

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

FINANCIAL AND COMPLIANCE AUDIT
Fiscal Years Ended June 30, 2003 and 2002

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Gunderson LLP**
Certified Public Accountants & Consultants

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, 2003. 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
August 28, 2003

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**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
Fiscal Year Ended June 30, 2003**

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, 2003 and 2002 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, 2003 and 2002. We noted one reportable condition and material weakness related to incorrect default aversion fees. This is described in Recommendation No. 1 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, 2003.

Management Judgments and Accounting Estimates. The Division provides an allowance for loan losses of 80% of its purchased loans receivable. There were no other significant accounting estimates of financial data which would be particularly sensitive and require substantial judgment by management.

Significant Audit Adjustments. There were no 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.

Additional Required Communications (continued)

Uncorrected Misstatements. There was one uncorrected misstatement aggregated by us during our current audit and pertaining to the most recent period presented in the financial statements. The adjustment was to reduce an estimated account receivable due from the U.S. Department of Education (“DE”) to the amount confirmed by \$119,036. The Division has determined that this uncorrected misstatement is immaterial, both individually and in the aggregate, to the financial statements taken as a whole. By not correcting this misstatement, the Division’s revenue and accounts receivable are overstated for Fiscal Year 2003.

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 had three current year findings and recommendations relating to the billings of default aversion fees, maintaining its required reserve balance and collection of other accounts receivable. The Division agreed with two of these recommendations and partially agreed with one of the recommendations.

Summary of Progress in Implementing Prior Year Recommendations

In regard to the four findings and recommendations from the prior year, two were partially implemented and one was implemented. The fourth finding was implemented in August 2003 in conjunction with the implementation of an integrated system.

RECOMMENDATION LOCATOR

<u>Rec. No.</u>	<u>Page No.</u>	<u>Recommendation Summary</u>	<u>Division's Response</u>	<u>Implementation Date</u>
1	7	CSLP should ensure that adequate controls are in place over default aversion fees ("DAF").	Agree	December 2003
2	9	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) Partially Agree (b) Disagree	July 1, 2004 and ongoing
3	10	CSLP should establish control procedures over its other accounts receivable to improve monitoring and collections.	Agree	June 2004

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 2003, students borrowed over \$323 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 2003, PLUS Loan borrowings approximated \$24.7 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, 45,651 consolidation loans have been made totaling over \$861.8 million.

Findings and Recommendations

Under Billings of Default Aversion Fees for Consolidation Loans

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. Under the Federal Higher Education Act of 1965, Sections 422A and 422B, the CSLP is allowed to bill for default aversion fees (DAFs) 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. 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.

During our audit of the CSLP for Fiscal Year 2002, we identified duplicate billing errors related to the DAF. As a result of the duplicate billings, excess funds in the amount of \$420,643 were transferred from the Federal Fund and used for the operations of the CSLP. In addition, we identified another problem in which the DAF was not calculated on the principal and interest amounts owed at the time the default claim was filed as it should be, but rather on the current principal and interest amounts at billing. Using incorrect principal and interest amounts in computing the DAF resulted in over-billing \$731 in fees to the Federal Fund. In both instances, the problem areas were corrected and the adjustment to the financial statements was made as of June 30, 2002.

During our audit for Fiscal Year 2003, CSLP identified further billing problems regarding the DAF, which were communicated to the U.S. Department of Education auditors in June 2003. CSLP tracks some consolidation loans on a stand-alone database while other consolidation loans are tracked on the main system. During Fiscal Year 2003, the CSLP has been in the process of converting all consolidation loans on the stand-alone system onto its mainframe guarantee system. As part of the conversion, the CSLP’s Quality Assurance team performed reviews of data from the stand-alone system. During this process, the following errors were identified.

- Eligible loans entering delinquency status prior to system automation for DAF billings in June 2000 were never billed for the fee. This resulted in unbilled DAF charges of \$856,787 on 4,327 loans as of May 2003. In other words, these fees should have been billed to the Federal Fund and transferred to the Operating Fund but were not.
- Refunds or transfers of the DAF fee back to the Federal Fund are made when a default claim is subsequently paid. CSLP identified 442 loans as of May 2003 where DAF refunds totaling \$63,237 were transferred back to the Federal Fund, although the DAF was never originally billed to the Federal Fund.
- Adjustments made to DAF billings by CSLP staff resulted in 22 loans as of May 2003 with \$154,315 in over-billings of DAF fees to the Federal Fund. The adjustments were due to the decimal errors or other data variances and were identified by the CSLP Quality Assurance Team.

Findings and Recommendations (continued)

As of May 2003 the net effect of these errors identified by CSLP was \$765,709 in DAF billings that should have been billed to the Federal Fund and transferred to the Operating Fund.

The CSLP completed the conversion of consolidation loans from the stand-alone system onto the mainframe guarantee system in August 2003. The CSLP reports that the mainframe guarantee system contains significantly more automation and functionality than was available on the stand-alone system, which should help prevent further errors related to DAF billings. Specifically, the mainframe guarantee system contains a DAF quality assurance system process that reviews all active default aversion requests and cancellations and determines whether or not default aversion fees have been billed previously. If discrepancies are identified, the DAF billing program is not run until the issues are resolved. The CSLP believes that as a result of the reviews performed by the Quality Assurance team, all problems related to the DAF billings on the stand-alone system have been identified and resolved. However, CSLP is currently in the process of still testing the conversion and will need to verify and ensure that the controls put in place within the new mainframe guarantee system are operating as intended.

Recommendation No. 1:

The CSLP should continue to ensure that adequate controls are in place over default aversion fees ensuring that all data on consolidated loans converted to the mainframe guarantee system are adequately tested to avoid unforeseen problems and impacts on the mainframe system. Additionally, the CSLP should continue to monitor controls established in the mainframe system for default aversion fees and resolve all discrepancies identified.

CSLP Response:

Agree. The Colorado Student Loan Program (CSLP) took the following actions:

1. Established a Quality Assurance Team to review all applicable federal statutes, regulations and system specifications to ensure that CSLP's mainframe processes default aversion loans, billings and refunds correctly and in a timely manner.
2. On August 9, 2003, CSLP successfully converted all consolidation loans to the mainframe from an Access database. This effort reduces the likelihood of future errors due to the complexity of having consolidation loans on a separate database.
3. The Quality Assurance Team conducted a thorough review of all consolidation loans eligible, billed and refunded prior to converting the consolidation loans.
4. CSLP IT working with the Quality Assurance Team completed all system changes necessary to ensure that henceforth, CSLP will report all loans, billings and refunds correctly.

CSLP has implemented both weekly and monthly automated Quality Assurance processes that are completed prior to the actual default aversion billing. These pre-billing processes are designed to identify any and all exceptions to federal statutes or requirements. We have run six weekly QA checks and one monthly check since January 1, 2004. These QA reports show that the system is now working as intended and that CSLP is properly billing the Federal Government for DAF. Implementation date: December 2003

Findings and Recommendations (continued)

Monitoring the Federal Fund

In addition to the errors in default aversion fees (DAF) noted above that resulted in under billings to the Federal Fund of \$765,709 as of June 30, 2003, we also determined that the CSLP had not billed the Federal Fund for DAF due on certain loans since September 2002; these unbilled fees totaled \$765,887 as of the end of Fiscal Year 2003. Therefore, at June 30, 2003, the total fees not billed to the Federal Fund were \$1,531,596. The CSLP staff stated that these fees were not billed to the Federal Fund and transferred into the Operating Fund because the transfer would have caused the CSLP's Federal Fund to fall below its Federal Reserve Requirement. According to Section 428(c)(9)(A) of the federal regulations, the CSLP is required to maintain a reserve in the Federal Fund of .25% of the unpaid balance of outstanding loans guaranteed by the agency which is reported to the U.S. Department of Education (DE) on September 30 of each year. The Federal Higher Education Act states that if a guaranty agency falls below the required minimum reserve level in any two consecutive years, reimbursement payments for reinsurance will be reduced. For CSLP, this would result in a reduction in federal reimbursements payments on defaulted loans from a current range of 100% to 85% in the event of default.

In August 2002, CSLP was required to pay \$24,845,989 from the reserves of the Federal Fund to DE as part of Balanced Budget Act of 1997 and the 1998 Reauthorization of Higher Education Act. In addition to the reserved paid to DE, the Federal Fund has recorded a net loss from operations of (\$1,330,901) and (\$1,077,619) for the years ended June 30, 2003 and 2002, respectively.

In an effort to subsidize these losses occurring in the Federal Fund and maintain reserve levels, in September 2003 CSLP management transferred \$1.7 million from the Operating Fund into the Federal Fund. Our calculation at September 30, 2003 found that if this transfer was not made, CSLP would have been below the required reserve by approximately \$250,000. The Higher Education Act of 1965, Section 422B(d)(2) states that a guaranty agency may, at its discretion, transfer funds into the Federal Fund; however, such transfers are irrevocable and therefore cannot be treated as "loans." In October 2003 the CSLP billed the Federal Fund for \$1,777,402 in accumulated DAF (\$1,531,596 due as of June 30, 2003 plus \$245,806 due from August through October 2003). Therefore, while the CSLP was able to collect the fees due from the Federal Fund, it did so by subsidizing the Federal Fund at the time the measurement of the reserve was required, with operating revenue earned by the Operating Fund. The primary sources of operating revenue for the Operating Fund include CSLP's share of collections on loans and bankruptcies, account maintenance fees, loan processing and other contractual service fees.

CSLP is working to identify alternative plans to ensure that the reserve will be met by September 30, of each year without the subsidy from the operating revenue earned by the Operating Fund. These procedures should ensure that other options, such as charging additional allowable fees or investigation of other solutions, are pursued and implemented in a manner that eliminates or reduces the need for the Operating Fund to support the Federal Fund. Successful implementation of available options would allow the CSLP to transfer the default aversion fees to the Federal Fund on a timely basis. Without changes in the fee structure or other alternatives, CSLP will continue to need to subsidize the Federal Fund.

Findings and Recommendations (continued)

Recommendation No. 2:

The CSLP should continue to follow established procedures to monitor the Federal Fund with emphasis on:

- a. Determining the adequacy of funding to maintain required reserves and taking timely action, such as charging other allowable fees and investigating other solutions, to address potential problems by means other than using the Operating Fund to subsidize the Federal Fund.
- b. Contingent upon establishing adequate funding and reserves for the Federal Fund, making transfers of default aversion fees to the Operating Fund as permitted under the Federal Higher Education Act.

CSLP Response:

- a. Partially Agree. The agency suspended charging the guarantee fee for the Federal Fund in 1999. CSLP was relying on interest earnings on funds already noticed by the federal government as subject to recall to maintain its reserve ratio in the Federal Fund. The decision was not financially sustainable. Because the Federal Fund revenue did not keep pace with the Fund's expenditures, the agency will continue to subsidize the Federal Fund from the Operating Fund even as allowable fees are charged in the future.

Although the agency is taking timely action to resolve this issue, it does not have exclusive service jurisdiction in Colorado and competes with other guarantee agencies for Colorado business. While CSLP has been successful in the past 18 months in gaining new guarantee customers, the new revenues will not immediately compensate for the past losses.

Implementation Date: Charging other allowable fees, July 1, 2004; remaining issues, ongoing.

- b. Disagree. CSLP will continue to monitor its cash position and the long-term obligations of its Federal Fund on a monthly basis. The agency will make the transfers of funds due it as permitted by the Federal Higher Education Act of 1965.

However, current projections forecast a need to subsidize the Federal Fund from Agency Operating Fund revenues for the next several years.

Auditor's Addendum: We note that the CSLP has agreed to make the transfers, contingent on the availability of funds.

Findings and Recommendations (continued)

Monitoring Delinquent Accounts Receivable

The CSLP maintains an account to track miscellaneous accounts receivable balances. These amounts are due to the CSLP for claims that were overpaid by the CSLP to various lenders and for collections due from outside collection agencies. The balance in the account at June 30, 2003 was \$87,469. Approximately \$47,000 of this balance (54%) was over a year old and consisted primarily of miscellaneous claim overpayments by the CSLP to lenders. The overpayments were due to the claims being paid to lenders at 100% rather than at 98% of the loan amount. These payments also related to certain loans maintained on the separate database described in Recommendation No. 1.

During the audit, when inquiries were made to the CSLP staff regarding the collection status of the older account balances, the staff reported that the past due accounts were not being monitored on a regular basis for further collection efforts. The CSLP states that overpayments to the lenders can be offset against future claim payments due to the same lender. However, the CSLP staff reported that they have not followed established procedures, which require that outstanding balances be monitored to ensure that overpayments are offset as appropriate and all past due accounts are routinely pursued. As a result, amounts due have not been offset against claims on a timely basis and several balances due from lenders have become significantly past due. This could reduce the CSLP's ability to collect or subsequently offset the amounts billed.

Recommendation No. 3

The CSLP should establish control procedures over accounts receivable by routinely monitoring all balances on a timely basis, identifying delinquent accounts, and performing appropriate follow up. This should include ensuring that receivables are offset against future claims when possible. These policies should be documented, communicated to appropriate personnel, and monitored for compliance.

CSLP Response:

Agree. Although the amount of outstanding accounts receivable is not material, CSLP agrees that close monitoring of Accounts Receivables must occur. CSLP also believes it must maintain the ability to write-off Accounts Receivables when the cost of recovery exceeds the amount due.

Although policies are in place, CSLP will retrain employees in these areas on the requirements for obtaining funds due to CSLP. Implementation date: June 30, 2004

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, 2002 and the current disposition of these recommendations.

Recommendation No. 1

The CSLP should ensure that all new processes affecting the DAF billing system are adequately tested to avoid unforeseen impacts on the system and possible errors. Additionally, the CSLP should continue to implement and follow established control and system procedures to correct the duplicate billing errors within the system.

Disposition

Partially implemented. See current year Recommendation No. 1.

Recommendation No. 2

The CSLP should develop and implement a process and procedures to ensure that the default aversion fees are computed on the correct base amounts. Additionally, the CSLP should develop procedures to identify problems and prevent errors before they occur.

Disposition

Partially implemented. See current year Recommendation No. 1.

Recommendation No. 3

The CSLP should refund the appropriate amounts to the borrowers who were charged excess interest. The CSLP should develop procedures to prevent future IC transaction errors and to identify and correct inaccurate IC transactions within the computer system so that the proper interest accruals are made to the appropriate claims.

Disposition

Implemented.

Recommendation No. 4

The CSLP should continue efforts to integrate all information for defaulted loans into a single system. The CSLP should implement the necessary control procedures to timely identify problems and prevent errors in maintaining the defaulted loans.

Disposition

Implemented August 2003. See current year Recommendation No. 1.

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, 2003 and 2002 and the combined statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. 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 provides 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, 2003 and 2002 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, 2003 and 2002, 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 August 28, 2003, on our consideration of the Division's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

The Management's Discussion and Analysis (MD&A) is not a required part of the financial statements but is supplemental information required by the Governmental Accounting Standards Board. 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 made for the purpose of forming an opinion on the basic financial statements taken as a whole. 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
August 28, 2003

MANAGEMENT'S DISCUSSION AND ANALYSIS

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 years ended June 30, 2003 and 2002, 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 22.

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 as of Fiscal Year 2002 differ in form compared to prior years' 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 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 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 investments.

Financial Overview

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

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 and Drawdown Funds, which are designated for paying lender claims and returning funds to the United States Department of Education ("DE"), respectively. The Federal Reserve and Drawdown Funds are the property of DE.

Management Highlights

The Colorado Student Loan Program is in the business of guaranteeing student loans and, should a loan default, continuing in collection efforts on these loans. During Fiscal Year 2003 the gross volume of loans guaranteed increased by approximately \$112,630,814 from \$415,114,701 to \$527,745,515 (27%). A large portion of this increase resulted from increased consolidation loan volume. Consolidations, where borrowers can combine all outstanding student loans into one loan, increased approximately \$81,100,396. Outstanding loans (total loan portfolio) in Fiscal Year 2003 increased approximately \$162,728,131 to a total of \$2,552,825,028 or 6.8%.

The Colorado Student Loan Program's largest source of revenue in the Federal Reserve and Drawdown Funds 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 2003, this represented \$56,950,242 of the \$57,240,585 in revenue for the Federal Reserve and Drawdown Funds. For Fiscal Year 2002, revenue from reinsurance was \$52,521,503. For Fiscal Years 2003 and 2002, claims paid to lenders was \$58,570,453 and \$53,769,267, respectively; claims are the majority of expenses for the Federal Fund.

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 24% of subsequent loan collections on defaulted loans to cover costs associated with its collection efforts. For Fiscal Years 2003 and 2002, the Colorado Student Loan Program collected \$9,845,859 and \$9,513,796 on defaulted loans and bankruptcies, respectively. This represented 49.6% and 50.1% of the total operating and loan servicing revenues for Fiscal Years 2003 and 2002, respectively.

In September 2002, \$24,845,989 was paid from the Federal Reserve and Drawdown Funds to the DE as part of two separate reserve fund recalls from the Colorado Student Loan Program. The Balanced Budget Act of 1997 required the Colorado Student Loan Program to return \$23,268,032 to the DE. The *1998 Reauthorization of the Higher Education Act* required the Colorado Student Loan Program to return an additional \$1,577,957 to the DE in Fiscal Year 2003. Two additional installments of \$1,531,547 and \$1,531,546 will be paid in Fiscal Year 2007 and 2008, respectively to DE.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

CONDENSED STATEMENT OF NET ASSETS

June 30,	Agency Operating and Loan Servicing Funds		Percent Change	Federal Reserve and Drawdown Funds		Percent Change
	2003	2002		2003	2002	
ASSETS						
Current Assets	\$ 22,383,796	\$ 18,305,532	22%	\$ -	\$ 2,684,001	-100%
Restricted Assets	-	-		10,475,596	37,880,402	-72%
Capital Assets	643,182	1,127,491	-43%	-	-	
Total Assets	\$ 23,026,978	\$ 19,433,023	18%	\$ 10,475,596	\$ 40,564,403	-74%
LIABILITIES						
Current Liabilities	\$ 3,870,189	\$ 3,251,288	19%	\$ -	\$ -	
Liabilities Payable from Restricted Assets	-	-		6,339,647	31,491,109	-80%
Noncurrent Liabilities	891,401	1,050,544	-15%	-	-	
Total Liabilities	\$ 4,761,590	\$ 4,301,832	11%	\$ 6,339,647	\$ 31,491,109	-80%
NET ASSETS						
Invested in Capital Assets, Net of Related Debt	\$ 416,447	\$ 353,452	18%	\$ -	\$ -	
Restricted	-	-		4,135,949	9,073,294	-54%
Unrestricted	17,848,941	14,777,739	21%	-	-	
Total Net Assets	\$ 18,265,388	\$ 15,131,191	21%	\$ 4,135,949	\$ 9,073,294	-54%

CONDENSED STATEMENT OF CHANGES IN NET ASSETS

June 30,	Agency Operating and Loan Servicing Funds		Percent Change	Federal Reserve and Drawdown Funds		Percent Change
	2003	2002		2003	2002	
Operating Revenues	\$ 19,844,513	\$ 18,972,670	5%	\$ 57,240,585	\$ 52,707,215	9%
Operating Expenses	21,174,047	19,500,040	9%	58,571,486	53,784,834	9%
OPERATING LOSS	(1,329,534)	(527,370)	-152%	(1,330,901)	(1,077,619)	24%
Earnings on Investments	984,752	1,204,299	-18%	(1,644)	2,034,933	-100%
Total Transfers	3,478,979	2,251,877	55%	(3,604,800)	(2,418,531)	-49%
CHANGE IN NET ASSETS	\$ 3,134,197	\$ 2,928,806	7%	\$ (4,937,345)	\$ (1,461,217)	-238%

Agency Operating and Loan Servicing Funds

Unrestricted Net Assets of the Agency Operating and Loan Servicing Funds increased from \$14,777,739 to \$17,848,941 or \$3,134,197 (21%) in Fiscal Year 2003 due to the transfer of interest on the recall funds and default aversion fees for the Fiscal Year to the Agency Operating Fund from the Federal Reserve and Drawdown Funds. (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

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

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 increased 19% because accounts payable and accrued liabilities included in current liabilities increased from \$646,048 to \$2,031,499 or \$1,385,451 (214.5%) in Fiscal Year 2003. The most significant change included in accounts payable and accrued liabilities resulted from the statutory change of the payroll date for state employees from June 30 to July 1 resulting in accrued payroll at June 30, 2003 of \$984,458. In addition, an accrual was recorded for \$379,000 payable to Raytheon Corporation for fees related to the Quester Debt Management Collection System. The Quester system is designed to provide electronic accounting and collection services for outstanding student loans.

Federal Reserve and Drawdown Funds

Total Assets decreased in Fiscal Year 2003 from \$40,564,403 to \$10,475,596 or \$30,088,807 (74%). Approximately 83% of the decrease resulted from the payment to the DE of the required reserve recall. Details of this repayment can be found under the section Management Highlights. Total liabilities and restricted cash were reduced by the same transaction. Current assets decreased by \$2,684,001 due to the repayment of the loan made to the Agency Operating Fund from the Federal Reserve Fund.

The total change in net assets was a decrease of \$4,937,345. This decrease resulted from interfund transfers totaling \$3,604,800. The bulk of the transfer was interest from the Recall Fund to the Agency Operating Fund in the amount of \$2,602,040. 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.)

CONDENSED STATEMENT OF REVENUES

Years Ended June 30,	Agency Operating and Loan Servicing Funds		Percent Change	Federal Reserve and Drawdown Funds		Percent Change
	2003	2002		2003	2002	
OPERATING REVENUES						
Federal Grants and Contracts	\$ 14,334,462	\$ 13,788,378	4%	\$ 57,240,585	\$ 52,707,215	9%
Charges for Goods and Services	4,701,986	4,390,395	7%	-	-	
Interest on Purchased Loans	488,257	760,932	-36%	-	-	
Gifts and Donations	309,900	-		-	-	
Other	9,908	32,965	-70%	-	-	
Total Operating Revenues	\$ 19,844,513	\$ 18,972,670	5%	\$ 57,240,585	\$ 52,707,215	9%
NONOPERATING REVENUES	\$ 984,752	\$ 1,204,299	-18%	\$ (1,644)	\$ 2,034,933	-100%
TOTAL REVENUES	<u>\$ 20,829,265</u>	<u>\$ 20,176,969</u>	3%	<u>\$ 57,238,941</u>	<u>\$ 54,742,148</u>	5%

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Agency Operating and Loan Servicing Funds

Federal Grants and Contracts increased in Fiscal Year 2003 from \$13,788,378 to \$14,334,462 or \$546,084 (4%) in the Agency Operating and Loan Servicing Funds primarily due to increased defaulted loan collections. The Colorado Student Loan Program is allowed to retain 24% of all borrower payments collected on defaulted loans. Interest on Purchased Loans decreased by \$272,675 from \$760,932 to \$488,257 in Fiscal Year 2003 reflecting a decrease in the number of loans repurchased by lenders.

During Fiscal Year 2003, \$309,900 was received by Colorado Student Loan Program from various State agencies on behalf of the Colorado Mentor program for a media campaign to promote the CSLP website, which is recorded as Gifts and Donations. Non-operating revenues in the Agency Operating and Loan Servicing Funds consist of earnings on investments. Investment earnings decreased from \$1,204,299 to \$984,652 in Fiscal Year 2003 or \$219,547 (18%) due to lower Treasury investment earning rates.

Federal Reserve and Drawdown Funds

Federal Grants and Contracts increased in Fiscal Year 2003 from \$52,707,215 to \$57,240,585 or \$4,533,370 (9%) in the Federal Reserve and Drawdown Funds because of increased reinsurance received from DE. The Colorado Student Loan Program receives from 95% to 100% reinsurance on all claims paid to lending institutions. Claim payments increased, resulting in a corresponding reinsurance increase. Non-operating revenues (earnings on investments) decreased from \$2,034,933 to \$(1,644) in Fiscal Year 2003 or \$2,036,577 (100%) in the Federal Reserve and Drawdown Funds. Less cash was available to invest because of the recall repayments to DE. (See additional information in the Management Highlights section of this Management's Discussion and Analysis.) The repayments and lower investment returns combined to reduce investment earnings during Fiscal Year 2003.

CONDENSED STATEMENT OF EXPENSES

Years Ended June 30,	Agency Operating and Loan Servicing Funds			Federal Reserve and Drawdown Funds		
	2003	2002	Percent Change	2003	2002	Percent Change
OPERATING EXPENSES						
Guarantee Claims Paid to Lending Institutions				\$ 58,570,453	\$ 53,769,267	9%
Salaries and Fringe Benefits	\$ 13,520,461	\$ 12,280,362	10%	-	-	
Contracted Collection Costs	1,706,541	1,497,729	14%	-	-	
Other Operating and Travel	5,423,057	5,155,679	5%	1,033	15,567	-93%
Depreciation	523,988	566,270	-7%	-	-	
Total Operating Expenses	\$ 21,174,047	\$ 19,500,040	9%	\$ 58,571,486	\$ 53,784,834	9%
NON OPERATING EXPENSES						
	125,821	166,654	-25%	-	-	
TOTAL EXPENSES	\$ 21,299,868	\$ 19,666,694	8%	\$ 58,571,486	\$ 53,784,834	9%

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Agency Operating and Loan Servicing Funds

Salaries and Fringe Benefits increased from \$12,280,362 to \$13,520,461 or \$1,240,199 (10%) in Fiscal Year 2003. Much of this increase was due to the hiring of additional staff for the Quester Debt Collection Management computer software and annual salary and benefit increases. Contracted Collection Costs increased from \$1,497,729 to \$1,706,541 or \$208,812 (14%) in Fiscal Year 2003 due to new collection agency contracts that allow collection agencies to earn incentives for collecting above their target collection rates. Other Operating and Travel increased from \$5,155,679 to \$5,423,057 or \$267,378 (5%) primarily due to new charges related to the initial system programming for the Quester Debt Collection System paid for in Fiscal Year 2003. Quester is expected to increase the agency capacity and efficiency in its debt collections. Non-operating expenses decreased from \$166,654 to \$125,821 or \$40,833 (25%) in Fiscal Year 2003 due to a decrease in the statewide indirect cost allocation of expenses to Colorado Student Loan Program.

Federal Reserve and Drawdown Funds

Guarantee Claims Paid to Lending Institutions increased from \$53,769,267 to \$58,570,453 or \$4,801,186 (9%) in Fiscal Year 2003 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 approved by 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.

Agency Operating and Loan Servicing Funds

The original budgeted change in net assets for the Agency Operating and Loan Servicing Funds was \$462,983. The budget for change in net assets was later revised upward to \$5,223,554. The actual change in net assets was \$3,134,197. The actual change in net assets exceeded the original budget 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 \$830,000, which was carried forward into the current year because the project was not completed;
- Contingency fund for information technology equipment \$350,000, which was also carried forward to handle the purchase of a new imaging system for the agency as a contract expired;

MANAGEMENT’S DISCUSSION AND ANALYSIS (continued)

- Transfers to Federal Reserve Fund to meet reserve requirement \$1,096,453;
- Positions not hired in Business Systems Coordination unit \$222,000, but which was carried forward to hire those individuals in the current fiscal year, and
- A contract with Consumer Credit Counseling Service for \$76,594, which was brought in-house.

The change in net assets also includes non-operating revenue of \$3,604,800 in interfund transfers (see definition of interfund transfers and detail of transfers in section Interfund Transfers) from the Federal Reserve and Drawdown Funds to the Agency Operating Fund.

Federal Reserve and Drawdown Funds

The original budgeted net loss for the Federal Reserve and Drawdown Funds was \$585,277. The budget was later revised to a loss of \$3,831,368. The actual change in net assets was a decrease of \$4,937,345. This decrease was caused by interfund transfers of \$3,604,800 which consists primarily of interest transferred from the Recall Fund to the Agency Operating Fund in the amount of \$2,602,040. The decrease was also caused by the difference between the guarantee claims paid to lending institutions and federal reinsurance 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. For example, in Fiscal Year 2003 the DE found that Colorado Student Loan Program owed additional funds to the Federal Reserve Fund. Colorado Student Loan Program then made an interfund transfer from the Agency Operating Fund to the Federal Fund to satisfy this requirement. In addition, for a number of years, DE has required the CSLP to pay itself the Account Maintenance Fee by making a transfer from the Federal Fund in the fourth quarter of the federal fiscal year. The CSLP was required to do so this past fiscal year.

The following transfers were made during Fiscal Year 2003:

Transfers from Federal Fund to Agency Operating Fund:	
Default Aversion Fee	\$ 606,793
Account Maintenance Fee Shortfall	\$ 355,370
Interest Settlement Due from DE	\$ 329,111
Transfers from Recall Fund to Agency Operating Fund:	
Restricted Interest on Recall Funds	\$ 2,602,040
Transfers from Agency Operating Fund to Federal Fund:	
Buyout of Fixed Asset from DE	\$ (193,153)
DE Audit Finding for Interest Due on Funds Borrowed	<u>(95,361)</u>
Net Transfers from the Federal Fund to the Agency Operating Fund	<u>\$ 3,604,800</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Capital Assets

The Colorado Student Loan Program purchased \$39,679 in information technology equipment relating to upgrades to existing computers in Fiscal Year 2003. This transaction was the only significant change in capital outlay items in Fiscal Year 2003.

Economic Facts and Conditions for the Future

As noted previously, the Colorado Student Loan Program paid \$23,268,032 in August 2002 of reserves to the U.S. Department of Education (DE) as required by the Balanced Budget Act of 1997. This Act requires guarantors nationally to pay \$1 billion of reserves to the U.S. Department of Education.

Colorado Student Loan Program will pay another recall, required by the *1998 Reauthorization of the Higher Education Act*, to DE in three installments. The three installments total \$4,641,050. The first installment of \$1,577,957 was sent to DE in August 2002 (Fiscal Year 2003). Future installments are due as follows: \$1,531,547 in Fiscal Year 2007 and \$1,531,546 in Fiscal Year 2008.

Additionally, under federal law, the loan processing and issuance fee paid from federal funds to the Colorado Student Loan Program based on the net loans guaranteed will decrease from .65% to .40% beginning October 1, 2003. The collection retention on borrower payments on defaulted student loans will decrease from 24% to 23% beginning October 1, 2003. These changes are a result of the DE restructuring the reimbursement percentages for these items to meet its federal budget requirements. CSLP is also anticipating charging an insurance premium fee on all guaranteed loans beginning in Fiscal Year 2005 to ensure the continued stability of the Federal Reserve Fund.

Financial Contact

If you have any questions about this report please contact:

Colorado Student Loan Program

999 18th Street, Suite 425

Denver, CO 80202

Attention: Manager of Accounting

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
COMBINED STATEMENTS OF NET ASSETS
June 30, 2003 and 2002**

ASSETS

	2003	2002
CURRENT ASSETS		
Cash and pooled cash investments	\$ 20,141,567	\$ 18,938,974
Due from other governments		
Federal account maintenance fee	624,269	593,615
Federal loan processing and issuance fee	371,961	312,745
Other federal receivables	19,938	38,680
Other receivables, net	785,516	856,381
Due from other funds	-	5,500
Supplies inventory	100,161	91,073
Prepaid expenses	340,384	152,565
Total current assets	22,383,796	20,989,533
RESTRICTED ASSETS		
Restricted cash and pooled cash investments	4,107,441	34,865,299
Federal reinsurance receivable	6,360,406	3,015,103
Other receivables, net	7,749	-
Total restricted assets	10,475,596	37,880,402
CAPITAL ASSETS		
Office furniture and equipment	907,098	907,098
Computer hardware	2,784,610	2,744,931
Property held under capital lease	829,472	829,472
Leasehold improvements	97,946	97,946
	4,619,126	4,579,447
Less accumulated depreciation	(3,975,944)	(3,451,956)
Capital assets, net	643,182	1,127,491
 TOTAL ASSETS	 \$ 33,502,574	 \$ 59,997,426

LIABILITIES AND NET ASSETS

	2003	2002
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 2,031,499	\$ 646,048
Payable to the U.S. Department of Education:		
Loan collections and other liabilities due to federal government	1,023,490	709,706
Other current liabilities		
Current portion of obligation under capital lease	209,748	201,304
Current portion of note payable	-	346,000
Other	237,227	702,630
Interfund payable - other agencies	368,225	524,230
Deferred revenue	-	121,370
Total current liabilities	3,870,189	3,251,288
LIABILITIES PAYABLE FROM RESTRICTED ASSETS		
Recall reserves due to DE	3,063,093	27,909,082
Accounts payable and accrued liabilities	7,303	141,737
Loan collections and other liabilities due to federal government	3,269,251	3,440,290
Total liabilities payable from restricted assets	6,339,647	31,491,109
NONCURRENT LIABILITIES		
Accrued compensated absences	874,414	823,809
Obligation under capital leases, net of current portion	16,987	226,735
Total noncurrent liabilities	891,401	1,050,544
Total liabilities	11,101,237	35,792,941
NET ASSETS		
Invested in capital assets, net of related debt	416,447	353,452
Restricted	4,135,949	9,073,294
Unrestricted	17,848,941	14,777,739
Total net assets	22,401,337	24,204,485
TOTAL LIABILITIES AND NET ASSETS	\$ 33,502,574	\$ 59,997,426

These financial statements should be read only in connection with the accompanying summary of significant accounting policies and notes to financial statements.

**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, 2003 and 2002**

	2003	2002
OPERATING REVENUES		
Federal grants and contracts		
Division's share of collections on loans and bankruptcies	\$ 10,136,202	\$ 9,699,508
Federal account maintenance fee	2,233,668	2,215,008
Federal loan processing and issuance fee	2,254,935	2,059,574
Federal reinsurance	56,950,242	52,521,503
Charges for goods and services		
Contractual service fees	4,701,986	4,390,395
Interest on purchased loans and other	488,257	760,932
Gifts and donations	309,900	-
Other revenue	9,908	32,965
Total operating revenues	77,085,098	71,679,885
OPERATING EXPENSES		
Guarantee claims paid to lending institutions	58,570,453	53,769,267
Salaries and fringe benefits	13,520,461	12,280,362
Operating and travel		
Contracted collection costs	1,706,541	1,497,729
Other operating and travel	5,424,090	5,171,246
Depreciation	523,988	566,270
Total operating expenses	79,745,533	73,284,874
OPERATING LOSS	(2,660,435)	(1,604,989)
NONOPERATING REVENUES (EXPENSES)		
Earnings on investments	983,108	3,239,232
Income before operating transfer	(1,677,327)	1,634,243
Operating transfers to other agencies	(125,821)	(166,654)
CHANGE IN NET ASSETS	(1,803,148)	1,467,589
NET ASSETS, BEGINNING OF YEAR	24,204,485	22,736,896
NET ASSETS, END OF YEAR	\$ 22,401,337	\$ 24,204,485

These financial statements should be read only in connection with
the accompanying summary of significant accounting policies
and notes to financial statements.

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
COMBINED STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2003 and 2002**

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from		
Fees for service	\$ 4,656,981	\$ 4,963,067
Federal grants and contracts	68,301,361	68,599,296
Interest on purchased loans and other	488,257	760,932
Gifts and donations	309,900	-
Other sources	9,908	32,965
	<u>73,766,407</u>	<u>74,356,260</u>
Cash disbursed for		
Guarantee claims paid to lending institutions	(58,712,636)	(53,212,867)
Employees	(13,469,856)	(12,208,025)
Suppliers	(4,856,954)	(5,748,876)
Contracted collection costs	(1,706,541)	(1,497,729)
Recall reserves paid to DE	(24,845,989)	-
	<u>(103,591,976)</u>	<u>(72,667,497)</u>
Net cash provided (used) by operating activities	<u>(29,825,569)</u>	<u>1,688,763</u>
CASH FLOW FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers - out	(125,821)	(166,654)
Net cash used in noncapital financing activities	<u>(125,821)</u>	<u>(166,654)</u>
CASH FLOW FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal paid on capital debt	(346,000)	(173,000)
Proceeds from capital leases and note payable	-	170,732
Acquisition of capital assets	(39,679)	(286,401)
Capital lease payments	(201,304)	(188,819)
Net cash used in capital and related financing activities	<u>(586,983)</u>	<u>(477,488)</u>
CASH FLOW FROM INVESTING ACTIVITIES		
Earnings on investments	983,108	3,239,232
NET INCREASE (DECREASE) IN CASH AND TEMPORARY CASH INVESTMENTS	<u>(29,555,265)</u>	<u>4,283,853</u>
CASH AND TEMPORARY CASH INVESTMENTS, BEGINNING OF YEAR	<u>53,804,273</u>	<u>49,520,420</u>
CASH AND TEMPORARY CASH INVESTMENTS, END OF YEAR	<u>\$ 24,249,008</u>	<u>\$ 53,804,273</u>

	<u>2003</u>	<u>2002</u>
RECONCILIATION OF NET OPERATING LOSS		
TO NET CASH USED IN OPERATING ACTIVITIES		
Net operating loss	\$ (2,660,435)	\$ (1,604,989)
Adjustments to reconcile net operating loss to net cash provided (used) by operating activities		
Depreciation	523,988	566,270
Loss on sale of equipment	-	51,305
Effects of changes in net assets and liabilities		
Receivables	(3,353,315)	4,541,355
Due from other funds	5,500	(5,500)
Supplies inventory	(9,088)	5,200
Prepaid expenses	(187,819)	(66,972)
Accounts payable and accrued liabilities	1,251,017	(27,201)
Other current liabilities	(465,403)	(83,695)
Recall reserves due to DE	(24,845,989)	-
Loan collections and other liabilities due to federal government	142,745	(1,559,364)
Accrued compensated absences	50,605	72,337
Interfund payable other agencies	(156,005)	(316,328)
Deferred revenue	(121,370)	116,345
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u>\$ (29,825,569)</u>	<u>\$ 1,688,763</u>

These financial statements should be read only in connection with
the accompanying summary of significant accounting policies
and notes to financial statements.

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
June 30, 2003 and 2002**

The Student Loan Division (the “Division”) is an agency of the Department of Higher Education, State of Colorado, established pursuant to *Title 23, Article 3.1, Part 1, Colorado Revised Statutes, 1973*, as amended, and was created July 1, 1979. The Division administers the Federal Family Education Loan Program (“FFEL”), which consists of Stafford, Parent Loans for Undergraduate Students (“PLUS”), Supplemental Loans for Students (“SLS”), and Consolidation Loans Programs. The Division guarantees loans by certain lending institutions to students attending post-secondary schools, in compliance with operating agreements (the “Agreements”) with the U.S. Department of Education (“DE”), pursuant to *Section 428 of the Higher Education Act of 1965* (the “Act”). In addition, the Division must comply with provisions of the federal *1998 Reauthorization of Higher Education Act*.

METHOD OF ACCOUNTING AND REPORTING

The operations and accounts of the Division are accounted for under accounting principles generally accepted in the United States of America as an enterprise fund of the State of Colorado. The Division uses the accrual basis of accounting. Enterprise funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with a enterprise fund’s principal 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

Colorado voters passed an amendment to the State Constitution, Article X, Section 20, which has several limitations, including revenue raising, spending abilities, and other specific requirements of state and local governments. The amendment excludes from its provision Enterprises. Enterprises, defined as government-owned businesses authorized to issue revenue bonds and receiving less than 10% of their annual revenue in grants from all state and local governments combines, are excluded from the provisions of the Amendment. The Division qualifies as an Enterprise pursuant to *Title 23, Article 3.1, Part 103.5, Colorado Revised Statutes, 1998*, as amended.

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
June 30, 2003 and 2002**

SUPPLIES INVENTORY

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

COMPENSATED ABSENCES

Employees of the Division are entitled to paid vacations, sick days, and personal days off, depending on job classification, length of service, and other factors. The Division has recorded the amount of compensation for future absences as an accrued liability in the accompanying financial statements.

LOAN PROCESSING AND ISSUANCE FEE

In accordance with the *1998 Reauthorization of Higher Education Act*, the Division receives from DE a quarterly loan processing and issuance fee of .65% of the net loans guaranteed by the Division, effective October 1, 1998 through September 30, 2003. Beginning October 1, 2003, the fee will be reduced to .40%.

ACCOUNT MAINTENANCE FEE

In accordance with the *1998 Reauthorization of Higher Education Act*, the Division receives from DE a quarterly account maintenance fee of .10% of the original principal amount of outstanding loans.

LOAN DEFAULTS

Loan defaults, which result in claims from lending institutions on guarantees made by the Division result in the assignment of student loans to the Division. Although claim payments are made on defaults, deaths, disabilities and bankruptcies, only loans in default and loans included under Chapter 7 and Chapter 13 bankruptcies are collectible by the Division. Since October 1, 1998, the Division retains 24% of subsequent loan collections to cover the costs associated with the collection efforts. Beginning October 1, 2003, this collection reimbursement rate will be decreased by DE to 23% of loan collections. The balance of collections is remitted to the U.S. Department of Education.

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
June 30, 2003 and 2002**

DEFAULTED LOANS

During the years ended June 30, 2003 and 2002, the Division assigned certain loans to the U.S. Secretary of Education under the Treasury Offset Program. Under this program, 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.

FEDERAL REINSURANCE

Under the agreement with the U.S. Department of Education (“DE”), in accordance with Section 428 of the Act, the Division is reimbursed by the DE for 100% of claims due to deaths, disabilities, and bankruptcies. The Student Loan Reform Act of 1993 reduced federal reinsurance for loans made on or after October 1, 1993. Federal reinsurance on defaulted loans is paid according to the following schedule:

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

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 default for the Federal year ending September 30, 2003 and 2002 did not exceed 5% as of June 30, 2003 and 2002.

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
June 30, 2003 and 2002**

CAPITALIZATION POLICY

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

DEPRECIATION

Depreciation is charged using a straight-line method over the estimated useful five year lives of the assets. Depreciation expense charged to operations was \$523,988 and \$566,270 for the years ended June 30, 2003 and 2002, respectively.

STATEMENT OF CASH FLOWS

For purposes of the statement of cash flows, 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.

BASIS OF ACCOUNTING

Proprietary activities are accounted for, and reported on, in accordance with all Governmental Accounting Standards Board (GASB) pronouncements as well as all 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

By statute, the Division is continuously appropriated through user charges. Therefore, the budget is not legislatively adopted and Statements of Revenues and Expenses – Budget to Actual is not a required part of these financial statements. Total budgeted expenses for the Division for the fiscal year ended June 30, 2003 were \$84.4 million compared to actual expenses of approximately \$79.9 million. Total budgeted revenues of the Division were \$80.9 million as compared with actual revenues of approximately \$78.1 for the fiscal year ended June 30, 2003.

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002**

NOTE 1 – CASH AND INVESTMENTS

The Division deposits cash with the Colorado State Treasurer as required by the Colorado Revised Statutes (C.R.S.). The State Treasurer pools these deposits and invests them in securities approved by Section 24-75-601.1, C.R.S. The Division reports its share of the Treasurer’s unrealized gains and losses based on its participation in the State Treasurer’s pool. All of the investments are reported at fair value, which is determined based on quoted market prices at June 30, 2003 and 2002. The State Treasurer does not invest any of the pool resources in any external investment pool, and there is no assignment of income related to participation in the pool.

Additional information on the Treasurer’s pool may be obtained in the State of Colorado’s Comprehensive Annual Financial Report.

During the year ended June 30, 2003, the Division had a monthly average balance of approximately \$29,847,000 and \$48,914,000 for the years ended June 30, 2003 and 2002, respectively. This balance was invested with the State Treasury at an annual yield of 4.52% and 5.57% for the years ended June 30, 2003 and 2002, respectively.

The Division had \$23,189,759 and \$52,498,495 on deposit and \$91,562 and \$15,330 on hand or in transit to the State Treasury at June 30, 2003 and 2002, respectively. Detailed information on the State Treasurer’s pooled cash and investments is available from that office.

At June 30, 2003 and 2002, the Division had \$967,687 and \$1,290,448, respectively, on deposit with banks, none of which was covered by federal insurance or by collateral held by the Division’s agent in the Division’s name. However, the bank balances of \$2,040,989 and \$1,973,117, 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 uncollateralized or Category one.

	<u>2003</u>	<u>2002</u>
Cash accounts on deposit	\$ 22,309,203	\$ 51,243,762
Cash on hand/transit	91,562	15,330
Deposits with banks	967,687	1,290,448
Changes in market value	<u>880,556</u>	<u>1,254,733</u>
Total	<u>\$ 24,249,008</u>	<u>\$ 53,804,273</u>

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002**

NOTE 1 – CASH AND INVESTMENTS (CONTINUED)

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

	<u>2003</u>	<u>2002</u>
Cash and pooled cash investments	\$ 20,141,567	\$ 18,938,974
Restricted cash and pooled cash investments	<u>4,107,441</u>	<u>34,865,299</u>
Total	<u>\$ 24,249,008</u>	<u>\$ 53,804,273</u>

The Colorado Public Deposit Protection Act (PDPA) requires that all units of local government deposit cash in eligible public depositories. Eligibility is determined by state regulations. Amounts on deposit in excess of federal insurance levels must be collateralized by eligible collateral determined by the PDPA. 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 value of the collateral must be at least equal to 102% of the uninsured deposits.

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 80% of the purchased loans receivable has been recorded due to the significant uncertainty of the collectibility of the loans. Net purchased loans receivable at June 30, 2003 and 2002 were \$208,459 and \$218,454, respectively.

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002**

NOTE 3 – CAPITAL ASSETS

A summary of changes in capital assets is as follows:

	<u>Balance</u> <u>July 1, 2002</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2003</u>
Office furniture and equipment	\$ 907,098	\$ -	\$ -	\$ 907,098
Computer hardware	2,744,931	39,679	-	2,784,610
Property held under capital lease	829,472	-	-	829,472
Leasehold improvements	<u>97,946</u>	<u>-</u>	<u>-</u>	<u>97,946</u>
Total	4,579,447	39,679	-	4,619,126
Less accumulated depreciation	<u>(3,451,956)</u>	<u>(523,988)</u>	<u>-</u>	<u>(3,975,944)</u>
Capital assets, net	<u>\$ 1,127,491</u>	<u>\$ (484,309)</u>	<u>\$ -</u>	<u>\$ 643,182</u>

NOTE 4– NOTE PAYABLE

During Fiscal Year 1999, the Division entered into a note to obtain imaging software and hardware. Under the terms of the agreement, the Division will return the software to the vendor when the agreement is terminated in Fiscal Year 2004. The agreement also provides for the option to extend at that time. The note was non-interest bearing and required annual payments of \$173,000 over a five-year time period. The final payment on the note was made by the Division during the year ended June 30, 2003.

NOTE 5– LEASES

The Division leases various equipment with a total original cost of \$829,472 for both Fiscal Years 2003 and 2002, and accumulated depreciation of \$570,949 and \$405,054 at June 30, 2003 and 2002, respectively, under capital leases which expire from 2004 to 2005.

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002**

NOTE 5– LEASES (CONTINUED)

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

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

<u>Year Ending December 31,</u>	<u>Capital Leases</u>	<u>Operating Leases</u>
2004	\$ 215,127	\$ 604,120
2005	17,078	641,765
2006	<u>-</u>	<u>679,410</u>
Total	232,205	<u>\$ 1,925,295</u>
Less interest	<u>(5,470)</u>	
	226,735	
Less current portion	<u>(209,748)</u>	
Long-term portion	<u>\$ 16,987</u>	

Total rent expense for the years ended June 30, 2003 and 2002 was \$688,819 and \$721,894, respectively.

During the fiscal year ended June 30, 2003, the following changes occurred with long-term debt.

	<u>Balance July 1, 2002</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance June 30, 2003</u>
Note payable	\$ 346,000	\$ -	\$ (346,000)	\$ -
Capital lease obligations	428,039	-	(201,304)	226,735
Accrued compensated absences	<u>823,809</u>	<u>50,605</u>	<u>-</u>	<u>874,414</u>
Total	<u>\$1,597,848</u>	<u>\$ 50,605</u>	<u>\$ (547,304)</u>	<u>\$ 1,101,149</u>

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002**

NOTE 6 – COMMITMENTS

Statutory Guarantee Fund Requirements

For Federal Fiscal Year 2003 and 2002, 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, 2003 and 2002 based on the respective outstanding loan balances was \$6,382,063 and \$6,141,649, 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, 2003 and 2002 was \$7,199,042 and \$11,322,702, respectively. The required reserve amount is assessed by DE at September of each year.

Loans from Federal Reserve Fund

As part of the provisions of the *1998 Reauthorization of the Higher Education Act*, the Division's Agency Operating Fund is allowed to borrow from its Federal Reserve Fund, an amount equal to 180 days' expenses. The Division borrowed \$10,921,058 from its Federal Reserve Fund and deposited the funds into its Agency Operating Fund. The Division repaid \$2,684,001 and \$8,237,057 of the loan in the year ended June 30, 2003 and 2002, respectively. The loan was repaid in full during the year ended June 30, 2003.

NOTE 7 – CONTINGENCIES

Loan Guarantees

The outstanding principal balances of student loans guaranteed by the Division through June 30, 2003 is approximately \$2.6 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%. However, in the event of future adverse loss experience, the Division could be liable for up to 25% of the outstanding balance of loans in repayment status at the beginning of each year.

U.S. Department of Education Reviews

DE has also performed reviews of the Division which were primarily focused on the Division's treatment of establishing the Agency Operating Fund and Federal Reserve Fund in accordance with the *1998 Reauthorization of Higher Education Act* (see Note 12) and its guarantee operations. DE has communicated various findings primarily related to the improper allocation

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002**

NOTE 7 – CONTINGENCIES (CONTINUED)

of costs between the Division's Operating and Federal funds; unallowable operating costs paid with federal funds and the amount of interest due in the funds borrowed. The Division has responded to DE with its position regarding these findings.

The final resolution of these findings from DE is currently in process. Accordingly, no provision for any additional liability that may result from DE's review has been made to the accompanying financial statements.

NOTE 8 – EMPLOYEE PENSION PLAN

Plan Description

Virtually all of the Division's employees participate in 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, are included in PERA's financial statements which may be obtained by writing PERA at 1300 Logan Street, Denver, Colorado 80203.

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.

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002**

NOTE 8 – EMPLOYEE PENSION PLAN (CONTINUED)

Funding Policy

Most employees contribute 8.0 percent (10.0 percent for State troopers) of their gross covered wages to an individual account in the Plan. During Fiscal Year 2002 – 2003, the State contributed 10.04 percent (12.74 percent for State troopers and 11.82 percent for the Judicial Branch) of the employee's gross covered wages. Before January 1, 2003, 1.64% was allocated to the Health Care Trust Fund and after January 1, 2003, 1.1% was allocated to the Health Care Trust Fund.

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, 2003, 2002, and 2001 were \$962,226, \$891,355, and \$871,618, 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 (7 percent for judges in the Judicial Branch). 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 (6 percent for judges in the Judicial Branch). 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 fifty percent of any reduction in the overall contribution rate due to overfunding of the pension plan was available for the match. While the plan was not overfunded, the maximum one year change in the match rate is statutorily limited to one percent, and therefore, the match change from 3 percent to 2 percent. 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. Total member contributions for Fiscal Year 2003 were \$157,163.

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002**

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 2002 - 2003, 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. Medicare eligibility also affects the premium subsidy.

The Health Care Trust Fund is maintained by a 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, 2002, there were 35,418 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). 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.

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002**

NOTE 12 – FEDERAL LEGISLATIVE IMPACTS ON THE DIVISION

Balanced Budget Act of 1997

As a result of the Balanced Budget Act of 1997, guarantee agencies were required to transfer approximately \$1 billion of guarantor reserves to the Federal Treasury in Federal Fiscal Year 2002. Because of this Act, beginning in Fiscal Year 1998, each guarantee agency was required to establish a restricted account in which each agency will be required make an annual transfer of funds. The principal amount in the restricted accounts will not be available for use; however, interest earnings will be utilized for default reduction activities. The Division has transferred \$23,268,032 million to its recall fund as of June 30, 2002. In September 2002, the Division paid \$23,268,032 to DE for this recall.

1998 Reauthorization of Higher Education Act

In October 1998, legislation was passed re-authorizing the Higher Education Act. One of the provisions of reauthorization requires the guarantee agencies to pay back 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 September 2003, and will pay DE \$1,531,547 in Fiscal Year 2007 and \$1,531,546 in Fiscal Year 2008.

The legislation also required the Division to set up an Agency Operating Fund and a Federal Reserve Fund. These funds are maintained on the state's accounting system. The funds have been combined for financial reporting purposes.

NOTE 13 – RISK MANAGEMENT

The state currently self-insures its agencies, officials, and employees for the risks of losses to which they are exposed. That includes general liability, motor vehicle liability, worker's compensation, and medical claims. Property claims are not self-insured, rather the state has purchased insurance.

The Division participates in the Risk Management Fund of the State of Colorado. Agency premiums are based on an assessment of risk exposure and historical experience. Liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount of claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines and damage awards, the process used in computing claims liability does not

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
NOTES TO FINANCIAL STATEMENTS
June 30, 2003 and 2002**

NOTE 13 – RISK MANAGEMENT (CONTINUED)

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 were no significant reductions or changes in insurance coverage from the prior year in any of the above mentioned risk management arrangements. Settlements did not exceed insurance coverage in any of the past three fiscal years.

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 2003 that were normally paid at the end of the month were paid at the beginning of July. This created an accrued liability at June 30, 2003 of \$984,458 for incurred but unpaid salaries and wages.

This information is an integral part of the accompanying financial statements.

**Independent Auditor's Report on Compliance and on Internal Control
Over Financial Reporting 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, 2003, and have issued our report thereon dated August 28, 2003. 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.

Compliance

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 grants, 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 that are required to be reported under *Government Auditing Standards* and which are described in the findings and recommendations.

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 assurance 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 2 and relate to default aversion fees.

A material weakness is a 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 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 reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider Finding and Recommendation No. 1 to be a material weakness.

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
August 28, 2003

SUPPLEMENTAL INFORMATION

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
COMBINING SCHEDULES OF NET ASSETS
June 30, 2003
(With Comparative Totals for June 30, 2002)**

ASSETS

	Agency Operating and Loan Servicing Funds	Federal Reserve and Drawdown Funds	Totals	
			2003	2002
CURRENT ASSETS				
Cash and pooled cash investments	\$ 20,141,567	\$ -	\$ 20,141,567	\$ 18,938,974
Due from other governments				
Federal account maintenance fee	624,269	-	624,269	593,615
Federal loan processing and issuance fee	371,961	-	371,961	312,745
Other federal receivables	19,938	-	19,938	38,680
Other receivables, net	785,516	-	785,516	856,381
Due from other funds	-	-	-	5,500
Supplies inventory	100,161	-	100,161	91,073
Prepaid expenses	340,384	-	340,384	152,565
Total current assets	22,383,796	-	22,383,796	20,989,533
RESTRICTED ASSETS				
Restricted cash and pooled cash investments	-	4,107,441	4,107,441	34,865,299
Federal reinsurance receivable	-	6,360,406	6,360,406	3,015,103
Other receivables, net	-	7,749	7,749	-
Total restricted assets	-	10,475,596	10,475,596	37,880,402
CAPITAL ASSETS				
Office furniture and equipment	907,098		907,098	907,098
Computer hardware	2,784,610		2,784,610	2,744,931
Property held under capital lease	829,472		829,472	829,472
Leasehold improvements	97,946		97,946	97,946
	4,619,126	-	4,619,126	4,579,447
Less accumulated depreciation	(3,975,944)		(3,975,944)	(3,451,956)
Capital assets, net	643,182	-	643,182	1,127,491
TOTAL ASSETS	\$ 23,026,978	\$ 10,475,596	\$ 33,502,574	\$ 59,997,426

LIABILITIES AND NET ASSETS

	Agency Operating and Loan Servicing Funds	Federal Reserve and Drawdown Funds	Totals	
			2003	2002
CURRENT LIABILITIES				
Accounts payable and accrued liabilities	\$ 2,031,499	\$ -	\$ 2,031,499	\$ 646,048
Payable to the U.S. Department of Education:				
Loan collections and other liabilities due to federal government	1,023,490	-	1,023,490	709,706
Other current liabilities				
Current portion of obligation under capital lease	209,748	-	209,748	201,304
Current portion of note payable	-	-	-	346,000
Other	237,227	-	237,227	702,630
Interfund payable - other agencies	368,225	-	368,225	524,230
Deferred revenue	-	-	-	121,370
Total current liabilities	<u>3,870,189</u>	<u>-</u>	<u>3,870,189</u>	<u>3,251,288</u>
LIABILITIES PAYABLE FROM RESTRICTED ASSETS				
Recall reserves due to DE	-	3,063,093	3,063,093	27,909,082
Accounts payable and accrued liabilities	-	7,303	7,303	141,737
Loan collections and other liabilities due to federal government	-	3,269,251	3,269,251	3,440,290
Total liabilities payable from restricted assets	<u>-</u>	<u>6,339,647</u>	<u>6,339,647</u>	<u>31,491,109</u>
NONCURRENT LIABILITIES				
Accrued compensated absences	874,414	-	874,414	823,809
Obligation under capital leases, net of current portion	16,987	-	16,987	226,735
Total noncurrent liabilities	<u>891,401</u>	<u>-</u>	<u>891,401</u>	<u>1,050,544</u>
Total liabilities	<u>4,761,590</u>	<u>6,339,647</u>	<u>11,101,237</u>	<u>35,792,941</u>
NET ASSETS				
Invested in capital assets, net of related debt	416,447	-	416,447	353,452
Restricted	-	4,135,949	4,135,949	9,073,294
Unrestricted	17,848,941	-	17,848,941	14,777,739
Total net assets	<u>18,265,388</u>	<u>4,135,949</u>	<u>22,401,337</u>	<u>24,204,485</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 23,026,978</u>	<u>\$ 10,475,596</u>	<u>\$ 33,502,574</u>	<u>\$ 59,997,426</u>

**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, 2003
(With Comparative Totals for the Year Ended June 30, 2002)**

	Agency Operating and Loan Servicing Funds	Federal Reserve and Drawdown Funds	Totals	
			2003	2002
OPERATING REVENUES				
Federal grants and contracts				
Division's share of collections on loans and bankruptcies	\$ 9,845,859	\$ 290,343	\$ 10,136,202	\$ 9,699,508
Federal account maintenance fee	2,233,668	-	2,233,668	2,215,008
Federal loan processing and issuance fee	2,254,935	-	2,254,935	2,059,574
Federal reinsurance	-	56,950,242	56,950,242	52,521,503
Charges for goods and services				
Contractual service fees	4,701,986	-	4,701,986	4,390,395
Guarantee fees	-	-	-	-
Interest on purchased loans and other	488,257	-	488,257	760,932
Gifts and Donations	309,900	-	309,900	-
Other revenue	9,908	-	9,908	32,965
Total operating revenues	19,844,513	57,240,585	77,085,098	71,679,885
OPERATING EXPENSES				
Guarantee claims paid to lending institutions	-	58,570,453	58,570,453	53,769,267
Salaries and fringe benefits	13,520,461	-	13,520,461	12,280,362
Operating and travel				
Contracted collection costs	1,706,541	-	1,706,541	1,497,729
Other operating and travel	5,423,057	1,033	5,424,090	5,171,246
Depreciation	523,988	-	523,988	566,270
Total operating expenses	21,174,047	58,571,486	79,745,533	73,284,874
OPERATING LOSS	(1,329,534)	(1,330,901)	(2,660,435)	(1,604,989)
NONOPERATING REVENUES (EXPENSES)				
Earnings on investments	984,752	(1,644)	983,108	3,239,232
Income (loss) before operating transfers	(344,782)	(1,332,545)	(1,677,327)	1,634,243
Operating transfers to other agencies	(125,821)	-	(125,821)	(166,654)
Interfund transfers	3,604,800	(3,604,800)	-	-
Total transfers	3,478,979	(3,604,800)	(125,821)	(166,654)
CHANGE IN NET ASSETS	3,134,197	(4,937,345)	(1,803,148)	1,467,589
NET ASSETS, BEGINNING OF YEAR	15,131,191	9,073,294	24,204,485	22,736,896
NET ASSETS, END OF YEAR	\$ 18,265,388	\$ 4,135,949	\$ 22,401,337	\$ 24,204,485

**STUDENT LOAN DIVISION
DEPARTMENT OF HIGHER EDUCATION
STATE OF COLORADO
COMBINING SCHEDULES OF CASH FLOWS
For the Years Ended June 30, 2003
(With Comparative Totals for the Year Ended June 30, 2002)**

	Agency Operating and Loan Servicing Funds	Federal Reserve and Drawdown Funds	Totals	
			2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash received from				
Fees for service	\$ 4,656,981	\$ -	\$ 4,656,981	\$ 4,963,067
Federal grants and contracts	14,577,118	53,724,243	68,301,361	68,599,296
Interest on purchased loans and other	488,257	-	488,257	760,932
Gifts and Donations	309,900	-	309,900	-
Other sources	9,908	-	9,908	32,965
	<u>20,042,164</u>	<u>53,724,243</u>	<u>73,766,407</u>	<u>74,356,260</u>
Cash disbursed for				
Guarantee claims paid to lending institutions	-	(58,712,636)	(58,712,636)	(53,212,867)
Employees	(13,469,856)	-	(13,469,856)	(12,208,025)
Suppliers	(4,855,921)	(1,033)	(4,856,954)	(5,748,876)
Contracted collection costs	(1,706,541)	-	(1,706,541)	(1,497,729)
Recall reserves paid to DE	-	(24,845,989)	(24,845,989)	-
	<u>(20,032,318)</u>	<u>(83,559,658)</u>	<u>(103,591,976)</u>	<u>(72,667,497)</u>
Net cash provided (used) by operating activities	<u>9,846</u>	<u>(29,835,415)</u>	<u>(29,825,569)</u>	<u>1,688,763</u>
CASH FLOW FROM NONCAPITAL ACTIVITIES				
Transfers - out	<u>(125,821)</u>	<u>-</u>	<u>(125,821)</u>	<u>(166,654)</u>
Net cash used in noncapital activities	<u>(125,821)</u>	<u>-</u>	<u>(125,821)</u>	<u>(166,654)</u>
INTERFUND TRANSFERS	920,799	(920,799)	-	-
CASH FLOW FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Principal paid on capital debt	(346,000)	-	(346,000)	(173,000)
Proceeds from capital leases and note payable	-	-	-	170,732
Acquisition of capital assets	(39,679)	-	(39,679)	(286,401)
Capital lease payments	(201,304)	-	(201,304)	(188,819)
Net cash used in capital and related financing activities	<u>(586,983)</u>	<u>-</u>	<u>(586,983)</u>	<u>(477,488)</u>
CASH FLOW FROM INVESTING ACTIVITIES				
Earnings on investments	<u>984,752</u>	<u>(1,644)</u>	<u>983,108</u>	<u>3,239,232</u>
NET INCREASE (DECREASE) IN CASH AND TEMPORARY CASH INVESTMENTS	1,202,593	(30,757,858)	(29,555,265)	4,283,853
CASH AND INVESTMENTS, BEGINNING OF YEAR	<u>18,938,974</u>	<u>34,865,299</u>	<u>53,804,273</u>	<u>49,520,420</u>
CASH AND INVESTMENTS, END OF YEAR	<u>\$ 20,141,567</u>	<u>\$ 4,107,441</u>	<u>\$ 24,249,008</u>	<u>\$ 53,804,273</u>

	Agency Operating and Loan Servicing Funds	Federal Reserve and Drawdown Funds	Totals	
			2003	2002
RECONCILIATION OF NET OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES				
Net operating loss	\$ (1,329,534)	\$ (1,330,901)	\$ (2,660,435)	\$ (1,604,989)
Adjustments to reconcile net operating loss to net cash provided (used) by operating activities				
Depreciation	523,988	-	523,988	566,270
Loss on sale of equipment	-	-	-	51,305
Effects of changes in net assets and liabilities				
Receivables	(263)	(3,353,052)	(3,353,315)	4,541,355
Due from other funds	5,500	-	5,500	(5,500)
Supplies inventory	(9,088)	-	(9,088)	5,200
Prepaid expenses	(187,819)	-	(187,819)	(66,972)
Accounts payable and accrued liabilities	1,385,451	(134,434)	1,251,017	(27,201)
Other current liabilities	(465,403)	-	(465,403)	(83,695)
Recall reserves due to DE	-	(24,845,989)	(24,845,989)	-
Loan collections and other liabilities due to federal government	313,784	(171,039)	142,745	(1,559,364)
Accrued compensated absences	50,605	-	50,605	72,337
Interfund payable other agencies	(156,005)	-	(156,005)	(316,328)
Deferred revenue	(121,370)	-	(121,370)	116,345
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	\$ 9,846	\$ (29,835,415)	\$ (29,825,569)	\$ 1,688,763

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