalents	Danish krone	581,368
Equities, recoverable taxes, cash and cash equivalents	Euro	26,230,738
Equities, cash and cash equivalents	Hong Kong dollar	5,094,268
Equities	Japanese yen	12,180,695
Equities	Malaysian ringgit	1,201,585
Equities, cash and cash equivalents	New Israeli shekel	888,798
Equities, cash and cash equivalents	Norwegian krone	1,959,104
Equities, cash and cash equivalents	Singapore dollar	2,368,472
Equities, cash and cash equivalents	Swedish krona	1,423,592
Equities, cash and cash equivalents	Swiss franc	8,169,613
Total		<u>\$ 83,461,075</u>

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

As of June 30, 2011, the Illinois Prepaid Tuition Program owed \$114,628 to Illinois Universities for payment of tuition and fee benefits. During the year, \$88,000 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, 2011, were as follows:

	Balance July 1, 2010	Additions	Deletions	Balance June 30, 2011	Amounts Due Within One Year
Compensated absences	\$ 103,937	\$ 85,149	\$ 98,269	\$ 90,817	\$ 24,683

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**Note 6. Tuition Payable**

Tuition payable activity for the year ended June 30, 2011 is as follows:

Balance July 1, 2010	\$ 914,437,224
Add:	
Contributions	89,028,604
Less:	
Return of contributions	(24,954,903)
Tuition payments	(71,860,049)
Balance June 30, 2011	<u>\$ 906,650,876</u>
Reported as:	
Current	\$ 78,276,500
Noncurrent	828,374,376
	<u>\$ 906,650,876</u>

**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 2011 is estimated as a percentage of net tuition contracts paid to date. The rate is 9.17% and is based on the average increase in tuition for Illinois colleges.

Average monthly tuition payable balance	<u>\$ 915,115,846</u>
Estimate of 9.17% increase of tuition payable	<u>\$ 83,916,121</u>
Beginning balance accretion payable as of July 1, 2010	\$ 408,592,515
Accretion expense	83,916,121
Accretion payments	(6,830,324)
Ending balance accretion payable as of June 30, 2011	<u>\$ 485,678,312</u>
Reported as:	
Current	\$ 6,897,500
Noncurrent	478,780,812
	<u>\$ 485,678,312</u>

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**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 2011 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2011. 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 2011, 2010 and 2009, the employer contribution rate was 28.0%, 28.4% and 21.0%, respectively. The required and actual contribution for fiscal years 2011, 2010 and 2009 was \$584,767, \$614,330 and, \$268,065, respectively.

**Note 9. 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.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**Note 9. 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.

**Note 10. Fund Deficits**

**A. Deficit in Net Assets**

As of June 30, 2011, the Illinois Prepaid Tuition Program has a deficit in net assets of \$262,131,379. 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**

Gabriel, Roeder, Smith and Company, the independent actuarial firm retained by College Illinois!, has performed an actuarial soundness valuation of *College Illinois!*®, the State's section 529 prepaid tuition program, as of June 30, 2011 to evaluate the financial viability of the program as of June 30, 2011.

Beginning with FY 2010 the Program adopted an additional valuation methodology, the Actuarial Value method, where valuation of the assets is calculated by amortizing investment gains and losses over a 5-year timeframe. This methodology provides an actuarial value of assets that is a smoothed actuarial value which helps dampen some of the fluctuations in the deficit/surplus of the program which occurs as a result of year to year fluctuations in market value. The program also reports the deficit/surplus of the program based on the Market Value Method, which reflects the market value of the assets at a point in time. The following tables show both valuation methods and reconcile the change from the prior year.

Based on their report the estimated actuarially determined deficit for prepaid tuition program, as of June 30, 2011 based on the actuarial value of assets was \$478,688,661 as compared to \$340,875,271 in the prior year. On the market value of assets basis the deficit was \$536,337,122 as compared to \$531,271,895 in the prior year.

The June 30, 2011 actuarial valuations are based on an investment return assumption of 7.5 percent and an assumption of 2,500 new contract sales each year. Significant changes in the actuarial assumptions as compared to the prior year have contributed to the increase in deficit from the prior year. The investment return assumption of 7.5% compares to an assumed investment return of 8.4% in the prior year report and resulted in an increase in the deficit as of June 30, 2011 of approximately \$112 million compared to June 30, 2010. The increase in the deficit due to the change in the investment return assumption was offset for fiscal 2011 by investment returns that were higher than the actuarial projections and weighted average tuition rate increases that were lower than projected. The assumption for increase in the rate of tuition was in the range of 6.5 % - 8.5% and remained unchanged from the prior year.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**Note 10. Fund Deficits - Continued**

**C. Actuarial Report on Soundness – Unaudited - Continued**

The program's actuarially determined deficit is impacted by several major factors, including: actual investment performance, expected future investment performance, the level of actual tuition and fee increases at Illinois public universities, future expectations for tuition and fee increases at those institutions and the number of new contracts sold for each future enrollment period.

Implementation of the Truth-in-Tuition law (in 2004) has impacted and will continue to impact future tuition rate 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.

Each year when setting plan prices, the Commission reviews the assumptions that influence the actuarial deficit. Contract prices are generally set at a level that will provide revenue from contract sales sufficient not only to fund projected future contract obligations and current administrative costs, but also to improve the actuarial soundness of the program.

In the fall of 2008, *College Illinois!*® introduced SmartChoice Pricing. Under SmartChoice Pricing, contract purchasers have 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.

The Actuary's Report on Soundness as of June 30, 2011 indicates that the program's cash flow is expected to remain positive through the fiscal year that ends in 2021 even without reflecting expected proceeds from contracts sold after June 30, 2011.

	<u>Market Value of Assets</u>	<u>Actuarial Value of Assets</u>
Market value of current assets*	\$ 1,132,275,368	\$ 1,132,275,368
Unamortized investment gains and losses	-	57,648,461
Actuarial present value of future payments expected to be made by the contract purchasers	<u>149,735,044</u>	<u>149,735,044</u>
Subtotal	1,282,010,412	1,339,658,873
Actuarial present value of future payments expected to be made by the Program	<u>1,818,347,534</u>	<u>1,818,347,534</u>
Actuarial deficit as of June 30, 2011	<u>\$ (536,337,122)</u>	<u>\$ (478,688,661)</u>

\* Based on unaudited financial statements provided by Commission management.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

**Notes to Financial Statements**

---

**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, 2011.

**Note 12. New Governmental Accounting Standards**

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

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

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

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

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



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

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

Ms. Kym Hubbard  
Honorable 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, 2011, and have issued our report thereon dated March 27, 2012. That report contains an emphasis of a matter paragraph which states "As further discussed in Note 10, the Illinois Prepaid Tuition Program has a deficit as of June 30, 2011 of \$262 million." We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Commission is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Commission's internal control over financial reporting of the Illinois 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 and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the Commission's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiencies described in findings 11-1, 11-2, 11-3 and 11-4 in the accompanying schedule of findings to be material weaknesses.

A *significant deficiency* is a deficiency or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in finding 11-5 in the accompanying schedule of findings to be a significant deficiency.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings as findings 11-1 and 11-2.

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

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

*McGladrey & Pullen, LLP*

Schaumburg, Illinois  
March 27, 2012

**Current Findings – Government Auditing Standards**

**Finding 11-1 Procurement Law 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.

During our audit, we noted the following pertaining to the procurement process:

1. The Commission awarded a contract for investment due diligence services (due diligence services) for College Illinois. The RFP issued to procure the due diligence services was not specific to due diligence services, but rather was for real estate investment manager services.
2. Pricing for the due diligence services noted above was not included in the vendor's proposal and was negotiated at a later date, outside the competitive procurement process. The fee arrangement with the consultant awarded the due diligence services noted above did not ensure objectivity in the performance of the work which was the subject of the contract.
3. The required competitive procurement process for awarding investment manager contracts was not followed. During fiscal year 2011, two new investment managers were awarded investment manager contracts based on due diligence services performed by an investment consultant of the Commission (see 1 above), and not through a competitive bidding process in violation of the procurement law.

The auditors noted that on May 1, 2009, RFP#CI20092 was issued by the Commission, requesting proposals from real estate investment managers for; opportunistic, distressed debt, secondary real estate and value added real estate funds. The RFP was sent to 23 vendors. Out of the 23 vendors, 14 were responsive and 5 were pre-qualified as vendors. Upon review of a contract awarded in response to this RFP, the auditors noted that the Statement of Work (SOW) in the contract was for due diligence services related to the acquisition of two new investment managers. In the proposal submitted by the vendor who was awarded the contract, no qualifications or pricing for due diligence services was provided.

The terms of the agreement with the vendor performing the due diligence stated the vendor will receive as payment for services, an acquisition fee amounting to 0.75% of the aggregate capital investment for each of the new investments to be made. By paying the vendor on this basis, the Commission may have created an incentive for the vendor to recommend the investment. The vendor was awarded a contract for an amount not to exceed \$390,000 for advisory services, \$85,000 for due diligence services for each prospective investment, plus up to \$2,500 in expenses in addition to the contingent fee. The contingent fee totals \$787,500 based on 0.75% of the \$105 million aggregate capital commitment made to the two investment managers. Fees paid to the vendor as of the date of this report were \$271,875.

Upon completion of the due diligence report by the vendor noted above, the Commission awarded investment contracts to manage \$105 million in real estate investments to the two investment managers that were the subject of the due diligence performed, circumventing the required procurement process. The investment managers were paid fees ranging from 0.5%-1.5% of the amount invested.

Best practices require that vendors contracted to provide their opinion on investment purchase decisions, not be compensated on a basis that is dependent upon the opinion rendered.

**Current Findings – Government Auditing Standards**

**Finding 11-1 Procurement Law Not Followed (Continued)**

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

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

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

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

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. There may have been numerous vendors who specialize in the above mentioned types of services who did not reply to the requests for proposal because they did not appropriately describe the services needed. By circumventing the competitive procurement process, the Commission may have paid higher fees than it otherwise might have obtained through a truly competitive process. Additionally, by paying the vendor of due diligence services in the manner in which they did, the Commission may have created an incentive for the vendor to recommend the investments it was investigating.

In the prior year's finding, the Commission did not reduce a contract to writing and lacked documentation showing the vendor performed the services specified in the contract. In addition, we noted that other investment choices were not considered when evaluating a private equity investment. During the current year audit, we did not note any exceptions of this type in our sample testing. (Finding Code No. 11-1, 10-1)

**Current Findings – Government Auditing Standards**

**Finding 11-1 Procurement Law Not Followed (Continued)**

**Recommendation**

We recommend the following:

1. The Commission should comply with the requirements set forth in the Illinois Procurement Code and Administrative Rules in procuring professional and artistic services.
2. The Commission should establish policies whereby RFPs are thoroughly reviewed before issuance to ensure that all aspects of the needed services are thoroughly described. If the Commission determines at a later time that a necessary service is needed and was not initially included in the original RFP, the Commission should issue an addendum to the services needed provided that the RFP response submission deadline has not expired. In the event that the RFP deadline has expired, the Commission should issue a new RFP describing the new service needed.
3. The Commission should revisit its fee based compensation methods when contracting for opinions on investment purchase decisions that may influence the objectivity or the perception of the objectivity of the opinion rendered.

**Commission Response**

We accept the recommendation.

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 not use contingency-fee based compensation methods based on transaction completion.

In addition, a new procurement process has been instituted that includes review, approval, and monitoring by both the Agency Procurement Officer and the externally appointed State Procurement Officer.

It should also be noted that beginning July 2011, there have been significant changes made to the management and administration of the Agency. The changes include:

- Appointment of new members to the Commission and a new Chairperson.
- Appointment of a new Interim Executive Director in July 2011.
- Appointment of a new Executive Director in February 2012.
- Appointment of a new General Counsel with a reporting line to the Commission
- Hiring of a new Chief Investment Officer with a reporting line to the Commission.

We believe that these changes will ensure our procurement process is sound going forward.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

---

**Current Findings – Government Auditing Standards**

**Finding 11-2 Noncompliance with Investment Policy**

**(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 fully comply with the guidelines established in its investment policy.

During our audit we tested the Commission's adherence to its investment policy. Through our review of documentation provided and discussions with Commission management, we identified the following instances of noncompliance with the investment policy.

- The investment policy requires that the investment policy be reviewed on an annual basis. Commission personnel began the process of reviewing and proposing revisions to the Policy during fiscal year 2011; however, this process was never finalized. There is no evidence of review by the Investment Advisory Panel or the Commission Board, as required by the investment policy. The Commission last approved an investment policy on January 22, 2010.
- In accordance with the investment policy, the Commission was required to establish an Investment Committee. The Investment Committee is required to consist of two members of the Commission's board appointed by the Chair. This Committee was never established. The Commission indicated that the Portfolio Committee was also functioning as the Investment Committee; however, there is no provision in the investment policy allowing for this transition of responsibilities. The Portfolio Committee, unlike the Investment Committee, is made up of three members of management.
- In accordance with the investment policy, the Investment Advisory Panel is required to hold two meetings per year. The auditors were provided with evidence to support only one meeting held during fiscal year 2011. In addition, we noted that there were three vacancies on the Investment Advisory Panel as of June 30, 2011 with vacancies ranging from September 2003 to March 2011.
- In accordance with the investment policy, the Portfolio Committee is required to meet monthly. Evidence to support the occurrence of meetings was only available for September 2010 and October 2010.

According to Commission management, the compliance with the investment policy function for the agency was the responsibility of the Portfolio Committee which consisted of the Executive Director, the Chief Investment Officer (CIO) and the Director of Portfolio Management. During fiscal year 2011 the Agency did not have a Director of Portfolio Management. Therefore, during this time, the Portfolio Committee consisted of the Executive Director (ED) and Chief Investment Officer (CIO). The CIO and ED communicated on a weekly basis to discuss the portfolio performance, evaluation and rebalancing of asset allocations needed to ensure compliance with the investment policy. Most of the communications between the CIO and ED were not formalized in "minutes."

Investments represent the most significant asset for the Commission (approximately \$1.1 billion at June 30, 2011). Lack of compliance with the established investment policy results in inadequate monitoring of the Commission's assets. (Finding Code No. 11-2)

**Current Findings – Government Auditing Standards**

**Finding 11-2 Non-Compliance with Investment Policy (Continued)**

**Recommendation**

We recommend the Commission comply with its investment policy and:

- Conduct a formal review of its investment policy,
- Formally review and approve the investment policy annually,
- Establish the Investment Committee consisting of two members of the Commission appointed by the Chair of the Commission as required by the Policy to provide guidance to the Chief Investment Officer on issues related to investments,
- Take the actions necessary to fill the vacancies on the Investment Advisory Panel and ensure the Investment Advisory Panel meets twice yearly,
- Establish the Portfolio Committee and ensure that it meets monthly to review and rebalance the investment portfolio according to the investment policy guidelines, and
- Maintain minutes of all meetings for any committees or panels that have been established as required by the investment policy. Meeting minutes should document all pertinent discussions held by the respective committee or panel. Clear and concise documentation for all significant decisions and recommendations should exist to support decisions made by these groups.

**Commission Response**

We accept the recommendation.

Beginning July 2011, there have been significant changes made to the management and administration of the program. The changes include:

- Appointment of new members to the Commission and a new Chairperson.
- Appointment of new members to the Investment Advisory Panel.
- Appointment of a new Interim Executive Director in July 2011.
- Appointment of a new Executive Director in February 2012.
- Appointment of a new General Counsel with a reporting line to the Commission.
- The Commission hired a new Chief Investment Officer with a reporting line to the Commission.
- Establishment of an Investment Committee.

The Commission hired a new Chief Investment Officer with a reporting line to the Commission.

The new Commission along with the Executive staff of the agency is in the process of reviewing and approving new changes to the Agency's investment policy. These changes will be formalized in a revised Investment Policy. The Agency will continue to review its Investment Policy and suggest revisions on an ongoing basis.

Management believes that the changes at the agency will ensure that sufficient controls are in place to eliminate all instances of non-compliance with the investment policy.

**State of Illinois  
Illinois Student Assistance Commission  
Illinois Prepaid Tuition Program**

---

**Current Findings – Government Auditing Standards**

**Finding 11-3 Financial Statement Preparation**

**(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) does not have sufficient control over its financial statement preparation.

The Illinois Prepaid Tuition Program receives reports from its third-party investment custodian, which show the individual debt security investment credit ratings for each investment, by investment manager. This report is used to prepare the required credit risk disclosures in the financial statements. We performed testing on the reported ratings to ensure that disclosures in the financial statements were accurate and complied with Governmental Accounting Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)* (GASB 40). Debt security investments subject to credit risk totaled \$199 million at fiscal year-end June 30, 2011. In performing our testing, we identified various inaccuracies in the ratings reported for corporate bonds, municipal bonds, corporate asset backed securities, and U.S. agency obligations. Additionally, approximately \$30.5 million of government agency mortgage backed securities were not reported as “Not Rated” as required. These securities were omitted from the credit risk disclosure altogether. Upon investigating the errors and omissions it was determined that the ratings reported in the custodian’s report were not ratings as of June 30, 2011. The Commission did not discover this issue prior to preparing the draft financials for submission to the auditors.

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

Additionally, GASB Statement No. 40 requires “governments should provide information about the credit risk associated with their investments by disclosing the credit quality ratings of investments in debt securities as described by nationally recognized statistical rating organizations—rating agencies—as of the date of their financial statements” and “governments should disclose the credit quality ratings of external investment pools, money market funds, bond mutual funds, and other pooled investments of fixed-income securities in which they invest. If a credit quality disclosure is required and the investment is unrated, the disclosure should indicate that fact.”

According to Commission management, the Commission hired a new Custodian beginning fiscal year 2011. The GASB 40 information was provided by the new Custodian. The Custodian did not have standardized reports for one of the rating agencies and as a result provided inaccurate rating information.

Insufficient or ineffective controls over financial reporting could lead to significant reporting inaccuracies in the financial statements and notes to the financial statements. (Finding Code No. 11-3)

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

**Finding 11-3 Financial Statement Preparation (Continued)**

**Recommendation**

We recommend the Commission improve controls over financial reporting to ensure accurate presentation of the Illinois Prepaid Tuition Program's credit risk disclosures. An experienced employee should be assigned responsibility for ensuring securities ratings provided by the Custodian at year-end are accurate and properly disclosed in the financial statements.

**Commission Response**

We accept the recommendation.

The new Custodian will run the proper reports at June 30<sup>th</sup> of each year to ensure accurate credit ratings are obtained for disclosure in the financial statements. Additionally, we have hired a new Director of Accounting and Finance that will ensure securities ratings provided by the Custodian are accurate and properly disclosed in the financial statements.

**Current Findings – Government Auditing Standards**

**Finding 11-4 Alternative Investment Oversight and Manager Fees**

**(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 (the Commission) has not established policies and procedures to monitor and value its alternative investments for financial reporting purposes. Additionally, review of fees paid to investment managers was not adequately documented.

The Commission has a significant amount of investments. In recent years, the Commission has increased the volume of alternative investments. Alternative investments consist of real estate, infrastructure, hedge fund and private equity investments. As of June 30, 2011, alternative investments represent \$482 million or 42.6% of the Commission's portfolio. Alternative investments pose significant valuation concerns as these investments do not have readily available market data for valuation purposes.

During our testing of investments, we determined that the Commission does not have proper valuation protocols in place for alternative investments. Management asserts that investment staff participated in investor calls, site visits, corresponding with the general partner, attended annual meetings and reviewed interim financial information pertaining to these investments. In addition, management asserted that investment staff participated as members of advisory committees for the alternative investment fund and held quarterly meetings with investment managers. We were unable to obtain evidence that supports these monitoring controls were in place during fiscal year 2011, and there was no written policy or procedure that required these or other monitoring and valuation procedures.

We noted that the Commission does not prepare an analysis comparing audited financial statements of the alternative investment entity (Fund) to the investment balance as reported by the Commission as of the Funds' year-end. Additionally, the Commission does not perform a roll forward analysis of significant activity from this date (Fund year-end) to the Commission's year-end and compare the ending investment balance to that reported by the investment manager. Management values alternative investments using the investment statements received from the investment manager, custodian statements and investment consultant reports. However, the custodian and investment consultant only report the balances provided to them by the investment manager and do not perform independent valuation services.

During our testing of fees paid to investment managers, we noted there was no evidence of review of the fees being charged to the investment agreements to ascertain whether the fees charged are appropriate and in accordance with the agreed-upon terms of the arrangement. The Commission's investment consultant compares the management fee rates on the alternative investments to industry standards for each type of alternative investment and also shows the expected management fee. However, these fees may not align with those actually charged by the manager.

We also noted that the Commission first invested in certain investment funds in fiscal year 2011. Due to the timing of some of these investments, audited financial statement comparisons to investment balances may not be possible. The auditors noted an instance where the Commission entered into an investment in the second half of the fiscal year and the investment increased in value by 87% from the time of the initial contribution to June 30, 2011. Management should compare significant changes in investment balances to benchmark data for similar types of investments and should discuss reasons for significant increases or decreases in investment value attributable to unrealized gains and/or losses with the investment manager. Documentation of results and conclusions in these instances should also be maintained.

**Current Findings – Government Auditing Standards**

**Finding 11-4 Alternative Investment Oversight and Manager Fees (Continued)**

In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, the Commission is required to report its investments at fair value. Fair value is the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. For investments which are difficult to value, good business practice dictates that policies and procedures be established to determine and monitor fair value. Additionally, there is valuable guidance in a document issued by the AICPA that can be looked to for best practices. The AICPA's Alternative Investment Practice Aid provides guidance for the monitoring of alternative investments. This guidance states that management of the investor entity is responsible for the valuation of alternative investment amounts as presented in the investor entity's financial statements. The responsibility for valuation should not be outsourced or assigned to a party outside the investor entity's management.

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

According to Commission management, the monitoring and valuation of the alternative investments were primarily the responsibility of the Portfolio Committee which consisted of the Executive Director, the Chief Investment Officer (CIO) and the Director of Portfolio Management. During fiscal year 2011, the Commission did not have a Director of Portfolio Management. Therefore, during this time, the Portfolio Committee consisted of the Executive Director (ED) and Chief Investment Officer (CIO). The CIO and ED communicated on a weekly basis to discuss the portfolio performance, evaluation and rebalancing of asset allocations needed to ensure compliance with the investment policy. Most of the communications between the CIO and ED were not formalized in "minutes."

Failure to properly monitor investment valuation could result in a misstatement in the financial statements. In addition, improper investment valuation may inhibit the Commission's ability to properly analyze and make decisions regarding investments. (Finding Code No. 11-4)

**Recommendation:**

We recommend that management of the Commission maintain documentation for each alternative investment to support the existence of monitoring controls over the investment. Support should be in the form of meeting agendas, meeting notes, copies of any communications received from the investment manager, evidence of review of audited and unaudited financial statements or any operational reports received from the respective investment manager.

The Commission should have internal investment personnel charged with determining the value of alternative investments. Investment valuation should include a comparison of investment value at the date of the investment funds' most recent audited financial statements and a rollforward analysis of investment activity from that date to the Commission's fiscal year-end.

**Current Findings – Government Auditing Standards**

**Finding 11-4 Alternative Investment Oversight and Manager Fees (Continued)**

The Commission should maintain documentation to support any significant changes in investment valuation due to unrealized gains and/or losses. Documentation may include a comparison of unaudited statements from the investment fund to the investment value recorded, discussions with the investment manager, reviews of operational reports provided by the investment manager, a comparison of investment performance to comparable investments, a review of any appraisal reports obtained by the investment manager to support valuation (if applicable), etc.

The Commission should monitor and maintain evidence of review of all fees charged by the investment manager for reasonableness. The Commission should compare fees assessed to the investment agreements to ensure that the Commission is being properly charged.

**Commission Response**

We accept the recommendation.

Alternative investments are not publicly traded like stocks and therefore valuations are based on estimates by management working in conjunction with investment managers and investment advisors. However, the agency will do everything possible to gather support and retain documentation regarding investment valuation.

As stated previously, we have a new CIO who will ensure that appropriate investment valuations are obtained and that adequate backup documentation is maintained. Such documentation may include a comparison of unaudited statements from the investment fund to the investment value recorded, notes from discussions with the investment manager, reviews of operational reports provided by the investment manager, a comparison of investment performance to comparable investments, a review of any appraisal reports obtained by the investment manager to support valuation (if applicable), site visits (if applicable), and other documentation deemed appropriate.

**Current Findings – Government Auditing Standards**

**Finding 11-5 Timeliness of Actuarial Valuation Report**

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

The Illinois Student Assistance Commission (Commission) did not obtain a final actuarial valuation report pertaining to the soundness of the College Illinois Program, in a timely fashion.

The draft financial statements were due to the auditors by October 3, 2011 and were due to the State Comptroller by October 15, 2011 (SAMS Procedure 27.10.10), extended to October 24, 2011. Included in the Notes to Financial Statements is an excerpt from a report prepared by an independent actuary on the soundness of the College Illinois!@ prepaid tuition program. According to Commission management, the actuarial report was not scheduled to be issued until February 2012, approximately three months after the draft financial statement reporting deadline.

The State Comptroller establishes reporting deadlines for each State agency so they can complete the Statewide financial statements by the statutory and regulatory deadline. This year's assigned date was October 24, 2011. In accordance with the Illinois Prepaid Tuition Act (Act) 110 ILCS 979/30(d)), "The Commission shall annually prepare or cause to be prepared a report setting forth in appropriate detail an accounting of all Illinois prepaid tuition program funds and a description of the financial condition of the program at the close of each fiscal year. Included in this report shall be an evaluation by at least one nationally recognized actuary of the financial viability of the program." The Commission includes this report in its audited financial statements.

According to Commission management, the contracted actuary for the Commission passed away in April of 2011. The Commission had to issue a new RFP for actuarial services. This has resulted in a delay in the timing of the final actuarial evaluation report for fiscal year 2011.

As a result of this delay, issuance of the Illinois Prepaid Tuition financial statements will be delayed which could further result in delays in the issuance of the statewide financial statements. (Finding Code No. 11-5)

**Recommendation**

We recommend that the Commission work with its actuary to ensure the actuarial valuation report is completed in a timely fashion in order to enable timely completion of the Illinois Prepaid Tuition Program's financial reports.

**Commission Response**

We accept the recommendation.

The Commission hired a new actuary and this finding should not be repeated in the future.