# STUDENT LOAN DIVISION
# DEPARTMENT OF HIGHER EDUCATION
# STATE OF COLORADO
**Denver, Colorado**

## FINANCIAL AND COMPLIANCE AUDIT
**Fiscal Years Ended June 30, 2004 and 2003**

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Members of the Legislative Audit Committee:

This report contains the results of a financial and compliance audit of the Student Loan Division, Department of Higher Education, State of Colorado for the Fiscal Year ended June 30, 2004. The audit was conducted pursuant to Section 23-3.1-109, C.R.S., which authorizes the State Auditor to conduct an annual audit of the Student Loan Division, Department of Higher Education, State of Colorado. The report presents our conclusions, findings and recommendations and the responses of the Student Loan Division, Department of Higher Education, State of Colorado.

Clifton Gunderson LLP

Denver, Colorado
September 1, 2004

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**STUDENT LOAN DIVISION**
**DEPARTMENT OF HIGHER EDUCATION**
**STATE OF COLORADO**
**Fiscal Year Ended June 30, 2004**

## Authority, Purpose, and Scope

This audit was conducted under Section 23-3.1-109, C.R.S., which authorizes the State Auditor to conduct an annual audit of the Student Loan Division, Department of Higher Education, State of Colorado, (the "Division"). The State Auditor contracted with Clifton Gunderson LLP to perform this audit. The audit was conducted in accordance with auditing standards generally accepted in the United States of America as promulgated by the American Institute of Certified Public Accountants in *Statements on Auditing Standards;* the standards for financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; the Single Audit Act of 1996, as amended; and the provisions of Office of Management and Budget ("OMB") Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations,* as amended. The purpose of this report is to present the results of the financial and compliance audit of the Student Loan Division, Department of Higher Education, State of Colorado for the Fiscal Years ended June 30, 2004 and 2003 and to report on current year findings and on the implementation status of the prior year recommendations.

## Audit Opinions and Reports

We expressed an unqualified opinion on the Division's financial statements, as of and for the Fiscal Years ended June 30, 2004 and 2003. We noted two reportable conditions related to reconciliation of the repurchase liability account and data input errors affecting default aversion fees. These are described in Recommendation No. 1 and No. 2 in the "Findings and Recommendations" section of this report.

## Additional Required Communications

***Accounting Policies.*** There were no changes to the Division's accounting policies during the year ended June 30, 2004.

***Management Judgments and Accounting Estimates.*** The Division provides an allowance for loan losses of 92% of its purchased loans receivable. The allowance is determined based on historical collection experience of the related receivable. We reviewed management's methodology for estimating this allowance and determined that the allowance was adequate. There were no other significant accounting estimates of financial data which would be particularly sensitive and require substantial judgment by management.

**Additional Required Communications** (continued)

***Significant Audit Adjustments.*** There was an audit adjustment made to capitalize certain software acquired in the amount of $170,583. This was not recorded on the State's accounting system by CSLP. There was also an adjustment to increase net assets of the Federal Fund as of June 30, 2002 in the amount of $1,567,094 for an overstatement of a liability from prior years. Both of these adjustments are reflected on CSLP's financial statements and were corrected in the State's accounting system. There were no other adjustments arising from the audit that could, in our judgment, either individually or in the aggregate, have a significant effect on the Division's financial reporting process.

***Uncorrected Misstatements.*** There were two uncorrected misstatements aggregated by us during our current audit and pertain to the most recent period presented in the financial statements. The first was an adjustment to reduce an estimated accounts receivable due from the U.S. Department of Education ("DE") to the amount confirmed by $301,421. In the prior year, we had a similar adjustment. The net effect of the two adjustments is $182,385 overstatement of revenue for Fiscal Year 2004. The second adjustment was to establish an allowance of $41,486 for accounts receivable amounts outstanding greater than 90 days. The Division has determined that these uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

***Disagreements with Management.*** There were no disagreements with management on financial accounting and reporting matters, auditing procedures, or other matters which would be significant to the Division's financial statements or our report on those financial statements.

**Current Year Findings and Recommendations**

The Division has three current year findings and recommendations relating to maintaining proper controls and support for the repurchase liability due to the US Department of Education ("DE"), a data input error of default aversion fees, and proper capitalization of capital assets. The Division has partially agreed with these recommendations. A summary of the recommendations and the Division's responses can be found in the Recommendation Locator.

**Summary of Progress in Implementing Prior Year Recommendations**

In regard to the findings and recommendations from the prior year, two were implemented and one was partially implemented.

| Rec. No. | Page No. | Recommendation Summary | Division's Response | Implementation Date |
|---|---|---|---|---|
| 1 | 6 | The CSLP should establish control procedures over the repurchase liability accounts. | Partially Agree | September 2004 |
| 2 | 7 | CSLP should ensure adequate controls are in place over default aversion fees ("DAF"). | Partially Agree | May 2004 |
| 3 | 9 | The CSLP should properly capitalize assets and record costs incurred relating to capital assets. | Partially Agree | Fiscal Year 2005 |

# Student Loan Division, Department of Higher Education

## Background

The Colorado Student Loan Program ("CSLP" or "Student Loan Division" or the "Division") was created by an act of the Colorado Legislature in June 1979, to assist Colorado residents in meeting expenses incurred in availing themselves of higher education opportunities. CSLP's mission is to provide students with access and choice in higher education by ensuring the availability and value of financing programs.

CSLP represents a partnership between lenders, schools, and the federal government. The loan capital is provided by approximately 37 private lenders – banks, savings and loan associations, credit unions, pension funds, insurance companies, or secondary markets, plus three schools for graduate borrowers. CSLP administers the Federal Family Education Loan Program and guarantees the loans made to students and parents in accordance with Federal regulations established pursuant to *Title IV, Part B, of the Higher Education Act of 1965 (P.L. 89-329) as amended,* (20 U.S.C. 1071 *et seq).*

Students borrow to attend approximately 72 participating Colorado schools and any participating national school – colleges, universities, community colleges, career schools (proprietary), graduate and professional. The school certifies both student enrollment and financial cost. CSLP insures the lender against financial loss from default, disability, death, or bankruptcy. CSLP provides needed technical and training assistance to schools and lenders, and performs periodic compliance reviews to assure that both schools and lenders are performing in accordance with applicable laws, regulations, and policies. CSLP performs loan-servicing functions for lenders from disbursement through repayments, assists borrowers through default prevention activities, and pursues collection of defaulted loans.

The federal government is the reinsurer. If CSLP must reimburse a lender for an uncollected loan, it files a claim for reimbursement to the federal government. The federal reimbursement rate can vary depending on the volume of claims paid per year. The federal government also subsidizes the student's interest payments while in school at least half-time and during authorized periods of deferment and pays an additional special allowance to lenders to make up for the difference between the lender's cost of money and the interest rate they can charge the student.

### Federal Family Education Loan Program

CSLP administers the Federal Family Education Loan Program (the "FFEL" program) for the federal government. The FFEL program consists of Stafford, PLUS, and Consolidation Loans as described below.

**Federal Stafford Loans (Subsidized and Unsubsidized)**

Colorado's Stafford Loan Program is the single largest financial aid program for post-secondary education in Colorado. The program makes low-interest rate loans to eligible residents. If the student does not qualify financially for federal interest subsidy, the student can still borrow but will be responsible for interest payments. Since the creation of the Division in 1979, over 1.5 million loans totaling over $4.1 billion have been made to students. In Fiscal Year 2004, students borrowed over $454 million in Stafford Loans.

**Federal PLUS Loans**

Parents of dependent undergraduate students are eligible to borrow under the Federal Parent Loans for Undergraduate Students (PLUS) Loan program. The maximum amount that can be borrowed is limited only by the cost of school attendance minus any other financial aid. The school financial aid office and/or the lender make the final determination on the amount. In Fiscal Year 2004, PLUS Loan borrowings approximated $32 million through the Colorado Student Loan Program.

**Federal Consolidation Loans**

Federal Consolidation Loans allow student borrowers to combine their Stafford, Perkins, Federally Insured Student Loans ("FISL"), Health Professional Student Loans ("HPSL"), or Federal Supplemental Loans for Students ("SLS") indebtedness, allowing one payment per billing period. PLUS loans made after October 17, 1986, can be consolidated by parent borrowers. Effective January 1, 1993, defaulted loans, where payments are being made, are allowed to be consolidated. Loan consolidation may result in a lower payment, and no insurance premium is charged. Since inception of this program, approximately 99,000 consolidation loans have been made totaling over $2.1 billion.

## Reconciliation of Repurchase Liability

As previously mentioned, Colorado lenders provide loans under the Federal Family Education Loan Program (FFEL Program) through the CSLP to students who want to attend college in Colorado. If a student should default on a loan, the lender files a claim for the outstanding amount of the loan with the CSLP, which serves as the insurer on loans made under the FFEL Program. The CSLP claims staff reviews the claim and if all requirements are met, the CSLP reimburses the lender for the outstanding principal balance plus accrued interest. In turn, CSLP files for reimbursement from the U.S. Department of Education (USDE), which acts as the reinsurer on loans under the FFEL Program. The CSLP usually receives its payment from the USDE within 30 days after filing a claim for reinsurance.

In some instances the lender may wish to repurchase the loan from the CSLP after having been paid for its claim. For example, the lender may determine that an error was made and the loan was incorrectly identified as being in default, when in fact it was not. When the CSLP sells a repurchased loan back to the lender, the CSLP is responsible for reimbursing the USDE for any reinsurance it has been paid related to the loan. When a loan is repurchased, the CSLP records a liability to the USDE to reflect reinsurance owed back to the USDE.

However, if the CSLP has not yet filed a claim or received a reinsurance payment for the repurchased loan, no amount is owed back to the USDE. We found that as of June 30, 2004 the liability account for recording reinsurance payments owed back to USDE was overstated by $1,713,493 due to instances in which the CSLP had not previously filed for or received a reinsurance payment on repurchased loans. Therefore, no liability should have been reflected. Of the $1,713,493 overstatement, $146,399 was from Fiscal Year 2004 and the remaining $1,567,094 was from prior years. The CSLP made the adjustment and the liability account is reported correctly on the CSLP's Fiscal Year 2004 financial statements. The adjustment was also made on the State's accounting system.

This error occurred because the CSLP does not have controls in place to ensure that the liability account reflected amounts related only to instances in which it has filed for and received reinsurance payments on repurchased loans. In addition, we found that the CSLP does not review the activity in this account and ensure that the underlying detail related to specific loans supports the ending balance. Therefore, the CSLP does not know which loans comprise the balance in the liability account.

The CSLP has the responsibility to ensure that the repurchase liability accurately and completely represents all funds due to the USDE and to reconcile the account balance to supporting detail.

## Findings and Recommendations (continued)

**Recommendation No. 1**

The CSLP should establish control procedures over repurchased loans by monitoring and reconciling the account balances on monthly basis in which repurchase loan activity is recorded. This should include ensuring that the funds received from the lender and the subsequent payments made to the U.S. Department of Education are tracked on an individual loan basis.

**CSLP Response:**

Partially Agree. The repurchase liability has been reviewed and audited at least for the past two years with no prior year findings. During the audit process for fiscal year 2004, the normal audit inquiry was made concerning the balance of the repurchase liability account. At that time, the accounting staff of CSLP brought to the attention of the auditors a concern about the amount reported. The accounting staff requested system reports to verify the amount being reported and found that the repurchase liability was overstated. The accounting staff provided the auditors with the documentation necessary to support the proposed audit adjustment.

Over the past two years, the amount reported annually was not material to the audit. However, the amount reported increased the total in the repurchase liability account each year. The auditors were given copies of these reports as well over these years and did not find them to be out of the ordinary. After an internal agency system audit, CSLP implemented a new Form 2000 reporting process in September 2004. This process will address this issue. The agency reviews the amounts in the repurchase liability accounts and compares them to the amounts reported on the Form 2000 for Fiscal Year 2005.

***Auditor Addendum: Management is responsible for the accurate and complete presentation of financial information and for having appropriate controls in place. The CSLP lacked appropriate reconciliation procedures to ensure the repurchase liability was correct.***

## Data Input Errors Related to Default Aversion Fees

The Colorado Student Loan Program (the “CSLP” or the “Division”) engages in default aversion activities designed to prevent the default on a loan by a borrower. Among other activities, the CSLP’s default aversion activities provide collection assistance to the lender on a delinquent loan, including due diligence activities, prior to the loan being legally in a default status. The fee is based on one percent of the total unpaid principal and accrued interest owed on the loan in cases where the lender requests default aversion assistance. CSLP transferred $1,747,925 in Default Aversion Fees (“DAF”) from its Operating Fund from its Federal Fund for fees earned in Fiscal Year 2004.

Under the Federal Higher Education Act of 1965, Sections 422A and 422B, the CSLP is allowed to bill for DAF to the federal government by transferring these fees from CSLP’s Federal Fund to its Operating Fund to be used in the operations of the Division. However, during our audit we found that the CSLP had a data input error relating to the DAF. As a result of the data input error, $8,927 in default aversion fees were incorrectly transferred from the Federal Fund to the Operating Fund.

The CSLP has controls in place where the default aversion assistance request ("DAAR") principal and interest is compared to the principal and interest on which the DAF is computed. However, these controls did not detect this input error. Subsequent to our testwork, CSLP has modified its controls to detect all errors, including data input errors.

**Recommendation No. 2:**

The CSLP should continue to ensure that adequate controls are in place over default aversion fees ensuring that data input and similar errors are detected and corrected on a timely basis.

**CSLP Response:**

Partially Agree. CSLP does not believe this Finding is material. For the period of December 14, 2003, through June 30, 2004, the Default Aversion management team reviewed all past billing reports. Corrections made as a result of the review by Default Aversion management resulted in under-billing the Department of Education for DAF by $3,909.13. The data input error cited by the auditor resulted in over-billing only for that month. The error was discovered and was corrected on the June 2004 billing, prior to the end of the fiscal year.

CSLP has put in place numerous systems to validate the DAF billing to the Department of Education – one of which is an electronic review and automatic e-mail notification on the status of DAF billing for each week. A report was written in May 2004 to discover such errors. With the finding of the data entry error a retrospective report was run for the period of December 14, 2003, through June 30, 2004, to address any additional errors.

The report indicated 76 lender reporting errors (lenders request default aversion assistance) and four internal data entry errors were discovered. All errors were corrected and reported to the Department of Education prior to the end of June 2004.

Default Aversion management continues to review these reports on a monthly basis.

***Auditor Addendum: Regardless of the amount of the error identified during the audit, the fundamental issue discussed here is the inadequate controls over financial transactions. Inadequate controls can result not only in errors but also in greater risk of fraud and abuse. We note that the CSLP has had prior findings in the area of Default Aversion Fees.***

## Findings and Recommendations (continued)

## Capitalized Software Costs

Under generally accepted accounting principles, the CSLP is responsible for recording and safeguarding capital assets that are determined to provide an economic benefit for future years. In Fiscal Year 2004, the CSLP acquired imaging software that gives the CSLP the ability to scan and maintain loan documentation electronically. The total cost of the software, which includes costs for modifications to the base software written specifically for the CSLP, was $170,583. The CSLP installed the software and put it into service at the end of Fiscal Year 2004. We found that the CSLP had incurred the cost but did not capitalize the coding and base system costs of the software.

The State Fiscal Procedures Manual, issued by the State Controller, states that software is considered a capital asset and therefore should be capitalized and depreciated over its estimated useful life. After we brought this to CSLP's attention, it made the adjustment of $170,583 to capitalize the software on its financial statements and on the State's accounting system (COFRS). CSLP staff stated that they were not aware of specific guidance relating to capitalizing such costs and, therefore, did not capitalize the software costs on the State's accounting system.

The CSLP is responsible for ensuring that capital assets are properly recorded on COFRS, therefore, the CSLP should capitalize all assets on COFRS that benefit future periods in accordance with the State's capitalization policy.

**Recommendation No. 3:**

The CSLP should ensure that software that is considered a capital asset is timely and accurately recorded on the State's accounting system and its internal property and equipment schedules. The CSLP should also consult with the State Controller's office when determining the proper accounting treatment for acquired software.

**CSLP Response:**

Partially Agree. CSLP has relied on the American Institute of Certified Public Accountant's (AICPA) authoritative guidance in its Statement of Position 98-1 that "The SOP applies to all nongovernmental entities. . . ." The SOP **did not** require governmental agencies to capitalize software costs.

CSLP's believes the Fiscal Procedures Manual does not reflect the requirement for the capitalization of software. Software is listed under equipment and software alone is normally not recognized as equipment. When a computer system is purchased, software often is preloaded. The total price of the purchase would be capitalized above the $5,000 limitation under the existing definition. Because software purchases alone are not listed in the Fiscal Procedures Manual and AICPA's guidance does not affect government agencies, CSLP did not capitalize the software-only purchases.

## Findings and Recommendations (continued)

CSLP's management agreed to begin the software capitalization process with fiscal year 2005. The auditor, however, disagreed and required changing the Fiscal Year 2004 statements. The agency complied. We do not, however, agree that we were required to do so given the SOP's clear exclusion of government entities and the lack of a software-only statement in the Fiscal Procedures.

***Auditor Addendum: The imaging software purchase of over $170,000 exceeded the State Fiscal Rule capitalization threshold. We note that the CSLP has adjusted its records to reflect this treatment.***

## Disposition of Prior Year Audit Findings

The following is a summary of audit recommendations made as part of the financial audit for the year ended June 30, 2003 and the current disposition of these recommendations.

| Recommendation No. 1 | Disposition |
|---|---|
| CSLP should ensure that adequate controls are in place over default aversion fees ("DAF"). | Partially implemented. See current year Recommendation No. 1. |

| Recommendation No. 2 | Disposition |
|---|---|
| CSLP should continue to follow established procedures (a) to maintain its required reserve and taking timely action, such as charging other allowable fees, to address funding problems and (b) making transfers of the DAF fee. | a) Implemented. Towards the end of Fiscal Year June 30, 2004, CSLP started to collect a guarantee fee on Stafford, subsidized and unsubsidized, and Plus loans. The CSLP has entered into a Voluntary Flexible Agreement ("VFA") with the federal government which means that it will not be required to maintain a reserve. This agreement is effective on July 1, 2004.<br>b) Implemented. |

| Recommendation No. 3 | Disposition |
|---|---|
| CSLP should establish control procedures over its other accounts receivable to improve monitoring and collections. | Implemented. |

**Clifton Gunderson LLP**
Certified Public Accountants & Consultants

## Independent Auditor's Report

Members of the Legislative Audit Committee:

We have audited the accompanying combined statement of net assets of the Student Loan Division, Department of Higher Education, State of Colorado (the "Division") as of June 30, 2004 and 2003 and the combined statements of revenues, expenses and changes in net assets and cash flows for the years then ended, which collectively comprise Division's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Division's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in the Summary of Significant Accounting Policies, the financial statements of the Division are intended to present the financial position, and results of operations and cash flows for only that portion of the financial reporting entity, the State of Colorado, that is attributable to the transactions of the Division. They do not purport to, and do not present fairly, the financial position of the State of Colorado as of June 30, 2004 and 2003 and the changes in its financial position and its cash flows, where applicable, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Division as of June 30, 2004 and 2003, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 1, 2004, on our consideration of the Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis (MD&A) is not a required part of the basic financial statements but is supplemental information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this supplemental information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the Division's basic financial statements. The accompanying supplemental information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements, and, in our opinion, is presented fairly, in all material respects, in relation to the basic financial statements taken as whole.

Clifton Gunderson LLP

Denver, Colorado
September 1, 2004

The Management's Discussion and Analysis (MD & A) is required by Governmental Accounting Standards. It was prepared by Colorado Student Loan Program's management and is designed to provide an analysis of the Colorado Student Loan Program's financial condition and operating results for the Fiscal Year ended June 30, 2004 and 2003, and to inform the reader on the Colorado Student Loan Program's financial issues and activities.

The MD & A should be read in conjunction with the Colorado Student Loan Program's financial statements, which begin on page 23.

**Basic Financial Statements**

In June 1999, the Governmental Accounting Standards Board (GASB) released Statement Number 34, Basic Financial Statements and Management's Discussion and Analysis – for State and Local Governments. These reporting standards require a Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets and Statement of Cash Flows. The CSLP implemented GASB 34 in Fiscal Year 2002; therefore, the financial statements issued prior to Fiscal Year 2002 will differ in form compared to current financial statements.

The financial report includes the report of independent auditors, the management's discussion and analysis, and the basic financial statements. The financial statements are interrelated and represent the financial status of the Colorado Student Loan Program.

The Balance Sheet is now referred to as the Statement of Net Assets, which includes the assets, liabilities and net assets at the end of the Fiscal Year. Over time, increases or decreases in the net assets continue to serve as a useful indicator of whether the financial position of the Colorado Student Loan Program is improving or deteriorating.

The Statement of Revenues, Expenses and Changes in Net Assets presents the revenues earned and expenses incurred during the Fiscal Year. Revenues and expenses are reported on the accrual basis. Thus, revenues and expenses are reported in the statement for some items that will result in cash flows in future fiscal periods.

The Statement of Cash Flows presents information related to cash inflows and outflows summarized by operating, noncapital, investing and capital and related financing activities. Operating activities represent the day-to-day activities of the Colorado Student Loan Program. Noncapital activities represent transfers to other agencies. Capital and related financing activities represent acquisitions of capital assets and payments on capital debt and capitalized leases. Investing activities represent investment earnings on temporary cash investments.

**Financial Overview**

The Colorado Student Loan Program is an Enterprise Fund of the State of Colorado. CSLP's funds are accounted for in the Agency Operating Fund, Loan Servicing Fund, and Federal Reserve Fund. The following condensed financial statements do not distinguish between the

Agency Operating and Loan Servicing Funds (operating funds for the guarantor and lender servicing functions of the agency), but do make a distinction between these operating funds and the Federal Reserve Fund, which is designated for paying lender claims and returning funds to the United States Department of Education ("DE"), respectively. The Federal Reserve Fund is the property of DE.

**Management Highlights**

The Colorado Student Loan Program's largest source of revenue in the Federal Reserve Fund is reinsurance from the DE on claims paid to lenders on defaulted loans. The Colorado Student Loan Program receives reinsurance from DE for 95% to 100% of the amount of lender claims paid. For Fiscal Year 2004, this represented \$50,492,123 of the \$51,275,215 in revenue for the Federal Reserve Fund. For Fiscal Year 2003, revenue from reinsurance was \$56,950,242. For Fiscal Years 2004 and 2003, claims paid to lenders were \$51,760,586 and \$58,570,453, respectively; claims are the majority of expenses for the Federal Fund.

The Colorado Student Loan Program is in the business of guaranteeing student loans and should a loan default, continuing collection efforts on these loans. During Fiscal Year 2004 the gross loan volume increased by approximately \$1,191,588,082 from \$527,745,515 to \$1,719,333,597 (226%). A large portion of this increase resulted from increased (755%) consolidation loan volume. Consolidations, where borrowers can combine all outstanding student loans into one loan repaid over a longer term, increased by \$1,089,470,489. Outstanding loans (total loan portfolio) in Fiscal Year 2004 increased \$1,079,813,427 to a total of \$3,632,638,455, a 42.3% increase.

The largest source of revenue in the Agency Operating and Loan Servicing Funds is the Colorado Student Loan Program's share of collections on defaulted loans and bankruptcies. Colorado Student Loan Program retains 23% of funds it collects from borrower payments, rehabilitations and consolidations of defaulted loans to cover costs associated with its collection efforts. For Fiscal Years 2004 and 2003, the Colorado Student Loan Program collected \$10,492,059 and \$9,845,859 on defaulted loans and bankruptcies, respectively. This represented 50.1% and 49.6% of the total operating revenues for Fiscal Years 2004 and 2003, respectively.

The Federal Balanced Budget Act of 1997 and the 1998 Reauthorization of the Higher Education Act required the Colorado Student Loan Program to return funds to the Federal Government. In Fiscal Year 2003 two payments were made. One payment of \$24,845,989 and a second payment of \$1,577,957 were made from the Federal Reserve Fund and an existing fund titled Federal Drawdown Fund. The Drawdown Fund no longer existed after Fiscal Year 2003. Two additional recall payments of \$1,531,547 and \$1,531,546 will be paid to DE in Fiscal Year 2007 and Fiscal Year 2008, respectively.

**CONDENSED STATEMENT OF NET ASSETS**

| June 30, | Agency Operating and Loan Servicing Funds 2004 | Agency Operating and Loan Servicing Funds 2003 | Percent Change | Federal Reserve and Drawdown Funds 2004 | Federal Reserve and Drawdown Funds 2003 | Percent Change |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Current Assets | $ 24,090,034 | $ 22,383,796 | 8% | $ - | $ - | |
| Restricted Assets | - | - | | 7,690,188 | 10,475,596 | -27% |
| Capital Assets | 732,502 | 643,182 | 14% | - | - | |
| Total Assets | $ 24,822,536 | $ 23,026,978 | 8% | $ 7,690,188 | $ 10,475,596 | -27% |
| **LIABILITIES** | | | | | | |
| Current Liabilities | $ 3,640,500 | $ 3,870,189 | -6% | $ - | $ - | |
| Noncurrent Liabilities | 1,086,726 | 891,401 | 22% | - | - | |
| Liabilities Payable from Restricted Assets | - | - | | 4,541,600 | 4,772,553 | -5% |
| Total Liabilities | $ 4,727,226 | $ 4,761,590 | -1% | $ 4,541,600 | $ 4,772,553 | -5% |
| **NET ASSETS** | | | | | | |
| Invested in Capital Assets, Net of Related Debt | $ 386,451 | $ 416,447 | -7% | $ - | $ - | |
| Restricted | - | - | | 3,148,588 | 5,703,043 | -45% |
| Unrestricted | 19,708,859 | 17,848,941 | 10% | - | - | |
| Total Net Assets | $ 20,095,310 | $ 18,265,388 | 10% | $ 3,148,588 | $ 5,703,043 | -45% |

**CONDENSED STATEMENT OF CHANGES IN NET ASSETS**

| June 30, | Agency Operating and Loan Servicing Funds 2004 | Agency Operating and Loan Servicing Funds 2003 | Percent Change | Federal Reserve and Drawdown Funds 2004 | Federal Reserve and Drawdown Funds 2003 | Percent Change |
|---|---|---|---|---|---|---|
| Operating Revenues | $ 20,946,214 | $ 19,844,513 | 6% | $ 51,275,215 | $ 57,240,585 | -10% |
| Operating Expenses | 21,061,620 | 21,174,047 | -1% | 51,760,586 | 58,571,486 | -12% |
| **OPERATING LOSS** | (115,406) | (1,329,534) | 91% | (485,371) | (1,330,901) | 64% |
| Earnings on Investments | 44,052 | 984,752 | -96% | 29,578 | (1,644) | 190% |
| Loss on sale of equipment | (49,944) | - | | - | - | |
| Total Transfers | 1,951,220 | 3,478,979 | -44% | (2,098,662) | (3,604,800) | 42% |
| **CHANGE IN NET ASSETS** | $ 1,829,922 | $ 3,134,197 | -42% | $ (2,554,455) | $ (4,937,345) | 48% |

*Agency Operating and Loan Servicing Funds*

Unrestricted Net Assets of the Agency Operating and Loan Servicing Funds increased from $17,848,941 to $19,708,859 or $1,859,918 (10.4%) in Fiscal Year 2004 due to the transfer of default aversion and account maintenance fees for the Fiscal Year to the Agency Operating Fund from the Federal Reserve Fund. (See Condensed Statement of Revenues and Condensed Statement of Expenses on the following pages.) Due to the implementation of GASB 34 in Fiscal

Year 2002, a category entitled "Invested in Capital Assets, Net of Related Debt" is listed under Net Assets section of the Condensed Statement of Net Assets. This category consists of the Capital Assets less any debt related to the Capital Assets, such as Notes Payable and Capital Leases Payable.

Current liabilities decreased 6% because accounts payable and accrued liabilities included in current liabilities decreased from $3,870,189 to $3,640,500 or a reduction of $229,689 in Fiscal Year 2004. The most significant change occurred in accounts payable for a $379,000 payable to Raytheon Corporation for fees related to the Quester Debt Management Collection System in Fiscal Year 2003 that was paid in Fiscal Year 2004 thus reducing the accounts payable amount. The Quester system is designed to provide electronic accounting and collection services for outstanding student loans. The noncurrent liabilities increased 22% primarily due to obligations recorded under a new capital lease for a network server.

*Federal Reserve Fund*

Total Assets decreased in Fiscal Year 2004 from $10,475,596 to $7,690,188 or $2,785,408 (26.6%). The decrease resulted from a reduction in the amount of Federal Reinsurance due to the agency at the end of the Fiscal Year. This reduction was caused by a reduction in the amount of claim reimbursement due from the federal government.

The total change in net assets was a decrease of $2,554,455. This decrease resulted mainly from interfund transfers totaling $2,098,662. The transfer amount is related to the payment to the Agency Operating Fund for default aversion and account maintenance fees due. The decrease also reflects the difference between the guarantee claims paid to lending institutions and federal reinsurance received on those claims. (See Economic Facts and Conditions for the Future for a discussion on insurance premium fee to be charged.)

The Federal Reserve Fund's beginning net asset balance of $4,135,949 was restated to $5,703,043 for Fiscal Year 2003 to reflect the overstatement of repurchase obligations due to the Federal Government prior to June 30, 2002. The beginning net assets were increased by $1,567,094 and the liability was decreased by the same amount as of June 30, 2002. The cash payments for these amounts were appropriately paid to the Federal Government. However, the adjustment reflecting the payments was not appropriately recorded on the financials. Measures have been taken to prevent this oversight from reoccurring. The following summarizes the restatement to beginning net assets as of June 30, 2002 in the Federal Fund:

| | |
|---|---|
| Net Assets June 30, 2002 as previously reported for the Federal Fund | $ 9,073,294 |
| Adjustment | 1,567,094 |
| Net Assets June 30, 2002 as restated for the Federal Fund | $ 10,640,388 |

| Years Ended June 30, | Agency Operating and Loan Servicing Funds 2004 | Agency Operating and Loan Servicing Funds 2003 | Percent Change | Federal Reserve and Drawdown Funds 2004 | Federal Reserve and Drawdown Funds 2003 | Percent Change |
|---|---|---|---|---|---|---|
| **OPERATING REVENUES** | | | | | | |
| Federal Grants and Contracts | $ 15,277,292 | $ 14,334,462 | 7% | $ 51,106,407 | $ 57,240,585 | -11% |
| Charges for Goods and Services | 5,217,078 | 4,701,986 | 11% | 168,808 | - | 100% |
| Interest on Purchased Loans | 414,475 | 488,257 | -15% | - | - | |
| Other | 37,369 | 319,808 | -88% | - | - | |
| Total Operating Revenues | 20,946,214 | 19,844,513 | 6% | 51,275,215 | 57,240,585 | -10% |
| **NONOPERATING REVENUES** | 44,052 | 984,752 | -96% | 29,578 | (1,644) | 190% |
| **TOTAL REVENUES** | $ 20,990,266 | $ 20,829,265 | 1% | $ 51,304,793 | $ 57,238,941 | -10% |

*Agency Operating and Loan Servicing Funds*

Federal Grants and Contracts increased in Fiscal Year 2004 from $14,334,462 to $15,277,292 or $942,830 (6.6%) in the Agency Operating and Loan Servicing Funds primarily due to increased defaulted loan collections and an increase in the account maintenance and loan processing and issuance fee. The Colorado Student Loan Program is allowed to retain 23% of all borrower payments collected on defaulted loans. Purchased Loan interest decreased by $73,782 from $488,257 to $414,475 in Fiscal Year 2004. This decrease reflected a slight decrease in the number of loans repurchased by lenders.

During Fiscal Year 2004, $13,800 was received by Colorado Student Loan Program on behalf of the Colorado Mentor program compared to the previous year when $309,900 in donations was received for a media campaign to promote the website. The amount received in Fiscal Year 2004 was used primarily for maintenance of data from participants who entered the program after the initial year. These amounts were recorded as Gifts and Donations reflected in the "other" operating revenues. Non-operating revenues in the Agency Operating and Loan Servicing Funds consist of earnings on temporary cash investments. Investment earnings decreased from $984,752 to $44,052 in Fiscal Year 2004 or $940,700 (95.5%) due to a smaller amount of cash available on a monthly basis for investment, lower interest rates and a market adjustment to the State's pool investments at the end of the Fiscal Year 2004.

*Federal Reserve Fund*

Federal Grants and Contracts decreased in Fiscal Year 2004 from $57,240,585 to $51,106,407 or $6,134,178 (10.7%) in the Federal Reserve Fund. This decrease was caused mainly by a reduction in the amount of claims purchased from lenders. The Colorado Student Loan Program receives from 95% to 100% reinsurance on all claims paid to lending institutions. Claim payments decreased, resulting in a corresponding reinsurance decrease. Charges for Goods and Services increased $168,808 (100%) primarily due to a guarantee fee charged towards the end of Fiscal Year 2004. Non-operating revenues (earnings on temporary cash investments) increased from $(1,644) to $29,578 in Fiscal Year 2004 or $31,222 (190%) in the Federal Reserve Fund. The main reason for the difference is the investment market adjustment on the State Treasury pooled investments as of June 30, 2004. (See additional information in the Management Highlights section of this Management's Discussion and Analysis.)

**CONDENSED STATEMENT OF EXPENSES**

| | Agency Operating and Loan Servicing Funds | | | Federal Reserve and Drawdown Funds | | |
|---|---|---|---|---|---|---|
| **Years Ended June 30,** | **2004** | **2003** | **Percent Change** | **2004** | **2003** | **Percent Change** |
| **OPERATING EXPENSES** | | | | | | |
| Guarantee Claims Paid to Lending Institutions | | | | $ 51,760,586 | $ 58,570,453 | -12% |
| Salaries and Fringe Benefits | $ 12,722,611 | $ 13,520,461 | -6% | - | - | |
| Contracted Collection Costs | 2,548,645 | 1,706,541 | 49% | - | - | |
| Other Operating and Travel | 5,376,354 | 5,423,057 | -1% | - | 1,033 | -100% |
| Depreciation | 414,010 | 523,988 | -21% | - | - | |
| Total Operating Expenses | 21,061,620 | 21,174,047 | -1% | 51,760,586 | 58,571,486 | -12% |
| **NON OPERATING EXPENSES** | 147,442 | 125,821 | 17% | - | - | |
| **TOTAL EXPENSES** | $ 21,209,062 | $ 21,299,868 | 0% | $ 51,760,586 | $ 58,571,486 | -12% |

*Agency Operating and Loan Servicing Funds*

Salaries and Fringe Benefits decreased from $13,520,461 to $12,722,611 or $797,850 (5.9%) in Fiscal Year 2004. The majority of the reduction was due to an effort by CSLP to reduce staff throughout the Agency to more appropriate levels for the work being accomplished within the Agency. Contracted Collection Costs increased from $1,706,541 to $2,548,645 or $842,104 (49.4%) in Fiscal Year 2004 due to a large increase in consolidation collections by the outside collection agencies. Other Operating and Travel decreased slightly from $5,423,057 to $5,376,354 or $46,703 (0.9%) due in large part to management efforts to decrease costs of doing business. Non-operating transfers to other agencies increased from $125,821 to $147,442 or $21,621 (17.2%) in Fiscal Year 2004 due to an increase in the statewide indirect cost allocation of expenses to Colorado Student Loan Program.

*Federal Reserve Fund*

Guarantee Claims Paid to Lending Institutions decreased from $58,570,453 to $51,760,586 or $6,809,867 (11.6%) in Fiscal Year 2004 as noted under the revenue analysis above.

*Budget versus Actual*

The Colorado Student Loan Program prepares an annual budget, based on fiscal year projected revenues and expenses that is reviewed and approved by the Executive Director of the Department of Higher Education. In Fiscal Year 2005, the budget will be approved by the Board of Directors, established by H.B. 04-1350, and the Executive Director of the Department of Higher Education.

During the preparation of the annual budget, the Agency Operating Fund and the Loan Servicing Fund are budgeted as separate funds. For financial presentation purposes, both the audit report and MD & A combine these presentations into one fund entitled Agency Operating and Loan Servicing Funds. In future financial presentations beginning with Fiscal Year 2005, the Agency Operating Fund, Loan Servicing Fund and Federal Reserve Fund will be discrete funds within the financial presentation.

*Agency Operating and Loan Servicing Funds*

The original budgeted change in net assets for the Agency Operating and Loan Servicing Funds was $549,527. The budget for change in net assets was later revised upward to $960,479. The actual change in net assets was $1,829,922. The actual changes exceeded the budgeted amount because actual operating expenses were lower than budgeted.
Items that were in the original budget but not expended were as follows:

- Quester Debt Collection System hosting and travel $1,238,321, was carried forward into the current year because the project was not completed;
- Administrative Shared expenditures. $113,397, for travel, dues and fees and memberships was not expended. Most of these funds were used to offset the excess cost in outside collection agency fees;
- Replacement positions were not filled in Business Research unit, $83,608. This unit was later merged with other units within the agency.
- Reduction in purchased property services, mainly maintenance contracts, within Information Technology, $88,898.
- Partnership Initiatives did not hire additional staff as proposed, $82,669.

The change in net assets also includes non-operating revenue of $2,098,662 in interfund transfers (see definition of interfund transfers and detail of transfers in section Interfund Transfers) from the Federal Reserve Fund to the Agency Operating Fund.

*Federal Reserve Fund*

The original budgeted net gain for the Federal Reserve Fund was $308,505. The budget was later revised to a loss of $292,823. The actual change in net assets was a decrease of $2,554,455. This decrease was caused by interfund transfers of $2,098,662, which consists primarily of account maintenance and default aversion fees owed to the Agency Operating Fund. A portion of the decrease also resulted from the difference between claims paid by the agency and reinsurance it received on those claims.

*Interfund Transfers*

Interfund transfers are made to reclassify revenues and expenditures that have been classified to a particular fund during the Fiscal Year and are now owed to another fund. In Fiscal Year 2004, the Colorado Student Loan Program made an interfund transfer from the Agency Operating Fund to the Federal Fund to satisfy its Federal Fund Reserve requirement. In addition, for a number of years, DE has required the agency to pay itself the Account Maintenance Fee from the Federal Fund in the fourth quarter of the federal fiscal year. The agency was required to do so this past Fiscal Year.

CSLP made the following transfers during Fiscal Year 2004:

| | |
|---|---|
| Transfers from Federal Fund to Agency Operating Fund: | |
| Default Aversion Fee | $ 3,536,751 |
| Account Maintenance Fee Shortfall | 521,328 |
| Default Aversion Settlement due DE | (257,231) |
| | |
| Transfers from Agency Operating Fund to Federal Fund: | |
| Transfer to Federal Reserve Fund for the September 30, 2003 Reserve Requirement | (1,700,000) |
| DE Audit Finding | (2,186) |
| Net Transfers from the Federal Fund to the Agency Operating Fund | $ 2,098,662 |

*Capital Assets*

The Colorado Student Loan Program spent $407,962 for a new mainframe and imaging equipment during Fiscal Year 2004. This transaction was the only significant change in capital outlay items in Fiscal Year 2004. Total capitalized assets for Fiscal Year 2004 were $578,545.

*Economic Facts and Conditions for the Future*

Effective July 1, 2004, the U.S. Department of Education granted College Access Network (a statutory name change for CSLP was effective July 1, 2004 under H.B. 04-1350) a three-year contract with the DE known as a Voluntary Flexible Agreement (VFA). Provisions within the contract entitle either the DE or College Access Network to rescind the agreement with 90 days notice.

The VFA has a number of provisions that impact the revenue of College Access Network. Some of the new provisions are:

- DE will reinsure College Access Network's claim payments to lenders at 100%, rather than at 95-98% as in past years. Claims are paid from the Agency Operating Fund and the dollar-for-dollar reimbursement offsets those payments.
- Collections will be funded at a variable rate rather than a fixed rate of 23%. The VFA's emphasis is on preventing defaults, not on collecting on accounts in default.
- Default Aversion Fee will be paid on a variable rate with 1.01% being the floor and rising to 1.10%. Formerly the rate was a flat 1% on all eligible default aversion requests. In addition, College Access Network may re-bill DE for aversion requests on eligible loans that are older than 12 months.

- Account Maintenance and Loan Processing Issuance Fee are invoiced to DE monthly rather than quarterly as in the past.
- A new Delinquency Prevention fee is based on how successful College Access Network is in preventing delinquencies. This fee is also invoiced to DE on a monthly basis.
- College Access Network is now allowed to rehabilitate a loan based on a borrower making nine consecutive payments rather than 12 as has been done in the past. The agency benefits from rehabilitating student loans, a process that allows student borrowers to rehabilitate their credit rating and bring their loans out of default.
- The Federal Reserve Fund is escrowed and the .25% reserve requirement is waived under the agreement.

College Access Network began assessing a 1% insurance premium for loans disbursed after July 1, 2004. The estimated $3.9 million in revenue in the current Fiscal Year from the fee goes to the Federal Reserve Fund.

Under H.B. 04-042, effective in Fiscal Year 2005, College Access Network has a statutorily created Board of Directors whose members are appointed by the Governor to advise it on financial matters and policy issues. The Board chairman named a three-member audit committee. The Board reviews quarterly financials, contracts exceeding $250,000, the agency budget, agency audits and financial operating procedures.

**Financial Contact**

If you have any questions about this report, please contact:

College Access Network
999 18th Street, Suite 425
Denver, CO 80202
Attention: Director of Accounting and Human Resources

**STUDENT LOAN DIVISION**
**DEPARTMENT OF HIGHER EDUCATION**
**STATE OF COLORADO**
**COMBINED STATEMENTS OF NET ASSETS**
**June 30, 2004 and 2003**

## ASSETS

| | 2004 | 2003 |
|---|---|---|
| **CURRENT ASSETS** | | |
| Cash and pooled cash investments | $ 21,769,042 | $ 20,141,567 |
| Due from other governments | | |
| Federal account maintenance fee | 676,034 | 624,269 |
| Federal loan processing and issuance fee | 479,701 | 371,961 |
| Other federal receivables | 89,103 | 19,938 |
| Other receivables, net | 837,027 | 785,516 |
| Supplies inventory | 75,592 | 100,161 |
| Prepaid expenses | 163,535 | 340,384 |
| Total current assets | 24,090,034 | 22,383,796 |
| **RESTRICTED ASSETS** | | |
| Restricted cash and pooled cash investments | 4,310,075 | 4,107,441 |
| Federal reinsurance receivable | 3,372,364 | 6,360,406 |
| Other receivables, net | 7,749 | 7,749 |
| Total restricted assets | 7,690,188 | 10,475,596 |
| **CAPITAL ASSETS** | | |
| Office furniture and equipment | 951,017 | 907,098 |
| Computer hardware and software | 2,990,093 | 2,784,610 |
| Property held under capital lease | 987,884 | 829,472 |
| Leasehold improvements | 97,946 | 97,946 |
| | 5,026,940 | 4,619,126 |
| Less accumulated depreciation | (4,294,438) | (3,975,944) |
| Capital assets, net | 732,502 | 643,182 |
| **TOTAL ASSETS** | $ 32,512,724 | $ 33,502,574 |

## LIABILITIES AND NET ASSETS

| | 2004 | 2003 |
|---|---|---|
| **CURRENT LIABILITIES** | | |
| Accounts payable and accrued liabilities | $ 1,668,964 | $ 2,031,499 |
| Payable to the U.S. Department of Education: | | |
| Loan collections and other liabilities due to federal government | 1,078,204 | 1,023,490 |
| Other current liabilities | | |
| Current portion of obligation under capital lease | 131,859 | 209,748 |
| Other | 291,077 | 237,227 |
| Interfund payable - other agencies | 347,841 | 368,225 |
| Deferred revenue | 122,555 | - |
| Total current liabilities | 3,640,500 | 3,870,189 |
| **LIABILITIES PAYABLE FROM RESTRICTED ASSETS** | | |
| Recall reserves due to DE | 3,063,093 | 3,063,093 |
| Accounts payable and accrued liabilities | 9,016 | 7,303 |
| Loan collections and other liabilities due to federal government | 1,469,491 | 1,702,157 |
| Total liabilities payable from restricted assets | 4,541,600 | 4,772,553 |
| **NONCURRENT LIABILITIES** | | |
| Accrued compensated absences | 872,534 | 874,414 |
| Obligation under capital leases, net of current portion | 214,192 | 16,987 |
| Total noncurrent liabilities | 1,086,726 | 891,401 |
| Total liabilities | 9,268,826 | 9,534,143 |
| **NET ASSETS** | | |
| Invested in capital assets, net of related debt | 386,451 | 416,447 |
| Restricted | 3,148,588 | 5,703,043 |
| Unrestricted | 19,708,859 | 17,848,941 |
| Total net assets | 23,243,898 | 23,968,431 |
| **TOTAL LIABILITIES AND NET ASSETS** | $ 32,512,724 | $ 33,502,574 |

**STUDENT LOAN DIVISION**
**DEPARTMENT OF HIGHER EDUCATION**
**STATE OF COLORADO**
**COMBINED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**
**For the Years Ended June 30, 2004 and 2003**

| | 2004 | 2003 |
|---|---|---|
| **OPERATING REVENUES** | | |
| Federal grants and contracts | | |
| Division's share of collections on loans and bankruptcies | $ 11,106,343 | $ 10,136,202 |
| Federal account maintenance fee | 2,338,103 | 2,233,668 |
| Federal loan processing and issuance fee | 2,447,130 | 2,254,935 |
| Federal reinsurance | 50,492,123 | 56,950,242 |
| Charges for goods and services | | |
| Contractual service fees | 5,217,078 | 4,701,986 |
| Guarantee fees | 168,808 | - |
| Interest on purchased loans and other | 414,475 | 488,257 |
| Gifts and donations | 13,800 | 309,900 |
| Other revenue | 23,569 | 9,908 |
| Total operating revenues | 72,221,429 | 77,085,098 |
| **OPERATING EXPENSES** | | |
| Guarantee claims paid to lending institutions | 51,760,586 | 58,570,453 |
| Salaries and fringe benefits | 12,722,611 | 13,520,461 |
| Operating and travel | | |
| Contracted collection costs | 2,548,645 | 1,706,541 |
| Other operating and travel | 5,376,354 | 5,424,090 |
| Depreciation | 414,010 | 523,988 |
| Total operating expenses | 72,822,206 | 79,745,533 |
| **OPERATING LOSS** | (600,777) | (2,660,435) |
| **NONOPERATING REVENUES (EXPENSES)** | | |
| Earnings on investments | 73,630 | 983,108 |
| Loss on sale of equipment | (49,944) | - |
| Income before operating transfer | (577,091) | (1,677,327) |
| Operating transfers to other agencies | (147,442) | (125,821) |
| **CHANGE IN NET ASSETS** | (724,533) | (1,803,148) |
| **NET ASSETS, BEGINNING OF YEAR, AS RESTATED FOR JUNE 20, 2002** | 23,968,431 | 25,771,579 |
| **NET ASSETS, END OF YEAR** | $ 23,243,898 | $ 23,968,431 |

**STUDENT LOAN DIVISION**
**DEPARTMENT OF HIGHER EDUCATION**
**STATE OF COLORADO**
**COMBINED STATEMENTS OF CASH FLOWS**
**For the Years Ended June 30, 2004 and 2003**

| | 2004 | 2003 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Cash received from | | |
| Fees for service | $ 5,456,930 | $ 4,656,981 |
| Federal grants and contracts | 68,965,119 | 68,301,361 |
| Interest on purchased loans and other | 414,475 | 488,257 |
| Gifts and donations | 13,800 | 309,900 |
| Other sources | 23,569 | 9,908 |
| | 74,873,893 | 73,766,407 |
| Cash disbursed for | | |
| Guarantee claims paid to lending institutions | (51,758,873) | (58,712,636) |
| Employees | (12,724,491) | (13,469,856) |
| Suppliers | (5,504,005) | (4,856,954) |
| Contracted collection costs | (2,548,645) | (1,706,541) |
| Recall reserves paid to DE | - | (24,845,989) |
| | (72,536,014) | (103,591,976) |
| Net cash provided (used) by operating activities | 2,337,879 | (29,825,569) |
| **CASH FLOW FROM NONCAPITAL FINANCING ACTIVITIES** | | |
| Transfers - out | (147,442) | (125,821) |
| Net cash used in noncapital financing activities | (147,442) | (125,821) |
| **CASH FLOW FROM CAPITAL AND RELATED FINANCING ACTIVITIES** | | |
| Principal paid on capital debt | - | (346,000) |
| Proceeds from capital leases and note payable | 329,144 | - |
| Acquisition of capital assets | (578,545) | (39,679) |
| Capital lease payments | (184,557) | (201,304) |
| Net cash used in capital and related financing activities | (433,958) | (586,983) |
| **CASH FLOW FROM INVESTING ACTIVITIES** | | |
| Earnings on investments | 73,630 | 983,108 |
| **NET INCREASE (DECREASE) IN CASH AND TEMPORARY CASH INVESTMENTS** | 1,830,109 | (29,555,265) |
| **CASH AND TEMPORARY CASH INVESTMENTS, BEGINNING OF YEAR** | 24,249,008 | 53,804,273 |
| **CASH AND TEMPORARY CASH INVESTMENTS, END OF YEAR** | $ 26,079,117 | $ 24,249,008 |

| | 2004 | 2003 |
|---|---|---|
| **RECONCILIATION OF NET OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES** | | |
| Net operating loss | $ (600,777) | $ (2,660,435) |
| Adjustments to reconcile net operating loss to net cash provided (used) by operating activities | | |
| Depreciation | 414,010 | 523,988 |
| Effects of changes in net assets and liabilities | | |
| Receivables | 2,707,861 | (3,353,315) |
| Due from other funds | - | 5,500 |
| Supplies inventory | 24,569 | (9,088) |
| Prepaid expenses | 176,849 | (187,819) |
| Accounts payable and accrued liabilities | (360,822) | 1,251,017 |
| Other current liabilities | 53,850 | (465,403) |
| Recall reserves due to DE | - | (24,845,989) |
| Loan collections and other liabilities due to federal government | (177,952) | 142,745 |
| Accrued compensated absences | (1,880) | 50,605 |
| Interfund payable other agencies | (20,384) | (156,005) |
| Deferred revenue | 122,555 | (121,370) |
| **NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES** | $ 2,337,879 | $ (29,825,569) |

During the year ended June 30, 2004, there was a non-cash reduction to a capital lease obligation in the amount of $25,271.

**STUDENT LOAN DIVISION**
**DEPARTMENT OF HIGHER EDUCATION**
**STATE OF COLORADO**
**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**
**June 30, 2004 and 2003**

The Colorado Student Loan Program (the "Division") was created as an agency in the Department of Higher Education, State of Colorado pursuant to Title 23, Article 3.1, Part 1, Colorado Revised Statutes July 1, 1979. The Division administers the Federal Family Education Loan Program ("FFEL") consisting of Stafford, Parent Loans for Undergraduate Students ("PLUS"), Supplemental Loans for Students ("SLS") and Consolidation Loans Programs. The Division guarantees loans made by qualified Title IV lenders to students attending post-secondary schools, in compliance with operating agreements (the "Agreements") with the U.S. Department of Education, pursuant to *Section 428 of the Higher Education Act of 1965* (the "Act") and the provisions of the *1998 Reauthorization of the Higher Education Act.*

## METHOD OF ACCOUNTING AND REPORTING

The Division follows generally accepted accounting principles for enterprise entities using an accrual basis of accounting. Under these principles, enterprise funds must distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from the Division's services in connection with ongoing operations.

## USE OF ESTIMATES IN PREPARATION OF FINANCIAL STATEMENTS

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 periods. Actual results could differ from those estimates.

## TAX, SPENDING AND DEBT LIMITATIONS

The Colorado Constitution, Article X, Section 20, (commonly referred to as the Taxpayer Bill of Rights or TABOR) limits most state agencies from raising revenue and increasing spending. The Division is exempt from the Article's provisions because the Division is an enterprise fund as defined in Title 23, Article 3.1, Part 103.5, Colorado Revised Statues, 1998. Enterprises funds defined under TABOR are government-owned businesses authorized to issue revenue bonds and which receive less than 10% of their annual revenue from the State of Colorado.

**STUDENT LOAN DIVISION**
**DEPARTMENT OF HIGHER EDUCATION**
**STATE OF COLORADO**
**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**
**June 30, 2004 and 2003**

## SUPPLIES INVENTORY

Supplies are carried in an inventory account at cost, which approximates market and are subsequently charged to expense when consumed.

## COMPENSATED ABSENCES

Division employees are entitled to paid vacations, sick days and personal days off, depending on job classification, length of service and other factors. The Division records the amount of compensation for future absences as an accrued liability in its financial statements in accordance with applicable State Fiscal Rules. The balance of compensated absences as of June 30, 2004 and 2003 was $872,534 and $874,414, respectively.

## LOAN PROCESSING AND ISSUANCE FEE

Under the *1998 Reauthorization of the Higher Education Act*, the U.S. Department of Education pays the Division a quarterly loan processing and issuance fee of .40% on net loans guaranteed by the Division, effective October 1, 2003. Prior to October 1, 2003, the fee was .65%.

## ACCOUNT MAINTENANCE FEE

Under the *1998 Reauthorization of the Higher Education Act*, the U.S. Department of Education pays the Division a quarterly account maintenance fee of .10% of the original principal amount of outstanding loans.

## LOAN DEFAULTS

Claims on guarantees made by the Division for defaulted loans result in the assignment of student loans to the Division, which must take action to collect on the defaulted loans. Although claim payments are made on defaults, deaths, disabilities and bankruptcies, only loans in default and loans included under Chapters 7 and 13 bankruptcies are collectible by the Division. For the Fiscal Year ended June 30, 2004, the Division retains 23% of its loan collections to cover costs associated with its collection efforts. From October 1, 1998, through September 30, 2003, the Division retained 24% of its loan collections. Funds exceeding those retained by the agency are remitted to the U.S. Department of Education.

## DEFAULTED LOANS OFFSET PROGRAM

For the year ending June 30, 2004, the Division assigned certain loans to the U.S. Secretary of Education under the Treasury Offset Program as authorized by the Internal Revenue Service. Defaulted loans meeting certain criteria are assigned to the Federal government for offset with Federal income tax refunds against outstanding defaulted student loan balances owed by the borrower. The State of Colorado utilizes a similar program where borrowers have State income tax refunds offset against the amount owed on defaulted student loan balances.

## FEDERAL REINSURANCE

Section 428 of *1998 Reauthorization of the Higher Education Act* allows the Division to be reimbursed 100% on claims due to deaths, disabilities and bankruptcies. However, the Student Loan Reform Act of 1993 reduced federal reinsurance for loans in default made on or after October 1, 1993. For the fiscal years reflected in this audit, Federal reinsurance on defaulted loans was paid according to the following schedule:

| Rate of Annual Losses (Defaults) | Federal Reinsurance on Loans Made Prior to October 1, 1993 | Federal Reinsurance on Loans Made October 1, 1993 Through September 30, 1998 | Federal Reinsurance on Loans Made October 1, 1998 and Thereafter |
|---|---|---|---|
| 0% to 5% | 100% | 98% | 95% |
| More than 5% but less than or equal to 9% | 90% | 88% | 85% |
| Over 9% | 80% | 78% | 75% |

The rate of annual losses (defaults) for purposes of the application for Federal reinsurance is a result of the year-to-date incurred losses divided by the original amount of guaranteed loans in repayment status at the beginning of the year. The annual rate of defaults for Federal years ending September 30, 2004 and September 30, 2003 did not exceed 5% for either of these two years.

**STUDENT LOAN DIVISION**
**DEPARTMENT OF HIGHER EDUCATION**
**STATE OF COLORADO**
**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**
**June 30, 2004 and 2003**

## CAPITALIZATION POLICY

The Division's threshold for capitalizing property and equipment is $5,000.

## DEPRECIATION

The Division uses a straight-line method of depreciation over the estimated useful five-year life of an asset. Depreciation expenses charged to Division operations were $414,010 and $523,988, for state Fiscal Years ended June 30, 2004 and 2003, respectively.

## STATEMENT OF CASH FLOWS

For purposes of the Division's cash flow statement, cash equivalents are defined as investments with maturities of three months or less at date of acquisition and pooled cash held by the Colorado State Treasurer for the Division.

## BASIS OF ACCOUNTING

The Division's financial statements are prepared in accordance with all Governmental Accounting Standards Board (GASB) pronouncements, Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

## BUDGETS AND BUDGETARY ACCOUNTING

The Division is a State enterprise receiving its funding from fees associated with the issuance, collection and servicing of student loans. The Division's budget is not legislatively adopted and Statements of Revenues and Expenses – Budget to Actual are not a required part of these financial statements. Total budgeted expenses for the Division for the state Fiscal Year ended June 30, 2004 were $83.7 million compared to actual expenses of $72.9 million. Total budgeted revenues of the Division were $81.8 million as compared with actual revenues of $72.3 million for the Fiscal Year ended June 30, 2004. The differential between budget and actual expenditures resulted almost exclusively from lower claim payments.

**STUDENT LOAN DIVISION**
**DEPARTMENT OF HIGHER EDUCATION**
**STATE OF COLORADO**
**NOTES TO FINANCIAL STATEMENTS**
**June 30, 2004 and 2003**

## NOTE 1 – CASH AND INVESTMENTS

The Division deposits cash with the Colorado State Treasurer as required by Colorado Revised Statutes (CRS). The Treasurer pools the Division's deposits along with the deposits from other state agencies and invests them in securities as required by CRS 24-75-601.1. The Division reports its share of the Treasurer's unrealized gains and losses based on its participation in the State Treasurer's pool. All Division investments are reported at fair market value based on quoted market prices at June 30, 2004 and 2003. The State Treasurer does not invest any of the pool resources in any external investment and there is no assignment of income related to participation in the pool.

Additional information on the Treasurer's pool may be obtained from the State of Colorado's Comprehensive Annual Financial Report (CAFR).

The Division's average monthly cash balances were $25,919,000 and $29,847,000, respectively for the years ended June 30, 2004 and 2003. These balances were invested with the State Treasury at an average rate of 3.02% and 4.38% for the years ended June 30, 2004 and 2003, respectively. Temporary cash investments are carried at cost at fair market value.

The Division had $25,239,975 and $23,189,759 on deposit and $3,876 and $91,562 on hand or in transit to the State Treasury at June 30, 2004 and June 30, 2003, respectively. Detailed information on the State Treasurer's pooled cash and investments is available from that office.

The Colorado Public Deposit Protection Act (PDPA) requires that all units of local government deposit cash in eligible public depositories. State regulations set eligibility criteria. Eligible collateral institutions determined by the PDPA must collateralize amounts on deposit in excess of federal insurance levels. The institution is allowed to create a single collateral pool for all public funds held. The pool is maintained by another institution or held in trust for all the uninsured public deposits as a group. The fair market value of the collateral must be at least equal to 102% of the uninsured deposits.

At June 30, 2004 and June 30, 2003, the Division had carrying balances of $835,266 and $967,687, respectively, on deposit with banks. Bank balances of $1,820,718 and $2,040,989, respectively, were covered by the collateral held in the pledging institution's trust department in the name of the public deposit pool as required by statute and none was uninsured or un-collateralized. The following are the Division's cash totals for the past two Fiscal Years:

## NOTE 1 – CASH AND INVESTMENTS (CONTINUED)

| | 2004 | 2003 |
|---|---|---|
| Cash accounts on deposit | $ 25,084,780 | $ 22,309,203 |
| Cash on hand/transit | 3,876 | 91,562 |
| Deposits with banks | 835,266 | 967,687 |
| Changes in market value | 155,195 | 880,556 |
| **Total** | $ 26,079,117 | $ 24,249,008 |

Cash and temporary cash investments are presented in the accompanying statement of net assets as follows:

| | 2004 | 2003 |
|---|---|---|
| Cash and pooled cash investments | $ 21,769,042 | $ 20,141,567 |
| Restricted cash and pooled cash investments | 4,310,075 | 4,107,441 |
| Total | $ 26,079,117 | $ 24,249,008 |

## NOTE 2 – PURCHASED LOANS RECEIVABLE

Purchased loans receivable represent loan balances not reinsured by the DE that are the property of the Division. Since the loans are purchased by the CSLP and become an asset of the Division, they do not fall within the scope of reinsurance from the DE. An allowance for loan losses equal to 92% and 80% of the purchased loans receivable for 2004 and 2003, respectively, has been recorded due to the significant uncertainty of the collectibility of the loans. Net purchased loans receivable included in other receivables at June 30, 2004 and 2003 were $88,474 and $208,459, respectively.

## NOTE 3 – CAPITAL ASSETS

A summary of changes in capital assets is as follows:

| | Balance July 1, 2003 | Additions | Deletions | Balance June 30, 2004 |
|---|---|---|---|---|
| Office furniture and equipment | $ 907,098 | $ 43,919 | $ - | $ 951,017 |
| Computer hardware and software | 2,784,610 | 205,483 | - | 2,990,093 |
| Property held under capital lease | 829,472 | 329,144 | (170,732) | 987,884 |
| Leasehold improvements | 97,946 | - | - | 97,946 |
| Total | 4,619,126 | 578,546 | (170,732) | 5,026,940 |
| Less accumulated depreciation | (3,975,944) | (414,010) | 95,516 | (4,294,438) |
| **Capital assets, net** | $ 643,182 | $ 164,536 | $ (75,216) | $ 732,502 |

## NOTE 4– NOTE PAYABLE

The Division entered into a note to obtain imaging software and hardware with the Pennsylvania Higher Education Assistance Authority (PHEAA) in 1999. Under the agreement, the Division was required to return all software to PHEAA at the point of termination, which occurred in Fiscal Year 2004. The note was non-interest bearing and required annual payments of $173,000 per year over a five-year time period beginning Fiscal Year 1999. The final payment on the note was made by the Division in the year ended June 30, 2003 and the software and all related codebooks have been returned to PHEAA in accordance with the agreement.

## NOTE 5– LEASES

The Division leases various equipment with a total original cost of $987,884 and $829,472 for Fiscal Years 2004 and 2003, respectively and accumulated depreciation of $623,934 and $570,949 at June 30, 2004 and 2003, respectively, under capital leases which expire from 2005 to 2007.

**NOTE 5– LEASES** (CONTINUED)

The Division also leases its office space and various other office equipment under operating leases which expire in 2006 and 2007.

Future minimum rentals under capital leases and noncancellable operating leases are as follows:

| Year Ending December 31, | Capital Leases | Operating Leases |
|---|---|---|
| 2005 | $ 165,546 | $ 641,765 |
| 2006 | 129,948 | 679,410 |
| 2007 | 108,289 | - |
| Total | 403,783 | $ 1,321,175 |
| Less interest | (57,732) | |
| | 346,051 | |
| Less current portion | (131,859) | |
| **Long-term portion** | $ 214,192 | |

Total rent expense for the years ended June 30, 2004 and 2003 was $703,735 and $688,819, respectively.

During the Fiscal Year ended June 30, 2004, the following changes occurred with long-term debt.

| | Balance July 1, 2003 | Additions | Deletions | Balance June 30, 2004 | Amounts Due Within One Year |
|---|---|---|---|---|---|
| Capital lease obligations | $ 226,735 | $ 329,144 | $ (209,828) | $ 346,051 | $ 131,859 |
| Accrued compensated absences | 874,414 | 117,007 | (118,887) | 872,534 | - |
| Total | $ 1,101,149 | $ 446,151 | $ (328,715) | $ 1,218,585 | $ 131,859 |

The Division has determined that accrued compensated absences due within one year are not considered material to the financial statements.

## NOTE 6 – COMMITMENTS

### Statutory Guarantee Fund Requirements

For Federal Fiscal Year 2004 and 2003, the Division is required by Federal and State statute to maintain a reserve of .25% of the unpaid balance of outstanding loans. The computed reserve balance at June 30, 2004 and 2003 based on the respective outstanding loan balances was \$9,081,596 and \$6,382,063, respectively. The total reserve balance maintained by the Division consisting of the net asset balance of the Federal Reserve Fund plus recall reserves payable to DE at June 30, 2004 and 2003 was \$6,211,681 and \$7,199,042, respectively. The required reserve amount is assessed by DE at September 30th of each year. In conjunction with the Division's Voluntary Flexible Agreement ("VFA"), effective July 1, 2004, entered into with DE, the reserve requirement was waived under the agreement (see Note 15).

### Loans from Federal Reserve Fund

Under the 1998 Reauthorization of the Higher Education Act, the Division's Agency Operating Fund is allowed to borrow from its Federal Reserve Fund of an amount equal to and no greater than 180 days' expenses. The Division borrowed \$10,921,058 from its Federal Reserve Fund and deposited the funds into its Agency Operating Fund in Fiscal Year 2000. The Division has made payments to repay this amount. The Division made a final payment on the remainder of the loan in the amount of \$2,684,001 in state Fiscal Year ending June 30, 2003.

## NOTE 7 – CONTINGENCIES

### Loan Guarantees

The outstanding principal balance of student loans guaranteed by the Division through June 30, 2004 was approximately \$3.6 billion. As disclosed in the summary of significant accounting policies, the Federal government reinsures new loans guaranteed at a minimum rate of 95% until the Division's rate of annual losses (defaults) exceeds 5%. If the Division exceeds the 5% threshold (the trigger rate), it may be liable for up to a maximum of 25% of the outstanding balance of loans in repayment at the beginning of each year. The Division did not exceed its trigger rate in either 2003 or 2004.

## NOTE 7 – CONTINGENCIES (CONTINUED)

### U.S. Department of Education Reviews

In Fiscal Year 2004, the U.S. Department of Education has reviewed the Division's Agency Operating Fund and Federal Reserve Fund in accordance with provisions from the *1998 Reauthorization of the Higher Education* Act (see Note 12). All findings from these reviews have been addressed and are closed.

## NOTE 8 – EMPLOYEE PENSION PLAN

### Plan Description

Virtually all of the Division's employees participate in the Combined State and School Division Trust Fund (CSSDTF), a defined benefit pension plan. The purpose of the Defined Benefit Pension Plan is to provide income to members and their families at retirement or in case of death or disability. This Plan is a cost-sharing multiple-employer deferred benefit plan administered by the Public Employees Retirement Association (PERA). PERA was established by State statute in 1931. Responsibility for the organization and administration of the Plan is placed with the Board of Trustees of PERA. Changes to the Plan require legislation by the General Assembly. The State Plan, as well as the other division's plans, is included in PERA's financial statements which may be obtained by writing PERA at 1300 Logan Street, Denver, Colorado 80203, by calling PERA at 303-832-9550 or 1-800-729-PERA (7372), or by visiting www.copera.org.

Plan members vest after five years of service and most are eligible for retirement benefits at age 50 with 30 years of service, age 60 with 20 years of service, or at age 65 with 5 years of service. Members are also eligible for retirement benefits without a reduction for early retirement if they are at least 55 and have a minimum of 5 years of service credit and their age plus years of service equals 80 or more. State troopers and judges comprise a small percentage of Plan members but have higher contribution rates and are eligible for retirement benefits at different ages and years of service. Monthly benefits are calculated as a percentage of highest average salary (HAS). HAS is one-twelfth of the average of the highest salaries on which contributions were paid, associated with three periods of 12 consecutive months of service credit.

Members disabled, who have five or more years of service credit, six months of which has been earned since the most recent period of membership, may receive retirement benefits if determined to be permanently disabled. If a member dies before retirement, their spouse or their eligible children under the age of 18 (23 if a full time student) are entitled to monthly benefit payments. If there is no eligible spouse, financially dependent parents will receive a survivor's benefit.

## NOTE 8 – EMPLOYEE PENSION PLAN (CONTINUED)

### Funding Policy

Plan members and the State are required to contribute to the CSSDTF at a rate set by statute. Most employees contribute 8.0 percent of their gross covered wages to an individual account in the Plan. During Fiscal Year 2003 and 2004, the State contributed 10.15 percent and 10.04 percent, respectively, of the employee's gross covered wages. Before January 1, 2003, 1.64 percent was allocated to the Health Care Trust Fund and after January 1, 2003, 1.1 percent was allocated to the Health Care Trust Fund. Through May 31, 2004, the amount needed to meet the match requirement established by the PERA Board was allocated to the Matchmaker program (see Note 9 below). The balance remaining after allocations to the Matchmaker program and the Health Care Trust Fund was allocated to the defined benefit plan.

The annual gross covered wages subject to PERA is the gross earnings less any reduction in pay to offset employer contributions to the State sponsored IRC 125 Plan established under Section 125 of the Internal Revenue Code. The contribution requirements of Plan members and their employers are established, and may be amended, by the General Assembly.

The Division's contributions to the three programs described above for the Fiscal Years ending June 30, 2004, 2003, and 2002 were $982,767, $962,226, and $891,355, respectively. These contributions met the required contributions for each year.

## NOTE 9 – VOLUNTARY TAX-DEFERRED RETIREMENT PLANS

Beginning on January 1, 2001, the Matchmaker Program established a State match for PERA member's voluntary contributions to tax-deferred retirement plans. For calendar years 2001 and 2002, the match was 100 percent of up to 3 percent of the employee's gross covered wages paid during the month. For calendar year 2003, the match was 100 percent of up to 2 percent of the employee's gross covered wages paid during the month. For calendar year 2004 through May 31, 2004, the match was 100 percent of up to 1 percent of the employee's gross covered wages paid during the month. The PERA Board sets the level of the match annually based on the actuarial funding of the defined benefit pension plan. Two percent of gross salary plus 50 percent of any reduction in the overall contribution rate due to over funding of the pension plan was available for the match. While the plan was not over-funded, the maximum one-year change in the match rate is statutorily limited to one percent, and therefore, the match changed from 2 percent to 1 percent on January 1, 2004. Legislation passed in the 2004 session of the General Assembly terminated the match for pay periods ending after May 31, 2004. The match will resume when

## NOTE 9 – VOLUNTARY TAX-DEFERRED RETIREMENT PLANS (CONTINUED)

the actuarial value of the defined benefit plan assets are one hundred ten percent of actuarially accrued plan liabilities. PERA offers a voluntary 401(k) plan entirely separate from the defined benefit pension plan. The State offers a 457 Deferred Compensation Plan and certain agencies and institutions of the State offer a 403(b) Plan. Members who contribute to any of these plans also receive the State match.

## NOTE 10 – POSTRETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

### Health Care Program

PERACare (formerly known as the PERA Health Care Program) began covering benefit recipients and qualified dependents on July 1, 1986. This benefit was developed after legislation in 1985 established the program and the Health Care Fund. Under this program, PERA subsidizes a portion of the monthly premium for health care coverage. The benefit recipient pays any remaining amount of that premium through an automatic deduction from the monthly retirement benefit. During Fiscal Year 2003 - 2004, the premium subsidy was $115 for those with 20 years of service credit ($230 for members under age 65), and it was reduced by 5 percent for each year of service fewer than 20.

The Health Care Trust Fund is maintained by an employer's contribution as discussed in Note 8.

Monthly premium costs for participants depend on the health care plan selected, the number of persons being covered, Medicare eligibility, and the number of years of retiree service credit. PERA contracts with a major medical indemnity carrier to administer claims for self-insured plans and with health maintenance organizations to provide services within Colorado. As of December 31, 2003, there were 37,067 enrollees in the Plan.

### Life Insurance Program

PERA provides its members access to two group life insurance plans offered by Prudential and Anthem Life (formerly known as Rocky Mountain Life Insurance Company). Members may join one or both plans, and they may continue coverage into retirement. Premiums are collected monthly by payroll deduction or other means.

## NOTE 11 – LITIGATION

The Division is involved in various legal proceedings primarily for personnel related actions. The Division believes the actions are without merit and intends to vigorously defend against the actions. The amount of liability, if any, from the outcome of these actions cannot presently be estimated; however, management believes the ultimate impact on the Division's financial position will not be material. Nevertheless, due to uncertainties in the settlement process, it is at least reasonably possible that management's view of the outcome may change in the near term.

## NOTE 12 – FEDERAL LEGISLATIVE IMPACTS ON THE DIVISION

### Balanced Budget Act of 1997

The U.S. Balanced Budget Act of 1997 requires that guarantee agencies transfer approximately $1 billion of guarantor reserves to the Federal Treasury in Federal Fiscal Year 2002. Beginning in Fiscal Year 1998, each guarantee agency was required to establish a restricted account in which each agency was subject to the annual transfer of funds to the federal government. The principal amount in the restricted accounts was not available for agency use. Interest earnings were allowed to be used to conduct default reduction activities. The Division paid $23,268,032 to DE for this recall in September 2002.

### 1998 Reauthorization of the Higher Education Act

The Higher Education Act was reauthorized in October 1998. A provision of this Act requires guarantee agencies to repay reserves to the Federal Treasury of $250 million by September 30, 2007. The Division's share of this recall is $4,641,050. The Division paid DE $1,577,957 in Fiscal Year 2003, and will pay DE $1,531,547 in Fiscal Year 2006 and $1,531,546 in Fiscal Year 2007.

The legislation also requires that the Division set up a separate Agency Operating fund and Federal Reserve fund. These funds are maintained separately on the State's accounting system but are combined for financial reporting purposes.

## NOTE 13 – RISK MANAGEMENT

The State currently self-insures its agencies, officials and employees for risks of losses to which they are exposed including general liability, motor vehicle liability, worker's compensation and medical claims. Property claims are not self-insured but are covered by State purchased insurance.

**NOTE 13 – RISK MANAGEMENT** (CONTINUED)

The Division participates in the Risk Management Fund of the State. Division premiums are based on a risk exposure assessment and historical trends. A liability is reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include claims incurred but not reported. Because actual claim liabilities depend on such complex factors as inflation, changes in legal doctrines and damage awards, the process used in computing claims liability may not necessarily result in an exact amount. Claims liabilities are re-evaluated periodically to take into consideration recently settled claims, the frequency of claims and other economic and social factors.

There have been no significant reductions or changes in the Division's insurance coverage from the prior year.

**NOTE 14 – ACCRUED PAYROLL**

Prior to Fiscal Year 2003, salaries and wages earned through the end of the Fiscal Year were paid to employees on June 30. Under Senate Bill 03-197, salaries and wages for June 2004 and 2003 that were normally paid at the end of the month were paid at the beginning of July, in the subsequent fiscal year. This created accrued liabilities at June 30, 2004 and 2003, of $938,747 and $984,458, respectively, for incurred but unpaid salaries and wages.

**NOTE 15 – SUBSEQUENT EVENT**

Under H.B. 04-1350, the Division changed its name to College Access Network effective July 1, 2004.

Additionally, the Division entered into a Voluntary Flexible Agreement ("VFA") with DE effective July 1, 2004. The CSLP and DE are parties to certain agreements governing CSLP's participation as a guarantee agency in the FFEL program and have entered into the VFA to amend certain terms of existing agreements. The new agreement will modify CSLP's financial model and allow CSLP to test new ways to operate within the FFEL program. DE has also agreed to provide certain waivers of statutory and regulatory requirements to permit this testing. The waivers in part provide that the CSLP will not be required to maintain a minimum reserve level as required by federal statute (see Note 6).

## NOTE 16 – PRIOR PERIOD ADJUSTMENT

An adjustment was made to increase the net assets of the Federal Fund as of June 30, 2002 in the amount of $1,567,094 for the overstatement of a liability due to DE from previous years.

Clifton Gunderson LLP
Certified Public Accountants & Consultants

**Independent Auditor's 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**

Members of the Legislative Audit Committee:

We have audited the basic financial statements of the Student Loan Division, Department of Higher Education, State of Colorado (the "Division") as of and for the year ended June 30, 2004, which collectively comprise the Division's basic financial statements and have issued our report thereon dated September 1, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Division's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Division's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Finding and Recommendation No. 1 and No. 2 and relate to repurchase liabilities and default aversion fees.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Division'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 findings and recommendations.

This report is intended solely for the information and use of the Legislative Audit Committee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Clifton Gunderson LLP

Denver, Colorado
September 1, 2004

**SUPPLEMENTAL INFORMATION**

**STUDENT LOAN DIVISION**
**DEPARTMENT OF HIGHER EDUCATION**
**STATE OF COLORADO**
**COMBINING SCHEDULES OF NET ASSETS**
**June 30, 2004**
**(With Comparative Totals for June 30, 2003)**

## ASSETS

| | Agency Operating and Loan Servicing Funds | Federal Reserve and Drawdown Funds | Totals 2004 | Totals 2003 |
|---|---|---|---|---|
| **CURRENT ASSETS** | | | | |
| Cash and pooled cash investments | $ 21,769,042 | $ - | $ 21,769,042 | $ 20,141,567 |
| Due from other governments | | | | |
| Federal account maintenance fee | 676,034 | - | 676,034 | 624,269 |
| Federal loan processing and issuance fee | 479,701 | - | 479,701 | 371,961 |
| Other federal receivables | 89,103 | - | 89,103 | 19,938 |
| Other receivables, net | 837,027 | - | 837,027 | 785,516 |
| Supplies inventory | 75,592 | - | 75,592 | 100,161 |
| Prepaid expenses | 163,535 | - | 163,535 | 340,384 |
| Total current assets | 24,090,034 | - | 24,090,034 | 22,383,796 |
| **RESTRICTED ASSETS** | | | | |
| Restricted cash and pooled cash investments | - | 4,310,075 | 4,310,075 | 4,107,441 |
| Federal reinsurance receivable | - | 3,372,364 | 3,372,364 | 6,360,406 |
| Other receivables, net | - | 7,749 | 7,749 | 7,749 |
| Total restricted assets | - | 7,690,188 | 7,690,188 | 10,475,596 |
| **CAPITAL ASSETS** | | | | |
| Office furniture and equipment | 951,017 | - | 951,017 | 907,098 |
| Computer hardware and software | 2,990,093 | - | 2,990,093 | 2,784,610 |
| Property held under capital lease | 987,884 | - | 987,884 | 829,472 |
| Leasehold improvements | 97,946 | - | 97,946 | 97,946 |
| | 5,026,940 | - | 5,026,940 | 4,619,126 |
| Less accumulated depreciation | (4,294,438) | - | (4,294,438) | (3,975,944) |
| Capital assets, net | 732,502 | - | 732,502 | 643,182 |
| **TOTAL ASSETS** | $ 24,822,536 | $ 7,690,188 | $ 32,512,724 | $ 33,502,574 |

## LIABILITIES AND NET ASSETS

| | Agency Operating and Loan Servicing Funds | Federal Reserve and Drawdown Funds | Totals 2004 | Totals 2003 |
|---|---|---|---|---|
| **CURRENT LIABILITIES** | | | | |
| Accounts payable and accrued liabilities | $ 1,668,964 | $ - | $ 1,668,964 | $ 2,031,499 |
| Payable to the U.S. Department of Education: | | | | |
| Loan collections and other liabilities due to federal government | 1,078,204 | - | 1,078,204 | 1,023,490 |
| Other current liabilities | | | | |
| Current portion of obligation under capital lease | 131,859 | - | 131,859 | 209,748 |
| Other | 291,077 | - | 291,077 | 237,227 |
| Interfund payable - other agencies | 347,841 | - | 347,841 | 368,225 |
| Deferred revenue | 122,555 | - | 122,555 | - |
| Total current liabilities | 3,640,500 | - | 3,640,500 | 3,870,189 |
| **LIABILITIES PAYABLE FROM RESTRICTED ASSETS** | | | | |
| Recall reserves due to DE | - | 3,063,093 | 3,063,093 | 3,063,093 |
| Accounts payable and accrued liabilities | - | 9,016 | 9,016 | 7,303 |
| Loan collections and other liabilities due to federal government | - | 1,469,491 | 1,469,491 | 1,702,157 |
| Total liabilities payable from restricted assets | - | 4,541,600 | 4,541,600 | 4,772,553 |
| **NONCURRENT LIABILITIES** | | | | |
| Accrued compensated absences | 872,534 | - | 872,534 | 874,414 |
| Obligation under capital leases, net of current portion | 214,192 | - | 214,192 | 16,987 |
| Total noncurrent liabilities | 1,086,726 | - | 1,086,726 | 891,401 |
| Total liabilities | 4,727,226 | 4,541,600 | 9,268,826 | 9,534,143 |
| **NET ASSETS** | | | | |
| Invested in capital assets, net of related debt | 386,451 | - | 386,451 | 416,447 |
| Restricted | - | 3,148,588 | 3,148,588 | 5,703,043 |
| Unrestricted | 19,708,859 | - | 19,708,859 | 17,848,941 |
| Total net assets | 20,095,310 | 3,148,588 | 23,243,898 | 23,968,431 |
| **TOTAL LIABILITIES AND NET ASSETS** | $ 24,822,536 | $ 7,690,188 | $ 32,512,724 | $ 33,502,574 |

**STUDENT LOAN DIVISION**
**DEPARTMENT OF HIGHER EDUCATION**
**STATE OF COLORADO**
**COMBINING SCHEDULES OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**
**For the Year Ended June 30, 2004**
**(With Comparative Totals for the Year Ended June 30, 2003)**

| | Agency Operating and Loan Servicing Funds | Federal Reserve and Drawdown Funds | Totals 2004 | Totals 2003 |
|---|---|---|---|---|
| **OPERATING REVENUES** | | | | |
| Federal grants and contracts | | | | |
| Division's share of collections on loans and bankruptcies | $ 10,492,059 | $ 614,284 | $ 11,106,343 | $ 10,136,202 |
| Federal account maintenance fee | 2,338,103 | - | 2,338,103 | 2,233,668 |
| Federal loan processing and issuance fee | 2,447,130 | - | 2,447,130 | 2,254,935 |
| Federal reinsurance | - | 50,492,123 | 50,492,123 | 56,950,242 |
| Charges for goods and services | | | | |
| Contractual service fees | 5,217,078 | - | 5,217,078 | 4,701,986 |
| Guarantee fees | - | 168,808 | 168,808 | - |
| Interest on purchased loans and other | 414,475 | - | 414,475 | 488,257 |
| Gifts and donations | 13,800 | - | 13,800 | 309,900 |
| Other revenue | 23,569 | - | 23,569 | 9,908 |
| Total operating revenues | 20,946,214 | 51,275,215 | 72,221,429 | 77,085,098 |
| **OPERATING EXPENSES** | | | | |
| Guarantee claims paid to lending institutions | - | 51,760,586 | 51,760,586 | 58,570,453 |
| Salaries and fringe benefits | 12,722,611 | - | 12,722,611 | 13,520,461 |
| Operating and travel | | | | |
| Contracted collection costs | 2,548,645 | - | 2,548,645 | 1,706,541 |
| Other operating and travel | 5,376,354 | - | 5,376,354 | 5,424,090 |
| Depreciation | 414,010 | - | 414,010 | 523,988 |
| Total operating expenses | 21,061,620 | 51,760,586 | 72,822,206 | 79,745,533 |
| **OPERATING LOSS** | (115,406) | (485,371) | (600,777) | (2,660,435) |
| **NONOPERATING REVENUES (EXPENSES)** | | | | |
| Earnings on investments | 44,052 | 29,578 | 73,630 | 983,108 |
| Loss on sale of equipment | (49,944) | - | (49,944) | - |
| Income (loss) before operating transfers | (121,298) | (455,793) | (577,091) | (1,677,327) |
| Operating transfers to other agencies | (147,442) | - | (147,442) | (125,821) |
| Interfund transfers | 2,098,662 | (2,098,662) | - | - |
| Total transfers | 1,951,220 | (2,098,662) | (147,442) | (125,821) |
| **CHANGE IN NET ASSETS** | 1,829,922 | (2,554,455) | (724,533) | (1,803,148) |
| **NET ASSETS, BEGINNING OF YEAR, AS RESTATED FOR JUNE 30, 2002** | 18,265,388 | 5,703,043 | 23,968,431 | 25,771,579 |
| **NET ASSETS, END OF YEAR** | $ 20,095,310 | $ 3,148,588 | $ 23,243,898 | $ 23,968,431 |

**STUDENT LOAN DIVISION**
**DEPARTMENT OF HIGHER EDUCATION**
**STATE OF COLORADO**
**COMBINING SCHEDULES OF CASH FLOWS**
**For the Years Ended June 30, 2004**
**(With Comparative Totals for the Year Ended June 30, 2003)**

| | Agency Operating and Loan Servicing Funds | Federal Reserve and Drawdown Funds | Totals 2004 | Totals 2003 |
|---|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | |
| Cash received from | | | | |
| Fees for service | $ 5,288,122 | $ 168,808 | $ 5,456,930 | $ 4,656,981 |
| Federal grants and contracts | 15,103,336 | 53,861,783 | 68,965,119 | 68,301,361 |
| Interest on purchased loans and other | 414,475 | - | 414,475 | 488,257 |
| Gifts and donations | 13,800 | - | 13,800 | 309,900 |
| Other sources | 23,569 | - | 23,569 | 9,908 |
| | 20,843,302 | 54,030,591 | 74,873,893 | 73,766,407 |
| Cash disbursed for | | | | |
| Guarantee claims paid to lending institutions | - | (51,758,873) | (51,758,873) | (58,712,636) |
| Employees | (12,724,491) | - | (12,724,491) | (13,469,856) |
| Suppliers | (5,504,005) | | (5,504,005) | (4,856,954) |
| Contracted collection costs | (2,548,645) | - | (2,548,645) | (1,706,541) |
| Recall reserves paid to DE | - | - | - | (24,845,989) |
| | (20,777,141) | (51,758,873) | (72,536,014) | (103,591,976) |
| Net cash provided (used) by operating activities | 66,161 | 2,271,718 | 2,337,879 | (29,825,569) |
| **CASH FLOW FROM NONCAPITAL ACTIVITIES** | | | | |
| Transfers - out | (147,442) | - | (147,442) | (125,821) |
| Net cash used in noncapital activities | (147,442) | - | (147,442) | (125,821) |
| **INTERFUND TRANSFERS** | 2,098,662 | (2,098,662) | - | - |
| **CASH FLOW FROM CAPITAL AND RELATED FINANCING ACTIVITIES** | | | | |
| Principal paid on capital debt | - | - | - | (346,000) |
| Proceeds from capital leases and note payable | 329,144 | - | 329,144 | - |
| Acquisition of capital assets | (578,545) | - | (578,545) | (39,679) |
| Capital lease payments | (184,557) | - | (184,557) | (201,304) |
| Net cash used in capital and related financing activities | (433,958) | - | (433,958) | (586,983) |
| **CASH FLOW FROM INVESTING ACTIVITIES** | | | | |
| Earnings on investments | 44,052 | 29,578 | 73,630 | 983,108 |
| **NET INCREASE (DECREASE) IN CASH AND TEMPORARY CASH INVESTMENTS** | 1,627,475 | 202,634 | 1,830,109 | (29,555,265) |
| **CASH AND INVESTMENTS, BEGINNING OF YEAR** | 20,141,567 | 4,107,441 | 24,249,008 | 53,804,273 |
| **CASH AND INVESTMENTS, END OF YEAR** | $ 21,769,042 | $ 4,310,075 | $ 26,079,117 | $ 24,249,008 |

| | Agency Operating and Loan Servicing Funds | Federal Reserve and Drawdown Funds | Totals 2004 | Totals 2003 |
|---|---|---|---|---|
| **RECONCILIATION OF NET OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES** | | | | |
| Net operating loss | $ (115,406) | $ (485,371) | $ (600,777) | $ (2,660,435) |
| Adjustments to reconcile net operating loss to net cash provided (used) by operating activities | | | | |
| Depreciation | 414,010 | - | 414,010 | 523,988 |
| Effects of changes in net assets and liabilities | | | | |
| Receivables | (280,181) | 2,988,042 | 2,707,861 | (3,353,315) |
| Due from other funds | - | - | - | 5,500 |
| Supplies inventory | 24,569 | - | 24,569 | (9,088) |
| Prepaid expenses | 176,849 | - | 176,849 | (187,819) |
| Accounts payable and accrued liabilities | (362,535) | 1,713 | (360,822) | 1,251,017 |
| Other current liabilities | 53,850 | - | 53,850 | (465,403) |
| Recall reserves due to DE | - | | | (24,845,989) |
| Loan collections and other liabilities due to federal government | 54,714 | (232,666) | (177,952) | 142,745 |
| Accrued compensated absences | (1,880) | - | (1,880) | 50,605 |
| Interfund payable other agencies | (20,384) | - | (20,384) | (156,005) |
| Deferred revenue | 122,555 | - | 122,555 | (121,370) |
| **NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES** | $ 66,161 | $ 2,271,718 | $ 2,337,879 | $ (29,825,569) |

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